OFFERING MEMORANDUM

NOT FOR GENERAL CIRCULATION IN THE UNITED STATES

HECKLER & KOCH

€295,000,000

Heckler & Koch GmbH

9.50% Senior Secured Notes due 2018

The 9.50% Senior Secured Notes due 2018 have been issued in the amount of €295 million (the "Notes") and are the senior secured obligations of Heckler & Koch GmbH (the "Issuer" or "HKO").

The Notes bear interest at the rate of 9.50% per year. Interest on the Notes is payable on May 15 and November 15 of each year, beginning on November 15, 2011. The Notes will mature on May 15, 2018. The Issuer may redeem some or all of the Notes at any time on or after May 15, 2014. Prior to May 15, 2014, the Issuer may also redeem all or part of the Notes by paying a "make-whole" premium. In addition, prior to May 15, 2014, the Issuer may redeem up to 35% of the aggregate principal amount of the Notes with the net proceeds from certain public equity offerings. Furthermore, the Issuer may during each 12-month period ending July 31, 2012, July 31, 2013 and July 31, 2014 redeem up to 10% of the aggregate principal outstanding amount of the Notes at a redemption price equal to 103% of the principal amount of Notes redeemed plus accrued and unpaid interest. The redemption prices are discussed under the caption "Description of the Notes—Optional Redemption." In the event of a Change of Control (as defined herein), we must make an offer to purchase each series of the Notes at a purchase price equal to 101% of the principal amount thereof, plus accrued and unpaid interest to the date of purchase.

The Notes are the senior secured obligations of the Issuer and rank senior in right of payment to any of its future indebtedness that is subordinated in right of payment to the Notes. The Notes rank equally in right of payment with any of its existing and future indebtedness that is not subordinated in right of payment to the Notes. In addition, the Notes are effectively subordinated in right of payment to any of its future indebtedness that is secured by liens on its assets to the extent of the assets securing such indebtedness. The Notes are guaranteed on a senior basis by the direct and indirect subsidiaries of the Issuer (each, a "Guarantee," and collectively, the "Guarantees"). The Notes are secured by a first ranking security interest over our capital stock and the capital stock of our subsidiaries, as described in "Description of the Notes—Collateral." The first ranking security interest over our capital stock and the capital stock of our subsidiaries may be released in circumstances described in "Description of the Notes—Collateral—Release of Collateral."

Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF Market of that exchange.

This offering memorandum constitutes a prospectus of the Luxembourg Law dated July 10, 2005 on Prospectuses for Securities.

Investing in the Notes involves risks. See "Risk Factors" beginning on page 15.

The Notes and the Guarantees have not been, and will not be, registered under the U.S. Securities Act of 1933, as amended (the "Securities Act"), or any state securities laws. Accordingly, the Notes are being offered and sold only to qualified institutional buyers ("QIBs") in accordance with Rule 144A under the Securities Act ("Rule 144A") and outside the United States in accordance with Regulation S under the Securities Act ("Regulation S"). Prospective purchasers that are QIBs are hereby notified that the seller of the Notes may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a description of certain restrictions on transfers of the Notes, see "Plan of Distribution" and "Notice to Investors."

The Notes have been issued in the form of one or more global notes in registered form. On the Issue Date, the global notes were deposited and registered in the name of a nominee of a common depositary for Euroclear S.A./N.V. ("Euroclear") or Clearstream Banking, *société anonyme* ("Clearstream Banking").

Price: 98.750% plus accrued interest, if any, from May 12, 2011.

The initial purchasers expect to deliver the Notes to purchasers, in book-entry form only, through Euroclear and Clearstream Banking on May 12, 2011 (the "Issue Date").

Sole Global Coordinator and Bookrunner

Citi

Joint Lead Manager

Close Brothers Seydler Bank AG

May 17, 2011

You should rely only on the information contained in this offering memorandum. We have not, and the initial purchasers (as defined below) have not, authorized anyone to provide you with different information or represent anything about the Issuer, its financial results or this offering that is not contained in this offering memorandum. If given or made, any such other information or representation should not be relied upon as having been authorized by the Issuer or the initial purchasers. We are not, and the initial purchasers are not, making an offer of these securities in any jurisdiction where this offer is not permitted. You should not assume that the information contained in this offering memorandum is accurate as of any date other than the date on the front of this offering memorandum.

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IMPORTANT INFORMATION

This offering memorandum has been prepared by us solely for use in connection with the proposed offering of the Notes described in this offering memorandum and for their listing on the Official List of the Luxembourg Stock Exchange.

Citigroup Global Markets Limited and Close Brothers Seydler Bank AG (the "initial purchasers") make no representation or warranty, express or implied, as to the accuracy or completeness of the information contained in this offering memorandum. Nothing contained in this offering memorandum is, or shall be relied upon as, a promise or representation by the initial purchaser as to the past or future. We have furnished the information contained in this offering memorandum and take the responsibility for the correct reproduction and extraction of the information. The initial purchasers have not independently verified any of the information contained herein (financial, legal and otherwise) and assumes no responsibility for the accuracy or completeness of any such information.

The initial purchasers will provide you with a copy of this offering memorandum and any related amendments or supplements. By receiving this offering memorandum, you acknowledge that you have had an opportunity to request from us for review, and that you have received, all additional information you deem necessary to verify the accuracy and completeness of the information contained in this offering memorandum. You also acknowledge that you have not relied on the initial purchasers in connection with your investigation of the accuracy of this information or your decision whether to invest in the Notes.

The information set forth in relation to sections of this offering memorandum describing clearing arrangements, including the section entitled "Book-Entry; Delivery and Form," is subject to any change in or reinterpretation of the rules, regulations and procedures of Euroclear or Clearstream Banking currently in effect. While we accept responsibility for accurately summarizing the information concerning Euroclear and Clearstream Banking, we accept no further responsibility in respect of such information.

Neither the United States Securities and Exchange Commission (the "SEC"), any state securities commission nor any other regulatory authority, has approved or disapproved the Notes nor have any of the foregoing authorities passed upon or endorsed the merits of this offering or the accuracy or adequacy of this offering memorandum. Any representation to the contrary could be a criminal offense in certain countries.

The Notes are subject to restrictions on transferability and resale and may not be transferred or resold except as permitted under the Securities Act and the applicable state securities laws pursuant to registration or exemption therefrom. As a prospective purchaser, you should be aware that you may be required to bear the financial risks of this investment for an indefinite period of time. Refer to "Plan of Distribution" and "Notice to Investors."

The distribution of this offering memorandum and the offering and sale of the Notes in certain jurisdictions may be restricted by law. See "Notice to New Hampshire Residents" and "Notice to Investors in the United Kingdom."

In making an investment decision, prospective investors must rely on their own examination of the Issuer and the terms of the offering, including the merits and risks involved. In addition, neither the Issuer nor the initial purchasers nor any of our or their representatives are making any representation to you regarding the legality of an investment in the Notes and you should not construe anything in this offering memorandum as legal, business or tax advice. You should consult your own advisors as needed to make your investment decision and to determine whether you are legally permitted to purchase the Notes under applicable legal investment or similar laws or regulations. You must comply with all laws applicable in any jurisdiction in which you buy, offer or sell the Notes or possess or distribute this offering memorandum, and you must obtain all applicable consents and approvals; neither we nor the initial purchasers shall have any responsibility for any of the foregoing legal requirements.

In this offering memorandum, we rely on and refer to information and statistics regarding our industry. We obtained this market data from independent industry publications or other publicly available information. Although we believe that these sources are reliable, we have not independently verified and do not guarantee the accuracy and completeness of this information.

The Notes have been issued in the form of one or more global notes. The global notes have been deposited and registered in the name of the nominee of a common depositary for Euroclear and Clearstream Banking. Transfers of interests in the global notes will be effected through records maintained by Euroclear, Clearstream Banking and their respective participants. The Notes have not been issued in definitive registered form except under the circumstances described in the section "Book-Entry; Delivery and Form."

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ANNOTATED, 1955, AS AMENDED ("RSA 421-B") WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

NOTICE TO INVESTORS IN THE UNITED KINGDOM

This offering memorandum is for distribution only to persons who (i) have professional experience in matters relating to investments falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (as amended, the "Financial Promotion Order"), (ii) are persons falling within Article 49(2)(a) to (d) ("high net worth companies, unincorporated associations etc") of the Financial Promotion Order, (iii) are outside the United Kingdom, or (iv) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000) in connection with the issue or sale of the Notes may otherwise lawfully be communicated or caused to be communicated (all such persons together being referred to as "relevant persons"). This offering memorandum is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this offering memorandum relates is available only to relevant persons and will be engaged in only with relevant persons. Recipients of this offering memorandum are not permitted to transmit it to any other person. The Notes are not being offered to the public in the United Kingdom.

NOTICE REGARDING SERVICE OF PROCESS AND ENFORCEMENT OF JUDGMENTS

ALL OF THE DIRECTORS AND EXECUTIVE OFFICERS OF THE ISSUER ARE NON-RESIDENTS OF THE UNITED STATES. ALL OR A SUBSTANTIAL PORTION OF THE ASSETS OF SUCH NON-RESIDENT PERSONS AND OF THE ISSUER ARE LOCATED OUTSIDE THE UNITED STATES. AS A RESULT, IT MAY NOT BE POSSIBLE FOR INVESTORS TO EFFECT SERVICE OF PROCESS WITHIN THE UNITED STATES UPON SUCH PERSONS OR THE ISSUER, OR TO ENFORCE AGAINST THEM IN U.S. COURTS JUDGMENTS OBTAINED IN SUCH COURTS PREDICATED UPON THE CIVIL LIABILITY PROVISIONS OF THE FEDERAL SECURITIES LAWS OF THE UNITED STATES. THE ISSUER HAS BEEN ADVISED BY COUNSEL THAT THERE IS DOUBT AS TO THE ENFORCEABILITY IN GERMANY IN ORIGINAL ACTIONS OR IN ACTIONS FOR ENFORCEMENT OF JUDGMENTS OF U.S. COURTS, OF LIABILITIES PREDICATED SOLELY UPON THE SECURITIES LAWS OF THE UNITED STATES.

STABILIZATION

In connection with this offering, Citigroup Global Markets Limited (the "Stabilizing Manager") or any person acting on behalf of the Stabilizing Manager may over-allot the Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail for a limited period after the Issue Date.

However, there is no assurance that the Stabilizing Manager or any person acting on behalf of the Stabilizing Manager will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the offering of the Notes is made and, if begun, may be ended at any time, but it must end no later than 30 days after the date on which the Issuer received the proceeds of the issue, or no later than 60 days after the date of the allotment of the Notes, whichever is the earlier. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period. The Stabilizing Manager does not intend to disclose the extent of any stabilizing transactions or the amount of any long or short position.

NOTE ON DEFINED TERMS USED IN THIS OFFERING MEMORANDUM

- “$” or “dollar” refer to the lawful currency of the United States;
- “€” or “euro” refer to the single currency of the participating Member States in the Third Stage of European Economic and Monetary Union of the Treaty Establishing the European Community, as amended from time to time;
- “£” or “GBP” refer to the lawful currency of the United Kingdom;
- “2004 Notes” refers to our €120 million 9.25% Senior Secured Notes due 2011;
- “EU” refers to the European Union;
- “Financing” refers to the refinancing of the 2004 Notes, the purchase of all HKB PIK Loans held by third parties and the payment of related transaction fees and expenses;
- “Group” refers to the Issuer, HKF, NSAF, SAG, HKD, HKI, HKS and SUI;
- “Guarantors” refers to HKF, NSAF, SAG, HKD, HKI, HKS and SUI;
- “HKB” refers to Heckler & Koch Beteiligungs GmbH, our indirect parent;
- “HKB PIK Loans” refers to the loans made under the PIK loan facility agreement dated March 23, 2006, as amended, between HKB and Merrill Lynch International, as administrative agent, and the other parties thereto;
- “HKD” refers to our indirect, wholly-owned subsidiary, Heckler & Koch Defense, Inc.;
- “HKF” refers to our indirect, wholly-owned subsidiary, Heckler & Koch France SAS;
- “HKH” refers to HK Holding, Inc., our direct parent;
- “HKI” refers to our indirect, wholly-owned subsidiary Heckler & Koch, Inc.;
- “HKO” refers to the Issuer (or its predecessor companies, if the context requires);
- “HKS” refers to HK Sidearms GmbH;
- “IFRS” refers to International Financial Reporting Standards;
- “NATO” refers to the North Atlantic Treaty Organization;
- “NSAF” refers to our indirect, wholly-owned subsidiary, NSAF Limited;
- “Reorganization” refers to the transactions described in “Summary—The Transactions—Reorganization”;
- “SAG” refers to our indirect, wholly-owned subsidiary Small Arms Group Holding, Inc.;
- “SUI” refers to our indirect, wholly-owned subsidiary, Suhler USA, Inc.;
- “Transactions” refers to the Financing and the Reorganization;
- “United Kingdom” and “U.K.” refer to the United Kingdom of Great Britain and Northern Ireland;
- “United States” and “U.S.” refer to the United States of America; and
- “we,” “us,” “our” and “Group” and other similar terms refer to the Issuer (or its predecessor companies, if the context requires) and its consolidated subsidiaries.

PRESENTATION OF FINANCIAL AND OTHER DATA

Financial Information

We conduct substantially all of our manufacturing and a significant portion of our sales through the Issuer. The remaining portion of our business is conducted through our subsidiaries. In this offering memorandum, we present the consolidated financial information for the Issuer. This information consists of:

- the audited consolidated financial statements of the Issuer as of and for the year ended December 31, 2010 (including for comparative purposes the consolidated financial information as of and for the year ended December 31, 2009); and

- the audited consolidated financial statements of the Issuer as of and for the year ended December 31, 2009 (including for comparative purposes the consolidated financial information as of and for the year ended December 31, 2008).

The audited consolidated financial statements for the Issuer as of and for the year ended December 31, 2009, includes comparative consolidated financial information as of and for the year ended December 31, 2008. This comparative information has been restated from the audited consolidated financial statements for the Issuer as of and for the year ended December 31, 2008. During the second quarter of 2009, we acquired two U.S. subsidiaries (Heckler & Koch, Inc. ("HKI") and Suhler USA, Inc. ("SUI"), collectively the "SUI/HKI Group") from an affiliated group. Since the affiliated group has always been under common control with us, we exercised the option of restating our current and prior year figures as if this transaction had taken place at the end of 2007. The restatement has resulted in the SUI/HKI Group's consolidated balance sheet being added to that of the Group as at December 31, 2007, with internal accounts payable/receivable consolidated out. The HKO investment made in April 2009 has been shown as if it were made in December 2007, with this amount being held as a payable until 2009; the difference between this consideration and the net equity of the SUI/HKI Group at December 31, 2007 has been offset against Group equity (a reduction of approximately €4 million in 2007). From January 1, 2008 onwards, the income statements for the SUI/HKI Group have been added to those of the Group, with internal transactions (sales, cost of sales, other income/expense) consolidated out. Similarly, the cash flow statements of the SUI/HKI Group were added to those of the Group, with internal payments consolidated out. See Note 41 to the audited consolidated financial statements of the Issuer included elsewhere in this offering memorandum.

The Issuer is an indirect wholly-owned subsidiary of Heckler & Koch Beteiligungs GmbH ("HKB"). Although HKB in the past has made a number of investments and conducted operations in addition to its ownership of the Issuer, at present, on a stand-alone basis, its primary asset consists of its ownership of the Issuer through HK Holdings, Inc. ("HKH"). In addition, it holds certain receivables from its shareholders, but substantially all of its prior investments have either been sold or wound down. See Notes 18 and 36 to the HKB Financial Statements (as defined below). Its primary liability consists of its obligations under the HKB PIK Loans. See Note 25 to the HKB Financial Statements. Its activities consist of managing its investment in the Issuer and, to a lesser extent, employee, professional and lease costs associated with its existence as an independent entity. As described below under "Summary—The Transactions—Reorganization," we intend to form a fiscal unity with HKB. Whether or not the fiscal unity is achieved, we may seek to combine with HKB. Upon the establishment of a fiscal unity, we will be obligated to deliver the consolidated financial statements of HKB (as opposed to the Issuer) under the reporting obligations in the Indenture and the covenant described under "Description of the Notes—Certain Covenants—Limitation on Restricted Payments" will apply to HKB as if it was the Issuer and to the Issuer as if it was a Restricted Subsidiary. Accordingly, we are providing certain financial information regarding HKB on a consolidated basis to aid investors in understanding its assets, liabilities and results of operations.

This information consists of the audited consolidated financial statements of HKB as of and for the year ended December 31, 2010 (including, for comparative purposes the consolidated financial information as of and for the year ended December 31, 2009) (the "HKB Financial Statements").

Except as otherwise noted, the financial statements included in this offering memorandum have been prepared in accordance with IFRS and as adopted by the European Union, including interpretations of the International Financial Reporting Interpretations Committee.

Some financial information in this offering memorandum has been rounded and, as a result, the numerical figures shown as totals in this offering memorandum may vary slightly from the exact arithmetic aggregation of the figures that precede them.

Non-IFRS Financial Measures

This offering memorandum contains non-IFRS measures and ratios, including EBITDA, net debt and leverage and coverage ratios that are not required by, or presented in accordance with, IFRS as adopted by the European Union. We present non-IFRS measures because they are used by management in monitoring our business and because we believe that they and similar measures are frequently used by securities analysts, investors and other interested parties in evaluating companies in our industry. The non-IFRS measures may not be comparable to other similarly titled measures of other companies and have limitations as analytical tools and should not be considered in isolation or as a substitute for analysis of our operating results as reported under IFRS. Non-IFRS measures and ratios such as EBITDA, net debt and leverage and coverage ratios are not measurements of our performance or liquidity under IFRS and should not be considered as alternatives to operating profit or profit for the year or any other performance measures derived in accordance with IFRS or any other generally accepted accounting principles or as alternatives to cash flow from operating, investing or financing activities.

Industry Data

We operate in an industry in which it is difficult to obtain precise industry and market information. We have obtained the market and competitive position data in this offering memorandum from industry publications and from surveys or studies conducted by third parties that we believe to be reliable, including from Jane's Strategic Advisory Services ("JSAS"). JSAS calculates market data based on presence in the number of inventories in the non-U.S. NATO markets (excluding product lines from the Soviet Union). We have not independently verified the market and competitive position data contained in this offering memorandum. We accept responsibility for the information contained in this offering memorandum. The information contained in this offering memorandum is in accordance with the facts and does not omit anything likely to affect the completeness of this offering memorandum.

In addition, in many cases we have made statements in this offering memorandum regarding our industry and our competitive position in the industry based on our experience and our own investigation of market conditions. We cannot assure you that any of these assumptions are accurate or correctly reflect our competitive position in the industry, and none of our internal surveys or information have been verified by independent sources, which may have estimates or opinions regarding industry-related information which differ from our own.

INFORMATION REGARDING FORWARD-LOOKING STATEMENTS

This offering memorandum includes forward-looking statements. These forward-looking statements can be identified by the use of forward-looking terminology, including the terms "believes," "estimates," "anticipates," "expects," "intends," "may," "will" or "should" or, in each case, their negative, or other variations or comparable terminology, or by discussions of strategy, plans or intentions. These forward-looking statements include statements that are not statements of historical facts including, without limitation, statements under the headings "Summary," "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Business" and elsewhere and relate to our intentions, beliefs or current expectations concerning, among other things, our results of operations, financial condition, liquidity, prospects, growth, strategies and the industry in which we operate.

By their nature, forward-looking statements involve risk and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and the development of the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this offering memorandum. In addition, even if our results of operations, financial condition and liquidity, and the development of the industry in which we operate are consistent with the forward- looking statements contained in this offering memorandum, those results or developments may not be indicative of results or developments in subsequent periods. Important factors that could cause those differences include, but are not limited to:

- the adverse affect on our business caused by future reductions or changes in spending by NATO countries;
- the highly competitive nature of the markets in which we participate;
- our ability to bid for large contracts, which may depend on our ability to obtain performance guarantees from financial institutions;
- the extensive and restrictive regulations of our products in certain jurisdictions, to which our competitors are not necessarily subject;
- additional costs that may be incurred in bidding for government contracts;
- the exposure of our business to risk of loss due to undertaking large, long-term fixed-price contracts for our sales exposes our business to risk of loss;
- our ability to recover the additional costs in developing products and variations that diversify our product portfolio;
- adverse outcomes in existing and future legal proceedings and government investigations;
- market pressure in relation to technological changes;
- the disruptions that our manufacturing facilities, in particular our main facility in Oberndorf am Neckar, Germany, may experience;
- the risk of negative audit by government agencies;
- our dependence on a small number of countries and customers for our sales;
- failure to comply with applicable firearms laws and regulations;
- cancellation of government contracts at any time;
- our dependence on our brand and intellectual property;
- our dependence on a single supplier for a majority of our high quality steel;
- misconduct by employees or agents;
- our dependence on our key personnel and highly skilled employees;
- risks associated with international currency exchange;

- significant increases in commodity and energy prices;
- our ability to obtain or maintain licenses required for the conduct of our business;
- the adverse effect on our operating results by the impact of environmental laws and regulations to which we are subject;
- potential effects of our pension accruals on our liabilities;
- our potential liability as a result of past sales of firearms to civilians and U.S. law enforcement agencies; and
- consequences of our debt service obligations, and the fact that we are indirectly controlled by three individual shareholders, whose interests may conflict with yours.

We urge you to read the sections of this offering memorandum entitled "Risk Factors," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Business" for a more complete discussion of the factors that could affect our future performance and the industry in which we operate. In light of these risks, uncertainties and assumptions, the forward- looking events described in this offering memorandum may not occur.

We undertake no obligation to publicly update or publicly revise any forward- looking statement, whether as a result of new information, future events or otherwise. All written and oral forward-looking statements attributable to us or to persons acting on our behalf are expressly qualified in their entirety by the cautionary statements referred to above and contained elsewhere in this offering memorandum.

SUMMARY

The following summary highlights significant aspects of our business and the offering of the Notes, but you should carefully read this entire offering memorandum to understand the structure of the offering of the Notes, our business, the risks associated with investing in the Notes, the terms of the Notes, and the tax and other considerations that are important to an investment decision.

Our Company

We are a leading European manufacturer of small arms with a premium-quality product portfolio for the NATO armed forces and their allies. We design, produce and distribute small arms, including rifles, side arms, fully automatic weapons, grenade launchers and a variety of other related products. We believe we are the market leader in the supply of assault rifles, side arms, grenade launchers and grenade machine guns to European NATO and government agencies. We also believe our products are widely considered to be best-in-class in each of their respective categories primarily as a result of long-standing commitment to integrated research and development, engineering and manufacturing. We have been in operation for more than 60 years and our brand name is highly respected by armed forces globally.

We supply the armed forces of NATO, including the U.S. Army, and the special forces of NATO, including the U.S. Special Forces. We are the sole supplier of the standard assault rifle to the German, British, Norwegian and Spanish armed forces. We supply law enforcement agencies worldwide, including the European police forces and U.S. local and federal law enforcement agencies, such as the FBI and the Secret Service. We also supply the commercial market for civilians. We believe that one of our significant markets for future growth is the United States. In the year ended December 31, 2010, 55% of our sales were to Europe and 17% of our sales were to the United States.

We own state-of-the-art manufacturing facilities in Oberndorf am Neckar in Southern Germany, where we manufacture most of our products, and rent manufacturing facilities in New Hampshire, U.S., where we manufacture a number of side arms for the U.S. market.

As of December 31, 2010, we had 719 employees (calculated as full-time equivalents).

For the year ended December 31, 2010, we generated revenue of €247.2 million and EBITDA of €61.2 million. As of December 31, 2010, our order book (defined as contractual sales yet to be delivered) was €169.7 million with approximately 75% of the order book deliverable in the year ending December 31, 2011.

Our Industry

The market for small arms (which includes rifles, side arms, fully automatic weapons and grenade launchers) can be divided into three categories: military small arms, law enforcement small arms and commercial small arms. According to JSAS, the global market for small arms is expected to be $4.4 billion in 2011 and is expected to be $25.1 billion in the aggregate from 2012 through 2016. The military small arms market is expected to grow as a result of sustained military conflicts in a variety of regions despite declining defense budgets, as small arms are considered to be essential military equipment and are especially important in modern asymmetric warfare.

Our Key Strengths

We believe that we maintain a strong competitive position as a result of numerous factors, including the following:

We have a world-class brand. We believe we have a world-class brand, which is one of the most internationally recognized in the small arms market. We believe we have the largest presence in the market for assault rifles, grenade launchers and side arms, and have the second largest presence in the market for machine guns. Our brand name, when used with our products, connotes quality, reliability, performance and integrity and distinguishes our products from international competition. We expect to leverage our strong brand name to access customers around the world in each of the military, law enforcement and commercial small arms markets.

We have a premium product portfolio. We believe each of the products in our portfolio is technologically advanced and best-in-class in its category. We commit a significant amount of our resources to the research, design and development of technologically advanced small arms. This commitment of resources is a key driver in the delivery of our premium products. We also believe we are able to meet a variety of our customers' requirements through a wide range of products in our portfolio, from premium-quality side arms to highly innovative products such as the XM25 grenade launcher.

We have an elite customer base. Our customer base comprises the armed forces of NATO and their allies and law enforcement agencies. We believe our elite customer base is a testimony to the premium quality of our products, signaling to potential customers that our products will sufficiently meet their requirements. We believe our long-standing relationships with our customers and our significant expertise provide us with an advantage in winning future contracts. We have supplied the armed forces in Germany, the United Kingdom, Norway and Spain for more than 50 years, 40 years, 30 years and 30 years, respectively.

We have high visibility of sales and a significant order book. In the recent past, the majority of our revenue was derived from contracts that we entered into with our customers as part of larger, long-term small arms programs, primarily with European NATO countries. NATO governments and their allies allocate their budgets for these programs in stages, which include a series of subsequent contracts in relation to a range of products, often with the same defense contractor. This tends to lead into a longer-term commitment for additional products, spare parts and support. On the larger contracts, due to the long lead-times between government initiation of a program and the end of volume production in relation to such program, which can take up to 10 years, we believe we have high visibility of sales. Our current order book of contracted revenue should provide us with relatively predictable sales and strong cash flows for at least the next 12 months.

The table below highlights as of March 31, 2011, (i) those small arms programs awarded to us by governments after technical evaluation of our products, but prior to the various sales contracts being executed, and (ii) our order book of contracted sales for the next five years.

	Total	2011	2012	2013	2014	2015
			(€ millions)			
Programs(1)(2)	336	86	91	60	48	51
Order Book(2)	150	107	28	10	3	2

(1) Represents the sales that we expect to record in the event we receive firm orders under small arms programs that we have been awarded by governments. There can be no assurance, however, that these contracts will become part of our order book of contracted sales.

(2) Includes information for the Issuer, HKD, HKF, HKI, HKS and NSAF.

The table above does not include other business prospects for which we are bidding or potential prospects that we have identified.

We have an experienced management team and a highly skilled workforce. Our workforce is managed by a group of managers with an average of over 20 years experience in the military and defense industries. As a result of the depth of experience and strength of our workforce and our managers, we have the ability to respond rapidly to customer requirements regarding design and production. Throughout our organization, we have a highly skilled workforce, including engineers and technical personnel. Most of these personnel have undergone apprenticeships with us since the early stages of their careers and have been trained by us in our own technical training facilities. As a result, we believe we are able to provide our personnel with highly specific training and also forge a strong relationship with them. The average rate of turnover of our workforce for the last three years was less than 3%.

Our Strategy

Our strategy derives directly from our vision:

"Be the World's Premier Small Arms Systems Company."

We implement this by focusing our strategy on three key elements: managing our business for higher margins and increased profitability, seeking to achieve a stable business supported by a diverse set of customers, geographies and products, and continuing to manage our business for sustainable long-term growth.

Continue to manage our business for higher margins and increased profitability. We have historically been able to manage for strong margins through our industry-leading engineering capabilities. In recent years, we have also pursued the strategy of offering integrated small arms packages and providing life cycle management for our products to our customers.

We intend to continue leveraging our engineering expertise to provide products of the highest quality and with the best capabilities in the industry. We will also leverage our engineering expertise in our manufacturing to reduce costs and further enhance quality. We believe these focus areas will help us achieve higher margins and help us increase the profitability of the company. We believe our engineering expertise also allows us to develop new products to meet emerging trends in the market and also helps us introduce products ahead our competitors. We believe this occasionally allows us to charge higher prices for our products and to achieve higher margins.

We intend to continue our focus on offering a complete “Small Arms Package.” Certain customers are increasingly asking us to provide full solutions to their logistics and accessory requirements in addition to satisfying their small arms requirements. This allows us in some cases to sell a product mix with higher margins, and consequently helps us increase profitability. To offer these integrated packages, we will in the future consider acquisitions of other such companies that have a product offering complementary to ours, as and when such opportunities arise.

We intend to continue exploring ways to deliver life cycle management services to our customers. Our customers are increasingly seeking ways to outsource the management of the full life cycle of small arms, including support, supply, and maintenance of small arms from production to retirement. We believe this is an opportunity to increase margins and profitability as we can utilize existing assets, equipment and capitalize on our experience and scale to deliver a service more efficiently than our customers could otherwise achieve.

Further increase the stability of our business through diversification of product offering, geographic focus and customer types. We have expanded from being a German supplier of assault rifles to the German army to being a leading European supplier of a wide range of small arms to a range of customers in many countries. This has allowed us to achieve a stable business model and a broad geographic reach.

Going forward, we intend to continue to evolve our product offering to meet changing customer needs. Examples of the products that we have previously developed include the MP7, the HK121 and the P11. By responding to the demand for such types of products, we have been able to capture opportunities from our customers in addition to their needs for traditional small arms and have generated additional revenue.

We intend to increase our geographical diversification. We have previously diversified from supplying the German army to supplying most European NATO members with small arms, and have more recently become a supplier to the U.S. Army, in addition to the U.S. Special Forces. This development has helped us decrease our reliance on a small number of customers, and we remain committed to achieving sales to new customers in NATO countries and countries that are friendly to NATO.

We also intend to continue our efforts to supply small arms to non-military customers. We have grown from being a purely military focused supplier into supplying the law enforcement and commercial markets.

We also intend to seek opportunities to leverage our co-production expertise. We have a track record of developing partnerships with companies in foreign markets where we transfer the capability of manufacturing a portion of the product as a requirement for a contract. Historically, such opportunities have supplied us with long-term revenue opportunities, and have helped us generate revenue from services supplied during the transfer of manufacturing capabilities. We will continue to actively seek co-production opportunities in NATO countries and allies of NATO countries.

Pursue long-term sustainable growth opportunities. Historically, we have been able to achieve growth by leveraging our core competencies and key strengths. We will continue to seek out such growth opportunities in the future.

We believe that our leading brand, expanding portfolio of premium products, and design leadership will be a key driver for continuing to win business from existing customers and drive business from new customers. Additionally, we believe that our diversification will allow us to grow our business in addition to ensuring a continued stable set of revenue streams, as it allows us to capture customers in the United States and other export markets, both within the military small arms and other market segments.

Outside the United States, the addition of many former Warsaw Pact countries into NATO opened new markets, which we have been able to access successfully, and where we see significant further business opportunities. The addition of other countries into NATO may also provide further attractive growth opportunities for us to expand our presence in those markets as these countries focus on either finding rifle replacements or upgrades for their armed forces.

We also believe these initiatives, which drive higher margins, may contribute to revenue growth as they allow us to capture incremental revenue opportunities and, in certain cases, achieve higher pricing for our products.

Our History

We were founded on December 28, 1949 by Edmund Heckler, Theodor Koch and Alex Seidel, each of whom was a former engineer at Mauser Works, in Oberndorf am Neckar in 1949. Our early product lines featured parts and spares for sewing machines and bicycles. In the late 1950s, we expanded into the small arms sector of the defense contracting industry.

Our first significant contract to sell small arms was in 1956, when we won the tender for the rifle for the newly established Army of the Federal Republic of Germany. In the 1970s and 1980s, we continued to grow, not only in the production of small arms, but also in the production of other products such as machine tools and industrial, electronics and automation products. Due to our diversification in the 1970s and 1980s, which turned out to be loss-making, we required an outside partner to continue the business by 1990. In 1991, we were purchased by a predecessor of BAE Systems plc ("BAE").

In the early 1990s, BAE restructured and streamlined its business to focus on the core business of defense contracting in the small arms sector.

Through a series of transactions in 2002 and 2003, we were acquired by HKB, a German company controlled by two of our three ultimate shareholders.

In 2003, as part of a strategy to reduce the risk of potential class action lawsuits in the United States, HK Sidearms GmbH ("HKS") was formed in order to manufacture side arms for the Group. HKS was then sold to a company owned by two of our three ultimate shareholders. In 2004, we sold the U.S. commercial sales and distribution company HKI for €12.4 million to the same company owned by two of our three ultimate shareholders. Following the passing in the United States of the Protection of Lawful Commerce in Arms Act and the resulting reduced risk of potential class action lawsuits in the U.S., we re-acquired HKI and its holding company SUI in 2009 for a purchase price of €13 million. We re-acquired HKS in 2010 for a purchase price of €6.4 million.

The Transactions

The Financing

The net proceeds of the offering will be used to refinance the 2004 Notes, to purchase all HKB PIK Loans held by third parties in the amount of € 170.1 million and to pay related transaction fees and expenses. See "Use of Proceeds." Due to, among other reasons, limitations in German law on our ability to distribute the proceeds from the offering of the Notes to HKB, we intend to purchase all HKB PIK Loans held by third parties. The HKB PIK Loans will remain outstanding as an asset of HKO until we complete one of the transactions described under "—Reorganization" below. All lenders of the HKB PIK Loans (other than HKB which holds approximately €5 million in aggregate principal amount of the HKB PIK Loans) have agreed to transfer their HKB PIK Loans to HKO at an agreed price subject to certain conditions including the completion of the offering of the Notes offered hereby. We will settle the purchase of the HKB PIK Loans as soon as practicable after the Issue Date.

Reorganization

After we purchase all HKB PIK Loans held by third parties, the management of HKB intends to establish a fiscal unity with us. This may be preceded by the sale by HKH to HKB of the shares of HKO held by HKH so that HKO becomes a direct subsidiary of HKB. We expect the establishment of fiscal unity to be achieved by the end of the first quarter of the year ending December 31, 2012. Under German law, in order to establish a fiscal unity, HKO must be able to freely distribute its profits to HKB. As a result, it would not be possible to establish a fiscal unity at a time in which the covenant described under "Description of the Notes—Certain Covenants—Limitation on Restricted Payments" restricts dividends or other distributions by HKO to HKB.

As a result, the establishment of the fiscal unity will be subject to the fulfillment of the following four conditions by or on the date of such establishment:

- HKB will accede to the Indenture (as defined herein) and provide a guarantee of the Notes;
- HKB would not have been in breach of certain covenants (including covenants limiting incurrence of debt, the granting of liens and transactions with its affiliates) in the Indenture assuming they had been applicable to HKB since the Issue Date;
- At all times since the initial purchase of the HKB PLK Loans following the Issue Date, the HKB PLK Loans have been held by HKB and its wholly owned subsidiaries; and
- No event of default or default had occurred and was then continuing with respect to the Issuer and the Guarantors.

Upon the establishment of fiscal unity, we will be obligated to deliver the consolidated financial statements of HKB (as opposed to HKO) under the reporting obligations in the Indenture. The covenant described under “Description of the Notes—Certain Covenants—Limitation on Restricted Payments” will apply to HKB as if it was the Issuer and to HKO as if it was a Restricted Subsidiary. As a result, HKO will be permitted to freely distribute cash and other property to HKB and the Notes will effectively become obligations of HKB and its subsidiaries on a consolidated basis. Management believes that as of the date of this offering memorandum, HKB has no significant liabilities other than those appearing on the balance sheet as of December 31, 2010. See “Presentation of Financial and Other Data” and the HKB Financial Statements included elsewhere in this offering memorandum.

Whether or not the fiscal unity is achieved, we may seek to combine with HKB. In the event that we combine with HKB, the shareholders of HKB will pledge their interests in the merged entity as described under “Description of the Notes—Collateral—Release of Collateral.”

Recent Developments

Trading Update

Revenue in the first quarter of 2011 was lower than revenue in the first quarter of 2010, primarily due to a delayed shipment. The shipment is expected to be made in the second quarter of 2011. EBITDA in the first quarter of 2011 is anticipated to be slightly higher than the first quarter of 2010 due, in part, to an improvement in product mix.

Recent Order

Since December 31, 2010, we have received substantial new orders that have increased our programs and order book. These orders are reflected in the table set forth on page 2 of this offering memorandum, and these orders have included substantial orders from a relatively new client.

German Export Matters

We have been advised by the German government that export licenses to the Middle East and North Africa in respect of military and defense-related products generally are likely to receive a higher level of review due to the recent events in these regions. We anticipate that this could result in delays in shipments in respect of current contracts and programs and in our ability to enter into new contracts with countries in those regions.

Our Corporate and Financing Structure

The following diagram is an overview of the corporate and financing structure of the Issuer, on a *pro forma* basis, giving effect to the Financing.

[GRAPHIC]

(1) The aggregate principal amount of the HKB PIK Loans as of December 31, 2010 was €163.1 million (net of the portion of the HKB PIK Loans held by HKB). For a description of the HKB PIK Loans, see "Description of Certain Financing Arrangements."

(2) The Notes are guaranteed on a senior basis by all direct and indirect subsidiaries of the Issuer. For the year ended December 31, 2010, the Issuer and the Guarantors generated all of our revenue and our EBITDA and, as of December 31, 2010, held all of our consolidated total assets. The Notes have been secured by a pledge by HKH of all of the capital stock of HKO, by HKO of all of the capital stock of its direct subsidiaries, by SUI of all of the capital stock of HKI and by Small Arms Group Holding, Inc. ("SAG") of all of the capital stock of Heckler & Koch Defense, Inc. ("HKD")

(3) The Issuer may establish a fiscal unity with HKB. This may be preceded by the sale by HKH to HKB of the shares of HKO held by HKH so that HKO becomes a direct subsidiary of HKB. The establishment of the fiscal unity will be subject to the fulfillment of certain conditions, including a guarantee by HKB and HKH of the Notes. In addition, the Issuer may merge with HKB at any time before the maturity of the HKB PIK Loans. See "Summary—The Transactions—Reorganization" and "Description of the Notes—Reorganization."

The Offering

The following summary contains basic information about the Notes. It may not contain all the information that is important to you. For a more complete understanding of the Notes, please see "Description of the Notes" and the subsections mentioned specifically in this summary. Terms used in this summary and not otherwise defined have the meanings given to them in "Description of the Notes."

s (see	Heckler & Koch GmbH
Notes Offered	€295 million aggregate principal amount of Notes.
Maturity Date.................................	The Notes will mature on May 15, 2018.
Interest Payment Dates	9.50% per annum, payable semi-annually in arrears on each May 15 and November 15, beginning on November 15, 2011. Interest on the Notes accrues from the Issue Date.
Guarantees	The Notes are guaranteed by Suhler USA, Inc., Heckler & Koch, Inc., Heckler & Koch France SAS, HK Sidearms GmbH, NSAF Limited, Small Arms Group Holding, Inc. and Heckler & Koch Defense, Inc. For the year ended December 31, 2010, the Issuer and the Guarantors generated all of our revenue and EBITDA and, as of December 31, 2010, held all of our consolidated total assets.
Ranking...	The Notes are general obligations of the Issuer and: • are secured by a first ranking security interest over the Collateral (as defined below); • rank senior in right of payment to any of the Issuer's future indebtedness that is subordinated in right of payment to the Notes; • rank equally in right of payment with any of the Issuer's existing and future indebtedness that is not subordinated in right of payment to the Notes; and • are effectively subordinated in right of payment to any of the Issuer's future indebtedness that is secured by liens on assets of the Issuer to the extent of the assets securing such indebtedness. Each Guarantee are the general obligation of the relevant Guarantor and: • rank senior in right of payment to all of such Guarantor's existing and future indebtedness that is subordinated in right of payment to its Guarantee; • rank equally in right of payment with all of such Guarantor's existing and future indebtedness that is not subordinated in right of payment to its Guarantee; and • are effectively subordinated to all of such Guarantor's obligations that are secured by assets of such Guarantor to the extent of the value of the assets securing such obligations.
Form and Denomination	The Issuer have issued the Notes on the Issue Date in global form in denominations of €100,000 and integral multiples of € 1,000 in excess thereof, maintained in book-entry form. Notes in denominations of less than €100,000 will not be available.
Collateral..	The obligations of the Issuer and Guarantors under the indenture governing the Notes (the "Indenture") and the Notes have been secured by a first ranking security interest over the capital stock of the Issuer and the capital stock of the direct and indirect subsidiaries of the Issuer (the "Collateral").
Optional Redemption	At any time prior to May 15, 2014, the Issuer may redeem the Notes at 100% of their principal amount plus accrued and unpaid interest, if any, and any other amounts payable thereon, to the dates of redemption, plus the Applicable Redemption Premium (as defined under "Description of the Notes—Optional Redemption—Optional Redemption prior to May 15, 2014"). At any time prior to May 15, 2014, the Issuer may redeem up to 35% of the aggregate principal amount of either or both series of the Notes with the net cash proceeds of certain equity offerings at the redemption price listed under "Description of the Notes—Optional Redemption—Optional Redemption prior to May 15, 2014." At any time on or after May 15, 2014, the Issuer may also redeem all or part of either or both series of the Notes at the redemption prices listed under "Description of the Notes—Optional Redemption—Optional Redemption on or after May 15, 2014." In addition, the Issuer may during each 12-month period ending July 31, 2012, July 31, 2013 and July 31, 2014 redeem up to 10% of the aggregate principal outstanding amount of the Notes at a redemption price equal to 103% of the

	principal amount of Notes redeemed plus accrued and unpaid interest to the date of redemption (subject to the rights of holders of Notes on the relevant record date to receive interest on the relevant interest payment date). For a more detailed description, see "Description of the Notes—Optional Redemption."
Redemption upon Changes in Withholding Taxes	In the event of certain developments affecting taxation or certain other circumstances, the Issuer may redeem the Notes in whole, but not in part, at any time, at a redemption price of 100% of the principal amount, plus accrued and unpaid interest, if any, and additional amounts, if any, to the date of redemption. See "Description of the Notes—Optional Redemption—Redemption Upon Changes in Withholding Taxes."
Additional Amounts	Any payments made by the Issuer with respect to the Notes will be made without withholding or deduction for taxes in any taxing jurisdiction unless required by law. If the Issuer is required by law to withhold or deduct for taxes of a relevant taxing jurisdiction with respect to a payment to the holders of the Notes, we will pay the additional amount necessary so that the net amount received by the holders of the Notes after the withholding is not less than the amount that they would have received in the absence of the withholding, subject to certain exceptions. See "Description of the Notes—Additional Amounts."
Change of Control	In the event of a "change of control" as defined in the Indenture ("Change of Control"), the Issuer will be obligated to make an offer to purchase all outstanding Notes at a redemption price of 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of purchase. See "Description of the Notes—Purchase of Notes upon a Change of Control."
Certain Covenants	The Indenture contains covenants that restrict the ability of the Issuer and its Restricted Subsidiaries to: • incur more debt; • make certain restricted payments and investments; • enter into transactions with affiliates; • pay dividends, repurchase stock and make distributions of certain other payments; • create liens; • impair the security interests over the Collateral; • transfer or sell assets; and • merge or consolidate with other entities. For a more detailed description of these covenants, see "Description of the Notes—Certain Covenants."
Transfer Restrictions	We have not registered the Notes under the Securities Act or any U.S. state securities law. You may only offer or sell Notes in a transaction exempt from or not subject to the registration requirements of the Securities Act. See "Plan of Distribution" and "Notice to Investors."
Use of Proceeds	See "Use of Proceeds."
Original Issue Discount	The Notes may be issued with original issue discount for U.S. federal income tax purposes. See "Taxation Considerations—U.S. Federal Income Tax Considerations.
Trustee, Security Trustee, Paying Agent and Transfer Agent	The Bank of New York Mellon, London Branch.
Registrar, Transfer Agent and Paying Agent	The Bank of New York Mellon (Luxembourg) S.A.
Listing and Trading	Application has been made to list the Notes on the Luxembourg Stock Exchange.
Governing Law	The Notes and the Indenture are governed by the laws of the State of New York. The Security Documents have been submitted to the laws of the jurisdictions in which the Collateral subject to such Security Documents is located.
Risk Factors	Investing in the Notes involves risks. You should carefully consider the information under the heading "Risk Factors" and the other information included in this offering memorandum before deciding whether to invest in the Notes.

Summary Historical Financial Information

The following tables set forth summary historical financial information for the Group as of and for the years ended December 31, 2008, 2009 and 2010. For a detailed discussion of the presentation of financial data, see "Presentation of Financial and Other Data." The summary historical financial information presented below should be read in conjunction with the audited consolidated financial statements for the Group and notes thereto included elsewhere in this offering memorandum.

The financial statements contained herein were prepared in accordance with IFRS. The summary historical information set forth below should also be read in conjunction with the information set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Use of Proceeds" and "Related Party Transactions." Historical results are not necessarily indicative of future expected results.

	For the year ended and as of December 31,		
	2010	**2009**	**2008**
		(€ thousands)	
Revenue	247,244	234,748	200,992
Cost of sales	(144,067)	(153,563)	(133,181)
Gross profit	**103,178**	**81,185**	**67,810**
Research & development	(4,112)	(3,051)	(2,087)
Sales, marketing & distribution	(31,752)	(24,714)	(23,162)
Administration	(14,758)	(14,224)	(10,880)
Other operating income	6,512	6,344	8,791
Other operating expenses	(7,289)	(6,132)	(9,688)
Results from operating activities	**51,777**	**39,408**	**30,784**
Financial income	5,141	2,500	7,265
Financial expense	(16,347)	(17,684)	(17,435)
Net financial result	**(11,206)**	**(15,184)**	**(10,170)**
Profit before income tax	**40,571**	**24,224**	**20,614**
Income tax expense	(10,170)	(7,270)	(8,229)
Profit for the period	**30,402**	**16,954**	**12,385**
Cash flow statement data:			
Net cash flows from operating activities	43,449	57,361	21,836
Net cash flows from investing activities	(10,412)	(20,012)	(17,101)
Net cash flows from financing activities	(30,861)	(15,204)	(11,757)
Capital expenditure	(8,644)	(8,480)	(9,120)
Balance sheet data:			
Cash and cash equivalents	54,883	52,133	29,762
Working capital(1)	81,293	63,097	71,565
Total assets	357,561	341,463	340,788
Total debt	119,207	117,851	120,045
Total liabilities	261,154	263,876	267,409
Total equity	96,407	77,587	73,379

(1) Working capital is comprised of current assets excluding cash and cash equivalents less current liabilities.

	For the year ended and as of December 31,		
	2010	**2009**	**2008**
	(€ thousands, except ratios)		
Other financial data:			
EBITDA(1)	61,194	49,335	41,565
Net debt(2)	64,324	65,718	90,283
Pro forma net debt(3)	253,617		
Pro forma cash interest expense(4)	28,025		
Ratio of *pro forma* net debt to EBITDA(1)(3)	4.1x		
Ratio of EBITDA to *pro forma* cash interest expense(1)(4)	2.18x		

(1) EBITDA is a supplemental measure of financial performance that is not required by, or presented in accordance with, IFRS. "EBITDA" is generally defined as profit for the period before other finance income, other finance expense, income tax expense and depreciation and amortization. In our definition of EBITDA, we further exclude exchange gains and derivatives and exchange losses and derivatives. EBITDA is not a defined measurement of performance under IFRS, and you should not consider EBITDA as an alternative to (a) results from operating activities or profit for the period (as determined in accordance with IFRS), or as a measure of our operating performance, (b) cash flows from operating, investing or financing activities (as determined in accordance with IFRS), or as a measure of our ability to

meet cash needs or (c) any other measures of performance under IFRS. EBITDA may not be indicative of our historical operating results, and is not meant to be a projection or forecast of our future results. We believe that EBITDA is a measure commonly reported and widely used by investors in comparing performance without regard to depreciation, which can vary significantly depending upon accounting methods, interest expense or taxation, or non-operating factors.

EBITDA has been disclosed in this offering memorandum to permit a more complete and comprehensive analysis of our operating performance and of our ability to service our debt. Because companies do not calculate EBITDA identically, our presentation of EBITDA may not be comparable to similarly titled measures used by other companies.

The following is a reconciliation of EBITDA to profit/(loss) for the period, the most directly comparable IFRS measure:

	For the year ended December 31,		
	2010	**2009**	**2008**
	(€ thousands)		
Profit/(loss) for the period	30,402	16,954	12,385
Exchange gains and derivatives	(3,162)	(1,267)	(4,469)
Other finance income	(1,979)	(1,233)	(2,796)
Exchange losses and derivatives	736	2,105	2,179
Other finance expense	15,611	15,579	15,256
Income tax expense	10,170	7,270	8,229
Depreciation & amortization	9,417	9,927	10,781
EBITDA	61,194	49,335	41,565

(2) Represents total debt less cash and cash equivalents.

(3) We define *pro forma* net debt as net debt after giving *pro forma* effect to the Financing as described in “Use of Proceeds,” as if the Financing had occurred on December 31, 2010, less cash and cash equivalents. See “Capitalization.”

(4) *Pro forma* cash interest expense represents interest expense adjusted for the Financing as described in “Use of Proceeds” as if the Financing had occurred on January 1, 2010. *Pro forma* cash interest expense excludes the non-cash interest expense relating to the amortization of original issue discount and estimated debt issuance costs.

Pro forma cash interest expense has been presented for illustrative purposes only and does not purport to represent what our financial expense would have actually been had the Financing occurred on the date assumed, nor does it purport to project our financial expense for any future period or our financial condition at any future date.

RISK FACTORS

Before making an investment decision with respect to the Notes, you should carefully consider the following risks relating to our businesses and the legal structure underlying the offering of the Notes as well as the other information in this offering memorandum. These risks are not the only ones we face. Additional risks and uncertainties not presently known to us, or that we now believe are immaterial, could also adversely affect our businesses, results of operations, financial condition, or our ability to fulfill our obligations under the Notes.

Risks Relating to Our Business

Our business could be adversely affected by future reductions or changes in spending by countries to which we sell our products.

A few countries that vary from time to time drive our revenue. Our results of operations can be significantly affected both by the overall defense and law enforcement policies of these governments, and more specifically, the current procurement and budget priorities of the defense and law enforcement agencies of the countries in which we sell our products.

There are many competing factors that influence how both governments and individual defense agencies within those governments allocate their budgets. These factors include both internal fiscal concerns and external fiscal, political and economic factors. We expect that the recent worldwide financial crisis and the consequent increased sovereign budget deficits are likely to put long-term pressure on defense budgets in many of the countries to which we sell our products.

Given these factors, there can be no assurances that the amount spent on defense by countries to which we sell our products will be maintained or that individual defense agencies will allocate a percentage of their budget for the purchase of small arms. A future decline in government budgets of the countries to which we sell our products or any refocus by defense agencies away from small arms could have a material adverse effect on our revenue, our financial condition and results of operations.

The markets in which we operate are highly competitive.

Because of the nature of our customers, the markets in which we operate are highly competitive. Many of our customers are generally required under their national laws to equip their armies, law enforcement agencies and other government agencies by way of international or European state tendering principles, in which every competitor who meets NATO specifications has the right to bid on contracts to supply small arms. Our ability to compete in these tenders depends to a large extent upon the effectiveness and innovation of our research and development team, our ability to offer better contract performance than our competitors at a lower cost and our readiness with respect to facilities, equipment and personnel to undertake the contracts for which we compete. In addition, we must be able to provide certain “offset” provisions to these potential customers in order to make our tenders attractive. The nature of offset varies from government to government, but a significant number of countries require some form of offset as part of the tender in order to ensure that local industry, particularly the defense industry, benefits from the contract. We generally face competition from a number of competitors in each business area. In addition to direct competitors, we compete indirectly with other companies engaged in different areas of the defense industry for a portion of the defense-related budgets of NATO governments. Some of our competitors are subsidiaries of large corporations or government organizations and may have financial and other resources that are substantially greater than ours. In addition, these competitors may have a greater ability to lobby governments to ensure that they receive a portion of limited government defense budgets, which may reduce the amount that governments can spend on small arms and, by extension, the amount they can use to purchase our products. See “Business—Competition.” A failure to successfully compete in the markets in which we operate may result in a material adverse effect on our revenue, financial condition and results of operations.

Our ability to bid for large contracts may depend on our ability to obtain performance guarantees from financial institutions.

In the normal course of our business we may be asked to provide performance guarantees to our customers in relation to our contracts. These guarantees may include guarantees that a contract will be completed or that our products will be delivered at certain set times and will meet certain defined criteria. Some customers may require that our performance guarantees be issued by a financial institution in the form of a letter of credit, surety bond or other financial guarantee. A deterioration of our credit rating and financial position or change in regulations regarding our products may prevent us from obtaining such guarantees from financial institutions or make the process more difficult or expensive. If we are not able to obtain performance guarantees or if such performance guarantees were to become expensive, we could be prevented from bidding on or obtaining certain contracts or our profit margins with respect to those contracts could be adversely affected, which could in turn have a material adverse effect on our revenue, financial condition and results of operations.

Government contracts are usually subject to competitive bidding, and bidding for such contracts may require us to incur additional costs.

We are unlikely to win all of the contracts for which we compete and, even if we do, these contracts may not result in a profit. We are also subject to risks associated with the substantial expense, time and effort required to prepare bids and proposals for competitively awarded contracts that may not be awarded to us. A failure to profitably win government contracts may have a material adverse effect on our revenue, financial condition and results of operations.

We are subject to extensive and restrictive regulations of our products in certain jurisdictions, to which our competitors are not necessarily subject.

We are regulated by the national governments of the countries in which our products originate and to which our products are delivered. We are subject to regulations in the countries that import our products, where governments require end-user and other certifications of the purchaser. We may be subject to more restrictive export licenses and related regulations of our firearms in certain jurisdictions than our competitors. See "Business—Regulation."

Because a large majority of our products are currently produced or have been designed in Germany, all of our sales are currently subject to strict German export restrictions. Historically, the German Security Council (*Bundessicherheitsrat*) has maintained a policy of restrictive export licenses on defense-related products that led, in the past, to a denial or revocation of licenses that we had obtained or wished to obtain. The denial or revocation of export licenses has caused us to postpone or decline entering into new contracts and prevented us from performing under existing contracts. The German Federal Office of Economics and Export Control (*Bundesamt für Wirtschaft and Ausfuhrkontrolle*, or "BAFA") generally limits the grant of defense goods export licenses to EU and NATO countries and NATO allies, with certain exceptions assessed on a case-by-case basis. In addition, the markets to which we can sell our products are extremely restricted; in many cases more restrictive than those of our competitors who operate under the laws of different jurisdictions and may sell to a larger client base and increase their market share and brand recognition more rapidly than we are able to. The limitation from this restriction has become more pronounced in light of the recent conflicts in the Middle East and North Africa. In addition, the granting of an export license can take up to a year and could result in our being at risk of breaching our contracts or losing customers. The delay, denial or revocation of export licenses has had in the past and could have in the future a material adverse effect on our revenue, financial condition and results of operations.

Undertaking large, long-term fixed-price contracts for our sales exposes our business to risk of loss.

As part of our business, we may sign contracts with our customers, which may take many months or even years to complete. While we have implemented measures to assist us in completing our contracts on time and within budget, there can be no assurance that we will not experience material delays or budget overruns in connection with some of our contracts due to factors outside our control.

Further, although some of our contracts are "cost-plus," in which we earn a margin over production costs, most of our contracts are "fixed-price," in which we receive a set price for delivery of products. Although we do have some ability to renegotiate the prices in certain circumstances, fixed-priced contracts are inherently risky since we assume substantially all of the risks associated with completing the contract as well as the potential cost of post-completion warranty obligations should the product fail to meet required specifications. In addition, contracting conditions normally include provisions for liquidated damages or liability for consequential loss for delay. Any cost overruns or delays on a contract could therefore have a material adverse effect on our revenue, financial condition and results of operations.

In addition, some of our contracts may be modified or cancelled by our customers for reasons beyond our control, including lack of, or changes in, funding. Any failure of a government agency to obtain funds for any of our contracts, or any modification of our contracts as a result of a change in funding, could have a material adverse effect on our revenue, financial condition and results of operations.

Resources devoted to research and development may not yield new products that achieve commercial success.

We devote significant resources to investment in research and development. The research and development process is expensive, prolonged and entails considerable uncertainty. Development of a new small arms product typically takes between one and three years. Because of the complexities and uncertainties associated with research and development, products that we are currently developing may not complete the development process or obtain the regulatory approvals required for us to market such products successfully. The development of new products may take longer and cost more to develop and may be less successful than we currently anticipate as a result of:

- products that may appear promising in development but fail to reach market within the expected or optimal time frame, or fail to ever reach market, for any number of reasons, including efficacy and the difficulty or excessive cost to manufacture;

- failure to enter into or successfully implement optimal alliances where appropriate for the development and commercialization of products, or a failure to maintain a consistent scope and variety of promising late-stage pipeline products; or

- failure of one or more of our products to achieve or maintain commercial viability. We cannot assure you that any of our products currently in our development pipeline will be commercially successful.

Adverse outcomes in existing and future legal proceedings and government investigations could have a material adverse effect on our revenues, financial condition and results of operations.

As a government contractor, we are subject to a higher risk of investigations, criminal prosecution, civil fraud, whistleblower lawsuits and other legal actions and liabilities than purely commercial sector companies, the results of which could cause our results of operations to suffer. We currently are involved in various legal proceedings and government investigations.

In December 2009, a complaint against us was made to the German Federal Cartel Office by a company now managed by one of our former managing directors. The complaint alleged that we had attempted to hinder the company's ability to trade by boycotting the company's technology with other firms. In March 2010, the German Federal Cartel Office carried out a search at our offices to uncover evidence that would support this allegation. The search order also indicates that the German Federal Cartel Office accuses us and other manufacturers of small arms of a restrictive horizontal agreement of not promoting the development of smart guns which was aimed at restricting technical development. This allegation could constitute an administrative offense and subject us to financial penalties. We believe we have meritorious defenses to the allegation asserted against us and have fully cooperated with the investigation. If the German Federal Cartel Office finds against us, however, we may be subject to a fine and restrictions in our ability to conduct business with the German government. In this case, the affected companies may also claim damages from us.

In April 2010, a complaint was filed with the German state prosecutor's office by a third party working with a former managing director of ours, alleging that we illegally exported weapons and parts to several states in Mexico in violation of our export licenses. We believe we have meritorious defenses to the allegation asserted against us and have fully cooperated with the investigation. If the state prosecutor's office finds against us, however, this could lead to a criminal conviction of our employees involved and we may be subject to a fine and a restriction on our ability to receive export licenses from the German government, which may cause delays in deliveries of products and may subject us to penalties or loss of customer confidence.

Adverse outcomes in these and/or potentially similar future proceedings, including intellectual property disputes, antitrust or competition inquiries and litigation, product liability litigation, tax proceedings and environmental litigation, could subject us to substantial fines, penalties and administrative or injunctive remedies. Furthermore, we may incur substantial expense and devote significant management resources in addressing such legal proceedings and government investigations. Adverse outcomes in such legal proceedings and government investigations and the expense of resources incurred may have a material adverse effect on our revenue, financial condition and results of operations.

We could be adversely affected if we fail to keep pace with technological changes or our new products are not accepted in the market.

Across our markets, our products are characterized by the need to evolve with changes in modern-day warfare. This in turn leads to a requirement for lighter, more versatile weapons. Particularly when our customers require us to develop new prototypes of weapons as part of their specific program requirements, these and other demands by our clients will require us to enhance our existing products and develop new products. Our success is dependent in a large part on our ability to:

- anticipate our customers' needs and provide products to meet those needs;

- develop new products that are accepted by our customers;

- integrate more modern materials into our products;

- differentiate our products from our competitors' offerings; and

- enhance and upgrade our existing products.

In order to be able to keep pace with technological changes and demands by our customers, we must devote sufficient resources to the development of new products. Research and development and related work may entail substantial labor and time commitments and result in significant cost. There can be no assurance that such work will result in viable technologies or products, that the market will accept such products or that sufficient resources will be available to develop and test our products in the future. There may also be errors or defects in new or enhanced versions of our products, which may delay our ability to bring them to the market or result in after-sales commitments, the costs of which we may not be able to recover. Any such delay or costs may have a material adverse effect on our revenue, financial condition and results of operations.

We manufacture substantially all of our products at one facility and disruptions at this facility adversely affecting our revenues financial position and results of operations.

We currently manufacture substantially all of our products at our facilities in Oberndorf am Neckar, Germany. Any natural disaster or other serious disruption at this facility due to fire, electrical outage or any other calamity could damage our capital equipment or supporting infrastructure or disrupt our ability to ship our products from, or receive our supplies at, either of these facilities. Any such event could materially impair our ability to manufacture and deliver our products. Even a short disruption in our production output could delay shipments and subject us to penalties or deliver the cash deposits backing our performance guarantees. It could also cause damage to relationships with customers, causing them to reduce or eliminate the amount of products they purchase from us. Any such disruption could result in a material adverse effect on our revenue, financial condition and results of operations.

Our government contracts are subject to audit and our business could suffer as a result of a negative audit by government agencies.

As a government contractor, we are sometimes subject to financial audits and other reviews by the relevant government of our costs, performance, accounting, compliance with procurement and bidding rules and other business practices. Based on the results of their audits, the relevant government may challenge the price we have negotiated for our products and our procurement practices, impose fines and penalties, terminate our contracts or debar us from bidding on future contracts. In addition, some of our costs, including most financing costs, amortization of intangible assets, portions of our research and development costs, and some marketing expenses may not be reimbursable or allowed in our negotiation of fixed-price contracts. Any future government audit or review may result in a material adverse effect on our revenue, financial condition and results of operations.

We are exposed to risks with respect to both geographic and customer concentration.

Among our most important customers are the governmental agencies of Germany, Great Britain, the United States and certain countries in the Middle East. Revenue from customers in these countries, excluding related parties, made up 52% of our revenue in the year ended December 31, 2010. If we are not able to replace these contracts with contracts of similar size, our sales will decrease, which may have a material adverse effect on our revenue, our financial condition and results of operations.

Failure to comply with applicable firearms laws and regulations could have a material adverse effect on our business.

As a firearms manufacturer manufacturing in Germany and the United States and having distribution operations in Germany, the United States, the United Kingdom and France, we are subject to national firearms laws of these countries that pertain to the manufacture, sale and distribution of firearms. Our places of business are subject to compliance inspections by the respective authorities, and compliance failures, which constitute violations of law or regulation, could result in the assessment of fines and penalties by these agencies, including license revocation. Any curtailment of our privileges to manufacture, sell or distribute our products could have a material adverse effect on our revenue, financial condition and results of operations.

Our government and other contracts contain termination provisions such that they can be canceled at any time at the government's sole discretion.

We are subject to business risk specific to companies engaged in supplying defense-related equipment and services to the countries in which we operate. These risks sometimes include the ability of the government in question to suspend or permanently prevent us from receiving new contracts or from extending existing contracts based on violations or suspected violations of procurement laws or regulations, terminate our existing contracts or not purchase the agreed-upon number of small arms weapons systems or other products to be delivered by us in full.

Certain government counterparties may terminate contracts with us either for their convenience or if we default by failing to perform. Termination for convenience provisions generally would enable us to recover only our costs incurred or committed, and settlement expenses and profit on the work completed, prior to termination. Termination for default provisions do not permit these recoveries and make us liable for excess costs incurred by certain government counterparties in procuring undelivered items from another source. In addition, a termination arising out of our default could expose us to liability and have a material adverse effect on our ability to compete for future contracts and orders. Any of the foregoing events may have a material adverse effect on our revenue, financial condition and results of operations.

We are dependent on our brand and intellectual property.

We believe that our trademarks and other proprietary rights are fundamental to our success and market position. There can be no assurance that actions taken by us to establish, protect and monitor the use of our intellectual property will be successful. The law and practice relating to the protection of intellectual property rights varies greatly from country to country. The laws of some countries do not protect our products and intellectual property rights to the same extent as the laws of the United States or the European Union.

Historically, we have had difficulty defending our intellectual property. As a result, our intellectual property has been used by former customers and by other third parties in ways that are not authorized by us. In certain instances, these uses could cause damage to our trademarks, as well as our reputation. For example, prior to our acquisition by HKB in 2002, we maintained (and, with respect to the G3 rifle, the German government maintained) certain agreements with governments whereby these governments were given the right to manufacture MP5 submachine guns and G3 rifles. Although the designs for these products are currently outdated and the licenses and any related agreements with us (and, with respect to the G3 rifle, with the German government) have expired or been terminated, we understand that these governments may occasionally manufacture these products. In addition, these firearms may be manufactured bearing markings associated with us. Although not connected to us, the use of our intellectual property (and, in the case of the G3 rifle, the German government's intellectual property) by these governments may negatively affect public perceptions of our products, thereby decreasing our profitability or otherwise causing a material adverse effect on our revenue, financial condition and results of operations.

We purchase a majority of our high quality steel from a single supplier.

We purchase a majority of our high quality steel from a single source that specializes in the production of special steel and super alloys. Bankruptcy of the supplier or other events which disrupt our supplies of steel for a significant period of time and require us potentially to source steel from an alternative supplier could have a material adverse affect on our revenue, financial condition and the results of operations. For example, it may take a significant amount of time for our alternative supplier to achieve the required production levels, resulting in a delay in production. In addition, we may not be able to negotiate price reductions with our majority supplier similar to those we may be able to negotiate with other suppliers.

Misconduct by management, employees or agents could harm us and is difficult to detect and deter.

Our management, employees or agents may engage in misconduct, fraud or other improper activities that may have adverse consequences on our prospects and results of operations. Misconduct by management, employees or agents, including foreign sales representatives, could include the export of defense articles or technical data without an export license, the payments of bribes in order to obtain business, failure to comply with applicable government procurement regulations, violation of government requirements concerning the protection of classified information and misappropriation of government or third-party property and information. The occurrence of any such activity could result in our suspension or debarment from contracting with the governments, as well as the imposition of fines and penalties, which would cause material harm to our business. It is not always possible to deter misconduct by agents and employees and the precautions we take to detect and prevent this activity may not be effective in all cases.

The audit report in respect of the financial statements of HKB includes an exception.

During the term of the Notes, it is possible that the covenants set forth in the section entitled "Description of the Notes" will apply to HKB and its subsidiaries rather than HKO and its subsidiaries. At such time, HKB would also guarantee the Notes. See "Summary—The Transactions." Accordingly, we are providing certain financial information regarding HKB on a consolidated basis to aid investors in understanding HKB's assets, liabilities and results of operations.

The audit report in respect of the HKB Financial Statements includes an exception. Our auditors have included the following language in their audit report:

"... as at the balance sheet date, unsecured receivables from loans to shareholders exist in the amount of €8,764 [thousands]. The recoverability of these receivables could not be sufficiently assessed, as the shareholders are private individuals whose asset and financial position cannot be entirely separated using authoritative audit evidence. It can therefore not be excluded that the statements are erroneous in this respect."

Accordingly, investors should examine the HKB Financial Statements and the conditions that would apply to moving the covenants from HKO to HKB. See the audit report in the HKB Financial Statements included elsewhere in this offering memorandum and the "Description of the Notes—The Reorganization."

A loss of key personnel or highly skilled employees could adversely affect our business.

Our performance depends significantly both on our ability to retain members of our management team, many of whom have significant experience in the military and in the defense industries, and our ability to attract and retain a highly skilled workforce which includes experienced engineers and technical personnel. If any of our senior executives or other key personnel cease their employment with us, our future operations could be harmed.

Labor law disputes or strikes by our employees may have a material adverse impact on our revenue, financial condition and results of operations.

A works council exists at our Oberndorf am Neckar site. While relations between the works council and ourselves are positive, it is impossible to predict with certainty the nature of future relations. Labor law disputes or strikes could have a material adverse effect on our revenue, financial condition or results of operations.

In June 2008, we entered into a complementary collective bargaining agreement to adopt a new framework for reforming collective wage agreements (*Entgelt-Rahmen-Abkommen*, or "ERA"). Pursuant to this agreement, a new framework was adopted on July 1, 2009. This agreement assigns workers to pay scales according to the requirements of the tasks that they perform. This agreement, tailored specifically for Heckler & Koch, can be terminated for the first time in June 2014 and on termination it must be replaced by an alternative agreement.

We have collective bargaining agreements in line with Baden-Württemberg (*Süd-Württemberg/Hohenzollern*) agreements between the metal-working industry and the main union, with the principal agreement expiring in March 2012.

We face risks associated with international currency exchange.

While we transact business primarily in euros and bill and collect most of our revenue in euros, we transact a portion of our business in U.S. dollars and British pounds sterling, thereby exposing us to some foreign exchange fluctuations. Fluctuations in foreign currency exchange rates could affect the sale of our products or the cost of goods and operating margins and could have a material adverse impact on our revenue, financial condition and results of operations.

Significant increases in commodity and energy prices could have a material impact on our financial condition and results of operations.

The manufacturing of products is dependent upon the availability of raw materials such as steel and polymer. Increases in the prices of any of these raw materials as well as an increase in energy prices could have a material impact on our revenue, financial condition and results of operations.

We may be unable to obtain or maintain licenses required for the conduct of our business.

In the course of our business, we are subject to two sets of German regulations, the laws and regulations for non-weapons of war (*Waffengesetz*) and the German War Weapons Control Act for weapons of war pursuant to the German Weapons Act (*Kriegswaffenkontrollgesetz*). We currently possess valid licenses for all our products. There can be no assurance, however, that we will be able to maintain such licenses in the future.

Weapons of war are defined in the War Weapons List (*Kriegswaffenliste*) as items, substances and organisms, including, *inter alia*, machine guns except those with water cooling, machine pistols, fully automatic rifles, semi-automatic rifles except those for hunting and sporting purposes and machine guns, rifles and grenade pistols. Non-weapons of war includes all other weapons, such as side arms. The manufacture and distribution of non-weapons of war requires a general license for manufacture and trade, which is issued by the competent local authority. The license is granted to a specific individual (*Personalkonzession*) and is unlimited in duration. If the individual to whom the license is issued were to retire or otherwise leave our company, we would be required to appoint another individual to obtain a new license.

Under the German War Weapons Control Act, the manufacture, transport and transfer of weapons of war requires a license that specifies the quantity and identity of the weapons produced. The licenses are issued to the company itself, but require the appointment of a managing director (*Geschäftsführer*) as "responsible person" (*verantwortliche Person*). Generally, we would not expect that changing the appointment of a "responsible person" would interrupt our business. While weapons of war licenses are not issued to individuals and there is little risk of interruption to our business, the duration of these licenses is generally limited to two years by the issuing authority in practice.

The issuance of any new licenses may be withheld or delayed by the competent authorities or due to an intervention by the German government, leading to us being both unable to fulfill our existing contracts and to enter into new contractual obligations, each of which could have a material adverse effect on our revenue, financial condition and results of our operations.

Our operating results may be adversely affected by the impact of environmental laws and regulations to which we are subject.

Our operations are subject to an increasingly demanding level of local, national and supranational laws and regulations on the protection of the environment, health and safety. These laws and regulations address, among other things, the identification, acceptance, treatment, storage, handling, transportation and disposal of hazardous and solid materials and waste, air and water emissions, soil and water contamination, noise, the prevention or minimization of climate change, and exposure of employees and others to hazardous materials or waste.

Any violation or liability under these laws and regulations could give rise to significant costs, require us to pay fines, penalties or damages, result in the closure of our operations, damage to our reputation, or impair our continued ability to conduct our business. Our failure to obtain or a delay in obtaining an environmental, health or safety permit, the non-renewal of or a challenge to a permit, or the imposition of more stringent conditions by a permit could have a material adverse effect on our revenue, financial condition or results of operations. Environmental, health and safety laws and regulations have changed rapidly in recent years, and it is possible that we will be subject to even more stringent standards in the future, including those that limit our ability to access the raw materials we require in order to operate our business.

Our pension provisions relating to our liabilities may not indicate our actual liabilities.

In our accounts, which are prepared in accordance with IFRS, our provisions for pensions and similar employee defined benefit obligations were € 52.6 million as of December 31, 2010. This figure has been calculated by actuaries using the assumptions required by IAS 19; however, any future payments relating to these liabilities may be higher than the amount currently recognized in the financial statements. The German pension schemes, which are defined-benefit plans, are closed to new employees.

We may be subject to liability as a result of sales of firearms to civilians and U.S. local law enforcement agencies.

Our U.S. entities and other entities that engage in the manufacture and distribution of products to civilians and U.S. local law enforcement agencies have been and may in the future be subject to liabilities arising from litigation in the United States. Although we believe that the likelihood of success of an action for monetary damages against us have significantly decreased after the U.S. Congress passed the Protection of Lawful Commerce in Arms Act into law in October 2005, there can be no assurance that success under such an action will not occur. Moreover, our insurance does not cover punitive damages. Because of the extent of potential liability from product liability and negligent distribution claims and the uncertainty of litigation in the U.S. courts, there can be no assurance that our resources will be adequate to cover any product liability and negligent distribution damages, or that the payment of such damages would not have a material adverse effect on our financial condition and results of operations.

Risks Relating to Our Debt and the Notes

Our business may be adversely impacted as a result of our substantial debt, which requires the use of a substantial portion of our cash flow and may limit access to additional capital. We and our subsidiaries may be able to incur additional debt.

As of December 31, 2010, on a *pro forma* basis, after giving effect to the issuance of the Notes and the application of the net proceeds of this offering, we had total debt of €295.0 million (all of which is represented by the Notes), and pension and similar liabilities of € 52.6 million. As of December 31, 2010, we had provided our customers with €17.1 million of bid, advance payment and performance bonds, none of which has been drawn as a result of a breach of any customer commitments. However, if drawn, the bid, performance and advance payment bonds would rank equally with the Notes.

Our substantial debt could have important consequences for holders of the Notes. For example, it is likely to:

- require us to dedicate a substantial portion of our cash flow from operations to payments on debt, thereby reducing the availability of our cash flow to fund working capital, capital expenditures, research and development efforts and other general corporate purposes;
- increase our vulnerability to general adverse economic and industry conditions;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;

- limit our ability to make strategic acquisitions or take other corporate actions;

- place us at a competitive disadvantage compared to competitors who have less debt; and

- limit our ability to borrow additional funds and increase the cost of any such borrowings, particularly because of the financial and other restrictive covenants contained in the Indenture.

We and our subsidiaries may be able to incur additional debt in the future, which could be structurally senior to the Notes, including secured debt. Although the terms of the Indenture contain restrictions on the incurrence of additional debt, these restrictions are subject to a number of qualifications and exceptions. To the extent new debt is added to our current debt levels, the substantial leverage-related risk described above could intensify.

The purchase of HKB PIK Loans may reduce our equity or increase our indebtedness.

We intend to purchase all HKB PIK Loans held by third parties with some of the proceeds of the Notes. See "Use of Proceeds." In the future, we will be required to evaluate the HKB PIK Loans to their fair market value for accounting and insolvency law purposes. To the extent that the value of the HKB PIK Loans were to be reduced below the purchase price, this would reduce our equity or could cause over indebtedness (*Überschuldung*). This could have a material adverse impact on our financial condition and results of operations, including an inability to refinance or otherwise repay the principal of and/or interests on the Notes.

The terms of the Indenture impose various restrictions on us. These restrictions may affect our ability to successfully carry out our business strategy, which in turn could affect our ability to make payments of principal or interest on the Notes.

The Indenture contains, and certain of our future financing agreements may contain, various restrictive covenants that limit our discretion in operating our business. In particular, these agreements will significantly limit our ability and that of our subsidiaries to, among other things:

- incur additional debt;

- make restricted payments (including paying dividends on capital stock or redeeming or repurchasing capital stock);

- make certain investments or acquisitions;

- create liens on assets to secure debt;

- impair the Collateral securing the Notes;

- sell or otherwise dispose of our assets, including the capital stock of certain of our subsidiaries and any other property or assets that are sold other than in the ordinary course of business;

- guarantee debt;

- engage in transactions with affiliates; and

- merge, consolidate or transfer substantially all of our assets.

These restrictions may adversely affect our ability to carry out our business strategy and finance future operations or capital needs. See "Description of the Notes—Certain Covenants." This, in turn, may affect our revenue, financial condition or results of operations, which could affect our ability to make payments of principal or interest on the Notes as those payments become due.

If we fail to comply with the restrictions in the Indenture, or in any other financing agreements, a default may allow our creditors, if the agreements so provide, to accelerate the related debt as well as any other debt to which a cross-acceleration or cross-default provision applies. In addition, other lenders may be able to terminate any commitments they had made to supply us with further funds. We are not certain whether we would have, or be able to obtain, sufficient funds to make these accelerated payments. See "Description of the Notes—Events of Default."

We may not be able to generate sufficient cash to service all or our indebtedness, including the Notes offered hereby, and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our ability to generate cash. This is subject, in part, to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. Accordingly, our business may not generate sufficient cash flows from operations or future distributions may not be available to us in amounts sufficient to enable us to pay our indebtedness, including the Notes, or to fund our other liquidity needs. If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness, including the Notes. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. If our operating results and available cash are insufficient to meet our debt service obligations, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them, and these proceeds may not be adequate to meet any debt service obligations then due. Any future refinancing of our indebtedness could be at higher interest rates and may require us to comply with more onerous covenants which could further restrict our business operations.

If we fail to comply with the payment requirements of any of our debt, including the Notes, it could lead to the acceleration of the related debt and the acceleration of debt under any other debt instruments containing cross-acceleration or cross-default provisions. If this occurred, we might not be able to refinance or otherwise repay this debt.

We may not be able to raise the funds necessary to finance a change of control offer required by the Indenture. Our inability to do so would result in an event of default under the Indenture.

If we were to experience a change of control (as such term is defined in the Indenture), we would be required to make an offer to repurchase all outstanding Notes at 101% of their principal amount, plus accrued and unpaid interest, if any, to the date of repurchase. However, we may be unable to do so because we might not have enough available funds at the time of such change of control to make the required purchase of the Notes. See "Description of the Notes—Purchase of Notes upon a Change of Control." In addition, certain of our future debt, may limit our ability to repurchase the Notes upon a change of control or may require that they be repaid upon a change of control.

The term "all or substantially all" in the context of a Change of Control has no clearly established meaning under the relevant law and is subject to judicial interpretation.

The definition of "Change of Control" contained in the Indenture includes a disposition of all or substantially all of the assets of the Issuer and its restricted subsidiaries taken as whole to any person. Although there is a limited body of case law interpreting the phrase "all or substantially all," there is no precise established definition of the phrase under applicable law. Accordingly, in certain circumstances there may be a degree of uncertainty as to whether a particular transaction would involve a disposition of "all or substantially all" of the assets of the Issuer and its restricted subsidiaries taken as a whole. As a result, it may be unclear as to whether a change of control has occurred and whether the Issuer is required to make an offer to repurchase the Notes.

The pledge over the share capital of the Issuer may be released without the consent of the noteholders.

The pledge over the share capital of the Issuer, made for the benefit of the noteholders, may be released without the consent of the noteholders upon the occurrence of the Permitted HKB Merger (see "Description of the Notes" for a definition and description of the Permitted HKB Merger). While the conditions to the release of the share charge require the shareholders of the surviving entity to pledge all of the shares in such surviving entity for the benefit of the noteholders, such new pledges will be made by multiple parties, will be subject to new hardening periods, and, as a result, may be less useful to the noteholders in a distressed enforcement.

Further, the pledge over the share capital of the Issuer will be automatically released (both before and after the occurrence of the Permitted HKB Merger):

- in connection with any sale or other disposition of the share capital of the Issuer to an unaffiliated party if not less than €50.0 million is received by the Issuer from such sale; or

- following an initial public offering if not less than €50.0 million is received by the Issuer from such offering.

If an insolvency or distressed enforcement were to occur after the pledge over the share capital of the Issuer has been released, noteholders would have fewer, and less robust, enforcement options.

The security interests over the Collateral have been granted to the security trustee rather than directly to the holders of the Notes. The ability of the security trustee to enforce the Collateral may be restricted by local law.

The security interests in the Collateral have not been granted directly to the holders of the Notes, but have been granted in favor of the security trustee. The Indenture provides that only the security trustee has the right to enforce the security documents governing the security interests. As a consequence, holders of the Notes do not have direct security interests and are not entitled to take enforcement action in respect of the Collateral except through the security trustee. By accepting a Note, you will be deemed to have agreed to these restrictions. As a result of these restrictions, holders of the Notes will have limited remedies and recourse against us in the event of a default. See “Description of the Notes.”

Due to the laws and other jurisprudence governing the creation and perfection of security interests and enforceability of such security interests it is necessary in certain jurisdictions, including Germany and France, to grant the security trustee an own “parallel debt” claim in order to grant the collateral to the security trustee. The Indenture provides for the creation of such “parallel debt” claim in favor of the security trustee (“Parallel Debt”) mirroring the obligations of the Issuer and the Guarantors towards the holders of the Notes and the trustee under or in connection with the Indenture (“Principal Obligations”). Share pledges in such jurisdictions have been granted to the security trustee as security for the Parallel Debt and do not directly secure the Principal Obligations. In respect of the security interest granted to secure the Parallel Debt, the holders of the Notes do not have direct security and are not be entitled to take enforcement actions in respect of such security except through the security trustee. Therefore, the holders of the Notes bear the risk of insolvency or bankruptcy of the security trustee in relation to such Collateral. In addition, the Parallel Debt construct has not been tested under law in certain of these jurisdictions and to the extent that the security interests in the Collateral created under the Parallel Debt construct are successfully challenged by other parties, the holders of the Notes will not receive any proceeds from an enforcement of such security interests. See “Limitations on Validity and Enforceability of the Guarantees and the Collateral and Certain Insolvency Considerations.”

The value of the Collateral securing the Notes may not be sufficient to satisfy our obligations under the Notes.

The Collateral solely consists of all of our capital stock held by HKH and all of the capital stock of our direct subsidiaries that we hold and are the only assets underlying the security interest. If we default on the Notes, holders of the Notes are secured only to the extent of the value of the assets underlying their security interest. The value of our capital stock and of the capital stock of our direct subsidiaries realized in any enforcement depends on many factors including, among others, the ability to sell the stock in an orderly sale, the availability of buyers and whether approvals required to purchase our business or the business of our direct subsidiaries would be available to a buyer of the stock. Against this background, there may not be any buyer willing and able to purchase our capital stock or the capital stock of our direct subsidiaries. Each of these factors could reduce the likelihood of an enforcement action as well as reduce the amount of any proceeds from an enforcement action.

The granting of the security interests in the Collateral may create hardening periods for such security interests in accordance with the law applicable in certain jurisdictions.

The granting of new security interests in connection with the issuance of the Notes may create hardening periods for such security interests in certain jurisdictions. The applicable hardening period for these new security interests will run as from the moment each new security interest has been granted, perfected or recreated. At each time, if the security interest granted, perfected or recreated were to be enforced before the end of the respective hardening period applicable in such jurisdiction, it may be declared void and/or it may not be possible to enforce it. See “Limitations on Validity and Enforceability of the Guarantees and the Collateral and Certain Insolvency Considerations.” The pledge over the share capital of the Issuer may be released without the consent of the holders of the Notes.

We are controlled by three individual shareholders, whose interests may conflict with yours.

The share capital of our principal shareholder, HKB, is entirely held by three individual shareholders who together have, directly or indirectly, the power, among other things, to affect our legal and capital structure and our day-to-day operations, as well as the ability to elect and change our management and to approve any other changes to our operations or strategic direction. The interests of our three ultimate shareholders may, however, in certain circumstances conflict with your interests as holders of the Notes. If, for example, we were to encounter financial difficulties or were unable to pay our debts as they matured, our three ultimate shareholders could take actions contrary to your interests. Our three ultimate shareholders could also vote to declare dividends or to cause us to incur additional indebtedness, in each case as permitted under the Indenture, causing capital outflows or increasing our debt service obligations, all of which could hinder our ability to meet our obligations under the Notes. In addition, our three ultimate shareholders may benefit if they pursue acquisitions, divestitures, financings, currency exchange or interest rate hedging or other transactions that, in their judgment, could enhance the value of their equity investment, even though these transactions might involve risk to holders of the Notes.

The change of control provisions contained in the Indenture may not protect holders of the Notes in the event of certain highly leveraged transactions, including reorganizations, restructurings or mergers, because these transactions may not involve a change of voting power or beneficial interest of the magnitude required to trigger the change of control provisions. See "Description of the Notes—Purchase of Notes upon a Change of Control."

Enforcing your rights as a holder of the Notes or under the Guarantees or the Collateral across multiple jurisdictions may prove difficult.

The Issuer is organized under the laws of Germany; the Guarantors are organized under the laws of Germany, France, United States and England and Wales. In the event of bankruptcy, insolvency, administration or similar event, proceedings could be initiated in any of these jurisdictions. Your rights under the Notes, the Guarantees and the Collateral are likely to be subject to insolvency and administrative laws of several jurisdictions and there can be no assurance that you will be able to effectively enforce your rights in such complex proceedings.

The insolvency, administration and other laws of the jurisdiction of organization of the Issuer and the Guarantors may be materially different from, or conflict with, each other and with the laws of the United States, including in the areas of rights of creditors, priority of governmental and other creditors, ability to obtain post-petition interest, the duration of proceeding and preference periods. The application of these laws, and any conflict between them, could call into question whether, and to what extent, the laws of any particular jurisdiction should apply, adversely affect your ability to enforce your rights under the Guarantees and the security documents in these jurisdictions or limit any amounts that you may receive. See "Limitations on Validity and Enforceability of the Guarantees and the Collateral and Certain Insolvency Considerations."

Corporate benefit, capital maintenance laws and other limitations on the Guarantees may adversely affect the validity and enforceability of the Guarantees of the Notes.

The laws of certain of the jurisdictions in which the Guarantors are organized limit the ability of these subsidiaries to guarantee debt of a related company or grant security on account of a related company's debts. These limitations arise under various provisions or principles of corporate law which include rules governing capital maintenance, under which, among others, the risks associated with a guarantee or grant of security on account of a parent or sister company's debt need to be reasonable and economically and operationally justified from the guarantor's or grantor's perspective, as well as thin capitalization and fraudulent transfer principles. If these limitations were not observed, the Guarantees by these Guarantors could be subject to legal challenge. In these jurisdictions, including Germany, the Guarantees will contain language limiting the amount of debt guaranteed so that applicable local law restrictions will not be violated. Accordingly, if you were to enforce the Guarantees by a Guarantor in one of these jurisdictions, your claims are likely to be limited. In some cases, where the amount that can be guaranteed or secured is limited by reference to the net assets and legal capital of the Guarantor or by reference to the outstanding debt owed by the relevant Guarantor to us under intercompany loans that amount might have reached zero or close to zero at the time of any insolvency or enforcement. Furthermore, although we believe that the Guarantees by these Guarantors have been validly given in accordance with local law restrictions, there can be no assurance that a third-party creditor would not challenge these Guarantees and prevail in court. See "Limitations on Validity and Enforceability of the Guarantees and the Collateral and Certain Insolvency Considerations."

Fraudulent conveyance laws may protect our creditors to your disadvantage.

Our obligations under the Notes may, subject to the terms of the Indenture, be secured by the Issuer and the other providers of the Collateral and be guaranteed by the Guarantors. See "Description of the Notes—Subsidiary Guarantees" and "Description of the Notes—Collateral." Each of the Guarantees and the Collateral, if any, may be subject to review under the fraudulent transfer and conveyance laws of the relevant jurisdiction where the Issuer, HKH and each of the Guarantors operates. The following discussion of fraudulent transfer and conveyance law, although an overview, describes generally applicable terms and principles, which are defined under the relevant jurisdiction's fraudulent transfer statutes.

In an insolvency proceeding, it is possible that creditors of the Issuer, HKH and the Guarantors or the insolvency administrator may challenge the Guarantees, the Collateral and intercompany obligations as fraudulent transfers or conveyances. If so, such laws may permit a court, if it makes certain findings, to:

- avoid or invalidate all or a portion of the obligations of the Guarantors and the providers of the Collateral under their respective Guarantees and Collateral;

- direct that holders of the Notes return any amounts paid under a Guarantee or Collateral to the Issuer, HKH or the relevant Guarantor or to a fund for the benefit of its creditors; and

- take other action that is detrimental to you.

If we cannot satisfy our obligations under the Notes and any Guarantee is found to be a fraudulent transfer or conveyance, we cannot assure you that we can ever repay in full any amounts outstanding under the Notes. In addition, the liability of each Guarantor and provider of the Collateral under the Indenture are limited to the amount that will result in its Guarantee not constituting a fraudulent conveyance or improper corporate distribution, and there can be no assurance as to what standard a court would apply in making a determination of the maximum liability of each Guarantor and provider of the Collateral.

In order to initiate any of these actions under fraudulent transfer principles, courts typically must determine that, at the time the relevant Collateral or Guarantee was issued, the Guarantor or provider of the Collateral, as applicable:

- issued such Guarantee or Collateral with the intent of hindering, delaying or defrauding current or future creditors; or

- received less than reasonably equivalent value for incurring the debt represented by the Guarantees on the basis that the Guarantees were incurred for our benefit, and only indirectly for the benefit of the Guarantors or providers of Collateral, or some other basis and (i) was insolvent or rendered insolvent by reason of the issuance of the Guarantee or Collateral, (ii) was undercapitalized or became undercapitalized because of the Guarantee or Collateral, (iii) was engaged, or was about to engage, in a business or transaction for which the assets of the Guarantor or providers of Collateral were unreasonably small or (iv) intended to incur, or believed it would incur, debts beyond its ability to make required payments as and when they would become due.

Different jurisdictions evaluate insolvency on various criteria, but a Guarantor or provider of Collateral is generally considered insolvent at the time it issued a Guarantee or granted the Collateral, as applicable, if:

- its liabilities exceeded the fair market value of its assets;

- it cannot pay its debts as and when they become due; or

- the present saleable value of its assets is less than the amount required to pay its total existing debts and liabilities, including contingent liabilities, as they become matured or absolute.

We cannot assure you which standard a court would apply in determining whether a company was “insolvent” as of the date the Guarantees were issued or the Collateral was granted, that, regardless of the method of valuation, a court would not determine that a Guarantor was insolvent on that date, or that a court would not determine, regardless of whether or not a company was insolvent on the date its Guarantee was issued or the Collateral was granted, that payments to holders of the Notes constituted fraudulent transfers on other grounds. If a court decides that any Guarantee was a fraudulent conveyance and voided such Guarantee, or held it unenforceable for any other reason, you would cease to have any claim in respect of the Guarantee or the Collateral See “Limitation on Validity and Enforceability of the Guarantees and the Collateral and Certain Insolvency Considerations.”

The insolvency laws of Germany may not be as favorable to you as the bankruptcy laws of the jurisdiction with which you are familiar.

We are incorporated under the laws of Germany. The Guarantors and other providers of Collateral are incorporated under the laws of Germany, France, England and the United States. Insolvency proceedings with respect to each of these companies could be required to proceed under the laws of the jurisdiction in which its “centre of main interests,” as defined in The Council of the European Union Regulation No. 1346/2000 on Insolvency Proceedings, is situated at the time insolvency proceedings are commenced. Although there is a rebuttable presumption that the “centre of main interests” will be in the jurisdiction where its registered office is situated, this presumption is not conclusive.

The insolvency laws of Germany or any other relevant jurisdiction may not be as favorable to your interests as those of the United States or another jurisdiction with which you may be familiar. Such multi-jurisdictional proceedings are likely to be complex and costly for creditors and otherwise may result in greater uncertainty and delay regarding the enforcement of your rights.

Under German law, insolvency proceedings can be initiated through filing of an insolvency petition (*Insolvenzantrag*) either by the debtor or by a creditor in the event of over-indebtedness (*Überschuldung*) of the debtor, *i.e.*, where its liabilities exceed the value of its assets (according to temporary legislation in force until the end of 2013, the debtor is in any case not over-indebted if its continuation as a going concern is predominantly likely) or in the event that the debtor is unable to pay its debts as and when they fall due (*Zahlungsunfähigkeit*). In addition, the debtor can file for insolvency proceedings if it is imminently at risk of being unable to pay its debts as and when they fall due (*drohende Zahlungsunfähigkeit*). The insolvency proceedings are court controlled, and the court opens the insolvency proceedings if certain formal requirements are met and if there are sufficient assets to cover at least the cost of the proceedings. The court usually appoints an insolvency administrator (*Insolvenzverwalter*) who, once the main insolvency proceedings have been opened, generally has full power to dispose of the debtor's assets, whereas the debtor is no longer entitled to dispose of its assets.

Under German law, the insolvency administrator may challenge transactions that it deems detrimental to insolvency creditors and that were effected prior to or after the opening of insolvency proceedings. These transactions can include the payment of any amounts to the holders of the Notes, as well as the provision of any credit support for their benefit (including the granting of any Guarantees or security for the benefit of the holder of the Notes). The administrator's right to challenge transactions can, depending on the circumstances, extend to transactions occurring ten years prior to the opening of insolvency proceedings. In the event that the validity or enforceability of these transactions are successfully challenged, the holder of the Notes may not be able to recover any amounts under the relevant Guarantee or security and would be under an obligation to repay the amount received and/or to waive their respective security interest. See "Limitations on Validity and Enforceability of the Guarantees and the Collateral and Certain Insolvency Considerations."

No prior market exists for the Notes. An active trading market may not develop for the Notes and you may not be able to sell your Notes.

There is currently no established market for the Notes and a market for the Notes may not develop. This may affect the ability of the holders of the Notes to sell their Notes or the price at which holders would be able to sell their Notes. If a market was to exist, the Notes could trade at prices that may be lower than the initial market values thereof depending on many factors, including prevailing interest rates and our business performance. Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF Market of that exchange.

Historically, the markets for non-investment grade debt, such as the Notes, have been subject to disruptions that have caused substantial volatility in their prices. The market, if any, for the Notes may be subject to similar disruptions. Any disruptions may have an adverse effect on the holders of the Notes.

We have been informed by the initial purchasers that they intend to make a market for the Notes after the offering is completed. However, the initial purchasers are not obliged to do so and may cease their market-making activity at any time without notice. In addition, such market-making activity will be subject to limitations imposed by the Securities Act and other applicable laws and regulations. As a result, we cannot assure you that an active trading market for the Notes will develop or, if one does develop, that it will be maintained. If an active trading market does not develop or cannot be maintained, this could have a material adverse effect on the liquidity and the trading price of the Notes. Market fluctuations, as well as economic conditions, have adversely affected the market price of many securities. We cannot assure you that these conditions will not adversely affect the market price of the Notes.

Transfer of the Notes are subject to certain restrictions.

We have not registered, and will not register the offer and sale or resale of the Notes under the Securities Act or the U.S. state securities laws or the securities laws of any other jurisdiction. You may not offer or sell the Notes, except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and applicable U.S. state securities laws. You should read the discussions in "Notice to Investors" for further information about these and other transfer restrictions. It is your obligation to ensure that offers and sales of Notes within the United States and other countries comply with applicable securities laws.

Credit ratings may not reflect all risks, are not recommendations to buy or hold the Notes and may be subject to revision, suspension or withdrawal at any time.

One or more independent credit rating agencies may assign credit ratings to the Notes. The credit ratings address our ability to perform our obligations under the terms of the Notes and credit risks in determining the likelihood that payments will be made when due under the Notes. The ratings may not reflect the potential impact of all risks related to the structure, market, additional risk factors discussed above and other factors that may affect the value of the Notes. A credit rating is not a recommendation to buy, sell or hold securities and may be subject to revision, suspension or withdrawal by the rating agency at any time. No assurance can be given that a credit rating will remain constant for any given period of time or that a credit rating will not be lowered or withdrawn entirely by the credit rating agency if, in its judgment, circumstances in the future so warrant. A suspension, reduction or withdrawal at any time of the credit rating assigned to the Notes by one or more of the credit rating agencies may adversely affect the cost and terms and conditions of our financings and could adversely affect the value and trading of the Notes.

You may not be able to recover in civil proceedings for U.S. securities laws violations.

It may not be possible for investors to effect service of process in the United States upon us or our directors and officers or to enforce against us or them judgments obtained in the U.S. courts predicated upon civil liability provisions of the federal securities laws of the United States. In particular, there is doubt as to the enforceability in Germany, in original actions or actions for the enforcement of judgments of U.S. courts, of civil liabilities predicated solely upon the federal securities laws of the United States. See "Service of Process and Enforcement of Civil Liabilities" where this issue is more fully described.

The Notes are initially be held in book-entry form and therefore you must rely on the procedures of the relevant clearing systems to exercise any rights and remedies.

Unless and until definitive registered notes are issued in exchange for book-entry interests in the Notes, owners of the book-entry interests will not be considered owners or holders of the Notes. Instead, the registered holder, or its nominee, are the sole holder of the Notes. Payments of principal, interest and other amounts owing on or in respect of the Notes in global form will be made to The Bank of New York Mellon (as paying agent for the Notes), which will make payments to the common depositary, which will in turn distribute payments to Euroclear and Clearstream. Thereafter, payments will be made by Euroclear and Clearstream, as applicable, to participants in these systems and then by such participants to indirect participants. After payment to the common depositary or the paying agent, as applicable, neither we, the trustee nor the paying agent will have any responsibility or liability for any aspect of the records relating to, or payments of, interest, principal or other amounts to Euroclear and Clearstream or to owners of book-entry interests.

Unlike holders of the Notes themselves, owners of book-entry interests will not have the direct right to act upon our solicitations or consents or requests for waivers or other actions from holders of the Notes that we may choose to make in the future. Rather, owners of book-entry interests will be permitted to act only to the extent that they have received appropriate proxies to do so from Euroclear and Clearstream or from a participant. We cannot assure you that procedures implemented for the granting of such proxies will be sufficient to enable you to vote on any such solicitations or requests for actions on a timely basis.

Similarly, upon the occurrence of an event of default under the Indenture, owners of book-entry interests will be restricted to acting through Euroclear and Clearstream. We cannot assure you that the procedures to be implemented through Euroclear and Clearstream, as applicable, will be adequate to ensure the timely exercise of rights under the Notes. See "Book-Entry; Delivery and Form."

Pending and future tax audits within our group might lead to additional tax payment obligations.

Additional tax expenses could accrue as a result of ongoing or future tax audits. Tax laws and regulations are complex and subject to varying interpretations. Therefore, there is a general risk that tax authorities could have a different view on certain tax matters than our Group, in particular in connection with financings (especially depreciations in respect of intra-group loans). As a result, the tax authorities might not concur with certain positions taken in our tax reports/returns or could revise original tax assessments, and substantially increase the tax burden (including interest and penalty payments) of the affected companies of our Group. This could adversely affect our business, financial condition and results of operations.

Changes in fiscal regulations or the interpretation of tax laws might have materially adverse consequences for our business, financial condition and results of operations.

Changes in fiscal regulations or the interpretation of tax laws by the courts in all jurisdictions in which we are conducting our business might have adverse effects on our business, for example if certain tax exemptions no longer apply. Changes in the tax law or the invalidity of granted tax rulings or tax agreements (e.g., as a result of cancellation, withdrawal, termination) might also lead to higher tax impacts on our group, and potentially have materially adverse consequences for our business, financial condition and results of operations.

Applicable tax rules in Germany may adversely affect our business, financial condition and results of operations.

For purposes of German corporate income and trade tax, debt financing of German companies is limited by, among other things, the interest barrier rule (*Zinsschranke*). Under that rule, net interest expense equalling or exceeding €3.0 million would, subject to certain exceptions, only be tax deductible to an extent of 30% of the respective current year EBITDA (as adjusted for tax purposes). Non-deductible interest expenses would be carried forward and would generally be tax-deductible in subsequent fiscal years, subject to various limitations. There can be no assurance that our EBITDA (as adjusted for tax purposes) will be sufficient to allow the deductibility of interest expenses under the Notes. Any inability to deduct the interest expenses may under the Notes adversely affect our tax position and could adversely affect our business, financial condition and results of operations.

Tax risks regarding intra-group transactions.

There is a potential risk that tax authorities may challenge former or future intra-group transactions, particular in respect of non-compliance with the transfer pricing rules (including documentation rules) or the arm's length principle. This could adversely affect our business, financial condition and results of operations.

The Notes may be issued with original issue discount for U.S. federal income tax purposes.

The stated principal amount of the Notes may exceed their issue price by an amount that equals or exceeds a de minimis threshold and, in such event, the Notes would be treated as issued with original issue discount for U.S. federal income tax purposes in an amount equal to such excess. In the event that the Notes are considered to be issued with original issue discount, U.S. Holders (as defined below under "Taxation Considerations—U.S. Federal Income Tax Considerations") will be required to include such original issue discount in their gross income (as ordinary income) as it accrues, in advance of their receipt of cash attributable to such original issue discount (regardless of the holder's accounting method for U.S. federal income tax purposes). See "Taxation Considerations—U.S. Federal Income Tax Considerations."

USE OF PROCEEDS

We expect that the net proceeds from the issuance and sale of the Notes are approximately €281.3 million, after deducting the initial purchasers' fees and commissions and the estimated offering expenses payable by us. The anticipated sources and uses of cash in connection with the Financing are set out below. Actual amounts may differ from these estimates.

Sources	€ in millions	Uses	€ in millions
Notes offered hereby(1)............	291.3	Refinance 2004 Notes(2)..........	124.7
Cash	13.5	Purchase HKB PIK Loans(3) ...	170.1
		Estimated transaction fees and expenses and other payments(4)..............................	10.0
Total sources	304.8	**Total uses**...............................	304.8

(1) Represents the aggregate principal amount of € 295 million, net of original issue discount.

(2) Represents the repayment in full of the outstanding principal amount of the 2004 Notes outstanding on the Issue Date, plus accrued and unpaid interest through the anticipated repayment date.

(3) Represents the purchase of all the HKB PIK Loans (other than HKB PIK Loans currently held by HKB) at the purchase price that has been agreed with the holders thereof.

(4) The fees and expenses represent our estimates of fees and expenses related to the Financing, including underwriting fees and commissions, other transaction costs and professional fees.

CAPITALIZATION

The following table sets forth our unaudited consolidated cash and cash equivalents and capitalization computed as of December 31, 2010 on a historical basis and as adjusted to give effect to this offering and the application of the net proceeds therefrom, as described under "Summary—The Transactions" and "Use of Proceeds."

You should read this table in conjunction with "Summary—The Transactions," "Use of Proceeds," "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Description of the Notes" and the financial statements of the Issuer included elsewhere in this offering memorandum.

	As of December 31, 2010		
	Historical	**Adjustments**	**As adjusted**
		(€ millions)	
Cash and cash equivalents[1]	54.9	(13.5)	41.4
Debt			
2004 Notes[2]	120.0	(120.0)	—
Notes offered hereby[3]	—	295.0	295.0
Total debt	120.0	175.0	295.0
Shareholders' equity	96.4	(13.7)	82.7
Total capitalization	216.4	161.3	377.7

(1) Represents cash and cash equivalents on our balance sheet as of December 31, 2010. As of March 31, 2011, we estimate we had €33.6 million of cash and cash equivalents.

(2) The 2004 Notes have been reflected in the table at their aggregate principal amount. The 2004 Notes are reflected on our December 31, 2010 balance sheet as €119.2 million, their amortized cost.

(3) The Notes have been reflected in the table at their aggregate principal amount. The issue costs associated with the Notes and the original issue discount will be amortized over the life of the Notes as additional interest expense.

SELECTED HISTORICAL FINANCIAL DATA OF THE GROUP

The following table set forth selected historical financial information for the Group as of and for the years ended December 31, 2008, 2009 and 2010. For a detailed discussion of the presentation of financial data, see "Presentation of Financial and Other Data." The selected historical financial information presented below should be read in conjunction with the audited consolidated financial statements for the Group and notes thereto included elsewhere in this offering memorandum.

The financial statements contained herein were prepared in accordance with IFRS. The selected historical information set forth below should also be read in conjunction with the information set forth under "Management's Discussion and Analysis of Financial Condition and Results of Operations," "Use of Proceeds" and "Related Party Transactions." Historical results are not necessarily indicative of future expected results.

	For the year ended and as of December 31,		
	2010	**2009**	**□□H□**
		(€ thousands)	
Revenue	247,244	234,748	200,992
Cost of sales	(144,067)	(153,563)	(133,181)
Gross profit	**103,178**	**81,185**	**67,810**
Research & development	(4,112)	(3,051)	(2,087)
Sales, marketing & distribution	(31,752)	(24,714)	(23,162)
Administration	(14,758)	(14,224)	(10,880)
Other operating income	6,512	6,344	8,791
Other operating expenses	(7,289)	(6,132)	(9,688)
Results from operating activities	**51,777**	**39,408**	**30,784**
Financial income	5,141	2,500	7,265
Financial expense	(16,347)	(17,684)	(17,435)
Net financial result	**(11,206)**	**(15,184)**	**(10,170)**
Profit before income tax	**40,571**	**24,224**	**20,614**
Income tax expense	(10,170)	(7,270)	(8,229)
Profit for the period	**30,402**	**16,954**	**12,385**
Cash flow statement data:			
Net cash flows from operating activities	43,449	57,361	21,836
Net cash flows from investing activities	(10,412)	(20,012)	(17,101)
Net cash flows from financing activities	(30,861)	(15,204)	(11,757)
Capital expenditure	(8,644)	(8,480)	(9,120)
Balance sheet data:			
Cash and cash equivalents	54,883	52,133	29,762
Working capital(1)	81,293	63,097	71,565
Total assets	357,561	341,463	340,788
Total debt	119,207	117,851	120,045
Total liabilities	261,154	263,876	267,409
Total equity	96,407	77,587	73,379

(1) Working capital is comprised of current assets excluding cash and cash equivalents less current liabilities.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read together with, and is qualified in its entirety by reference to, our audited consolidated historical financial information prepared in accordance with IFRS for the three-year period 2008-2010 and the audited consolidated historical financial information of HKB prepared in accordance with IFRS for the two-year period 2009-2010, in each case including the related notes thereto, included in this offering memorandum, beginning on page F-1. The following discussion should also be read in conjunction with "Presentation of Financial and Other Data" and "Selected Historical Financial Data of the Group." Except for the historical information contained herein, the discussions in this section contain forward-looking statements that reflect Group's plans, estimates and beliefs and involve risks and uncertainties. Our actual results could differ materially from those discussed in these forward-looking statements. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this offering memorandum, particularly in "Risk Factors" and "Information Regarding Forward-Looking Statements."

Overview

We are a leading European manufacturer of small arms with a premium-quality product portfolio for the NATO armed forces and their allies. We design, produce and distribute small arms, including rifles, side arms, fully automatic weapons, grenade launchers and a variety of other related products. We believe we are the market leader in the supply of assault rifles, side arms, grenade launchers and grenade machine guns to European NATO and government agencies. We also believe our products are widely considered to be best-in-class in each of their respective categories primarily as a result of long-standing commitment to integrated research and development, engineering and manufacturing. We have been in operation for more than 60 years and our brand name is highly respected by armed forces globally.

We supply the armed forces of NATO, including the U.S. Army, and the special forces of NATO, including the U.S. Special Forces. We are the sole supplier of the standard assault rifle to the German, British, Norwegian and Spanish armed forces. We supply law enforcement agencies worldwide, including the European police forces and U.S. local and federal law enforcement agencies, such as the FBI and the Secret Service. We also supply the commercial market for civilians. We believe that one of our significant markets for future growth is the United States. In the year ended December 31, 2010, 55% of our sales were to Europe and 17% of our sales were to the United States.

For the year ended December 31, 2010, we generated revenue of € 247.2 million and EBITDA of €61.2 million. As of December 31, 2010, our order book (defined as contractual sales yet to be delivered) was €169.7 million with approximately 75% of the order book deliverable in the year ending December 31, 2011.

Factors that Affect the Results of Our Operations

Defense procurement budgets of NATO countries

Over 70% of our sales in the year ended December 31, 2010 were to customers who are federal, state or local governmental agencies of NATO countries; this proportion was closer to 90% in previous years. Our results of operations can be significantly affected both by the overall defense policies of these governments, and more specifically, by the current procurement and budget priorities of NATO countries' defense and law enforcement agencies. There are many competing factors that influence how both NATO governments and individual defense agencies within those governments allocate their budgets. These factors include both internal fiscal concerns and external fiscal, political and economic factors. While changes in defense policy can have an impact on our business in the longer term, the procurement priorities of government defense agencies can affect our results of operations over the short to medium term. Although most of our sales to NATO countries are pursuant to long-term programs and contracts, delays by governments in placing orders, reductions or changes in timing of funding, changes in the size of orders or changes in specifications may occur. In addition, while relatively rare, from time to time governments have terminated arms procurement contracts. Any delays or changes by governments may have a material negative impact on our revenue and results of operations in the period in which they occur.

Gaining export licenses from the German authorities

Currently, virtually all our manufacturing and design takes place in Oberndorf am Neckar in Germany and, therefore, all exports of our products from Germany require licenses from the German authorities. The granting of licenses for the export of our products to NATO countries is normally a routine process, but it can be more time consuming to obtain licenses for certain countries outside of NATO. Although we work closely with the German authorities to monitor the provision of these licenses, geo-political events outside the control of either party can delay the granting of these licenses. This can have a major impact on our revenue and results of operations during the period in which they occur.

Procurement and service contracts and product mix

Our results of operations in any period are affected both by our product mix and by the terms of the individual procurement contracts in effect in any period. The revenues and margins we generate vary widely by product and are significantly affected by the defense policies, procurement and budget priorities of government defense agencies. In addition, unit costs tend to decrease over the first few years of production of a new product as a result of improving efficiency in the manufacturing process. Consequently, our margins for a specific product tend to increase and then stabilize over the life of the product. Our revenues and margins are also affected by how favorably we are able to negotiate the terms of our individual contracts with our customers, which terms may vary within such contracts depending on certain variables. The resulting mix of products we are selling in any period, coupled with the nature of our contract terms (particularly the pricing terms we are able to negotiate with our customers), can have an effect on our revenue and profitability from period to period.

Our results of operations are also affected by the terms and size of our service contracts, under which lower cost of sales are generally recognized compared to procurement contracts due to lower material costs. In contrast, higher sales, marketing and distribution costs are generally recognized under our service contracts compared to our procurement contracts.

Seasonality

The market in which we operate is impacted by our customers' budgets. The vast majority of our customers are governments with budgets which are set on an annual basis. Because these customers are often required to spend their entire budgets within the annual period in which they are granted, the majority of their spending often occurs in the fourth quarter of the fiscal year. As a result, on average, approximately 30% to 40% of our sales occur in our fourth quarter.

Political climate

The U.S. commercial market is impacted by the political climate in the United States as the expectation of tighter gun control legislations tends to stimulate rush demand. The demand for high-end products in this market particularly affects our results of operations as our products in the commercial market are premium products.

Recent Acquisitions and Contracts

- The original Objective Individual Combat Weapon "OICW" program included the development of an integrated grenade launcher. In conjunction with the U.S. Army, we are now developing the XM25 grenade launcher, which evolved from the OICW program. We continue to be contracted for development work.

- In the United States, we won a sole source contract for the supply of the GLM, a 40mm under-slung grenade launcher to be used on the M4/M16 assault rifles. The first two options under this contract have been signed and deliveries started in the first quarter of 2009. Further options for deliveries through the remainder of 2011 were signed in the first quarter of 2011.

- In 2007, we won contracts to supply the U.K. Ministry of Defence with grenade machine guns which were sent directly into operational areas. Deliveries of this product will continue through 2011.

- The U.K. Ministry of Defence also placed orders for medium machine guns to be delivered in 2009 and 2010, and further orders are expected for delivery in 2011.

- In 2007, the government of Norway placed a large order for the delivery of assault rifles and submachine guns, for delivery in 2008 and 2009. Further orders are expected for the delivery of products in 2011.

- In April 2008, the Group was awarded a contract in the Middle East, as presented to and approved by the German Federal Office of Economics and Export Control (BAFA).

- In the first half of 2009, we re-acquired HKI, the U.S. commercial sales and distribution business that we disposed of in 2004, and its parent SUI. Our financial statements for the year ended December 31, 2009 and 2010 consolidate the financial results of HKI and SUI as if they had been acquired on December 31, 2007 as they were acquired in a transaction under common control. In 2010, we re-acquired HKS, which we disposed of in 2003. Our financial statements for the year ended December 31, 2010 consolidate the results of HKS from its acquisition in July 2010 onwards.

- In 2009, we won a contract to supply the HK416 rifle to the U.S. Marine Corps.

- On an ongoing basis, we continue to win orders from the U.K. Ministry of Defence for a range of spares and accessories, from the German Army for a range of products, and from the EuroFighter Consortium for the Ammunition Feed System.

Explanation of Key Income Statement Items

Below is a summary description of the elements comprising the key line items of our income statement.

Revenue

Revenue represents the revenue received from the sale of goods, the sale of services and construction contracts, less sales deductions, discounts and value added taxes. Revenue from sale of goods and sale of services are recorded when the associated supplies and services have been rendered, the risks and rewards of ownership have transferred to the buyer and the receipt of the payment is probable. Revenue from construction contracts are recorded when the outcome of a construction contract can be estimated reliably in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable.

Cost of sales

Cost of sales comprises the cost of the goods, services and construction contracts that we sell. Cost of sales includes materials, labor and overhead costs relating to revenue.

Research and development costs

Research and development costs comprise personnel costs, the costs of test materials, tools, sub-contracted services and other overheads relating to research and development, including the amortization of capitalized development costs. Research costs are expensed as they are incurred. Development costs are also expensed as they are incurred, unless they satisfy the criteria for recognition as internally generated intangible assets according to IAS 38.57.

Sales, marketing and distribution costs

Sales, marketing and distribution costs primarily comprise personnel expenses, distribution costs and fees to sales representatives relating to sales, marketing and distribution together with material and marketing costs and depreciation relating to fixed assets used in the sales, marketing and distribution function. We incur fees to sales representatives relating to sales, marketing and distribution in countries where specialized local knowledge and contacts are required for successful marketing.

General administration costs

General administration costs comprise personnel expenses, office material costs and depreciation of fixed assets used in the administration function.

Other operating income

Other operating income comprise release and utilization of provisions, income from the provision of administration services, profit on disposal of non-current and held-for-sale assets, license fee income, income from fuel sales to employees and other operating income.

Other operating expenses

Other operating expenses comprise creation of provision for doubtful debts and write-off of bad debts, impairment of assets held for sale, loss on disposal of non-current assets, creation of certain general liability provisions, other taxes and other operating expenses.

Financial income

Financial income comprises interest income on short-term loans and on bank balances, discounting of non-current liabilities, gains on valuation of derivative financial instruments, gains on translation of foreign currencies and other financial income.

Financial expenses

Financial expenses comprise interest expenses, accretion of non-current liabilities relating to defined benefit provisions and other long-term provisions and the 2004 Notes, losses on valuation of derivative financial instruments, losses on translation of foreign currencies and other financial expenses relating to guarantee costs.

Income taxes

Income taxes comprise the German corporate income tax, the German trade tax, the German solidarity surcharge, similar income taxes for the foreign subsidiaries, and certain changes in deferred tax assets and liabilities.

Results of Operations

The following table sets out, for the periods presented, our consolidated income statement data. The information contained in the table below should be read in conjunction with our consolidated financial statements and the related notes.

	For the year ended December 31,		
	2010	2009	2008
		(€ thousands)	
Revenue	247,244	234,748	200,992
Cost of sales	(144,067)	(153,563)	(133,181)
Gross profit	**103,178**	**81,185**	**67,810**
Research & development	(4,112)	(3,051)	(2,087)
Sales, marketing & distribution	(31,752)	(24,714)	(23,162)
Administration	(14,758)	(14,224)	(10,880)
Other operating income	6,512	6,344	8,791
Other operating expenses	(7,289)	(6,132)	(9,688)
Results from operating activities	**51,777**	**39,408**	**30,784**
Financial income	5,141	2,500	7,265
Financial expense	(16,347)	(17,684)	(17,435)
Net financial result	**(11,206)**	**(15,184)**	**(10,170)**
Profit before income tax	**40,571**	**24,224**	**20,614**
Income tax expense	(10,170)	(7,270)	(8,229)
Profit for the period	**30,402**	**16,954**	**12,385**

The table below sets out the consolidated statements of income data expressed as a percentage of revenue for the periods indicated:

	For the year ended December 31,		
	2010	2009	2008
		(% of revenue)	
Cost of sales	(58.3)	(65.4)	(66.3)
Gross profit	**41.7**	**34.6**	**33.7**
Research & development	(1.7)	(1.3)	(1.0)
Sales, marketing & distribution	(12.8)	(10.5)	(11.5)
Administration	(6.0)	(6.1)	(5.4)
Other operating income	2.6	2.7	4.4
Other operating expenses	(2.9)	(2.6)	(4.8)
Results from operating activities	**20.9**	**16.8**	**15.3**
Financial income	2.1	1.1	3.6
Financial expense	(6.6)	(7.5)	(8.7)
Net financial result	**(4.5)**	**(6.5)**	**(5.1)**
Profit before income tax	**16.4**	**10.3**	**10.3**
Income tax expense	(4.1)	(3.1)	(4.1)
Profit for the period	**12.3**	**7.2**	**6.2**

The year ended December 31, 2010 compared with the year ended December 31, 2009

Revenue

Revenue increased by €12.5 million, or 5.3%, to €247.2 million in the year ended December 31, 2010, compared with revenue of €234.7 million in the year ended December 31, 2009. This increase was primarily due to an increase in revenue from a large project for the development of a co-production facility in Saudi Arabia (the "Co-production Facility Project"). The contract for the Co-production Facility Project was won in 2008 but a substantial amount of revenue was recognized in the year ended December 31, 2010. This increase in revenue was partially offset by decreased sales from contract for upgrades from NATO countries such as Norway for the HK416 and the United Kingdom for the GPMG, 40mm grenade machine guns and other products as a result of decreased orders under contracts for upgrades.

Revenue derived from Europe represented €135.2 million, or 54.7%, of our revenue in the year ended December 31, 2010, compared to €164.6 million, or 70.1% of our revenue in the year ended December 31, 2009, a 17.9% decrease primarily due to decreased sales for products by Norway and the United Kingdom. Revenue derived from the rest of the world represented €112.1 million, or 45.3%, of our revenue in the year ended December 31, 2010, compared to €70.1 million, or 29.9% of our revenue in the year ended December 31, 2009, a 59.8% increase primarily due to the revenue from the Co-production Facility Project.

Cost of sales

Cost of sales decreased by €9.5 million, or 6.2%, to €144.1 million in the year ended December 31, 2010, compared with cost of sales of €153.6 million in the year ended December 31, 2009. This decrease was primarily due to a decrease in sales of products with high materials costs such as the HK416 for Norway and the GPMG for the United Kingdom.

Cost of sales as a percentage of revenue decreased to 58.3% in the year ended December 31, 2010 compared to 65.4% in the year ended December 31, 2009. This decrease was primarily due to the aforementioned decrease in sales of products with higher materials costs and the increase in revenue from the contract relating to the Co-production Facility Project. A greater portion of cost was recognized as sales, marketing and distribution costs than as cost of sales under the Co-production Facility Project compared to other contracts.

Research and development costs

Our research and development costs in the year ended December 31, 2010 were €4.1 million, an increase of €1.0 million, or 32.3%, compared with €3.1 million in the year ended December 31, 2009. This increase was primarily due to higher expenditure on research and development, partially offset by increased capitalization of research and development costs in the year ended December 31, 2010 compared to the year ended December 31, 2009.

Sales, marketing and distribution costs

Sales, marketing and distribution costs increased by €7.1 million, or 28.7%, to €31.8 million in the year ended December 31, 2010, compared with €24.7 million in the year ended December 31, 2009. This increase was primarily due to a change in customer mix resulting in higher project-related costs, in particular for the Co-production Facility Project.

General administration costs

General administration costs increased by €0.6 million or 4.2% to €14.8 million in the year ended December 31, 2010, compared with €14.2 million in the year ended December 31, 2009. This increase was primarily due to higher professional fees relating to the refinancing of the group that has not yet been completed, partially offset by lower legal fees relating to a dispute with a former employee and a decreased amount of termination payments for former executives.

Other operating income

Other operating income increased by €0.2 million or 3.2% to € 6.5 million in the year ended December 31, 2010, compared with € 6.3 million in the year ended December 31, 2009. This increase was primarily due to higher releases of provisions including for late delivery penalties and offset obligations, partially offset by reductions in administration charges, license fees and other income from HKS following the re-acquisition of HKS in the year ended December 31, 2010.

Other operating expenses

Other operating expenses increased by €1.2 million or 19.7% to € 7.3 million in the year ended December 31, 2010, compared with € 6.1 million in the year ended December 31, 2009. This increase was primarily due to increased losses on retirement and disposal of fixed assets, such as the demolition of buildings in Oberndorf am Neckar.

Results from operating activities

The foregoing factors led to an increase in operating profit by €12.4 million, or 31.5%, to €51.8 million in the year ended December 31, 2010, compared with an operating profit of €39.4 million in the year ended December 31, 2009.

Net financial result

Net financial expense decreased €4.0 million from a loss of € 15.2 million to a loss of €11.2 million, primarily due to the increase in net foreign currency translation gains resulting from the higher exchange rate of the U.S. dollar against the euro and the increase in the discounting of non-current liabilities, partially offset by a decrease in interest income from a lower level of related party loans at a lower interest rate.

Net Income taxes

Net income taxes increased €2.9 million, or 39.7%, from an expense of €7.3 million to an expense of €10.1 million, primarily due to a higher level of taxable income in the year ended December 31, 2010.

Result for the period

The foregoing factors led to the recognition of a profit of €30.4 million in the year ended December 31, 2010, an increase of €13.4 million, or 78.8%, compared to the profit of €17.0 million recognized in the year ended December 31, 2009.

The year ended December 31, 2009 compared with the year ended December 31, 2008

Revenue

Revenue increased by €33.8 million, or 16.8%, to €234.7 million in the year ended December 31, 2009, compared with revenue of €201.0 million in the year ended December 31, 2008. This increase was primarily due to an increase in sales under contracts with the U.S. Army for the GLM and with the U.K. governmental agencies for the GPMG, 40mm grenade machine guns and other products and a change in product mix reflecting higher proportion of grenade launchers. This increase in revenue was partially offset by decreased sales of HK416 to Norway and USP and MG4 to Spain.

Revenue derived from Europe represented €164.4 million, or 70.1%, of our revenue in the year ended December 31, 2009, compared to € 142.6 million, or 70.9% of our revenue in the year ended December 31, 2008, a 15.5% increase. Revenue derived from the rest of the world represented €70.1 million, or 29.9%, of our revenue in the year ended December 31, 2009, compared to €58.4 million, or 29.1% of our revenue in the year ended December 31, 2008, a 20.1% increase.

Cost of sales

Cost of sales increased by €20.4 million, or 15.3%, to €153.6 million in the year ended December 31, 2009, compared with €133.2 million in the year ended December 31, 2008. This increase was primarily due to the corresponding increase in revenue and a change in product mix.

Cost of sales as a percentage of revenue remained substantially the same at 65.4% in the year ended December 31, 2009 compared to 66.3% in the year ended December 31, 2008.

Research and development costs

In the year ended December 31, 2009, research and development expenses increased by €1.0 million, or 47.6%, to €3.1 million, compared with €2.1 million in the year ended December 31, 2008. This increase was primarily due to a €1.1 million loss on retirement of a project following changes in expected demand for the product under development changes.

Sales, marketing and distribution costs

Sales, marketing and distribution expenses increased by €1.5 million, or 6.5%, to €24.7 million in the year ended December 31, 2009, compared with €23.2 million for the year ended December 31, 2008. This was primarily due to changes in the customer mix resulting in higher project related costs, including commissions, consulting fees and transportation costs.

General administration costs

General administration expenses increased by €3.3 million, or 30.3%, to €14.2 million in the year ended December 31, 2009, compared with €10.9 million for the year ended December 31, 2008. This increase was primarily due to higher legal fees in the United States relating a dispute with a former employee and the payment of a termination payment of our former executive.

Other operating income

Other operating income decreased by €2.5 million, or 28.4%, to €6.3 million in the year ended December 31, 2009, compared with €8.8 million in the year ended December 31, 2008. This decrease was primarily due to exceptional items in the year ended December 31, 2008 including a profit on the disposal of unused machines in our U.S. operations shown as "held-for-sale" and the release of a sales provision following the expiry of the associated obligation, partly offset by an increase in license fee income from HKI in the year ended December 31, 2009.

Other operating expenses

Other operating expenses decreased by €3.6 million to € 6.1 million in the year ended December 31, 2009, compared with €9.7 million in the year ended December 31, 2008. This was mainly due to exceptional items in 2008, including an impairment loss due to a fair market valuation on reclassification of a site in Oberndorf am Neckar as "held-for-sale," together with lower late delivery penalties in 2009 and lower provisions created for offset obligations and personnel costs such as untaken holidays, flextime accruals and bonuses.

Results from operating activities

Results from operating activities increased by €8.6 million, or 27.9%, to an operating profit of €39.4 million in the year ended December 31, 2009, compared with an operating profit of €30.8 million in the year ended December 31, 2008. The increase was primarily due to the factors discussed above.

Net financial result

Net financial expense increased €5.0 million, or 49.0%, from a loss of €10.2 million to a loss of €15.2 million, primarily due to the decrease in net foreign currency translation gains resulting from the higher exchange rate of the U.S. dollar against the euro and the decrease in net interest income resulting from lower interest rates.

Net income taxes

Net income taxes decreased €0.9 million, or 11.0%, from an expense of €8.2 million to an expense of €7.3 million, primarily due to an increase in deferred tax income from an expense of €0.3 million in 2008 to an income of €2.3 million in 2009 as a result of the utilization of tax loss carry forwards and the changes in deferred tax from an income to expense for provisions, derivatives, and other balance sheet items. This decrease in net income taxes was partially offset by a higher level of taxable income in the year ended December 31, 2009.

Result for the period

The foregoing factors led to the recognition of a profit of €17.0 million in the year ended December 31, 2009, an increase of € 4.6 million, or 37.1%, compared to the profit of €12.4 million recognized in the year ended December 31, 2008.

Liquidity and Capital Resources

Cash Flow

The table below summarizes our cash flows for the year ended December 31, 2010, 2009 and 2008.

	For the year ended December 31,		
	2010	2009	2008
		(€ thousands)	
Net cash from/(used in) operating activities	43,449	57,361	21,836
Net cash from/(used in) investing activities	(10,412)	(20,012)	(17,101)
Net cash from/(used in)/financing activities	(30,861)	(15,204)	(11,757)
Net increase/(decrease) in cash and cash equivalents	2,176	22,145	(7,022)
Opening cash	52,134	29,762	38,205
Effect of exchange rate fluctuation on cash held	574	227	(1,422)
Closing cash	54,883	52,134	29,762

Cash flow from operating activities

Cash flow from operating activities was €43.4 million in the year ended December 31, 2010 compared to €57.4 million generated in the year ended December 31, 2009. This €14.0 million decrease was primarily due to an increase of €11.3 million in income taxes paid as a result of a higher year-end adjustment and tax audit payments in the year ended December 31, 2010.

Cash flow from operating activities was €57.4 million in the year ended December 31, 2009 compared to €21.8 million generated in the year ended December 31, 2008. The difference was mainly due to the reduction of working capital in 2009 following the high level of accounts receivable at the end of 2008. This was due to large deliveries of products at the end of 2008.

Cash flow from investing activities

Cash flow used in investing activities in the year ended December 31, 2010 was €10.4 million compared to €20.0 million cash flow used in investing activities in the year ended December 31, 2009. This €9.6 million decrease was due primarily to a decrease in cash outflow relating to acquisitions as €6.1 million was spent on the acquisition of HKS in the year ended December 31, 2010 compared to €11.7 million on the acquisition of HKI and SUI in the year ended

December 31, 2009. It was also due to an increase in receipt from loans and interest income from €3.0 million in the year ended December 31, 2009 to €7.8 million in the year ended December 31, 2010.

Cash flow used in investing activities in the year ended December 31, 2009 was €20.0 million compared to €17.1 million cash flow used in investing activities in the year ended December 31, 2008. This increase was primarily due to the €11.7 million balance paid for the acquisition of HKI and SUI in the year ended December 31, 2009, partially offset by a €0.2 million decrease in capitalized development costs and a €2.1 million decrease in outstanding related party loans, including a loan which was repaid by HKI's seller in connection with the acquisition of HKI and SUI.

Cash flow from financing activities

Net cash flow used by financing activities was €30.9 million in the year ended December 31, 2010 compared to €15.2 million cash flow used by financing activities in the year ended December 31, 2009. This €15.7 million increase was primarily due to a €19.3 million increase in dividend paid to HKH in the year ended December 31, 2010 from the year ended December 31, 2009, which was partially offset by a repayment of a U.S. credit line utilized by HKI.

Net cash flow used by financing activities was €15.2 million in the year ended December 31, 2009 compared to €11.8 million cash flow used by financing activities in the year ended December 31, 2008. In both years, this relates to €11.1 million in interest per annum on the 2004 Notes, together with fees for bank guarantees and payments relating to finance leases. Due to the restatement, it also includes interest payments and movements in a U.S. credit line utilized by HKI and repaid prior to the acquisition in 2009.

Capital expenditures

In Germany, our policy is to invest in organic growth through improving our production efficiencies, adopting new production methods, expanding our capacity and upgrading our information and management systems, with a long-term goal of keeping maintenance capital expenditure requirements to below €6 million per annum. Over 97% of capital expenditure during the year ended December 31, 2010 was at the main site in Germany due to this being our manufacturing site, with investment in new machines and tooling to maintain high technical standards and improve capacity in order to support our order book. All manufacturing facilities in Germany are now on the main site, leading to efficiency improvements.

Our capital expenditure on other fixed assets excluding capitalized development costs amounted to €9.1 million, €8.5 million and €8.6 million for the year ended December 31, 2008, 2009 and 2010, respectively.

We expect that our capital expenditures will amount to approximately €6.5 million for the year ended December 31, 2011. The majority of the capital expenditure will be related to replacement of machinery.

Historical debt

Our balance sheet debt as at December 31, 2010 consisted of the 2004 Notes.

We have not guaranteed any loans, nor do we have any convertible or exchangeable bonds outstanding.

Liquidity and capital resources for the offering of the Notes

Immediately following the offering of the Notes and the redemption of the 2004 Notes, we will have €295 million of indebtedness, which will be comprised of the Notes.

Working Capital

We believe that our operating cash flows, together with the proceeds from the Notes will be sufficient to fund our working capital needs, anticipated capital expenditures and debt service requirements as they become due for the foreseeable future. As of December 31, 2010, our working capital was €81.3 million. Our working capital requirements include the cash required to collateralize the bid bonds, performance bonds and advance payment bonds that we may request to be issued under our facilities with Internationales Bankhaus Bodensee AG and Barclays Bank.

Contractual Obligations

The information presented in the table below reflects management's estimates of the contractual maturities of our obligations and summarizes the financial payments that we will be obliged to make as of December 31, 2010, on a *pro forma* basis, as adjusted for the Financing. These maturities may differ significantly from the actual maturities of these obligations.

Contractual obligations	Total	Less than 1 year	1-5 years	More than 5 years
			(€ in millions)	
Notes offered hereby	295.0	—	—	295.0
Operating lease obligations	2.0	0.4	1.4	0.2
Purchase obligations	32.6	32.6	—	—
Total	319.6	33.0	1.4	295.2

Off-Balance Sheet Arrangements

We currently have no off-balance sheet arrangements.

Guarantees Issued to Customers

For certain contracts we are required to provide our customers with third-party guarantees (via an insurance company or a bank) for advance payments received or for performance. As of December 31, 2010, we had a total of €17.1 million such guarantees outstanding, compared to €18.9 million as of December 31, 2009. See “Description of Certain Financing Arrangements.”

Quantitative and Qualitative Disclosures about Market Risk

Our financial risk management focuses on the major areas of market risk. The overall objective of our treasury policy is to identify, evaluate and hedge financial risk. We aim to minimize the adverse effects caused by exposure to financial risk on the profitability of the underlying business and thus on our financial performance.

Currency risk

The Group is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Group entities, primarily the euro, but also U.S. dollars and pound sterling. The majority of both our costs and our sales are in euro, so we only have foreign exchange transaction exposure for those sales in currencies different to the associated costs. The Group policy is to cover a portion of the expected U.S. dollar income and the associated foreign exchange transaction exposure with hedging transactions. As of December 31, 2010, we had forward cover contracts for a total of $12 million.

Group policy is not to speculate with loans or deposits in foreign currencies. Financing and investing within the Group usually take place in the appropriate functional currency and any financial instruments are purely for operating purposes.

Five of our small subsidiaries are outside the euro zone. Since our Group reporting currency is the euro, the income and expenses of these subsidiaries are converted to euro for consolidation. Changes in average foreign exchange conversion rates compared with prior periods can therefore have an effect on the consolidated results.

In addition, through these subsidiaries the Group has assets and liabilities in local currencies outside the euro zone. The conversion of these positions to euro is also affected by fluctuations in foreign exchange conversion rates. The change in valuation of these positions is reflected in the Group reserves.

In order to quantify the possible effects of foreign exchange rate fluctuations on the Group EBITDA, sales and equity, a sensitivity analysis has been carried out:

If the U.S. dollar had been 10% weaker against the euro compared to the rates used for the year ended December 31, 2010 (*i.e.*, an average of €1 = $1.4610 and a spot of €1 = $1.4698), then as of and for the year ended December 31, 2010, revenue would have been approximately €4.0 million lower, EBITDA would have been approximately €1.6 million lower and equity and reserves would have been approximately €3.6 million lower.

If the pound sterling had been 10% weaker against the euro compared to the rates used for the year ended December 31, 2010 (*i.e.*, an average of €1 = £0.9449 and a spot of €1 = £0.9468, then as of and for the year ended December 31, 2010, revenue would have been approximately €1.4 million lower, EBITDA would have been approximately €0.7 million lower and equity and reserves would have been approximately €0.0 million lower.

Interest rate risk

The Group's only interest-bearing liability is the 2004 Notes, which will be refinanced with the bonds offered hereby. The advance payment and performance guarantees that we procure from banks for our customers do not require us to pay interest. See "Business—Contracts—Payment and guarantees."

Commodity risk

Because our purchases of commodities in terms of quantities purchased are relatively small, our exposure to commodity risk is limited.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counter- party to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

Trade accounts receivable

Because the majority of our customers are federal, state or local governmental agencies of NATO countries, our exposure to credit risk is limited. However, the recent worldwide financial and economic crisis and the consequent increased sovereign budget deficits are likely to put long-term pressure on defense budgets in many of the countries we deliver to, leading to increased credit risk for certain customers. The credit ratings for some countries have been reduced, but the Group's exposure to credit risk with such countries is limited.

Our goods are sold subject to retention of title clauses so that in the event of non-payment the Group may have a secured claim and, where management is of the opinion that the risk is not sufficiently secured by the retention of title clauses, we require letters of credit or prepayments. The Group has internal credit management processes to review and manage overdue positions and if necessary stop further deliveries or initiate legal action.

In addition, provisions are held for doubtful debts. The maximum risk is the value shown as trade accounts receivable in the balance sheet. The book values of trade accounts receivable analyzed according to their aging, together with the associated provisions, are shown in Note 20 to our consolidated financial statements for the year ended December 31, 2010 included elsewhere in this offering memorandum.

Some of our customers limit their exposure to risks relating to our production of products through advance payment guarantees and performance guarantees. See "Business—Contracts—Payment and guarantees."

Cash and cash equivalents

Cash and cash equivalents include cash balances, checks, bank balances on current accounts and short-term deposits. The Group is exposed to credit risks if the banks holding our deposits default on their obligations. To minimize this risk, the banks are selected with care and the majority of the deposits are with a German bank which is partially owned by the State of Baden- Württemberg and participates in a deposit security reserve.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Group mainly generates cash through its operating activities and this is primarily used to finance capital expenditure and working capital. In 2004, additional financing was obtained through the issue of the 2004 Notes, the proceeds of which were mainly used to repay shareholder loans and partially finance the purchase of management shares. We will use a part of the proceeds of the Notes offered hereby to refinance the 2004 Notes. See "Use of Proceeds."

At present, the Group does not have any credit lines other than for the issue by banks of advance payment or performance guarantees.

Critical Accounting Policies

The discussion and analysis of our financial condition and results of operations are based upon our financial statements for the years ended December 31, 2009 and 2010. Our reported financial condition and results of operations are sensitive to accounting methods, assumptions and estimates that underlie the preparation of the financial statements. We base our estimates on historical experience and on various other assumptions, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

The selection of critical accounting policies and the sensitivity of reported results to changes in conditions and assumptions are factors to be considered when reviewing our financial statements. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.

Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variation in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue and expenses are recognized in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. When the outcome of construction contract cannot be estimated reliably, contract revenue is recognized only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognized immediately in profit or loss.

Goodwill

Goodwill is capitalized and subjected to an annual impairment test. If the carrying value is no longer recoverable, impairment is charged. Otherwise, the prior year carrying value is retained. We conduct an impairment test of goodwill at least annually.

Goodwill from acquisitions prior to January 1, 2006, the date of our transition to IFRS, has been capitalized; negative goodwill from acquisitions prior to this transition date has been offset against reserves. On divestment of a consolidated company any goodwill relating to it, other than negative goodwill, is included in the computation of the deconsolidation result.

Impairment of tangible assets and of intangible assets other than goodwill

As at each balance sheet date, if there are triggering events for impairment, material tangible assets and intangible assets are submitted to an impairment test in accordance with IAS 36. If the carrying value of an asset exceeds its recoverable amount, an impairment loss is recognized. The recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount for an individual asset cannot be determined, an estimate is made of the recoverable amount at the level of next higher cash generating unit.

If, in the following periods the recoverable amount exceeds the carrying value, reversal of impairment is only made for the lower of the amount necessary to (i) bring the carrying value of the asset to its recoverable amount or (ii) to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortization that would have been recognized.

The impairment and any reversal of impairment are recorded in the income statement.

Financial assets

Impairments to doubtful debts are mainly due to estimates and assessments of individual accounts receivable, based on the creditworthiness of individual customers. Impairment of accounts receivable is initially shown as a provision for doubtful debts. If a debt is regarded as irrecoverable, the impaired account receivable is written off.

Provisions for pensions and similar defined benefit obligations

The provisions for defined benefit obligations are computed using the projected unit credit method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The value is obtained from an actuarial report.

Actuarial gains and losses are recognized outside profit or loss, in the period in which they occur, in accordance with IAS 19.93A-D. These are shown in the statement of comprehensive income.

In determining the discount interest rates in accordance with IAS 19.78, the actuaries refer to market yields on high quality corporate bonds at the balance sheet date.

Income taxes and deferred taxes

The income tax expense represents the sum of current tax expense and deferred tax expense.

The current tax expense is determined on the basis of the taxable income for the relevant year. The taxable income is different from the net income for the year shown in the income statement since it excludes expenses and income which will be tax deductible/taxable in other years or which will never be tax deductible or taxable. The liability of the group for current tax expense is computed on the basis of the valid tax rates or of tax rates which have been enacted by the balance sheet date.

Deferred taxes are the expected tax charge or relief arising from differences between the carrying values of assets and debts in the Group IFRS consolidated financial statements and their values in the tax accounts of the individual companies. The balance sheet oriented liability method is applied. In general, deferred tax liabilities are recorded for all taxable temporary differences, and deferred tax assets are recorded to the extent that it is probable that taxable profits will be available for which the deductible temporary differences can be used. Such assets and liabilities are not recognized if the temporary difference arises from (i) the initial recognition of goodwill or (ii) from the initial recognition of other assets and liabilities in a transaction that affects neither the accounting profit/(loss) nor taxable profit/(loss). In addition, deferred taxes are recognized for the carry forward of unused tax losses to the extent that it is probable that it will be possible to utilize them in the future.

The carrying amount of deferred tax assets is reviewed each year at the balance sheet date and is reduced if it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the deferred tax asset to be utilized.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realized or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

The changes in deferred taxes are recognized in the income statement as tax income or expense unless they relate to items recognized directly under equity, *i.e.*, without effect on income; in this case the deferred taxes are recognized in the associated equity position without effect on income.

INDUSTRY OVERVIEW

Overview of the Current Market for Small Arms

The market for small arms (which includes rifles, side arms, fully automatic weapons and grenade launchers) can be divided into three categories: small arms for military use; small arms used by law enforcement agencies; and small arms for commercial use. According to JSAS, the global market of small arms is expected to be $4.4 billion in 2011 and $25.1 billion in the aggregate from 2012 through 2016.

The Market for Military Small Arms

With respect to small arms purchased by the military and law enforcement agencies, for security reasons, neither national armed forces nor manufacturers of military small arms provide detailed information on production. As a result, the market for such arms is not transparent. According to JSAS, the total global market for military small arms has historically averaged from 700,000 to 900,000 units per annum. The global market for military small arms in the aggregate from 2011 through 2016 is estimated to average approximately 1,000,000 units per annum as a result of increasing global population and sustained military conflicts in a variety of regions despite declining defense budgets and personnel reductions.

NATO country defense programs

Although we participate in individual contracts with the governments of NATO countries, the majority of our sales are derived from contracts which we execute with our customers as part of larger, long-term small arms programs. NATO governments allocate their budgets for these programs in stages, which includes a series of long-term contracts in relation to a range of products, often with the same defense contractor. Depending upon government priorities, ministries of defense and defense departments of NATO countries seek to arm their armed forces through two types of competitive procedures.

The first type of procedure is design-driven and involves a government contacting defense contractors, outlining certain requirements for a weapon and requesting that the contractors design a solution. Although this type of procedure is done through a competitive tender process, it is usually kept to a small number of defense contractors. After creating a design, the contractors will build a prototype which is then evaluated by the customer. Once this technical evaluation is complete, the government will choose one contractor for the full-scale development of the program and subsequent volume production. Our recent contracts with the U.S. Army in relation to the XM25 involved this type of design-driven process. For this procedure, the time required from preliminary contact or notice of tender through to the completion of volume production of the product can take from three to ten years.

The second type of procedure is product driven and is usually awarded through a more formal process where a large number of contractors will compete through a competitive tender. As part of this process, a government invites a series of contractors to present their existing products for technical and feasibility studies. This testing may take several months. After the government has awarded the contract, the contractors will begin with volume production. See “Business—Production Process” for a description of the process. For this procedure, the time required from preliminary contact or notice of tender through to the completion of production of the product can take from three to five years.

The Market for Law Enforcement Agency and Commercial Small Arms

The United States is the largest law enforcement agency and commercial small arms market. An estimate by JSAS indicates the global market for law enforcement agency and commercial small arms in 2011 will be 8.5 million units, of which 6.1 million units will be in the United States. The global market for law enforcement agency and commercial small arms in the aggregate from 2012 through 2016 is estimated to be 48.94 million units, of which 35.0 million is estimated to be in the United States.

BUSINESS

Our Company

We are a leading European manufacturer of small arms with a premium-quality product portfolio for the NATO armed forces and their allies. We design, produce and distribute small arms, including rifles, side arms, fully automatic weapons, grenade launchers and a variety of other related products. We also believe we are the market leader in the supply of assault rifles, side arms, grenade launchers and grenade machine guns to European NATO and government agencies. We believe our products are widely considered to be best-in-class in each of their respective categories primarily as a result of long-standing commitment to integrated research and development, engineering and manufacturing. We have been in operation for more than 60 years and our brand name is highly respected by armed forces globally.

We supply the armed forces of NATO, including the U.S. Army, and the special forces of NATO, including the U.S. Special Forces. We are the sole supplier of the standard assault rifle to the German, British, Norwegian and Spanish armed forces. We supply law enforcement agencies worldwide, including the European police forces and U.S. local and federal law enforcement agencies, such as the FBI and the Secret Service. We also supply the commercial market for civilians. We believe that one of our significant markets for future growth is the United States. In the year ended December 31, 2010, 55% of our sales were to Europe and 17% of our sales were to the United States.

We currently own state-of-the-art manufacturing facilities in Oberndorf am Neckar in Southern Germany, where we manufacture most of our products, and rent manufacturing facilities in New Hampshire, U.S., where we manufacture a number of side arms for the U.S. market.

As of December 31, 2010, we had 719 employees (calculated as full-time equivalents).

For the year ended December 31, 2010, we generated revenue of € 247.2 million and EBITDA of €61.2 million. As of December 31, 2010, our order book (defined as contractual sales yet to be delivered) was €169.7 million with approximately 75% of the order book deliverable in the year ending December 31, 2011.

Our Key Strengths

We believe that we maintain a strong competitive position as a result of numerous factors, including the following:

We have a world-class brand. We believe we have a world-class brand, which is one of the most internationally recognized in the small arms market. We believe we have the largest presence in the market for assault rifles, grenade launchers and side arms, and have the second largest presence in the market for machine guns. Our brand name, when used with our products, connotes quality, reliability, performance and integrity and distinguishes our products from international competition. We expect to leverage our strong brand name to access customers around the world in each of the military, law enforcement and commercial small arms markets.

We have a premium product portfolio. We believe each of the products in our portfolio is technologically advanced and best-in-class in its category. We commit a significant amount of our resources to the research, design and development of technologically advanced small arms. This commitment of resources is a key driver in the delivery of our premium products. We also believe we are able to meet a variety of our customers' requirements through a wide range of products in our portfolio, from premium-quality side arms to highly innovative products such as the XM25 grenade launcher.

We have an elite customer base. Our customer base comprises the armed forces of NATO and their allies and law enforcement agencies. We believe our elite customer base is a testimony to the premium quality of our products, signaling to potential customers that our products will sufficiently meet their requirements. We believe our long-standing relationships with our customers and our significant expertise provide us with an advantage in winning future contracts. We have supplied the armed forces in Germany, the United Kingdom, Norway and Spain for more than 50 years, 40 years, 30 years and 30 years, respectively.

We have high visibility of sales and a significant order book. In the recent past, the majority of our revenue was derived from contracts that we entered into with our customers as part of larger, long-term small arms programs, primarily with European NATO countries. NATO governments and their allies allocate their budgets for these programs in stages, which include a series of subsequent contracts in relation to a range of products, often with the same defense contractor. This tends to lead into a longer-term commitment for additional products, spare parts and support. On the larger contracts, due to the long lead-times between government initiation of a program and the end of volume production in relation to such program, which can take up to 10 years, we believe we have a high visibility of sales. Our current order book of contracted revenue should provide us with relatively predictable sales and strong cash flows for at least the next 12 months.

The table below highlights as of March 31, 2011, (i) those small arms programs currently awarded to us by governments after technical evaluation of our products, but prior to the various sales contracts being executed, and (ii) our current order book of contracted sales for the next five years.

	Total	2011	2012	2013	2014	2015
			(€ millions)			
Programs[(1)(2)]	336	86	91	60	48	51
Order Book[(2)]	150	107	28	10	2	2

(1) Represents the sales that we expect to record in the event we receive firm orders under small arms programs that we have been awarded by governments. There can be no assurance, however, that these contracts will become part of our order book of contracted sales.

(2) Includes information for the Issuer, HKD, HKF, HKI, HKS and NSAF.

The table above does not include other business prospects for which we are bidding or potential prospects that we have identified.

We have an experienced management team and a highly skilled workforce. Our workforce is managed by a group of managers with an average of over 20 years experience in the military and defense industries. As a result of the depth of experience and strength of our workforce and our managers, we have the ability to respond rapidly to customer requirements regarding design and production. Throughout our organization, we have a highly skilled workforce, including engineers and technical personnel. Most of these personnel have undergone apprenticeships with us since the early stages of their careers and have been trained by us in our own technical training facilities. As a result, we believe we are able to provide our personnel with highly specific training and also forge a strong relationship with them. The average rate of turnover of our workforce for the last three years was less than 3%.

Our Strategy

Our strategy derives directly from our vision:

"Be the World's Premier Small Arms Systems Company."

We implement this by focusing our strategy on three key elements: managing our business for higher margins and increased profitability, seeking to achieve a stable business supported by a diverse set of customers, geographies and products, and continuing to manage our business for sustainable long-term growth.

Continue to manage our business for higher margins and increased profitability. We have historically been able to manage for strong margins through our industry-leading engineering capabilities. In recent years, we have also pursued the strategy of offering integrated small arms packages and providing life cycle management for our products to our customers.

We intend to continue leveraging our engineering expertise to provide products of the highest quality and with the best capabilities in the industry. We will also leverage our engineering expertise in our manufacturing to reduce costs and further enhance quality. We believe these focus areas will help us achieve higher margins and help us increase the profitability of the company. We believe our engineering expertise also allows us to develop new products to meet emerging trends in the market and also helps us introduce products ahead our competitors. We believe this occasionally allows us to charge higher prices for our products and to achieve higher margins.

We intend to continue our focus on offering a complete "Small Arms Package." Certain customers are increasingly asking us to provide full solutions to their logistics and accessory requirements in addition to satisfying their small arms requirements. This allows us in some cases to sell a product mix with higher margins, and consequently helps us increase profitability. To offer these integrated packages, we will in the future consider acquisitions of other such companies that have a product offering complementary to ours, as and when such opportunities arise.

We intend to continue exploring ways to deliver life cycle management services to our customers. Our customers are increasingly seeking ways to outsource the management of the full life cycle of small arms, including support, supply, and maintenance of small arms from production to retirement. We believe this is an opportunity to increase margins and profitability as we can utilize existing assets, equipment and capitalize on our experience and scale to deliver a service more efficiently than our customers could otherwise achieve.

Further increase the stability of our business through diversification of product offering, geographic focus and customer types. We have expanded from being a German supplier of assault rifles to the German army to being a leading European supplier of a wide range of small arms to a range of customers in many countries. This has allowed us to achieve a stable business model and a broad geographic reach.

Going forward, we intend to continue to evolve our product offering to meet changing customer needs. Examples of the products that we have previously developed include the MP7, the HK121 and the P11. By responding to the demand for such types of products, we have been able to capture opportunities from our customers in addition to their needs for traditional small arms and have generated additional revenue.

We intend to increase our geographical diversification. We have previously diversified from supplying the German army to supplying most European NATO members with small arms, and have more recently become a supplier to the U.S. Army, in addition to the U.S. Special Forces. This development has helped us decrease our reliance on a small number of customers, and we remain committed to achieving sales to new customers in NATO countries and countries that are friendly to NATO.

We also intend to continue our efforts to supply small arms to non-military customers. We have grown from being a purely military focused supplier into supplying the law enforcement and commercial markets.

We also intend to seek opportunities to leverage our co-production expertise. We have a track record of developing partnerships with companies in foreign markets where we transfer the capability of manufacturing a portion of the product as a requirement for a contract. Historically, such opportunities have supplied us with long-term revenue opportunities, and have helped us generate revenue from services supplied during the transfer of manufacturing capabilities. We will continue to actively seek co-production opportunities in NATO countries and allies of NATO countries.

Pursue long-term sustainable growth opportunities. Historically, we have been able to achieve growth by leveraging our core competencies and key strengths. We will continue to seek out such growth opportunities in the future.

We believe that our leading brand, expanding portfolio of premium products, and design leadership will be a key driver for continuing to win business from existing customers and drive business from new customers. Additionally, we believe that our diversification will allow us to grow our business in addition to ensuring a continued stable set of revenue streams, as it allows us to capture customers in the United States and other export markets, both within the military small arms and other market segments.

Outside the United States, the addition of many former Warsaw Pact countries into NATO opened new markets, which we have been able to access successfully, and where we see significant further business opportunities. The addition of other countries into NATO may also provide further attractive growth opportunities for us to expand our presence in those markets as these countries focus on either finding rifle replacements or upgrades for their armed forces.

We also believe these initiatives, which drive higher margins, may contribute to revenue growth as they allow us to capture incremental revenue opportunities and, in certain cases, achieve higher pricing for our products.

Our History

We were founded on December 28, 1949 by Edmund Heckler, Theodor Koch and Alex Seidel, each of whom was a former engineer at Mauser Works, in Oberndorf am Neckar in 1949. Our early product lines featured parts and spares for sewing machines and bicycles. In the late 1950s, we expanded into the small arms sector of the defense contracting industry.

Our first significant contract to sell small arms was in 1956, when we won the tender for the rifle for the newly established Army of the Federal Republic of Germany. In the 1970s and 1980s, we continued to grow, not only in the production of small arms, but also in the production of other products such as machine tools and industrial, electronics and automation products. Due to our diversification in the 1970s and 1980s, which turned out to be loss-making, we required an outside partner to continue the business by 1990. In 1991, we were purchased by a predecessor of BAE.

In the early 1990s, BAE restructured and streamlined its business to focus on the core business of defense contracting in the small arms sector.

Through a series of transactions in 2002 and 2003, we were acquired by HKB, a German company controlled by two of our three ultimate shareholders.

In 2003, as part of a strategy to reduce the risk of potential class action lawsuits in the United States, HKS was formed in order to manufacture side arms for the Group. HKS was then sold to a company owned by two of our three ultimate shareholders. In 2004, we sold the U.S. commercial sales and distribution company HKI for €12.4 million to the same company owned by our two ultimate shareholders. Following the passing in the United States of the Protection of Lawful Commerce in Arms Act and the resulting reduced risk of potential class action lawsuits in the U.S., we re-acquired HKI and its holding company SUI in 2009 for a purchase price of €13 million. We re-acquired HKS in 2010 for a purchase price of €6.4 million.

Our Products

Within the industry, we believe our products are considered to be of the highest quality on the market. All of our products, both for the military and the law enforcement and commercial markets, are developed and tested to NATO specifications. Below is a chart setting forth our principal products, the primary customers for those products, and the percentage of sales attributable to each product for the year ended December 31, 2010.

Product/Service[(1)]	**Primary customers**	**Percentage of sales for the year ended Dec. 31, 2010**
G36 rifle	The armies of Germany and certain other European countries and the NATO Rapid Reaction Force	5.6%
HK416, HK417	Army of Norway and Special Forces of certain NATO countries	7.3%
SA80[(2)]	British Army	7.2%
USP	The special forces of the United States and certain European countries, and U.S. and European law enforcement agencies	5.4%
P2000/P30	U.S. Department of Homeland Security and German law enforcement agencies	8.6%
MP5	Special forces and law enforcement agencies worldwide	4.0%
UMP	NATO armies and law enforcement agencies	0.4%
GPMG	The British Ministry of Defence	4.7%
MP7/PDW	The special forces of Germany, the U.S. and Great Britain, and British Ministry of Defence Police	3.1%
MG43	NATO armies	1.7%
40mm Grenade Machine Gun	The armies of Greece, Germany, the Great Britain and the special forces of the United States	6.6%
HK69A1	NATO armies	0.3%
AG36/GLM	British Army, Spanish Army, U.S. Army	8.1%
Pre-funded R&D	U.S. and German governments	1.9%
Other products[(3)]	NATO and allied armed forces and law enforcement agencies and as a sub-contractor to the Eurofighter consortium	35.1%

(1) Includes products sold directly and under licensing arrangements.

(2) Relating to the upgrading of the SA80. We are not the original producer of the SA80.

(3) Includes sales of a variety of products, including other small arms, magazines, the ammunition feed system for the Eurofighter (“Typhoon”), and various accessories.

The weapons we produce can be broken down into the following categories: rifles, side arms, fully automatic weapons and grenade launchers, as well as a range of weapons-related products and accessories. Below is a brief description of some of our core products.

Rifles

For the year ended December 31, 2010, rifles contributed 21% of our revenue. Our core product offerings in this category are described below.

The G36 rifle. We designed the G36 as a replacement for the G3 rifle, which we produced for the German Army from the end of the 1950s until the end of the 1970s. The G36, whose intellectual property rights, unlike those of the G3, are owned exclusively by us, is partially produced from advanced lightweight polymer plastic and utilizes a piston-actuated gas operating system that enhances the performance beyond that of a traditional rifle. We produce numerous variants based upon size, weight, muzzle velocity, and rate of fire, including sharp shooter and compact carbine models. The G36 is used by the German Armed Forces, the Spanish Army and the armies of certain Baltic States, among others. In addition, several countries are in different stages of procurement of the G36, ranging from contract negotiation to initial testing.

The SA80 rifle. At the request of the British Ministry of Defence, we have refurbished a certain number of the SA80 rifles originally produced by Royal Ordnance plc (a subsidiary of BAE), improving the rifles' performance. Initially, we were contracted to refurbish 100,000 SA80 rifles, which was later increased to 200,000. This contract and another contract for the conversion of old SA80 rifles for drill and cadet purposes have been completed.

The HK416 rifle. Using the same modern operating system as the G36, the exterior of the HK416 rifle was designed to look similar to, and have similar operating characteristics as the U.S. Army's M16 standard rifle. As a result it has been adopted by many U.S. Special Forces units, as well as the Army of Norway. We also produce the MR556 rifle, a semi-automatic version of the HK416 rifle, for the commercial market.

The HK417 rifle. The HK417 rifle has a similar appearance to the HK416 and uses the same advanced operating system as both the HK416 and G36 rifles, but fires a larger caliber bullet. A much more specialized rifle, it has also been adopted by a number of Special Forces units. We also produce the MR762 rifle, a semi-automatic version of the HK417 rifle, for the commercial market.

Side arms

For the year ended December 31, 2010, side arms contributed 15% of our revenue. Our core product offerings in this category are described below.

The universal self-loading pistol ("USP"). The USP, which was our first polymer-framed pistol, incorporates many traditional design elements with highly advanced lightweight, polymer design and production technology. The USP was also the first service side-arm with a modular concept, which allows the control lever function to be switched from the left to the right side of the side-arm for left-handed shooters. The USP has been sold to the German Army, the Greek Army, the Special Forces of the United States and certain European countries, as well as U.S., German and Spanish law enforcement units.

The P2000/P30. The P2000 is a more recently developed side-arm which incorporates features that significantly improve accuracy and use. The P2000 has been sold to German police forces and federal law enforcement agencies in the United States. Further developments of this side-arm have been made, which incorporate an "Ergonomic Grip."

HK45. The HK45 is also a polymer-framed pistol available in both full and compact size versions, developed especially for sales to the U.S. Armed Forces. The HK45 is our first product to be partially manufactured in the United States.

Fully automatic weapons

For the year ended December 31, 2010, fully automatic weapons (including submachine guns and machine guns) contributed 14% of our revenue. Our core product offerings in this category are described below.

The MP5 submachine gun. We designed the MP5 in the 1960s based on the specifications of the German Border Guard. Since our initial development of the MP5, we have continually modernized and upgraded its design. As a result, it continues to be one of our core products. The MP5 is most commonly seen by members of the public in the hands of police forces stationed at European airports.

MP7 personal defense weapon. We developed the MP7 personal defense weapon in early 2000 and designed it to use a new caliber of ammunition. Although the MP7 is approximately half the size of a conventional submachine gun, the ammunition used in the MP7 is more effective, and the MP7 has a much longer range and is more accurate than either a side-arm or a conventional submachine gun. The MP7 is currently being used by the British and German Armed Forces and in increasing numbers by U.S. law enforcement and military forces.

Universal machine pistol ("UMP"). We developed this lightweight submachine gun to have superior accuracy compared to existing competing products. The UMP is available in three calibers and the frame is partially made from advanced polymer plastic. Customers for the UMP include the German Armed Forces and the French Gendarmerie.

The LMG36 machine gun. The LMG36 is a lightweight machine gun, which is derived from the G36.

The MG4 machine gun (or MG4 LMG). The MG4 is a lightweight, belt-fed machine gun which we designed to perform in severe climatic conditions. Customers for the MG4 include the German Army, the Spanish Army and certain NATO allies in the Middle East.

General Purpose Machine Gun. In 2007, we were asked by the U.K. Ministry of Defence to manufacture a new batch of its 7.62mm medium machine gun that it has in active service all over the world. These machine guns were originally manufactured under license by Enfield in the U.K. in the 1960s. Delivery started in 2008 and with new contracts subsequently signed, which are continuing.

HK 121. The HK121 is a 7.62 mm machine gun being developed especially for sales to the German Army. It is expected to become available in 2013.

Grenade launchers

For the year ended December 31, 2010, grenade launchers contributed 15% of our revenue. Our core product offerings in this category are described below. Although the percentage of sales from these products is still low, they represent an important strategic element in our future product portfolio.

The 40mm grenade machine gun. We developed the grenade machine gun in the late 1990s. The grenade machine gun has a removable barrel to facilitate maintenance, offers night vision capabilities and can launch up to 350 40mm high velocity grenades per minute. Customers include the U.K., Greece, Germany, the United States and several Eastern European countries. The grenade machine gun is our first complex, fully integrated weapon system, which also has large potential to be integrated in turret solutions for APCs (Armored Personnel Carriers), IFVs (Infantry Fighting Vehicles) such as the German “Dingo” and the U.S. “Humvee,” and also heavier vehicles like the U.S. “Stryker” IFV.

The XM25 grenade launcher. The XM25 is a 25mm caliber grenade launcher with intelligent ammunition technology. We supply to the U.S. Army under a sub-contract arrangement with Alliant Technologies Inc. (“ATK”), who are the prime-contractor. The intelligent ammunition technology allows the user to defeat targets from distances which in the past have been beyond the range of comparable conventional weapons systems. We are developing the weapon, while the fire-control system is being developed by another sub-contractor and the intelligent ammunition by ATK.

The HK69A1 40mm grenade launcher. The HK69A1 is a lightweight handheld grenade launcher designed to fire a variety of low velocity ammunition to a range of up to 400 meters. The HK69A1 is sold to the armies of NATO countries.

The AG36 40mm grenade launcher. The AG36 is a lightweight, rifle-mounted grenade launcher which can be added to the G36 rifle. It is currently being used by the German Armed Forces in large numbers and is starting to be introduced by other armies in order to enhance the close quarter combat capabilities.

The M320 grenade launcher. This is a single shot, lightweight, rifle mounted grenade launcher designed to fire all standard low velocity 40 × 46 mm ammunition up to a range of 400 meters. Deliveries to the U.S. Army started in the first quarter of 2009.

Other products

For the year ended December 31, 2010, other products contributed 35% of our revenue. Some of our product offerings in this category are described below.

Ammunition feed system production for the Typhoon. We are currently producing the electro-mechanical feed system for the Mauser cannon which will be part of the weapons systems for the Typhoon, a state of the art, military combat aircraft jointly developed by the governments of the United Kingdom, Germany, Spain and Italy.

Parts and machinery. We supply parts and machinery as part of our licensing agreements with other countries. See “—Intellectual Property and Licensing Agreements.” We also supply spare kits for GPMG and the HK416 rifle.

Production Process

Research and development

Since our formation, one of our most important strengths has been our research and development capabilities. Our research and development team continuously works to improve our current designs, manufacturing processes and raw material inputs, and develops new designs and manufacturing processes for new products. A central tenet of our research and development approach is to improve the accuracy, safety, reliability and longevity of the small arms we produce. As a result of this focus and on the basis of various tests, we guarantee that the operating life of one of our G36 and HK416 rifles is 10,000 rounds of ammunition.

Examples of some of our most recent innovative research and development applications include the MP7 personal defense weapon, XM25 airburst grenade weapon, light weight medium machine gun and the IdZ ("Infantryman of the Future") program. Infantryman of the Future is a major technology program for us, which will include close liaison with Future Infantry initiatives in the United States, the United Kingdom, Spain and other NATO countries. The German Army is at the forefront of this development, which is one of the most important land forces development programs in the Western Hemisphere.

Our research and development has been both self-funded and funded by our customers as part of our contracts. The following table summarizes our research and development costs for the last five years.

Year ended December 31:	2006	2007	2008	2009	2010
			(€ millions)		
Government funding for research and development	3.2	5.8	3.1	2.1	4.7
Company-funded research and development, both capitalized and expensed in year	3.2	3.1	5.0	4.7	5.2
Total research and development	6.4	8.9	8.1	6.8	9.9
Total as a percentage of revenue	5.2%	6.0%	4.4%	2.9%	4.0%

Historically, through development contracts, some of our new product designs have been funded by our customers. This type of funding has led to our customers owning some or all of the intellectual property produced as part of these contracts. For example, the German government owns the intellectual property to the G3, the first rifle that we produced. We now mostly develop new products independently, and have developed products, including the HK416 and HK417 rifles, the MP7 personal defense weapon and the grenade machine gun almost entirely on a self-funded basis. Although this has increased the risk to us in the event the designs we develop are not accepted by our customers, it has allowed us to retain all of the intellectual property rights to our designs and has allowed us to react more quickly to emerging customer requirements.

Our research and development team is currently made up of 71 employees, including engineers, product testers and draftsmen who use both traditional drafting methods and state of the art computer-assisted design and development techniques. The team continues to introduce new products by employing innovations in the design and manufacture of side arms.

In the contracting process, the research and development team is often instrumental in helping us win the tendering process. See "—Contracts—Long-term contracts."

Raw materials and components

In general, we maintain the ability to manufacture the majority of our products from raw materials. However, we have qualified a number of subcontractors to increase the flexibility of our production processes by outsourcing, if required. The only significant production process that we currently outsource is chroming, which is a process of plating certain of our products with chromium to increase their strength and durability, and the only part we are not capable of producing ourselves are springs. The raw materials that we use include specially treated, cold forged steel and plastic polymers.

We are not dependent on any one source for plastic polymers and standard components, but have short- and medium-term contracts, usually without volume requirements or fixed prices, with a variety of suppliers. As a result, we can tailor our supply orders to fit the demand for our products.

With respect to our supply of steel, we purchase a majority of our specially treated steel from a single source that specializes in the production of special steel and super alloys. However, we purchase steel from this supplier from two separate manufacturing plants a reasonable distance apart and also have qualified an alternative supplier from whom we have started acquiring this steel, mitigating the risk of interruption to our steel supply.

Given the complexity of certain orders from our customers, it can take as long as one year from the time of the order until the first unit is delivered. To be able to meet customer expectations, we sometimes order both raw materials and components in advance of customer orders, based on our experience in the contracting process. In addition, in order to mitigate any adverse impact from disruption in supply, we maintain a supply of steel in our facility in Oberndorf am Neckar which would allow us, at current levels of production, to produce our products for several months without interruption, while the alternative supplier accelerates production to meet our new demand.

Manufacturing

Facilities

Germany. We have a manufacturing facility in Oberndorf am Neckar, Germany. The facility, which is approximately 38,000 total square meters, and includes 27,000 square meters of production space, has a capacity to produce approximately 60,000 rifles, 30,000 other automatic weapons and other long guns and 100,000 side arms per annum. In addition, we maintain an indoor testing range in our main production facility and an outdoor testing range in the vicinity of the production facility.

United States. We have rented capacity in a small manufacturing facility located in New Hampshire, U.S., to enable the production of pistols designated as "Made in the U.S."

Process

The development of a product from design to volume production typically takes several years. For a description of the design of a product through the tendering and contract process, see "—Contracts—Competitive tenders."

Our manufacturing process is qualified to ISO 9001:2008 quality control standards throughout the production process. In addition, we utilize specifically tailored testing procedures and analysis depending upon the nature of the firearm and material that is produced. At the end of the production process, each of our products is tested for endurance and reliability, and is also subject to drop tests, ice, mud and saltwater immersion testing. Each of our firearms is proof fired and checked for function and accuracy before it leaves the factory. We believe that our firearm manufacturing safety record is excellent.

Contracts

Sales and marketing

Our products are purchased by European NATO countries and the United States. In addition, subject to German and other applicable national and international regulations, we also produce small arms for NATO allies elsewhere.

The majority of our products—56% of our revenue for the year ended December 31, 2010—are purchased by the German, British, French and U.S. armed forces and law enforcement agencies. Our sales force, which is primarily located in Germany, the United Kingdom, France and the United States, markets directly to these customers. Most of our sales staff, which comprises 71 full-time equivalent personnel as of December 31, 2010, have an engineering, military or defense-related background or education. They receive regular training and require a thorough knowledge of our entire range of products.

In markets where specialized local knowledge and contacts are required for successful marketing, we sell through local companies acting as our sales representatives, either on a commission basis as our sales agents, generally in the case of large order quantities, or as an importer for onward sale to the customer, generally in the case of small quantities. In addition, the use of local sales representatives allows us to gain access to markets which are less open to external competitors. Our sales representatives are on fixed-term sales representative agreements with us. Our contractual agreements with sales representatives usually define the territory in which the representative may operate and the product range represented. Mostly, these contracts provide that the representative acts as the sole representative for our product range in a particular territory, representing us exclusively in the field of small arms and infantry weapons. These contracts are reviewed and renewed on a yearly basis and each representative is required to certify that he will conduct business on our behalf in accordance with our own internal corporate governance standards, which are themselves subject to independent annual review.

Warranties and service

Through our customer contracts, we warrant that our products are free from defects in material and workmanship for a period of up to two years from the date of delivery to the central depot of a customer. The terms of the warranty may vary slightly from contract to contract. As of December 31, 2010, we had reserves on our balance sheet of less than 1.2% of our revenue for claims in relation to these warranties.

We offer support services and repair of firearms to our customers in our Oberndorf am Neckar facility. However, because most of our customers are governments with extensive internal repair and maintenance capabilities, in the past we were not often required to provide this service. The militaries and law enforcement agencies of NATO countries are beginning to focus on ways to outsource the management of the full life-cycle of their small arms, which includes all of the support, supply and maintenance functions relating to small arms from after production through to retirement. By utilizing our existing asset base and capitalizing on our experience as a leading producer of military small arms, we already provide this service to the U.K. Ministry of Defence Police and intend to continue to penetrate this market in relation to both our own products and those produced by other manufacturers. See "—Our Strategy."

Customers

Our revenue is primarily derived from contracts with agencies of NATO and allied governments. For the year ended December 31, 2010, our order book consisted of 170 ongoing contracts with our customers. These contracts include both contracts for production of our firearms in our own facilities, subject to certain offset agreements in relation to those contracts (see "—Long-term contracts"), and licensing agreements, where we grant certain licensing partners the ability to produce our products in their own countries (see "—Intellectual Property and Licensing Agreements").

Our revenue is also derived from sales to the commercial market, including sales to U.S. local law enforcement agencies. Most of our revenue from the commercial market is derived from sales to distributors in the United States, which is the world's largest commercial market.

Our top ten customers, treating individual governmental agencies as separate customers, rather than treating all agencies of a government as being one customer accounted for about 70% of our sales for the year ended December 31, 2010. Our most significant customer contract, which accounted for approximately 20% of our revenue for the year ended December 31, 2010, was a contract relating to the Co-production Facility Project.

Long-term contracts

Governments purchase our products as part of larger small arms programs, which last from three to ten years. Contracts with our customers, who are almost exclusively agencies of NATO and allied governments, usually have terms ranging from one to three years. Although there have been some exceptions, we generally win the initial contract for each small arms program through competitive tenders.

Competitive tenders

Because of the nature of our customers, the market in which we compete is both highly regulated and very competitive. Many of our customers are required under their national laws to equip their armies, law enforcement agencies and other government agencies by way of international or European state tendering principles. Under these principles, all products purchased through the tender process must come from suppliers who have passed NATO standards and specifications with respect to their products. Within this limited group, every competitor has the right to compete in the tender. In addition, the tender procedures themselves must be both transparent and fair, with no potential supplier being favored over others for political or other reasons.

These competitive tenders require firms, including us, to compete with respect to a variety of criteria established by the customer at the beginning of the competitive tender process. The nature of the criteria varies from country to country, and includes requirements based on price, quality and specific design and performance specifications. Some customers require products that do not exist either in our inventory or in our designs. These customers provide us with extremely detailed requirements and conditions for the new product. Some customers require, as part of the tender process, that we provide both designs and prototypes of products to be tested by the customer before a contract is awarded and will often provide revised instructions or specifications based on these tests.

In addition, customers often require that, as part of the contract, certain "value" or "offset" remains in the customer's home country. One of the most typical forms of offset is the requirement that the contractor sources parts or builds components in the customer's country. Other forms of offset include the contractor providing limited licensing to the customer to build the products in its home country. The nature of offset varies from government to government, but a significant number of countries require some form of offset as part of the tender in order to ensure that local industry, particularly the defense industry, receives benefit from the contract. Less than 4% of our sales for the year ended December 31, 2010 have associated offset commitments.

Upon receiving an invitation to bid on a contract, we confirm with the German authorities on an informal basis that they will grant regulatory approval in relation to the delivery of the products. See "—Regulation." After receiving informal approval, we seek input from five internal teams: first, our research and development team, which is responsible for putting together the designs for the product; second, our manufacturing department, which is responsible for putting together the prototype of the product; third, our advisory board, which approves bids in an amount in excess of €10 million; fourth, our sales department and senior managers, who produce the bid for the contract and analyze the scope of the offset and fifth, our finance team who analyze the associated costs, risks and profit margins. Based on the collaborative effort of these teams, and following a review process whereby the head of each team signs off on the bid, we provide a formal bid for the tender.

Before we are awarded a contract, armed forces for NATO governments, which typically have very specific requirements for their equipment, often require us to provide prototype weapons which they can put through extensive laboratory and field tests. This testing phase may last for several months and may consist of the customer revising the specifications for a firearm based on this testing. The research and development team often works closely with the customer during this phase, evaluating the test results and helping to provide revisions to the specifications based on these tests. Only after this extensive testing and design revision is complete is a contract awarded.

Contract phases

Performance and delivery phase. The performance phase of a contract, which relates to our production of our product for the customer and subsequent delivery, can last anywhere from one to five years. In cases where we deliver the product in conjunction with a national small arms manufacturer, the performance phase is usually divided into three sub-phases, although this can vary from contract to contract depending upon the offset and other arrangements made with the customer. In the first phase, we supply the customer with complete products from our manufacturing site in Germany, usually in lots, the timing and amount of which are pre-set in the contract. In the second phase, partially assembled products are delivered to the customer for assembly in a national manufacturing site. In this phase we may also, depending upon the terms of the contract, help the customer establish the site to assemble the product. In the third phase, we provide component parts to a national manufacturing site to be completely assembled in the customer's country. Depending upon the nature of the contract, we may also provide them a limited license to manufacture and assemble some of these components. See "—Intellectual Property and Licensing Agreements."

Warranty and guarantee phase. Once delivery is complete, the next contract phase, the warranty and guarantee phase, begins and typically lasts two years from the date of shipment of the product. See "—Warranties and service."

Maintenance and service phase. In addition, depending upon the terms of the contract, we may agree to provide up to 10 years of field support, repairs and delivery of spare parts for which we charge the customer. In line with our strategy, this area of the business is expected to expand to include full life-cycle management of military and law enforcement small arms. See "—Our Strategy."

Payment and guarantees

Our contracts can be categorized as either "cost-plus" or "fixed-price." Under cost-plus contracts, we earn a margin over production costs. Under fixed-price contracts, we receive a set price for delivery of products. Both cost-plus and fixed-price contracts may also provide for an award fee or incentive fee based upon achieving specific milestones. At present, almost all of our contracts are fixed price. The only cost-plus contracts we enter into are contracts which are focused on the development of a new product. In many NATO countries, particularly the United States, the United Kingdom and Germany, government contracts are often conditioned upon the continuing availability of appropriate parliamentary or congressional appropriations. Funds are usually appropriated once yearly. Consequently, at the outset of a significant program, our contracts with various government agencies are usually only partially funded. Often, we receive a payment of between five and ten percent of the contract value in advance of contract performance, although contract terms may vary depending upon the policies of our customers' procuring agencies. Additional monies are normally committed to the contract by the procuring agency only as the appropriate legislative body for future years makes appropriations.

Before we deliver our products to the customer, we may be required to provide them with up to three forms of guarantees which are issued by a third party, which is usually a bank. Sometimes, customers require bid bonds to be submitted with our tenders. Advanced payment guarantees may be provided to the customer in exchange for the customer's advanced payment against delivery of the product. The customer releases such guarantees when the customer receives the product from us. Performance guarantees may be provided to the customer to guarantee the delivery of certain quantities of our products in accordance with the delivery schedules set forth in the contract. This type of guarantee will cover any penalties we incur for delay or mistakes in product delivery. After the delivery of the product to the customer, the customer usually releases the performance guarantees, unless they also cover the warranty period for our products, in which case the customer does not release the guarantee until the warranty period has expired.

Contract termination

Under their terms, our customers are often permitted to terminate our contracts, either for their convenience or in the event that we default. Upon termination of a cost-plus contract, we are typically entitled to reimbursement of our allowable costs. If the termination is for convenience, we are also usually entitled to receive payment of fair compensation for work performed plus the costs of settling and paying claims by terminated subcontractors, if applicable, other settlement expenses and reasonable profit on the costs incurred or committed.

If a cost-plus contract is terminated by reason of our default, the contract usually requires that we be paid an amount agreed upon for completed and partially completed products and services accepted by the government customer. The government customer is usually not liable for our costs for unaccepted items and is entitled to repayment of any advance payments and progress payments related to the terminated portions of the contract. We may also be liable for excess costs incurred by the government customer in procuring undelivered items from another source.

Intellectual Property and Licensing Agreements

The intellectual property that we own includes the trade name "Heckler & Koch" and related trademarks, as well as proprietary rights relating to the designs of our products and the industrial processes relating to the production of those products. In addition, as of December 31, 2010, we had 84 registered patents. We own most of the intellectual property related to our products and our production processes, with the exception of the intellectual property relating to the G3 rifle, which is owned by the German state. Typically, if a customer pays for the research and development expense relating to the development of a new design or manufacturing process, they will request a user right to the resulting intellectual property. As a result, in order to maintain our proprietary rights, we often self-fund our own research and development.

In certain instances, we grant licenses to our customers whereby we license the ability to produce certain components or to assemble our products. While we and the German government have granted certain countries licenses to produce the MP5 submachine gun and the G3 rifle in entirety, we have since then limited the scope of our licenses to manufacturing only certain components in a country. We currently provide no support in respect of the MP5 submachine gun and the G3 rifle licenses and do not receive any revenue from these licenses.

In the past 30 years, we have granted only partial licenses for the manufacture of certain components for our products to certain foreign governments. All of these partial licenses are limited since they only provide limited user rights and limited export rights. All licenses granted in the last 30 years disallow export sales of products produced under license, which are required to be used solely to equip national armed forces. License agreements, like procurement contracts, must be approved by the German authorities or other appropriate national regulatory authorities before any intellectual property may be delivered to a licensee. See "—Regulation" below.

In addition to providing a "data package" of intellectual property rights to a licensee government under a license agreement, we also provide the government with certain services and related work-share arrangements. These arrangements can include everything from training for local staff, provision of tooling and related machining services, to support for quality control processes. Depending upon the nature of the licensing contract, the licensee government may take more responsibility for producing the product over the course of the contract.

Regulation

We are subject to extensive and complex German, U.S. and other governmental laws and regulations, including manufacture and export licensing restrictions. Because of the nature of the regulations, we may be subject to restrictions under multiple jurisdictions, depending upon where the intellectual property for a product is created or a product is manufactured.

Germany

Our business in Germany is subject to various regulatory requirements and obligations including weapons and foreign trade laws, general antitrust law as well as environmental and other regulations.

Manufacture and distribution licenses

Manufacture and trade activities relating to small arms in Germany are subject to the regulatory regime of the German Weapons Act (*Waffengesetz*) of October 11, 2002, as last amended on July 17, 2009 and the German War Weapons Control Act (*Kriegswaffenkontrollgesetz*) of November 22, 1990, as last amended on June 6, 2009.

The German War Weapons Control Act provides that all activities in connection with weapons intended for war (production, acquisition and transfer of actual control, every type of transport or brokering transactions) require prior licensing by the competent German authorities. Weapons intended for war (war weapons) comprise the items, substances and organisms listed under the war weapons list (*Kriegswaffenliste*), including, *inter alia*, machine guns, except those with water cooling, machine pistols, fully automatic rifles, semi-automatic rifles except rifles for hunting and sporting purposes, and machine guns, rifles and grenade pistols.

Commercial manufacture of, and trade in, weapons not intended for warfare are subject to the regime of the German Weapons Act, which regulates the use of weapons and ammunition for public security and order. It sets forth general requirements for weapons and ammunition licenses, with modified requirements for special licenses for special groups such as hunters, marksmen, shooting associations and shooting clubs, ammunition collectors, weapon manufacturers, weapon dealers, shooting ranges and security firms, among others, and their specific use of a weapon. Pursuant to the German Weapons Act, our business of weapons not intended for warfare requires a general license for manufacture and trade, which is issued by the competent local authorities. The competent local authorities issue this license, which may be restricted to specific types of guns and is unlimited in duration and quantity, to a specific person.

If the person in possession of the license retires or otherwise leaves our company, we would be obliged to appoint another person and obtain a new license. However, we do not expect that obtaining a new license will interrupt our business.

Under the German War Weapons Control Act, the manufacture of war weapons requires a license that may be limited in scope or duration and be subject to conditions. In certain circumstances, such as successive deliveries to the same customer, a license can be modified or extended. In addition, the German War Weapons Control Act requires further licenses for the transport or distribution of weapons destined for war. The licenses are granted by the Federal Ministry for Economics and Technology (*Bundesministerium für Wirtschaft und Technologie*) and may be limited in duration. License may be denied or revoked if, for example, there is reason to believe that the applicant, his or her legal representative, the body or member of such body authorized to represent a legal person, a shareholder authorized to represent a commercial partnership or the head of a company or plant of the applicant, does not possess the reliability required for the intended act. In particular, a license may be revoked if there is a risk that the weapons may be used for aggressive acts or the license conflicts with the obligations of Germany under public international law.

We currently possess valid licenses for all our products. There can be no assurance, however, that we will be able to maintain such licenses in the future. In addition, when we sell to customers outside Germany, we are subject to further restrictive export laws and regulations.

Export licenses

Most of our products are designed and manufactured in Germany. The export of our products is therefore governed by the German War Weapons Control Act (*Kriegswaffenkontrollgesetz*), the German Foreign Trade Act (*Außenwirtschaftsgesetz*) and its implementing ordinance (*Außenwirtschaftsverordnung*, the "Foreign Trade Ordinance"). The "Political Principles Adopted by the Government of the Federal Republic of Germany for the export of War Weapons and Other Military Equipment" of January 19, 2000 and the "Council Common Position 2008/944/CFSP" of December 8, 2008 establish the guidelines for the competent German authorities regarding the control of activities in connection with the export of war weapons.

First, the German Foreign Trade Act and the Foreign Trade Ordinance require the licensing of all weapons exports. All weapons subject to export restrictions are listed in Part I Section A of the Export Control List (the "Export List"), which is recorded in Annex AL to the Foreign Trade Ordinance. A license is also required for the export of so-called dual-use items. According to Annex AL of the Foreign Trade Ordinance, dual-use items are goods, software and technology that may be used for civil and military purposes. The Federal Office of Economics and Export Control (*Bundesamt für Wirtschaft und Ausfuhrkontrolle*), a subordinate agency operating under the jurisdiction of the Federal Ministry of Economics and Technology, is responsible for the granting or denying of export licenses under the German Foreign Trade Act and Ordinance.

Some of the weapons on the Export List are also weapons intended for war. For the export of these weapons, a license must be obtained under the German War Weapons Control Act. In addition, an export license is required pursuant to the German Foreign Trade Act and the Foreign Trade Ordinance. The licensing agency for commercial transactions is the Federal Ministry of Economics and Technology.

Our material customers are mainly NATO and NATO allied countries such as Australia, New Zealand and certain countries in the Middle East and Far East. The export license is generally granted for the EU, NATO, and NATO-equivalent countries. For the other countries, there has been a restrictive and reservation policy on the granting of the export license. Nevertheless, our management believes that we will continue to obtain the required licenses to export to our material customers, although such licenses might be subject to delays in some cases.

The average time required to obtain an export license is between three and four weeks. However, the authorities can take up to three months or, in certain circumstances, even in excess of a year to grant a license.

In July 2009, the EU enacted Directive 2009/81/EC on the coordination of procedures for the awarding of certain works contracts, supply contracts and service contracts in the fields of defense and security (the so-called Defense and Security Procurement Directive). According to this new Directive, contracting authorities may use the negotiated procedure with prior publication of a contract notice, which allows contracting authorities to negotiate all details of the contract, as a standard procedure. They may also require specific commitments from supplier candidates for the protection of classified information and the timeliness of supply. The new Directive also contains specific provisions on research and cooperation. The Member States are required to implement Directive 2009/81/EC into national law by August 21, 2011.

End-user certificates

We will generally not sell to other companies or distributors but only to end-users, except where the applicable national laws and/or our customers explicitly require a local sales intermediary. Exports to countries other than EU and NATO countries and NATO allies require end-user certificates pursuant to Section 17, paragraph 2 of the Foreign Trade Ordinance. End-user certificates are issued by the governments of the countries of destination, indicating exactly who will receive the firearm and for what purpose, and are required by the German government for any customer other than customers located in EU and NATO countries and NATO allies. The purpose of the end-user certificate is to avoid the re-exportation of military weapons or armaments equipment to countries of political concern and/or to unauthorized individuals or groups. If this does occur, the governmental agency issuing the end-user certificates risks being put on a watch list and having all further requests for export of arms delayed or denied by the German government.

Foreign Corrupt Practices Act

We abide by the Foreign Corrupt Practices Act ("FCPA"), which concerns bribery of foreign officials by U.S. individuals, companies and direct foreign subsidiaries of U.S. companies. The FCPA consists of both anti-bribery provisions and accounting provisions. The anti-bribery provisions prohibit most indirect or direct payments to foreign and international officials, regardless of the amount.

OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions

We require our employees to abide by all applicable laws concerning the prevention of bribery of local or foreign officials by individuals or companies. These provisions prohibit most indirect or direct payments to foreign and international officials, regardless of the amount.

Competition

Due to the nature of our customers, many of which are generally required by their national laws to equip their armed forces, law enforcement agencies and other government agencies by way of international or European state tendering principles, in which every competitor who meets NATO specifications has the right to compete, we encounter significant competition. In addition, we compete with other companies engaged in different areas of the defense industry for a portion of the defense-related budgets of NATO governments. Some of these companies have financial, technical, marketing, manufacturing, distribution and other resources that are substantially greater than ours. Our ability to compete for these contracts depends to a large extent upon the effectiveness and innovation of our research and development programs, our ability to offer better program performance than our competitors at a lower cost and our readiness with respect to facilities, equipment and personnel to undertake the programs for which we compete.

We generally face competition from a number of competitors in each business area:

Military and Law Enforcement Market

Product Group	Our Products	Main Competition
Rifles	G36 family, HK416, HK417	Fabbrica D' Armi Pietro Beretta S.p.A. ("Beretta"), Colt, FN Herstal ("FN"), Steyr Mannlicher GmbH & Co KG ("Steyr"), SAN Swiss Arms AG ("Swiss Arms"), Israel Military Industries Ltd. ("IMI"), Freedom Group Inc. ("Freedom")
Side Arms	USP, Mark 23, P2000, P30	J.P. Sauer & Sohn GmbH ("SIG Sauer"), Glock GmbH, Carl Walther GmbH, Beretta, FN, Steyr, Smith & Wesson Holding Corporation, Sturm Ruger & Co., Inc., Taurus, CZ
Fully Automatic Weapons	MP5 submachine gun, UMP, MP7, LMG 36, MG4 family	Colt, Beretta, FN, IMI
Grenade Launchers	GMG 40mm, HK69A1, AG36 40mm XM25 grenade launcher	Colt, FN, General Dynamics Corporation, Singapore Technologies Kinetics Denel (Pty) Ltd.

Commercial Market (including sales to certain U.S. local law enforcement

agencies)

Product Group	Our Products	Main Competition
Rifles..........................	MR556, MR762	Colt, FN, Steyr, Swiss Arms, IMI, Freedom, Smith & Wesson
Side Arms	USP, Mark 23, P2000, P30	SIG Sauer Glock GmbH, Carl Walther GmbH, Beretta, FN, Steyr, Smith & Wesson Holding Corporation, Sturm Ruger & Co., Inc., Taurus, CZ

Environmental Matters

We are subject to, and must comply with, a variety of local, national and supranational laws and regulations regarding the protection of the environment, health and safety. These laws and regulations address, among other things, the identification, acceptance, treatment, storage, handling, transportation and disposal of hazardous and solid materials and waste, air and water emissions, soil and water contamination, noise, the prevention or minimization of climate change, and exposure of employees and others to hazardous materials or waste. Management currently believes that we are not subject to any contamination or environmental risks that have not yet been identified. Insurance coverage is maintained to cover such risks, however, if we are ordered to remove any contaminants, the cost of decontamination could exceed the cover, and further contamination or other environmental impacts of our past, present or future operations could be discovered for which no insurance coverage is in place. We have environmental management programs in place, on both the corporate and individual facility levels, to mitigate these risks.

Insurance

We have insurance coverage that we believe to be adequate for the risks of the business in which we are engaged. Although our insurer does not cover punitive damages, we believe that all of our insurance policies meet industry standards. Although we are not currently subject to any litigation, it would be extremely difficult to quantify the amount of damages that we would owe if a claim for monetary damages was successful, and given our insurer does not cover punitive damage claims, the amount we may owe that will not be covered by insurance may be significant. See “Risk Factors—Risks Relating to Our Business—We may be subject to liability as a result of sales of firearms to civilian and U.S. local law enforcement agencies.”

We also maintain fire insurance for our buildings and inventory as well as business interruption, environmental contamination liability insurance and various other insurance policies, which we believe provides us with adequate protection against the ordinary risks of conducting our business.

LEGAL PROCEEDINGS

In December 2009, a complaint against the Issuer was made to the German Federal Cartel Office by a company now managed by one of our former managing directors. The complaint alleged that we had attempted to hinder the plaintiff's ability to trade. In March 2010, the German Federal Cartel Office carried out a search at our offices to uncover evidence that would support this allegation. The search order further indicates that the German Federal Cartel Office accuses us and other manufacturers of small arms of a restrictive horizontal agreement of not promoting the development of smart guns which was aimed at restricting technical development. This allegation could constitute an administrative offense and subject us to financial penalties. We believe we have meritorious defenses to the allegation asserted against us and have fully cooperated with the investigation. If the German Federal Cartel Office finds against us, however, we may be subject to a fine and a restriction in our ability to conduct business with the German government. In this case, affected companies may also claim for damages against us.

In April 2010, a complaint was filed with the German state prosecutor's office by a third party working with a former employee of ours, alleging that we illegally exported weapons and weapons parts to Mexico in violation of our export licenses. We believe we have meritorious defenses to the allegation asserted against us and have fully cooperated with the investigation. If the state prosecutor's office finds against us, however, this could lead to a criminal conviction of our employees involved and we may be subject to a fine and a restriction on our ability to receive export licenses from the German government.

In addition to the foregoing, we are involved in certain claims, suits and legal proceedings in the ordinary course of our business.

MANAGEMENT

The Managing Directors

Our managing directors (*Geschäftsführer*) are responsible for managing our day-to-day business in accordance with applicable German law and our articles of association. Further, the managing directors legally represent us in dealings with third parties. In carrying out their duties, the managing directors have to exercise the standard of care of a diligent and conscientious businessperson. In complying with this standard of care, the managing directors have to take into account a broad range of considerations, including our interests and the interests of our shareholders and employees.

We currently have two managing directors. Under our articles of association and in accordance with German law, the managing directors are appointed for an indefinite term by our shareholders meeting. Each of the managing directors has signed a service contract with us.

Name	Age	Position
Niels Ihloff	40	Managing Director
Martin Lemperle	60	Managing Director

Niels Ihloff studied business administration and law before completing a legal clerkship in England, and practiced law from 1997 to 2002. He joined the legal department of our indirect parent company, HKB, in 2003 from which time he served in a commercial role in addition to his general counsel function. He has worked for the Group in London, Washington, D.C. and Oberndorf am Neckar. In 2008, he joined us as head of commercial, legal and personnel and in 2009, he became a managing director with responsibility for personnel.

Martin Lemperle joined us in 1966. In the early 1970s, he temporarily left us to obtain professional qualifications including mechanical engineering and time and motion study. He has worked in several areas of operations, including planning and as head of production and is now a managing director with responsibility for operations, covering purchasing, production and logistics. Prior to his role as managing director, Mr. Lemperle served in various positions within the company, from training as a toolmaker in 1966 to becoming Head of Operations in 2006. He has been a managing director since May 2009.

The business address of the managing directors is:

Heckler & Koch-Str. 1, 78727 Oberndorf am Neckar, Germany.

Other Senior Management

The table below shows the current members of our senior management who report to the managing directors and their positions.

Name	Age	Position
Wolfgang Bantle	46	Head of Research and Development
Uwe Kaltenbach	49	Group Controller, Prokurist
Wolfgang Mackrodt	62	Head of Sales, Prokurist

Wolfgang Bantle joined us in 1989. After completing his mechanical engineering studies, he served as a mechanic, production planner and program manager of our U.K. business. From 1995-2008 Mr. Bantle was project manager in the field of development for projects such as SA80 Weapon System, HK416, HK417 and AGL. In 2009, he became head of research and development.

Uwe Kaltenbach joined us in 1985 and has served as controller and head of finance. In 2010, he became our group controller.

Wolfgang Mackrodt joined us in 1994. He was trained as a translator and interpreter and also studied business administration. In 1974, he joined the diplomatic service as an interpreter. He served as embassy counselor at the German foreign office in 1991 on various assignments. Mr. Mackrodt has been our sales and marketing director since 2008.

The business address of the current members of our senior management is:

Heckler & Koch-Str., 78727 Oberndorf am Neckar, Germany.

The Advisory Board

We established an advisory board (*Beirat*) in June 2004. The resolutions of the advisory board generally require a majority of the votes cast by its members, unless otherwise required by German law or the articles of association. The advisory board meets at least quarterly. Its main functions are:

- to monitor the management board; and
- to approve the matters which are subject to its consent as required by German law, the articles of association or matters which the advisory board has made generally subject to its approval.

The members of the advisory board are appointed for a period of three financial years by the shareholders subject to withdrawal or removal. The advisory board currently consists of three appointed members. The table below shows the current members of our advisory board.

Name	Age	Position
Keith Halsey	53	Member of advisory board
Andreas Heeschen	50	Member of advisory board
Wilhelm Haaga	57	Member of advisory board

Keith Halsey joined us as a member of the advisory board in 2002 and is one of the three ultimate shareholders. Mr. Halsey is a member of the board of Boss Gunmakers, Bruichladdich and C.S.T. Ltd.

Andreas Heeschen is a member of our advisory board and is one of the three ultimate shareholders, in addition to holding a position as managing director of HKB. Mr. Heeschen has also served as managing director of ProChemie GmbH since 2002 and as director of HKH since 2003.

Wilhelm Haaga joined us in 1978 and has served in various capacities, including head of finance, chief financial officer and managing director. Mr. Haaga was appointed a member of the advisory board in 2010 and serves as the managing director of HKB and HKI.

The members of our advisory board can be contacted at Heckler & Koch-Str. 1, 78727 Oberndorf am Neckar, Germany.

Aggregate Compensation Paid to Our Advisory Board

The aggregate compensation paid to the members of our advisory board to cover expenses for their services to us and its subsidiaries for the year ended December 31, 2010, was €0. Former members of the advisory board received remuneration of €15,000 in the year ended December 31, 2010 relating to their expenses and services in the year ended December 31, 2009.

Aggregate Compensation Paid to Our Management Board

For the year ended December 31, 2010, the aggregate compensation paid to the members of our management board as compensation for their services to us and its subsidiaries was approximately €1.8 million, including a termination bonus and other bonus payments.

Pension Schemes

The total amount set aside to provide pension, retirement or similar benefits to our current and former employees and managing director is approximately €53 million as at December 31, 2010. Our traditional defined benefits plans are closed to new entrants. During 2004, we organized a new defined contribution plan. We have undertaken an exercise to establish whether we should maintain control of the German Pension Schemes or whether we should contract with a financial institution to take them over. This exercise established that it would be less expensive for us to maintain control of our own schemes.

Employees

As of December 31, 2010, we had 719 full-time equivalent employees worldwide, of whom 71 were in research and development, 71 in sales, 88 in administration, and 448 in manufacturing with an additional 41 apprentices.

We maintain a work’s council at our plant in Oberndorf am Neckar in Germany with whom we have an excellent relationship. We have collective bargaining agreements in line with Baden-Württemberg (*Süd-*

Württemberg/Hohenzollern) agreements between the metalworking industry and the main union, with the principal agreement expiring in March 2012.

In June 2008, we entered into a complementary collective bargaining agreement to adopt a new framework for reforming collective wage agreements (*Entgelt-Rahmen-Abkommen*, "ERA"). Pursuant to this agreement, a new framework was adopted on July 1, 2009. ERA is a remuneration system that was developed for employees in the metalworking sector in Germany. The new system eliminates the distinction between hourly and salaried employees. With ERA, the basic wage determined by collective bargaining agreements is supplemented by a performance-based component that is also covered by the collective bargaining agreements, and which can reach 15 percent of the base wage. The exact amount of the performance-based component is determined in an annual review, which relies on more in-depth dialogue between managers and their employees. The agreement can be terminated no earlier than June 2014; on termination it must be replaced by an alternative agreement.

PRINCIPAL SHAREHOLDERS

HKB indirectly holds 100% of our share capital through HKH, its wholly-owned U.S. subsidiary. HKB is owned by three individual shareholders, Messrs. Andreas Heeschen, Keith Halsey and Alfred Schefenacker, who together hold 100% of the share capital. See "Related Party Transactions—Management and Service Agreements."

The transfer or disposal by our three ultimate shareholders of their shares in HKB may be subject to the German Foreign Trade Act (*Außenwirtschaftsgesetz*) and the German Foreign Trade Regulation (*Außenwirtschaftsverordnung*), which may require notification of such transfer or disposal and prohibit or restrict the direct or indirect acquisition of the voting rights in HKB by a non-resident company or a resident company in which a non-resident holds at least 25% of the voting rights or by a group of such companies if the share in voting rights of the non-resident purchaser will reach at least 25% after the acquisition.

RELATED PARTY TRANSACTIONS

Other than as stated in "Principal Shareholders," none of the members of our management board, our advisory board, our direct or indirect shareholders holding greater than 3% of our shares, has or had any interest in any transactions with us or our affiliates which are or were unusual in their nature or conditions or significant to our business or our affiliates taken as a whole and that were effected during the current or immediately preceding three financial years.

Transactions with Our Shareholders

As of December 31, 2010, HKB owed us €218,000 in net recharges. See "—Management and Service Agreements."

In the past, we provided short-term loans to HKB. As of the year ended December 31, 2010, 2009 and 2008, the outstanding loans to HKB and the associated interest were €4.9 million, €4.9 million and € 5.0 million, respectively. All outstanding loans to HKB and accrued interest were repaid in full in March 2011.

During the year ended December 31, 2009, we provided a €7.4 million loan to two of our ultimate shareholders and recognized €0.2 million in interest. We sold the loan and the interest to HKH, our direct shareholder, and offset these amounts against €10.2 million due for a dividend declared but not paid in the year ended December 31, 2009. We recognized a net payable of €2.3 million against HKH, which were settled in January 2010, relating to these transactions and to other amounts recharged for taxes, tax advice and audits.

In March 2011, we granted two of our three ultimate shareholders secured loans of €1.5 million each for a term of nine months. See Note 41 to our consolidated financial statements included elsewhere in this offering memorandum.

Transactions with Members of Our Advisory Board

In the year ended December 31, 2010, consultancy fees of €882,000 were paid to a member of our advisory board.

In the year ended December 31, 2009 and in March 2011, we provided loans to two of our ultimate shareholders who are also a member of our advisory board. See "—Transactions with Our Shareholders" above.

Transactions with Our Managing Directors

In the year ended December 31, 2009, a short-term secured loan was granted to a new managing director as part of his relocation package. As of December 31, 2010, we had €604,000 in loan receivable and €14,000 in interest receivable relating to this short-term secured loan. This short-term secured loan is scheduled to mature on June 30, 2011.

Management and Service Agreements

Immediately following our acquisition by HKB, we, NSAF and HKD entered into a management agreement with HKB; following the acquisition of HKF, the agreement was amended to include HKF. Under the terms of this agreement, HKB agreed to provide certain advisory services in exchange for fees paid in accordance with a fee schedule. At the same time, HKB entered into a service agreement with us under which we agreed to provide certain administrative and management services to HKB. In the fiscal year ended December 31, 2010, 2009 and 2008, the net fees paid to HKB by us, NSAF, HKF and HKD and HKI under these agreements amounted to € 0.3 million in total per annum.

In 2009, NSAF entered into an agreement to rent an office in London, United Kingdom, from HKB at £212,000 per annum. The rents for the initial term to February 2010 and from February 2010 to February 2011 were both paid in advance. This agreement was terminated in 2011.

Relationship with the Commercial Business

Following the passing in the United States of the Protection of Lawful Commerce in Arms Act and the resulting reduced risk of potential class action lawsuits in the U.S., we re-acquired HKI and its holding company SUI in 2009 from a company owned by two of our three ultimate shareholders for a purchase price of €13 million.

In the second quarter of 2009, we made advance payments totaling € 5.8 million to Prochemie GmbH (formerly HK Sidearms Holding GmbH), a company in which one of our ultimate shareholders is a shareholder and also serves as a managing director, as part of negotiations relating to the re-acquisition of HKS and SUI. In June 2010, we re-acquired HKS and its holding company SUI.

Until the acquisition of HKS, we provided certain parts and components for side arms to HKS and HKS provided side arms to us. These transactions were made on an arm's length basis and were subject to the terms of a purchase contract. In addition, until the acquisition of HKS, we provided accounting, finance and human resources services to HKS and received licensing fees. For the year ended December 31, 2010, 2009 and 2008, the fees received from HKS for such services and license fees amounted to approximately €0.8 million, € 1.7 million and €1.7 million, respectively.

HKB

For certain information in respect of transactions between HKB and its related parties, see Note 36 to the HKB Financial Statements.

DESCRIPTION OF CERTAIN FINANCING ARRANGEMENTS

The description set forth below does not purport to be complete and is qualified entirely by reference to the agreements which set forth the principal terms and conditions of certain finance documents. Unless the context requires otherwise or terms have not been separately defined, the terms used have the same meanings as set out in the relevant agreement.

Bid Bonds, Performance Bonds and Advance Payment Bonds

Our indebtedness (other than indebtedness incurred in the ordinary course of business) consists of indebtedness incurred under bid bonds, performance bonds and advance payment bonds.

Landesbank Baden-Württemberg

Under the credit-line agreement dated May 31, 2010 and the pledge agreement dated December 13, 2010 between us and Landesbank Baden-Württemberg, we have the ability to request the issue of bid bonds, performance bonds and advance payment bonds consisting of an aggregate amount of up to €22 million so long as we cover the issue amount with 100% cash deposits pledged to Landesbank Baden-Württemberg under the pledge agreement. The credit-line agreement expires on May 31, 2011 and will not be extended; however, all bank guarantees issued until such date will remain in place and will remain secured by the pledge over the cash deposits.

As of December 31, 2010, the bank had provided bonds in the amount of €17.0 million to our customers, with the amount in excess of the agreed limit being covered by 100% cash deposits.

Barclays Bank

Under the on-demand multiple facilities agreement dated May 19, 2010 between our subsidiary, NSAF Limited and Barclays Bank PLC, we have the ability to request the issue of bid bonds, performance bonds and advance payment bonds up to an aggregate of £350,000 so long as the bank balance of NSAF Limited is at least as high as the value of bonds issued.

As of December 31, 2010, the bank had provided bonds in the amount of £62,000 to our customers.

Internationales Bankhaus Bodensee AG

Under the bond credit-line agreement and the pledge agreement, each dated March 24, 2011 between us and Internationales Bankhaus Bodensee AG, we have the ability to request the issue of bid bonds, performance bonds and advance payment bonds up to an aggregate of €1 million so long as we cover the issue amount with 100% cash deposits. The bond credit-line agreement has an indefinite term but may be terminated by Internationales Bankhaus Bodensee AG at any time.

HKB PIK Loans

As a result of the Financing, HKO will own HKB PIK Loans in the amount of €170.1 million. The HKB PIK Loans capitalize interest quarterly at a rate equal to EURIBOR plus 10.0%. The HKB PIK Loans mature on April 7, 2013.

DESCRIPTION OF THE NOTES

In this "Description of the Notes", references to "the Issuer," "we," "ours," "our," "our company" or "us" includes only Heckler & Koch GmbH and not our subsidiaries or parent companies, except for the purpose of financial data determined on a consolidated basis. In addition, all references to "Notes" include "book-entry interests" in the Notes, as defined herein. The definitions of certain terms used in this description are set forth under the subheading "—Certain Definitions".

We have issued the Notes under an Indenture dated as of May 12, 2011 (the "*Indenture*") between, among others, us and The Bank of New York Mellon, as trustee (the "*Trustee*"). The Indenture is not required to be, nor will it be, qualified under the Trust Indenture Act and it will not incorporate by reference any provisions of the Trust Indenture Act except as such terms are expressly included in the Indenture (if any).

The Notes are initiallyguaranteed by Suhler USA, Inc., Heckler & Koch, Inc., Heckler & Koch France SAS, HK Sidearms GmbH, NSAF Limited, Small Arms Group Holding, Inc. and Heckler & Koch Defense, Inc.

The registered holder of a Note are treated as its owner for all purposes. Only registered holders will have rights under the Indenture, including, without limitation, with respect to enforcement and the pursuit of other remedies. The Notes will not be registered under the U.S. Securities Act of 1933, as amended (the "*Securities Act*") and will therefore be subject to certain transfer restrictions.

The following describes the material terms of the Indenture. It does not, however, restate the Indenture in its entirety and where reference is made to particular provisions of the Indenture, such provisions, including the definitions of certain terms, are qualified in their entirety by reference to all of the provisions of the Notes and the Indenture. You should read the Indenture, because it contains additional information and because the Indenture, the material terms of which are described in this section, defines your rights as holders of the Notes. A copy of the form of the Indenture may be obtained by requesting it from the Issuer at the address indicated under "Where You Can Find More Information." For so long as the Notes are listed on the Luxembourg Stock Exchange and the rules of such stock exchange shall require, copies of the Indenture may be obtained upon request to the Luxembourg Stock Exchange or the office of the Registrar in Luxembourg.

We have made an application to list the Notes on the Luxembourg Stock Exchange. The Issuer has designated The Bank of New York Mellon, London Branch, in London as its paying agent and transfer agent and any change to the paying agent and/or transfer agent will be published in a leading newspaper having general circulation in Luxembourg (currently expected to be the *Luxemburger Wort* or, to the extent and in the manner permitted by such rules, post such notice on the official website of the Luxembourg Stock Exchange (*www.bourse.lu*)). See "Listing and General Information."

Principal, Maturity and Interest

The Notes will mature on May 15, 2018, unless redeemed prior thereto as described herein. We have issued Notes in an aggregate principal amount of €295 million in this offering, which amount is due at maturity. Subject to our compliance with the covenant described under "—Certain Covenants—Limitation on Debt," we are permitted to issue additional Notes under the Indenture ("*Additional Notes*"); *provided* that if any Additional Notes are not fungible with the Notes for U.S. federal income tax purposes, such Additional Notes will be issued as a separate series under the Indenture and will have a separate common code and ISIN or CUSIP, as applicable, from the Notes. The Notes and the Additional Notes that are actually issued will be treated as a single class for all purposes of the Indenture, including waivers, amendments, redemptions and offers to purchase. Unless the context otherwise requires, references to the "Notes" for all purposes of the Indenture and in this "Description of the Notes" include references to any Additional Notes that we actually issue.

Each Note bears interest at 9.50% per annum semi-annually from the date of the Indenture or from the most recent interest payment date to which interest has been paid or provided for, whichever is the later. Interest is payable on each Note on May 15 and November 15 of each year, commencing on November 15, 2011. Interest is payable to the holders of record on each Note in respect of the principal amount thereof outstanding as of the immediately preceding May 1 or November 1, as the case may be. We compute interest on the basis of a 360-day year comprised of twelve 30-day months and pay interest on overdue principal and other overdue amounts at the same rate.

Form of Notes

The Notes have been issued on the date of the Indenture only in fully registered form without coupons and only in minimum denominations of € 100,000 and integral multiples of €1,000 in excess thereof.

The Notes are initially represented by one or more global notes (the "*Global Notes*"). The Global Notes have been deposited with a common depositary for Euroclear and Clearstream Banking and registered in the name of a nominee of such common depositary. Ownership of interests in the Global Notes, referred to as "book-entry interests," are limited to persons that have accounts with Euroclear or Clearstream Banking or persons that may hold interests through them. Book-entry interests are shown on, and transfers thereof will be effected only through, records maintained in book-entry form by Euroclear and Clearstream Banking and their participants. The terms of the Indenture provides for the issuance of definitive registered Notes in certain circumstances. See "Book-entry; Delivery and Form."

Transfer and Exchange

The Global Notes may be transferred in accordance with the Indenture, which provides for, among other things, the transfer of the Notes by the Luxembourg transfer agent so long as the Notes are listed on the Luxembourg Stock Exchange. All transfers of book-entry interests between participants in Euroclear or Clearstream Banking are effected by Euroclear or Clearstream Banking pursuant to customary procedures and subject to applicable rules and procedures established by Euroclear or Clearstream Banking and their respective participants. See "Book-entry; Delivery and Form."

The Notes are subject to certain restrictions on transfer and certification requirements, as described under "Notice to Investors."

Payments on the Notes; Paying Agent

We will make all payments (including principal, premium and interest) on the Notes, and we will accept the Notes for exchange and transfer, at our office or through an agent in London, England that we will maintain for these purposes. Initially that agent is the corporate trust office of the Trustee. We will make payments on the Global Notes to the common depositary as the registered holder of the Global Notes. We will make all payments in same day funds.

We have undertaken that we will maintain a Paying Agent in a Member State of the European Union that is not obliged to withhold or deduct tax pursuant to European Council Directive 2003/48/EC or any other Directive implementing the conclusions of the European Council of Economics and Finance Ministers ("*ECOFIN*") meeting of November 26-27, 2000 or any law implementing or complying with, or introduced in order to conform to, such Directive, *provided* that under no circumstances will we be obliged to maintain a paying agent in such a Member State unless at least one Member State of the European Union does not require a paying agent in that Member State to withhold or deduct tax pursuant to the Savings Directive. The initial paying agent is The Bank of New York Mellon, London Branch in London.

The Issuer will also maintain one or more registrars (each, a "Registrar") and a transfer agent (the "Transfer Agent") in a member state of the European Union. The initial Registrar is The Bank of New York Mellon (Luxembourg) S.A. in Luxembourg. The initial Transfer Agent will be The Bank of New York Mellon, London Branch in London. The Registrar in Luxembourg will maintain a register reflecting ownership of Definitive Registered Notes (as defined herein) outstanding from time to time and will make payments on and facilitate transfer of Definitive Registered Notes on behalf of the Issuer.

No service charge will be made for any registration of transfer, exchange or redemption of the Notes, but we may require payment of a sum sufficient to cover any transfer tax or similar governmental charge payable in connection with any such registration of transfer or exchange.

Ranking

The Notes

The Notes are the Issuer's general obligations and:

(a) are secured by a first ranking security interest over the Capital Stock of the Issuer and of our Restricted Subsidiaries, as described below under "—Collateral;"

(b) rank senior in right of payment to any of the Issuer's future indebtedness that is subordinated in right of payment to the Notes;

(c) rank equally in right of payment with any of the Issuer's existing and future indebtedness that is not subordinated in right of payment to the Notes; and

(d) are effectively subordinated in right of payment to any of the Issuer's future indebtedness that is secured by liens on assets of the Issuer to the extent of the assets securing such indebtedness.

The Subsidiary Guarantees

Each Subsidiary Guarantee is the general obligation of the relevant Subsidiary Guarantors and:

(a) rank senior in right of payment to all of such Subsidiary Guarantor's existing and future indebtedness that is subordinated in right of payment to its Subsidiary Guarantee;

(b) rank equally in right of payment with all of such Subsidiary Guarantor's existing and future indebtedness that is not subordinated in right of payment to its Subsidiary Guarantee; and

(c) are effectively subordinated to all of such Subsidiary Guarantor's obligations that are secured by assets of such Subsidiary Guarantor to the extent of the value of the assets securing such obligations.

At December 31, 2011, as adjusted to give effect to the offering of the Notes and the application of the net proceeds therefrom and the use of funds from our own resources as described under "Use of Proceeds," and after excluding intercompany balances, the Issuer and the Restricted Subsidiaries would have had total debt of €295.0 million (all of which would have been represented by the Notes) and pension and similar liabilities of €52.7 million. As of December 31, 2010, we had provided our customers with € 17.1 million of bid, advance payment and performance bonds, none of which has ever been drawn as a result of a breach of any customer commitments. However, if drawn, the performance and advance payment bonds would rank equally in right of payment with the Notes.

Although the Indenture contains limitations on the amount of additional Debt that we and our Restricted Subsidiaries may incur, the amount of such additional Debt could be substantial. Such additional Debt may be secured by Liens. The persons holding such Liens may have rights and remedies with respect to the property subject to such Liens that, if exercised, could adversely affect the value of the Collateral or the ability of the Trustee to realize or foreclose on the Collateral.

Each Subsidiary Guarantee is a full and unconditional obligation of the relevant Subsidiary Guarantors subject only to limitations under applicable law.

Collateral

Our obligations under the Notes and the Indenture (including the Subsidiary Guarantees) are secured by a first ranking security interest over the Capital Stock of the Issuer and each of our Restricted Subsidiaries. Furthermore, the Indenture provides that neither we, nor any of our Restricted Subsidiaries, will create any Lien on our Capital Stock or the Capital Stock of any of our direct or indirect Restricted Subsidiaries, other than as permitted under the covenant described under "—Certain Covenants—Limitation on Liens." This security is enforceable by the Trustee, on behalf of the holders of the Notes, upon acceleration of the amounts due under the Indenture and the Notes following an Event of Default. HKH, a wholly-owned subsidiary of HKB and the Issuer's sole shareholder, and the Trustee have entered into a first ranking share pledge agreement (the "*HKO Share Pledge Agreement*") pursuant to which the Capital Stock of the Issuer has been pledged on a first ranking basis to secure the payment and performance when due of the obligations of the Issuer and the Subsidiary Guarantors under the Notes and the Indenture. The HKO Share Pledge Agreement is governed by German law. The Issuer and two of the Subsidiary Guarantors and the Trustee will enter into a series of first ranking share pledge agreements (the "*Subsidiary Share Pledge Agreements*" and, together with the HKO Pledge Share Pledge agreement, the "*Share Pledge Agreements*") pursuant to which the Capital Stock of each of our Restricted Subsidiaries has been pledged on a first ranking basis to secure the payment and performance when due of the obligations of the Issuer and the Subsidiary Guarantors under the Notes and the Indenture. The Subsidiary Share Pledge Agreements are governed by the law of the jurisdiction of incorporation or formation of the Restricted subsidiary Pledged.

Under German law, a security interest created pursuant to a pledge is only enforceable for the benefit of the creditor of the claim that is secured by the pledge. A third party, since it is not the creditor of the respective claim, cannot enforce the pledge. In order to ensure that the Trustee will have an independent claim secured by the pledge of the Capital Stock of the Issuer, the Issuer and each Subsidiary Guarantor has acknowledged, or will acknowledge, by way of an abstract acknowledgment of indebtedness that each and every obligation owed by it to the holders of the Notes under the Indenture also will be owing in full to the Trustee. Accordingly, the Trustee has its own independent right to demand payment and performance when due of all obligations under the Indenture and the Notes. Although this structure conforms to German market practice, it has not been tested in court and there is a risk that a German court may refuse to enforce the Share Pledge Agreements governed by German law. If a challenge to the validity or enforceability of the security interest created by one or more of such Share Pledge Agreements were successful, holders of the Notes might be unable to recover any amounts under such Share Pledge Agreements. Your ability to enforce the Subsidiary Share Pledge Agreements may be limited by the other laws. See "Risk Factors—Risks Relating to Our Debt and the Notes—Enforcing your rights as a holder of the Notes or under the Guarantees or the Collateral across multiple jurisdictions may prove difficult."

Release of Collateral

Each Share Pledge Agreement will be released upon legal defeasance or satisfaction and discharge of the Indenture as described under "—Legal Defeasance or Covenant Defeasance of Indenture" and "—Satisfaction and Discharge."

In addition a Subsidiary Share Pledge Agreement in respect of any Restricted Subsidiary will be released:

(i) in connection with any sale or other disposition of all the Capital Stock of that Restricted Subsidiary to a Person that is not (either before or after giving effect so such transaction) the Issuer or a Restricted Subsidiary, if the sale or other disposition does not violate the covenant described under "—Certain Covenants—Limitation on Sale of Certain Assets;"

(ii) if we designate that Restricted Subsidiary to be an Unrestricted Subsidiary in accordance with the applicable provisions of the Indenture; or

(iii) as described under the caption "—Amendment, Supplement and Waiver."

The HKO Share Pledge Agreement will be released:

(i) in connection with the Permitted HKB Merger; provided, however, that substantially simultaneously with the Permitted HKB Merger, the shareholders of the surviving entity pledge all of the shares in the surviving entity on a first ranking basis to secure the payment and performance when due of the obligations of the Issuer and the Subsidiary Guarantors under the Notes and the Indenture under a pledge agreement substantially consistent with the HKO Share Pledge Agreement;

(ii) in connection with any sale or other disposition of Capital Stock of the Issuer to a Person that is not (either before or after giving effect so such transaction) a Permitted Holder if not less than €50.0 million is received by the Issuer from the sale of Qualified Capital Stock or Subordinated Shareholder Debt (or contributed on account of outstanding Qualified Capital Stock) or through the repayment of Debt owed to the Issuer by HKB or a Permitted Holder; or

(iii) following a Public Equity Offering if not less than € 50.0 million is received by the Issuer from the sale of Qualified Capital Stock and/or the proceeds described in clause (b) of the definition of Public Equity Offering.

Subsidiary Guarantees

The Notes are guaranteed by the Subsidiary Guarantors. The Subsidiary Guarantees are joint and several obligations of the Subsidiary Guarantors. Each Subsidiary Guarantee is secured by the Collateral.

The Subsidiary Guarantee of a Subsidiary Guarantor will be released:

(i) in connection with any sale or other disposition of all or substantially all the assets of that Subsidiary Guarantor (including by way of merger or consolidation) to a Person that is not (either before or after giving effect to such transaction) the Issuer or a Restricted Subsidiary, if the sale or other disposition does not violate the covenant described under "—Certain Covenants—Limitation on Sale of Certain Assets;"

(ii) in connection with any sale or other disposition of all the Capital Stock of that Subsidiary Guarantor to a Person that is not (either before or after giving effect so such transaction) the Issuer or a Restricted Subsidiary, if the sale or other disposition does not violate the covenant described under "—Certain Covenants—Limitation on Sale of Certain Assets;"

(iii) if we designate that Subsidiary Guarantor to be an Unrestricted Subsidiary in accordance with the applicable provisions of the Indenture;

(iv) in the case of any Restricted Subsidiary that after the date of the Indenture is required to guarantee the Notes pursuant to the covenant described under "—Certain Covenants—Limitation on Guarantees of Debt by Restricted Subsidiaries," upon the release or discharge of the guarantee of Debt by such Restricted Subsidiary which resulted in the obligation to guarantee such Notes, so long as no Event of Default would arise as a result and no Debt of the Issuer or any Guarantor is at that time guaranteed by such Restricted Subsidiary;

(v) upon legal defeasance or satisfaction and discharge of the Indenture as described under "—Legal Defeasance or Covenant Defeasance of Indenture" and "—Satisfaction and Discharge;" or

(vi) as described under the caption "—Amendment, Supplement and Waiver."

Any Subsidiary Guarantees issued as described herein will be limited to an amount not to exceed the maximum amount that can be guaranteed by the applicable Subsidiary Guarantor by law or without rendering the guarantee, as it relates to such Subsidiary Guarantor, voidable under applicable law relating to fraudulent conveyance or fraudulent transfer or similar laws affecting the rights of creditors generally. However, under German or New York law, each of the guarantees may nevertheless be subject to a claim that the relevant guarantee should be limited, subordinated or voided in favor of existing or future creditors of the relevant Subsidiary Guarantor. While the guarantees by their terms are governed by New York law, if any such claim were to be made, it is unclear which law would be applied to the guarantees or what the outcome of any such claim would be. See "Risk Factors—Risks Relating to Our Debt and the Notes—Fraudulent conveyance laws may protect our creditors to your disadvantage" and "Risk Factors—Risks Relating to Our Debt and the Notes—The insolvency laws of Germany may not be as favorable to you as the bankruptcy laws of the jurisdiction with which you are familiar."

Reorganization

It is expected that, following the offering of the Notes, HKB will either establish a Fiscal Unity with the Issuer or enter into a Permitted HKB Merger. Under German law, it will not be possible to establish a Fiscal Unity if the covenant described under "—Certain Covenants—Limitation on Restricted Payments" below remains applicable to the Issuer.

In connection with the creation of a Fiscal Unity:

(i) HKB, together with any of its subsidiaries which are not the Issuer or Subsidiary Guarantors (collectively, the "*Parent Guarantors*") will guarantee as primary obligors and not merely as sureties, on a senior basis the full and punctual payment when due, whether at Stated Maturity, by acceleration or otherwise, of all payment obligations of the Issuer under the Indenture and the Notes, whether for payment of principal of or interest on or in respect of the Notes, fees, expenses, indemnification or otherwise;

(ii) the Permitted Guarantors will execute a supplemental Indenture under which they will agree to be bound by each of the covenants and other terms and conditions in the Indenture;

(iii) at the time of the establishment of a Fiscal Unity no Default or Event of Default then has occurred and is continuing or would occur as the result of such transaction;

(iv) at all times since the initial purchase of the HKB PIK Loans following the Issue Date, the HKB PIK Loans have been held by HKB and its Wholly Owned Subsidiaries; and

(v) the Parent Guarantors will certify that they have each complied with the covenants set forth under "—Certain Covenants—Limitation on Debt", "—Certain Covenants—Limitation on Restricted Payments", "—Certain Covenants—Limitation on Transactions with Affiliates" (other than in respect of transactions with the Issuer and its Restricted Subsidiaries) and "—Certain Covenants—Limitation on Liens" on a *pro forma* basis as if such covenants had applied to them from and after the Issue Date.

From and after the Reorganization Effectiveness Time (as defined below): (x) the Issuer and each Parent Guarantor (other than HKB), if any, shall be deemed to be a Restricted Subsidiary and HKB shall be deemed to be the Issuer for purposes of the restrictive covenants set forth under the heading "—Certain Covenants," (y) the terms of all such covenants shall be interpreted as if HKB had been the Issuer since the Issue Date, including with respect to any Restricted Payments made by HKB and its Restricted Subsidiaries and the calculation required under clause (b)(iii) described under "—Certain Covenants—Limitation on Restricted Payments" and (z) any dividend or other distribution to a Parent Guarantor (but for the avoidance of doubt not any subsequent dividend or distribution by HKB) shall be disregarded.

The Reorganization (as set forth above) shall be effective (the "Reorganization Effectiveness Time") upon delivery by the Issuer, substantially simultaneously as the steps above are completed, to the Trustee of an Officer's Certificate appending any requisite supplemental indenture and other related documents.

Additional Amounts

All payments that the Issuer makes under or with respect to the Notes or that the Subsidiary Guarantors make under or with respect to the Subsidiary Guarantees will be made free and clear of and without withholding or deduction for or on account of any present or future tax, duty, levy, impost, assessment or other governmental charge (including, without limitation, penalties, interest and other similar liabilities related thereto) of whatever nature (collectively, "*Taxes*") imposed or levied on such payments by or on behalf of any jurisdiction in which the Issuer or any Subsidiary Guarantor is incorporated, resident or doing business for tax purposes or from or through which any of the foregoing makes any payment on the Notes or with respect to the Subsidiary Guarantors by or within any department, political subdivision or governmental authority of or in any of the foregoing having power to tax (each, a "*Relevant Taxing Jurisdiction*"), unless the Issuer or such Subsidiary Guarantor, as the case may be, is required to withhold or deduct Taxes by law or by the interpretation or administration of law. If the Issuer or a Subsidiary Guarantor is required to withhold or deduct any amount for or on account of Taxes imposed or levied on behalf of a Relevant Taxing Jurisdiction from any payment made under or with respect to the Notes or any Subsidiary Guarantee, the Issuer or the Subsidiary Guarantor, as the case may be, will pay additional amounts ("*Additional Amounts*") as may be necessary to ensure that the net amount received by each holder of the Notes after such withholding or deduction (including any withholding or deduction in respect of any Additional Amounts) will not be less than the amount the holder would have received if such Taxes had not been withheld or deducted.

Neither the Issuer nor any Subsidiary Guarantor will, however, pay Additional Amounts in respect or on account of:

(a) any Taxes, to the extent such Taxes are imposed or levied by a Relevant Taxing Jurisdiction by reason of the holder's present or former connection with such Relevant Taxing Jurisdiction (other than the mere receipt, ownership, holding or disposition of Notes, or by reason of the receipt of any payments in respect of any Note or any Subsidiary Guarantee, or the exercise or enforcement of rights under any Notes or any Subsidiary Guarantee);

(b) any Taxes to the extent such Taxes are imposed or withheld by reason of the failure of the holder or beneficial owner of Notes, following the Issuer's written request addressed to the holder or beneficial owner, to comply with any certification, identification, information or other reporting requirements (to the extent such holder or beneficial owner is legally eligible to do so), whether required by statute, treaty, regulation or administrative practice of a Relevant Taxing Jurisdiction, as a precondition to exemption from, or reduction in the rate of deduction or withholding of, Taxes imposed by the Relevant Taxing Jurisdiction (including, without limitation, a certification that the holder or beneficial owner is not resident in the Relevant Taxing Jurisdiction);

(c) any estate, inheritance, gift, sales, transfer, personal property or similar Taxes;

(d) any Tax which is payable otherwise than by deduction or withholding from payments made under or with respect to the Notes or any Subsidiary Guarantee;

(e) any Tax imposed on or with respect to any payment by the Issuer or Subsidiary Guarantor to the holder if such holder is a fiduciary or partnership or person other than the sole beneficial owner of such payment to the extent that Taxes would not have been imposed on such payment had such holder been the sole beneficial owner of such Note;

(f) any Tax that is imposed on or with respect to a payment made to a holder or beneficial owner who would have been able to avoid such withholding or deduction by presenting the relevant Notes to another paying agent in a member state of the European Union;

(g) any Taxes, to the extent such Taxes were imposed as a result of the presentation of a Note for payment (where presentation is required) more than 30 days after the relevant payment is first made available to the holder (except to the extent that the holder would have been entitled to Additional Amounts had the Note been presented on the last day of such 30-day period); or

(h) any withholding or deduction in respect of any Taxes where such withholding or deduction is imposed on a payment to an individual and is required to be made pursuant to European Council Directive 2003/48/EC or any Directive implementing the conclusions of the ECOFIN Council meetings of November 26 and 27, 2000 on the taxation of savings income or any law implementing or complying with, or introduced in order to conform to, any such Directive.

The Issuer and the Subsidiary Guarantors will (i) make such withholding or deduction as is required by applicable law and (ii) remit the full amount deducted or withheld to the relevant authority in accordance with applicable law.

At least 30 calendar days prior to each date on which any payment under or with respect to the Notes or any Subsidiary Guarantee is due and payable, if the Issuer or a Subsidiary Guarantor will be obligated to pay Additional Amounts with respect to such payment (unless such obligation to pay Additional Amounts arises after the 30th day prior to the date on which payment under or with respect to the Notes or any Subsidiary Guarantee is due and payable, in which case it will be promptly thereafter), the Issuer will deliver to the Trustee an Officer's Certificate stating that such Additional Amounts will be payable and the amounts so payable and will set forth such other information necessary to enable the Trustee to pay such Additional Amounts to holders on the payment date. The Trustee shall be entitled to rely solely on such Officer's Certificate as conclusive proof that such payments are necessary. The Issuer will promptly publish a notice in accordance with the provisions set forth in "—Notices" stating that such Additional Amounts will be payable and describing the obligation to pay such amounts.

In addition, the Issuer and the Subsidiary Guarantors will pay any present or future stamp, issue, registration, court, documentary, excise or property taxes or other similar taxes, charges and duties, including without limitation, interest, penalties and other similar liabilities with respect thereto, imposed by any Relevant Taxing Jurisdiction in respect of (i) the execution, issue, delivery or registration of the Notes or any Subsidiary Guarantee or any other document or instrument referred to thereunder, or (ii) the receipt of any payments with respect to, or enforcement of, the Notes or any Subsidiary Guarantee.

Upon written request, the Issuer or a Subsidiary Guarantor will furnish to the Trustee or a holder within a reasonable time certified copies of tax receipts evidencing the payment by the Issuer or such Subsidiary Guarantor (as the case may be) of any Taxes imposed or levied by a Relevant Taxing Jurisdiction, in accordance with the procedures described in "—Notices" hereafter, in such form as provided in the normal course by the taxing authority imposing such Taxes. If, notwithstanding the efforts of the Issuer or Subsidiary Guarantor to obtain such receipts, the same are not obtainable, the Issuer or such Subsidiary Guarantor will provide the Trustee or such holder with other evidence reasonably satisfactory to the Trustee or holder of such payments by the Issuer or Subsidiary Guarantor. If requested in writing by the Trustee, the Issuer and (to the extent necessary) any Subsidiary Guarantors will provide to the Trustee such information as may be reasonably available to the Issuer and the Subsidiary Guarantors (and not otherwise in the possession of the Trustee) to enable determination of the amount of any withholding taxes attributable to any particular holder(s).

Whenever the Indenture or this "Description of the Notes" refers to, in any context, the payment of principal, premium, if any, interest or any other amount payable under or with respect to any Note (including payments thereof made pursuant to a Subsidiary Guarantee), such reference includes the payment of Additional Amounts, if applicable.

The preceding provisions will survive any termination, defeasance or discharge of the Indenture and shall apply *mutatis mutandis* to any jurisdiction in which any successor person to the Issuer or any Subsidiary Guarantor is incorporated, resident or doing business for tax purposes or any jurisdiction from or through which such person makes any payment on the Note (or any Subsidiary Guarantee) and any political subdivision or taxing authority or agency thereof or therein.

Currency Indemnity

Euro is the sole currency of account and payment for all sums payable under the Notes and the Indenture. Any amount received or recovered in respect of the Notes in a currency other than euro (whether as a result of, or of the enforcement of, a judgment or order of a court of any jurisdiction, in the winding-up or dissolution of our company, any Subsidiary or otherwise) by the Trustee or a holder of the Notes in respect of any sum expressed to be due to such holder from us will constitute a discharge of our obligation only to the extent of the euro amount which the recipient is able to purchase with the amount so received or recovered in such other currency on the date of that receipt or recovery (or, if it is not possible to purchase euro on that date, on the first date on which it is possible to do so). If the euro amount to be recovered is less than the euro amount expressed to be due to the recipient under any Note, we will indemnify the recipient against the cost of making such purchase. For the purposes of this paragraph, it will be sufficient for the holder to certify that it would have suffered a loss had the actual purchase of euro been made with the amount so received in that other currency on the date of receipt or recovery (or, if a purchase of euro on that date had not been possible, on the first on which it would have been possible). These indemnities, to the extent permitted by law:

(a) constitute a separate and independent obligation from our other obligations;

(b) give rise to a separate and independent cause of action;

(c) apply irrespective of any waiver granted by any holder; and

(d) will continue in full force and effect despite any other judgment, order, claim or proof for a liquidated amount in respect of any sum due under any Note or any other judgment or order.

Optional Redemption

Optional Redemption Prior to May 15, 2014

At any time prior to May 15, 2014, upon not less than 30 nor more than 60 days' notice, we may on any one or more occasions redeem up to 35% of the aggregate principal amount of Notes at a redemption price of 109.5% of their principal amount, plus accrued and unpaid interest, if any, to the redemption date, with the net proceeds received by us from one or more Equity Offerings. We may only do this, however, if:

(a) at least 65% of the aggregate principal amount of Notes that we initially issued would remain outstanding immediately after the proposed redemption; and

(b) the redemption occurs within 90 days after the closing of the Equity Offering.

At any time prior to May 15, 2014, we may also redeem all or part of the Notes at our option, upon not less than 30 nor more than 60 days' notice, at a redemption price equal to 100% of the principal amount thereof, plus the Applicable Redemption Premium and accrued and unpaid interest to the redemption date. We may provide in such notice that payment of such price and performance of our obligations with respect to such redemption or purchase may be performed by another Person.

"*Applicable Redemption Premium*" means with respect to any Note on any redemption date, the excess of:

(a) the present value at such redemption date of (x) the redemption price of such Note at May 15, 2014 (such redemption price being set forth in the table appearing below under the caption "Optional Redemption—Optional Redemption On or After May 15, 2014"), plus (y) all required scheduled interest payments that would otherwise be due to be paid on such Note during the period between the redemption date and at May 15, 2014 (excluding accrued but unpaid interest), computed using a discount rate equal to the Bund Rate at such redemption date plus 50 basis points; over

(b) the outstanding principal amount of such Note.

Calculation of the Applicable Redemption Premium will be made by us or on our behalf by such Person as we shall designate; *provided*, *however*, that such calculation shall not be a duty or obligation of the Trustee or any Paying Agent.

In addition, the Issuer may during each 12-month period ending July 31, 2012, July 31, 2013 and July 31, 2014 redeem up to 10% of the aggregate principal outstanding amount of the Notes at its option, upon not less than 30 nor more than 60 days' prior notice, at a redemption price equal to 103% of the principal amount of Notes redeemed, plus accrued and unpaid interest and Additional Amounts, if any, to the date of redemption (subject to the rights of holders of Notes on the relevant record date to receive interest on the relevant interest payment date).

Optional Redemption On or After May 15, 2014

At any time on or after May 15, 2014 and prior to maturity, we may redeem all or part of the Notes, as the case may be, at our option, upon not less than 30 nor more than 60 days' prior notice. These redemptions will be in amounts of €1,000, or integral multiples thereof at the following redemption prices (expressed as percentages of the principal amount at maturity), plus accrued and unpaid interest, if any, to the redemption date, if redeemed during the 12-month period commencing on May 15, of the years set forth below. This redemption is subject to the right of holders of record on the relevant regular record date that is prior to the redemption date to receive interest due on an interest payment date:

Year	**Redemption Price Notes**
2014	107.125%
2015	104.750%
2016	102.375%
2017 and thereafter	100.000%

Redemption upon Changes in Withholding Taxes

If, as a result of:

(a) any amendment to, or change in, the laws (or regulations or rulings promulgated thereunder) of any Relevant Taxing Jurisdiction which becomes effective after the date of the Indenture; or

(b) any amendment or change which becomes effective after the date of the Indenture in the official application or official interpretation of such laws, regulations or rulings (including by virtue of a holding, judgment or order by a court competent jurisdiction) of any Relevant Taxing Jurisdiction (each of the foregoing clauses (a) and (b), a "*Change in Tax Law*"),

the Issuer would be obligated to pay, on the next date for any payment and as a result of that amendment or change, Additional Amounts as described above under "—Additional Amounts" with respect to the Relevant Taxing Jurisdiction, which the Issuer cannot avoid by the use of reasonable measures available to it, then the Issuer may redeem all, but not less than all, of the Notes, at any time thereafter, upon not less than 30 nor more than 60 days' notice (which notice shall be irrevocable and given in accordance with the procedures described above under "—Notices"), at a redemption price of 100% of their principal amount, plus accrued and unpaid interest, if any, to the redemption date. Prior to the giving of any notice of the redemption described in this paragraph, the Issuer will deliver to the Trustee:

(a) an Officer's Certificate stating that the obligation to pay such Additional Amounts cannot be avoided by the Issuer's taking reasonable measures available to it; and

(b) a written opinion of independent tax counsel to the Issuer of recognized standing qualified under the laws of the Relevant Taxing Jurisdiction and reasonably satisfactory to the Trustee to the effect that the Issuer has or will become obligated to pay such Additional Amounts as a result of a Change in Tax Law.

Notwithstanding the foregoing, no such notice of redemption will be given (a) earlier than 90 days prior to the earliest date on which the Issuer would be obliged to make such payment of Additional Amounts if a payment in respect of the Notes, were then due and (b) unless at the time such notice is given, the obligation to pay Additional Amounts remains in effect.

We will publish a notice of any optional redemption of the Notes described above in accordance with the provisions of the Indenture described under "—Notices." Any notice of redemption may, in our discretion, be subject to the satisfaction of one or more conditions precedent.

Mandatory Redemption or Sinking Fund; Offers to Purchase; Open Market Purchases

We are not required to make any mandatory redemption or sinking fund payments with respect to the Notes. Under certain circumstances, however, we may be required to offer to purchase the Notes in accordance with the provisions of the Indenture described under "—Purchase of Notes upon a Change of Control" or "—Certain Covenants—Limitation on Sale of Certain Assets." We and our Restricted Subsidiaries may at any time and from time to time purchase Notes in the open market or otherwise.

Purchase of Notes upon a Change of Control

If a Change of Control occurs at any time, then we must make an offer (the "*Change of Control Offer*") to each holder of Notes to purchase such holder's Notes, in whole or in part in integral multiples of €1,000, *provided* that Notes of €100,000 or less may only be redeemed in whole and not in part, in each case, at a purchase price (the "*Change of Control Purchase Price*") in cash in an amount equal to 101% of the principal amount thereof, plus accrued and unpaid interest, if any, to the date of purchase (the "*Change of Control Purchase Date*") (subject to the rights of holders of record on relevant record dates to receive interest due on an interest payment date). Purchases made under a Change of Control Offer will also be subject to other procedures set forth in the Indenture.

Within 30 days following any Change of Control, we will:

(a) if and for so long as the Notes are listed on the Luxembourg Stock Exchange, publish a notice of the Change of Control Offer in a leading newspaper having general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, to the extent and in the manner permitted by such rules, post such notice on the official website of the Luxembourg Stock Exchange (*www.bourse.lu*); and

(b) send notice of the Change of Control Offer by first-class mail, with a copy to the Trustee, to each holder of Notes to the address of such holder appearing in the security register, which notice will state:

   (i) that a Change of Control has occurred, and the date it occurred;

   (ii) the circumstances and relevant facts regarding such Change of Control (including, but not limited to, and to the extent reasonably available, applicable information with respect to *pro forma* historical income, cash flow and capitalization after giving effect to such Change of Control);

   (iii) the Change of Control Purchase Price and the Change of Control Purchase Date, which will be a business day no earlier than 30 days nor later than 60 days from the date such notice is mailed, or such later date as is necessary to comply with requirements under the Exchange Act and any applicable securities laws or regulations;

   (iv) that any Note accepted for payment pursuant to the Change of Control Offer will cease to accrue interest after the Change of Control Purchase Date unless we fail to pay the Change of Control Purchase Price;

   (v) that any Note (or part thereof) not tendered will continue to accrue interest; and

   (vi) any other procedures that a holder of Notes must follow to accept a Change of Control Offer or to withdraw such acceptance.

(c) deliver or cause to be delivered to the Trustee the Notes properly accepted together with an Officer's Certificate stating the aggregate principal amount of Notes or portions of Notes being purchased by us.

The Trustee will promptly authenticate and deliver (or cause to be transferred by book entry) a new Note or Notes subject to receipt of the Officer's Certificate described in (c) above, equal in principal amount to any unpurchased portion of Notes surrendered, if any, to the holder of Notes in global form or to each holder of certificated Notes; *provided* that each such new Note will be in a principal amount of €100,000 and integral multiples of €1,000 in excess thereof. We will publicly announce the results of a Change of Control Offer on or as soon as practicable after the Change of Control Purchase Date.

Our ability to repurchase Notes pursuant to a Change of Control Offer may be limited by a number of factors. Our future indebtedness and future indebtedness of our Subsidiaries may also contain prohibitions of certain events that would require such indebtedness to be repurchased upon a Change of Control. Moreover, the exercise by the holders of the Notes of their right to require us to repurchase the Notes upon a Change of Control could cause a default under such indebtedness, even if the Change of Control itself does not, due to the possible financial effect on us of such repurchase.

We will not be required to make a Change of Control Offer upon a Change of Control if a third party makes the Change of Control Offer in the manner, at the times otherwise in compliance with the requirements set forth in the Indenture applicable to a Change of Control Offer made by us and purchases all Notes validly tendered and not withdrawn under such Change of Control Offer.

If we make a Change of Control Offer, we can provide no assurance that we will have available funds sufficient to pay the Change of Control Purchase Price for all the Notes that might be delivered by holders of the Notes seeking to accept the Change of Control Offer. If we fail to make or consummate a Change of Control Offer or pay the Change of Control Purchase Price when due such failure would result in an Event of Default and would give the Trustee and the holders of the Notes the rights described under "—Events of Default."

Even if sufficient funds were otherwise available, the terms of our other indebtedness may prohibit our prepayment of the Notes prior to their scheduled maturity. If we were not able to prepay any indebtedness containing any such restrictions or obtain requisite consents, we would be unable to fulfill our repurchase obligations to holders of Notes who exercise their repurchase rights following a Change of Control, which would cause a Default under the Indenture.

The Change of Control provisions described above are applicable whether or not any other provisions of the Indenture are applicable. Except as described above with respect to a Change of Control, the provisions of the Indenture do not give holders the right to require us to repurchase the Notes in the event of certain highly leveraged transactions, or certain other transactions, including a reorganization, restructuring, merger or similar transaction and, in certain circumstances, an acquisition by our management or their Affiliates, that may adversely affect holders of the Notes, if such transaction is not a transaction defined as a Change of Control. Any such transaction, however, would have to comply with the applicable provisions of the Indenture, including the "Limitation on Debt" covenant.

We will comply with the applicable tender offer rules, including Rule l4e-l under the Exchange Act, and any other applicable securities laws and regulations (including those of the United States and Germany) in connection with a Change of Control Offer. To the extent that the provisions of any securities laws or regulations conflict with provisions of the Indenture, we will comply with the applicable securities laws and regulations and will not be deemed to have breached our obligations under the Indenture by virtue of such conflict.

Certain Covenants

The Indenture contains, among others, the following covenants.

Limitation on Debt

(a) We will not, and will not permit any Restricted Subsidiary to, create, issue, incur, assume, guarantee or in any manner become directly or indirectly liable with respect to or otherwise become responsible for, contingently or otherwise, the payment of (individually and collectively, to "*incur*" or, as appropriate, an "*incurrence*"), any Debt (including any Acquired Debt) unless no Default or Event or Default would occur or be continuing after giving effect on a *pro forma* basis to such incurrence of Debt, and at the time of such incurrence and after giving *pro forma* effect to the application of the proceeds thereof the Consolidated Fixed Charge Coverage Ratio for the four full fiscal quarters for which financial statements are available immediately preceding the incurrence of such Debt, taken as one period, would be greater than 2.0 to 1.0.

(b) This covenant will not, however, prohibit the following (collectively, "*Permitted Debt*"):

(i) the incurrence by us or any Restricted Subsidiary of Debt under Credit Facilities and any Permitted Refinancing Debt incurred to renew, refund, refinance, replace, defease or discharge any Debt incurred pursuant to this clause (i) in an aggregate principal amount at any one time outstanding not to exceed the greater of (x) €30.0 million and (y) an amount equal to 45% of Total Inventories, *plus* in the case of any refinancing of any Debt permitted under this clause (i) or any portion thereof, the aggregate amount of fees, underwriting discounts, premiums and other costs and expenses incurred in connection with such refinancing, *minus* the amount of any permanent repayments or prepayment of such Debt with the proceeds of Asset Sales made in accordance with "—Limitation on Sale of Certain Assets" (but only to the extent of any corresponding commitment reduction if such Debt is revolving credit borrowings);

(ii) the incurrence by us of Debt pursuant to the Notes (other than Additional Notes);

(iii) any Debt of ours or any Restricted Subsidiary (other than Debt described in another clause of this paragraph) outstanding on the date of the Indenture;

(iv) the incurrence by us or any Restricted Subsidiary of intercompany Debt between us or any Restricted Subsidiary or between or among Restricted Subsidiaries; *provided* that

(1) if we are the obligor on any such Debt, unless required by a Credit Facility, it is (x) unsecured and (y) is subordinated in right of payment from and after such time as the Notes shall become due and payable (whether upon Stated Maturity, acceleration or otherwise) to the payment and performance of our obligations under the Notes; and

(2) (x) any disposition, pledge or transfer of any such Debt to a Person (other than a disposition, pledge or transfer to us or a Restricted Subsidiary) and (y) any transaction pursuant to which any Restricted Subsidiary that has Debt owing to us or another Restricted Subsidiary ceases to be a Restricted Subsidiary, will, in each case, be deemed to be an incurrence of such Debt not permitted by this clause (iv);

(v) guarantees of our Debt or Debt of any Restricted Subsidiary by any Restricted Subsidiary that are permitted by and made in accordance with the provisions of the "Limitation on Guarantees of Debt by Restricted Subsidiaries" covenant described below;

(vi) the incurrence by us or any Restricted Subsidiary of Debt arising from agreements providing for guarantees, indemnities or obligations in respect of purchase price adjustments in connection with the acquisition or disposition of assets, including, without limitation, shares of Capital Stock, other than guarantees or similar credit support given by us or any Restricted Subsidiary of Debt incurred by any Person acquiring all or any portion of such assets for the purpose of financing such acquisition, *provided* that the maximum aggregate liability in respect of all such Debt permitted pursuant to this clause (other than for title, environmental or tax warranties or indemnities) will at no time exceed the net proceeds, including non-cash proceeds (the Fair Market Value of such non-cash proceeds being measured at the time received and without giving effect to any subsequent changes in value) actually received from the sale of such assets or in the case of an acquisition, the Fair Market Value of any assets or capital stock acquired;

(vii) the incurrence by us or any Restricted Subsidiary of Debt under Currency Agreements, directly related to transactions entered into in the ordinary course of business and not for speculative purposes;

(viii) the incurrence by us or any Restricted Subsidiary of Debt under one or a related series of Interest Rate Agreements entered into for the purpose of limiting interest rate risk; *provided* that such Interest Rate Agreement or Interest Rate Agreements are not entered into for speculative purposes, other than obligations outstanding by reason of any reasonable fees, indemnities and compensation payable thereunder;

(ix) the incurrence by us or any Restricted Subsidiary of Debt represented by Capitalized Lease Obligations, mortgage financings or purchase money obligations, or other Debt incurred or assumed in connection with the acquisition or development of real or personal, movable or immovable, property or assets in each case incurred for the purpose of financing or refinancing all or any part of the purchase price, lease expense or cost of construction or improvement of property used in our or any Restricted Subsidiary's business (including any reasonable related fees or expenses incurred in connection with such acquisition or development); *provided* that (a) the principal amount of such Debt so incurred when aggregated with other Debt previously incurred in reliance on this clause (ix) and still outstanding shall not in the aggregate exceed the greater of € 10.0 million or 3.0% of total assets, and (b) the total principal amount of any Debt incurred in connection with an acquisition or development permitted under this clause (ix) did not in each case at the time of incurrence exceed (1) the Fair Market Value of the acquired or constructed asset or improvement so financed or (2) in the case of an uncompleted constructed asset, the amount of the asset to be constructed, as determined on the date the contract for construction of such asset was entered into by us or the relevant Restricted Subsidiary (including, in each case, any reasonable related fees and expenses incurred in connection with such acquisition, construction or development);

(x) the incurrence of Debt by us or any Restricted Subsidiary of Debt in respect of workers' compensation and claims arising under similar legislation, or pursuant to self-insurance obligations or similar requirements, in each case arising in the ordinary course of business;

(xi) the incurrence of Debt by us or any Restricted Subsidiary arising from: (1) the honoring by a bank or other financial institution of a check, draft or similar instrument inadvertently (except in the case of daylight overdrafts) drawn against insufficient funds in the ordinary course of business; *provided* that such Debt is extinguished within 15 business days of incurrence, (2) bankers' acceptances, performance, surety, judgment, appeal or similar bonds, instruments or obligations; and (3) completion guarantees provided or letters of credit obtained by us or any Restricted Subsidiary in the ordinary course of business;

(xii) the incurrence of Debt by us or any Restricted Subsidiary (other than and in addition to Debt permitted under clauses (i) through (xi) above and clauses (xiii) and (xiv) below) in an aggregate principal amount at any one time outstanding not to exceed €10.0 million;

(xiii) the incurrence by a Person of Permitted Refinancing Debt in exchange for or the net proceeds of which are used to refund, replace or refinance Debt incurred by it pursuant to, or described in, paragraphs (a), (b)(ii) and (b)(iii) of this covenant, as the case may be; and

(xiv) the incurrence of Debt in the ordinary course of business by a bank to facilitate the operation of bank accounts of ours and our Restricted Subsidiaries maintained with such a bank on a net balance basis where such balances arise in connection with ordinary banking arrangements to manage cash balances of ours and our Restricted Subsidiaries as a group and not for the purpose of obtaining net external financing.

(c) For purposes of determining compliance with any restriction on the incurrence of Debt in euro where Debt is denominated in a different currency, the amount of such Debt will be the Euro Equivalent determined on the date of such incurrence (or, in the case of first commitment, in the case of revolving credit Debt), *provided* that if any such Debt denominated in a different currency is subject to a Currency Agreement (with respect to euro) covering principal amounts payable on such Debt, the amount of such Debt expressed in euro will be adjusted to take into account the effect of such agreement. The principal amount of any Permitted Refinancing Debt incurred in the same currency as the Debt being refinanced will be the Euro Equivalent of the Debt refinanced determined on the date such Debt being refinanced was initially incurred. Notwithstanding any other provision of this covenant, for purposes of determining compliance with the "Limitation on Debt" covenant, increases in Debt solely due to fluctuations in the exchange rates of currencies will not be deemed to exceed the maximum amount that we or a Restricted Subsidiary may incur under the "Limitation on Debt" covenant.

(d) For purposes of determining any particular amount of Debt under the "Limitation on Debt" covenant:

(i) guarantees, Liens or obligations with respect to letters of credit supporting, or bankers acceptances or other similar instruments relating to, Debt otherwise included in the determination of such particular amount will not be included;

(ii) any Liens granted pursuant to the equal and rateable provisions referred to in the "Limitation on Liens" covenant will not be treated as Debt; and

(iii) accrual of interest, accrual of dividends, the accretion of accreted value, the obligation to pay commitment fees and the payment of interest in the form of additional Debt will not be treated as Debt.

(e) In the event that an item of Debt meets the criteria of more than one of the types of Debt described in the "Limitation on Debt" covenant, we, in our sole discretion, will classify items of Debt and will only be required to include the amount and type of such Debt in one of such clauses and we will be entitled to divide and classify an item of Debt in more than one of the types of Debt described in the "Limitation on Debt" covenant, and may change the classification of an item of Debt (or any portion thereof) to any other type of Debt described in the "Limitation on Debt" covenant at any time.

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Limitation on Restricted Payments

(a) We will not, and will not permit any Restricted Subsidiary to, directly or indirectly, take any of the following actions (each of which is a "*Restricted Payment*" and which are collectively referred to as "*Restricted Payments*"):

(i) declare or pay any dividend on or make any distribution (whether made in cash, securities or other property) with respect to any of our or the Restricted Subsidiaries' Capital Stock (including, without limitation, any loan to shareholders or any payment in connection with any merger or consolidation involving us or any Restricted Subsidiary) (other than (1) to us or any Wholly Owned Restricted Subsidiaries or (2) to all holders of Capital Stock of such Restricted Subsidiary on a *pro rata* basis or on a basis that results in the receipt by us or a Restricted Subsidiary of dividends or distributions of greater value than it would receive on a *pro rata* basis) except for dividends or distributions payable solely in shares of our or Qualified Capital Stock or in options, warrants or other rights to acquire such shares of Qualified Capital Stock;

(ii) purchase, redeem or otherwise acquire or retire for value (including, without limitation, in connection with any merger or consolidation), directly or indirectly, any shares of our Capital Stock or any Parent or any options, warrants or other rights to acquire such shares of Capital Stock;

(iii) make any principal payment on, or repurchase, redeem, defease or otherwise acquire or retire for value, prior to any scheduled principal payment, sinking fund payment or Stated Maturity, any Subordinated Debt (other than in anticipation of satisfying a sinking fund obligation, principal installment or final maturity due within 30 days of such payment, repurchase, redemption, defeasance acquisition or retirement); or

(iv) make any Investment (other than any Permitted Investment) in any Person.

If any Restricted Payment described above is not made in cash, we will calculate the amount of the proposed Restricted Payment at the Fair Market Value of the asset to be transferred.

(b) Notwithstanding paragraph (a) above, we may make a Restricted Payment if, at the time of and after giving *pro forma* effect to, such proposed Restricted Payment:

(i) no Default or Event of Default has occurred and is continuing and such Restricted Payment will not be an event that is or, after notice of lapse of time or both, would be, an "event of default" under the terms of any Debt of any Restricted Subsidiary;

(ii) we could incur at least €1.00 of additional Debt (other than Permitted Debt) pursuant to the "Limitation on Debt" covenant; and

(iii) the aggregate amount of all Restricted Payments declared or made after the date of the Indenture does not exceed the sum of:

(1) 50% of our aggregate Consolidated Adjusted Net Income on a cumulative basis during the period beginning on the date of the Indenture and ending on the last day of our last fiscal quarter ending prior to the date of such proposed Restricted Payment (or, if such aggregate cumulative Consolidated Adjusted Net Income shall be a negative number, *minus* 100% of such negative amount); *plus*

(2) the aggregate Net Cash Proceeds received by us after the date of the Indenture as capital contributions or from the issuance or sale (other than to any Subsidiary) of Subordinated Shareholder Debt or shares of our Qualified Capital Stock (including upon the exercise of options, warrants or rights) or warrants, options or rights to purchase shares of our Qualified Capital Stock (except, in each case to the extent such proceeds are used to purchase, redeem or otherwise retire Capital Stock or Subordinated Debt as set forth in (ii) or (iii) of paragraph (c) below) (excluding the Net Cash Proceeds from the issuance of Subordinated Shareholder Debt or our

Qualified Capital Stock financed, directly or indirectly, using funds borrowed from us or any Subsidiary until and to the extent such borrowing is repaid and excluding Excluded Cash Contributions), *plus*

(3) (x) the amount by which our Debt or Debt of any Restricted Subsidiary is reduced on our consolidated balance sheet after the date of the Indenture upon the conversion or exchange (other than by us or our Subsidiary) of such Debt into our Qualified Capital Stock, and (y) the aggregate Net Cash Proceeds received after the date of the Indenture by us from the issuance or sale (other than to any Subsidiary) of Redeemable Capital Stock that has been converted into or exchanged for our Qualified Capital Stock, to the extent such Redeemable Capital Stock was originally sold for cash or Cash Equivalents, together with, in the cases of both (x) and (y), the aggregate net cash proceeds received by us at the time of such conversion or exchange (excluding the Net Cash Proceeds from the issuance of our Qualified Capital Stock financed, directly or indirectly, using funds borrowed from us or any Subsidiary until and to the extent such borrowing is repaid), *plus*

(4) (x) in the case of the disposition or repayment of any Investment constituting a Restricted Payment made after the date of the Indenture, an amount (to the extent not included in Consolidated Adjusted Net Income) equal to the lesser of the return of capital with respect to such Investment and the initial amount of such Investment, in either case, less the cost of the disposition of such Investment and net of taxes, and (y) in the case of the designation of an Unrestricted Subsidiary as a Restricted Subsidiary (as long as the designation of such Subsidiary as an Unrestricted Subsidiary was deemed a Restricted Payment), the Fair Market Value of our interest in such Subsidiary *provided* that such amount will not in any case exceed the amount of the Restricted Payment deemed made at the time that the Subsidiary was designated as an Unrestricted Subsidiary.

(c) Notwithstanding paragraphs (a) and (b) above, we and any Restricted Subsidiary may take the following actions so long as (with respect to clauses (ii) through (vi) and (viii) below) no Default or Event of Default has occurred and is continuing:

(i) the payment of any dividend within 60 days after the date of its declaration if at such date of its declaration such payment would have been permitted by the provisions of paragraph (a)(i) above;

(ii) the purchase, redemption or other acquisition or retirement for value of any shares of our Capital Stock or options, warrants or other rights to acquire such Capital Stock in exchange for (including any such exchange pursuant to the exercise of a conversion right or privilege in connection with which cash is paid in lieu of the issuance of fractional shares or scrip), or out of the Net Cash Proceeds of a substantially concurrent issuance and sale (other than to a Subsidiary) of, shares of our Qualified Capital Stock or options, warrants or other rights to acquire such Capital Stock;

(iii) the purchase, redemption, defeasance or other acquisition or retirement for value or payment of principal of any Subordinated Debt in exchange for, or out of the Net Cash Proceeds of a substantially concurrent issuance and sale (other than to a Subsidiary) of, shares of our Qualified Capital Stock;

(iv) the purchase, redemption, defeasance or other acquisition or retirement for value of Subordinated Debt (other than Redeemable Capital Stock) in exchange for, or out of the Net Cash Proceeds of a substantially concurrent incurrence (other than to a Subsidiary) of, Permitted Refinancing Debt;

(v) the repurchase of Capital Stock deemed to occur upon the exercise of stock options if the cumulative aggregate value of such repurchases does not exceed the cumulative aggregate amount of the exercise price of such options received;

(vi) payments or distributions to dissenting shareholders pursuant to applicable law in connection with or in contemplation of a merger, consolidation or transfer of assets that complies with the provisions of the Indenture relating to mergers, consolidations or transfers of substantially all of our assets;

(vii) cash payments in lieu of issuing fractional shares pursuant to the exercise or conversion of any exercisable or convertible securities;

(viii) any other Restricted Payment, *provided* that the total aggregate amount of Restricted Payments made under this clause (viii) does not exceed €5.0 million;

(ix) following a Public Equity Offering, the payment of dividends on the Capital Stock of HKO up to 6% per annum of the aggregate net cash proceeds received by HKO in any such Public Equity Offering or subsequent Public Equity Offering; provided, that if such Public Equity Offering was of Capital Stock of HKB, the net proceeds of any such dividend to HKB are used to fund a corresponding dividend in equal or greater amount on the Capital Stock of HKB; and

(x) dividends, loans, advances or distributions to any Parent or other payments by us or any Restricted Subsidiary in amounts equal to (without duplication) the amounts required for any Parent to pay any Parent Expenses.

The actions described in clauses (i), (vi) and (vii) of this paragraph (c) are Restricted Payments that will be permitted to be made in accordance with this paragraph (c) but that reduce the amount that would otherwise be available for Restricted Payments under clause (iii) of paragraph (b) above.

Limitation on Issuances and Sales of Capital Stock of Restricted Subsidiaries

We will not sell, pledge, or otherwise dispose of, and will not permit any Restricted Subsidiary (other than as permitted under the "Limitation on Liens" covenant), directly or indirectly, to issue or sell, any shares of Capital Stock of a Restricted Subsidiary (including options, warrants or other rights to purchase shares of such Capital Stock). The foregoing sentence, however, will not apply to:

(a) issuances or sales to us or a Wholly Owned Restricted Subsidiary;

(b) issuances or sales to directors of directors' qualifying shares or issuances or sales to nationals of shares of Capital Stock of Restricted Subsidiaries, in each case to the extent required by applicable law;

(c) any issuance or sale of Capital Stock of a Restricted Subsidiary if, immediately after giving effect to such issuance or sale such Restricted Subsidiary would no longer constitute a Restricted Subsidiary and any remaining Investment in such Person would have been permitted to be made under the "Limitation on Restricted Payments" covenant if made on the date of such issuance or sale;

(d) Capital Stock issued by a Person prior to the time:

(i) such Person becomes a Restricted Subsidiary,

(ii) such Person merges with or into a Restricted Subsidiary, or

(iii) a Restricted Subsidiary merges with or into such Persons;

but only if that Capital Stock was not issued or incurred by such Person in anticipation of it becoming a Restricted Subsidiary.

Limitation on Transactions with Affiliates

We will not, and will not permit any Restricted Subsidiary to, directly or indirectly, enter into or suffer to exist any transaction or series of related transactions (including, without limitation, the sale, purchase, exchange or lease of assets or property or the rendering of any service), with, or for the benefit of, any Affiliate of ours or any Restricted Subsidiary's Affiliate or any direct or indirect holder or any Affiliate of such holder of 10% or more of any class of our or any Restricted Subsidiary's Capital Stock unless such transaction or series of transactions is entered into in good faith and in writing and:

(a) such transaction or series of transactions is on terms that are no less favorable to us or such Restricted Subsidiary, as the case may be, than those that could have been obtained in a comparable arm's length transactions with third parties that are not such holders or Affiliates;

(b) with respect to any transaction or series of related transactions involving aggregate payments or the transfer of assets or provision of services, in each case having a value greater than €7.5 million, we will deliver a resolution of our advisory board (set out in an Officer's Certificate to the Trustee) resolving that such transaction complies with clause (a) above and that the fairness of such transaction has been approved by a majority of the Disinterested Members (or in the event there is only one Disinterested Member, by such Disinterested Member) of our advisory board; and

(c) with respect to any transaction or series of related transactions involving aggregate payments or the transfer of assets or the provision of services, in each case having a value greater than €15.0 million, we will deliver to the Trustee a written opinion of an investment banking firm of international standing (or, if an investment banking firm is generally not qualified to give such an opinion, by an internationally recognized appraisal firm or accounting firm) stating that the transaction or series of transactions is fair to us or such Restricted Subsidiary from a financial point of view.

Notwithstanding the foregoing, the restrictions set forth in this description will not apply to:

(i) customary directors' fees, indemnification and similar arrangements, consulting fees, employee salaries bonuses, employment agreements and arrangements, compensation or employee benefit arrangements, including stock options, or legal fees, so long as our advisory board has approved the terms thereof and deemed the services theretofore or thereafter to be performed for such compensation or payments to be fair consideration therefor;

(ii) any Restricted Payments not prohibited by the "Limitation on Restricted Payments" covenant;

(iii) loans and advances (but not any forgiveness of such loans or advances) to our or any Restricted Subsidiary's officers, directors and employees for travel, entertainment, moving and other relocation expenses, in each case made in the ordinary course of business, *provided* that such loans and advances do not exceed €2.0 million in the aggregate at any one time outstanding;

(iv) agreements and arrangements existing on the date of the Indenture and any amendment or modifications thereto, *provided* that any amendments or modifications to the terms thereof are not more disadvantageous to the holders of the Notes and to us or our Restricted Subsidiary, as applicable, in any material respect than the original agreement as in effect on the date of the Indenture and *provided*, *further*, that such amendment or modification is (x) on a basis substantially similar to that which would be conducted in an arm's length transaction with third parties who are not Affiliates and (y) in the case of any transaction having a Fair Market Value of greater than €7.5 million, approved by our advisory board (including a majority of the Disinterested Members);

(v) any payments or other transactions pursuant to a tax sharing agreement between us and any other Person with which we file a consolidated tax return or with which we are part of a consolidated group for tax purposes or any tax advantageous group contribution made pursuant to applicable legislation;

(vi) the issuance of securities pursuant to, or for the purpose of the funding of, employment arrangements, stock options, and stock ownership plans, restricted stock plans, long-term incentive plans, stock appreciation rights plans, participation plans or similar employee benefit plans, as long as the terms thereof are or have been previously approved by our advisory board;

(vii) the granting and performance of registration rights for our securities;

(viii) transactions between or among us and Restricted Subsidiaries or among Restricted Subsidiaries;

(ix) the Permitted HKB Merger or the establishment of a Fiscal Unity in accordance with the terms of the Indenture; and

(x) investments made pursuant to clause (s) of the definition of Permitted Investments.

Limitation on Liens

We will not, and will not permit any Restricted Subsidiary to, directly or indirectly, create, incur, assume or suffer to exist any Lien of any kind (except for Permitted Liens) or assign or otherwise convey any right to receive any income, profits or proceeds on or with respect to any of our or any Restricted Subsidiary's property or assets, including any shares of stock or Debt of any Restricted Subsidiary, whether owned at or acquired after the date of the Indenture, or any income, profits or proceeds therefrom (the "*Initial Lien*") unless:

(a) in the case of any Lien securing Subordinated Debt, our obligations in respect of the Notes, and all other amounts due under the Indenture are directly secured by a Lien on such property, assets or proceeds that is senior in priority to such Lien; and

(b) in the case of any other Lien, our obligations in respect of the Notes and all other amounts due under the Indenture are equally and rateably secured with the obligation or liability secured by such Lien.

Any Lien created for the benefit of the holders pursuant to this covenant will provide by its terms that such Lien will be automatically and unconditionally released and discharged (a) upon the release and discharge of the Initial Lien other than as a consequence of an enforcement action with respect to the assets subject to such Lien or (b) as set forth under the heading "—Collateral."

Impairment of Security Interest

(a) We will not, and will not permit any Restricted Subsidiary to, take or knowingly or negligently omit to take, any action which action or omission might or would have the result of materially impairing the security interest with respect to the Collateral for the benefit of the Trustee and the holders of the Notes, and the Issuer will not, and will not permit any Restricted Subsidiary to, grant to any Person other than the Trustee, for the benefit of the Trustee and the holders of the Notes, any interest whatsoever in any of the Collateral, except (i) subject to paragraph (b) we may incur Permitted Collateral Liens and (ii) the security interest in the Collateral may be released in accordance with the terms of the Indenture (including, without limitation, in connection with a Permitted HKB Merger).

(b) The Indenture will provide that, at our discretion and without the consent of the holders of the Notes, the Trustee may from time to time enter into one or more amendments to the Security Documents to: (1) cure any ambiguity, omission, defect or inconsistency therein, (2) provide for Permitted Collateral Liens, (3) add to the Collateral or (4) make any other change thereto that does not adversely affect the holders in any material respect; *provided*, *however*, that no Security Document may be amended, extended, renewed, restated, supplemented or otherwise modified or replaced, unless contemporaneously with such amendment, extension, renewal, restatement, supplement, modification or renewal, we deliver to the Trustee either:

    (i) a solvency opinion, in form reasonably satisfactory to the Trustee, from an investment banking firm, appraisal firm or accounting firm of international standing confirming our solvency, together with our Subsidiaries, taken as a whole, after giving effect to any transactions related to such amendment, extension, renewal, restatement, supplement, modification or replacement;

    (ii) a certificate from our advisory board or finance director (acting in good faith) substantially in the form attached to the Indenture confirming our solvency, together with our Subsidiaries taken as a whole, after giving effect to any transactions related to such amendment, extension, renewal, restatement, supplement or replacement which certificate shall be substantially in the form attached to the Indenture; or

    (iii) an opinion of counsel, in form satisfactory to the Trustee, confirming that, after giving effect to any transactions related to such amendment, extension, renewal, restatement, supplement, modification or replacement, the Lien or Liens securing the Notes created under the Security Documents so amended, extended, renewed, restated, supplemented, modified or replaced are valid and perfected Liens not otherwise subject to any limitation imperfection or new hardening period, in equity or at law, that such Lien or Liens were not otherwise subject to immediately prior to such amendment, extension, renewal, restatement, supplement, modification or replacement.

If we comply with this covenant, the Trustee will (subject to customary protections and indemnifications) consent to such amendment, extension, renewal, restatement, supplement, modification or replacement.

Limitation on Sale of Certain Assets

(a) We will not, and will not permit any Restricted Subsidiary to, engage in any Asset Sale unless:

    (i) the consideration we or such Restricted Subsidiary receives for such Asset Sale is not less than the Fair Market Value of the assets sold (as determined by our advisory board or, in the case of any Asset Sale having a Fair Market Value greater than €7.5 million, as determined by our advisory board and evidenced by a resolution of our advisory board);

(ii) at least 75% of the consideration we or the relevant Restricted Subsidiary receives in respect of such Asset Sale consists of (1) cash (including any Net Cash Proceeds received from the conversion within 90 days of such Asset Sale of securities received in consideration of such Asset Sale); (2) Cash Equivalents; (3) the assumption by the purchaser of (x) our Debt or Debt of any Restricted Subsidiary (other than Subordinated Debt) as a result of which neither we nor the Restricted Subsidiaries remain obligated in respect of such Debt or (y) Debt of a Restricted Subsidiary that is no longer a Restricted Subsidiary as a result of such Asset Sale, if we are and each other Restricted Subsidiary is released from any guarantee of such Debt as a result of such Asset Sale; or (4) a combination of the consideration specified in clauses (1) to (3); and

(iii) we deliver an Officer's Certificate to the Trustee certifying that such Asset Sale complies with the provisions described in the foregoing clauses (i) and (ii).

(b) If we or any Restricted Subsidiary engages in an Asset Sale, we or such Restricted Subsidiary may use the Net Cash Proceeds of the Asset Sale, within 360 days after such Asset Sale, to permanently repay or prepay any then-outstanding secured Pari Passu Debt of any Restricted Subsidiary (and to effect a corresponding commitment reduction if such Debt is revolving credit borrowings) owing to a Person other than us or a Restricted Subsidiary, or (ii) invest in properties and assets to replace the properties and assets that were the subject of the Asset Sale or in Related Business Assets, or (iii) any combination of the foregoing. The amount of such Net Cash Proceeds not so used as set forth in this paragraph (b) constitutes "*Excess Proceeds*." Pending the final application of any such Net Cash Proceeds, we may temporarily reduce revolving credit borrowings or otherwise invest such Net Cash Proceeds in any manner that is not prohibited by the terms of the Indenture.

(c) When the aggregate amount of Excess Proceeds exceeds € 15.0 million, we will, within 5 business days, make an offer to purchase (an "*Excess Proceeds Offer*") from all holders of Notes and from the holders of any Pari Passu Debt, to the extent required by the terms thereof, on a *pro rata* basis, in accordance with the procedures set forth in the Indenture or the agreements governing any such Pari Passu Debt, the maximum principal amount (expressed as an integral multiple of € 1,000 of the Notes and any such Pari Passu Debt that may be purchased with the amount of Excess Proceeds. The offer price as to each Note and any such Pari Passu Debt will be payable in cash in an amount equal to (solely in the case of the Notes) 100% of the principal amount of such Note and (solely in the case of Pari Passu Debt) no greater than 100% of the principal amount (or accreted value, as applicable) of such Pari Passu Debt, plus in each case accrued interest, if any, to the date of purchase.

To the extent that the aggregate principal amount of Notes and any such Pari Passu Debt tendered pursuant to an Excess Proceeds Offer is less than the amount of Excess Proceeds, we may use the amount of such Excess Proceeds not used to purchase Notes and Pari Passu Debt for general corporate purposes that are not otherwise prohibited by the Indenture. If the aggregate principal amount of Notes and any such Pari Passu Debt validly tendered and not withdrawn by holders thereof exceeds the amount of Excess Proceeds, the Notes and any such Pari Passu Debt to be purchased will be selected on a pro rata basis (based upon the principal amount of Notes and the principal amount or accreted value of such Pari Passu Debt tendered by each holder). Upon completion of such Excess Proceeds Offer, the amount of Excess Proceeds will be reset to zero.

(d) If we are obligated to make an Excess Proceeds Offer, we will purchase the Notes and Pari Passu Debt, at the option of the holders thereof, in whole or in part in integral multiples of €1,000, on a date that is not earlier than 30 days and not later than 60 days from the date the notice of the Excess Proceeds Offer is given to such holders, or such later date as may be required under the Exchange Act. No Notes of € 100,000 or less, may be purchased in part.

If we are required to make an Excess Proceeds Offer, we will comply with the applicable tender offer rules, including Rule 14e-1 under the Exchange Act, and any other applicable securities laws and regulations.

Notwithstanding any of the foregoing, we or any Restricted Subsidiary may engage in an Asset Swap and the provisions in clauses (b), (c) and (d) above shall not apply to such Asset Swap except in respect of any Net Cash Proceeds received by us or any Restricted Subsidiary; *provided* that we will not, and will not permit any Restricted Subsidiary to, engage in any Asset Swap, unless:

(i) at the time of entering into such Asset Swap and immediately after giving effect to such Asset Swap, no Default or Event of Default shall have occurred and be continuing or would occur as a consequence thereof; and

(ii) with respect to any Asset Swap involving the transfer of assets having a value greater than €7.5 million, as determined by our advisory board and evidenced by a resolution of our advisory board, we deliver a resolution of our advisory board (set out in an Officer's Certificate to the Trustee) resolving that the fairness of such Asset Swap has been approved by a majority of the Disinterested Members (or in the event there is only one Disinterested Member, by such Disinterested Member) of our advisory board.

Limitation on Guarantees of Debt by Restricted Subsidiaries

(a) We will not permit any Restricted Subsidiary, directly or indirectly, to guarantee, assume or in any other manner become liable for the payment of any of our Debt (other than the Notes), unless such Restricted Subsidiary simultaneously executes and delivers a supplemental Indenture to the Indenture providing for a guarantee of payment of the Notes by such Restricted Subsidiary on the same terms as the guarantee of such Debt.

This paragraph (a) will not be applicable to any guarantees of any Restricted Subsidiary:

(i) incurred under clause (i) of the definition of "Permitted Debt"; or

(ii) that existed at the time such Person became a Restricted Subsidiary if the guarantee was not incurred in connection with, or in contemplation of, such Person becoming a Restricted Subsidiary.

(b) Notwithstanding the foregoing, any guarantee of the Notes created pursuant to the provisions described in the foregoing paragraph (a) may provide by its terms that it will be automatically and unconditionally released and discharged upon:

(i) any sale, exchange or transfer, to any Person who is not our Affiliate, of all of our Capital Stock in, or all or substantially all the assets of, such Restricted Subsidiary (which sale, exchange or transfer is not prohibited by the Indenture); or

(ii) (with respect to any guarantee created after the date of the Indenture) the release by the holders of our Debt described in the preceding paragraph of their guarantee by such Restricted Subsidiary (including any deemed release upon payment in full of all obligations under such Debt other than as a result of payment under such guarantee), at a time when:

(1) no other Debt of ours has been guaranteed by such Restricted Subsidiary; or

(2) the holders of all such other Debt that is guaranteed by such Restricted Subsidiary also release their guarantee by such Restricted Subsidiary (including any deemed release upon payment in full of all obligations under such Debt other than as a result of payment under such guarantee).

(c) Notwithstanding the foregoing, we will not permit any Restricted Subsidiary, directly or indirectly, to guarantee, assume or in any other manner become liable for the payment of any obligations of ours or any of our Subsidiaries in respect of any operating leases, other than any guarantee thereof existing on the date of the Indenture or any replacement of such existing guarantees, *provided* that the terms and conditions of any such replacement guarantee is not materially less favorable to the holders of the Notes than those under the guarantee so replaced.

Limitation on Dividends and Other Payment Restrictions Affecting Restricted Subsidiaries

(a) We will not, and will not permit any Restricted Subsidiary to, directly or indirectly, create or otherwise cause or suffer to exist or become effective any consensual encumbrance or restriction of any kind on the ability of any Restricted Subsidiary to:

(i) pay dividends, in cash or otherwise, or make any other distributions on or in respect of its Capital Stock or any other interest or participation in, or measured by, its profits, in each case, to the Issuer or any Restricted Subsidiary;

(ii) pay any Debt owed to us or any other Restricted Subsidiary;

(iii) make loans or advances to us or any other Restricted Subsidiary; or

(iv) transfer any of its properties or assets to us or any other Restricted Subsidiary.

(b) The provisions of the covenant described in paragraph (a) above will not apply to:

(i) encumbrances and restrictions imposed by the Notes or the Indenture, or by other indentures governing other Debt we incur (and if such Debt is guaranteed, by the guarantors of such Debt) ranking equally with the Notes (or any guarantee), *provided* that the restrictions imposed by such other indentures are no more restrictive than the restrictions imposed by the Indenture;

(ii) encumbrances or restrictions contained in any agreement in effect on the date of the Indenture in the form contained in such agreement on the date of the Indenture;

(iii) encumbrances or restrictions imposed by Debt permitted to be incurred under Credit Facilities or any guarantees thereof in accordance with the "Limitation on Debt" covenant;

(iv) in the case of clause (a)(iv) above, customary provisions restricting subletting or assignment of any lease or assignment of any other contract to which we or any Restricted Subsidiary is a party or to which any of our or any Restricted Subsidiary's respective properties or assets are subject or customary restrictions contained in operating leases for real property and restricting only the transfer of such real property or effective only upon the occurrence and during the continuance of a default in the payment of rent;

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(v) encumbrances or restrictions contained in any agreement or other instrument of a Person acquired by us or any Restricted Subsidiary in existence at the time of such acquisition (but not created in contemplation thereof), which encumbrance or restriction is not applicable to any Person, or the properties or assets of any Person, other than the Person, or the property or assets of the Person, so acquired;

(vi) any encumbrance or restriction contained in contracts for sales of Capital Stock or assets permitted by the "Limitation on Sale of Certain Assets" covenant with respect to the assets or Capital Stock to be sold pursuant to such contract or in customary merger or acquisition agreements (or any option to enter into such contract) for the purchase or acquisition of Capital Stock or assets or any of our Subsidiaries by another Person;

(vii) in the case of clause (a)(iv) above, any customary encumbrances or restrictions pertaining to an asset subject to a Lien to the extent set forth in the security document governing such Lien;

(viii) encumbrances or restrictions imposed by applicable law or regulation or by governmental licenses, concessions, franchises or permits;

(ix) any encumbrance or restriction existing under any agreement that extends, renews, refinances or replaces the agreements containing the encumbrances or restrictions in the foregoing clauses (b)(i), (ii) and (iii); *provided* that the terms and conditions of any such encumbrances or restrictions are not materially less favorable to the holders of the Notes than those under or pursuant to the agreement so extended, renewed, refinanced or replaced;

(x) restrictions on cash or other deposits or net worth imposed by customers under contracts entered into the ordinary course of business;

(xi) customary limitations on the distribution or disposition of assets or property in joint venture agreements entered into the ordinary course of business and in good faith; *provided* that

(a) such encumbrance or restriction is applicable only to such Restricted Subsidiary;

(b) the encumbrance or restriction is not materially more disadvantageous to the holders of the Notes than is customary in comparable agreements (as determined by us); and

(c) we determine that any such encumbrance or restriction will not materially affect our ability to make any anticipated principal or interest payments on the Notes;

(xii) any encumbrance or restriction in connection with purchase money obligations and Capitalized Lease Obligations for property acquired in the ordinary course of business that impose restrictions of the type described in clause (a)(iv) above on the transfer of the properties so acquired; or

(xiii) any encumbrance or restriction arising by reason of customary non-assignment provisions in agreements.

Suspension of Covenants Following Achievement of Investment Grade Status

If we attain Investment Grade Status and no Default or Event of Default has occurred and is continuing, we and our Subsidiaries, upon the giving of written notice by us to the Trustee, will not be subject to the covenants described under:

- "—Limitation on Debt;"
- "—Limitation on Restricted Payments;"
- "—Limitation on Issuances and Sales of Capital Stock of Restricted Subsidiaries;"

- "—Limitation on Transactions with Affiliates;"
- "—Limitation on Sale of Certain Assets;"
- "—Limitation on Guarantees of Debt by Restricted Subsidiaries;"
- "—Limitation on Dividends and Other Payment Restrictions Affecting Restricted Subsidiaries," and
- "Consolidation, Merger and Sale of Assets" (collectively, the "Suspended Covenants").

If at any time our credit rating is downgraded from Investment Grade Status, then the Suspended Covenants will thereafter be reinstated as if such covenants had never been suspended and be applicable pursuant to the terms of the Indenture (including in connection with performing any calculation or assessment to determine compliance with the terms of the Indenture), unless and until we subsequently attain Investment Grade Status (in which event the Suspended Covenants shall again no longer be in effect for such time as we maintain Investment Grade Status); *provided, however*, that no Default, Event of Default or breach of any kind shall be deemed to exist under the Indenture with respect to the Suspended Covenants based on, and neither we nor any of our Subsidiaries shall bear any liability for, any actions taken or events occurring after we attain Investment Grade Status and before any reinstatement of such Suspended Covenants as provided above, or any actions taken at any time pursuant to any contractual obligation arising prior to such reinstatement, regardless of whether such actions or events would have been permitted if the applicable Suspended Covenants remained in effect during such period. There can be no assurance that the Notes will ever achieve Investment Grade Status or that any such rating, if achieved, will be maintained.

Designation of Unrestricted and Restricted Subsidiaries

Our advisory board may designate any Subsidiary (including newly acquired or newly established Subsidiaries) to be an "Unrestricted Subsidiary" only if:

(a) no Default has occurred and is continuing at the time of or after giving effect to such designation;

(b) we would be permitted to make an Investment (other than a Permitted Investment) at the time of designation (assuming the effectiveness of such designation) pursuant to the first paragraph of the "Limitation on Restricted Payments" covenant in an amount equal to the greater of (i) the net book value of our interest in such Subsidiary calculated in accordance with IFRS or (ii) the Fair Market Value of our interest in such Subsidiary;

(c) we would be permitted under the Indenture to incur €1.00 of additional Debt (other than Permitted Debt) pursuant to the "Limitation on Debt" covenant at the time of such designation (assuming the effectiveness of such designation);

(d) neither we nor any Restricted Subsidiary has a contract, agreement, arrangement, understanding or obligation of any kind, whether written or oral, with such Subsidiary unless the terms of such contract, arrangement, understanding or obligation are no less favorable to us or such Restricted Subsidiary than those that might be obtained at the time from Persons who are not Affiliates of ours or of any Restricted Subsidiary;

(e) such Unrestricted Subsidiary does not own any Capital Stock, Redeemable Capital Stock or Debt of, or own or hold any Lien on any property or assets of, or have any Investment in, us or any other Restricted Subsidiary;

(f) such Unrestricted Subsidiary is not liable, directly or indirectly, with respect to any Debt, Lien or other obligation that, if in default, would result (with the passage of time or notice or otherwise) in a default on any of our Debt or Debt of any Restricted Subsidiary;

(g) such Unrestricted Subsidiary, either alone or in the aggregate with all other Unrestricted Subsidiaries, does not operate, directly or indirectly, all or substantially all of the business of our company and its Subsidiaries; and

(h) such Unrestricted Subsidiary is a Person with respect to which neither we nor any of the Restricted Subsidiaries has any direct or indirect obligation to:

    (i) subscribe for additional Capital Stock of such Person; or

(ii) maintain or preserve such Person's financial condition or to cause such Person to achieve any specified levels of operating results.

In the event of any such Designation, we will be deemed to have made an Investment constituting a Restricted Payment pursuant to the "Limitation on Restricted Payments" covenant for all purposes of the Indenture in an amount equal to the greater of (i) the net book value of our interest in such Subsidiary calculated in accordance with IFRS or (ii) the Fair Market Value of our interest in such Subsidiary.

The Indenture further provides that neither we nor any Restricted Subsidiary will at any time:

(a) provide a guarantee of, or similar credit support to, any Debt of any Unrestricted Subsidiary (including of any undertaking, agreement or instrument evidencing such Debt); *provided* that we may pledge Capital Stock or Debt of any Unrestricted Subsidiary on a non-recourse basis as long as the pledgee has no claim whatsoever against us other than to obtain such pledged property, except to the extent permitted under the "Limitation on Restricted Payments" and "Limitation on Transactions with Affiliates" covenants;

(b) be directly or indirectly liable for any Debt of any Unrestricted Subsidiary, except to the extent permitted under the "Limitation on Restricted Payments" and "Limitation on Transactions with Affiliates" covenants; or

(c) be directly or indirectly liable for any other Debt that provides that the holder thereof may (upon notice, lapse of time or both) declare a default thereon (or cause the payment thereof to be accelerated or payable prior to its final scheduled maturity) upon the occurrence of a default with respect to any other Debt that is Debt of an Unrestricted Subsidiary (including any corresponding right to take enforcement action against such Unrestricted Subsidiary).

Our advisory board may designate any Unrestricted Subsidiary as a Restricted Subsidiary if:

(a) no Default or Event of Default has occurred and is continuing at the time of or will occur and be continuing after giving effect to such designation; and

(b) unless such redesignated Subsidiary shall not have any Debt outstanding (other than Debt that would be Permitted Debt), immediately before and after giving effect to such proposed designation, and after giving *pro forma* effect to the incurrence of any such Debt of such redesignated Subsidiary as if such Debt was incurred on the date of the redesignation, we could incur €1.00 of additional Debt (other than Permitted Debt) pursuant to the "Limitation on Debt" covenant.

Any such designation as an Unrestricted Subsidiary or Restricted Subsidiary by our advisory board will be evidenced to the Trustee by filing a resolution of our advisory board with the Trustee giving effect to such designation and an Officer's Certificate certifying that such designation complies with the foregoing conditions, and giving the effective date of such designation. Any such filing with the Trustee must occur within 45 days after the end of our fiscal quarter in which such designation is made (or, in the case of a designation made during the last fiscal quarter of our fiscal year, within 90 days after the end of such fiscal year).

Reports to Holders

So long as any Notes are outstanding, the Issuer will furnish to the Trustee:

(1) within 120 days after the end of our fiscal year, information substantially similar in scope to the information about us and our Restricted Subsidiaries included in this offering memorandum under "Risk Factors," "Business," "Management's Discussion and Analysis of Financial Condition and Results of Operations" (updated to reflect our consolidated financial statements), "Management," "Related Party Transactions," "Description of Certain Financing Arrangements" and consolidated audited income statements, balance sheets and cash flow statements and the related notes thereto for us for the most recent two fiscal years, together with a report thereon by our certified independent accountants, and information with respect to any acquisition or disposition representing greater than 20% of our consolidated revenues, EBITDA or assets on a *pro forma* basis, including *pro forma* financial information for the acquisition or disposition (*provided* that an acquisition or disposition that has occurred fewer than 30 days prior to the date of the report shall be reported upon in the next quarterly report); and

(2) within 60 days after the end of each of the first three fiscal quarters in each fiscal year, unaudited consolidated income statements, balance sheets and cash flow statements of us for such interim periods, including a financial review of such periods (including a detailed comparison against the prior year's comparable period), a discussion of (a) our financial condition and results of operations and material changes between the current quarterly period and the quarterly period of the prior year, (b) material developments in our business, and (c) financial developments and trends in the business in which we are engaged, and information with respect to any acquisition or disposition representing greater than 20% of our consolidated revenues, EBITDA or assets on a *pro forma* basis including *pro forma* financial information for the acquisition or disposition (*provided* that an acquisition or disposition that has occurred fewer than 30 days prior to the date of the report shall be reported upon in the next report).

Upon the establishment of a Fiscal Unity:

(a) HKB will furnish to the Trustee (i) information in respect of each fiscal year ending on and after December 31, 2011 and before 120 days prior to the date of the establishment of such Fiscal Unity which information shall be substantially similar in scope to the information provided by the Issuer under clause (1) of the preceding paragraph; and

(b) simultaneously with the delivery of the information provided for in clause (a) a textual description of the principal differences in the financial statements included in such information to the financial statements of the Issuer for the equivalent fiscal periods.

From and after the establishment of the Fiscal Unity, HKB will be treated as the Issuer for purposes of this covenant and will thereafter provide information substantially similar in scope as was provided by the Issuer in respect of prior periods in respect of HKB and its consolidated subsidiaries.

In addition, we shall furnish to the holders of the Notes and to prospective investors, upon the requests of such holders, any information required to be delivered pursuant to Rule 144A(d)(4) under the Securities Act so long as the Notes are not freely transferable under the Exchange Act by Persons who are not "affiliates" under the Securities Act.

We will also make available copies of all reports (a) on our website and (b) if and so long as the Notes are listed on the Luxembourg Stock Exchange, copies of such reports will also be made available at the specified office of the paying agent in Luxembourg.

Consolidation, Merger and Sale of Assets

We will not, in a single transaction or through a series of transactions, consolidate with or merge with or into any other Person or permit any other Person to be substituted as the issuer of the Notes or sell, assign, convey, transfer, lease or otherwise dispose of, or take any action pursuant to any resolution passed by our advisory board or shareholders with respect to a de-merger or division pursuant to which we would dispose of, all or substantially all of our properties and assets to any other Person or Persons or permit any Restricted Subsidiary to enter into any such transaction or series of transactions if such transaction or series of transactions, in the aggregate, would result in the sale, assignment, conveyance, transfer, lease or other disposition of all or substantially all of our properties and assets and those of our Restricted Subsidiaries on a consolidated basis to any other Person or Persons. The previous sentence will not apply if at the time and immediately after giving effect any such transaction or series of transactions:

(a) either we will be the continuing corporation or the Person (if other than us) formed by such consolidation or into which we or such Restricted Subsidiary is merged, de-merged or divided, or the Person which is substituted for us as the issuer of the Notes or the Person that acquires by sale, assignment, conveyance, transfer, lease or disposition all or substantially all our properties and assets and those of the Restricted Subsidiaries on a consolidated basis (the "*Surviving Entity*"):

  (i) will be a corporation duly organized and validly existing under the laws of any member state of the Pre-Expansion European Union, Switzerland, the United States of America, any state thereof, or the District of Columbia, and

  (ii) will expressly assume, by a supplemental Indenture in form satisfactory to the Trustee, our obligations under the Notes and the Indenture and the Notes and the Indenture will remain in full force and effect as so supplemented; and

  (iii) in the case of a substitution, we will be a Wholly Owned Restricted Subsidiary of the Surviving Entity.

(b) immediately after giving effect to such transaction or series of transactions on a *pro forma* basis (and treating any obligation of our company or any Restricted Subsidiary incurred in connection with or as a result of such transaction or series of transactions as having been incurred by us or such Restricted Subsidiary at the time of such transaction), no Default or Event of Default will have occurred and be continuing;

(c) immediately before and immediately after giving effect to such transaction or series of transactions on a *pro forma* basis (on the assumption that the transaction or series of transactions occurred on the first day of the four-quarter period immediately prior to the consummation of such transaction or series of transactions with the appropriate adjustments with respect to the transaction or series of transactions being included in such *pro forma* calculation), either (i) we (or the Surviving Entity if we are not the continuing obligor under the Indenture) could incur at least €1.00 of additional Debt (other than Permitted Debt) under the provisions of the "Limitation on Debt" covenant or (ii) we (or the Surviving Entity if we are not the continuing obligor under the Indenture) have a Consolidated Fixed Charge Coverage Ratio equal to or greater than such ratio of our company and the Restricted Subsidiaries immediately prior to such substitution, transaction or series of transactions;

(d) if any of our or any Restricted Subsidiary's property or assets would thereupon become subject to any Lien, the provisions of the "Limitation on Liens" covenant are complied with; and

(e) we or the Surviving Entity will have delivered to the Trustee, in form satisfactory to the Trustee, an Officer's Certificate and an opinion of independent counsel, each stating that such consolidation, merger, sale, assignment, conveyance, transfer, lease or other disposition, and if a supplemental Indenture is required in connection with such transaction, such supplemental indenture, comply with the requirements of the Indenture and that all conditions precedent in the Indenture relating to such transaction have been satisfied and that the Indenture and the Notes constitute our or the Surviving Entity's legal, valid and binding obligations, enforceable in accordance with their terms.

The Surviving Entity will succeed to, and be substituted for, and may exercise every right and power of, our company under the Indenture, but, in the case of a lease of all or substantially all of our assets, we will not be released from the obligation to pay the principal of and interest, and Additional Amounts, if any, on the Notes.

A Subsidiary Guarantor (other than a Subsidiary Guarantor whose Subsidiary Guarantee is to be released in accordance with the terms of the Subsidiary Guarantee and the Indenture) will not, directly or indirectly: (1) consolidate or merge with or into another Person (whether or not such Subsidiary Guarantor is the surviving corporation), or (2) sell, assign, transfer, lease, convey or otherwise dispose of all or substantially all of the properties or assets of such Subsidiary Guarantor and its Restricted Subsidiaries taken as a whole, in one or more related transactions, to another Person, unless:

(1) immediately after giving effect to that transaction, no Default or Event of Default exists; and

(2) either:

    (a) a Subsidiary Guarantor or the Issuer is the surviving Person; or

    (b) the Person acquiring the property in any such sale or disposition or the Person formed by or surviving any such consolidation or merger assumes all the obligations of that Subsidiary Guarantor under its Subsidiary Guarantee, the Indenture and the Security Documents to which such Subsidiary Guarantor is a party pursuant to a supplemental indenture and appropriate Security Documents reasonably satisfactory to the Trustee; or

    (c) the Net Cash Proceeds of such sale or other disposition are applied in accordance with the applicable provisions of the Indenture.

Subject to the preceding sentence nothing in the Indenture will prevent any Wholly Owned Restricted Subsidiary from consolidating with, merging into or transferring all or substantially all of its properties and assets to us or any other Wholly Owned Restricted Subsidiary.

Although there is a limited body of case law interpreting the phrase "all or substantially all", there is no precise established definition of the phrase under applicable law. Accordingly, in certain circumstances there may be a degree of uncertainty as to whether a particular transaction would involve "all or substantially all" of the property or assets of a Person.

Events of Default

Each of the following will be an "Event of Default" under the Indenture:

(a) default for 30 days in the payment when due of any interest or any Additional Amounts on any Note;

(b) default in the payment of the principal of or premium, if any, on any Note at its Maturity (upon acceleration, optional or mandatory redemption, if any, required repurchase or otherwise);

(c) failure to comply with the provisions of "—Certain Covenants—Consolidation, Merger and Sale of Assets";

(d) failure to make or consummate an offer in accordance with the provisions of "—Certain Covenants—Limitation on Sale of Certain Assets;"

(e) failure to make or consummate a Change of Control Offer in accordance with the provisions of "—Purchase of Notes upon a Change of Control;"

(f) failure to comply with any covenant or agreement of ours or of any Restricted Subsidiary that is contained in the Indenture (other than specified in clause (a), (b), (c), (d) or (e) above) and such failure continues for a period of 60 days or more after the written notice specified in clause (2) below;

(g) default under the terms of any instrument evidencing or securing our Debt or Debt of any Restricted Subsidiary having an outstanding principal amount in excess of €15.0 million individually or in the aggregate that results in the acceleration of the payment of such Debt or constitutes the failure to pay such Debt at Stated Maturity thereof (other than by regularly scheduled required prepayment) and such failure to make any payment has not been waived or the maturity of such Debt has not been extended, and in either case the total amount of such Debt unpaid or accelerated exceeds €15.0 million or its equivalent at the time;

(h) any Subsidiary Guarantee of a Subsidiary Guarantor ceases to be, or shall be asserted by the relevant Subsidiary Guarantor, or any Person acting on behalf of such Subsidiary Guarantor, not to be, in full force and effect or enforceable in accordance with its terms (other than as provided for in the Indenture or such Subsidiary Guarantee);

(i) one or more final judgments, orders or decrees (not subject to appeal and not covered by insurance) shall be rendered against us or any Restricted Subsidiary, either individually or in an aggregate amount, in excess of €15.0 million, and either a creditor shall have commenced an enforcement proceeding upon such judgment, order or decree or there shall have been a period of 60 consecutive days or more during which a stay of enforcement of such judgment, order or decree was not (by reason of pending appeal or otherwise) in effect;

(j) the occurrence of certain events of bankruptcy, insolvency or reorganization with respect to us or any Restricted Subsidiary; or

(k) the first priority security interest over the Collateral shall not constitute a valid or perfected lien or, at any time, cease to be in full force and effect for any reason other than the satisfaction in full of all obligations under the Indenture and discharge of the Indenture or any security interest created thereunder shall be declared invalid or unenforceable by a court of competent jurisdiction or the Issuer or any Subsidiary Guarantor shall assert, in any pleading in any court of competent jurisdiction, that any such security interest is invalid or unenforceable and (but only in the event that such failure to be in full force and effect or such assertion is capable of being cured) such failure to be in full force and effect or such assertion shall have continued uncured for a period of 21 days (the "*security default provision*").

If an Event of Default (other than as specified in clause (j) above) occurs and is continuing, the Trustee or the holders of not less than 25% in aggregate principal amount of the Notes then outstanding by written notice to us (and to the Trustee if such notice is given by the holders) may, and the Trustee, upon the written request of such holders, shall, declare the principal of, premium, if any, and any Additional Amounts and accrued interest on all of the outstanding Notes immediately due and payable, and upon any such declaration all such amounts payable in respect of the Notes will become immediately due and payable.

If an Event of Default specified in clause (j) above occurs and is continuing, then the principal of, premium, if any, and any Additional Amounts and accrued interest on all of the outstanding Notes shall become and be immediately due and payable without any declaration or other act on the part of the Trustee or any holder of Notes.

At any time after a declaration of acceleration under the Indenture, but before a judgment or decree for payment of the money due has been obtained by the Trustee, the holders of a majority in aggregate principal amount of the outstanding Notes, by written notice to us and the Trustee, may rescind such declaration and its consequences if:

(a) we have paid or deposited with the Trustee a sum sufficient to pay:

  (i) all overdue interest and Additional Amounts on all Notes then outstanding;

  (ii) all unpaid principal of and premium, if any, on any outstanding Notes that has become due otherwise than by such declaration of acceleration and interest thereon at the rate borne by the Notes;

  (iii) to the extent that payment of such interest is lawful, interest upon overdue interest and overdue principal at the rate borne by the Notes; and

  (iv) all sums paid or advanced by the Trustee under the Indenture and the compensation, expenses, disbursements and advances of the Trustee, its agents and counsel;

(b) the rescission would not conflict with any judgment or decree of a court of competent jurisdiction; and

(c) all Events of Default, other than the nonpayment of amounts of principal of, premium, if any, and any Additional Amounts and interest on the Notes that has become due solely by such declaration of acceleration, have been cured or waived.

No such rescission shall affect any subsequent default or impair any right consequent thereon.

The holders of not less than a majority in aggregate principal amount of the outstanding Notes may, on behalf of the holders of all the Notes, waive any past defaults under the Indenture, except a continuing default in the payment of the principal of, premium, if any, and Additional Amounts or interest on any Note.

No holder of any of the Notes has any right to institute any proceedings with respect to the Indenture or any remedy thereunder, unless the holders of at least 25% in aggregate principal amount of the outstanding Notes have made a written request, and offered reasonable security or indemnity, to the Trustee to institute such proceedings as Trustee under the Notes and the Indenture, the Trustee has failed to institute such proceedings within 60 days after receipt of such notice and the Trustee within such 60-day period has not received directions inconsistent with such written request by holders of a majority in aggregate principal amount of the outstanding Notes. Such limitations do not, however, apply to a suit instituted by a holder of a note for the enforcement of the payment of the principal of, premium, if any, and Additional Amounts or interest on such note on or after the respective due dates expressed in such Note.

If a Default or an Event of Default occurs and is continuing and is actually known to the Trustee, the Trustee will mail to each holder of the Notes notice of the Default or Event of Default within 15 business days after the Trustee's actual knowledge of the Default or Event of Default. Except in the case of a Default or an Event of Default in payment of principal of, premium, if any, Additional Amounts or interest on any Notes, the Trustee may withhold the notice to the holders of such Notes if a committee of its trust officers in good faith determines that withholding the notice is in the interests of the holders of the Notes.

We are required to furnish to the Trustee annual statements as to our performance, and the performance of any Restricted Subsidiaries of our respective obligations under the Indenture and as to any default in such performance. We are also required to notify the Trustee within 10 business days of the occurrence of any Default.

Legal Defeasance or Covenant Defeasance of Indenture

The Indenture provides that we may, at our option and at any time prior to the Stated Maturity of the Notes, elect to have our obligations discharged with respect to the outstanding Notes ("*legal defeasance*"). Legal defeasance means that we will be deemed to have paid and discharged the entire Debt represented by the outstanding Notes except as to:

(a) the rights of holders of outstanding Notes to receive payments in respect of the principal of, premium, if any, and interest on such Notes when such payments are due from the trust referred to below,

(b) our obligations to issue temporary Notes, register the transfer or exchange of any Notes, replace mutilated, destroyed, lost or stolen Notes, maintain an office or agency for payments in respect of the Notes and segregate and hold such payments in trust,

(c) the rights, powers, trusts, duties and immunities of the Trustee and our obligations in connection therewith, and

(d) the legal defeasance provisions of the Indenture.

In addition, we may, at our option and at any time, elect to have our obligations released with respect to certain covenants set forth in the Indenture ("*covenant defeasance*"), and thereafter any omission to comply with such obligations will not constitute a Default or an Event of Default with respect to the Notes. In the event covenant defeasance occurs, certain events described under "—Events of Default" will no longer constitute an Event of Default with respect to the Notes. These events do not include events relating to nonpayment, bankruptcy, receivership and insolvency. We may exercise our legal defeasance option regardless of whether we previously exercised covenant defeasance.

In order to exercise either legal defeasance or covenant defeasance:

(a) we must irrevocably deposit or cause to be deposited in trust with the Trustee, for the benefit of the holders of the Notes, cash in euro, European Government Obligations, or a combination thereof, in such amounts as will be sufficient, in the opinion of an internationally recognized firm of independent public accountants, to pay and discharge the principal of, premium, if any, and interest, on the outstanding Notes on the Stated Maturity or on the applicable redemption date, as the case may be, if, at or prior to electing either legal defeasance or covenant defeasance, we must have delivered to the Trustee an irrevocable notice to redeem all of the outstanding Notes of such principal, premium, if any, or installment of interest;

(b) in the case of legal defeasance, we must have delivered to the Trustee an opinion of counsel stating that (x) we have received from, or there has been published by, the U.S. Internal Revenue Service a ruling, or (y) since the date of the Indenture, there has been a change in applicable U.S. federal income tax law, in either case to the effect that, and based thereon such opinion shall confirm that, the holders of the outstanding Notes will not recognize income, gain or loss for U.S. federal income tax purposes as a result of such legal defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such legal defeasance had not occurred;

(c) in the case of covenant defeasance, we must have delivered to the Trustee an opinion of counsel to the effect that the holders of the Notes outstanding will not recognize income, gain or loss for U.S. federal income tax purposes as a result of such covenant defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such covenant defeasance had not occurred;

(d) in the case of covenant defeasance, we must have delivered to the Trustee an opinion of counsel to the effect that the holders of the Notes outstanding will not recognize income, gain or loss for German or U.S. federal income tax purposes as a result of such covenant defeasance and will be subject to German or U.S. federal income tax on the same amounts, in the same manner and at the same times as would have been the case if such covenant defeasance had not occurred;

(e) no Default or Event of Default will have occurred and be continuing on the date of such deposit or, insofar as bankruptcy or insolvency events described in clause (1)(k) of "—Events of Default" above is concerned, at any time during the period ending on the 180th day after the date of such deposit;

(f) such legal defeasance or covenant defeasance will not result in a breach or violation of, or constitute a default under (other than a Default or Event of Default resulting from the borrowing of funds to be applied to such deposit), the Indenture or any material agreement or instrument to which we or any Restricted Subsidiary is a party or by which we or any Restricted Subsidiary is bound;

(g) we must have delivered to the Trustee an opinion of counsel in our country of incorporation to the effect that after the 123rd day following the deposit, the trust funds will not be subject to the effect of any applicable bankruptcy, insolvency, reorganization or similar laws affecting creditors' rights generally and an opinion of independent counsel reasonably acceptable to the Trustee that the Trustee shall have a perfected security interest in such trust funds for the rateable benefit of the holders of the Notes;

(h) we must have delivered to the Trustee an Officer's Certificate stating that the deposit was not made by us with the intent of preferring the holders of the Notes with the intent of defeating, hindering, delaying or defrauding our creditors or others, or removing its assets beyond the reach of its creditors or increasing our debts to the detriment of our creditors; and

(i) we will have delivered to the Trustee an Officer's Certificate and an opinion of counsel, each stating that all conditions precedent provided for relating to either the legal defeasance or the covenant defeasance, as the case may be, have been complied with.

If the funds deposited with the Trustee to effect covenant defeasance are insufficient to pay the principal of, premium, if any, and interest on the Notes when due because of any acceleration occurring after an Event of Default, then we will remain liable for such payments.

Satisfaction and Discharge

The Indenture will be discharged and will cease to be of further effect (except as to surviving rights of registration of transfer or exchange of the Notes as expressly provided for in the Indenture) when:

(a) we have irrevocably deposited or caused to be deposited with the Trustee as trust funds in trust for such purpose an amount in cash in euros, European Government Obligations or a combination of cash in euros and European Government Obligations sufficient to pay and discharge the entire Debt on such Notes that have not, prior to such time, been delivered to the Trustee for cancellation, for principal of, premium, if any, and any Additional Amounts and accrued interest on the Notes to the date of such deposit (in the case of Notes which have become due and payable) or to the Stated Maturity or redemption date, as the case may be, and we have delivered irrevocable instructions to the Trustee to apply the deposited money toward the payment of Notes at Maturity or on the redemption date, as the case may be and either:

    (i) all the Notes theretofore authenticated and delivered (other than destroyed, lost or stolen Notes that have been replaced or paid and Notes for whose payment money has been deposited in trust or segregated and held in trust by us and thereafter repaid to us or discharged from such trust as provided for in the Indenture) have been delivered to the Trustee for cancellation; or

    (ii) all Notes not theretofore delivered to the Trustee for cancellation (x) have become due and payable, (y) will become due and payable at Stated Maturity within one year or (z) are to be called for redemption within one year under arrangements satisfactory to the Trustee for the giving of notice of redemption by the Trustee in our name, and at our expense, and

(b) we have paid or caused to be paid all sums payable by us under the Indenture;

(c) we have delivered to the Trustee an Officer's Certificate and an opinion of counsel, each stating that:

    (i) all conditions precedent provided in the Indenture relating to the satisfaction and discharge of the Indenture have been complied with; and

    (ii) such satisfaction and discharge will not result in a breach or violation of, or constitute a default under, the Indenture or any other agreement or instrument to which we or any Subsidiary is a party or by which we or any Subsidiary is bound.

Amendments and Waivers

The Indenture contains provisions permitting us and the Trustee to enter into a supplemental Indenture without the consent of the holders of the Notes for certain limited purposes, including, among other things, curing ambiguities, defects or inconsistencies, or making any change that does not adversely affect the rights of any holder of the Notes in any material respect. With the consent of the holders of not less than a majority in aggregate principal amount of the Notes then outstanding, we and the Trustee are permitted to amend or supplement the Indenture and the Security Documents; *provided* that no such modification or amendment may, without the consent of (i) the holders of at least 90% of the aggregate principal amount of then-outstanding Notes or (ii) each holder of the Notes adversely affected thereby:

(a) change the Stated Maturity of the principal of, or any installment of or Additional Amounts or interest on, any Note;

(b) reduce the principal amount of any Note (or Additional Amounts or premium, if any) or the rate of interest on any Note;

(c) change the coin or currency in which the principal of any note or any premium or any Additional Amounts or the interest thereon is payable;

(d) impair the right to institute suit for the enforcement of any payment on or after the Stated Maturity thereof (or, in the case of redemption, on or after the redemption date or purchase date, in the case of an offer to purchase);

(e) reduce the principal amount of Notes whose holders must consent to any amendment, supplement or waiver of provisions of the Indenture;

(f) modify any of the provisions relating to the waiver of past defaults or relating to the waiver of certain covenants, except to increase the percentage of outstanding Notes required for such actions or to provide that certain other provisions of the Indenture cannot be modified or waived without the consent of (i) the holders of at least 90% of the aggregate principal amount of then-outstanding Notes or (ii) each holder of the Notes adversely affected thereby;

(g) make any change to the provisions of the Indenture described under "—Ranking" or any other provisions of the Indenture affecting the ranking of the Notes, in each case in a manner that adversely affects the rights of the holders of the Notes;

(h) release any Collateral that may have been granted in respect of the Notes otherwise than in accordance with the terms of the Indenture or release any Subsidiary Guarantee other than in accordance with the Indenture; or

(i) make any change in the provisions of the Indenture described under "—Additional Amounts" that adversely affects the rights of any holder of the Notes or amend the terms of the Notes or the Indenture in a way that would result in a loss of an exemption from any of the Taxes described thereunder or an exemption from any obligation to withhold or deduct Taxes so described thereunder unless we agree to pay Additional Amounts (if any) in respect thereof in the supplemental Indenture.

Notwithstanding the foregoing, without the consent of any holder of the Notes, we and the Trustee may modify or amend the Indenture:

(i) to evidence the succession of another Person to our company and the assumption by any such successor of the covenants in the Indenture and in the Notes in accordance with "—Certain Covenants—Consolidation, Merger and Sale of Assets;"

(ii) to add to our covenants and those of any other obligor upon the Notes for the benefit of the holders of the Notes or to surrender any right or power conferred upon us or any other obligor upon the Notes, as applicable, in the Indenture, in the Notes;

(iii) to cure any ambiguity, or to correct or supplement any provision in the Indenture or the Notes which may be defective or inconsistent with any other provision in the Indenture or the Notes or make any other provisions with respect to matters or questions arising under the Indenture or the Notes;

(iv) to evidence and provide the acceptance of the appointment of a successor Trustee under the Indenture;

(v) to mortgage, pledge, hypothecate or grant a security interest in favor of the Trustee for the benefit of the holders of the Notes as additional security for the payment and performance of our obligations under the Indenture, in any property, or assets, including any of which are required to be mortgaged, pledged or hypothecated, or in which a security interest is required to be granted to the Trustee pursuant to the Indenture or otherwise;

(vi) to provide for uncertificated Notes in addition to or in place of certificated Notes;

(vii) to conform the text of the Indenture, the Notes and the Subsidiary Guarantees to any provision of this Description of the Notes to the extent that such provision in this Description of the Notes was intended to be a verbatim recitation of a provision of the Indenture, the Notes or the Subsidiary Guarantees;

(viii) to release any Subsidiary Guarantee in accordance with the terms of the Indenture; or

(ix) to provide for the issuance of Additional Notes in accordance with the limitations set fourth in the Indenture on the Issue Date.

The holders of a majority in aggregate principal amount of the Notes outstanding may waive compliance with certain restrictive covenants and provisions of the Indenture.

The consent of the holders of Notes is not necessary under the Indenture to approve the particular form of any proposed amendment. It is sufficient if such consent approves the substance of the proposed amendment.

In formulating its opinion on such matters, the Trustee shall be entitled to rely absolutely on such evidence as it deems appropriate, including an opinion of counsel and an Officer's Certificate.

Notices

Notices regarding the Notes will be:

(a) if and so long as the Notes are listed on the Luxembourg Stock Exchange and the rules and regulations of the Luxembourg Stock Exchange so require, published in a leading newspaper having a general circulation in Luxembourg (which is expected to be the *Luxemburger Wort* or, to the extent and in the manner permitted by such rules, post such notice on the official website of the Luxembourg Stock Exchange (*www.bourse.lu*)); and

(b) in the case of certificated Notes, mailed to holders of such Notes by first-class mail at their respective addresses as they appear on the registration books of the registrar.

Notices given by first-class mail will be deemed given five calendar days after mailing and notices given by publication will be deemed given on the first date on which publication is made.

If and so long as the Notes are listed on any other securities exchange, notices will also be given in accordance with any applicable requirements of such securities exchange.

If and so long as any Notes are represented by Global Notes, notice to holders of the Notes will (in addition to publication as described above) also be given by delivery of the relevant notice to Euroclear and Clearstream Banking for communication to entitled account holdings in substitution for the previously mentioned publication.

The Trustee

The Indenture provides that, except during the continuance of an Event of Default, the Trustee will perform only such duties as are specifically set forth in the Indenture. If an Event of Default has occurred and is continuing, the Trustee will exercise such rights and powers vested in it under the Indenture and use the same degree of care and skill in its exercise as a prudent person would exercise under the circumstances in the conduct of such person's own affairs. Subject to such provisions, the Trustee will be under no obligation to exercise any of its rights or powers under the Indenture at the request of any Holders, unless such Holders have offered to the Trustee security and indemnity satisfactory to it against any loss, liability or expense.

The Indenture contains limitations on the rights of the Trustee under the Indenture in the event the Trustee becomes our creditor. The Trustee will be permitted to engage in other transactions.

No Personal Liability of Directors, Officers, Employees and Stockholders

No director, officer, employee, incorporator or stockholder of the Issuer or any Subsidiary Guarantor, as such, will have any liability for any obligations of the Issuer or the Subsidiary Guarantors under the Notes, the Indenture, the Subsidiary Guarantees or for any claim based on, in respect of, or by reason of, such obligations or their creation. Each holder of Notes by accepting a Note waives and releases all such liability. The waiver and release are part of the consideration for issuance of the Notes. The waiver may not be effective to waive liabilities under applicable securities laws.

Prescription

Claims against us or any Subsidiary Guarantor for the payment of principal or Additional Amounts, if any, on the Notes will be prescribed ten years after the applicable due date for payment thereof. Claims against us or any Subsidiary Guarantor for the payment of interest on the Notes will be prescribed six years after the applicable due date for payment of interest.

Governing Law

The Indenture and the Notes are governed by, and construed in accordance with, the laws of the State of New York.

Certain Definitions

"*Acquired Debt*" means Debt of a Person

(a) existing at the time such Person becomes a Restricted Subsidiary or is merged into or consolidated with us or any of the Restricted Subsidiaries, or

(b) assumed in connection with the acquisition of assets from such Person, in each case *provided* that such Debt was not incurred in connection with, or in contemplation of, such Person becoming a Restricted Subsidiary or such acquisition, as the case may be.

Acquired Debt will be deemed to be incurred on the date the acquired Person becomes a Restricted Subsidiary or the date of the related acquisition of assets from any Person.

"*Affiliate*" means, with respect to any specified Person,

(a) any other Person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified Person, or

(b) any other Person 10% or more of the Voting Stock of which is beneficially owned or held, directly or indirectly by such specified Person.

For the purposes of this definition, "control," when used with respect to any specified Person, means the power to direct or cause the direction of the management and policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise; and the terms "controlling," "controlled" have meanings correlative to the foregoing.

"*Asset Sale*" means any sale, issuance, conveyance, transfer, lease or other disposition (including, without limitation, by way of merger, consolidation or sale and leaseback transaction) (collectively, a "*transfer*"), directly or indirectly, in one or a series of related transactions, of

(a) any Capital Stock of any Restricted Subsidiary;

(b) all or substantially all of our properties and assets of any division or line of our or any Restricted Subsidiary's business; or

(c) any other of our or any Restricted Subsidiary's properties or assets, other than in the ordinary course of business.

For the purposes of this definition, the term "Asset Sale" does not include any transfer of properties or assets:

(i) that is governed by the provisions of the Indenture described under "—Certain Covenants—Consolidation, Merger and Sale of Assets;"

(ii) by us to any Restricted Subsidiary, or by any Restricted Subsidiary to us or any other Restricted Subsidiary in accordance with the terms of the Indenture;

(iii) representing accounts receivable, inventory or other assets in the ordinary course of business and any other sale or disposition of obsolete or permanently retired equipment and facilities that are no longer useful in the conduct of our and any Restricted Subsidiary's business;

(iv) an Asset Swap effected in compliance with "—Certain Covenants—Limitation on Sale of Certain Assets;"

(v) any single transaction or series of related transactions that involves assets having a Fair Market Value of less than €2.5 million;

(vi) a Restricted Payment or Permitted Investment that is permitted under the "—Certain Covenants—Limitation on Restricted Payments" covenant;

(vii) any surrender or waiver of contract rights or settlement, release, recovery on or surrender of contract, tort or other claims in the ordinary course of business;

(viii) the granting of Liens not prohibited by the covenant described above under the caption "—Certain Covenants—Limitation on Liens;"

(ix) the sale or other disposition of cash or Cash Equivalents;

(x) the disposition of receivables in connection with the compromise settlement or collection thereof in the ordinary course of business or in bankruptcy or similar proceedings and exclusive of factoring or similar arrangements; and

(xi) the disposition of assets to a Person who is providing services (the provision of which have been outsourced by us or any Restricted Subsidiary to such Person) related to such assets.

"*Asset Swap*" means the concurrent purchase and sale or exchange of Related Business Assets between us or any Restricted Subsidiary and another Person (other than a sale, disposition or transfer that is governed by the provisions of the Indenture described under "—Certain Covenants—Consolidation, Merger and Sale of Assets").

"*Average Life*" means, as of the date of determination with respect to any Debt, the quotient obtained by dividing

(a) the sum of the products of:

   (i) the number of years from the date of determination to the date or dates of each successive scheduled principal payment of such Debt multiplied by

   (ii) the amount of each such principal payment by;

(b) the sum of all such principal payments.

"*Bankruptcy Law*" means any law relating to bankruptcy, insolvency, receivership, winding-up, liquidation, reorganization or relief of debtors or any amendment to, succession to or change in any such law, including without limitation, German and other relevant statutes and Title 11, United States Bankruptcy Code of 1978.

"*Bund Rate*" means, with respect to any redemption date, the rate per annum equal to the equivalent yield to maturity as of such redemption date of the Comparable German Bund issue, assuming a price for the Comparable German Bund issue (expressed as a percentage of its principal amount) equal to the Comparable German Bund Price for such redemption date, where:

(a) "*Comparable German Bund Issues*" means the German Bundesanleihe security selected by any Reference German Bund Dealer as having a fixed maturity most nearly equal to the period from such redemption date to May 15, 2014, and that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of euro-denominated corporate debt securities in a principal amount approximately equal to the then-outstanding principal amount of the notes and of a maturity most nearly equal to May 15, 2014; *provided*, *however*, that if the period from such redemption date to May 15, 2014 is less than one year, a fixed maturity of one year shall be used;

(b) "*Comparable German Bund Price*" means, with respect to any redemption date, the average of the Reference German Bund Dealer Quotations for such redemption date, after excluding the highest and lowest such Reference German Bund Dealer Quotations, or if we obtain fewer than four such Reference German Bund Dealer Quotations, the average of all such quotations;

(c) "*Reference German Bund Dealer*" means any dealer of German Bundesanleihe securities appointed by us in consultation with the Trustee; and

(d) "*Reference German Bund Dealer Quotations*" means, with respect to each Reference German Bund Dealer and any redemption date, the average as determined by us of the bid and offered prices for the Comparable German Bund issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Trustee by such Reference German Bund Dealer at 3.30 p.m. Frankfurt, Germany time on the third business day preceding such redemption date.

"*Capital Stock*" means, with respect to any Person, any and all shares, interests, partnership interests (whether general or limited), participations, rights in or other equivalents (however designated) of such Person's equity, any other interest or participation that confers the right to receive a share of the profits and losses, or distributions of assets of, such Person and any rights (other than debt securities convertible into or exchangeable for Capital Stock), warrants or options exchangeable for or convertible into such Capital Stock, whether now outstanding or issued after the date of the Indenture.

"*Capitalized Lease Obligation*" means, with respect to any Person, any obligation of such Person under a lease of (or other agreement conveying the right to use) any property (whether real, personal or mixed), which obligation is required to be classified and accounted for as a capital lease obligation under IFRS, and, for purposes of the Indenture, the amount of such obligation at any date will be the capitalized amount thereof at such date, determined in accordance with IFRS and the Stated Maturity thereof will be the date of the last payment of rent or any other amount due under such lease prior to the first date such lease may be terminated without penalty.

"*Cash Equivalents*" means any of the following:

(a) any evidence of Debt denominated in euro or dollars with a maturity of 180 days or less from the date of acquisition issued or directly and fully guaranteed or insured by any member state of the European Union as of the date of the Indenture, the United States of America, any state thereof or the District of Columbia, or any agency or instrumentality thereof (each, an "*Approved Jurisdiction*");

(b) time deposit accounts, certificates of deposit, money market deposits or bankers' acceptances denominated in euro or dollars with a maturity of 180 days or less from the date of acquisition of a bank or trust company organized in any member state of the European Union as of the date of the Indenture or any commercial banking institution that is a member of the U.S. Federal Reserve System, in each case having combined capital and surplus and undivided profits of not less than €500 million, whose debt has a rating, at the time as any investment is made therein, of at least "A" by S&P and at least "A2" by Moody's;

(c) commercial paper with a maturity of 180 days or less from the date of acquisition issued by a corporation that is not our or any Restricted Subsidiary's Affiliate and is organized under the laws of any member state of the European Union as of the date of the Indenture, the United States of America or any state thereof and, at the time the investment is made, rated at least A1 by S&P or at least P-l by Moody's;

(d) repurchase obligations with a term of not more than 7 days for underlying securities of the type described in (a) above entered into with a financial institution meeting the qualifications described in clause (b) above; and

(e) Investments in money market mutual funds at least 95% of the assets of which constitute Cash Equivalents of the kind described in clauses (a) through (d) above.

"*Change of Control*" means the occurrence of any of the following events:

(a) prior to our first Public Equity Offering, the Permitted Holders cease to be the "beneficial owners" (as defined in Rules 13d3 and 13d5 under the Exchange Act), directly or indirectly, of a majority in the aggregate of the total voting power of our Voting Stock, whether as a result of the issuance of our securities, any merger, consolidation, liquidation or dissolution of us, any direct or indirect transfer of securities by any Permitted Holders or otherwise (for purposes of this clause (a), a Permitted Holder shall be deemed to beneficially own any Voting Stock of an entity (the "*specified entity*") held by another entity (the "*parent entity*") so long as the Permitted Holder beneficially owns (as so defined), directly or indirectly, in the aggregate a majority of the voting power of the Voting Stock of such parent entity);

(b) on or after the date of the first Public Equity Offering referred to in clause (a) above, (i) any "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act or any successor provisions to either of the foregoing), other than one or more Permitted Holders or the underwriters or the initial purchasers participating in the Public Equity Offering, is or becomes the "beneficial owner" (as defined in Rules 13d3 and 13d5 under the Exchange Act, except that a Person will be deemed to have "beneficial ownership" of all securities that such Person has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than 35% of the voting power of our outstanding Voting Stock (for the purposes of this clause (b), such other person or group shall be deemed to beneficially own all Voting Stock of a corporation held by any other corporation (the "*parent entity*") so long as such person or group beneficially owns, directly or indirectly, in the aggregate a majority of the total voting power of the Voting Stock of such parent entity) and (ii) one or more Permitted Holders do not beneficially own a larger percentage of such Voting Stock than such person or group; or

(c) (i) if we consummate any transaction (including, without limitation, any merger, consolidation, amalgamation or other combination) pursuant to which our outstanding Voting Stock is converted into or exchanged for cash, securities or other property, or (ii) we convey, transfer, lease or otherwise dispose of, or any resolution with respect to a demerger or division is passed by our advisory board or shareholders pursuant to which we would dispose of, all or substantially all of our assets and those of our Restricted Subsidiaries, considered as a whole (other than a transfer of substantially all of such assets to one or more Wholly Owned Restricted Subsidiaries), in each case to any Person other than in a transaction:

(x) where our outstanding Voting Stock is not converted or exchanged at all (except to the extent necessary to reflect a change in the jurisdiction of our incorporation) or is converted into or exchanged for Voting Stock (other than Redeemable Capital Stock) of the surviving or transferee corporation; and

(y) where the Voting Stock of the surviving or transferee corporation is and is expected to continue to be listed on a stock exchange or automated quotation system and publicly traded, no "person" or "group" (as such terms are used in Sections 13(d) and 14(d) of the Exchange Act) is the "beneficial owner" (as defined in Rules 13d3 and 13d5 under the Exchange Act, except that a Person will be deemed to have "beneficial ownership" of all securities that such Person has the right to acquire, whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of more than 35% of the total outstanding Voting Stock of the surviving or transferee corporation; or

(d) we are liquidated or dissolved or adopt a plan of liquidation or dissolution other than in a transaction which complies with the provisions described under "—Certain Covenants—Consolidation, Merger and Sale of Assets;" or

(e) following the establishment of the Fiscal Unity and prior to a Permitted HKB Merger, HKB ceases to beneficially own, directly or indirectly, 100% of the Voting Stock of the Issuer (other than directors' qualifying shares) unless:

(x) at least 75% of our Capital Stock is beneficially owned, directly or indirectly, by HKB; and

(y) all holders of our Capital Stock (other than HKB or a Wholly Owned Restricted Subsidiary of HKB) agree in writing to a compensation payment (the "*Guaranteed Dividend*") per annum not in excess of 6% per annum of the net cash proceeds received by HKO and agree not to pursue legal action against the level of the Guaranteed Dividend.

"*Commission*" means, the United States Securities and Exchange Commission.

"*Consolidated Adjusted Net Income*" means, for any period, our and the Restricted Subsidiaries' consolidated net income (or loss) for such period as determined in accordance with IFRS, adjusted by excluding (to the extent included in such consolidated net income or loss), without duplication:

(a) any net after-tax extraordinary gains or losses;

(b) any net after-tax gains or losses attributable to asset sales other than in the ordinary course of business;

(c) the portion of net income or loss of any Person (other than us or a Restricted Subsidiary), including Unrestricted Subsidiaries, in which we or any Restricted Subsidiary has an ownership interest, except to the extent of the amount of dividends or other distributions actually paid to us or any Restricted Subsidiary in cash dividends or distributions during such period;

(d) the net income (but not the loss) of any Restricted Subsidiary to the extent that the declaration or payment of dividends, or similar distributions by such Restricted Subsidiary is not at the date of determination permitted, directly or indirectly, by operation of the terms of its charter or any agreement, instrument, judgment, decree, order, statute, rule or governmental regulation applicable to such Restricted Subsidiary or its shareholders;

(e) net after-tax gains or losses attributable to the termination of any employee pension benefit plan;

(f) any restoration to net income of any contingency reserve, except to the extent provision for such reserve was made out of income accrued at any time following the date of the Indenture;

(g) any net gain arising from the acquisition of any securities or extinguishment, under IFRS, of any Debt of such Person or any impairment charge associated with the write-down of the HKB PIK Loans;

(h) the net income attributable to discontinued operations (including, without limitation, operations disposed of during such period whether or not such operations were classified as discontinued);

(i) any gains (but not losses) from currency exchange transactions not in the ordinary course of business;

(j) any non-cash compensation charge or expense arising from any grant of stock, stock options or other equity-based awards;

(k) any one time non-cash charges or any increase in amortization or depreciation, in each case, in relation to any acquisition of another Person or business or resulting from any reorganization or restructuring involving us or our Subsidiaries;

(l) any unrealized foreign currency transaction gains or losses in respect of Debt of any person denominated in a currency other than the functional currency of such Person and any unrealized foreign exchange gains or losses relating to translation of assets and liabilities denominated in foreign currencies;

(m) any unrealized foreign currency translation or transaction gains or losses in respect of Debt or other obligations of the Issuer or any Restricted Subsidiary owing to the Issuer or any Restricted Subsidiary;

(n) the cumulative effect of a change in accounting principles after the date of the Indenture; and

(o) any non-cash income on the HKB PIK Loans.

"*Consolidated Fixed-Charge Coverage Ratio*" of our company means, for any period, the ratio of

(a) the sum of Consolidated Adjusted Net Income, plus in each case to the extent deducted in computing Consolidated Adjusted Net Income for such period:

    (i) Consolidated Interest Expense,

    (ii) Consolidated Tax Expense and

    (iii) Consolidated Non-cash Charges, less all non-cash items increasing Consolidated Adjusted Net Income for such period and less all cash payments during such period relating to non-cash charges that were added back to Consolidated Adjusted Net Income in determining the Consolidated Fixed Charge Coverage Ratio in any prior period

(b) to the sum of:

    (i) Consolidated Interest Expense and

(ii) cash and non-cash dividends due (whether or not declared) on our and any Restricted Subsidiary's Preferred Stock (to any Person other than us and any Restricted Subsidiary), in each case for such period

provided that:

(w) if we or any Restricted Subsidiary has incurred any Debt since the beginning of such period that remains outstanding or if the transaction giving rise to the need to calculate the Consolidated Fixed Charge Coverage Ratio is an incurrence of Debt or both, Consolidated Adjusted Net Income and Consolidated Interest Expense for such period shall be calculated after giving effect on a *pro forma* basis to such Debt as if such Debt had been incurred on the first day of such period and the discharge of any other Debt repaid, repurchased, defeased or otherwise discharged with the proceeds of such new Debt as if such discharge had occurred on the first day of such period;

(x) if, since the beginning of such period, we or any Restricted Subsidiary shall have made any asset sale, Consolidated Adjusted Net Income for such period shall be reduced by an amount equal to Consolidated Adjusted Net Income (if positive) directly attributable to the assets which are the subject of such asset sale for such period, or increased by an amount equal to Consolidated Adjusted Net Income (if negative) directly attributable thereto for such period and Consolidated Interest Expense for such period shall be reduced by an amount equal to Consolidated Interest Expenses directly attributable to any Debt of ours or of any Restricted Subsidiary repaid, repurchased, defeased or otherwise discharged with respect to us and the continuing Restricted Subsidiaries in connection with such asset sale for such period (or, if the Capital Stock of any Restricted Subsidiary is sold, Consolidated Interest Expense for such period directly attributable to the Debt of such Restricted Subsidiary to the extent we and the continuing Restricted Subsidiaries are no longer liable for such Debt after such sale);

(y) if since the beginning of such period we or any Restricted Subsidiary (by merger or otherwise) shall have made an Investment in any Restricted Subsidiary (or any Person which becomes a Restricted Subsidiary) or acquisition of assets, including any acquisition of an asset occurring in connection with a transaction causing a calculation to be made hereunder, which constitutes all or substantially all of an operating unit of a business, Consolidated Adjusted Net Income and Consolidated Interest Expense for such period shall be calculated after giving *pro forma* effect thereto (including the incurrence of any Debt) as if such investment or acquisition occurred on the first day of such period; and

(z) if since the beginning of such period any Person (that subsequently became a Restricted Subsidiary or was merged with or into us or any Restricted Subsidiary since the beginning of such period) shall have made any Asset Sale or any Investment that would have required an adjustment pursuant to clause (w) or (y) if made by us or a Restricted Subsidiary during such period, Consolidated Adjusted Net Income and Consolidated Interest Expenses for such period will be calculated after giving *pro forma* effect thereto as if such asset sale or Investment occurred on the first day of such period.

If any Debt bears a floating rate of interest and is being given *pro forma* effect, the interest expense on such Debt shall be calculated as if the rate in effect on the date of determination had been the applicable rate for the entire period (taking into account any Interest Rate Agreement applicable to such Debt for a period equal to the remaining term of such Interest Rate Agreement).

"*Consolidated Interest Expense*" means, for any period, without duplication and in each case determined on a consolidated basis in accordance with IFRS, the sum of:

(a) our and the Restricted Subsidiaries' interest expense for such period, including, without limitation,

(i) amortization of debt discount,

(ii) the net cost of Interest Rate Agreements and Currency Agreements (including amortization of discounts),

(iii) commissions, discounts and other fees and charges owed with respect to letters of credit and bankers acceptance financing and similar transactions,

(iv) the interest portion of any deferred payment obligation and amortization of debt issuance costs; *plus*

(b) the interest component of our and the Restricted Subsidiaries' Capitalized Lease Obligations accrued and/or scheduled to be paid or accrued during such period; *plus*

(c) our and the Restricted Subsidiaries non-cash interest and interest that was capitalized during such period; *plus*

(d) the interest on Debt of another Person that is guaranteed by us or any Restricted Subsidiary or secured by a Lien on our or any Restricted Subsidiary's assets, whether or not such interest is paid by us or such Restricted Subsidiary.

"*Consolidated Non-cash Charges*" means, for any period, the aggregate depreciation, amortization and other non-cash expenses of our company and the Restricted Subsidiaries for such period, determined on a consolidated basis in accordance with IFRS (excluding any such non-cash charge that requires an accrual of or reserve for cash charges for any future period).

"*Consolidated Secured Debt Leverage Ratio*" of the Issuer means, as of the date of determination, the ratio of:

(a) consolidated Debt of the Issuer secured by Liens ranking equal to (by law or contract) the Liens on the Collateral securing the Notes on all or any portion of the Collateral (other than Debt incurred pursuant to clause (i) of paragraph (b) of "—Certain Covenants—Limitation on Debt") to

(b) the sum of Consolidated Adjusted Net Income for the period of the most recent four consecutive quarters for which financial statements are available under "—Certain Covenants—Reports to Holders", plus in each case to the extent deducted in computing Consolidated Adjusted Net Income for such period:

(i) Consolidated Interest Expense,

(ii) Consolidated Tax Expense and

(iii) Consolidated Non-cash Charges, less all non-cash items increasing Consolidated Adjusted Net Income for such period and less all cash payments during such period relating to non-cash charges that were added back to Consolidated Adjusted Net Income in determining the Consolidated Fixed Charge Coverage Ratio in any prior period;

in each case with such pro forma adjustments to consolidated Debt, Consolidated Adjusted Net Income and Consolidated Tax Expense as are appropriate and consistent with the pro forma provisions set forth in the definition of Consolidated Fixed-Charge Coverage Ratio.

"*Consolidated Tax Expense*" means, for any period with respect to any Relevant Taxing Jurisdiction, the provision for federal, state, local and foreign income taxes of our company and the Restricted Subsidiaries for such period as determined on a consolidated basis in accordance with IFRS.

"*Contingent Obligations*" means, with respect to any Person, any obligation of such Person guaranteeing in any manner, whether directly or indirectly, any operating lease, dividend or other obligation that, in each case, does not constitute Indebtedness ("*primary obligations*") of any other Person (the "*primary obligor*"), including any obligation of such Person, whether or not contingent:

(a) to purchase any such primary obligation or any property constituting direct or indirect security therefor;

(b) to advance or supply funds:

(i) for the purchase or payment of any such primary obligation; or

(ii) to maintain the working capital or equity capital of the primary obligor or otherwise to maintain the net worth or solvency of the primary obligor; or

(c) to purchase property, securities or services primarily for the purpose of assuring the owner of any such primary obligation of the ability of the primary obligor to make payment of such primary obligation against loss in respect thereof.

"*Credit Facility*" or "*Credit Facilities*" means, one or more debt facilities, as the case may be, including U.S. industrial revenue bonds, or commercial paper or other facilities with banks, insurance companies or other institutional lenders providing for revolving credit loans, term loans, notes, letters of credit or other forms of guarantees and assurances or other credit facilities, including overdrafts, in each case, as amended, restated, modified, renewed, refunded, replaced or refinanced in whole or in part from time to time; provided, that such debt or commercial paper or other facilities may not provide for or consist of the borrowing or issuance of any Public Debt and provided, further, that no such amendment, restatement, modification, renewal, refund, replacement or refinancing may consist of or provide for the borrowing or issuance of Public Debt.

"*Currency Agreements*" means any spot or forward foreign exchange agreements and currency swap, currency option or other similar financial agreements or arrangements designed to protect against or manage exposure to fluctuations in foreign currency exchange rates.

"*Debt*" means, with respect to any Person, without duplication:

(a) all liabilities of such Person for borrowed money (including overdrafts) or for the deferred purchase price of property or services, excluding any trade payables and other accrued current liabilities incurred in the ordinary course of business;

(b) all obligations of such Person evidenced by bonds, notes, debentures or other similar instruments;

(c) all obligations, contingent or otherwise, of such Person in connection with any letters of credit, bankers' acceptances or other similar facilities;

(d) all indebtedness of such Person created or arising under any conditional sale or other title retention agreement with respect to property acquired by such Person (even if the rights and remedies of the seller or lender under such agreement in the event of default are limited to repossession or sale of such property), but excluding trade payables arising in the ordinary course of business;

(e) all Capitalized Lease Obligations of such Person;

(f) all obligations of such Person under or in respect of Interest Rate Agreements or Currency Agreements;

(g) all Debt referred to in (but not excluded from) the preceding clauses (a) through (f) of other Persons and all dividends of other Persons, the payment of which is secured by (or for which the holder of such Debt has an existing right, contingent or otherwise, to be secured by) any Lien upon or with respect to property (including, without limitation, accounts and contract rights) owned by such Person, even though such Person has not assumed or become liable for the payment of such Debt (the amount of such obligation being deemed to be the lesser of the fair market value of such property or asset or the amount of the obligation so secured);

(h) all guarantees by such Person of Debt referred to in this definition of any other Person;

(i) all Redeemable Capital Stock of such Person valued at the greater of its voluntary or involuntary maximum fixed repurchase price plus accrued and unpaid dividends; and

(j) Preferred Stock of any Restricted Subsidiary;

provided that the term "Debt" shall not include (i) non-interest bearing installment obligations and accrued liabilities incurred in the ordinary course of business that are not more than 90 days past due; (ii) Debt in respect of the incurrence by us or any Restricted Subsidiary of Debt in respect of stand-by letters of credit, performance bonds or surety bonds provided by us or any Restricted Subsidiary in the ordinary course of business to the extent such letters of credit or bonds are not drawn upon or, if and to the extent drawn upon are honored in accordance with their terms and if, to be reimbursed, are reimbursed no later than the third business day following receipt by such Person of a demand for reimbursement following payment on the letter of credit or bond; (iii) anything accounted for as an operating lease in accordance with IFRS as at the date of the Indenture; (iv) Debt incurred by us or one of the Restricted Subsidiaries in connection with a transaction where (x) such Debt is borrowed from a bank or trust company organized in any member state of the European Union as of the date of the Indenture, or any commercial banking institution that is a member of the U.S. Federal Reserve System, in each case having a combined capital and surplus and undivided profits of not less than €500 million, whose debt has a rating immediately prior to the time such transaction is entered into, of at least "A" by S&P and "A2" by Moody's and (y) a substantially concurrent Investment is made by us or a Restricted Subsidiary in the form of cash deposited with the lender of such Debt, or a Subsidiary or affiliate thereof, in amount equal to such Debt; (v) Subordinated Shareholder Debt; (vi) Contingent Obligations in the ordinary course of business; (vii) in connection with the purchase by us or any Restricted Subsidiary of any business, and post-closing adjustments to which the seller may become entitled to the extent such payment is determined by a final closing balance sheet or such payment depends on the performance of such business after the closing; or (vi) for the avoidance of doubt, any contingent obligations in respect of workers' compensation claims, early retirement or termination obligations, pension fund obligations or contributions or similar claims, obligations or contributions or social security or wage taxes.

For purposes of this definition, the "maximum fixed repurchase price" of any Redeemable Capital Stock that does not have a fixed redemption, repayment or repurchase price will be calculated in accordance with the terms of such Redeemable Capital Stock as if such Redeemable Capital Stock were purchased on any date on which Debt will be required to be determined pursuant to the Indenture, and if such price is based upon, or measured by, the fair market value of such Redeemable Capital Stock, such fair market value will be determined in good faith by the board of directors of the issuer of such Redeemable Capital Stock; *provided*, that if such Redeemable Capital Stock is not then permitted to be redeemed, repaid or repurchased, the redemption, repayment or repurchase price shall be the book value of such Redeemable Capital Stock as reflected in the most recent financial statements of such Person.

"*Default*" means any event that is, or after notice or passage of time or both would be, an Event of Default.

"*Disinterested Member*" means, with respect to any transaction or series of related transactions, a member of our advisory board who does not have any material direct or indirect financial interest in or with respect to such transaction or series of related transactions or is not an Affiliate, or an officer, director or employee of any Person (other than us) who has any direct or indirect financial interest in or with respect to such transaction or series of related transactions.

"*dollars*" means the lawful currency of the United States of America.

"*Equity Interests*" means Capital Stock and all warrants, options or other rights to acquire Capital Stock (but excluding any debt security that is convertible into, or exchangeable for, Capital Stock).

"*Equity Offering*" means (a) a sale of Qualified Capital Stock of the Issuer other than offerings registered on Form S-8 (or any successor form) under the Securities Act or any similar offering in other jurisdictions, or (b) the sale of Capital Stock or other securities, the proceeds of which are contributed as Subordinated Shareholder Debt or Qualified Capital Stock of the Issuer or are used to repay the HKB PIK Loans, in each case other than a sale of Qualified Capital Stock, Capital Stock or other securities to one or more Permitted Holders.

"*euro*" or "€" means the lawful currency of the member states of the European Union who have agreed to share a common currency in accordance with the provisions of the Maastricht Treaty dealing with European monetary union.

"*Euro Equivalent*" means, with respect to any monetary amount in a currency other than euro, at any time for the determination thereof, the amount of euro obtained by converting such foreign currency involved in such computation into euro at the spot rate for the purchase of euro with the applicable foreign currency as published under "Currency Rates" in the section of the Financial Times entitled "Currencies, Bonds and Interest Rates" on the date two Business Days prior to such determination.

"*European Government Obligations*" means direct obligations (or certificates representing an ownership interest in such obligations) of a member state of the European Union as of the date of the Indenture (including any agency or instrumentality thereof) for the payment of which the full faith and credit of such government is pledged.

"*Exchange Act*" means the U.S. Securities Exchange Act of 1934, as amended, or any successor statute, and the rules and regulations promulgated by the Commission thereunder.

"*Excluded Cash Contributions*" means cash received by the Issuer (a) which results in the release of the Lien under the HKO Share Pledge Agreement as described under clauses (ii) or (iii) of the third paragraphs of "—Collateral—Release of Collateral" or (b) which forms the basis for the Guaranteed Dividend as defined in "Change of Control".

"*Fair Market Value*" means, with respect to any asset or property, the sale value that would be obtained in an arm's-length free market transaction between an informed and willing seller under no compulsion to sell and an informed and willing buyer under no compulsion to buy, as determined in good faith by our advisory board.

"*Fiscal Unity*" means the establishment of a fiscal unity (*Organschaft*) between the Issuer and HKB.

"*guarantees*" means, as applied to any obligation,

(a) a guarantee (other than by endorsement of negotiable instruments for collection in the ordinary course of business), direct or indirect, in any manner, of any part or all of such obligation and

(b) an agreement, direct or indirect, contingent or otherwise, the practical effect of which is to assure in any way the payment or performance (or payment of damages in the event of nonperformance) of all or any part of such obligation, including, without limiting the foregoing, by the pledge of assets and the payment of amounts drawn down under letters of credit.

"*Highly Rated Securities*" means,

(a) securities issued or directly and fully guaranteed or insured by the United States government or any agency or instrumentality thereof (other than Cash Equivalents);

(b) European Government Obligations (other than Cash Equivalents);

(c) debt securities or debt instruments with a rating of "A" or higher from S&P or "A2" or higher from Moody's or the equivalent of such rating by such rating organization or, if no rating of S&P for Moody's then exists, the equivalent of such rating by any other nationally recognized securities rating agency, but excluding any debt securities or instruments constituting loans or advances among the Issuer and its Subsidiaries;

(d) investments in any fund that invests exclusively in investments of the type described in clauses (a), (b) and (c) above which fund may also hold cash and Cash Equivalents pending investment and/or distribution; and

(e) corresponding instruments in countries other than those identified in clause (a) and (b) above customarily utilized for high quality investments.

"*IFRS*" means International Financial Reporting Standards as in effect as of the date of the Indenture.

"*Interest Rate Agreements*" means any interest rate protection agreements and other types of interest rate hedging agreements (including, without limitation, interest rate swaps, caps, floors, collars and similar agreements) designed to protect against or manage exposure to fluctuations in interest rates.

"*Investment*" means, with respect to any Person, any direct or indirect advance, loan or other extension of credit (including guarantees) or capital contribution to (by means of any transfer of cash or other property to others or any payment for property or services for the account or use of others), or any purchase, acquisition or ownership by such Person of any Capital Stock, bonds, notes, debentures or other securities or evidences of Debt issued or owned by, any other Person and all other items that would be classified as investments on a balance sheet prepared in accordance with IFRS. In addition, the portion (proportionate to our equity interest in such Subsidiary) of the fair market value of the net assets of any Restricted Subsidiary at the time that such Restricted Subsidiary is designated an Unrestricted Subsidiary will be deemed to be an "Investment" that we made in such Unrestricted Subsidiary at such time. The portion (proportionate to our equity interest in such Subsidiary) of the fair market value of the net assets of any Unrestricted Subsidiary at the time that such Unrestricted Subsidiary is designated a Restricted Subsidiary will be considered a reduction in outstanding Investments. "Investments" excludes extensions of trade credit on commercially reasonable terms in accordance with normal trade practices. For the avoidance of doubt, loans to shareholders or loans to Parents shall be restricted pursuant to clause (a)(i) of the covenant set forth under "—Limitation on Restricted Payment" and not an Investment.

"*Investment Grade Status*" shall occur when the Notes receive a rating of "BBB" or higher from S&P and rating of "Baa3" or higher from Moody's (or, if either such entity ceases to rate the Notes for reasons outside of our control, the equivalent investment grade credit rating from any other "nationally recognized statistical rating organization," as that term is used in Rule 15c3-1 under the Exchange Act, selected by us as a replacement agency).

"*Lien*" means any mortgage or deed of trust, charge, pledge, lien (statutory or otherwise), privilege, security interest, hypothecation, assignment for security, claim, or preference or priority or other encumbrance upon or with respect to any property of any kind, real or personal, movable or immovable, now owned or hereafter acquired. A Person will be deemed to own subject to a Lien any property which such Person has acquired or holds subject to the interest of a vendor or lessor under any conditional sale agreement, capital lease or other title retention agreement.

"*Maturity*" means, with respect to any indebtedness, the date on which any principal of such indebtedness becomes due and payable as therein or herein provided, whether at the Stated Maturity with respect to such principal or by declaration of acceleration, call for redemption or purchase or otherwise.

"*Moody's*" means Moody's Investors Service, Inc. and its successors.

"*Net Cash Proceeds*" means,

(a) with respect to any Asset Sale, the proceeds thereof in the form of cash or Cash Equivalents including payments in respect of deferred payment obligations when received in the form of, or stock or other assets when disposed for, cash or Cash Equivalents (except to the extent that such obligations are financed or sold with recourse to us or any Restricted Subsidiary), net of:

  (i) brokerage commissions and other fees and expenses (including, without limitation, fees and expenses of legal counsel, accountants, investment banks and other consultants) related to such Asset Sale,

  (ii) provisions for all taxes payable as a result of such Asset Sale,

  (iii) all payments made on any Debt that is secured by any Property subject to such Asset Sale, in accordance with the terms of any Lien upon or other security agreement of any kind with respect to such Property, or which must by its terms, or in order to obtain a necessary consent to such Asset Sale, or by applicable law, be repaid out of the proceeds from such Asset Sale,

  (iv) amounts required to be paid to any Person (other than us or any Restricted Subsidiary) owning a beneficial interest in the assets subject to the Asset Sale and

  (v) appropriate amounts to be provided by us or any Restricted Subsidiary, as the case may be, as a reserve required in accordance with IFRS against any liabilities associated with such Asset Sale and retained by us or any Restricted Subsidiary, as the case may be, after such Asset Sale, including, without limitation, pension and other post-employment benefit liabilities, liabilities related to environmental matters and liabilities under any indemnification obligations associated with such Asset Sale, and

(b) with respect to any capital contributions, issuance or sale of Capital Stock or options, warrants or rights to purchase Capital Stock, or debt securities or Capital Stock that have been converted into or exchanged for Capital Stock as referred to under "—Certain Covenants—Limitation on Restricted Payments," the proceeds of such issuance or sale in the form of cash or Cash Equivalents, payments in respect of deferred payment obligations when received in the form of, or stock or other assets when disposed of for, cash or Cash Equivalents (except to the extent that such obligations are financed or sold with recourse to us or any Restricted Subsidiary), net of attorney's fees, accountant's fees and brokerage, consultation, underwriting and other fees and expenses actually incurred in connection with such issuance or sale and net of taxes paid or payable as a result of thereof.

"*Officer's Certificate*" means a certificate signed by an officer of our company or of a Surviving Entity, as the case may be, and delivered to the Trustee.

"*Parent*" means any Person of which the Issuer at any time is or becomes a Subsidiary after the Issue Date.

"*Parent Expenses*" means:

(a) costs (including all professional fees and expenses) incurred by any Parent in connection with reporting obligations under or otherwise incurred in connection with compliance with applicable laws, rules or regulations of any governmental, regulatory or self-regulatory body or stock exchange, the Indenture or any other agreement or instrument relating to Debt of the Parent, including in respect of any reports filed with respect to the Securities Act, Exchange Act or the respective rules and regulations promulgated thereunder;

(b) customary indemnification obligations of any Parent owing to directors, officers, employees or other Persons under its charter or by-laws or pursuant to written agreements with any such Person to the extent relating to the Issuer and its Subsidiaries;

(c) obligations of any Parent in respect of director and officer insurance (including premiums therefor) to the extent relating to the Issuer and its Subsidiaries; or

(d) general corporate overhead expenses, including (i) professional fees and expenses and other operational expenses of any Parent related to the ownership or operation of the business of the Issuer or any of its

Restricted Subsidiaries or (ii) costs and expenses with respect to any litigation or other dispute relating to the Transactions or the ownership, directly or indirectly, of the Issuer by any Parent.

"*Pari Passu Debt*" means any Debt of ours that ranks equally in right of payment with the Notes or the Subsidiary Guarantees.

"*Permitted Collateral Lien*" means the following types of Liens:

(a) Liens on the Collateral to secure Debt permitted under "—Certain Covenants—Limitation on Debt"; *provided* that the assets and properties securing such Debt will also secure the Notes on a first ranking basis and *provided*, *further*, that, following the incurrence of such Debt secured by such Liens on the Collateral and giving effect to the application of the proceeds thereof, on a pro forma basis, the Consolidated Secured Debt Leverage Ratio for the four full fiscal quarters for which financial statements are available immediately preceding the incurrence of such Debt, taken as one period, would be less 3.5 to 1.0;

(b) Liens on the Collateral to secure Debt permitted under clauses (i), (ii), (xii) and (xiii) (to the extent that the Permitted Refinancing Debt refinances Debt secured by a Lien on the Collateral) of paragraph (b) of "—Certain Covenants—Limitation on Debt";

(c) Liens of the type described in clauses (f), (g), (h), (i), (j), (k), (l), (m), (n) and (t) of the definition of "Permitted Liens"; *provided* that, in the case of clause (l) thereof, any proceeding instituted contesting such Lien shall conclusively operate to stay the sale or forfeiture of any portion of the Collateral on account of such Lien; and

(d) any extension, renewal or replacement, in whole or in part, of any Lien described in the foregoing clauses (a) through (e); *provided* that any such extension, renewal or replacement will be of the same priority and be no more restrictive in any material respect than the Lien so extended, renewed or replaced and will not extend in any material respect to any additional property or assets.

"*Permitted Debt*" has the meaning given to such term under "—Certain Covenants—Limitation on Debt."

"*Permitted HKB Merger*" shall mean the merger of the Issuer and HKB if the following conditions have been met:

(a) a Fiscal Unity has been established prior to (including as part of a series of related transactions) in accordance with the terms of the Indenture; or

(b) if a Fiscal Unity has not been established, (x) the merger complies with the covenant described under "—Certain Covenants—Consolidation, Merger and Sale of Assets", (y) at all times since the initial purchase of the HKB PIK Loans following the Issue Date, the HKB PIK Loans have been held by HKB and its Wholly Owned Subsidiaries and (z) HKB, together with any of its subsidiaries which are not the Issuer or Subsidiary Guarantors, have complied with the covenants set forth under "—Certain Covenants—Limitation on Transactions with Affiliates" (other than in respect of transactions with the Issuer and its Restricted Subsidiaries), "—Limitation on Restricted Payments," and "—Limitation on Liens" on a pro forma basis as if such covenants had applied to them from and after the Issue Date.

"*Permitted Holders*" means (i) Andreas Heeschen, (ii) Keith Halsey, (iii) Dr. Alfred Schefenacker and (iv) any Affiliate or Related Person of any such Permitted Holder, and any successor to any such Permitted Holder, Affiliate or Related Person.

"*Permitted Investments*" means any of the following:

(a) Investments in cash or Cash Equivalents or Highly Rated Securities;

(b) intercompany Debt to the extent permitted under clause (d) of the definition of "Permitted Debt;"

(c) Investments in (i) the form of loans or advances to us, (ii) a Restricted Subsidiary or (iii) another Person if as a result of such Investment such other Person becomes a Restricted Subsidiary or such other Person is merged or consolidated with or into, or transfers or conveys all or substantially all of its assets to, us or a Restricted Subsidiary;

(d) Investments acquired by us or any Restricted Subsidiary in connection with an Asset Sale permitted under "—Certain Covenants—Limitation on Sale of Certain Assets" to the extent such Investments are non-cash proceeds permitted thereunder;

(e) payroll, travel and similar advances to cover matters that are expected at the time of such advances to be treated as expenses in accordance with IFRS;

(f) Investments in the Notes;

(g) Investments existing at, or made pursuant to binding commitments existing at, the date of the Indenture;

(h) Investments in Interest Rate and Currency Agreements permitted under the "Limitation on Debt" covenant;

(i) loans and advances (or guarantees to third-party loans) to employees made in the ordinary course of business and consistent with our past practices or past practices of such Restricted Subsidiary, as the case may be, in an amount outstanding not to exceed at any one time €2.0 million;

(j) Investments in a Person to the extent that the consideration therefor consists of the net proceeds of the substantially concurrent issue and sale (other than to any Subsidiary) of shares of our Qualified Capital Stock; *provided* that the net proceeds of such sale have been excluded from, and shall not have been included in, the calculation of the amount determined under clause (2)(c)(ii) of the "Limitation on Restricted Payments" covenant;

(k) any payments or other transactions pursuant to a tax sharing agreement between us and any other Person with whom we file or filed a consolidated tax return or with which we are or were part of a consolidated group for tax purposes or any tax advantageous group contribution made pursuant to applicable legislation;

(l) Investments acquired by us or any Restricted Subsidiary in connection with an Asset Sale permitted under "—Certain Covenants—Limitation on Sale of Certain Assets" to the extent that such Investments are non-cash proceeds as permitted under such covenant;

(m) Other Investments made for Fair Market Value that do not exceed €10.0 million outstanding at any one time in the aggregate;

(n) Currency Arrangements and Interest Rate Agreements, which transactions or obligations are incurred in compliance with "Certain Covenants—Limitation on Debt;"

(o) any acquisition of assets or Capital Stock solely in exchange for the issuance of Equity Interests (other than Redeemable Capital Stock) of the Issuer or Subordinated Shareholder Debt;

(p) any Investment received in compromise or resolution of (i) obligations of trade creditors or customers that were incurred in the ordinary course of business of the Issuer or any of its Restricted Subsidiaries, including pursuant to any plan or reorganization or similar arrangement upon the bankruptcy or insolvency of any trade creditor or customer; or (ii) litigation, arbitration or other disputes;

(q) any Investment in receivables owing to the Issuer or any Restricted Subsidiary created or acquired in the ordinary course of business;

(r) Investments in respect of compensation and retirement payments under compensation and early retirement plans; and

(s) Investments in the HKB PIK Loans, other than the HKB PIK Loans held by HKB on the Issue Date.

"*Permitted Liens*" means the following types of Liens:

(a) Liens existing as of the date of the issuance of the Notes;

(b) Liens on our or any Restricted Subsidiary's assets or property securing Debt under the Credit Facilities permitted to be incurred pursuant to clause (b)(i) of the definition of "Permitted Debt";

(c) Liens on any property or assets of a Restricted Subsidiary granted in favor of us or any Wholly Owned Restricted Subsidiary;

(d) Liens on any of our or any Restricted Subsidiary's property or assets securing the Notes;

(e) any interest or title of a lessor under any Capitalized Lease Obligation or operating lease;

(f) Liens arising out of conditional sale, title retention, consignment or similar arrangements for the sale of goods entered into by us or any Restricted Subsidiary in the ordinary course of business in accordance with such grantor's past practices prior to the date of the Indenture;

(g) statutory Liens of landlords and carriers, warehousemen, mechanics, suppliers, material-men, repairmen, stevedores, masters, crew, employees, pension plan administrators or other like Liens arising in the ordinary course of our or any Restricted Subsidiary's business and with respect to amounts not yet delinquent or being contested in good faith by appropriate proceedings and for which a reserve or other appropriate provision, if any, as shall be required in conformity with IFRS shall have been made or Liens arising solely by virtue of any statutory or common law provisions relating to bankers' liens, rights of setoff or similar rights and remedies as to deposit accounts or other funds maintained with a creditor depositary institution;

(h) Liens for taxes, assessments, government charges or claims that are being contested in good faith by appropriate proceedings promptly instituted and diligently conducted and for which a reserve or other appropriate provision, if any, as shall be required in conformity with IFRS shall have been made;

(i) Liens incurred or deposits made to secure the performance of tenders, bids, leases, statutory or regulatory obligations, surety and appeal bonds, government contracts, performance bonds and other obligations of a like nature incurred in the ordinary course of business (other than obligations for the payment of borrowed money);

(j) zoning restrictions, easements, licenses, reservations, title defects, rights of others for licenses rights-of-way, utilities, sewers, electrical lines, telephone lines, telegraph wires, restrictions and other similar charges or encumbrances not interfering in any material respect with our or any Restricted Subsidiary's business incurred in the ordinary course of business;

(k) Liens arising by reason of any judgment, decree or order of any court so long as such Lien is adequately bonded and any appropriate legal proceedings that may have been duly initiated for the review of such judgment, decree or order shall not have been finally terminated or the period within which such proceedings may be initiated shall not have expired;

(l) Liens on property of, or on shares of Capital Stock or Indebtedness of, any Person existing at the time such Person becomes, or becomes a part of, any Restricted Subsidiary; *provided* that such Liens do not extend to or cover any property or assets of our or any Restricted Subsidiary other than the property or assets acquired and *provided further* that such Liens were created prior to, and not in connection with or in contemplation of such acquisition;

(m) Liens securing our or any Restricted Subsidiary's obligations under Interest Rate Agreements or Currency Agreements permitted under "—Certain Covenants—Limitation on Debt" or any collateral for the Debt to which such Interest Rate Agreements or Currency Agreements relate;

(n) Liens incurred or deposits made in the ordinary course of business in connection with workers' compensation, unemployment insurance and other types of social security or other insurance (including unemployment insurance);

(o) Liens arising solely by virtue of any statutory or common law provisions relating to banker's Liens, rights of setoff or similar rights and remedies as to deposit accounts or other funds maintained with a depositary institution; provide that such deposit account is not intended by us or any Restricted Subsidiary to provide collateral to the depositary institution;

(p) Liens arising from the United States Uniform Commercial Code financing statement filings (or similar filings in other applicable jurisdictions) regarding operating leases entered into by us and any Restricted Subsidiary in the ordinary course of business;

(q) Liens with respect to any sale and leaseback transaction permitted under the terms of the indenture;

(r) purchase money Liens to finance property or assets of ours or any Restricted Subsidiary acquired in the ordinary course of business; *provided* that (i) the related purchase money Debt shall not exceed the cost of such property or assets and shall not be secured by any property or assets of ours or any Restricted Subsidiary other than the property and assets so acquired and (ii) the Lien securing such Debt shall be created within 90 days of such acquisitions;

(s) Liens securing Debt not in excess of €10.0 million in the aggregate; and

(t) any extension, renewal or replacement, in whole or in part, of any Lien described in the foregoing clauses (a) through (s); *provided* that any such extension, renewal or replacement shall be no more restrictive in any material respect than the Lien so extended, renewed or replaced and shall not extend in any material respect to any additional property or assets.

"*Permitted Refinancing Debt*" means any renewals, extensions, substitutions, refinancings or replacements (each, for purposes of this clause and clause (b) of "—Certain Covenants—Limitation on Debt," a "*refinancing*") of any Debt of ours or a Restricted Subsidiary or pursuant to this definition, including any successive refinancings, so long as:

(a) such Debt is in an aggregate principal amount (or if incurred with original issue discount, an aggregate issue price) not in excess of the sum of (i) the aggregate principal amount (or if incurred with original issue discount, the aggregate accreted value) then outstanding of the Debt being refinanced and (ii) an amount necessary to pay any fees and expenses, including premiums and defeasance costs, related to such refinancing,

(b) the Average Life of such Debt is equal to or greater than the Average Life of the Debt being refinanced,

(c) the Stated Maturity of such Debt is no earlier than the Stated Maturity of the Debt being refinanced, and

(d) the new Debt is not senior in right of payment to the Debt that is being refinanced,

provided that Permitted Refinancing Debt will not include (i) Debt of a Subsidiary that refinances our Debt or (ii) Debt of any Restricted Subsidiary that refinances Debt of an Unrestricted Subsidiary.

"*Person*" means any individual, corporation, limited liability company, partnership, joint venture, association, joint-stock company, trust, unincorporated organization or government or any agency or political subdivision thereof.

"*Pre-Expansion European Union*" means the European Union as of January 1, 2004, including the countries of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Sweden and the United Kingdom, but not including any country which became or becomes a member of the European Union after January 1, 2004.

"*Preferred Stock*" means, with respect to any Person, Capital Stock of any class or classes (however designated) of such Person which is preferred as to the payment of dividends or distributions, or as to the distribution of assets upon any voluntary or involuntary liquidation or dissolution of such Person, over the Capital Stock of any other class of such Person whether now outstanding, or issued after the date of the Indenture, and including, without limitation, all classes and series of preferred or preference stock of such Person.

"*pro forma*" means, with respect to any calculation made or required to be made pursuant to the terms of the Notes, a calculation made in good faith by our advisory board after consultation with our independent certified public accountants, as the case may be.

"*Property*" means, with respect to any Person, any interest of such Person in any kind of property or asset, whether real, personal or mixed, or tangible or intangible, including Capital Stock, and other securities of, any other Person. For purposes of any calculation required pursuant to the Indenture, the value of any Property shall be its Fair Market Value.

"*Public Debt*" means any bonds, debentures, notes or other indebtedness of a type that could be issued or traded in any market where capital funds (whether debt or equity) are traded, including private placement sources of debt and equity as well as organized markets and exchanges, whether such indebtedness is issued in a public offering or in a private placement to institutional investors or otherwise but excluding Additional Notes.

"*Public Equity Offering*" means (a) any offering of Qualified Capital Stock of the Issuer that is listed on a national exchange or that is publicly offered or (b) any offering of Qualified Capital Stock of any direct or indirect parent company of the Issuer that is listed on a national exchange or that is publicly offered, in the case of this clause (b), the proceeds of which are contributed as Subordinated Shareholder Debt or Qualified Capital Stock of the Issuer or are used to repay the HKB PIK Loans.

"*Qualified Capital Stock*" of any person means any and all Capital Stock of such person other than Redeemable Capital Stock.

"*Redeemable Capital Stock*" means any class or series of Capital Stock that, either by its terms, by the terms of any security into which it is convertible or exchangeable or by contract or otherwise, is, or upon the happening of an event or passage of time would be, required to be redeemed prior to the final Stated Maturity of the Notes or is redeemable at the option of the holder thereof at any time prior to such final Stated Maturity (other than upon a change of control of our company in circumstances in which the holders of the Notes would have similar rights), or is convertible into or exchangeable for debt securities at any time prior to such final Stated Maturity; *provided* that any Capital Stock that would constitute Qualified Capital Stock but for provisions thereof giving holders thereof the right to require such Person to repurchase or redeem such Capital Stock upon the occurrence of any "asset sale" or "change of control" occurring prior to the Stated Maturity of the Notes will not constitute Redeemable Capital Stock if the "asset sale" or "change of control" provisions applicable to such Capital Stock are no more favorable to the holders of such Capital Stock than the provisions contained in "—Certain Covenants—Limitation on Sale of Certain Assets" and "—Purchase of Notes upon a Change of Control" covenants described herein and such Capital Stock specifically provides that such Person will not repurchase or redeem any such stock pursuant to such provision prior to our repurchase of such Notes as are required to be repurchased pursuant to "—Certain Covenants—Limitation on Sale of Certain Assets" and "—Purchase of Notes upon a Change of Control."

"*Related Business*" means any business related to the development, manufacture, sale and servicing of small arms, weapons systems and related military products and any business reasonably related thereto.

"*Related Business Assets*" means assets used or useful in a Related Business.

"*Related Person*" with respect to any Permitted Holder means: (i) any spouse, family member or relative of such individual, any trust or partnership for the benefit of one or more of such individual and any such spouse, family member or relative, or the estate, executor, administrator, committee or beneficiaries of any thereof; or (ii) any trust, corporation, partnership or other Person for which one or more of the Permitted Holders and other Related Persons or any thereof constitute the beneficiaries, stockholders, partners or owners thereof; or Persons beneficially holding in the aggregate a majority (or more) controlling interest therein.

"*Restricted Subsidiary*" means any Subsidiary of ours other than an Unrestricted Subsidiary.

"*S&P*" means Standard and Poor's, a division of The McGrawHill-Companies, Inc. and its successors.

"*Securities Act*" means the United States Securities Act of 1933, as amended, or any successor statute, and the rules and regulations promulgated by the Commission thereunder.

"*Security Document*" means the Share Pledge Agreements and any other pledge agreements or other documents under which a security interest is granted to the secure the payment and performance when due of the obligations of the Issuer and/or the Subsidiary Guarantors under the Notes and the Indenture.

"*Stated Maturity*" means, when used with respect to any Note or any installment of interest thereon, the date specified in such Note as the fixed date on which the principal of such Note or such installment of interest, respectively, is due and payable, and, when used with respect to any other Debt, means the date specified in the instrument governing such Debt as the fixed date on which the principal of such indebtedness, or any installment of interest thereon, is due and payable.

"*Subordinated Debt*" means Debt of our company or any Restricted Subsidiary that is subordinated in right of payment to the Notes.

"*Subordinated Shareholder Debt*" means, collectively, any subordinated shareholder debt provided to the Issuer by any direct or indirect parent of the Issuer or any Permitted Holder, in exchange for or pursuant to any security, instrument or agreement other than Capital Stock, together with any such security, instrument or agreement and any other security or instrument other than Capital Stock issued in payment of any obligation under any Subordinated Shareholder Debt; *provided* that such Subordinated Shareholder Debt:

(a) does not (including upon the happening of any event) mature or require (including upon the happening of any event) any amortization or other payment of principal (including pursuant to a sinking fund or otherwise) prior to the first anniversary of the maturity of the Notes (other than through conversion or exchange of any such security or instrument for Equity Interests of the Issuer (other than Redeemable Capital Stock) or for any other security or instrument meeting the requirements of the definition);

(b) does not (including upon the happening of any event) require or provide for the payment of cash interest prior to the first anniversary of the maturity of the Notes;

(c) does not (including upon the happening of any event) provide for the acceleration of its maturity nor confers on its shareholders any right (including upon the happening of any event) to declare a default or event of default, accelerate, place on demand or exercise any remedies or take any enforcement action, in each case, prior to the first anniversary of the maturity of the Notes;

(d) is not secured by a Lien on any assets of the Issuer or a Restricted Subsidiary and is not guaranteed by any Subsidiary of the Issuer;

(e) is subordinated in right of payment to the prior payment in full in cash of the Notes and Subsidiary Guarantees such that:

 (i) the Issuer shall make no payment in respect of such Subordinated Shareholder Debt (whether in cash, securities or otherwise, except as permitted by clause (a) above) and may not acquire such Subordinated Shareholder Debt except as permitted by the Indenture until the prior payment in full in cash of all obligations in respect of the Notes, any Subsidiary Guarantee and the Indenture;

 (ii) upon any total or partial liquidation, dissolution or winding-up of the Issuer or in a bankruptcy, reorganization, insolvency, receivership or similar proceeding relating to the Issuer or its property, the holders of the Notes shall be entitled to receive payment in full in cash of the obligations under the Notes or any Subsidiary Guarantee before the holders of such Subordinated Shareholder Debt shall be entitled to receive any payment in respect of such Subordinated Shareholder Debt;

 (iii) such Subordinated Shareholder Debt may not be amended such that it would cease to qualify as Subordinated Shareholder Debt until a date that is after the prior payment in full in cash of all obligations in respect of the Notes, any Subsidiary Guarantee and the Indenture;

 (iv) the holders of such Subordinated Shareholder Debt shall assign any rights to vote, including by way of power of attorney, in a bankruptcy, insolvency or similar proceeding to the Trustee under the Indenture to the extent necessary to give effect to the priority and subordination provisions described in this definition; and

 (v) the holders of such Subordinated Shareholder Debt shall agree that, in the event any payment on such Subordinated Shareholder Debt is received by such holder in contravention of the terms of the Indenture, then such payment shall be held in trust for the benefit of, and shall be paid over or delivered to, the Trustee, on behalf of the holders of the Notes;

(f) has been granted as security for the Notes by the obligee thereunder;

(g) does not (including upon the happening of any event) restrict the payment of amounts due in respect of the Notes, a Subsidiary Guarantee or compliance by the Issuer or any Subsidiary Guarantor with its obligations under the Notes, the Indenture, the Subsidiary Guarantees, the Share Pledge Agreement or any Credit Facility or the Issuer and its Restricted Subsidiaries;

(h) does not (including upon the happening of an event) constitute Voting Stock; and

(i) is not (including upon the happening of any event) mandatorily convertible or exchangeable, or convertible or exchangeable at the option of the holder, in whole or in part, prior to the first anniversary of the maturity of the Notes mature other than into or for Capital Stock (other than Redeemable Capital Stock) of the Issuer.

"*Subsidiary*" means, with respect to any Person,

(a) a corporation a majority of whose Voting Stock is at the time, directly or indirectly, owned by such Person, by one or more Subsidiaries of such Person or by such Person and one or more Subsidiaries thereof and

(b) any other Person (other than a corporation), including, without limitation, a partnership, limited liability company, business trust or joint venture, in which such Person, one or more Subsidiaries thereof or such Person and one or more Subsidiaries thereof, directly or indirectly, at the date of determination thereof, has at least majority ownership interest entitled to vote in the election of directors, managers or Trustees thereof (or other Person performing similar functions).

"*Subsidiary Guarantors*" means Suhler USA, Inc., Heckler & Koch, Inc., Heckler & Koch France SAS, HK Sidearms GmbH, NSAF Limited, Small Arms Group Holding, Inc. and Heckler & Koch Defense, Inc. and any Restricted Subsidiary that provides a Subsidiary Guarantee in accordance with the provisions of the Indenture and their respective successors, in each case until the Subsidiary Guarantee of such Person has been released in accordance with the provisions of the Indenture.

"*Surviving Entity*" has the meaning given to such term under "—Certain Covenants—Consolidation, Merger and Sale of Assets".

"*Total Inventories*" means as of any date, the amount of raw materials, work-in-progress and finished goods of the Issuer and the Restricted Subsidiaries, net of any provisions in respect of the foregoing items, in each case as of the date of the most recent balance sheet of the Issuer which has been delivered in accordance with the provisions of "—Certain Covenants—Reports to Holders."

"*Trust Indenture Act*" means the United States Trust Indenture Act of 1939, as amended, or any successor statute, and the rules and regulations promulgated by the Commission thereunder.

"*Unrestricted Subsidiary*" means

(a) any Subsidiary of ours that at the time of determination is an Unrestricted Subsidiary (as designated by our advisory board pursuant to the "Limitations on Unrestricted Subsidiaries" covenant) and

(b) any Subsidiary of an Unrestricted Subsidiary.

"*Voting Stock*" means any class or classes of Capital Stock pursuant to which the holders thereof have the general voting power under ordinary circumstances to elect at least a majority of the board of directors, managers or trustees (or Persons performing similar functions) of any Person (irrespective of whether or not, at the time, stock of any other class or classes shall have, or might have, voting power by reason of the happening of any contingency).

"*Wholly Owned Restricted Subsidiary*" means any Restricted Subsidiary, all of the outstanding Capital Stock (other than directors' qualifying shares or shares of foreign Restricted Subsidiaries required to be owned by foreign nationals pursuant to applicable law) of which are owned by us or by one or more other Wholly Owned Restricted Subsidiaries by us and one or more other Wholly Owned Restricted Subsidiaries.

"*Wholly Owned Subsidiary*" means a Subsidiary of a Person, all of the outstanding Capital Stock (other than directors' qualifying shares) of which are owned by such Person or one or more of its Wholly Owned Subsidiaries.

LIMITATIONS ON VALIDITY AND ENFORCEABILITY OF THE GUARANTEES AND THE COLLATERAL AND CERTAIN INSOLVENCY CONSIDERATIONS

The following is a brief description of certain aspects of insolvency law in Germany, where the Issuer and some of the Guarantors are organized. See "Risk Factors—Risks Relating to Our Debt and the Notes—The insolvency laws of Germany may not be as favorable to you as the bankruptcy laws of the jurisdiction with which you are familiar."

European Union Insolvency Law

The Issuer and several of the Guarantors are organized under the laws of the Member States of the EU.

Pursuant to Council Regulation (EC) no. 1346/2000 on insolvency proceedings (the "EU Insolvency Regulation"), the court of the Member State (other than Denmark) where the company concerned has its "center of main interests" (as that term is used in Article 3(1) of the EU Insolvency Regulation) has the jurisdiction to open insolvency proceedings in relation to a company. The determination of where any such company has its "center of main interests" is a question of fact on which the courts of the different Member States may have differing and even conflicting views. To date, no final decisions have been made in cases that have been brought before the European Court of Justice relating to the questions of interpretation or the effects of the EU Insolvency Regulation throughout the EU.

The term "center of main interests" is not a static concept and may change from time to time. Although there is a rebuttable presumption under Article 3(1) of the EU Insolvency Regulation that any such company has its "center of main interests" in the Member State in which it has its registered office, Preamble 13 of the EU Insolvency Regulation states that the "center of main interests" of a debtor should correspond to the place where the debtor conducts the administration of its interests on a regular basis and "is therefore ascertainable by third parties." In that respect, factors such as where board meetings are held, the location where the company conducts the majority of its business and the location where the large majority of the company's creditors are established may all be relevant in the determination of the place where the company has its "center of main interests."

If the "center of main interests" of a company is and will remain located in the state in which it has its registered office, the main insolvency proceedings in respect of the company under the EU Insolvency Regulation would be commenced in such jurisdiction and, accordingly, a court in such jurisdiction would be entitled to commence the types of insolvency proceedings referred to in Annex A to the EU Insolvency Regulation, with these proceedings being governed by the *lex fori concursus*, i.e. the local law of the court opening such main insolvency proceedings. Insolvency proceedings opened in one Member State under the EU Insolvency Regulation are to be recognized in the other Member States (other than Denmark), although secondary proceedings may be opened in another Member State. If the "center of main interests" of a debtor is in one Member State (other than Denmark), under Article 3(2) of the EU Insolvency Regulation, the courts of another Member State (other than Denmark) have the jurisdiction to open "territorial proceedings" only in the event that such debtor has an "establishment" in the territory of such other Member State. The effects of those territorial proceedings are restricted to the assets of the debtor situated in the territory of such other Member State. If the company does not have an establishment in any other Member State, no court of any other Member State has jurisdiction to open territorial proceedings in respect of such company under the EU Insolvency Regulation.

In the event that any one or more of the Issuer, the Guarantors or any of their respective subsidiaries experience financial difficulty, it is not possible to predict with certainty in which jurisdiction or jurisdictions insolvency or similar proceedings would be commenced, or the outcome of such proceedings. Applicable insolvency laws may affect the enforceability of the obligations of the Issuer and the Guarantors.

Germany

German insolvency law

As some Guarantors are incorporated in Germany, insolvency proceedings may be initiated in Germany in the event of an insolvency of any such Guarantor. Subject to the statements made above under the heading "European Union," such proceedings would then be governed by German law.

Under German law, insolvency proceedings can be initiated either by the debtor or by a creditor in the event of over-indebtedness (*Überschuldung*) or illiquidity (*Zahlungsunfähigkeit*) of the debtor. The debtor is over-indebted if its liabilities exceed the value of its assets which must be assessed on the basis of an over-indebtedness balance sheet (*Überschuldungsstatus*) to be drawn up either (i) on the basis of the liquidation value of the debtor or (ii) based upon the going concern value if a continuation of the business is more likely than not (according to temporary legislation being in force until end of 2013, the debtor is not deemed over-indebted if, given the circumstances its continuation as a going concern, is more likely than not). The debtor is illiquid if it is unable to pay its debts as and when they become due. If a limited liability company (*Gesellschaft mit beschränkter Haftung*) or any other kind of limited liability company becomes subject to illiquidity and/or over-indebtedness, the management of such company is obliged to file for insolvency without delay. In addition, the debtor can file for insolvency proceedings if it is imminently at risk of being unable to pay its debts as and when they become due (*drohende Zahlungsunfähigkeit*).

The insolvency proceedings are controlled by the competent insolvency court which monitors the due performance of the proceedings. Upon receipt of the insolvency petition, the insolvency court may take preliminary protective measures to secure the property of the debtor during the preliminary proceedings (*Insolvenzeröffnungsverfahren*). The insolvency court may prohibit or suspend any measures taken to enforce individual claims against the debtor's assets during these preliminary proceedings so long as these protective measures are reasonable to protect the debtor's assets and/or to ensure the continuation of the debtor's business. As part of such protective measures, the court may appoint a preliminary insolvency administrator (*vorläufiger Insolvenzverwalter*). The rights and duties of the preliminary administrator depend on the decision of the court. The duties of the preliminary administrator may be, in particular, to safeguard and to preserve the debtor's property and to assess whether the debtor's net assets will be sufficient to cover the costs of the insolvency proceedings. Depending on the decision of the court, the right to manage and dispose of the business and assets of the debtor may pass to the preliminary insolvency administrator. The court orders the opening (*Eröffnungsbeschluss*) of main insolvency proceedings (*eröffnetes Insolvenzverfahren*) if certain requirements are met, in particular if (i) the debtor is facing imminent illiquidity (if the petition has been filed by the debtor) or illiquidity and/or over-indebtedness and (ii) there are sufficient assets to cover at least the cost of the insolvency proceedings. Otherwise, the petition for opening of insolvency proceedings will usually be dismissed for insufficiency of assets. If insolvency proceedings are opened, the court usually appoints an insolvency administrator (*Insolvenzverwalter*) who has full power to dispose of the debtor's assets, and the debtor is no longer entitled to dispose of its assets. As an exception, the court may order insolvency proceedings to be run by the relevant debtor itself under the supervision of a custodian (*Sachwalter*), in which case the relevant debtor retains, to a large extent, its authority to dispose of its assets. Such order remains subject to review and may be repealed in which case an insolvency administrator would be appointed. An insolvency administrator may raise new financial indebtedness and incur other liabilities to continue the debtor's operations and satisfaction of these liabilities as preferential debts of the estate (*Masseschulden*) will be preferred to any insolvency liabilities created by the debtor (including secured debt).

All secured and unsecured creditors that wish to assert claims against the debtor must participate in the insolvency proceedings, unless they have a right to separate an asset from the insolvency estate (*Aussonderungsrecht*). Any judicial enforcement action (*Zwangsvollstreckung*) brought against the debtor by any of its creditors is subject to an automatic stay once insolvency proceedings have been opened (and, if so ordered by a court, also between the time when an insolvency petition is filed and the time when insolvency proceedings commence). If, during the final month proceeding the date of the date of filing for insolvency proceedings, a creditor acquires through execution (*i.e.*, attachment) a security interest in part of the debtor's property that would normally form part of the insolvency estate, such security becomes null and void by operation of law upon the opening of the insolvency proceedings. Unsecured creditors may file their claims in the insolvency proceedings and will be paid on a pro rata basis from the insolvency estate (to the extent sufficient assets are available). Secured creditors are not entitled to enforce their security interests after an insolvency petition has been filed, to the extent the Insolvency Code authorizes the insolvency administrator to dispose of the relevant collateral (though, between the time when an insolvency petition is filed and the time when insolvency proceedings commence, such stay on enforcement requires a court order). Secured creditors have only certain preferential rights (*Absonderungsrechte*) in the insolvency proceedings, and the enforcement proceeds less, in some cases, certain contributory charges, are paid to the relevant secured creditor up to an amount equal to its secured claims. Remaining amounts are distributed among the unsecured creditors. If the Issuer or a Guarantor incorporated in Germany (a "German Security Provider") were to grant security over its assets to other creditors, such security may result in a preferred treatment of such secured creditors while the remaining assets may not be sufficient to satisfy the claims of the holders of the Notes under the notes granted by the Issuer and under the Guarantee granted by the Guarantors. In addition, it may take several years before an insolvency dividend, if any, is distributed to unsecured creditors. A different distribution of enforcement proceeds can be proposed in an insolvency plan (*Insolvenzplan*) that can be submitted by the debtor or the insolvency administrator and requires the consent of the debtor as well as the consent of each class of creditors in accordance with specific majority rules.

Limitation on enforcement

Any security (including a Guarantee) granted by a Guarantor incorporated in Germany in the form of a GmbH (limited liability company) is subject to certain provisions of the German Limited Liability Company Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung,* or "GmbHG").

Sections 30 and 31 of the GmbHG ("Sections 30 and 31") prohibit a GmbH from disbursing its assets to its shareholders to the extent that the amount of the GmbH's net assets (*i.e.*, assets less liabilities and liability reserves) is already less than, or would fall below, the amount of its stated share capital. The granting of guarantees, share pledges and other security by a GmbH in order to guarantee or secure liabilities of a direct or indirect parent or sister company may be considered disbursements under Sections 30 and 31. Therefore, in order to enable a GmbH to issue guarantees or create security to secure guarantee liabilities of a direct or indirect parent or sister company without the risk of violating Sections 30 and 31, it is standard market practice to subject such guarantee and security to a so called "limitation language." Pursuant to such limitation language, the beneficiaries of the guarantees and secured parties agree to enforce the guarantee and security interest against the GmbH only to the extent that such enforcement would not result in the GmbH's net assets falling below its stated share capital or, if the net assets are already below its stated share capital, does not further reduce such amount. Accordingly, the documentation in relation to the guarantees and security, to the extent they concern a German Guarantor, contain such limitation language and, hence, such guarantees and security interests are limited in the manner described.

The court decisions of the German Federal Supreme Court (*Bundesgerichtshof*) regarding so-called "destructive interference" (*existenzvernichtender Eingriff*) (i.e., a situation where a shareholder deprives a GmbH of the liquidity necessary for it to meet its own payment obligations) may be applied by courts to the enforcement of guarantees and security interests granted by the German Guarantors. In such case, the amount of proceeds to be realized in an enforcement process may be reduced. German courts may apply this case law to the granting of guarantees and security interests by the German Guarantors.

German capital maintenance and liquidity protection rules are subject to ongoing court decisions. We cannot assure you that future court rulings may not further limit the access to any security granted by a German Guarantor incorporated in the form of a GmbH, which can negatively affect the ability of the Issuer to make payment on the Notes, of the secured parties to enforce the Collateral or of the beneficiaries of the Guarantees to enforce the Guarantees.

In Germany, the security over the collateral that will constitute security for the obligations of the Issuer under the Notes and the Indenture and of the Guarantors under the Guarantees will not be granted directly to the noteholders but only in favor of the trustee, as beneficiary of parallel debt obligations (the "Parallel Debt"). Under German law, "accessory" security interests such as pledges (*Pfandrechte*) require that the pledgee and the creditor be the same person; the holders of interests in the Notes from time to time will not be party to the security documents. Therefore, since the noteholders are not a party to the pledges, the noteholders may not, individually or collectively, take any direct action to enforce any rights under the pledges. The noteholders may only act to enforce the security through the trustee. This Parallel Debt is created to address a requirement that the trustee, as grantee of certain types of collateral, be a creditor of the relevant security provider. The Parallel Debt is in the same amount and payable at the same time as the obligations of the Issuer under the Indenture and the Notes and of the Guarantors under the Guarantees (the "Principal Obligations"). Any payment in respect of the Principal Obligations shall discharge the corresponding Parallel Debt and any payment in respect of the Parallel Debt shall discharge the corresponding Principal Obligations. Although the trustee will have, pursuant to the Parallel Debt, a claim against the providers of security for the full principal amount of the Notes, noteholders bear some risks associated with a possible insolvency or bankruptcy of the security trustee. The Parallel Debt obligations referred to above are contained in the Indenture, which are governed by New York law. In addition to the specific risks described above, there is no assurance generally that such a structure will be effective before German courts as there is no judicial or other guidance as to its efficacy, and therefore the ability of the trustee to enforce the collateral may be restricted.

Hardening periods and fraudulent transfer

In the event of insolvency proceedings with respect to a German Security Provider are opened in Germany, any Guarantee and other security provided by that entity could be subject to potential challenges by an insolvency administrator (*Insolvenzverwalter*) under the rules of avoidance as set out in the German Insolvency Code (*Insolvenzordnung*).

Based on these rules, an insolvency administrator may challenge transactions that are deemed detrimental to the insolvent debtor's creditors as a whole and were effected prior to the commencement of insolvency proceedings. Such transactions may include the payment of any amounts to the holders of the Notes as well as granting them any security interest or guarantee, such as the Guarantee and security granted in connection with the issuance of the Notes. An administrator's right to challenge transactions may, depending on the circumstances, extend to transactions that have occurred up to ten years prior to the filing of the petition for commencement of insolvency proceedings. In the event such a transaction is successfully challenged, the holders of the Notes would be under an obligation to repay the amounts received to the insolvency estate or to forfeit the security interest or Guarantee.

In particular, an act (*Rechtshandlung*) or a transaction (*Rechtsgeschäft*) (which term includes the issuance of guarantees and granting of security as well as the repayment of debt) may be challenged in the following cases:

- any act granting an insolvency creditor, or enabling an insolvency creditor to obtain, security (including a guarantee) or satisfaction (i) if such act was performed during the last three months prior to the filing of the petition for the commencement of the insolvency proceedings and the debtor was illiquid (*zahlungsunfähig*) at the time when such act was taken and the creditor had knowledge of such illiquidity (or of circumstances that imperatively suggest that the debtor was illiquid) at such time, or (ii) if such act was performed after the filing of the petition for the commencement of the insolvency proceedings and the creditor had knowledge of the illiquidity of the debtor or the filing of such petition (or of circumstances imperatively suggesting such illiquidity or filing);

- any act granting an insolvency creditor, or enabling an insolvency creditor to obtain, security (including a guarantee) or satisfaction to which such creditor was not entitled or which was granted or obtained in a form or at a time to which or at which such creditor was not entitled to such security or satisfaction if (i) such act was performed during the last month prior to the filing of the petition for the commencement of the insolvency proceedings or after such filing, (ii) such act was performed during the second or third month prior to the filing of the petition and the debtor was illiquid at such time, or (iii) such act was performed during the second or third month prior to the filing of the petition for the commencement of the insolvency proceedings and the creditor knew at the time such act was taken that such act was detrimental to the other insolvency creditors (or of circumstances that imperatively suggest that such act was detrimental to the other insolvency creditors);

- any transaction by the debtor that is directly detrimental to the insolvency creditors or by which a proprietary claim against a debtor is obtained or becomes enforceable if (i) it was entered into during the three months prior to the filing of the petition of the commencement of the insolvency proceedings, the debtor was illiquid at the time of such transaction and the counterparty to such transaction had knowledge of the illiquidity at such time or (ii) it was entered into after such filing and the counterparty to such transaction had knowledge of either the debtor's illiquidity or such filing at the time of the transaction;

- any act whereby a debtor grants security (including guarantees) for a third party debt, which might be regarded as having been granted gratuitously (*unentgeltlich*), if it was effected in the four years prior to the filing of a petition for the commencement of insolvency proceedings against the debtor;

- any act performed by the debtor during the ten years prior to the filing of the petition for the commencement of insolvency proceedings with the intent to prejudice the insolvency creditors and the other party knew of such intention at the time of such act;

- any act that provides security (including a guarantee) or satisfaction for a shareholder loan made to the debtor or a similar claim if (i) in the case of the provision of security, the act occurred during the ten years prior to the filing of the petition for the commencement of the insolvency proceedings or after the filing of such petition, or (ii), in the case of satisfaction, the act occurred during the last year prior to the filing of the petition for the commencement of the insolvency proceedings or after the filing of such petition; and

- any act whereby the debtor satisfies a loan repayment claim or an economically equivalent claim of a third party if: (i) the transaction was effected in the last year prior to the filing of a petition for commencement of insolvency proceedings or thereafter; and (ii) a shareholder of the debtor had granted security or was liable as a guarantor (*Bürge*) (in which case the shareholder has to compensate the debtor for the amounts paid (subject to further conditions)).

Furthermore, even in the absence of an insolvency proceeding, a third party creditor that has obtained an enforcement order but has failed to obtain full satisfaction of its enforceable claims by a levy of execution, has, under certain circumstances, the right to challenge certain transactions, such as the payment of debt and the granting of guarantees and security interests pursuant to the German Act on the Non-insolvency Avoidance of Transactions by the Debtor (*Anfechtungsgesetz*).

In addition, a creditor who obtained security from a debtor may be liable in tort if such creditor was aware of the debtor's insolvency at the time security was granted. The German Federal Supreme Court (*Bundesgerichtshof*) held that this could be the case if, for example, the creditor was to act with the intention of detrimentally influencing the position of the other creditors of the debtor in violation of the legal principle of bonos mores (*Sittenwidrigkeit*). Such intention could be present if the beneficiary of the transaction was aware of any circumstances indicating that debtor as the grantor of the guarantee or security is close to financial collapse (*Zusammenbruch*), or had reason to enquire further with respect thereto.

BOOK-ENTRY; DELIVERY AND FORM

General

The Notes sold to QIBs in reliance on Rule 144A are represented by one or more global notes in registered form without interest coupons attached (the "Rule 144A Global Notes"). The Notes sold to persons outside the United States in reliance on Regulation S are represented by one or more global notes in registered form without interest coupons attached (the "Regulation S Global Notes"). The Rule 144A Global Notes and the Regulation S Global Notes are collectively referred to as the "Global Notes." The Rule 144A Global Notes and the Regulation S Global Notes have been deposited with a common depositary and registered in the name of the nominee of the common depositary for the accounts of Euroclear and Clearstream Banking.

Ownership of interests in the Rule 144A Global Note ("Rule 144A Book-Entry Interests") and in the Regulation S Global Note (the "Regulation S Book-Entry Interests" and, together with the Rule 144A Book-Entry Interests, the "Book-Entry Interests") is limited to persons that have accounts with Euroclear and/or Clearstream Banking, or persons that hold interests through such participants. Euroclear and Clearstream Banking hold interests in the Global Notes on behalf of their participants through customers' securities accounts in their respective names on the books of their respective depositaries. Except under the limited circumstances described below, Book-Entry Interests will not be held in definitive certificated form.

Book-Entry Interests are shown on, and transfers thereof will be done only through, records maintained in the book-entry form by Euroclear and Clearstream Banking and their participants. The laws of some jurisdictions, including certain states of the United States, may require that certain purchasers of securities take physical delivery of such securities in definitive certificated form. The foregoing limitations may impair the ability to own, transfer or pledge Book-Entry Interests. In addition, while the Notes are in global form, holders of Book-Entry Interests will not be considered the owners or "holders" of Notes for any purpose.

So long as the Notes are held in global form, Euroclear and/or Clearstream Banking, as applicable (or their respective nominees), will be considered the sole holders of Global Notes for all purposes under the Indenture. In addition, participants must rely on the procedures of Euroclear and/or Clearstream Banking, and indirect participants must rely on the procedures of Euroclear, Clearstream Banking and the participants through which they own Book-Entry Interests, to transfer their interests or to exercise any rights of holders under the Indenture.

Neither we nor the trustee do not have any responsibility, or be liable, for any aspect of the records relating to the Book-Entry Interests.

Redemption of the Global Notes

In the event any Global Note (or any portion thereof) is redeemed, Euroclear and/or Clearstream Banking, as applicable, will redeem an equal amount of the Book-Entry Interests in such Global Note from the amount received by it in respect of the redemption of such Global Note. The redemption price payable in connection with the redemption of such Book-Entry Interests will be equal to the amount received by Euroclear and Clearstream Banking, as applicable, in connection with the redemption of such Global Note (or any portion thereof). We understand that, under the existing practices of Euroclear and Clearstream Banking, if fewer than all of the Notes are to be redeemed at any time, Euroclear and Clearstream Banking will credit their respective participants' accounts on a proportionate basis (with adjustments to prevent fractions), by lot or on such other basis as they deem fair and appropriate; *provided*, *however*, that no Book-Entry Interest of €100,000 principal amount or less may be redeemed in part.

Payments on Global Notes

We will make payments of any amounts owing in respect of the Global Notes (including principal, premium, if any, and interest) to the paying agent, which will pass the funds to the common depositary or its nominee for Euroclear and Clearstream Banking, which will distribute such payments to participants in accordance with their customary procedures. We will make payments of all such amounts without deduction or withholding for, or on account of, any present or future taxes, duties, assessments or governmental charges of whatever nature, except as may be required by law and as described under "Description of the Notes—Additional Amounts." If any such deduction or withholding is required to be made, then, to the extent described under "Description of the Notes—Additional Amounts" above, we will pay additional amounts as may be necessary in order that the net amounts received by any holder of the Global Notes or owner of Book-Entry Interests after such deduction or withholding will equal the net amounts that such holder or owner would have otherwise received in respect of such Global Note or Book-Entry Interest, as the case may be, absent such withholding or deduction. We expect that standing customer instructions and customary practices will govern payments by participants to owners of Book-Entry Interests held through such participants.

Under the terms of the Indenture, the Issuer, the trustee, the paying agent and the transfer agent treat the registered holder of the Global Notes (*e.g.*, Euroclear or Clearstream Banking (or their respective nominees)) as the owner thereof for the purpose of receiving payments and for all other purposes. Consequently, none of us, the trustee, the paying agent, the transfer agent or any of our or its respective agent has or will have any responsibility or liability for:

- any aspect of the records of Euroclear, Clearstream Banking or any participant or indirect participant relating to, or payments made on account of, a Book-Entry Interest or for maintaining, supervising or reviewing the records of Euroclear, Clearstream Banking or any participant or indirect participant relating to, or payments made on account of, a Book-Entry Interest, or

- Euroclear, Clearstream Banking or any participant or indirect participant.

Currency of Payment for the Global Notes

The principal of, premium, if any, and interest on, and all other amounts payable in respect of, the Global Notes will be paid in euro.

Action by Owners of Book-Entry Interests

Euroclear and Clearstream Banking have advised the Issuer that they will take any action permitted to be taken by a holder of Notes (including the presentation of Notes for exchange as described above) only at the direction of one or more participants to whose account the Book-Entry Interests in the Global Notes are credited and only in respect of such portion of the aggregate principal amount of Notes as to which such participant or participants has or have given such direction. Euroclear and Clearstream Banking will not exercise any discretion in the granting of consents, waivers or the taking of any other action in respect of the Global Notes. However, if there is an Event of Default under the Indenture, each of Euroclear and Clearstream Banking reserves the right to exchange the Global Notes for definitive registered notes in certificated form ("Definitive Registered Notes") and to distribute Definitive Registered Notes to its participants.

Transfers

Transfers between participants in Euroclear and Clearstream Banking will be affected in accordance with Euroclear and Clearstream Banking rules and will be settled in immediately available funds. If a holder requires physical delivery of Definitive Registered Notes for any reason, including to sell Notes to persons in states which require physical delivery of securities or to pledge such securities, such holder must transfer its interests in the Global Notes in accordance with the normal procedures of Euroclear and Clearstream Banking and in accordance with the procedures set forth in the Indenture.

The Global Note for Rule 144A Book-Entry Interests have a legend to the effect set forth under "Notice to Investors." Book-Entry Interests in the Global Notes are subject to the restrictions on transfers and certification requirements discussed under "Notice to Investors."

Rule 144A Book-Entry Interests may be transferred to a person who takes delivery in the form of a Regulation S Book-Entry Interest only upon delivery by the transferor of a written certification (in the form provided in the Indenture) to the effect that such transfer is being made in accordance with Regulation S or Rule 144 under the Securities Act or any other exemption (if available under the Securities Act).

In connection with transfers involving an exchange of a Regulation S Book-Entry Interest for a Rule 144A Book-Entry Interest, appropriate adjustments will be made to reflect a decrease in the principal amount of the Regulation S Global Note and a corresponding increase in the principal amount of the Rule 144A Global Note.

Any Book-Entry Interest in one of the Global Notes that is transferred to a person who takes delivery in the form of a Book-Entry Interest in any other Global Note will, upon transfer, cease to be a Book-Entry Interest in the first-mentioned Global Note and become a Book-Entry Interest in such other Global Note, and accordingly will thereafter be subject to all transfer restrictions, if any, and other procedures applicable to Book-Entry Interests in such other Global Note for as long as it remains such a Book-Entry Interest.

Definitive Registered Notes

Under the terms of the Indenture, owners of the Book-Entry Interests will receive Definitive Registered Notes:

- if Euroclear or Clearstream Banking notifies us that it is unwilling or unable to continue to act as depositary and a successor depositary is not appointed by us within 120 days; or

- if the owner of a Book-Entry Interest requests such exchange in writing delivered through either Euroclear or Clearstream Banking following an Event of Default under the Indenture.

In the case of the issuance of Definitive Registered Notes, the holder of a Definitive Registered Note may transfer such note by surrendering it to the Registrar or a Transfer Agent. In the event of a partial transfer or a partial redemption of a holding of Definitive Registered Notes represented by one Definitive Registered Note, a Definitive Registered Note will be issued to the transferee in respect of the part transferred and a new Definitive Registered Note in respect of the balance of the holding not transferred or redeemed will be issued to the transferor or the holder, as applicable; provided that no Definitive Registered Note in a denomination less than €100,000, as applicable, will be issued. We will bear the cost of preparing, printing, packaging and delivering the Definitive Registered Notes.

We are not be required to register the transfer or exchange of Definitive Registered Notes for a period of 15 calendar days preceding (i) the record date for any payment of interest on the Notes, (ii) any date fixed for redemption of the Notes or (iii) the date fixed for selection of the Notes to be redeemed in part. Also, we are not required to register the transfer or exchange of any Notes selected for redemption. In the event of the transfer of any Definitive Registered Note, the trustee may require a holder, among other things, to furnish appropriate endorsements and transfer documents as described in the Indenture. We may require a holder to pay any taxes and fees required by law and permitted by the Indenture and the Notes.

If Definitive Registered Notes are issued and a holder thereof claims that such Definitive Registered Note has been lost, destroyed or wrongfully taken, or if such Definitive Registered Note is mutilated and is surrendered to the registrar or at the office of the transfer agent, we will issue and the trustee will authenticate a replacement Definitive Registered Note if the trustee's and our requirements are met. We or the trustee may require a holder requesting replacement of a Definitive Registered Note to furnish an indemnity bond sufficient in the judgment of both to protect ourselves, the trustee or the paying agent appointed pursuant to the Indenture from any loss which any of them may suffer if a Definitive Registered Note is replaced. We may charge for any expenses incurred by us in replacing a Definitive Registered Note.

In case any such mutilated, destroyed, lost or stolen Definitive Registered Note has become or is about to become due and payable, or is about to be redeemed or purchased by us pursuant to the provisions of the Indenture, we, in our discretion, may, instead of issuing a new Definitive Registered Note, pay, redeem or purchase such Definitive Registered Note, as the case may be.

Definitive Registered Notes may be transferred and exchanged only after the transferor first delivers to the trustee a written certification (in the form provided in the Indenture) to the effect that such transfer will comply with the transfer restrictions applicable to such notes. See "Notice to Investors."

So long as the Notes are listed on the Official List of the Luxembourg Stock Exchange, we will publish a notice of any issuance of Definitive Registered Notes in a newspaper having general circulation in Luxembourg (which we expect to be the *Luxemburger Wort*) or, to the extent and in the manner permitted by such rules, posted on the official website of the Luxembourg Stock Exchange (*www.bourse.lu*). Payment of principal, any repurchase price, premium and interest on Definitive Registered Notes will be payable at the office of our paying agent in Official List of the Luxembourg so long as the Notes are listed on the Luxembourg Stock Exchange.

Information Concerning Euroclear and Clearstream Banking

We understand as follows with respect to Euroclear and Clearstream Banking. Euroclear and Clearstream Banking hold securities for participating organizations. They also facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream Banking provide various services to their participants, including the safekeeping, administration, clearance, settlement, lending and borrowing of internationally traded securities. Euroclear and Clearstream Banking interface with domestic securities markets. Euroclear and Clearstream Banking participants are financial institutions such as underwriters, securities brokers and dealers, banks, trust companies and certain other organizations. Indirect access to Euroclear and Clearstream Banking is also available to others such as banks, brokers, dealers and trust companies that clear through or maintain a custodian relationship with a Euroclear or Clearstream Banking participant, either directly or indirectly.

TAXATION CONSIDERATIONS

The following is a summary of certain German and U.S. federal income tax considerations for the prospective purchasers of the Notes. This discussion is limited to persons who purchase the Notes at original issue and at their "issue price" (the first price at which a substantial part of the Notes are sold to investors for cash, excluding sales to bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers) and, in the case of a U.S. Holder (as defined below) that hold the Notes as capital assets and use the U.S. dollar as their functional currency, and in the case of German-resident noteholders that use the euro as their functional currency. The discussion does not consider the circumstances of particular purchasers subject to special tax regimes, such as banks, insurance companies, dealers, tax exempt organizations or persons holding the Notes as part of a hedge, straddle, conversion, integrated or constructive sale transaction. This summary is based upon the law as in effect and as applied on the date of this offering memorandum and is subject to any change in law, court rulings or administrative practice that may take effect after such date even with retrospective effect. The discussion is a general summary only and is not a substitute for tax advice.

EACH PROSPECTIVE PURCHASER SHOULD SEEK ADVICE FROM AN INDEPENDENT TAX ADVISOR ABOUT THE TAX CONSEQUENCES UNDER ITS OWN PARTICULAR CIRCUMSTANCES OF INVESTING IN OFFERED SECURITIES UNDER THE LAWS OF GERMANY, THE UNITED STATES AND ITS CONSTITUENT JURISDICTIONS AND ANY OTHER JURISDICTION WHERE THE PURCHASER MAY BE SUBJECT TO TAXATION.

As used herein, "noteholder" means a beneficial owner of a Note.

German Income Tax Considerations

Investors are advised to consult their own tax advisor for the tax consequences of the purchase, the ownership and the disposition of Notes, including the effect of any state or local taxes under the tax laws of the Federal Republic of Germany as well as of any other country of which they are residents.

German Tax Resident Private Noteholders

General

Interest, including any Additional Amounts, received by German resident private noteholders (*i.e.*, private individuals whose residence or habitual abode is located in Germany), is generally subject to income tax at a flat rate of 25% (plus 5.5% solidarity surcharge thereon and, if applicable, church tax).

The flat tax regime also applies to capital gains, including any Additional Amounts, from the sale or redemption of the Notes held by German resident private noteholders. Losses from the sale or redemption of the Notes can only be offset against other investment income within the meaning of the flat tax regime. In the event that an offset is not possible in the assessment period in which the losses have been realized, such losses will be carried forward into future assessment periods only and can, subject to certain restrictions, be offset against investment income generated in future assessment periods.

Capital gains and losses are determined by the difference between the sales/redemption proceeds after the deduction of expenses directly connected to the sale/redemption and the acquisition costs of the Notes.

Withholding Tax

For German resident private noteholders, the flat tax on interest on the Notes is generally levied by way of withholding tax, provided that the Notes are held in custody with a German branch of a German or non-German bank or financial services institution or with a securities trading company or securities trading bank in the Federal Republic of Germany ("Disbursing Agent").

The applicable withholding tax rate is 25% (plus 5.5% solidarity surcharge thereon and, if applicable, church tax).

The withholding tax regime should also apply to any gains from the sale or redemption of Notes realized by German resident private noteholders holding the Notes in custody with a Disbursing Agent. However, to the extent the Notes have not been held in custody with the same Disbursing Agent since their time of acquisition, withholding tax is levied on 30% of the proceeds from the disposal or redemption unless the current Disbursing Agent has been provided with evidence of the actual acquisition costs of the Notes by the previous Disbursing Agent or by a statement of a bank or financial services institution within another Member State of the European Union, within the European Economic Area or certain other countries in accordance with Art. 17 para. 2 subpara. i of the EU Council Directive 2003/48/EC dated June 3, 2003, on the Taxation of Savings Income in the Form of Interest Payments ("EU Savings Tax Directive").

For German resident private noteholders, the withholding tax is generally definitive (*i.e.*, in principle there will be no further income tax liability on investment income from which withholding tax was deducted and the noteholder is not required to declare such income in his/her tax return). In the case of investment income which is not subject to the withholding tax regime, a special flat tax assessment procedure applies, *i.e.*, the noteholder has to declare the income in his or her tax return and is taxed at the flat tax rate in accordance with the flat tax principles outlined above. This applies *mutatis mutandis* in the case that church tax (although due) is not levied by way of the withholding tax. Finally, the special flat tax assessment procedure applies upon request of the noteholder, provided that further pre-requisites are met. German resident private noteholders having a lower personal income tax rate may, upon application, also include the investment income in their general income tax return to achieve a lower tax rate. Taxes withheld in excess of the assessed tax liability will be refunded.

German resident private noteholders are entitled to a lump-sum deduction from investment income in the amount of €801 (€1,602 for married couples filing tax returns jointly) *per annum*, whereby higher expenses directly attributable to a capital investment are not deductible. The Disbursing Agent will take into account those lump-sum deductions upon filing of an exemption certificate (*Freistellungsauftrag*). No withholding tax will be deducted if the noteholder has submitted to the Disbursing Agent a certificate of non-assessment (*Nichtveranlagungs—Bescheinigung*) issued by the competent local tax office.

German Tax Resident Business Noteholders

Interest, including any Additional Amounts, received by German resident business noteholders (*i.e.*, individual or corporate noteholder that hold the Notes as business assets—including via a partnership, as the case may be—whose residence, habitual abode, statutory seat or place of effective management is located in Germany) and capital gains from the sale or redemption of the Notes are subject to income tax or corporate income tax, as the case may be, as well as solidarity surcharge (and in the case of individuals, if applicable, church tax); gains derived from an original issue discount, if any, are, in principle, treated as deferred income which is realized *pro rata temporis*. In addition, trade tax is levied to such income, if the Notes are held as assets of a German trade or business. Losses should as a rule be tax deductible.

The withholding tax regime outlined above should apply *mutatis mutandis* to German resident business noteholders. However, German corporate noteholders and other noteholders holding the Notes as assets of a German trade or business should in essence not be subject to the withholding tax on gains from the sale or redemption of the Notes (*i.e.*, for these noteholders only interest, including any Additional Amounts, but not gains from the sale or redemption of the Notes are subject to the withholding tax regime, if, in case of certain corporate noteholders, the corporate status is evidenced by a certificate of the competent tax office and, in the case the notes held as business assets by individuals or partnerships, upon application). The noteholder is obliged to include the respective income and related (business) expenses in the annual income tax return.

Any withholding tax imposed is credited against the German resident business noteholder's (corporate or individual) income tax liability (and the solidarity surcharge as well as, if applicable, church tax) in the course of the tax assessment procedure, *i.e.*, the withholding tax is not definitive. Any potential surplus of the withholding tax will be refunded.

The trade tax liability depends on the trade tax factor determined by the municipality where the German resident business noteholder maintains his/her permanent establishment.

Foreign Tax Resident Noteholders

Foreign resident noteholders (*i.e.*, individual or corporate noteholder whose residence, habitual abode, statutory seat or place of effective management is not located in Germany) should generally not be taxable in Germany with interest, including any Additional Amounts, on and the gains from the sale or redemption of the Notes and, in general, no German withholding tax should be withheld from such income. This should hold true, even if the Notes are held in custody with a Disbursing Agent. Exceptions apply where the Notes are held as business assets of a German permanent establishment or the income otherwise qualifies as income from German sources for tax purposes.

Other Taxes

No stamp, issue, registration or similar taxes or duties will be payable in Germany in connection with the issuance, delivery or execution of the Notes. Currently, net assets tax (*Vermögensteuer*) is not levied in Germany.

EU Savings Tax Directive

Under the EU Savings Tax Directive, each Member State is required to provide the tax authorities of another Member State with details of interest payments or other similar income paid by a person within its jurisdiction to, or collected by such a person for, an individual resident in that other Member State. Austria and Luxembourg may instead apply a withholding system for a transitional period in relation to such payments, deducting tax at rates rising over time to 35%. The transitional period is to terminate at the end of the first full fiscal year following agreement by certain non-EU countries to the exchange of information relating such payments. The directive has been implemented in Germany by the decree on the taxation of interest income (*Zinsinformationsverordnung*), which has applied since July 1, 2005.

A number of non-EU countries and certain dependent or associated territories of certain Member State have adopted similar measures (either provision of information or transitional withholding) in relation to payments made by a person within its jurisdiction to, or collected by such a person for, an individual resident in a Member State. In addition, the Member States have entered into reciprocal provision of information or transitional withholding arrangements with certain of those dependent or associated territories in relation to payments made by a person in a Member State to, or collected by such a person for, an individual resident in one those territories.

U.S. Federal Income Tax Considerations

General

UNITED STATES IRS CIRCULAR 230: To ensure compliance with Internal Revenue Service ("IRS") Circular 230, you are hereby notified that: (i) any discussion of U.S. federal tax issues in this offering memorandum is not intended or written to be relied upon, and cannot be relied upon, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code of 1986, as amended (the "Code"); (ii) such discussion is written in connection with the promotion or marketing of the transactions or matters addressed herein; and (iii) Holders should seek advice based on their particular circumstances from an independent tax advisor.

The following summary describes certain U.S. federal income tax consequences that may be relevant with respect to the acquisition, ownership and disposition of Notes by U.S. Holders (as defined below) who purchase Notes in this offering at their "issue price" (*i.e.*, the first price at which a substantial amount of Notes is sold for money to investors (not including bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers)). This summary only addresses U.S. federal income tax considerations of U.S. Holders that will hold the Notes as capital assets. It does not purport to be a comprehensive description of all the tax considerations that may be relevant to a decision to purchase the Notes. In particular, this summary does not address tax considerations applicable to U.S. Holders that may be subject to special tax rules including, without limitation, the following: (i) financial institutions; (ii) insurance companies; (iii) dealers or traders in securities or currencies; (iv) tax-exempt entities; (v) persons that will hold Notes as part of a "hedging" or "conversion" transaction or as a position in a "straddle" or as part of a "synthetic security" or other integrated transaction for U.S. federal income tax purposes; (vi) persons that have a "functional currency" other than the U.S. dollar; (vii) regulated investment companies; (viii) partnerships or other pass-through entities or investors in such entities; and (ix) persons that have ceased to be U.S. citizens or lawful permanent residents of the United States. Further, this summary does not address alternative minimum tax consequences or U.S. federal Medicare-related tax consequences and estate and gift tax consequences.

This summary is based on the Code and U.S. Treasury regulations and judicial and administrative interpretations thereof, as of the date of this offering memorandum. All of the foregoing are subject to change, which change could apply retroactively and could affect the tax consequences described below.

For purposes of this summary, a "U.S. Holder" is a beneficial owner of a Note that is, for U.S. federal income tax purposes: (i) an individual who is a citizen or resident of the United States; (ii) a corporation, or other entity treated as a corporation, created or organized in or under the laws of the United States, any state thereof, or the District of Columbia; (iii) an estate the income of which is subject to U.S. federal income taxation regardless of its source; or (iv) a trust if (1) a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust or (2) the trust was in existence on August 20, 1996 and has properly elected to continue to be treated as a U.S. person.

If any entity treated as a partnership or other pass through entity for U.S. federal income tax purposes holds Notes, the tax treatment of a partner in or owner of the partnership or other pass through entity will generally depend upon the status of the partner or owner and the activities of the entity. Holders that are a partner in or owner of a partnership or other pass through entity that is considering holding Notes should consult their own tax advisors.

Each prospective investor should consult its own tax advisor with respect to the U.S. federal (including income, estate and gift), state, local and foreign tax consequences of acquiring, owning and disposing of Notes. U.S. Holders should also review the discussion under "—German Income Tax Considerations" for the German tax consequences to a U.S. Holder of the ownership of Notes.

Payments of Stated Interest

Stated interest paid on a Note will be taxable to a U.S. Holder as ordinary interest income at the time it is received or accrued, depending on the U.S. Holder's method of accounting for U.S. federal income tax purposes.

A U.S. Holder who uses the cash method of accounting and who receives a payment of stated interest (including a payment attributable to accrued but unpaid stated interest upon the sale, exchange, redemption, retirement or other disposition of a Note) will be required to include in income the U.S. dollar value of the euro payment received (determined based on the spot rate on the date the payment is received), regardless of whether the payment is in fact converted to U.S. dollars at that time. A cash basis U.S. Holder will not realize foreign currency exchange gain or loss on the receipt of stated interest income but may recognize exchange gain or loss upon the actual disposition of the euros received.

A U.S. Holder who uses the accrual method of accounting will accrue stated interest income in euro and, unless a special election is made, translate that amount into U.S. dollars based on the average spot rate of exchange in effect for the accrual period (or, with respect to an accrual period that spans two taxable years, at the average spot rate for the partial period within the applicable taxable year). Alternatively, an accrual method U.S. Holder may elect to translate stated interest income into U.S. dollars at the spot rate on the last day of the interest accrual period (or, in the case of a partial accrual period, the spot rate on the last day of such partial accrual period) or, if the date of receipt is within five business days of the last day of the interest accrual period, the spot rate on the date of receipt. A U.S. Holder that makes this election must apply it consistently to all debt instruments from year to year and cannot change the election without the consent of the IRS. A U.S. Holder that uses the accrual method will recognize foreign currency gain or loss with respect to accrued stated interest income on the date the interest payment (or proceeds from the sale, exchange, redemption, retirement or other disposition attributable to accrued stated interest) is actually received. The amount of foreign currency gain or loss recognized will equal the difference between the U.S. dollar value of the euro payment received (determined based on the spot rate on the date the payment is received) in respect of the accrual period and the U.S. dollar value of stated interest income that has accrued during the accrual period (as determined above), regardless of whether the payment is in fact converted to U.S. dollars. This foreign currency gain or loss generally will be treated, for U.S. foreign tax credit purposes, as U.S. source ordinary income or loss, and generally will not be treated as an adjustment to interest income or expense.

Stated interest received by a U.S. Holder will be treated as foreign source income for purposes of calculating that holder's foreign tax credit limitation. The limitation on foreign taxes eligible for the U.S. foreign tax credit is calculated separately with respect to specific classes of income. The rules governing foreign tax credits are complex and, therefore, U.S. Holders should consult their own tax advisors regarding the availability of foreign tax credits in their particular circumstances.

Original Issue Discount

If the Notes are issued at an issue price less than their stated principal amount they will be considered to have been issued with original issue discount ("OID") for U.S. federal income tax purposes unless the OID is less than a de minimis threshold (generally $^{1}/_{4}$ of 1% of the Notes' stated principal amount multiplied by the rounded down number of years to maturity from its issue date).

Payments of stated interest will be taxable as described under "—Payments of Stated Interest."

A U.S. Holder of a Note treated as issued with OID must include the OID in income as ordinary income for U.S. federal income tax purposes as it accrues under a constant yield method in advance of receipt of the cash payments attributable to such income, regardless of such U.S. Holder's regular method of tax accounting. In general, the amount of OID included in income by the U.S. Holder of a Note is the sum of the daily portions of OID with respect to such Note for each day during the taxable year (or portion of the taxable year) on which the U.S. Holder held the Note. The daily portion of OID on any Note is determined by allocating to each day in any accrual period a ratable portion of the OID allocable to that accrual period. An accrual period may be of any length and the accrual periods may vary in length over the term of the Note, provided that each accrual period is no longer than one year and each scheduled payment of principal or interest occurs either on the first day or final day of an accrual period. The amount of OID allocable to each accrual period is generally equal to the excess of (i) the product of the Note's "adjusted issue price" (as defined below) at the beginning of such accrual period and its yield to maturity (determined on the basis of compounding at the close of each accrual period and appropriately adjusted to take into account the length of the particular accrual period) over

(ii) the amount of any qualified stated interest payments allocable to such accrual period. The "adjusted issue price" of a Note at the beginning of any accrual period is the sum of the issue price of the Note plus the amount of OID allocable to all prior accrual periods. All stated interest on the Notes is qualified stated interest. Under these rules, U.S. Holders generally will have to include in taxable income increasingly greater amounts of OID in successive accrual periods. The amount of OID included in gross income increases the U.S. Holder's adjusted tax basis in the Note.

Regardless of the U.S. Holder's regular method of accounting, any U.S. Holder of Notes treated as issued with OID must (i) determine OID allocable to each accrual period in euro using the constant yield method described above, and (ii) translate the amount of OID into U.S. dollars and recognize foreign currency gain or loss in the same manner as described above for stated interest accrued by an accrual basis U.S. Holder. U.S. Holders should note that because the cash payment in respect of accrued OID on a Note will not be made until maturity or other disposition of the Note, a greater possibility exists for fluctuations in foreign currency exchange rates (and the required recognition of exchange gain or loss) than is the case for foreign currency instruments issued without OID. U.S. Holders are urged to consult their tax advisors regarding the interplay between the application of the OID and foreign currency exchange gain or loss rules.

If Notes are issued with OID, U.S. Holders may obtain information regarding the amount of OID, the issue price, the issue date and the yield to maturity relating to a Note by contacting the financial controller at Heckler & Koch-Strasse 1, 78727 Oberndorf am Neckar, Germany.

The rules governing OID instruments are complex and, accordingly, prospective investors should consult their own tax advisors concerning the application of such rules to the Notes.

Disposition of a Note

Upon the sale, exchange, redemption, retirement or other taxable disposition of a Note, a U.S. Holder generally will recognize taxable gain or loss equal to the difference between the amount realized on such disposition (except to the extent any amount realized is attributable to accrued but unpaid stated interest, which is taxed as ordinary income to the extent not previously so taxed) and the U.S. Holder's adjusted tax basis in the Note. A U.S. Holder's adjusted tax basis will generally be the U.S. dollar value of the euro paid for the Note, determined on the date of purchase, increased by any OID previously included in income. If the Note is traded on an established securities market, a cash basis taxpayer (and if it elects, an accrual basis taxpayer) will determine the U.S. dollar value of the euro amount paid for the Note on the settlement date of the purchase. The amount realized on the sale, exchange, redemption, retirement or other disposition of a Note for an amount of foreign currency will generally be the U.S. dollar value of such foreign currency based on the spot exchange rate on the date payment is received or the Note is disposed of; *provided, however*, that if the Note is traded on an established securities market, a cash basis taxpayer (and if it elects, an accrual basis taxpayer) will determine the U.S. dollar value of such foreign currency on the settlement date of the disposition. If an accrual method taxpayer makes the election described above, such election must be applied consistently to all determinations of tax basis and amount realized with respect to all debt instruments from year to year and cannot be changed without the consent of the IRS.

Except as discussed below with respect to foreign currency gain or loss, any gain or loss realized by a U.S. Holder on the disposition of a Note will be capital gain or loss and will be treated as long-term capital gain or loss if the Note has been held for more than one year at the time of the disposition of the Note. For certain non-corporate holders (including individuals), any such long-term capital gain is currently subject to U.S. federal income tax at preferential rates. The deductibility of capital losses is subject to limitations.

Gain or loss realized upon the sale, exchange, retirement, redemption or other taxable disposition of a Note that is attributable to fluctuations in currency exchange rates will be ordinary income or loss which will not be treated as interest income or expense. Payments received upon such a disposition that are attributable to accrued stated interest will be treated in accordance with the rules applicable to payments of stated interest described above. Furthermore, the gain or loss attributable to fluctuations in currency exchange rates will include the difference between (i) the U.S. dollar value of your purchase price for the Note, determined on the date the Note is retired or disposed of, and (ii) the U.S. dollar value of your purchase price for the Note, determined on the date you acquired the Note (or, in each case, determined on the settlement date if the Notes are traded on an established securities market and the holder is either a cash basis or an electing accrual basis holder). If a Note is not traded on an established securities market (or, if a Note is so traded, but a U.S. Holder is an accrual basis taxpayer that has not made the settlement date election), a U.S. Holder will recognize foreign currency exchange gain or loss to the extent that the U.S. dollar value of the foreign currency received (based on the spot rate on the settlement date) differs from the U.S. dollar value of the amount realized. In addition, as discussed above, if Notes are treated as issued with OID, a U.S. Holder will recognize foreign currency gain or loss with respect to amounts of previously accrued OID based upon the difference, if any, between the rate of exchange at which the OID was included in income in each accrual period while the Note was held by the holder and the applicable rate of exchange at which the holder is required to translate foreign currency at the time the Note matures or is otherwise disposed of. The foreign currency gain or loss arising from the disposition of a Note will be recognized only to the extent of the total gain or loss realized by the U.S. Holder on the sale, exchange, retirement, redemption or other disposition of the Note. Generally, the foreign currency gain or loss will be U.S. source ordinary income or loss for U.S. foreign tax credit purposes.

Exchange of Foreign Currencies

A U.S. Holder that purchases a Note with foreign currency will generally recognize exchange gain or loss equal to the difference, if any, between the tax basis in such foreign currency in U.S. dollars and the fair market value of the foreign currency in U.S. dollars on the date of payment of the foreign currency. Such gain or loss generally will be ordinary income or loss and generally will be U.S. source income or loss for U.S. foreign tax credit purposes.

A U.S. Holder's tax basis in the euros received as interest on a Note will be the U.S. dollar value thereof at the spot rate in effect on the date the euros are includible in income. A U.S. Holder's tax basis in euros received on the sale, exchange, redemption or retirement of a Note will be equal to the U.S. dollar value of the euros determined at the time of the euros are paid to such U.S. Holder. Any gain or loss recognized by a U.S. Holder on a sale, exchange or other disposition of the euros will be ordinary income or loss and generally will be U.S. source income or loss for U.S. foreign tax credit purposes.

Tax Return Disclosure Requirements

Certain U.S. Treasury regulations require the reporting of transactions generally not regarded as tax shelters, including certain foreign currency transactions giving rise to losses in excess of a certain minimum amount (*e.g.*, $50,000 in the case of an individual or trust), such as the receipt or accrual of interest or a sale, exchange, retirement or other taxable disposition of a foreign currency note or foreign currency received in respect of a foreign currency note. Persons considering the purchase of Notes should consult with their own tax advisors to determine the tax return disclosure obligations, if any, with respect to an investment in the Notes or the disposition of euros, including any requirement to file IRS Form 8886 (Reportable Transaction Statement).

Backup Withholding and Information Reporting

Backup withholding and information reporting requirements may apply to certain payments to U.S. Holders of interest on the Notes and to the proceeds of a sale, exchange or other disposition (including a retirement or redemption) of a Note. Backup withholding (currently at a rate of 28%) may be required if the U.S. Holder fails (i) to furnish the U.S. Holder's taxpayer identification number, (ii) to certify that such U.S. Holder is not subject to backup withholding or (iii) to otherwise comply with the applicable requirements of the backup withholding rules. Certain U.S. Holders (including, among others, corporations) are not subject to the backup withholding and information reporting requirements. Backup withholding is not an additional tax. Any amounts withheld under the backup withholding rules from a payment to a U.S. Holder generally may be claimed as a credit against such U.S. Holder's U.S. federal income tax liability and may entitle you to a refund, provided that the required information is timely furnished to the IRS.

PLAN OF DISTRIBUTION

Subject to the terms and conditions stated in the purchase agreement dated May 6, 2011, the initial purchasers have agreed to purchase, and we have agreed to sell to them, €295 million aggregate principal amount of the Notes.

The purchase agreement provides that the obligation of the initial purchasers to purchase the Notes is subject to approval of legal matters by counsel and to other conditions. The initial purchasers must purchase all of the Notes if they purchase any of the Notes.

The Notes and the Guarantees have not been and will not be registered under the U.S. Securities Act or qualified for sale under the securities laws of any state or jurisdiction outside the United States and may not be offered to, or for the account or benefit of, persons in the United States except in transactions exempt from the registration requirements of the U.S. Securities Act. See "Notice to Investors."

The initial purchasers may make offers and sales in the United States through their affiliates. The initial purchasers may use affiliates or other appropriately licensed entities for sales of the Notes in jurisdictions in which they are otherwise not permitted.

We have been advised that the initial purchasers propose to resell the Notes at the offering price set forth on the cover page of this offering memorandum within the United States to qualified institutional buyers (as defined in Rule 144A) in reliance on Rule 144A and outside the United States in offshore transactions in reliance on Regulation S. The price at which the Notes are offered may be changed at any time without notice.

In addition, until 40 days after the commencement of this offering, an offer or sale of Notes within the United States by a dealer that is not participating in this offering may violate the registration requirements of the U.S. Securities Act if that offer or sale is made otherwise than in accordance with Rule 144A.

Each initial purchaser represents and warrants that:

(i) they have only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of Section 21 of the FSMA) received by them in connection with the issuance or sale of the Notes in circumstances in which Section 21(1) of the FSMA does not apply to the Issuer or any Guarantor; and

(ii) they have complied and will comply with all applicable provisions of the FSMA with respect to anything done by them in relation to the Notes in, from or otherwise involving the United Kingdom.

Application has been made for the Notes to be listed on the Official List of the Luxembourg Stock Exchange and for trading on the Euro MTF market. We cannot assure you that the prices at which the Notes will sell in the market after this offering will not be lower than the initial offering price or that an active trading market for the Notes will continue after this offering.

In connection with this offering, the initial purchasers did not acting for anyone other than us and were not responsible to anyone other than us for providing the protections afforded to their clients or for providing advice in relation to this offering.

Buyers of the Notes sold by the initial purchasers may be required to pay stamp taxes and other charges in accordance with the laws and practice of the country of purchase in addition to the initial offering price set forth on the cover of this offering memorandum.

In connection with the issue of the Notes, the Stabilizing Manager or persons acting on its behalf may over-allot the Notes or effect transactions with a view to supporting the market price of the Notes at a level higher than that which might otherwise prevail. However, there is no assurance that the Stabilizing Manager or persons acting on its behalf will undertake stabilization action. Any stabilization action may begin on or after the date on which adequate public disclosure of the terms of the offer of Notes is made and, if begun, may be ended at any time, but it must end no later than the earlier of 30 days after the issue date of the Notes and 60 days after the date of the allotment of the Notes. See "Stabilization."

We have agreed to indemnify the initial purchasers against certain liabilities, including liabilities under the U.S. Securities Act.

The initial purchasers and their affiliates perform various financial advisory, investment banking and commercial banking services from time to time for us and our affiliates.

NOTICE TO INVESTORS

You are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of any of the Notes offered hereby.

The Notes and the Guarantees have not been and will not be registered under the Securities Act, or any state securities laws, and, unless so registered, may not be offered or sold except pursuant to an exemption from, or in a transaction not subject to, the registration requirements of the Securities Act and state or other applicable securities laws. Accordingly, the Notes offered hereby are being offered and sold only to qualified institutional buyers (as defined in Rule 144A under the Securities Act) in reliance on Rule 144A under the Securities Act and in offshore transactions in reliance on Regulation S under the Securities Act.

We use the terms “offshore transaction,” “U.S. person” and “United States” with the meanings given to them in Regulation S.

Each purchaser of Notes, by its acceptance thereof, will be deemed to have acknowledged, represented to and agreed with the Issuer, each Guarantor and the initial purchasers as follows:

(1) You understand and acknowledge that the Notes and the Guarantees have not been registered under the Securities Act or any other applicable securities laws and that the Notes are being offered for resale in transactions not requiring registration under the Securities Act or any other securities laws, including sales pursuant to Rule 144A under the Securities Act, and, unless so registered, may not be offered, sold or otherwise transferred except in compliance with the registration requirements of the Securities Act or any other applicable securities laws, pursuant to an exemption therefrom or in any transaction not subject thereto and in each case in compliance with the conditions for transfer set forth in paragraphs (4) and (5) below.

(2) You are not our “affiliate” (as defined in Rule 144 under the Securities Act), you are not acting on our behalf and you are either:

(a) a person in the United States or a U.S. person who is a QIB, within the meaning of Rule 144A under the Securities Act and are aware that any sale of these Notes to you will be made in reliance on Rule 144A under the Securities Act, and such acquisition will be for your own account or for the account of another QIB; or

(b) you are not a U.S. person and you are purchasing the Notes in an offshore transaction in accordance with Regulation S under the Securities Act.

(3) You acknowledge that none of the Issuer, the Guarantors, or the initial purchasers, nor any person representing any of them, has made any representation to you with respect to us or the offer or sale of any of the Notes, other than the information contained in this offering memorandum, which offering memorandum has been delivered to you and upon which you are relying in making your investment decision with respect to the Notes. You acknowledge that neither the initial purchasers nor any person representing the initial purchasers make any representation or warranty as to the accuracy or completeness of this offering memorandum. You have had access to such financial and other information concerning us and the Notes as you have deemed necessary in connection with your decision to purchase any of the Notes, including an opportunity to ask questions of, and request information from, the Issuer and the initial purchasers.

(4) You are purchasing the Notes for your own account, or for one or more investor accounts for which you are acting as a fiduciary or agent, in each case for investment, and not with a view to, or for offer or sale in connection with, any distribution thereof in violation of the Securities Act or any state or other securities laws, subject to any requirement of law that the disposition of your property or the property of such investor account or accounts be at all times within its or their control and subject to your or their ability to resell such Notes pursuant to Rule 144A or any other exemption from registration available under the Securities Act, or in any transaction not subject to the Securities Act.

(5) You agree on your own behalf and on behalf of any investor account for which you are purchasing the Notes, and each subsequent holder of the Notes by its acceptance thereof will be deemed to agree, to offer, sell or otherwise transfer such Notes prior to the date (the “Resale Restriction Termination Date”) that is one year (in the case of Rule 144A Notes) or 40 days (in the case of Regulation S Notes) after the later of the date of the original issue and the last date on which we or any of our affiliates were the owner of such Notes (or any predecessor thereto) only (i) to us, (ii) pursuant to a registration statement

that has been declared effective under the Securities Act, (iii) for so long as the Notes are eligible for resale pursuant to Rule 144A under the Securities Act, to a person you reasonably believe is a QIB that purchases for its own account or for the account of a QIB to whom notice is given that the transfer is being made in reliance on Rule 144A under the Securities Act, (iv) pursuant to offers and sales that occur outside the United States in compliance with Regulation S under the Securities Act or (v) pursuant to any other available exemption from the registration requirements of the Securities Act, subject in each of the foregoing cases to any requirement of law that the disposition of its property or the property of such investor account or accounts be at all times within its or their control and to compliance with any applicable state securities laws, and any applicable local laws and regulations, and further subject to our and the trustee's rights prior to any such offer, sale or transfer (I) pursuant to clause (v) to require the delivery of an opinion of counsel, certification and/or other information satisfactory to each of them and (II) in each of the foregoing cases, to require that a certificate of transfer in the form appearing on the reverse of the security is completed and delivered by the transferor to the trustee. The foregoing restrictions on resale will not apply subsequent to the Resale Restriction Termination Date.

Each purchaser acknowledges that each Note will contain a legend substantially to the following effect:

THIS SECURITY HAS NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "U.S. SECURITIES ACT") OR THE SECURITIES LAWS OF ANY STATE OR OTHER JURISDICTION. NEITHER THIS SECURITY NOR ANY INTEREST OR PARTICIPATION HEREIN MAY BE OFFERED, SOLD, ASSIGNED, TRANSFERRED, PLEDGED, ENCUMBERED OR OTHERWISE DISPOSED OF IN THE ABSENCE OF SUCH REGISTRATION OR UNLESS SUCH TRANSACTION IS EXEMPT FROM, OR NOT SUBJECT TO, THE REGISTRATION REQUIREMENTS OF THE U.S. SECURITIES ACT.

THE HOLDER OF THIS SECURITY BY ITS ACCEPTANCE HEREOF (1) REPRESENTS THAT (A) IT IS A "QUALIFIED INSTITUTIONAL BUYER" (AS DEFINED IN RULE 144A UNDER THE U.S. SECURITIES ACT) OR (B) IT IS NOT A U.S. PERSON ACQUIRING THIS NOTE IN AN "OFFSHORE TRANSACTION" PURSUANT TO RULE 144A OR RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, (2) AGREES ON ITS OWN BEHALF AND ON BEHALF OF ANY INVESTOR FOR WHICH IT HAS PURCHASED SECURITIES TO OFFER, SELL OR OTHERWISE TRANSFER SUCH SECURITY, PRIOR TO THE DATE (THE "RESALE RESTRICTION TERMINATION DATE") WHICH IS [IN THE CASE OF RULE 144A NOTES: ONE YEAR AFTER THE LATER OF THE ORIGINAL ISSUE DATE HEREOF AND THE LAST DATE ON WHICH THE ISSUER OR ANY AFFILIATE OF THE ISSUER WAS THE OWNER OF THIS SECURITY (OR ANY PREDECESSOR OF THIS SECURITY)] [IN THE CASE OF REGULATION S NOTES: 40 DAYS AFTER THE LATER OF THE DATE WHEN THE SECURITIES WERE FIRST OFFERED TO PERSONS OTHER THAN DISTRIBUTORS IN RELIANCE ON REGULATION S AND THE DATE OF THE COMPLETION OF THE DISTRIBUTION] ONLY (A) TO THE ISSUER, (B) PURSUANT TO A REGISTRATION STATEMENT WHICH HAS BEEN DECLARED EFFECTIVE UNDER THE U.S. SECURITIES ACT, (C) FOR SO LONG AS THE SECURITIES ARE ELIGIBLE FOR RESALE PURSUANT TO RULE 144A, TO A PERSON IT REASONABLY BELIEVES IS A "QUALIFIED INSTITUTIONAL BUYER" AS DEFINED IN RULE 144A THAT PURCHASES FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER TO WHOM NOTICE IS GIVEN THAT THE TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A, (D) PURSUANT TO OFFERS AND SALES THAT OCCUR OUTSIDE THE UNITED STATES IN COMPLIANCE WITH REGULATION S UNDER THE U.S. SECURITIES ACT OR (E) PURSUANT TO ANY OTHER AVAILABLE EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE U.S. SECURITIES ACT, SUBJECT IN EACH OF THE FOREGOING CASES TO ANY REQUIREMENT OF LAW THAT THE DISPOSITION OF ITS PROPERTY OR THE PROPERTY OF SUCH INVESTOR ACCOUNT OR ACCOUNTS BE AT ALL TIMES WITHIN ITS OR THEIR CONTROL AND IN COMPLIANCE WITH ANY APPLICABLE STATE SECURITIES LAWS AND ANY APPLICABLE LOCAL LAWS AND REGULATIONS AND FURTHER SUBJECT TO THE ISSUER'S AND THE TRUSTEE'S RIGHTS PRIOR TO ANY SUCH OFFER, SALE OR TRANSFER (I) PURSUANT TO CLAUSE (E) TO REQUIRE THE DELIVERY OF AN OPINION OF COUNSEL, CERTIFICATION AND/OR OTHER INFORMATION SATISFACTORY TO EACH OF THEM AND (II) IN EACH OF THE FOREGOING CASES, TO REQUIRE THAT A CERTIFICATE OF TRANSFER IN THE FORM APPEARING ON THE OTHER SIDE OF THIS SECURITY IS COMPLETED AND DELIVERED BY THE TRANSFEROR TO THE TRUSTEE

AND (3) AGREES THAT IT WILL GIVE TO EACH PERSON TO WHOM THIS SECURITY IS TRANSFERRED A NOTICE SUBSTANTIALLY TO THE EFFECT OF THIS LEGEND.

If you purchase Notes, you will also be deemed to acknowledge that the foregoing restrictions apply to holders of beneficial interests in these Notes as well as to holders of these Notes.

(6) You agree that you will give to each person to whom you transfer the Notes notice of any restrictions on the transfer of such Notes.

(7) You acknowledge that the Registrar will not be required to accept for registration or transfer any Notes acquired by you except upon presentation of evidence satisfactory to the Issuer and the Trustee that the restrictions set forth therein have been complied with.

(8) You acknowledge that the Issuer, the initial purchasers and others will rely upon the truth and accuracy of your acknowledgements, representations, warranties and agreements and agree that if any of the acknowledgements, representations, warranties and agreements deemed to have been made by your purchase of the Notes are no longer accurate, you shall promptly notify the initial purchasers. If you are acquiring any Notes as a fiduciary or agent for one or more investor accounts, you represent that you have sole investment discretion with respect to each such investor account and that you have full power to make the foregoing acknowledgements, representations and agreements on behalf of each such investor account.

(9) You understand that no action has been taken in any jurisdiction (including the United States) by the Issuer or the initial purchasers that would result in a public offering of the Notes or the possession, circulation or distribution of this offering memorandum or any other material relating to us or the Notes in any jurisdiction where action for such purpose is required.

LEGAL MATTERS

Certain legal matters in connection with the offering of the Notes will be passed upon for the Issuer by Shearman & Sterling LLP, counsel to the Issuer as to matters of United States, United Kingdom, German and French law. Certain legal matters in connection with this offering of the Notes will be passed upon for the initial purchasers by Cahill Gordon Reindel LLP as to matters of United States law.

INDEPENDENT AUDITORS

The consolidated financial statements of the Group, as of and for the years ended December 31, 2008, 2009 and 2010 included in the offering memorandum, have been audited by KPMG AG Wirtschaftsprüfungsgesellschaft ("KPMG"), German independent auditors, as stated in their reports appearing herein. The address of KPMG is Theodor-Heuss-Straße 5, 70174 Stuttgart, Germany.

WHERE YOU CAN FIND MORE INFORMATION

We are not currently subject to the periodic reporting and other information requirements of the U.S. Securities Exchange Act of 1934, as amended (the "Exchange Act").

Each purchaser of the Notes from the initial purchasers will be furnished with a copy of this offering memorandum and, to the extent provided to the initial purchasers by us for such purpose, any related amendments or supplements to this offering memorandum. Each person receiving this offering memorandum and any related amendments or supplements to the offering memorandum acknowledges that:

(1) such person has been afforded an opportunity to request from us, and to review and has received, all additional information considered by it to be necessary to verify the accuracy and completeness of the information herein;

(2) such person has not relied on the initial purchasers or any person affiliated with the initial purchasers in connection with its investigation of the accuracy of such information or its investment decision; and

(3) except as provided pursuant to (1) above, no person has been authorized to give any information or to make any representation concerning the Notes offered hereby other than those contained herein and, if given or made, such other information or representation should not be relied upon as having been authorized by us or the initial purchasers.

For so long as any of the Notes remain outstanding and are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, we will, during any period in which we are not subject to Section 13 or 15(d) under the U.S. Exchange Act, nor exempt from reporting thereunder pursuant to Rule 12g3-2(b), make available to any holder or beneficial holder of a Note, or to any prospective purchaser of a Note designated by such holder or beneficial holder, the information specified in, and meeting the requirements of, Rule 144A(d)(4) under the Securities Act upon the written request of any such holder or beneficial owner. Any request should be directed to us at Heckler & Koch-Strasse 1, 78727 Oberndorf am Neckar, Germany, Attention: Uwe Kaltenbach, Fax: +4974 23 79 82252. We have also agreed, pursuant to the Indenture, to provide to the holders of the Notes certain additional information and reports.

SERVICE OF PROCESS AND ENFORCEMENT OF CIVIL LIABILITIES

We are incorporated under the laws of the Federal Republic of Germany, and our advisory board members, management board members, directors or executives (or certain other persons named in this offering memorandum) are not residents of the United States. Furthermore, a substantial portion of our assets are located outside the United States. As a result, it may not be possible for investors to effect service of process within the United States upon those persons or us, or to enforce against them judgments of U.S. courts predicated upon the civil liability provisions of U.S. federal or state securities laws.

We have been advised by our German counsel that there is doubt as to the enforceability in Germany of civil liabilities based on federal or state securities laws of the United States, either in an original action or in an action to enforce a judgment obtained in U.S. federal or state courts. The United States and the Federal Republic of Germany currently do not have a treaty providing for the reciprocal recognition and enforcement of judgments, other than arbitration awards, in civil and commercial matters. Consequently, a final judgment for payment given by any federal or state court in the United States, whether or not predicted solely upon U.S. federal or state securities laws, would not automatically be enforceable in Germany. A final judgment by a U.S. federal or state court based on civil liability, however, may be recognized and enforced in Germany in an action before a court of competent jurisdiction in accordance with the proceedings set forth by the German Code of Civil Procedure (*Zivilprozessordnung*). In such an action, a

German court generally will not reinvestigate the merits of the original matter decided by a U.S. court, except as noted below. The recognition and enforcement of the U.S. judgment by a German court is conditional upon a number of factors, including the following:

- U.S. courts could take jurisdiction of the case in accordance with the principles on jurisdictional competence according to German law;
- the document introducing the proceedings was duly made known to the defendant in a timely manner that allowed for adequate defense;
- the judgment is not contrary to (i) any prior judgment which became *res judicata* rendered by a German court or (ii) any prior judgment which became *res judicata* rendered by a foreign court which is to be recognized in Germany and the procedure leading to the respective judgment is not in contradiction to a proceeding previously commenced in Germany;
- the judgment is consistent with the procedure of a matter pending before a German court, provided that such matter was pending before the German court before the procedure on which the U.S. court rendered its judgment commenced;
- the effects of its recognition will not be in conflict with material principles of German law, including without limitation, fundamental rights under the constitution of Germany (*Grundrechte*). In this context, it should be noted that any component of a U.S. federal or state court civil judgment awarding punitive damages or any other damages which do not serve a compensatory purpose, such as treble damages, will not be enforced in Germany. They are regarded to be in conflict with material principles of German law;
- the reciprocity of enforcement of judgments is guaranteed; and
- the judgment became *res judicata* in accordance with the law of the place where it was pronounced.

Enforcement and foreclosure based on U.S. judgments may be sought against German defendants after having received an enforcement decision from a competent German court in accordance with the above principles. Subject to the foregoing, purchasers of securities may be able to enforce judgments in Germany in civil and commercial matters obtained from U.S. federal or state courts. We cannot, however, assure you that those judgments will be enforceable. In particular, the obligations need to be of a specific kind and type for which an enforcement procedure exists under German law. Enforcement is also subject to the effect of any applicable bankruptcy, insolvency, reorganization, liquidation, moratorium as well as other similar laws affecting creditor's rights generally.

Furthermore, German civil procedure differs substantially from U.S. civil procedure. With respect to the production of evidence, for example, U.S. federal and state law and the laws of several other jurisdictions based on common law provide for pre-trial discovery, a process by which parties to the proceedings may, prior to trial, compel the production of documents by adverse or third parties and the deposition of witnesses. Evidence obtained in this manner may be decisive in the outcome of any proceeding. No such pre-trial discovery process exists under German law.

If the party in whose favor such final judgment is rendered brings a new suit in a competent court in Germany, such party may submit to the German court the final judgment rendered in the United States. Under such circumstances, a judgment by a federal or state court in the United States will be regarded by a German court only as evidence of the outcome of the dispute to which such judgment relates. A German court may choose to re-hear the dispute and may render a judgment not in line with the judgment rendered by a federal or state court in the United States.

In addition, it is doubtful whether a German court would accept jurisdiction and impose civil liability in an original action predicated solely upon U.S. federal securities laws.

LISTING AND GENERAL INFORMATION

Listing

Application has been made to admit the Notes to listing on the Official List of the Luxembourg Stock Exchange and to trading on the Euro MTF Market of that exchange. Notice of any optional redemption, change of control or any change in the rate of interest payable on the Notes will be published in a leading Luxembourg newspaper of general circulation (which is expected to be the *Luxemburger Wort*) or, to the extent and in the manner permitted by such rules, posted on the official website of the Luxembourg Stock Exchange (www.bourse.lu).

For so long as the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange, copies of the following documents may be inspected and obtained at the specified office of the paying agent in Luxembourg during normal business hours on any weekday:

- our organizational documents including the bylaws;
- our most recent audited financial statements, and any interim quarterly financial statements published by us; and
- the Indenture relating to the Notes (which includes the Guarantees and the form of the Notes).

The Issuer will maintain a paying and transfer agent in Luxembourg for as long as any of the Notes are admitted to listing on the Official List of the Luxembourg Stock Exchange. The Issuer reserves the right to vary such appointment and will publish notice of such change of appointment in a leading newspaper having a general circulation in Luxembourg (which is expected to be the *Luxemburger Wort*) or, to the extent and in the manner permitted by such rules, posted on the official website of the Luxembourg Stock Exchange (www.bourse.lu).

Pursuant to Chapter 7; 703; Chapter 3, Section 2, Article 19 of the Rules and Regulations of the Luxembourg Stock Exchange, the Notes are freely transferable except as described in “Notice to Investors.”

As of the date of this offering memorandum, the most recent audited financial statements available for the Issuer were as of and for the year ended December 31, 2010.

Clearing information

The Regulation S Global Notes and the Rule 144A Global Notes have been accepted for clearance through the facilities of Euroclear and Clearstream. The Rule 144A Global Notes have a common code number of 062643676 and an ISIN of XS0626436769. The Regulation S Global Notes have a common code number of 062643811 and an ISIN of XS0626438112.

Legal information

Issuer Legal Information

The Issuer was incorporated as a limited liability company organized under the laws of Germany on December 30, 2003. The Issuer’s share capital consists of one share in the nominal amount of €25,000.

The Issuer is registered in the commercial register at the local court in Stuttgart under the registration number HRB 481250. Its business address is Heckler & Koch-Strasse 1, 78727 Obendorf, Germany.

The issuance of the Notes offered pursuant to this offering memorandum has been authorized by a shareholder resolution dated May 6, 2011, by an advisory board resolution dated May 6, 2011 and by management board resolutions dated May 6, 2011.

Guarantor Legal Information

The companies that are Guarantors or providers of the Collateral have the following corporate information:

- *Suhler USA, Inc.* Suhler USA, Inc. is a corporation incorporated under the laws of Alabama on May 16, 2005. Its business address is 5675 Transport Boulevard, Columbus, Georgia 31907.

- *Heckler & Koch, Inc.* Heckler & Koch, Inc. is a corporation incorporated under the laws of Virginia on December 24, 1975. Its business address is 5675 Transport Boulevard, Columbus, Georgia 31907.

- *Heckler & Koch France SAS.* Heckler & Koch France SAS is a simplified limited company incorporated under the laws of France. Its business address is 7 Rue de la Plaine, 78 860 St Nom La Breteche.

- *HK Sidearms GmbH.* HK Sidearms GmbH is a limited liability company incorporated under the laws of Germany on May 5, 1991. Its business address is Heckler & Koch Strasse 1, 78727 Oberndorf am Neckar, Germany.

- *NSAF Limited.* NSAF Limited is a private company incorporated under the laws of England and Wales on October 31, 2001. Its business address is Unit 3 Easter Park, Lenton Lane, Nottingham NG7 2PX.

- *Small Arms Group Holding, Inc.* Small Arms Group Holding, Inc. is a corporation incorporated under the laws of Virginia on February 25, 2003. Its business address is 19980 Highland Vista Drive, Suite 190, Ashburn, Virginia 20147.

- *Heckler & Koch Defense, Inc.* Heckler & Koch Defense, Inc. is a corporation incorporated under the laws of Virginia on February 25, 2003. Its business address is 19980 Highland Vista Drive, Suite 190, Ashburn, Virginia 20147.

Financial Year and Accounts

The Issuer's financial year begins on January 1 and ends of December 31 of each year. The Issuer will prepare and publish annual audited financial statements. Any future published financial statements prepared by the Issuer will be available, during normal office hours, at the executive office of the Issuer.

General

Except as disclosed in this offering memorandum:

- there has been no material adverse change in our financial position since December 31, 2010; and

- we have not been involved in any litigation, administrative proceeding or arbitration relating to claims or amounts which are material in the context of the issue of the Notes, and, so far as we are aware, no such litigation, administrative proceeding or arbitration is pending or threatened.

GLOSSARY

Assault rifle......................................	any of the automatic rifles or semi-automatic rifles with large magazines designed for military use (a translation of the German "*Sturmgewehr*").
Belt-fed	a weapon's design in which ammunition is drawn from a belt rather than a magazine.
Carbine..	short, light rifle, especially those used by mounted soldiers.
Cost-plus contract	contracts that earn profit by a margin over production costs.
Data package....................................	a bundle of intellectual property rights given to a customer in connection with a licensing agreement.
End-user certificate	a certificate required by the German government indicating who will receive firearms and for what purpose.
Low velocity ammunition................	ammunition at or below the speed of sound.
Offset	contractual arrangement by which the customer requires that a certain part of the value of a contract remains within the customer's country (typically in form of sourcing or construction of components).
Order book.......................................	contractual sales yet to be delivered.
Performance guarantee	a guarantee against delay or mistakes in delivery.
Side arms	pistols and revolvers.
Small arms	among our weaponry are such diverse elements as man-portable, individual, and crew-served weapon systems used mainly against personnel and lightly armored or unarmored equipment. Small arms include pistols, hunting rifles, and fully automatic weapons.
Submachine gun...............................	a portable, automatic firearm commonly firing low velocity ammunition.
Weapons of war	fully automatic, large caliber arms or any weapon that, due to its specialized use, is characterized as a weapon of war, such as sniper rifles.

INDEX TO FINANCIAL STATEMENTS

AUDITOR’S REPORT

We have audited the consolidated financial statements prepared by Heckler & Koch GmbH, Oberndorf/Neckar, comprising the balance sheet, the income statement, statement of comprehensive income, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2010. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB (and supplementary provisions of the shareholder agreement/ articles of incorporation) are the responsibility of the parent company’s management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit. In addition we have been instructed to express an opinion as to whether the consolidated financial statements comply with full IFRS.

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

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to section 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group’s position and suitably presents the opportunities and risks of future development.”

Stuttgart, 31 March 2011

KPMG AG
Wirtschaftsprüfungsgesellschaft (Audit Firm)

Dr. Kursatz Wirtschaftsprüfer (Auditor)	Feller Wirtschaftsprüfer (Auditor)

Heckler & Koch GmbH

Oberndorf/Neckar

Consolidated Statements

According to IFRS

for the Financial Year

2010

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS OF

	Note	31.12.10	31.12.09
		EUR '000	
Assets			
Property, plant & equipment	17	53,065	54,219
Intangible assets—goodwill	16	60,365	60,365
Intangible assets—other	16	42,400	41,190
Other investments	18	0	1
Deferred tax assets	15	11,094	6,779
Total non-current assets		**166,924**	**162,553**
Inventories	19	73,184	71,806
Prepayments for inventories		3,727	5,843
Prepayments for other current assets		1,823	1,234
Other loans, investments & derivatives	18,36	6,096	5,762
Current tax assets		523	220
Trade and other receivables	20,36	50,402	41,911
Cash & cash equivalents	21	54,883	52,133
Total current assets		**190,637**	**178,910**
Total assets		**357,561**	**341,463**
Equity			
Share capital		25	25
Additional paid in capital		13,695	13,695
Reserves		82,687	63,867
Total equity	22	**96,407**	**77,587**
Liabilities			
Loans & borrowings due to third parties	25	119,207	117,851
Employee defined benefit obligations	23	52,594	48,470
Provisions	24	13,493	12,432
Trade and other payables	26	111	167
Deferred tax liabilities	15	21,287	21,275
Total non-current liabilities		**206,692**	**200,196**
Trade and other payables	26,36	33,689	33,422
Advanced & stage payments received		9,275	16,224
Deferred income		92	292
Finance lease obligations	25	0	86
Derivatives	29	40	828
Current income tax payable		6,594	8,874
Provisions & accruals	24	4,772	3,956
Total current liabilities		**54,461**	**63,680**
Total liabilities		**261,154**	**263,876**
Total equity & liabilities		**357,561**	**341,463**

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR TO DECEMBER 31

	Note	2010	2009
		EUR '000	
Revenue	6	247,244	234,748
Cost of sales	7	(144,067)	(153,563)
Gross profit		**103,178**	**81,185**
Research & development	8	(4,112)	(3,051)
Sales, marketing & distribution	9	(31,752)	(24,714)
Administration	10	(14,758)	(14,224)
Other operating income	11	6,512	6,344
Other operating expenses	12	(7,289)	(6,132)
Results from operating activities	13	**51,777**	**39,408**
Financial income		5,141	2,500
Financial expense		(16,347)	(17,684)
Net financial result	14	**(11,206)**	**(15,184)**
Profit before income tax		**40,571**	**24,224**
Income tax expense	15	(10,170)	(7,270)
Profit for the period		**30,402**	**16,954**
Attributable to the shareholders of Heckler & Koch GmbH %		**30,402**	**16,954**
Earnings per share	22	**N/A**	**N/A**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR TO DECEMBER 31

	Note	2010	2009
		EUR '000	
Forex translation differences for foreign operations		(381)	690
Hedging gains/(losses)	22	788	(828)
DBO actuarial gains/(losses)	22	(3,694)	(3,719)
Deferred tax	22	806	1,260
Other comprehensive income		**(2,481)**	**(2,596)**
Profit for the period		**30,402**	**16,954**
Total comprehensive income for the period		**27,920**	**14,358**
Attributable to the shareholders of Heckler & Koch GmbH		**27,920**	**14,358**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR DECEMBER 31, 2008 TO DECEMBER 31, 2010

Note 22	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Hedging Reserve	Consolidated Retained Earnings	Shareholder Equity
				EUR '000			
As of 31.12.2008	25	79,695	(521)	3,662	—	(9,482)	73,379
Reclassification of reserves		(66,000)	—	—	—	66,000	—
Total recognised income & expense		—	690	(2,688)	(598)	16,954	14,358
Dividends declared		—	—	—	—	(10,150)	(10,150)
As of 31.12.2009	25	13,695	169	974	(598)	63,322	77,587
Total recognised income & expense		—	(381)	(2,670)	569	30,402	27,920
Dividends declared		—	—	—	—	(9,100)	(9,100)
As of 31.12.2010	25	13,695	(212)	(1,695)	(29)	84,623	96,407

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR TO DECEMBER 31

	Note	2010	2009
		EUR '000	
Cash flows from operating activities			
Profit for the period		30,402	16,954
Adjustments for:			
Depreciation		8,131	8,636
Amortisation of intangible assets	16	1,286	1,291
Retirement losses on intangible assets		1,229	1,133
Net interest expense	14	13,628	14,343
Gain/loss on disposal of property, plant & equipment		1,390	310
Gain/loss on disposal of investments	14	0	1
Income tax expense	15	10,170	7,270
		66,235	49,938
Change in inventories		129	(667)
Change in trade & other receivables		3,684	21,767
Change in prepayments		1,585	(5,691)
Change in trade & other payables		(11,943)	(56)
Change in provisions & employees' benefits	23,24	170	(2,824)
		59,859	62,467
Income tax paid		(16,410)	(5,107)
Net cash from/(used in) operating activities		**43,449**	**57,361**
Cash flows from investing activities			
Interest received		655	976
Proceeds from sale of property, plant & equipment		211	138
Proceeds from sale of investments	18	302	292
Acq'n of property, plant, equipment & intangibles	16,17	(8,644)	(8,480)
Net investment in loans	18,36	7,162	2,054
Acquisition of subsidiaries & other investments	18,36	(6,710)	(12,316)
Capitalised development expenditure	16	(3,388)	(2,676)
Net cash from/(used in) investing activities		**(10,412)**	**(20,012)**
Cash flows from financing activities			
Proceeds from utilisation of US credit line	25	0	1,264
Repayment of US credit line	25	0	(4,674)
Interest paid		(11,523)	(11,654)
Payment of finance lease liabilities	25	(88)	(139)
Dividends paid		(19,250)	0
Net cash from/(used in) financing activities		**(30,861)**	**(15,204)**
Net inc./(dec.) in cash & cash equivalents		**2,176**	**22,145**
Cash & cash equivalents at 1st January		52,134	29,762
Effect of exchange rate fluctuations on cash held		574	227
Cash & cash equivalents at 31st December	21	**54,883**	**52,134**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR 2010

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR 2010

General disclosures

(1) Presentation of the consolidated financial statements

Heckler & Koch GmbH, the parent company of the Group, is registered under HRB 481250 at the Stuttgart district court. The company's registered office is in Oberndorf/Neckar, Germany and the postal address is Heckler & Koch GmbH, Heckler & Koch-Str. 1, 78727 Oberndorf/Neckar, Germany. The articles of incorporation are from May 19, 2004 and the registered name of the company is Heckler & Koch GmbH. The financial year is the calendar year.

The object of Heckler & Koch GmbH and its subsidiaries (the "Heckler & Koch Group") is the development, manufacture and distribution of defence and security products, and the provision of related services.

(2) Executive board approval

The board of directors of Heckler & Koch GmbH finalised & approved the consolidated financial statements on March 23, 2011.

(3) Statement of compliance with applicable law and IFRS

The consolidated financial statements of Heckler & Koch GmbH as at December 31, 2010, have been prepared in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) as applicable in the EU, together with interpretations of the International Financial Reporting Interpretation Committee (IFRIC) and the supplementary German commercial law regulations pursuant to § 315a (1) HGB. All IFRS's and IFRIC's which were effective for the financial year 2010 have been applied.

For the financial year 2010, the following Standards and amendments to previous Standards became effective for the first time and affected the Group's net assets, financial position, results of operations or cash flows to some extent:

IFRS 3 Business Combinations (2008)

Revised IFRS 3 has been applied prospectively from January 1, 2010. It incorporates the following changes that could be relevant to the Group:

- It now also applies to contractual business combinations and combinations of mutual companies
- The definition of a business has been broadened—the possibility of an integrated set of activities and assets being run as a business is sufficient for this set to be defined as a business.
- Acquisition date fair value of contingent consideration must be recognised as part of the consideration transferred.
- There is now a choice of methods for valuing any non-controlling interest. This can be measured at either its proportionate interest in the fair values of the identifiable assets and liabilities of the acquiree, or at fair value.
- Transaction costs will be expensed as incurred (€45k transaction costs were expensed instead of being capitalised).

For the financial year 2010, the following Standards and amendments to previous Standards became effective for the first time and had no material effect on the Group's net assets, financial position, results of operations or cash flows:

IAS 27 Consolidated and Separate Financial Statements (amended 2008)

The amended IAS 27 requires accounting for changes in ownership interests by the Group in a subsidiary, while maintaining control, to be recognised as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

IAS 39 Financial Instruments: Recognition and Measurements: Eligible Hedged Items (amended)

The amended IAS 39 clarifies the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship.

IFRIC 12, IFRIC 15, IFRIC 16 and IFRIC 18 were officially effective for financial years beginning on or after January 1, 2009. However on their adoption, the EU set different dates for them to become effective. These interpretations are effective for consolidated financial statements prepared in accordance with §315a HGB for the year to December 31, 2010 however they have no material effects on the Group's net assets, financial position, results of operations or cash flows.

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2010, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for IFRS 9 Financial Instruments, which becomes mandatory for the Group's 2013 consolidated financial statements and could change the classification and measurement of financial assets. The Group does not plan to adopt this standard early and the extent of the impact has not been determined.

The consolidated financial statements have been prepared in euro. Unless otherwise stated, all financial information presented in euro has been shown to the nearest thousand (€k, EUR'000). As a result, the totals in this report may vary slightly from the exact arithmetic aggregation of the figures that precede them.

For the income statement, expenses have been classified by function. In order to enhance the clarity of presentation, various items in the balance sheet and in the income statement have been aggregated.

(4) Group entities

Apart from the single entity statements of Heckler & Koch GmbH, the consolidated financial statements of Heckler & Koch GmbH as at December 31, 2010, include the annual financial statements of six (2009: six) foreign and one (2009: no) German subsidiaries. Subsidiaries are companies in which the parent enterprise exercises more than half the voting rights or is able to control their financial and business policy for other reasons (control relationship). Inclusion commences at the time from which the control relationship exists; it ends when the possibility of control ceases.

The following table shows a list of the seven subsidiaries and one joint venture included in the consolidation, together with their total equity and profit for the year figures from their financial statements, as prepared for consolidation purposes under IFRS, in their functional currencies:

		2010			2009		
	Functional Currency	**%**	**Equity**	**Profit**	**%**	**Equity**	**Profit**
Direct holdings							
NSAF Limited, Nottingham, England	GBP '000	100%	5,453	3,679	100%	5,724	3,894
Heckler & Koch France S.A.S., Paris, France	EUR '000	100%	1,244	569	100%	674	401
HK Sidearms GmbH, Oberndorf a. N., Germany	EUR '000	100% from 1.7.10	9,278	1,141	0%	—	—
Small Arms Group Holding Inc., Ashburn VA, USA	USD '000	100%	140	(6)	100%	146	(11)
Sistemas de Armamento Ibericos S.L., Madrid, Spain	EUR '000	—	—	—	50% to 12.09	25	—
Suhler USA, Inc., AL, USA	USD '000	100%	16,884	(0)	100%PF	16,884	19
Indirect holdings							
Heckler & Koch Defense Inc., Ashburn VA, USA	USD '000	100%	(15,843)	8,855	100%	(24,698)	(1,512)
Heckler & Koch, Inc., VA & GA, USA	USD '000	100%	14,120	(472)	100%PF	14,592	1,515

As part of the restructuring undertaken in 2003 to separate the civilian and military businesses in order to reduce liability risks, Heckler & Koch GmbH ("HKO") sold its civilian business including pistol assembly to Heckler & Koch Jagd- & Sportwaffen GmbH. In the USA the civilian business of Heckler & Koch, Inc. was also isolated. Both civilian businesses were sold to a related party. Following changes to laws in the US this separation was no longer necessary.

During 2009 HKO acquired HKI and its parent company Suhler USA, Inc. ("SUI") in a common control transaction. Since both groups were ultimately controlled by the same person, figures have been presented as if the combination had occurred prior to the start of the earliest period shown (i.e. as at 31.12.2007). A detailed reconciliation is shown in Note 41 to the 2009 Consolidated Financial Statements.

The restructuring activities were completed on July 1, 2010 with the acquisition of 100% of HK Sidearms GmbH ("HKS", formerly Heckler & Koch Jagd- & Sportwaffen GmbH. At the date of acquisition, after purchase price allocation, HKS had €8k plant, equipment and software, net €281k deferred assets, €2,664k inventories, €1,440k trade receivables (none impaired), €164k other assets and prepayments, € 5,873k net receivables from the Group, €261k cash and cash equivalents, €1,432k tax provisions, €870k pension and other provisions and €220k payables due to third parties. The purchase price for HKS of € 6.4m was paid in full in cash.

HKS purchases parts and assemblies from HKO and sells the assembled pistols mainly to HKO and HKI. The acquisition of HKS on July 1, 2010 therefore reduced the external revenue for the Group by €9.7m and, due to initial unrealised profit elimination, also reduced the Group's EBITDA by around €1.0m. If the acquisition had taken place on January 1, 2010, Group revenues for the year would have been €239.3m and EBITDA would have been an estimated €60.7m, due to the unrealised profit eliminations during the first year. If the acquisition had taken place several years ago however, the EBITDA is estimated at around €62.8m with the increase being due to the release of prior year unrealised profit eliminations.

The investment in the dormant joint venture, Sistemas de Armamento Ibericos S.L., ceased during the final quarter of 2009. Prior to this, it was included in the consolidated financial statements using the equity method described in IAS 28, as permitted by IAS 31.

(5) Summary of significant accounting policies and basis of measurement

The consolidated financial statements have been prepared on a historical cost basis; where IFRS requires recognition at fair value, this has been applied.

The significant accounting policies and measurement methods applied in preparing the consolidated financial statements are described below:

Consolidation methods

The assets and liabilities of the domestic and foreign companies included in the consolidated financial statements are recognised and measured using the accounting and measurement methods that apply uniformly for the Heckler & Koch Group.

On the acquisition of a company, the assets and liabilities of the subsidiaries concerned are measured at their fair value at the time of acquisition. If the acquisition costs for the participation exceed the net fair value of the identified assets and debts, the difference is capitalised as goodwill. If the acquisition costs are lower, the fair value of the assets and liabilities and the amount of the acquisition costs are reassessed. Any remaining negative goodwill (lucky buy) is recorded immediately in the income statement.

In subsequent periods, the associated fair value adjustments to assets and liabilities are maintained, written off or released in accordance with the corresponding assets and liabilities. Capitalised goodwill is not amortised, but is subject to an annual impairment test in accordance with IFRS 3 instead.

A business combination in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination, and that control is not transitory, is classified as being "under common control". Business combinations involving entities under common control are excluded from the scope of IFRS 3. The Group uses the book values for such acquired entities and offsets a difference between the net assets acquired and the consideration paid, if any, in equity. Providing that the entities were under common control during the comparative periods, the comparatives are restated as if the combination had been in existence throughout the reporting periods presented.

The financial year of all companies included corresponds to the financial year of the parent company.

All receivables, liabilities, sales revenues, other income and expenses within the scope of consolidation are eliminated. Unrealised profits from intra-group supplies are eliminated from inventories or fixed assets as appropriate.

Currency translation

The Heckler & Koch Group reporting currency is the euro (€).

Foreign currency transactions are translated in the individual financial statements of Heckler & Koch GmbH and its consolidated companies at the rates pertaining at the time of the transactions. As at the balance sheet date, assets and liabilities in foreign currency are measured at the spot rate on the balance sheet date. Differences arising on translation are recorded in the income statement.

The financial statements of the foreign companies are translated from their functional currencies into euro. Since subsidiaries and joint ventures operate their business independently, their functional currency is their individual local currency. In the consolidated financial statements, income and expenses from the financial statements of subsidiaries that are prepared in foreign currency are translated at the average rate for the year calculated from the daily rates. This method is used for simplicity since usually the local currency income and expenditure involved are fairly evenly spread throughout the year and consequently any potential variances are not material. Assets and liabilities are translated at the spot rate on the balance sheet date. Goodwill is treated in the same way as an asset or liability and translated at the balance sheet spot rate. Foreign currency translation variances are taken directly to the foreign currency translation reserve in equity. In the event of the disposal of a consolidated entity, associated accumulated foreign currency translation variances are recorded as part of the profit or loss on disposal.

The rates used for currency translation are shown in the table below:

Currency	**Abbr.**	**Rate on balance 31.12.2010**	**Rate on balance 31.12.2009**	**Average exchange 2010**	**Average exchange 2009**
US Dollar (USA)	**USD**	1.3362	1.4406	1.3282	1.3947
Pound (United Kingdom)	**GBP**	0.8608	0.8881	0.8590	0.8919

Significant accounting policies

Goodwill

Goodwill is an asset representing the future economic benefits that cannot be individually identified and separately recognised from the net assets obtained through a business combination. Goodwill is allocated to the following cash generating units (segments):

	2010	**2009**
	EUR ’000	
Site location: Germany—Defence	59,232	59,232
Site location: France	1,133	1,133
Total	**60,365**	**60,365**

Goodwill is capitalised and subjected to an annual impairment test. If the carrying value is no longer recoverable, impairment is charged. Otherwise the prior year carrying value is retained. Any impairment charge against goodwill is not reversed, even if the valuation exceeds the carrying value.

Heckler & Koch conducts an impairment test of goodwill at least annually. The recoverable value of the cash generating unit is compared with its carrying value. The recoverable value used in the calculation is the value in use. The value in use of the cash generating unit is determined by discounting future cash flows. The computation is based on the following material assumptions:

A detailed plan is made of the cash flows for the cash generating unit for the forecast period of five years. Subsequent periods are accounted for by a terminal value determined on the basis of the final year, adjusted for material one-off events during earlier years and the volume of the current order book and applying a 1% growth rate. The key assumptions for the determination of the value in use are the composition and value of sales. These assume that governments will continue to modernise their armed forces in the next few years, and are based on information over future requirements together with past experience. IAS 36.134(f) does not apply.

The discount rate used for December 31, 2010 is a uniform pre-tax cost of capital of 9.25% (2009: 9.25%); in line with the financing structure, this is similar to the interest rate on the Notes.

Goodwill from acquisitions prior to January 1, 2006 has been capitalised; negative goodwill from acquisitions prior to this transition date has been offset against reserves. On divestment of a consolidated company any goodwill relating to it, other than negative goodwill, is included in the computation of the deconsolidation result.

Intangible assets

Purchased intangible assets, mainly patents, licences and software, are capitalised at acquisition cost. Internally generated intangible assets, with the exception of goodwill, are capitalised if it is sufficiently probable that a future economic benefit will flow from the use of the asset and the costs of the asset can be determined reliably. The manufacturing costs of internally generated intangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset.

With the exception of goodwill and trademarks, all intangible assets have finite useful lives and are amortised using the straight-line method over this period. Licences and software usually have useful lives of 10 years. Standard software usually has a useful life of 4 or 5 years. Capitalised development costs usually have useful lives of 8 years from the date that sales of the developed product commence. If the expected useful life is materially longer or shorter, the expected useful life is used.

Tangible assets

Tangible assets which will be used in the business for more than one year are capitalised and valued at acquisition or manufacturing costs less depreciation calculated using the straight-line, use-related method, together with impairment if appropriate. The manufacturing costs of internally generated tangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. The permitted alternative method of revaluation is not applied.

The following useful lives are applied for scheduled depreciation Group-wide:

Category of tangible asset	years
Buildings	25 - 40
Plant and machinery	5 - 10
Tooling	3 - 5
Vehicles	6
Fixtures, fittings and office equipment	5 - 10

The useful lives and methods of depreciation are reviewed regularly in order to ensure that these are in line with the actual expected economic use.

Impairment of tangible assets and of intangible assets other than goodwill

As at each balance sheet date, if there are triggering events for impairment, material tangible assets and intangible assets are submitted to an impairment test in accordance with IAS 36. If the carrying value of an asset exceeds its recoverable amount, an impairment loss is recognised. The recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount for an individual asset cannot be determined, an estimate is made of the recoverable amount at the level of next higher cash generating unit.

If, in the following periods the recoverable amount exceeds the carrying value, reversal of impairment is only made for the lower of the amount necessary to (i) bring the carrying value of the asset to its recoverable amount or (ii) to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortisation that would have been recognised.

The impairment and any reversal of impairment are recorded in the income statement.

Financial instruments

As defined by IAS 32 and used in IAS 39, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Original financial instruments

Financial instruments held by the Group are classified as one of the following:

- financial assets at fair value through profit or loss
- loans and receivables

- held-to-maturity investments
- available-for-sale financial assets
- financial liabilities at fair value through profit or loss
- other financial liabilities, valued at amortised cost using the effective interest method

The classification of a financial instrument is determined based on the intended principal purpose upon initial recognition. Financial assets include cash and cash equivalents, trade accounts receivable, loans receivable and derivatives that are assets held for trading. Financial liabilities include trade accounts payable, amounts owed to banks, derivatives that are liabilities held for trading and other financial liabilities.

Trade accounts receivable/payable result from the provision/receipt of goods and/or services in the normal course of business. Securities include financial instruments in the form of shares or participation in funds.

An instrument is classified at **fair value through profit or loss** if it is held for trading or is designated as such upon initial recognition. For the periods covered by these financial statements, the only financial instruments designated by the Group as held at "fair value through profit or loss" are derivatives that do not meet the requirements for hedge accounting. Upon initial recognition any attributable transaction costs are recognised in profit or loss. Financial instruments at fair value through profit or loss are measured at fair value, and any changes in the fair value are recognised in profit or loss.

Financial assets

All regulated market acquisitions and disposals of financial assets are recognised on the date of settlement.

Financial assets are recognised initially at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition.

The recoverability of financial assets that are not held at fair value through profit or loss is reviewed regularly. Objective evidence for an impairment loss are in particular the insolvency of contractual partners or their failing to comply with payment plans. If the carrying value is higher than the recoverable amount, impairment is recognised via the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively linked to an event occurring after the impairment was recognised, the previously recognised impairment loss shall be partially or completely reversed through the income statement.

The fair values of financial assets in the balance sheet are usually their market values. If market values are not readily available, the fair values are determined using recognised valuation techniques and current market parameters. Valuation methods available include using recent arm's-length transactions between knowledgeable, willing parties, recent market transactions in similar financial instruments, adjusted for factors unique to the instrument being valued, discounted cash flow analysis or option pricing models.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or are transferred. To qualify for derecognition, the transfer must transfer the risks and rewards of ownership of the financial asset or the contractual rights to receive the cash flows.

Loans and receivables are financial assets resulting from monetary transactions, the supply of goods or services to third parties. Current assets in this category are measured at cost and non-current assets are measured at amortised cost using the effective interest method.

Impairments to doubtful debts are mainly due to estimates and assessments of individual accounts receivable, based on the creditworthiness of individual customers. Impairment of accounts receivable is initially shown as a provision for doubtful debts. If a debt is regarded as irrecoverable, the impaired account receivable is written off.

Financial instruments are classed as "**held to maturity**" if they are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits, for which the original term is less than three months. These are valued at nominal value.

Financial liabilities

Financial liabilities are mainly trade accounts payable, amounts owed to banks and other liabilities.

Financial liabilities are recognised initially at fair value less, in the case of a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the issue.

A financial liability is derecognised when the obligation specified in the contract is discharged, or cancelled, or expires.

Financial liabilities valued at amortised cost using the effective interest method, include trade accounts payable and interest-bearing loans. These are valued at amortised cost using the effective interest method. Any profit or loss is recognised in the income statement when the liabilities are derecognised or settled.

Derivative financial instruments and hedge accounting

A derivative is a financial instrument or other contract with all three of the following characteristics: (1) its value changes in response to a specified foreign exchange rate or other variable; (2) it requires no initial payment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and (3) it is settled at a future date.

During the first quarter of 2009, circumstances arose which made a hedging transaction for foreign exchange cover for a particular foreign currency contract advisable. In the past, all foreign exchange forward contracts were treated as derivatives held at fair value through profit or loss.

The Heckler & Koch Group only uses derivative financial instruments to manage its exposure to foreign currency translation risk arising from normal business operations. In line with IAS 39, all derivatives are measured at fair value. The fair values of derivatives in the balance sheet are usually their market values. If market values are not readily available, the fair value may be determined using recognised pricing models or evidenced by bank confirmations. Changes in fair value are accounted for as described below:

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Other non-trading derivatives

When a derivative financial instrument is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in profit or loss.

Construction work in progress

Construction work in progress represents the total, gross, unbilled amount expected to be collected from customers for contract work performed to date. It is measured at cost plus profit recognised to date (see "recognition of income and expense—construction contracts", below) less progress billings and recognised losses. Cost includes all expenditure related directly to specific projects.

Construction work in progress is presented as part of trade and other receivables in the balance sheet. If payments received from customers exceed the income recognised, then the difference is presented as advance payments received in the balance sheet.

Inventories

The inventories are recognised at acquisition or manufacturing costs or, if lower, their net realisable value. Raw materials, supplies and consumables as well as merchandise are measured at their adjusted average acquisition costs. The manufacturing costs of work in progress and finished goods are determined on the basis of directly attributable individual costs as well as a proportion of production-related overheads. The manufacturing costs do not include selling expenses, general and administrative expenses or financing costs. The net realisable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale. Provisions are made to recognise impairment of slow-moving inventories or to reduce to net realisable value.

Non-current assets held for sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. These assets are held at the lower of their carrying values and their fair value less costs to sell. These assets are not depreciated.

(5) Summary of significant accounting policies and basis of measurement

Provisions for pensions and similar defined benefit obligations

The provisions for defined benefit obligations are computed using the projected unit credit method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The value is obtained from an actuarial report.

Actuarial gains and losses are recognised outside profit or loss, in the period in which they occur, in accordance with IAS 19.93A-D. These are shown in the statement of comprehensive income.

In determining the discount interest rates in accordance with IAS 19.78, the actuaries refer to market yields on high quality corporate bonds at the balance sheet date.

Other non-current and current provisions

Other general liability provisions are recognised when a past event gives rise to a present obligation, it is probable that the obligation will be claimed and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date, or if the effect of the time value of money is material, the present value thereof. Reimbursement claims are recognised separately if it is virtually certain that reimbursement will be received if the Group settles the obligation.

Leases

For leasing agreements under which the Group is lessee, if the lease transfers substantially all the risks and rewards incidental to ownership of the asset (finance leases), then the assets are capitalised by the Group in accordance with IAS 17. Depreciation methods and useful lives are applied in line with similar owned assets. At the commencement of the lease term, finance leases are recognised as assets and liabilities in the balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset.

If the lease does not transfer substantially all the risks and rewards incidental to ownership of the asset, then the assets are capitalised by the lessor (operating leases). Leasing fees for operating leases are recognised in the income statement. If material, adjustments are made to straight-line leasing fees for agreements where payment schedules are different.

Recognition of income and expense

Sale of goods and services

Revenues are measured at the fair market value of the consideration received or to be received and represent the amounts that are to be obtained for goods and services in the normal course of business. The revenues are shown after subtracting sales deductions, discounts and value added taxes.

Revenues are recorded when the associated supplies and services have been rendered, the risks and rewards of ownership have transferred to the buyer and the receipt of the payment is probable.

Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue and expenses are recognised in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

Interest and other income

Interest income is accrued based on the loan outstanding and the applicable interest rate. The applicable interest rate is specified in the loan agreement and discounts the estimated future inflows of funds over the term of the financial asset to the net carrying value.

Other income is recognised in the period to which it relates, in accordance with the associated contract.

Other expenses

Other expenses are recognised on the basis of a direct link between the costs incurred and the related income in the income statement, either when the benefit is used or when the costs are caused.

Expenses for research and development

Research costs are expensed as they are incurred. Development costs are also expensed as they are incurred, unless they satisfy the criteria for recognition as internally generated intangible assets according to IAS 38.57.

Borrowing costs

Borrowing costs as defined in IAS 23 are capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset; the remaining borrowing costs are recognised as an expense in the period in which they are incurred.

Income taxes and deferred taxes

The income tax expense represents the sum of current tax expense and deferred tax expense.

The current tax expense is determined on the basis of the taxable income for the relevant year. The taxable income is different from the net income for the year shown in the income statement since it excludes expenses and income which will be tax deductible/taxable in other years or which will never be tax deductible or taxable. The liability of the group for current tax expense is computed on the basis of the valid tax rates or of tax rates which have been enacted by the balance sheet date.

Deferred taxes are the expected tax charge or relief arising from differences between the carrying values of assets and debts in the Group IFRS consolidated financial statements and their values in the tax accounts of the individual companies. The balance sheet oriented liability method is applied. In general, deferred tax liabilities are recorded for all taxable temporary differences, and deferred tax assets are recorded to the extent that it is probable that taxable profits will be available for which the deductible temporary differences can be used. Such assets and liabilities are not recognised if the temporary difference arises from (i) the initial recognition of goodwill or (ii) from the initial recognition of other assets and liabilities in a transaction that affects neither the accounting profit/(loss) nor taxable profit/(loss). In addition, deferred taxes are recognised for the carry forward of unused tax losses to the extent that it is probable that it will be possible to utilise them in the future.

The carrying amount of deferred tax assets is reviewed each year at the balance sheet date and is reduced if it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

The changes in deferred taxes are recognised in the income statement as tax income or expense unless they relate to items recognised in other comprehensive income or directly under equity; in this case the deferred taxes are recognised in other comprehensive income and the associated equity position.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised. If any are identified, they are disclosed in the notes unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised. They are disclosed in the notes, where an inflow of economic benefits is probable.

The use of estimates and assumptions

The preparation of the consolidated financial statements in compliance with the pronouncements of the IASB requires estimates to be made affecting the values recognised in the balance sheet, the nature and extent of contingent assets and liabilities identified at the reporting date and the value of income and expenses in the reporting period. The main assumptions and estimates for the Heckler & Koch Group concern the setting of useful lives, the recoverability of accounts receivable, the valuation of inventories, the recognition and measurement of provisions and the probability of future utilisation of deferred tax assets. Changes in estimates are recognised in the income statement prospectively.

Guarantee and warranty obligations can arise from legal or contractual requirements. Provisions are recognised for the expected cost of meeting claims under guarantee or warranty obligations. Claims are particularly likely if the warranty period has not yet expired, if warranty costs have been incurred in the past or if particular warranty claims are known. The evaluation of the risk of warranty claims is based on past experience and is used in determining the level of provision required.

Provisions for litigation risks are recognised if a company in the Heckler & Koch Group is a defendant and a judgement against the defendant is more likely than not. A provision is made for the amount likely to be incurred by the company if the judgement is against it. This figure includes the payments to be made by the company, in particular compensation, damages and settlements, as well as the expected legal expenses. If a company in the Heckler & Koch Group is a defendant and a judgement for the defendant is more likely than not, or if the company is the claimant, only litigation fees are provided for.

The use of estimates in other positions in the Group balance sheet and income statement are described in the accounting policies relating to the individual positions. In particular, these relate to: impairment of goodwill, impairment of non-current tangible and intangible assets, provisions for doubtful debts and the valuation of deferred tax assets and the pension provision.

Notes on the income statement

(6) Revenue

Net revenue increased by €12,497k to €247,244k compared with revenue of €234,748k in 2009.

The revenue of the Group was made up as follows:

	2010	2009
	EUR '000	
Sale of goods	231,810	228,592
Sale of services	7,366	5,387
Construction contract revenue	8,856	1,699
Gross revenue	**248,032**	**235,678**
Discounts, bonuses, etc.	(788)	(931)
Net revenue	**247,244**	**234,748**

Construction contract revenue is determined by reference to the stage of completion.

Breakdown by customer location:

	2010	2009
	EUR '000	
Domestic (Germany)	42,999	39,472
Foreign (rest of the world)	205,033	196,206
Gross revenue	**248,032**	**235,678**
Discounts, bonuses, etc.	(788)	(931)
Net revenue	**247,244**	**234,748**

(7) Cost of sales

The cost of sales decreased by €9,496k to €144,067k compared with €153,563k cost of sales in 2009 (restated). The cost of sales includes materials and production labour and overhead expenses relating to the revenue. Within cost of sales are €8,856k (2009: €1,699k) expenses relating to construction contract revenue.

(8) Research and development expenses

Research and development expenses comprise those personnel expenses and depreciation relating to these activities, together with the costs of test materials and tools that do not meet the criteria for capitalisation under IAS 38, together with the amortisation and retirement of capitalised development costs.

(9) Sales, marketing & distribution expenses

Sales, marketing & distribution expenses increased by €7,039k to €31,752k compared with €24,714k in 2009. The selling expenses mainly comprise personnel expenses, material and marketing costs as well as depreciation relating to the sales function and project related costs.

(10) Administration expenses

General administration expenses include personnel expenses and office material costs as well as the depreciation relating to the administration function.

(11) Other operating income

	2010	2009
	EUR '000	
Release and utilisation of provisions	2,477	2,097
Income from the provision of administration services	691	1,307
Profit on disposal of non-current & held for sale assets	92	29
Licence fee income	864	1,080
Fuel sales to employees	1,259	1,111
Other	1,129	719
Total	**6,512**	**6,344**

The other operating income includes out-of-period income of €1,488k (2009: €361k). This is due to income from the release of provisions and accruals €1,145k (2009: €332k), gains on disposals of non-current assets €92k (2009: €29k) and income from refunds etc. €251k (2009: nil).

(12) Other operating expenses

	2010	2009
	EUR '000	
Create provision for doubtful debts & write off of bad debts	(217)	(133)
Loss on disposal of non-current assets	(1,482)	(339)
Other taxes	(255)	(209)
Creation of general liability provisions	(2,877)	(1,463)
Other	(2,459)	(3,987)
Total	**(7,289)**	**(6,132)**

The other operating expenses include out-of-period expenses of €1,783k (2009: €583k). These are mainly due to losses on the disposal of non-current assets, doubtful and bad debts and credit-notes relating to prior years.

(13) Analysis of expenses by nature, showing EBITDA

The income statement shows operating expenses analysed by function; the following table shows EBITDA and operating profit with expenses analysed by nature:

	2010	2009
	EUR '000	
Net sales	247,244	234,748
Material costs and movement in inventories	(106,092)	(113,524)
Capitalised costs	2,511	1,639
Other operating income	6,512	6,344
Payroll	(46,279)	(46,334)
Other operating expenses	(42,703)	(33,537)
EBITDA	**61,194**	**49,335**
Depreciation and amortisation	(9,417)	(9,927)

Results from operating activities	**51,777**	**39,408**

(14) Financial result

	2010	2009
	EUR '000	
Financial income		
Interest	1,979	1,233
Gains on valuation of derivative financial instruments	42	—
Gains on translation of foreign currencies	3,120	1,267
Other	—	—
Total financial income	**5,141**	**2,500**
Financial expenses		
Interest	(11,275)	(11,194)
Accretion of non-current liabilities	(4,131)	(3,923)
Losses on valuation of derivative financial instruments	—	(946)
Losses on translation of foreign currencies	(736)	(1,159)
Other	(205)	(462)
Total financial expense	**(16,347)**	**(17,684)**
Financial result	**(11,206)**	**(15,184)**

The interest income includes interest on short-term loans and on bank balances and tax refunds. The gains and losses on valuation of derivative financial instruments relate to forward cover contracts and options intended to reduce exposure to currency risk on expected USD cash-flows. The gains and losses on translation of foreign currencies include gains and losses on utilisation of forward cover contracts, in addition to translation differences for items not covered by such arrangements. The accretion of non-current liabilities relates to defined benefit and other long-term provisions, and the bond. Other financial expenses relate to guarantee costs.

(15) Income taxes

The income tax expense comprises:

	2010	2009
	EUR ’000	
Current tax income/(expense)	(12,383)	(9,533)
Deferred tax income/(expense)	2,213	2,263
Tax expense in income statement	**(10,170)**	**(7,270)**

Income taxes include German corporation tax (“Körperschaftsteuer”), trade income tax (“Gewerbesteuer”) and associated reunification surcharges (“Solidaritätszuschlag”) for the German companies, together with similar income taxes for the foreign subsidiaries.

The companies in Germany have a calculated statutory tax rate of 27.7% (2009: 27.7%). Foreign taxation is calculated at the rates valid in each country; these vary between 28% and 36% (2009: between 28% and 38%).

Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates which have been enacted as of the balance sheet date in each country, that are expected to be in place on realisation.

The following table shows a reconciliation of the expected tax using the current statutory tax rate for the parent company of 27.7% and the actual income tax shown for the Group:

	2010	2009
	EUR ’000	
Profit/(loss) before tax	40,571	24,224
Expected tax rate (current German statutory rate)	**27.7%**	**27.7%**
Expected tax expense/income	**(11,248)**	**(6,716)**
Adjustments to expected tax expense due to:		
—change in tax rates	11	(207)
—non-tax-deductible expenses	(398)	(1,183)
—utilisation of tax losses that had not been capitalised	451	—
—taxes relating to other periods	(21)	(13)
—differences in foreign tax rates	(585)	(76)
—change in valuation adjustments for tax losses c/f	(15)	—
—change in valuation adjustments for temporary diff.	(100)	(236)
—other effects	1,737	1,162
Actual tax expense/income	**(10,170)**	**(7,270)**
Effective tax rate	**25.1%**	**30.0%**

Deferred tax relates to the following positions:

Balance Sheet Item	**Deferred tax assets 31.12.2010**	**Deferred tax assets 31.12.2009**	**Deferred tax liabilities 31.12.2010**	**Deferred tax liabilities 31.12.2009**
		EUR ’000		
Intangible non-current assets	—	—	11,508	11,191
Tangible non-current assets	14	8	4,213	4,969
Inventories	3,473	1,512	—	—
Trade accounts receivable	16	98	425	444
Other current assets	1,846	73	2,357	4,028
Employee defined benefit obligations	3,893	2,829	—	—
Other non-current provisions	747	1,563	—	—
Non-current financial liabilities	—	—	220	596
Other non-current liabilities	—	251	—	—
Current provisions	77	43	25	—
Trade accounts payable	1,008	402	—	—
Other current financial liabilities	—	—	—	—

Other current liabilities	11	—	2,539	47
Carryforward of unused tax losses	9	(0)	—	—
Total	**11,094**	**6,779**	**21,287**	**21,275**

During 2010, an increase in deferred tax assets of €1,024k (2009: €1,031k) was recognised directly in equity since this increase related to the actuarial gains on defined benefit schemes. A decrease in deferred tax assets of €218k (2009: increase of €229k) was recognised directly in equity since this decrease related to unrealised losses on effective hedging instruments. Apart from these, all other changes in deferred tax assets and liabilities were recognised in the income statement.

Potential deferred tax assets of €2,254k (2009: €4,597k) relating to losses carried forward by one of our operations in the US have not been recognised. Valuation adjustments of €2,233k (2009: €2,133k) have been made against potential deferred tax assets relating to temporary differences arising in this operation in the US.

Notes on the balance sheet

(16) Intangible assets

	Development costs (self-generated)	**Goodwill (acquired)**	**Trade marks Patents, licences, software (acquired)**	**Total**
		EUR ’000		
Net carrying value at 01.01.2009	**7,850**	**60,365**	**32,758**	**100,973**
Acquisition/manufacturing costs				
Balance at 01.01.2009	**11,464**	**80,384**	**46,642**	**138,490**
Effect of movement in exchange rates	—	—	(18)	(18)
Additions	2,676	—	337	3,013
Reclassifications	—	—	—	—
Disposals/retirements	(1,133)	—	(920)	(2,053)
Balance at 31.12.2009	**13,007**	**80,384**	**46,042**	**139,432**
Amortisation & depreciation				
Balance at 01.01.2009	**(3,614)**	**(20,019)**	**(13,884)**	**(37,517)**
Effect of movement in exchange rates	—	—	10	10
Amortisation for the year	(1,032)	—	(259)	(1,291)
Impairment	—	—	—	—
Reclassifications	—	—	—	—
Disposals/retirements	—	—	920	920
Balance at 31.12.2009	**(4,646)**	**(20,019)**	**(13,213)**	**(37,878)**
Net carrying value at 31.12.2009	**8,361**	**60,365**	**32,828**	**101,554**
Acquisition/manufacturing costs				
Balance at 01.01.2010	**13,007**	**80,384**	**46,042**	**139,432**
Effect of movement in exchange rates	—	—	35	35
Additions	3,388	—	321	3,709
Reclassifications	—	—	22	22
Disposals/retirements	(1,229)	—	(21)	(1,250)
Balance at 31.12.2010	**15,166**	**80,384**	**46,397**	**141,947**
Amortisation & depreciation				
Balance at 01.01.2010	**(4,646)**	**(20,019)**	**(13,213)**	**(37,878)**
Effect of movement in exchange rates	—	—	(18)	(18)
Amortisation for the year	(990)	—	(296)	(1,286)
Impairment	—	—	—	—
Reclassifications	—	—	(22)	(22)
Disposals/retirements	—	—	21	21
Balance at 31.12.2010	**(5,636)**	**(20,019)**	**(13,528)**	**(39,182)**
Net carrying value at 31.12.2010	**9,531**	**60,365**	**32,869**	**102,765**

As described in Note 5, goodwill and other intangible assets with indefinite lives are subject to annual impairment testing. Goodwill is allocated to the individual companies within the Group, which represent the segments and are the lowest level within the Group at which goodwill is monitored for internal management purposes.

As shown above, aggregate goodwill is unchanged from the previous year at €60,365k. This is the net book value at which it was held under German GAAP at the date of transition to IFRS (January 1, 2006). Originally, the parent company of the Group was called Heckler & Koch Wehrtechnik Holding GmbH. This company acquired the design, manufacturing and distribution company, Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003 and in 2004 the two companies were merged and renamed Heckler & Koch GmbH. As a result, the Group has goodwill of €59,232k allocated to its merged parent company. The balance of €1,133k is allocated to Heckler & Koch France SAS since this relates to its acquisition in 2004. Goodwill relates to the value of the companies in operation and is therefore treated as being of indefinite life. On the acquisition of Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003, the trademark was also recognised as an intangible asset of €31,866k. The Group's reputation is associated with this trademark so that, like goodwill, it is also treated as being of indefinite life.

NSAF Ltd was acquired for less than its equity and the negative goodwill arising from this transaction is included in the Group's retained earnings. The US subsidiaries Small Arms Group Holding Inc. and Heckler & Koch Defense Inc. were founded by the Group and have no goodwill allocated to them. The acquisition of the US subsidiaries Suhler USA, Inc. and Heckler & Koch, Inc. was a transaction under common control and the Group's figures have been restated as if this transaction took place prior to the beginning of the earliest period shown; consequently the difference between the price paid and the net assets acquired has been offset against equity rather than being shown as goodwill.

HK Sidearms GmbH was acquired in July 2010 for €6.4m, which was less than its equity and reserves. During the purchase price allocation, its inventories were reduced to their value to the Group by eliminating the Heckler & Koch GmbH profits included in them from before the acquisition. The remaining difference was allocated to reduce the Heckler & Koch, Inc. inventories, since these include HK Sidearms GmbH profits from before the acquisition. The intangible non-current assets acquired with HKS (€22k) and the associated cumulative amortisation (€22k) are shown in the "reclassifications" rows above.

Since the Group is privately owned, and similar companies have not been bought or sold regularly on an active market during the past year, it was not possible to base impairment tests on market value. Impairment tests were therefore based on value in use determined by discounting future cash flows projected based on actual operating results and the first five years of the annual ten year business plans.

The amortisation and impairment of intangible assets is included in the following income statement positions:

	2010	**2009**
	EUR '000	
Cost of sales	81	54
Research and development	999	1,046
Sales, marketing & distribution	1	22
Administration	205	169
Other expense	—	—
Total amortisation	**1,286**	**1,291**

As at December 31, 2010 the Group had a balance of €85k (2009: €41k) on order for intangible assets.

(17) Property, plant and equipment

	Land and buildings	**Plant and machinery**	**Fixtures, fittings and other assets**	**Assets under construction**	**Total**
			EUR '000		
Net carrying value at 01.01.2009	**25,550**	**20,303**	**8,698**	**695**	**55,246**
Acquisition/manufacturing costs					
Balance at 01.01.2009	**41,661**	**62,053**	**41,004**	**695**	**145,414**
Effect of movement in exchange rates	(57)	(29)	4	—	(81)
Additions	2,074	3,773	2,159	138	8,143
Reclassifications	51	551	93	(695)	—
Disposals	(23)	(1,929)	(3,161)	—	(5,114)
Balance at 31.12.2009	**43,706**	**64,419**	**40,100**	**138**	**148,362**
Amortisation & depreciation					
Balance at 01.01.2009	**(16,111)**	**(41,751)**	**(32,306)**	**—**	**(90,168)**
Effect of movement in exchange rates	(5)	6	(5)	—	(5)
Depreciation for the year	(1,083)	(4,745)	(2,808)	—	(8,636)
Impairment	—	—	—	—	—
Reclassifications	—	(1)	1	—	—

Disposals	17	1,929	2,720	—	4,666
Balance at 31.12.2009	**(17,183)**	**(44,561)**	**(32,399)**	**—**	**(94,143)**
Net carrying value at 31.12.2009	**26,523**	**19,857**	**7,701**	**138**	**54,219**
Acquisition/manufacturing costs					
Balance at 01.01.2010	**43,706**	**64,419**	**40,100**	**138**	**148,362**
Effect of movement in exchange rates	214	64	81	(0)	359
Additions	930	4,707	2,418	269	8,324
Reclassifications	17	118	84	(135)	84
Disposals	(1,668)	(4,631)	(787)	—	(7,086)
Balance at 31.12.2010	**43,199**	**64,676**	**41,896**	**272**	**150,043**
Amortisation & depreciation					
Balance at 01.01.2010	**(17,183)**	**(44,561)**	**(32,399)**	**—**	**(94,143)**
Effect of movement in exchange rates	(45)	(13)	(56)	—	(114)
Depreciation for the year	(1,109)	(4,634)	(2,388)	—	(8,131)
Impairment	—	—	—	—	—
Reclassifications	—	—	(76)	—	(76)
Disposals	720	4,036	729	—	5,485
Balance at 31.12.2010	**(17,617)**	**(45,172)**	**(34,189)**	**—**	**(96,978)**
Net carrying value at 31.12.2010	**25,582**	**19,504**	**7,707**	**272**	**53,065**

During 2010 there were no reclassifications of assets from property, plant and equipment to held for sale.

(17) Property, plant and equipment

The fixtures, fittings and other assets acquired with HKS on July 1, 2010 (€84k) and the associated cumulative amortisation (€76k) are shown in the "reclassifications" rows above.

The fixtures, fittings and other assets include net carrying values of nil (2009: €79k) for certain assets acquired on finance leases, in particular computer servers. See Note 25 for details of the lease obligations and the reconciliation between the total minimum lease payments at the balance sheet date and their present values.

As at December 31, 2010 the Group had a balance of €1,413k (2009: €655k) on order for tangible non-current assets (excluding amounts shown in the above table under assets in course of construction).

(18) Investments in equity accounted investees, other non-current investments and current loans, investments and derivatives

The Group held a €13k investment in a dormant joint venture that was consolidated at equity and was liquidated in 2009. A loss of €1k on liquidation was recognised in other expenses in 2009 and a cash receipt of €12k is included in investment activities in 2010.

The other non-current investments relate to the remaining balance not yet due on long-term loans.

The Group shows certain securities within other loans, investments and derivatives (2010: €933k, 2009: €612k). This investment is required by German law and these securities are pledged in full to secure claims relating to the German company's early retirement scheme "Altersteilzeit".

The Group has made short-term loans totalling, with interest, €4,901k (2009: €4,912k) to its indirect shareholder Heckler & Koch Beteiligungs GmbH; security for such loans has been provided by the ultimate shareholder of the Group through a mortgage. The mortgaged asset was assessed by an independent valuer at a value in excess of the amount secured. The loan and accrued interest was repaid in full in March 2011.

The Group only has derivative financial instruments relating to forward exchange and option contracts for USD/EUR, unless hedge accounting applies, these are held at fair value through profit or loss (2010: €262k, 2009: €239k).

(19) Inventories and prepayments for inventories

	31/12/2010	31/12/2009
	EUR '000	
Raw materials, consumables and supplies	21,551	19,937
Work in progress	33,357	29,891
Finished goods and merchandise	18,276	21,978
Total	**73,184**	**71,806**

Under inventories, provisions of €13,055k (2009: €10,496k) have been made to account for marketability risks and slow-moving items. These provisions reduce certain items of inventory to carrying values in line with their fair values (less costs to sell) of €14,396k (2009: € 14,127k). Impairment losses of €86k (2009: €124k) recorded in prior years have been reversed following increases in net realisable value due to the reassessment of saleability of certain items and the disposal of other items at higher values than their carrying values. A write-down of inventories of €1,972k (2009: €2,078k) was recognised as an expense.

Prepayments for inventories include €1,398k (2009: €2,686k) relating to advances paid for construction contracts (PoC).

(20) Trade and other receivables

	31/12/2010	31/12/2009
	EUR '000	
Trade accounts receivable	48,764	39,625

Receivables from directors and employees	798	1,020
Other assets	840	1,267
Total	**50,402**	**41,911**

The carrying values of trade accounts receivable and other receivables correspond to their fair market values. Trade accounts receivable include amounts due from the parent and indirect parent of the Group and are not interest-bearing; they usually have due dates between 30 and 90 days. These receivables also include amounts relating to construction contract revenue (€1,398k, 2009: €1,529k).

The receivables from directors and employees include a loan to a director and the associated interest (€619k, 2009: €322k), and foreign tax assets for former directors. The other receivables are mainly for VAT & similar tax claims against various countries arisen in the normal course of business.

If there is an indication that a receivable may be impaired, at the latest if becomes over 180 days overdue, the possibility of impairment is reviewed by the finance, sales and legal departments. Provisions of € 141k (2009: €958k) have been made for individual doubtful debt risks within trade accounts receivable. The provision for doubtful trade accounts receivable has had the following movements during the reporting period:

	2010	2009
	EUR '000	
Opening balance January 1st	958	1,043
Creations	219	123
Release/utilisation	(1,065)	(195)
Effects of foreign currency conversion	29	(12)
Closing balance December 31st	**141**	**958**

All expenses from impairment (or income from reversal of impairment) of trade receivables is shown under other operating expenses (or income).

The aging of financial instruments that are trade accounts receivable is as follows:

	31/12/2010	31/12/2009
	EUR '000	
Not overdue:	**39,085**	**29,994**
Overdue:		
– within 30 days	6,547	5,241
– between 30 and 60 days	734	2,067
– between 60 and 90 days	606	60
– between 90 and 180 days	951	551
– after more than 180 days	840	1,713
Total:	**9,679**	**9,631**
Net trade accounts receivable	**48,764**	**39,625**

As at the balance sheet date, no evidence had been identified to suggest that any of the accounts receivable that were neither overdue nor impaired were doubtful.

(21) Cash and cash equivalents

The position cash and cash equivalents includes cash balances, cheques, bank balances on current accounts and short-term deposits, the original term of which is less than three months. These are valued at nominal value.

(22) Shareholders' equity

The following reconciliation of movement in capital and reserves shows the changes in the individual items of equity in the Group:

	Subscribed Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Hedging Reserve	Consolidated Retained Earnings	Shareholder Equity
				EUR '000			
As of 31.12.2008	**25**	**79,695**	**(521)**	**3,662**	**—**	**(9,482)**	**73,379**
Reclassification of reserves	—	(66,000)	—	—	—	66,000	—

Total recognised income & expense	—	—	690	(2,688)	(598)	16,954	14,358
Dividends declared	—	—	—	—	—	(10,150)	(10,150)
As of 31.12.2009	**25**	**13,695**	**169**	**974**	**(598)**	**63,322**	**77,587**
Total recognised income & expense	—	—	(381)	(2,670)	569	30,402	27,920
Dividends declared	—	—	—	—	—	(9,100)	(9,100)
As of 31.12.2010	**25**	**13,695**	**(212)**	**(1,695)**	**(29)**	**84,623**	**96,407**

The subscribed capital shown is the nominal capital of the parent company Heckler & Koch GmbH. The nominal capital of Heckler & Koch GmbH of €25k is fully paid up. Since it is a German limited company ("GmbH"), the subscribed capital is not divided into shares.

The additional paid in capital arises from additional capital contributions from the shareholders; in 2009 €66 million was reclassified to consolidated retained earnings.

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

The reserve for defined benefit obligations comprises the cumulative actuarial gains and losses arising on the employee defined benefit obligation provisions, net of tax. The net decrease is due to actuarial losses of € 3,694k (2009: €3,719k) net of €1,024k (2009: €1,031k) deferred taxes

The hedging reserve comprises the cumulative gains and losses arising on the recognition of fair value movements on effective hedging instruments as defined by IAS 39. In 2010 there was a gain of €788k (2009: € 828k loss) net of €218k (2009: €229k) deferred taxes

The consolidated retained earnings include a reduction of €5,327k arising from the effects of the transition to IFRS on January 1, 2006 and a reduction of €4,097k in 2007 arising from the difference between acquisition price and net assets for the common control transaction acquisition of Suhler USA, Inc. and Heckler & Koch, Inc. that took place in April 2009 but has been shown as having taken place prior to the beginning of 2008.

Under the German limited liability companies act (GmbHG), the distributable dividend is determined by the retained earnings in the annual financial statements of Heckler & Koch GmbH drawn up in accordance with the German commercial code (HGB) adjusted for certain non-distributable items. In the financial year 2010, Heckler & Koch GmbH declared and distributed interim dividends of €9,100k (2009: €10,150k declared, but not distributed until the beginning of 2010). In Q1 2011 an additional dividend of €9,000k was declared and distributed for the financial year 2010.

The executive board and the supervisory board ("Beirat") of the parent company Heckler & Koch GmbH will propose to the shareholders meeting that no further dividends be distributed for the financial year 2010.

(23) Provisions for pensions and similar employee defined benefit obligations

The pension schemes at the foreign companies are defined contribution plans, while the two German companies have both defined benefit and defined contribution plans, although the defined benefit schemes for employees were closed to new entrants in 2002.

Under the **Defined Contribution Plans** the company pays contributions to state or private pension schemes on the basis of statutory or contractual obligations or on a voluntary basis. Having paid the contributions, the company has no further obligations. The current contribution payments are shown as pension expense for the relevant year: they amounted to a total of €3,236k (2009: €3,241k) for the Group.

The **Defined Benefit Plans** are accounted for in the Group by setting up provisions for pensions, retirement and death benefits determined by the Projected Unit Credit Method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The value is obtained from an actuarial report calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2005 G guideline tables).

The main assumptions are:

Measurement at	**31.12.2010**	**31.12.2009**
Discount rate	4.65%	5.00%
Increase in entitlement of active pension expectants	0.00%	0.00%
Future pension increase p.a.	2.00%	1.75%

Under the defined benefit schemes, on reaching the retirement age of 65, employees are entitled to benefits based on their length of service. The defined benefit schemes in operation before 1995 entitle members to benefits for the first ten years' service of 8% of the average monthly salary for the final year, plus 0.25% for each additional year of service. Together with the state pension, the company pension entitlement may not exceed 75% of the employee's average monthly salary for the final year. Increases are no longer possible since these schemes are closed and members' entitlements remain fixed.

Under the defined benefit scheme from January 1, 1995, members are entitled to benefits of a fixed sum per year of service depending on the member's grade. The relevant grade for active members is the grade on retirement. This scheme was closed to new entrants on November 30, 2002.

Senior employees are also covered by the above schemes, although some have individual pension agreements within their contracts.

The following amounts are recorded in the income statement with regard to defined benefit plans:

	2010	2009
	EUR '000	
Current service costs	313	277
Interest expense	2,457	2,700
Less expected return on scheme assets	(21)	(24)
Total net expense	**2,748**	**2,953**

The current service costs are shown within other expenses and the annual interest expense is shown within the interest result. Actuarial gains and losses are not recognised in the income statement but are shown in the statement of comprehensive income and taken to reserves.

The changes in the present value of the gross unfunded and funded defined benefit obligations are as follows:

	2010	2009
	EUR '000	
Present value of obligations as at Jan. 1st	**48,897**	**44,998**
Current service costs	313	277
Interest expense	2,457	2,700
Pension payments/utilisation	(2,866)	(2,766)
Actuarial (gains)/losses	3,669	3,688
Present value of HKS obligations at July 1st 2010	491	—
Present value of obligations as at Dec. 31st	**52,960**	**48,897**

The changes in the present value of the funded plan assets are as follows:

	2010	2009
	EUR '000	
Fair market value of plan assets as at 01.01.	**426**	**433**
Expected return on scheme assets	21	24
Reclassification of credit note balance to advances paid	(57)	—
Actuarial gains/(losses)	(25)	(31)
Fair market value of plan assets as at 31.12.	**366**	**426**

The fair market value of the plan assets relates to asset values from reinsurance policies. The expected long-term returns from these plan assets are calculated with 5.0% (2009: 5.5%). These are based on the past interest level for long-term retirement plans (for example life insurance policies). The actual earnings from the plan assets are €4k loss (2008: €7k loss). Contributions of around €30k are expected to be made in 2011.

The amount shown in the balance sheet for the Group's obligation is derived as follows:

	31.12.2010	31.12.2009	31.12.2008	31.12.2007	31.12.2006
			EUR '000		
Present value of obligations covered by funds and not covered by funds	**52,960**	**48,897**	**44,998**	**44,995**	**50,538**
Less fair market value of plan assets	(366)	(426)	(433)	(276)	(118)
Present value of net obligations	52,594	48,470	44,565	44,719	50,420

Actuarial losses not yet recognised	—	—	—	—	—
Net liability in the balance sheet	**52,594**	**48,470**	**44,565**	**44,719**	**50,420**

(24) Other current and non-current general liability provisions

The current and non-current general liability provisions are as follows:

	31/12/2010	31/12/2009
	EUR '000	
Current provisions & accruals	4,772	3,956
Non-current provisions	13,493	12,432
Total	**18,265**	**16,388**

The provisions comprise:

	Personnel obligations	Warranty obligations	Obligations relating to sales	Other risks	Total
			EUR '000		
Balance at 01.01.2010	**5,000**	**1,559**	**9,566**	**262**	**16,388**
Exchange rate difference	359	—	99	10	467
Utilisation	(774)	(488)	(201)	(202)	(1,665)
Release	(112)	—	(902)	—	(1,015)
Creation	1,339	1,894	453	403	4,090
Balance at 31.12.2010	**5,812**	**2,966**	**9,014**	**473**	**18,265**

Provisions for the German early retirement scheme ("Altersteilzeit") are included in the personnel obligations. These provisions take account of the additional costs to the company during the early retirement phase, partially offset by the reduced pay taken by employees in this scheme during the working phase. The value is based on the associated contractual obligations and is obtained from actuarial reports, calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2005 G guideline tables), discounted at 5.5%. There are no material uncertainties with regard to the value of these provisions. The early retirement scheme agreements usually cover four years. In the first two years the provision is created; the outflows of economic benefits occur in the last two years.

The personnel obligations also include provisions for long-service anniversary benefits, similar obligations and termination. These personnel provisions are determined based on the associated contractual obligations and the outflows of economic benefits (€461k; 2009: €523k) are generally expected within twelve months, although the anniversary benefits will be paid out over forty years. There are no material uncertainties with regard to the value of these provisions.

The provisions for warranties were recognised on the basis of past experience with regard to the Group liability for a warranty period of two years. Accordingly the outflows of economic benefits are expected within two years. There are no material uncertainties with regard to the value of these provisions.

Provisions relating to sales include provisions for offset obligations, late delivery penalties, costs to complete and price-audits on certain projects. These provisions have been recognised in line with the probability of their incidence, based on the associated contractual obligations and the current status and the outflows of economic benefits are generally expected within twelve months. There are no material uncertainties with regard to the value of these provisions.

The other provisions relate mainly to litigation risks, recognised in line with the probability of their incidence. The outcome of the litigation depends on the associated legal proceedings and accordingly these provision are based on particular uncertainties. The outflows of economic benefits are generally expected within twelve months.

The effects of accretion and changes in discount rates were material for the valuations of certain non-current general liability provisions. The financial result includes €1,161k net income due to discounting and accreting these other non-current provisions, leading to a reduction in the value recognised for these provisions.

(25) Current and non-current financial liabilities

The Group does not have any bank overdrafts or loans. The Group's main financial liability is the €120 million high yield bond issued by the parent company in 2004 with a fixed interest rate of 9.25% and a maturity date of July 2011. This bond is recognised in the balance sheet at its amortised cost of €119,207k (2009: €117,851k), with associated accrued interest payable of €5,118k (2009: €5,118k) held within other payables.

As security for Heckler & Koch GmbH's liabilities under the Bond Indenture, the subsidiaries of Heckler & Koch GmbH have entered into Supplementary Indentures and Abstract Acknowledgements of Indebtedness and have provided Subsidiary Guarantees. Heckler & Koch GmbH has also issued a €30 million Note Proceeds Loan to its US subsidiary Heckler & Koch Defense Inc. and has granted a security interest in its rights under this to the Bank of New York as trustee under the Indenture. In addition, HK Holding, Inc., the sole owner of Heckler & Koch GmbH, has granted first ranking pledges over all present and future shares in Heckler & Koch GmbH as security for the obligations under the Indenture.

The credit facilities for the Heckler & Koch Group are only for the issue by banks of advance payment or performance guarantees, including bid bonds. The value of guarantees currently outstanding is not recognised in the balance sheet. As of December 31, 2010 we had a total of €17.1 million such guarantees outstanding, compared to €18.9 million as of December 31, 2009. As a requirement for the provision and maintenance of these and other forward-cover and guarantee lines, our guarantee-providers require us to maintain a varying level of deposits with them as security. As at December 31, 2010 we had €18.2 million such security deposits (2009: €18.7 million); these pledged security deposits are included in cash and cash equivalents.

As mentioned in Note 17, the Group has acquired certain assets on finance leases, in particular computer servers. The finance lease liabilities are payable as follows:

	Future minimum lease payments 2010	**Interest 2010**	**Present value of minimum lease payments 2010**	**Future minimum lease payments 2009**	**Interest 2009**	**Present value of minimum lease payments 2009**
			EUR ’000			
Less than one year	—	—	—	87	2	86
Between one and five years	—	—	—	—	—	—
More than five years	—	—	—	—	—	—
Total finance lease liabilities	**—**	**—**	**—**	**87**	**2**	**86**

(26) Trade and other payables

Trade and other payables include outstanding liabilities from trade and operating costs, together with interest payable on the bond. Of these, € 111k (2009: €167k) are shown within non-current liabilities since they are not due within twelve months.

	31/12/2010	31/12/2009
	EUR '000	
Trade payables	22,960	19,155
Interest payable	5,118	5,118
Other payables	5,722	9,315
Total	**33,800**	**33,588**

The carrying value of the trade payables corresponds approximately to their fair market value.

With the exception of normal trading ownership retention clauses, the trade and other payables are not secured.

(27) Advanced and stage payments received

Advanced and stage payments received comprise payments received from customers in advance of the delivery of the associated products or services. The advance and stage payments include amounts relating to advances for construction contracts (€708k, 2009: €1,480k).

Other disclosures

(28) Financial risk management

Currency risk

The Group is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Group entities, primarily the euro (EUR), but also US dollars (USD) and Sterling (GBP). The majority of both our costs and our sales are in euro, so we only have foreign exchange transaction exposure for those sales in currencies different to the associated costs. Group policy is to cover a proportion of the expected USD ($) income and the associated foreign exchange transaction exposure with hedging transactions. As at December 31, 2010 we had forward cover contracts for a total of $12 million.

Group policy is not to speculate with loans or deposits in foreign currencies. Financing and investing within the Group usually take place in the appropriate functional currency and any financial instruments are purely for operating purposes.

Five small subsidiaries of Heckler & Koch GmbH are outside the Euro zone. Since the Heckler & Koch Group reporting currency is the euro, the income and expenses of these subsidiaries are converted to euro for consolidation. Changes in average foreign exchange conversion rates compared with prior periods can therefore have an effect on the consolidated results.

In addition, through these subsidiaries the Group has assets and liabilities in local currencies outside the Euro zone. The conversion of these positions to euro is also affected by fluctuations in foreign exchange conversion rates. The change in valuation of these positions is reflected in the Group reserves. The rates used for the consolidation are shown in the following table:

Currency	Abbr.	Rate on balance 31.12.2010	Rate on balance 31.12.2009	Average exchange 2010	Average exchange 2009
US Dollar (USA)	**USD**	1.3362	1.4406	1.3282	1.3947
Pound (United Kingdom)	**GBP**	0.8608	0.8881	0.8590	0.8919

In order to quantify the possible effects of foreign exchange rate fluctuations on the Group EBITDA, sales and equity, a sensitivity analysis has been carried out:

If the US dollar had been 10% weaker against the euro compared to the rates used for the 2010 consolidation, (i.e. had been an average of € 1 = $1.4610 and a spot of €1 = $1.4698), then 2010 sales would have been approximately €4.0 million lower, EBITDA would have been approximately €1.6 million lower and equity and reserves would have been approximately €3.6 million lower.

If the pound sterling had been 10% weaker against the euro compared to the rates used for the 2010 consolidation, (i.e. had been an average of € 1 = £0.9449 and a spot of €1 = £0.9468), then 2010 sales would have been approximately €1.4 million lower, EBITDA would have been approximately €0.7 million lower and equity and reserves would have been approximately €0.0 million higher.

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument may change depending on market interest rates. The Group has one interest-bearing liability, the €120 million bond which matures in July 2011 and has a fixed interest rate of 9.25%. The fair value of the bond is dependent on market interest rates but the related cash flows are fixed. It is intended to issue a new €100 million bond in the second quarter of 2011 with which the current bond can be repaid. The interest rate for the new bond has not yet been set and this increases the interest rate risk for the Group. However it is expected to be less than 9.25%. The advance payment and performance guarantees we procure from banks for our customers do not require us to pay interest.

Commodity risk

Because our purchases of commodities in terms of quantities purchased are relatively small, our exposure to commodity risk is limited.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counter-party to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

Trade accounts receivable

Because the vast majority of our customers are federal, state or local governmental agencies of NATO countries, our exposure to credit risk is limited. However the recent worldwide financial and economic crisis and the consequent increased sovereign budget deficits are likely to put long-term pressure on defence budgets in many of the countries we deliver to, leading to increased credit risk for certain customers. Rating agencies have reduced the credit ratings for some countries, but the Group does not have accounts receivable from less credit-worthy countries.

Our goods are sold subject to retention of title clauses so that in the event of non-payment the Group may have a secured claim. Where management is of the opinion that the risk is not sufficiently secured by the retention of title clauses, we require letters of credit or prepayments. The Group has internal credit management processes to review and manage overdue positions and if necessary stop further deliveries or initiate legal action.

In addition, provisions are held for doubtful debts. The maximum risk is the value shown as trade accounts receivable in the balance sheet. The book values of trade accounts receivable analysed according to their aging, together with the associated provisions, are shown in Note 20.

Cash and cash equivalents

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. The Heckler & Koch Group is exposed to credit risks if the banks holding our deposits default on their obligations. To minimise this risk, the banks are selected with care and the majority of the deposits are with a German bank which is partially owned by the State of Baden-Württemberg and participates in a deposit security reserve.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The target of the Group's approach to managing liquidity is to ensure that there will always be sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Heckler & Koch Group mainly generates cash through its operating activities and this is primarily used to finance capital expenditure and working capital. In 2004 additional financing was obtained through the issue of fixed rate

Notes, the proceeds of which were mainly used to (1) repay shareholder loans, and (2) partially finance the purchase of management shares. The bond was also intended to (3) prefund an expansion in the US, however the anticipated contract was not awarded so that the capital expenditure was not required, leaving a significant cash balance.

At present the Group does not have any credit lines set up other than for the issue by banks of advance payment or performance guarantees, however we believe that the current cash position is more than sufficient to meet liquidity requirements until the maturity of the Notes in July 2011. The requirement that the bond be refinanced in July 2011 presents the greatest liquidity risk for the Group at present. In December 2010 the Close Brothers Seydler Bank was given a mandate to prepare the issue of a new bond, expected to be for €100 million. This process is expected to be complete by the end of the second quarter of 2011.

The following table shows the timing of contractual payments due for financial instruments that are accounts payable, capital leases, loan interest, loan repayments or derivatives.

	Trade payables	Derivative financial liabilities	Other	Total
		EUR '000		
Balance at 31.12.2010				
Book value	22,960	40	124,493	147,492
Related payments	22,960	40	131,267	154,267
Payments due:				
—within one month	17,447	6	5,551	23,004
—between one and three months	5,476	34	—	5,510
—between three & twelve months	36	—	125,606	125,642
—between one and five years	—	—	111	111
—after more than five years	—	—	—	—

Variances between book value and related payments arise where certain non-current liabilities, in particular the bond, are held at their amortised costs. Additional information on financial liabilities is given in Note 25.

Capital management

The policy of the Executive Directors is to maintain strong capital base in order to ensure investor, creditor and market confidence is sustained and thereby to facilitate and support future business development. To achieve this policy, it is necessary to maintain a strong credit rating and healthy capital ratios. The rating downgrades from Standard & Poors' in February 2011 to CCC- and from Moody's in March 2011 to Caa1 are due to the fact that refinancing for the bond has not yet been finalised. The company expects that leading rating agencies will upgrade the rating once refinancing has been finalised.

The Group aims to have a simple corporate and capital structure and does not have any off balance sheet financing. In the normal course of business, performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf (see Note 25).

In 2004 the Group issued one simple debt instrument (High Yield Bond) that imposes certain restrictions on activities outside of the Group's core business and the Group's internal policies require that return on capital is monitored on all investments and large contract bid decisions.

Dividends to shareholders are restricted under the terms of the Bond; together with certain other transactions, they are classed as "Restricted Payments". The cumulative total of such payments, less any such investments that have been repaid, is limited to 50% of the "Cumulative Adjusted Net Income" since July 2004. In addition, such payments may not be made unless the "Consolidated Fixed Charge Coverage Ratio" for the four full fiscal quarters for which financial statements are available immediately preceding the planned payment, taken as one period, is greater than 2.5 to 1.0.

The Bond matures in July 2011. It was originally issued partly to finance the construction of a manufacturing facility in the United States in anticipation of a large contract award. As the contract was not awarded, the factory was not built and the cash was not used for this purpose and remained on the balance sheet in the form of bank deposits. In December 2010 the Close Brothers Seydler Bank was given a mandate to prepare the issue of a new bond, expected to be for €100 million. This process is expected to be complete by the end of the second quarter of 2011.

Neither the company nor any of its subsidiaries are subject to externally imposed capital requirements.

The Group's capital structure is as follows:

	2010	2009
	EUR '000	
Equity	**96,407**	**77,587**
as a percentage of total financing	27%	23%
Long-term liabilities	206,692	200,196
Short-term liabilities	54,461	63,680
Debt	**261,154**	**263,876**
as a percentage of total financing	73%	77%
Total equity & liabilities	**357,561**	**341,463**

(29) Additional disclosures on financial instruments

This note provides an overview of the significance of financial instruments and provides additional information on the balance sheet positions containing financial instruments.

The following table shows the book values (BV) and fair values (FV) of the financial assets:

	BV	FV	BV	FV	BV	FV	BV	FV	BV	FV
	EUR '000									
Balance at 31.12.2010										
Cash & equivalents	54,883	54,883	—	—	—	—	—	—	—	—
Loans & receivables	—	—	48,764	48,764	—	—	—	—	5,926	5,926
Held to maturity	—	—	—	—	933	933	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—
Held at fair value through profit or loss	—	—	—	—	—	—	262	262	—	—
Total financial assets	**54,883**	**54,883**	**48,764**	**48,764**	**933**	**933**	**262**	**262**	**5,926**	**5,926**
Balance at 31.12.2009										
Cash & equivalents	52,133	52,133	—	—	—	—	—	—	—	—
Loans & receivables	—	—	39,625	39,625	—	—	—	—	5,534	5,534
Held to maturity	—	—	—	—	612	612	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—
Held at fair value through profit or loss	—	—	—	—	—	—	239	239	—	—
Total financial assets	**52,133**	**52,133**	**39,625**	**39,625**	**612**	**612**	**239**	**239**	**5,534**	**5,534**

The fair values of loans and accounts receivable is believed to be equal to the book values. This is mainly due to the short terms of these instruments. The financial instruments held to maturity are participations in funds by which there is not material variance between book and fair value. During the reporting period there were no reclassifications of financial assets or transfers of financial assets that did not qualify for derecognition.

The following table shows the book values (BV) and fair values (FV) of non-derivative financial liabilities:

	Trade payables		Other financial liabilities	
	BV	FV	BV	FV
	EUR '000			
Balance at 31.12.2010				
Held at cost	22,960	22,960	5,286	5,286
Held at amortised cost	—	—	119,207	119,000
Non-derivative financial liabilities	**22,960**	**22,960**	**124,493**	**124,286**
Balance at 31.12.2009				
Held at cost	19,155	19,155	5,524	5,524
Held at amortised cost	—	—	117,936	124,086
Non-derivative financial liabilities	**19,155**	**19,155**	**123,460**	**129,610**

The other financial liabilities mainly relate to the bond and the interest liability for this.

During 2009 the company entered into a cash flow forward cover hedging arrangement for a large purchase contract with USD cash flows during 2009-2011. The derivative is recognised at its fair value as determined by the partner bank (€40k, 2009: €828k). The derivative is a perfect hedge since it enables the payments to match the related income in EUR, so changes in fair value are recognised in other comprehensive income (€ 788k income, 2009: €828 expense).

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31.12.2010	Level 1	Level 2	Level 3
		EUR ’000	
Derivative financial assets	—	262	—
Derivative financial liabilities	—	40	—

31.12.2009	Level 1	Level 2	Level 3
		EUR ’000	
Derivative financial assets	—	239	—
Derivative financial liabilities	—	828	—

Net income/(expenses) due to financial instruments:

	2010	2009
	EUR ’000	
Financial assets held for sale	—	—
Financial assets held to maturity	—	—
Loans and receivables and financial liabilities held at cost	2,197	8
Financial instruments held at fair value	42	(946)

The net income/(expense) from loans and receivables and financial liabilities held at cost include exchange gains and losses, impairments and reversals of previous impairments. The net income/(expense) from financial instruments held at fair value (derivatives) relates to the recognition of the valuation changes for forward contracts to hedge USD cash flows (2010: €277k income; 2009: €897k expense), together with €235k (2009: €49k).losses on valuation of options to hedge USD cash flows in 2010.

The total interest income and expenses relating to financial assets and liabilities not held at fair value through profit and loss are as follows:

	2010	2009
	EUR ’000	
Interest income	1,979	1,233
Accretion of non-current liabilities	(4,094)	(3,923)
Other interest expenses	(11,517)	(11,655)

(30) Cash flow statement

The Group cash flow shows the cash inflows and outflows leading to the change in cash and cash equivalents during the year. Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. As required by IAS 7, cash flows are analysed between operating, investing and financing activities.

Cash flows from investing and financing activities are determined directly while those from operating activities are calculated indirectly from the net results. The changes in balance sheet positions used in the indirect calculation are adjusted to exclude the effects of foreign exchange rate variances and changes in the companies consolidated into the Group. The changes in the balance sheet positions shown in the cash flow are therefore different to the euro changes in the Group balance sheet.

Interest received is classified as a cash flow due to investing activities. Interest paid and payments relating to finance leases are shown as cash flows due to financing activities.

(31) Segment reporting

The Heckler & Koch Group is organised around six (prior to the acquisition of HKS: five) operating companies, four of which serve defence and law enforcement sectors, whilst the fifth (HKI) serves US civil and local law enforcement sectors and the sixth (HKS) serves the German civilian market in addition to serving other Group companies. Correspondingly, the segments analysed are the site locations in Germany, split into Defence and Civil, Great Britain, France and the United States, with the US also split into Civil and Defense. Since these companies are each legal entities, the figures shown for each segment are the values for the individual companies as included in the Group's consolidated figures.

The activities in reporting segment Site Location Germany—Defence relate to the design, manufacture and distribution of defence and security products together with the provision of associated services. The site Germany—Defence mainly supplies to Group companies and to NATO members and allies in which no Group subsidiaries are located. Site Location Germany—Defence also has construction contract revenue, see Note 6.

The newly acquired reporting segment "Germany—Civil" assembles pistols for the reporting segments "Germany—Defence" and "USA—civil" and has sales and distribution activities for civil and security products in Germany. The reporting segment "USA—civil" has sales and distribution activities for civil and security products and provides related services in the US. The other reporting segments all have sales and distribution activities for defence and security products and provide related services. The sites located in the USA and France supply to these countries. The site located in Great Britain sells primarily to the United Kingdom, the British Commonwealth of Nations and also to certain other NATO allies.

(31) Segment reporting (Continued)

Operating segments

	Germany— Defence		Germany— Civil		USA— Civil		USA— Defense		Great Britain		France		Total pre-consolidation Restated		Consolidation transactions Restated		Total Restated	
Site Location	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
										EUR ’000								
Net external revenues	138,819	115,519	738	—	14,894	20,690	26,255	24,099	57,268	64,351	9,272	10,088	247,244	234,748	—	—	247,244	234,748
Inter-segment revenue	73,324	68,136	13,533	—	705	165	299	562	257	945	—	—	88,119	69,808	(88,119)	(69,808)	—	—
Depreciation and amortisation	(8,847)	(9,351)	(3)	—	(248)	(242)	(213)	(221)	(104)	(112)	(11)	(10)	(9,427)	(9,937)	10	10	(9,417)	(9,927)
Interest income	2,464	1,519	0	—	5	195	3	7	3	4	22	27	2,496	1,753	(517)	(520)	1,979	1,233
Interest expense	(15,603)	(15,504)	(6)	—	—	(74)	(500)	(519)	(1)	—	(14)	—	(16,124)	(16,096)	514	518	(15,611)	(15,579)
Share of profit of associates (at equity)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Tax on income	(10,564)	(4,972)	(416)	—	221	(638)	2	(4)	(1,675)	(1,720)	(289)	(210)	(12,722)	(7,544)	2,552	274	(10,170)	(7,270)
Profit/(loss) after tax	28,664	18,633	1,141	—	(355)	1,100	6,663	(1,092)	4,283	4,366	569	401	40,965	23,407	(10,563)	(6,453)	30,402	16,954
Other material non-cash items																		
—Impairment of assets	(124)	(500)	—	—	(45)	(108)	(19)	(585)	(181)	(4)	(1)	(12)	(370)	(1,208)	—	—	(370)	(1,208)
—Impairment losses reversed	—	26	—	—	25	—	5	—	76	124	—	—	106	150	—	—	106	150
Non-current assets, excluding deferred taxes and financial instruments	148,503	148,374	38	—	1,615	1,724	1,550	1,489	206	270	29	39	151,941	151,895	3,889	3,879	155,830	155,773
Investments in associates	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Capital Expenditure (Capex)	(8,403)	(8,306)	(33)	—	(5)	—	(172)	(81)	(31)	(79)	(1)	(14)	(8,644)	(8,480)	—	—	(8,644)	(8,480)
Reportable segment liabilities	250,276	245,970	7,062	—	12,887	6,410	28,429	34,820	5,443	13,189	1,460	1,821	305,557	302,210	(44,403)	(38,335)	261,154	263,876

The above table shows the revenues and results together with the assets and liabilities of the individual Group segments. With the exception of sales from both German segments to the other segments, trading between the different segments is only slight. The trade relationships between segments have been consolidated. Trade between the segments is conducted at ‘arm’s-length’ prices, as would have been agreed with informed and willing parties outside the Group.

(31) Segment reporting

Geographical and product group segments

The value of sales made to customers in different regions of the world and the proportions of sales due to the different product groups are shown in the following tables:

		Sales EUR '000	Sales %
Germany	2010	42,864	17%
	2009	39,413	17%
USA	2010	42,931	17%
	2009	46,968	20%
UK	2010	52,513	21%
	2009	61,775	26%
Rest of the world	2010	108,936	44%
	2009	86,593	37%
Total	2010	247,244	100%
	2009	234,748	100%
Outside Germany	2010	204,380	83%
	2009	195,335	83%

		Sales
Rifles	2010	21%
	2009	30%
Sub-machine guns & machine guns	2010	14%
	2009	18%
Pistols	2010	15%
	2009	20%
Development services	2010	2%
	2009	1%
Other products & services	2010	48%
	2009	31%
Total	2010	100%
	2009	100%

Major customers

IFRS requires customers known to be under common control to be treated as one customer. Since the Group sells to the government agencies, which include the law enforcement agencies and armed forces, in various countries, this requirement leads to all governmental agencies in a country being treated as one single joint customer.

On this basis the Group's major customers, to whom individually more than 10% of sales were made in 2009, are the governmental authorities of Saudi Arabia (2010: €54 million; 2009: €11 million) and the German governmental authorities (2010: €25 million; 2009: €14 million), which are shown in the segment Site Location Germany—Defense, the UK governmental agencies (2010: €52million; 2009: €61million), shown within the segment Site Location Great Britain and the US federal and state agencies (2010: €27million; 2009: €27million) shown mainly within the segment Site Location USA—Defense with the balance in the segment Site Location USA—Civil.

(32) Contingent liabilities and pledged assets

There are no material contingent liabilities as of December 31, 2010 or December 31, 2009. For details of pledged assets, see Notes 18 and 25.

(33) Operating leases

Our expenses include €749k (2009: €674k) due to rental and €248k (2009: €234k) due to other operating leases.

As at the balance sheet date, the group had outstanding obligations arising from binding operating leases that fall due as follows:

	31.12.2010	31.12.2009
	EUR '000	
Up to one year	449	323
More than one and up to five years	1,418	935
More than five years	192	249
Total	**2,059**	**1,507**

(34) Full-time equivalent number of employees

The workforce in the Heckler & Koch Group, as an annual average of full-time equivalents ("FTE"), was as follows:

	2010	2009
Manufacturing	445	449
Research & Development	72	74
Sales & Distribution	72	71
Administration	85	83
Total FTE employees excluding apprentices	**674**	**677**
Apprentices	41	35
Total FTE employees including apprentices	**715**	**711**

(35) Personnel expenses

Personnel expenses in the reporting year came to €46,279k (2009: €46,334k). Of these expenses, €3,236k (2009: €3,241k) relate to employer's contributions to social security funds and similar defined contribution plans for pensions.

(36) Related party disclosures

Parent and ultimate controlling party

The Group is wholly-owned by HK Holding, Inc., which in turn is a wholly- owned subsidiary of Heckler & Koch Beteiligungs GmbH, the ultimate parent company.

Other related party transactions

Transactions between the parent company and related parties that are its subsidiaries were eliminated in the course of consolidation and are not described in these disclosures in the Notes. Transactions with current and former members of the executive board are covered in Notes 38 and 39 respectively.

In addition, there are arm's-length business relationships between Group companies and related parties as defined by IAS 36, as follows:

- Management fees are recharged from Heckler & Koch Beteiligungs GmbH, "HKB", the indirect parent of the Group. In accordance with the Bond Indenture, these are restricted to €300k pa. At the end of the year, the Group held a net receivable of €218k (2009: €840k) against HKB; this related to the net management fee recharges together with the administration fees and to certain licence fees for the Group.

- In 2009 the Group entered into an agreement to rent an office in London from its indirect parent company, Heckler & Koch Beteiligungs GmbH (at £212k pa). The rental for the twelve months to February is paid in advance and the pre-paid element of £27k (2009: £27k) is included in other assets. The rental agreement has been terminated for 2011.

- The Group provides administrative services to its indirect parent company, Heckler & Koch Beteiligungs GmbH (€24k pa) and to Prochemie GmbH, formerly HK Sidearms Holding GmbH, (€18k pa) and, up until its merger with HKB in May 2009, to Suhler Jagd- & Sportwaffen Holding GmbH (€18k pa), companies partly owned by one or more of the ultimate shareholders of the Group.

- As in the past, the Group has granted short-term loans to its indirect parent, Heckler & Koch Beteiligungs GmbH, "HKB". As a result of these activities, the Group recognised interest income of €240k (2009: €470k). The loans and associated interest are valued at €4,901k (2009: €4,912k). The loans and accrued interest were repaid in full in March 2011.

- During 2009 the Group recognised €153k in interest on €7,446k Restricted Payments (as defined in the Bond Indenture) made to the ultimate shareholder of the Group. In December 2009 these restricted payments and the interest thereon were sold to HK Holding, Inc., "HKH", the direct parent of the Group and offset against the €10,150k dividend declared at the end of 2009. The Group recognised a net payable of €2,335k at the end of 2009 against HKH relating to these transactions and to other amounts recharged for taxes, tax advice and audits. The payments were made in January 2010 and are recognised in investing activities (€153k interest received and €7,446k from net investments in loans) and in financing activities (€10,150k dividend payments).

- During 2010 €9,100k dividends were declared and paid to HKH. The Group recognised a receivable of €225k against HKH relating to amounts recharged for tax advances, since these have to be paid from an American bank account.

- In mid-2010 the Group acquired HK Sidearms GmbH ("HKS") for €6.4 million from Prochemie GmbH, a related party. The purchase price was based on a valuation from an independent, internationally recognised appraisal firm. The HKS figures are included within the consolidated financial statements from July 2010.

- Until June 2010, HK Sidearms GmbH ("HKS") was a subsidiary of Prochemie GmbH (formerly HK Sidearms Holding GmbH); since July 2010 it is within the Heckler & Koch Group. Up until the acquisition in July 2010, the Group sold parts and assemblies to HKS (€9,501k; 2009 full year: €20,170k) and purchased goods from HKS (€13,492k; 2009 full year: €25,470). In addition until the acquisition, the Group provided infrastructure and administration services to (€649k, 2009 full year: €1,257k) and received licensing fees (€239k, 2009 full year: €408k) from this company. From July 2010 this company is included in the Group with the usual consolidating adjustments; however in 2009 the Group recognised a receivable of €3.528k and a payable of €6.224k against this company relating to these transactions.

(37) Governing bodies of the Group

Executive Board	
Martin Newton	Chief Executive Officer (until 02.09.2009)
Peter Beyerle	Director (until 03.01.2011)
Niels Ihloff	Director (from 20.05.2009)
Martin Lemperle	Director (from 20.05.2009)
Supervisory Board ("Beirat")	
Hans-Henning Offen	Chairman (until 31.07.2009, then resigned)
Andreas Heeschen	Chairman (from 01.08.2009)
Martin Newton	Vice Chairman (until September 2010)
Wilhelm Haaga	(from November 2010)
Keith Halsey	

(38) Remuneration of the executive and supervisory boards

The remuneration of the executive board in the financial year 2010 totalled €1,807k (2009: €3,332k) and includes a termination bonus of €450k (2009: €1,511k).

In 2009 a director was granted a short-term secured loan with an interest rate of 4% which was partly repaid in that year. In 2010 a repayment of €80k was received and additional loans totalling €364k granted. As at December 31, 2010 the Group recognised a loan receivable of €604k (2009: €320k) and an interest receivable of €14k (2009: €2k). On January 1, 2011 the term was extended until June 30, 2011.

As in the previous year, the Beirat did not receive any remuneration in 2010. Former members of the Beirat received remuneration in 2010 relating to 2009 of €15k (2009: nil). In 2010 €882k consultancy fees were paid to a member of the Beirat.

(39) Provisions for pensions and remuneration for former members of the executive board

Provisions of €11,912k (2009: €10,937k) have been set up for pension obligations to former members of the executive board, the executive boards of merged companies and their surviving dependants; some of these obligations are covered by plan assets of €366k (2009: €426k). The total pension payments and other remuneration paid to former members of the executive board, including payments to former members of executive boards of merged companies, amounted to €955k in 2010 (2009: €951k).

(40) Auditor's remuneration

	2010	2009
	EUR '000	
Audit of the financial statements	162	146
Other confirmation services	—	1
Tax services	151	206

Other services	464	11
Total	**778**	**364**

(41) Subsequent events

Given the positive revenue and profit development in the 2010 financial year, in addition to the interim dividends totalling €5.4 million declared and paid during 2010, in March 2011 a further dividend of €9.0 million was declared and paid to the parent company HK Holding, Inc..

HKO's loan receivable against HKB of €5.0 million, including accrued interest, was received in full in March 2011.

In compliance with the requirements in the Bond Indenture and business and company legal regulations, in March 2011 HKO granted two shareholders of the ultimate holding company HKB secured loans of €1.5 million each for 9 month terms.

No other material operating or structural changes or transactions have occurred prior to the approval of these consolidated financial statements.

Oberndorf/Neckar, March 23, 2011

The Executive Board

Niels Ihloff Martin Lemperle

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by Heckler & Koch GmbH, Oberndorf/Neckar, comprising the balance sheet, the income statement, statement of comprehensive income, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2009. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB (and supplementary provisions of the shareholder agreement/ articles of incorporation) are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit. In addition we have been instructed to express an opinion as to whether the consolidated financial statements comply with full IFRS.

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

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to section 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development."

Stuttgart, 30 April 2010

KPMG AG
Wirtschaftsprüfungsgesellschaft (Audit Firm)

Dr. Kursatz Wirtschaftsprüfer (Auditor)	Kolban Wirtschaftsprüfer (Auditor)

Heckler & Koch GmbH

Oberndorf/Neckar

Consolidated Statements

According to IFRS

for the Financial Year

2009

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS OF

	Note	31.12.09 restated	31.12.08 restated	31.12.07 restated
			EUR '000	
Assets				
Property, plant & equipment	17	54,219	55,246	56,300
Intangible assets—goodwill	16	60,365	60,365	60,365
Intangible assets—other	16	41,190	40,608	39,058
Investments in equity accounted investees	18	0	13	13
Other investments	18	1	9,654	6,147
Deferred tax assets	15	6,779	4,008	4,404
Total non-current assets		**162,553**	**169,894**	**166,286**
Inventories	19	71,806	71,684	63,495
Prepayments for inventories		5,843	859	1,024
Prepayments for other current assets		1,234	510	806
Other loans, investments & derivatives	18,36	5,762	6,427	482
Current tax assets		220	258	1,788
Trade and other receivables	20,36	41,911	61,395	46,945
Cash & cash equivalents	21	52,133	29,762	38,205
Assets classified as "held for sale"	17	0	0	180
Total current assets		**178,910**	**170,895**	**152,927**
Total assets		**341,463**	**340,788**	**319,213**
Equity				
Share capital		25	25	25
Share premium		13,695	79,695	79,695
Reserves		63,867	(6,341)	(16,535)
Total equity	22	**77,587**	**73,379**	**63,185**
Liabilities				
Loans & borrowings due to third parties	25	117,851	120,045	118,690
Finance lease obligations	25	0	224	368
Employee defined benefit obligations	23	48,470	44,565	44,719
Provisions	24	12,432	11,002	10,598
Trade and other payables	26	167	0	13,000
Deferred tax liabilities	15	21,275	22,006	22,141
Total non-current liabilities		**200,196**	**197,842**	**209,516**
Trade and other payables	26,36	33,422	48,852	32,686
Advanced & stage payments received		16,224	10,550	9,713
Deferred income		292	90	287
Finance lease obligations	25	86	0	0
Derivatives	29	828	0	0
Current income tax payable		8,874	4,428	459
Provisions & accruals	24	3,956	5,647	3,368
Total current liabilities		**63,680**	**69,568**	**46,512**
Total liabilities		**263,876**	**267,409**	**256,028**
Total equity & liabilities		**341,463**	**340,788**	**319,213**

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR TO DECEMBER 31

	Note	2009 restated	2008 restated
		EUR '000	
Revenue	6	234,748	200,992
Cost of sales	7	(153,563)	(133,181)
Gross profit		**81,185**	**67,810**
Research & development	8	(3,051)	(2,087)
Sales, marketing & distribution	9	(24,714)	(23,162)
Administration	10	(14,224)	(10,880)
Other operating income	11	6,344	8,791
Other operating expenses	12	(6,132)	(9,688)
Results from operating activities	13	**39,408**	**30,784**
Financial income		2,500	7,265
Financial expense		(17,684)	(17,435)
Net financial result	14	**(15,184)**	**(10,170)**
Profit before income tax		**24,224**	**20,614**
Income tax expense	15	(7,270)	(8,229)
Profit for the period		**16,954**	**12,385**
Attributable to the shareholders of Heckler & Koch GmbH		**16,954**	**12,385**
Earnings per share		**N/A**	**N/A**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE YEAR TO DECEMBER 31

	Note	2009 restated	2008 restated
		EUR '000	
Forex translation differences for foreign operations		690	(2,192)
Hedging gains/(losses)	22	(828)	0
DBO actuarial gains/(losses)	22	(3,719)	0
Deferred tax	22	1,260	(0)
Income & expense recognised directly in equity		**(2,596)**	**(2,192)**
Profit for the period		**16,954**	**12,385**
Total comprehensive income for the period		**14,358**	**10,194**
Attributable to the shareholders of Heckler & Koch GmbH		**14,358**	**10,194**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE YEAR TO DECEMBER 31

	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Hedging Reserve	Consolidated Retained Earnings	Shareholders' Equity
As of 31.12.2007............	**25**	**79,695**	**1,671**	**3,662**	**0**	**(17,771)**	**67,282**
Restatement for common control acquisition	0	0	0	0	0	(4,097)	(4,097)
As of 31.12.2007, restated	**25**	**79,695**	**1,671**	**3,662**	**0**	**(21,868)**	**63,185**
Total recognised income & expense......	0	0	(2,192)	0	0	12,385	10,194
As of 31.12.2008, restated	**25**	**79,695**	**(521)**	**3,662**	**0**	**(9,482)**	**73,379**
Total recognised income & expense......	0	0	690	(2,688)	(598)	16,954	14,358
Reclass additional paid in capital	0	(66,000)	0	0	0	66,000	0
Dividends declared	0	0	0	0	0	(10,150)	(10,150)
As of 31.12.2009, restated	**25**	**13,695**	**169**	**974**	**(598)**	**63,322**	**77,587**

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE YEAR TO DECEMBER 31

	Note	2009 restated	2008 restated
		EUR '000	
Cash flows from operating activities			
Profit for the period		16,954	12,385
Adjustments for:		0	0
Depreciation		8,636	8,456
Amortisation of intangible assets	16	1,291	1,422
Retirement losses on intangible assets		1,133	0
Impairment losses on assets classified as "held for sale"	12,17	0	903
Net interest expense	14	14,343	12,459
Gain/loss on disposal of property, plant & equipment		310	(552)
Gain/loss on disposal of investments	14	1	0
Income tax expense	15	7,270	8,229
		49,938	43,301
Change in inventories		(667)	(7,772)
Change in trade & other receivables		21,767	(17,154)
Change in prepayments		(5,691)	312
Change in trade & other payables		(56)	5,202
Change in provisions & employees' benefits	23,24	(2,824)	197
		62,467	24,086
Income tax paid		(5,107)	(2,250)
Net cash from/(used in) operating activities		**57,361**	**21,836**
Cash flows from investing activities			
Interest received		976	2,796
Proceeds from sale of property, plant & equipment		138	75
Proceeds from sale of assets held for sale		0	1,470
Proceeds from sale of investments	18	292	271
Acq'n of property, plant, equipment & intangibles	16,17	(8,480)	(9,120)
Net investment in loans	18,36	2,054	(8,106)
Acquisition of subsidiaries & other investments	18,36	(12,316)	(1,633)
Capitalised development expenditure	16	(2,676)	(2,853)
Net cash from/(used in) investing activities		**(20,012)**	**(17,101)**
Cash flows from financing activities			
Proceeds from utilisation of US credit line	25	1,264	2,492
Repayment of US credit line	25	(4,674)	(2,428)
Interest paid		(11,654)	(11,676)
Payment of finance lease liabilities	25	(139)	(146)
Net cash from/(used in) financing activities		**(15,204)**	**(11,757)**
Net inc./(dec.) in cash & cash equivalents		**22,145**	**(7,022)**
Cash & cash equivalents at 1st January		29,762	38,205
Effect of exchange rate fluctuations on cash held		227	(1,422)
Cash & cash equivalents at 31st December	21	**52,134**	**29,762**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR 2009

Contents

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR 2009

General disclosures

(1) Presentation of the consolidated financial statements

Heckler & Koch GmbH, the parent company of the Group, is registered under HRB 481250 at the Stuttgart district court. The company's registered office is in Oberndorf/Neckar, Germany and the postal address is Heckler & Koch GmbH, Heckler & Koch-Str. 1, 78727 Oberndorf/Neckar, Germany. The articles of incorporation are from May 19, 2004 and the registered name of the company is Heckler & Koch GmbH. The financial year is the calendar year.

The object of Heckler & Koch GmbH and its subsidiaries (the "Heckler & Koch Group") is the development, manufacture and distribution of defence and security products, and the provision of related services.

(2) Executive board approval

The board of directors of Heckler & Koch GmbH released the consolidated financial statements on April 30, 2010.

(3) Statement of compliance with applicable law and IFRS

The consolidated financial statements of Heckler & Koch GmbH as at December 31, 2009, have been prepared in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) as applicable in the EU, together with interpretations of the International Financial Reporting Interpretation Committee (IFRIC) and the supplementary German commercial law regulations pursuant to § 315a (1) HGB. All IFRS's and IFRIC's which were effective for the financial year 2009 have been applied.

For the financial year 2009, the following Standards and amendments to previous Standards became effective for the first time but had no material effects on the Group's net assets, financial position, results of operations or cash flows:

IAS 23 Borrowing Costs (revised)

IAS 39/IFRS 7 Reclassification of Financial Instruments

IAS 32/IAS 1 Puttable Financial Instruments and Obligations Arising on Liquidation

IFRS 1 and IAS 27 Cost of an Investment in a Subsidiary, Jointly-controlled Entity or Associate

IFRS 2 Share-based Payment: Vesting Conditions and Cancellations

IFRIC 9/IAS 39 Embedded Derivatives

IFRIC 13/IAS 18 Customer Loyalty Programmes

IFRIC 14/IAS 19 The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction

The following Standard was endorsed by the EU in 2007 and, although it was not effective for the financial year 2008, it was applied early by Heckler & Koch:

IFRS 8 Operating Segments

This requires the disclosure of information in the financial statements to enable users to evaluate the nature and financial effects of the business activities in which the Group engages and the economic environments in which the Group operates. The disclosure requirements follow the management approach whereby the operating segments are identified in line with Group internal management reporting. This Standard is mandatory from January 1, 2009.

The following new standards, amendments to standards and interpretations are effective for the year ended 31 December 2009, and have been applied in preparing these consolidated financial statements:

IAS 1Presentation of Financial Statements (2007)

This amendment mainly affects the Group’s 2009 consolidated financial statements through the change to the names of the individual financial statements, the requirement to identify the tax relating to individual items in comprehensive income and the requirement that for retrospective adjustments or reclassifications, a statement of financial position for the beginning of the earliest comparative period be presented.

IFRS 7 Improving Disclosures about Financial Instruments (amendments)

The amendments to IFRS 7 cover disclosures relating to the determination of fair values and liquidity risks and result in additional disclosures in these financial statements.

The following new standards, amendments to standards and interpretations are not yet effective for the year ended 31 December 2009, and have not been applied in preparing these consolidated financial statements:

IAS 27 Consolidated and Separate Financial Statements (amended 2008)

The amended IAS 27 requires accounting for changes in ownership interests by the Group in a subsidiary, while maintaining control, to be recognised as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss. The amendments to IAS 27, which become mandatory for the Group’s 2010 consolidated financial statements, are not expected to have a significant impact on the consolidated financial statements.

IAS 39 Financial Instruments: Recognition and Measurements: Eligible Hedged Items (amended)

The amended IAS 39 clarifies the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship. The amendments to IAS 39, which become mandatory for the Group’s 2010 consolidated financial statements, are not expected to have a significant impact on the consolidated financial statements.

IFRS 3 Business Combinations (2008)

Revised IFRS 3 Business Combinations (2008) incorporates the following changes that could be relevant to the Group’s future operations:

- The definition of a business has been broadened, which is likely to result in more acquisitions being treated as business combinations.

- Contingent consideration will be measured at fair value, with subsequent changes therein recognised in profit or loss.

- Transaction costs, other than share and debt issue costs, will be expensed as incurred.

- Any pre-existing interest in the acquiree will be measured at fair value with the gain or loss recognised in profit or loss.

- Any non-controlling (minority) interest will be measured at either fair value, or at its proportionate interest in the identifiable assets and liabilities of the acquiree, on a transaction-by-transaction basis.

Revised IFRS 3, which becomes mandatory for the Group’s 2010 consolidated financial statements, will be applied prospectively and therefore there will be no impact on prior periods in the Group’s 2010 consolidated financial statements.

The new interpretations IFRIC 12, IFRIC 15, IFRIC 16, IFRIC 17 and IFRIC 18 have been issued but are not yet effective. These have not been applied and are not expected to have material effects on the Group’s net assets, financial position, results of operations or cash flows.

The other Standards and Interpretations endorsed by the EU that have been issued but are not yet effective and have not been applied (amendment to IAS 32, IAS 39) are not expected to have material effects on the Group’s net assets, financial position, results of operations or cash flows.

The amendments to standards IFRS 1, IFRS 2 and IAS 24 and the new standards and interpretations IFRS 9, IFRIC 14 and IFRIC 19 have been issued but as of December 31, 2009 had not been endorsed by the EU. These have not been applied and are not expected to have material effects on the Group's net assets, financial position, results of operations or cash flows.

The consolidated financial statements have been prepared in euro. Unless otherwise stated, all financial information presented in euro has been shown to the nearest thousand (€k, EUR'000). As a result, the totals in this report may vary slightly from the exact arithmetic aggregation of the figures that precede them.

For the income statement, expenses have been classified by function. In order to enhance the clarity of presentation, various items in the balance sheet and in the income statement have been aggregated.

(4) Group entities

Apart from the single entity statements of Heckler & Koch GmbH, the consolidated financial statements of Heckler & Koch GmbH as at December 31, 2009, include the annual financial statements of six (2008 restated: six) foreign subsidiaries. Subsidiaries are companies in which the parent enterprise exercises more than half the voting rights or is able to control their financial and business policy for other reasons (control relationship). Inclusion commences at the time from which the control relationship exists; it ends when the possibility of control ceases.

During 2009 two subsidiaries were acquired in a common control transaction, so figures have been presented as if the combination had occurred prior to the start of the earliest period shown (i.e. as at 31.12.2007), due to the fact that they were ultimately controlled by the same person as controls the Group; consequently previously reported figures for the Group for 2008 have been restated. The reconciliation is shown in detail in Note 41.

The following table shows a list of the 6 subsidiaries and one joint venture included in the consolidation, together with their total equity and profit for the year figures from their financial statements, as prepared for consolidation purposes under IFRS, in their functional currencies:

		Ownership Interest								
		2009			2008			2007		
-restated'	Functional Currency	%	Equity	Profit	%	Equity	Profit	%	Equity	Profit
Direct holdings										
NSAF Limited, Nottingham, England	GBP '000	100%	5,724	3,894	100%	5,830	3,195	100%	5,638	1,851
Heckler & Koch France S.A.S., Paris, France	EUR '000	100%	674	401	100%	1,774	386	100%	1,388	79
Small Arms Group Holding Inc., Ashburn VA, USA	USD '000	100%	146	(11)	100%	157	(5)	100%	162	(14)
Sistemas de Armamento Ibericos S.L., Madrid, Spain	EUR '000	0%	—	—	50%	25	—	50%	25	—
Suhler USA, Inc., AL, USA	USA '000	100%	16,884	19	100% PF	16,865	(2)	100% PF	16,867	—
Indirect holdings										
Heckler & Koch Defense Inc., Ashburn VA, USA	USD '000	100%	(24,698)	(1,512)	100%	(23,186)	(3,420)	100%	(19.767)	(4,350)
Heckler & Koch, Inc., VA & GA, USA	USD '000	100%	14,592	1,515	100% PF	13,077	(76)	100% PF	13,153	—

The investment in the dormant joint venture, Sistemas de Armamento Ibericos S.L., ceased during the final quarter of 2009; for 2008 it is included in the consolidated financial statements using the equity method described in IAS 28, as permitted by IAS 31.

(5) Summary of significant accounting policies and basis of measurement

The consolidated financial statements have been prepared on a historical cost basis; where IFRS requires recognition at fair value, this has been applied.

The significant accounting policies and measurement methods applied in preparing the consolidated financial statements are described below:

Consolidation methods

The assets and liabilities of the domestic and foreign companies included in the consolidated financial statements are recognised and measured using the accounting and measurement methods that apply uniformly for the Heckler & Koch Group.

On the acquisition of a company, the assets and liabilities of the subsidiaries concerned are measured at their fair value at the time of acquisition. If the acquisition costs for the participation exceed the net fair value of the identified assets and debts, the difference is capitalised as goodwill. If the acquisition costs are lower, the fair value of the assets and liabilities and the amount of the acquisition costs are reassessed. Any remaining negative goodwill (lucky buy) is recorded immediately in the income statement.

In subsequent periods, the associated fair value adjustments to assets and liabilities are maintained, written off or released in accordance with the corresponding assets and liabilities. Capitalised goodwill is not amortised, but is subject to an annual impairment test in accordance with IFRS 3 instead.

A business combination in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination, and that control is not transitory, is classified as being "under common control." Business combinations involving entities under common control are excluded from the scope of IFRS 3. The Group uses the book values for such acquired entities and offsets a difference between the net assets acquired and the consideration paid, if any, in equity. Providing that the entities were under common control during the comparative periods, the comparatives are restated as if the combination had been in existence throughout the reporting periods presented.

The financial year of all companies included corresponds to the financial year of the parent company.

All receivables, liabilities, sales revenues, other income and expenses within the scope of consolidation are eliminated. Unrealised profits from intra- group supplies are eliminated from inventories or fixed assets as appropriate.

Currency translation

The Heckler & Koch Group reporting currency is the euro (€).

Foreign currency transactions are translated in the individual financial statements of Heckler & Koch GmbH and its consolidated companies at the rates pertaining at the time of the transactions. As at the balance sheet date, assets and liabilities in foreign currency are measured at the spot rate on the balance sheet date. Differences arising on translation are recorded in the income statement.

The financial statements of the foreign companies are translated to euro by using the functional currency method. Since subsidiaries and joint ventures operate their business independently, their functional currency is their individual local currency. In the consolidated financial statements, income and expenses from the financial statements of subsidiaries that are prepared in foreign currency are translated at the average rate for the year calculated from the daily rates. This method is used for simplicity since usually the local currency income and expenditure involved are fairly evenly spread throughout the year and consequently any potential variances are not material. Assets and liabilities are translated at the spot rate on the balance sheet date. Goodwill is treated in the same way as an asset or liability and translated at the balance sheet spot rate. Foreign currency translation variances are taken directly to the foreign currency translation reserve in equity. In the event of the disposal of a consolidated entity, associated accumulated foreign currency translation variances are recorded as part of the profit or loss on disposal.

The rates used for currency translation are shown in the table below:

Currency	**Abbr.**	**Rate on balance sheet date 31.12.2009**	**Rate on balance sheet date 31.12.2008**	**Rate on balance sheet date 31.12.2007**	**Rate on balance sheet date 2009**	**Average exchange rate 2008**
US Dollar (USA)	**USD**	1.4406	1.3917	1.4721	1.3947	1.4713
Pound (United Kingdom)......................	**GBP**	0.8881	0.9525	0.7346	0.8919	0.7962

Significant accounting policies

Goodwill

Goodwill is allocated to the following cash generating units (segments):

	2009	2008
	EUR '000	
Site location: Germany	59,232	59,232
Site location: France	1,133	1,133
Total	**60,365**	**60,365**

Goodwill is capitalised and subjected to an annual impairment test. If the carrying value is no longer recoverable, impairment is charged. Otherwise the prior year carrying value is retained. Any impairment charge against goodwill is not reversed, even if the valuation exceeds the carrying value.

Heckler & Koch conducts an impairment test of goodwill at least annually. The recoverable value of the cash generating unit is compared with its carrying value. The recoverable value used in the calculation is the value in use. The value in use of the cash generating unit is determined by discounting future cash flows. The computation is based on the following material assumptions:

> A detailed plan is made of the cash flows for the cash generating unit for the forecast period of five years. Subsequent periods are accounted for by a terminal value determined on the basis of the final year, adjusted for material one-off events during earlier years and the volume of the current order book.
>
> The discount rate used for December 31, 2009 is a uniform cost of capital of 9.25% (2008: 9.5%); in line with the financing structure, this is similar to the interest rate on the Notes.

Goodwill from acquisitions prior to January 1, 2006 has been capitalised; negative goodwill from acquisitions prior to this transition date has been offset against reserves. On divestment of a consolidated company any goodwill relating to it, other than negative goodwill, is included in the computation of the deconsolidation result.

Intangible assets

Purchased intangible assets, mainly patents, licences and software, are capitalised at acquisition cost. Internally generated intangible assets, with the exception of goodwill, are capitalised if it is sufficiently probable that a future economic benefit will flow from the use of the asset and the costs of the asset can be determined reliably. The manufacturing costs of internally generated intangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset.

With the exception of goodwill and trademarks, all intangible assets have finite useful lives and are amortised using the straight-line method over this period. Licences and software usually have useful lives of 10 years. Standard software usually has a useful life of 4 or 5 years. Capitalised development costs usually have useful lives of 8 years. If the expected useful life is materially longer or shorter, the expected useful life is used.

(5) Summary of significant accounting policies and basis of measurement

Tangible assets

Tangible assets which will be used in the business for more than one year are capitalised and valued at acquisition or manufacturing costs less depreciation calculated using the straight-line, use-related method, together with impairment if appropriate. The manufacturing costs of internally generated tangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset. The permitted alternative method of revaluation is not applied.

The following useful lives are applied for scheduled depreciation Group-wide:

Category of tangible asset	years
Buildings	25 - 40
Plant and machinery	5 - 10
Tooling	3
Vehicles	6
Fixtures, fittings and office equipment	5 - 10

The useful lives and methods of depreciation are reviewed regularly in order to ensure that these are in line with the actual expected economic use.

Impairment of tangible assets and of intangible assets other than goodwill

As at each balance sheet date, if there are triggering events for impairment, material tangible assets and intangible assets are submitted to an impairment test in accordance with IAS 36. If the carrying value of an asset exceeds its recoverable amount, an impairment loss is recognised. The recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount for an individual asset cannot be determined, an estimate is made of the recoverable amount at the level of next higher cash generating unit.

If, in the following periods the recoverable amount exceeds the carrying value, reversal of impairment is only made for the lower of the amount necessary to (i) bring the carrying value of the asset to its recoverable amount or (ii) to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortisation that would have been recognised.

The impairment and any reversal of impairment are recorded in the income statement.

Financial instruments

As defined by IAS 32 and used in IAS 39, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Original financial instruments

Financial instruments held by the Group are classified as one of the following:

- financial assets at fair value through profit or loss
- loans and receivables
- held-to-maturity investments
- available-for-sale financial assets
- financial liabilities at fair value through profit or loss
- other financial liabilities, valued at amortised cost using the effective interest method

The classification of a financial instrument is determined based on the intended principal purpose upon initial recognition. Financial assets include cash and cash equivalents, trade accounts receivable, loans receivable and derivatives that are assets held for trading. Financial liabilities include trade accounts payable, amounts owed to banks, derivatives that are liabilities held for trading and other financial liabilities.

An instrument is classified at **fair value through profit or loss** if it is held for trading or is designated as such upon initial recognition. For the periods covered by these financial statements, the only financial instruments designated by the Group as held at "fair value through profit or loss" are derivatives that do not meet the requirements for hedge accounting. Upon initial recognition any attributable transaction costs are recognised in profit or loss. Financial instruments at fair value through profit or loss are measured at fair value, and any changes in the fair value are recognised in profit or loss.

Financial assets

All regulated market acquisitions and disposals of financial assets are recognised on the date of settlement.

Financial assets are recognised initially at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition.

The recoverability of financial assets that are not held at fair value through profit or loss is reviewed regularly. If the carrying value is higher than the recoverable amount, impairment is recognised via the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively linked to an event occurring after the impairment was recognised, the previously recognised impairment loss shall be partially or completely reversed through the income statement.

The fair values of financial assets in the balance sheet are usually their market values. If market values are not readily available, the fair values are determined using recognised valuation techniques and current market parameters. Valuation methods available include using recent arm's-length transactions between knowledgeable, willing parties, recent market transactions in similar financial instruments, adjusted for factors unique to the instrument being valued, discounted cash flow analysis or option pricing models.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or are transferred. To qualify for derecognition, the transfer must transfer the risks and rewards of ownership of the financial asset or the contractual rights to receive the cash flows.

Loans and receivables are financial assets resulting from monetary transactions, the supply of goods or services to third parties. Current assets in this category are measured at cost and non-current assets are measured at amortised cost using the effective interest method.

Impairments to doubtful debts are mainly due to estimates and assessments of individual accounts receivable, based on the creditworthiness of individual customers. Impairment of accounts receivable is initially shown as a provision for doubtful debts. If a debt is regarded as irrecoverable, the impaired account receivable is written off.

Financial instruments are classed as "**held to maturity**" if they are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits, for which the original term is less than three months. These are valued at nominal value.

Financial liabilities

Financial liabilities are mainly trade accounts payable, amounts owed to banks and other liabilities.

Financial liabilities are recognised initially at fair value less, in the case of a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the issue.

A financial liability is derecognised when the obligation specified in the contract is discharged, or cancelled, or expires.

Financial liabilities valued at amortised cost using the effective interest method, include trade accounts payable and interest-bearing loans. These are valued at amortised cost using the effective interest method. Any profit or loss is recognised in the income statement when the liabilities are derecognised or settled.

Derivative financial instruments and hedge accounting

During the first quarter of 2009, circumstances arose which made a hedging transaction for foreign exchange cover for a particular foreign currency contract advisable. In the past, all foreign exchange forward contracts were treated as derivatives held at fair value through profit or loss.

The Heckler & Koch Group only uses derivative financial instruments to manage its exposure to foreign currency translation risk arising from normal business operations. In line with IAS 39, all derivatives are measured at fair value. The fair values of derivatives in the balance sheet are usually their market values. If market values are not readily available, the fair value may be determined using recognised pricing models and evidenced by bank confirmations. Changes in fair value are accounted for as described below.

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Other non-trading derivatives

When a derivative financial instrument is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in profit or loss.

Construction work in progress

Construction work in progress represents the gross unbilled amount expected to be collected from customers for contract work performed to date. It is measured at cost plus profit recognised to date (see "recognition of income and expense—construction contracts," below) less progress billings and recognised losses. Cost includes all expenditure related directly to specific projects.

Construction work in progress is presented as part of trade and other receivables in the balance sheet. If payments received from customers exceed the income recognised, then the difference is presented as advance payments received in the balance sheet.

Inventories

The inventories are recognised at acquisition or manufacturing costs or, if lower, their net realisable value. Raw materials, supplies and consumables as well as merchandise are measured at their adjusted average acquisition costs. The manufacturing costs of work in progress and finished goods are determined on the basis of directly attributable individual costs as well as a proportion of production-related overheads. The manufacturing costs do not include selling expenses, general and administrative expenses or financing costs. The net realisable value is the estimated selling price less the estimated cost of completion and the estimated costs necessary to make the sale. Provisions are made to recognise impairment of slow-moving inventories or to reduce to net realisable value.

Non-current assets held for sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. These assets are held at the lower of their carrying values and their fair value less costs to sell. These assets are not depreciated.

Provisions for pensions and similar defined benefit obligations

The provisions for defined benefit obligations are computed using the projected unit credit method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The value is obtained from an actuarial report.

Actuarial gains and losses are recognised outside profit or loss, in the period in which they occur, in accordance with IAS 19.93A-D. These are shown in the statement of comprehensive income.

In determining the discount interest rates in accordance with IAS 19.78, the actuaries refer to market yields on high quality corporate bonds at the balance sheet date.

Other non-current and current provisions

Other general liability provisions are recognised when a past event gives rise to a present obligation, it is probable that the obligation will be claimed and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date, or if the effect of the time value of money is material, the present value thereof. Reimbursement claims are recognised separately if it is virtually certain that reimbursement will be received if the Group settles the obligation.

Leases

For leasing agreements under which the Group is lessee, if the lease transfers substantially all the risks and rewards incidental to ownership of the asset (finance leases), then the assets are capitalised by the Group in accordance with IAS 17. Depreciation methods and useful lives are applied in line with similar owned assets. At the commencement of the lease term, finance leases are recognised as assets and liabilities in the balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset.

If the lease does not transfer substantially all the risks and rewards incidental to ownership of the asset, then the assets are capitalised by the lessor (operating leases). Leasing fees for operating leases are recognised in the income statement. If material, adjustments are made to straight-line leasing fees for agreements where payment schedules are different.

Recognition of income and expense

Sale of goods and services

Revenues are measured at the fair market value of the consideration received or to be received and represent the amounts that are to be obtained for goods and services in the normal course of business. The revenues are shown after subtracting sales deductions, discounts and value added taxes.

Revenues are recorded when the associated supplies and services have been rendered, the risks and rewards of ownership have transferred to the buyer and the receipt of the payment is probable.

Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue and expenses are recognised in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

Interest and other income

Interest income is accrued based on the loan outstanding and the applicable interest rate. The applicable interest rate is specified in the loan agreement and discounts the estimated future inflows of funds over the term of the financial asset to the net carrying value.

Other income is recognised in the period to which it relates, in accordance with the associated contract.

Other expenses

Other expenses are recognised on the basis of a direct link between the costs incurred and the related income in the income statement, either when the benefit is used or when the costs are caused.

Expenses for research and development

Research costs are expensed as they are incurred. Development costs are also expensed as they are incurred, unless they satisfy the criteria for recognition as internally generated intangible assets according to IAS 38.57.

Borrowing costs

Borrowing costs as defined in IAS 23 are capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset; the remaining borrowing costs are recognised as an expense in the period in which they are incurred.

Income taxes and deferred taxes

The income tax expense represents the sum of current tax expense and deferred tax expense.

The current tax expense is determined on the basis of the taxable income for the relevant year. The taxable income is different from the net income for the year shown in the income statement since it excludes expenses and income which will be tax deductible/taxable in other years or which will never be tax deductible or taxable. The liability of the group for current tax expense is computed on the basis of the valid tax rates or of tax rates which have been enacted by the balance sheet date.

Deferred taxes are the expected tax charge or relief arising from differences between the carrying values of assets and debts in the Group IFRS consolidated financial statements and their values in the tax accounts of the individual companies. The balance sheet oriented liability method is applied. In general, deferred tax liabilities are recorded for all taxable temporary differences, and deferred tax assets are recorded to the extent that it is probable that taxable profits will be available for which the deductible temporary differences can be used. Such assets and liabilities are not recognised if the temporary difference arises from (i) the initial recognition of goodwill or (ii) from the initial recognition of other assets and liabilities in a transaction that affects neither the accounting profit/(loss) nor taxable profit/(loss). In addition, deferred taxes are recognised for the carry forward of unused tax losses to the extent that it is probable that it will be possible to utilise them in the future.

The carrying amount of deferred tax assets is reviewed each year at the balance sheet date and is reduced if it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the balance sheet date.

The changes in deferred taxes are recognised in the income statement as tax income or expense unless they relate to items recognised directly under equity, i.e. without effect on income; in this case the deferred taxes are recognised in the associated equity position without effect on income.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised. If any are identified, they are disclosed in the notes unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised. They are disclosed in the notes, where an inflow of economic benefits is probable.

The use of estimates and assumptions

The preparation of the consolidated financial statements in compliance with the pronouncements of the IASB requires estimates to be made affecting the values recognised in the balance sheet, the nature and extent of contingent assets and liabilities identified at the reporting date and the value of income and expenses in the reporting period. The main assumptions and estimates for the Heckler & Koch Group concern the setting of useful lives, the recoverability of accounts receivable, the valuation of inventories, the recognition and measurement of provisions and the probability of future utilisation of deferred tax assets. Changes in estimates are recognised in the income statement prospectively.

Guarantee and warranty obligations can arise from legal or contractual requirements. Provisions are recognised for the expected cost of meeting claims under guarantee or warranty obligations. Claims are particularly likely if the warranty period has not yet expired, if warranty costs have been incurred in the past or if particular warranty claims are known. The evaluation of the risk of warranty claims is based on past experience and is used in determining the level of provision required.

Provisions for litigation risks are recognised if a company in the Heckler & Koch Group is a defendant and a judgement against the defendant is more likely than not. A provision is made for the amount likely to be incurred by the company if the judgement is against it. This figure includes the payments to be made by the company, in particular compensation, damages and settlements, as well as the expected legal expenses. If the company is the claimant, only litigation fees are provided for.

The use of estimates in other positions in the Group balance sheet and income statement are described in the accounting policies relating to the individual positions. In particular, these relate to: impairment of goodwill, impairment of non-current tangible and intangible assets, provisions for doubtful debts and the valuation of deferred tax assets and the pension provision.

Notes on the income statement

(6) Revenue

Net revenue increased by €33,756k to €234,748k compared with revenue of €200,992k in 2008 (restated).

The revenue of the Group was made up as follows:

	2009 restated	2008 restated
	EUR ’000	
Sale of goods	228,592	195,664
Sale of services	5,387	5,832
Construction contract revenue	1,699	—
Gross revenue	**235,678**	**201,496**
Discounts, bonuses, etc.	(931)	(505)
Net revenue	**234,748**	**200,992**

Construction contract revenue is determined by reference to the stage of completion.

Breakdown by customer location:

	2009 restated	2008 restated
	EUR ’000	
Domestic (Germany)	39,472	39,187
Foreign (rest of the world)	196,206	162,309
Gross revenue	**235,678**	**201,496**
Discounts, bonuses, etc.	(931)	(505)
Net revenue	**234,748**	**200,992**

(7) Cost of sales

The cost of sales increased by €20,382k to €153,563k compared with €133,181k cost of sales in 2008 (restated). The cost of sales includes materials and production labour and overhead expenses relating to the revenue. Within cost of sales are €1,699k (2008 restated: nil) expenses relating to construction contract revenue.

(8) Research and development expenses

Research and development expenses comprise those personnel expenses and depreciation relating to these activities, together with the costs of test materials and tools that do not meet the criteria for capitalisation under IAS 38 and the amortisation of capitalised development costs.

(9) Sales, marketing & distribution expenses

Sales, marketing & distribution expenses increased by €1,552k to €24,714k compared with €23,162k in 2008 (restated). The selling expenses mainly comprise personnel expenses, material and marketing costs as well as depreciation relating to the sales function.

(10) Administration expenses

General administration expenses include personnel expenses and office material costs as well as the depreciation relating to the administration function.

(11) Other operating income

	2009 restated	2008 restated

	EUR '000	
Release and utilisation of provisions	2,097	4,021
Income from the provision of administration services	1,307	1,338
Profit on disposal of non-current & held for sale assets	29	717
Licence fee income	1,080	512
Fuel sales to employees	1,111	1,155
Other	719	1,048
Total	**6,344**	**8,791**

The other operating income includes out-of-period income of €361k (2008 restated: €3,461k). This is due to income from the release of provisions and accruals €332k (2008 restated: €2,744k) and gains on disposals of non-current assets & assets reclassified as held-for-sale €29k (2008: €717k).

(12) Other operating expenses

	2009 restated	2008 restated
	EUR '000	
Impairment of assets held for sale	—	(903)
Create provision for doubtful debts & write off of bad debts	(133)	(332)
Loss on disposal of non-current assets	(339)	(165)
Other taxes	(209)	(179)
Creation of general liability provisions	(1,463)	(4,642)
Other	(3,987)	(3,468)
Total	**(6,132)**	**(9,688)**

The other operating expenses include out-of-period expenses of €583k (2008 restated: €1,399k). These are mainly due to the write-off of bad debts, credit-notes relating to prior years, losses on the disposal of non-current assets and, in prior year, impairment charges on assets held for sale.

(13) Analysis of expenses by nature, showing EBITDA

The income statement shows operating expenses analysed by function; the following table shows EBITDA and operating profit with expenses analysed by nature:

	2009 restated	2008 restated
	EUR '000	
Net sales	234,748	200,992
Material costs and movement in inventories	(113,524)	(93,993)
Capitalised costs	1,639	2,934
Other operating income	6,344	8,791
Payroll	(46,334)	(42,284)
Other operating expenses	(33,537)	(34,874)
EBITDA	**49,335**	**41,565**
Depreciation and amortisation	(9,927)	(10,781)
Results from operating activities	**39,408**	**30,784**

(14) Financial result

	2009 restated	2008 restated
	EUR '000	
Financial income		
Interest	1,233	2,796
Gains on valuation of derivative financial instruments	—	900
Gains on translation of foreign currencies	1,267	3,569
Other	—	—
Total financial income	**2,500**	**7,265**
Financial expenses		
Interest	(11,194)	(11,389)
Accretion of non-current liabilities	(3,923)	(3,579)

Losses on valuation of derivative financial instruments	(946)	—
Losses on translation of foreign currencies	(1,159)	(2,179)
Other	(462)	(289)
Total financial expense	**(17,684)**	**(17,435)**
Financial result	**(15,184)**	**(10,170)**

The interest income includes interest on short-term loans and on bank balances. The gains and losses on valuation of derivative financial instruments relate to forward cover contracts and options intended to reduce exposure to currency risk on expected USD cash-flows. The gains and losses on translation of foreign currencies include gains and losses on utilisation of forward cover contracts, in addition to translation differences for items not covered by such arrangements. The accretion of non-current liabilities relates to defined benefit provisions and the bond. Other financial expenses relate to guarantee costs.

(15) Income taxes

The income tax expense comprises:

	2009 restated	2008 restated
	EUR ’000	
Current tax income/(expense)	(9,533)	(7,931)
Deferred tax income/(expense)	2,263	(297)
Tax expense in income statement	**(7,270)**	**(8,229)**

Income taxes include German corporation tax (“Körperschaftsteuer”), trade income tax (“Gewerbesteuer”) and associated reunification surcharges (“Solidaritätszuschlag”) for the German company, together with similar income taxes for the foreign subsidiaries.

The company in Germany has a calculated statutory tax rate of 27.7% (2008: 27.7%). Foreign taxation is calculated at the rates valid in each country; these vary between 28% and 38% (2008 restated: between 28% and 37%).

Deferred taxes are calculated on the basis of statutory tax rates, or of tax rates which have been enacted as of the balance sheet date in each country, that are expected to be in place on realisation.

The following table shows a reconciliation of the expected tax using the current statutory tax rate for the parent company of 27.7% and the actual income tax shown for the Group:

	2009 restated	2008 restated
	EUR ’000	
Profit/(loss) before tax	24,224	20,614
Expected tax rate (current German statutory rate)	**27.7%**	**27.7%**
Expected tax expense	**(6,716)**	**(5,715)**
Adjustments to expected tax expense due to:		
– change in tax rates	(207)	(24)
– non-tax-deductible expenses	(1,183)	(989)
– utilisation of tax losses that had not been capitalised	—	—
– taxes relating to other periods	(13)	(1,416)
– differences in foreign tax rates	(76)	128
– change in valuation adjustments for tax losses c/f	—	(912)
– change in valuation adjustments for temporary diff.	(236)	227
– other effects	1,162	474
Actual tax expense	**(7,270)**	**(8,229)**
Effective tax rate	**30.0%**	**39.9%**

Deferred tax relates to the following positions:

Balance Sheet Item	Deferred tax assets 31.12.2009 restated	Deferred tax assets 31.12.2008 restated	Deferred tax assets 31.12.2007 restated	Deferred tax liabilities 31.12.2009	Deferred tax liabilities 31.12.2008 restated	Deferred tax liabilities 31.12.2007 restated
			EUR ’000			

Intangible non-current assets	—	—	—	11,191	10,989	10,588
Tangible non-current assets ..	8	10	—	4,969	5,609	6,354
Inventories	1,512	1,097	681	—	—	—
Trade accounts receivable.....	98	131	44	444	56	25
Other current assets..............	73	46	3	4,028	4,374	3,924
Employee defined benefit obligations........................	2,829	1,815	1,933	—	—	—
Other non-current provisions	1,563	645	627	—	—	—
Non-current financial liabilities	—	—	—	596	935	1,241
Other non-current liabilities..	251	58	95	—	—	—
Current provisions	43	—	3	—	—	—
Trade accounts payable.........	402	—	—	—	36	8
Other current financial liabilities	—	—	—	—	—	—
Other current liabilities	—	122	—	47	7	1
Carryforward of unused tax losses................................	—	83	1,018	—	—	—
Total	**6,779**	**4,008**	**4,403**	**21,275**	**22,006**	**22,141**

During 2009, an increase in deferred tax assets of €1,031k (2008: nil) was recognised directly in equity since it related to the actuarial gains on defined benefit schemes and an increase in deferred tax assets of €229k (2008: nil) was recognised directly in equity since it related to unrealised losses on effective hedging instruments. Apart from these, all other changes in deferred tax assets and liabilities were recognised in the income statement.

Potential deferred tax assets of €4,597k (2008 restated: €6,781k) relating to losses carried forward by our operations in the US have not been recognised. Valuation adjustments of €2,133k (2008: €0k) have been made against potential deferred tax assets relating to temporary differences arising in our operations in the US.

Notes on the balance sheet

(16) Intangible assets

	Development costs (self-generated)	Goodwill (acquired)	Trade marks Patents, licences, software (acquired) restated	Total restated
		EUR '000		
Net carrying value at 01.01.2008	**6,177**	**60,365**	**32,881**	**99,423**
Acquisition/manufacturing costs				
Balance at 01.01.2008	**8,611**	**80,384**	**46,525**	**135,519**
Effect of movement in exchange rates	—	—	75	75
Additions	2,853	—	126	2,979
Reclassifications	—	—	—	—
Disposals/retirements	—	—	(83)	(83)
Balance at 31.12.2008	**11,464**	**80,384**	**46,642**	**138,490**
Amortisation & depreciation				
Balance at 01.01.2008	**(2,434)**	**(20,019)**	**(13,644)**	**(36,096)**
Effect of movement in exchange rates	—	—	(60)	(60)
Amortisation for the year	(1,179)	—	(243)	(1,422)
Impairment	—	—	—	—
Reclassifications	—	—	—	—
Disposals/retirements	—	—	62	62
Balance at 31.12.2008	**(3,614)**	**(20,019)**	**(13,884)**	**(37,517)**
Net carrying value at 31.12.2008	**7,850**	**60,365**	**32,758**	**100,973**
Acquisition/manufacturing costs				
Balance at 01.01.2009	**11,464**	**80,384**	**46,642**	**138,490**
Effect of movement in exchange rates	—	—	(18)	(18)
Additions	2,676	—	337	3,013
Reclassifications	—	—	—	—
Disposals/retirements	(1,133)	—	(920)	(2,053)
Balance at 31.12.2009	**13,007**	**80,384**	**46,042**	**139,432**
Amortisation & depreciation				
Balance at 01.01.2009	**(3,614)**	**(20,019)**	**(13,884)**	**(37,517)**
Effect of movement in exchange rates	—	—	10	10
Amortisation for the year	(1,032)	—	(259)	(1,291)
Impairment	—	—	—	—
Reclassifications	—	—	—	—
Disposals/retirements	—	—	920	920
Balance at 31.12.2009	**(4,646)**	**(20,019)**	**(13,213)**	**(37,878)**
Net carrying value at 31.12.2009	**8,361**	**60,365**	**32,828**	**101,554**

As described in Note 5, goodwill and other intangible assets with indefinite lives are subject to annual impairment testing. Goodwill is allocated to the individual companies within the Group, which represent the segments and are the lowest level within the Group at which goodwill is monitored for internal management purposes.

As shown above, aggregate goodwill is held at €60,365k (unchanged from the previous year). This is the net book value at which it was held under German GAAP at the date of transition to IFRS (January 1, 2006). Originally, the parent company of the Group was called Heckler & Koch Wehrtechnik Holding GmbH. This company acquired the design, manufacturing and distribution company, Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003 and in 2004 the two companies were merged and renamed Heckler & Koch GmbH. As a result, the Group has goodwill of €59,232k allocated to its merged parent company. The balance of €1,133k is allocated to Heckler & Koch France SAS since this relates to its acquisition in 2004.

NSAF Ltd was acquired for less than its equity and the negative goodwill arising from this transaction is included in the Group's retained earnings. The US subsidiaries Small Arms Group Holding Inc. and Heckler & Koch Defense Inc. were founded by the Group and have no goodwill allocated to them. The acquisition of the US subsidiaries Suhler USA, Inc. and Heckler & Koch, Inc. was a transaction under common control and the Group's figures have been restated as if this transaction took place prior to the beginning of the earliest period shown; consequently the difference between the price paid and the net assets acquired has been offset against equity rather than being shown as goodwill.

Goodwill relates to the value of the companies in operation and is therefore treated as being of indefinite life. On the acquisition of Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003, the trademark was also recognised as an intangible asset. The Group's reputation is associated with this trademark so that, like goodwill it is also treated as being of indefinite life.

Since the Group is privately owned, and similar companies have not been bought or sold regularly during the past year, it was not possible to base impairment tests on market value. Impairment tests were therefore based on value in use determined by discounting future cash flows projected based on actual operating results and the first five years of the annual ten year business plans.

The amortisation and impairment of intangible assets is included in the following income statement positions:

	2009 restated	2008 restated
	EUR '000	
Cost of sales	54	37
Research and development	1,046	1,180
Sales, marketing & distribution	22	25
Administration	169	180
Other expense	—	—
Total amortisation	**1,291**	**1,422**

As at December 31, 2009 the Group had a balance of €41k (2008: €100k) on order for intangible assets.

(17) Property, plant and equipment

	Land and buildings restated	Plant and machinery restated	Fixtures, fittings and other assets restated	Assets under construction	Total restated
			EUR '000		
Net carrying value at 01.01.2008	**27,752**	**19,060**	**8,008**	**1,480**	**56,300**
Acquisition/manufacturing costs					
Balance at 01.01.2008	**44,386**	**57,945**	**38,609**	**1,480**	**142,420**
Effect of movement in exchange rates	11	46	(84)	—	(27)
Additions	172	4,663	3,464	695	8,994
Reclassifications	(2,568)	939	239	(1,480)	(2,870)
Disposals	(339)	(1,540)	(1,224)	—	(3,104)
Balance at 31.12.2008	**41,661**	**62,053**	**41,004**	**695**	**145,414**
Amortisation & depreciation					
Balance at 01.01.2008	**(16,634)**	**(38,885)**	**(30,601)**	**—**	**(86,120)**
Effect of movement in exchange rates	65	(5)	69	—	129
Depreciation for the year	(1,061)	(4,362)	(3,034)	—	(8,456)
Impairment	(903)	—	—	—	(903)
Reclassifications	2,270	—	—	—	2,270
Disposals	152	1,501	1,260	—	2,912
Balance at 31.12.2008	**(16,111)**	**(41,751)**	**(32,306)**	**—**	**(90,168)**
Net carrying value at 31.12.2008	**25,550**	**20,303**	**8,698**	**695**	**55,246**
Acquisition/manufacturing costs					
Balance at 01.01.2009	**41,661**	**62,053**	**41,004**	**695**	**145,414**
Effect of movement in exchange rates	(57)	(29)	4	—	(81)
Additions	2,074	3,773	2,159	138	8,143
Reclassifications	51	551	93	(695)	—
Disposals	(23)	(1,929)	(3,161)	—	(5,114)
Balance at 31.12.2009	**43,706**	**64,419**	**40,100**	**138**	**148,362**

Amortisation & depreciation					
Balance at 01.01.2009	**(16,111)**	**(41,751)**	**(32,306)**	**—**	**(90,168)**
Effect of movement in exchange rates	(5)	6	(5)	—	(5)
Depreciation for the year	(1,083)	(4,745)	(2,808)	—	(8,636)
Impairment	—	—	—	—	—
Reclassifications	—	(1)	1	—	—
Disposals	17	1,929	2,720	—	4,666
Balance at 31.12.2009	**(17,183)**	**(44,561)**	**(32,399)**	**—**	**(94,143)**
Net carrying value at 31.12.2009	**26,523**	**19,857**	**7,701**	**138**	**54,219**

During 2009 there were no reclassifications of assets from property, plant and equipment to held for sale.

During 2008, a small manufacturing site with a carrying value of €1,503k, which was no longer required following transfer of the production activities to the main site, was written down to its fair value (less costs to sell) of €600k and reclassified as "held for sale." This impairment charge of €903k relates to the segment "site location Germany" and is included in "other operating expenses" in the income statement. This site was sold in the fourth quarter of 2008.

The fixtures, fittings and other assets include net carrying values of €79k (2008: €212k) for certain assets acquired on finance leases, in particular computer servers. See Note 25 for details of the lease obligations and the reconciliation between the total minimum lease payments at the balance sheet date and their present values.

As at December 31, 2009 the Group had a balance of €655k (2008: €2,602k) on order for tangible non-current assets (excluding amounts shown in the above table under assets in course of construction).

(18) Investments in equity accounted investees, other non-current investments and current loans, investments and derivatives

The Group held a €13k investment in a dormant joint venture that was consolidated at equity in 2008 and was liquidated in 2009. A loss of €1k on liquidation was recognised in other expenses in 2009 (2008 restated: nil).

The other non-current investments relate to the remaining balance not yet due on long-term loans. The 2007 and 2008 balances include a €2,500k loan to a related party that was repaid in 2009. Due to the retrospective inclusion of SUI and HKI in the HKO consolidated statements for 2007 and 2008, loan receivables from a related party are now included (2008 restated: €7,154k, 2007 restated: €3,646k). These receivables were repaid prior to the Group's legal acquisition of SUI and HKI in 2009.

The Group shows certain securities within other loans, investments and derivatives (2009: €612k, 2008: €545k). This investment is required by German law and these securities are pledged in full to secure claims relating to the German company's early retirement scheme "Altersteilzeit."

The Group has made short-term loans totalling, with interest, €4,912k (2008: €4,982k) to its indirect shareholder Heckler & Koch Beteiligungs GmbH; security for such loans has been provided by the ultimate shareholder of the Group through a mortgage. The mortgaged asset was assessed by an independent valuer at a value in excess of the amount secured.

The Group only has derivative financial instruments relating to forward exchange and option contracts for USD/EUR, unless hedge accounting applies, these are held at fair value through profit or loss (2009: €239k, 2008: €900k).

(19) Inventories and pre-payments for inventories

	31.12.2009 restated	31.12.2008 restated	31.12.2007 restated
		EUR '000	
Raw materials, consumables and supplies	19,937	21,577	17,146
Work in progress	29,891	31,547	30,267
Finished goods and merchandise	21,978	18,560	16,082
Total	**71,806**	**71,684**	**63,495**

Under inventories, provisions of €10,496k (2008 restated: €8,574k, 2007 restated: €7,154k) have been made to account for marketability risks and slow-moving items. These provisions reduce certain items of inventory to carrying values in line with their fair values less costs to sell of €14,127k (2008 restated: €13,078k). Impairment losses of €124k (2008: €462k) recorded in prior years have been reversed following increases in net realisable value due to the reassessment of saleability of certain items and the disposal of other items at higher values than their carrying values. A write-down of inventories of €2,078k (2008 restated: €1,973k) was recognised as an expense.

Pre-payments for inventories include amounts relating to advances paid for construction contracts (PoC) (€2,686k, 2008: nil).

(20) Trade and other receivables

	31.12.2009	31.12.2008 restated	31.12.2007 restated
		EUR '000	
Trade accounts receivable	39,625	59,605	41,293
Receivables from directors and employees	1,020	282	204
Other receivables	1,267	1,508	5,449
Total	**41,911**	**61,395**	**46,945**

The carrying values of trade accounts receivable and other receivables correspond to their fair market values. Trade accounts receivable include amounts due from the parent and indirect parent of the Group and are not interest-bearing; they usually have due dates between 30 and 90 days. These receivables also include amounts relating to construction contract revenue (€1,529k, 2008: nil).

The receivables from directors and employees include a loan to a director and the associated interest (€322k, 2008: nil), and foreign taxes for employees with multiple locations. The other receivables are mainly for VAT & similar tax claims against various countries arisen in the normal course of business.

If there is an indication that a receivable may be impaired, at the latest if becomes over 180 days overdue, the possibility of impairment is reviewed by the finance, sales and legal departments. Provisions of €958k (2008 restated: €1,043k, 2007 restated: €1,318k) have been made for individual doubtful debt risks within trade accounts receivable. The provision for doubtful trade accounts receivable has had the following movements during the reporting period:

	2009	2008 restated
	EUR '000	
Opening balance January 1st	1,043	1,318
Creations	123	234
Release/utilisation	(195)	(530)
Effects of foreign currency conversion	(12)	21
Closing balance December 31st	**958**	**1,043**

All expenses from impairment (or income from reversal of impairment) of trade receivables is shown under other operating expenses (or income).

(20) Trade and other receivables

The aging of financial instruments that are trade accounts receivable is as follows:

	31.12.2009	31.12.2008 restated
	EUR ’000	
Not overdue:	**29,994**	**44,122**
Overdue:		
– within 30 days	5,241	9,625
– between 30 and 60 days	2,067	2,280
– between 60 and 90 days	60	1,458
– between 90 and 180 days	551	1,511
– after more than 180 days	1,713	608
Total:	**9,631**	**15,482**
Net trade accounts receivable	**39,625**	**59,605**

As at the balance sheet date, no evidence had been identified to suggest that any of the accounts receivable that were neither overdue nor impaired were doubtful.

(21) Cash and cash equivalents

The position cash and cash equivalents includes cash balances, cheques, bank balances on current accounts and short-term deposits, the original term of which is less than three months. These are valued at nominal value.

(22) Shareholders’ equity

The following reconciliation of movement in capital and reserves shows the changes in the individual items of equity in the Group:

	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Hedging Reserve	Consolidated Retained Earnings	Shareholders’ Equity
As of 31.12.2007	**25**	**79,695**	**1,671**	**3,662**	**—**	**(17,771)**	**67,282**
Restatement for common control acquisition	—	—	—	—	—	(4,097)	(4,097)
As of 31.12.2007, restated	**25**	**79,695**	**1,671**	**3,662**	**—**	**(21,868)**	**63,185**
Total recognised income & expense	—	—	(2,192)	0	—	12,385	10,194
As of 31.12.2008, restated	**25**	**79,695**	**(521)**	**3,662**	**—**	**(9,482)**	**73,379**
Total recognised income & expense	—	—	690	(2,688)	(598)	16,954	14,358
Reclass additional paid in capital	—	(66,000)	—	—	—	66,000	—
Dividends declared	—	—	—	—	—	(10,150)	(10,150)
As of 31.12.2009, restated	**25**	**13,695**	**169**	**974**	**(598)**	**63,322**	**77,587**

The subscribed capital shown is the nominal capital of the parent company Heckler & Koch GmbH. The nominal capital of Heckler & Koch GmbH of €25k is fully paid up. Since this is a German limited company (“GmbH”), the subscribed capital is not divided into shares.

The additional paid in capital arises from additional capital contributions from the shareholders; in 2009 €66 million was reclassified to consolidated retained earnings (2008: nil).

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

The reserve for defined benefit obligations comprises the cumulative actuarial gains and losses arising on the employee defined benefit obligation provisions, net of tax. The net decrease is due to actuarial losses of €3,719k (2008: €0k) net of €1,031k (2008: €0k) deferred taxes

The hedging reserve comprises the cumulative gains and losses arising on the recognition of fair value movements on effective hedging instruments as defined by IAS 39. In 2009 there was a loss of €828k (2008: nil) net of €229k (2008: nil) deferred taxes

The consolidated retained earnings include a reduction of €5,327k arising from the effects of the transition to IFRS on January 1, 2006 and a reduction of €4,097k in 2007 (restated) arising from the difference between acquisition price and net assets for the common control transaction acquisition of Suhler USA, Inc. and Heckler & Koch, Inc. that took place in April 2009 but has been shown in these restated accounts as having taken place prior to the beginning of 2008.

Under the German limited liability companies act (GmbHG), the distributable dividend is determined by the retained earnings in the annual financial statements of Heckler & Koch GmbH drawn up in accordance with the German commercial code (HGB). In the financial year 2009, Heckler & Koch GmbH declared an interim dividend of €10,150k (2008: nil); this liability was offset against a €7,600k claim assignment and the net liability is recognised in trade and other payables. In Q1 2010 an additional dividend of €3,700k was declared and distributed for the financial year 2009.

The executive board of the parent company Heckler & Koch GmbH will propose to the shareholders meeting that no further dividends be distributed for the financial year 2009.

(23) Provisions for pensions and similar employee defined benefit obligations

The pension schemes at the foreign companies are defined contribution plans, while the German parent company has both defined benefit and defined contribution plans, although the defined benefit schemes for employees were closed to new entrants in 2002.

Under the **Defined Contribution Plans** the company pays contributions to state or private pension schemes on the basis of statutory or contractual obligations or on a voluntary basis. Having paid the contributions, the company has no further obligations. The current contribution payments are shown as pension expense for the relevant year: they amounted to a total of €3,241k (2008 restated: €3,042k) for the Group.

The **Defined Benefit Plans** are accounted for in the Group by setting up provisions for pensions, retirement and death benefits determined by the Projected Unit Credit Method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The value is obtained from an actuarial report calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck’s 2005 G guideline tables).

The main assumptions are:

Measurement at	**31.12.2009**	**31.12.2008**
Discount rate	5.00%	6.00%
Increase in entitlement of active pension expectants	0.00%	0.00%
Future pension increase p.a.	1.75%	2.00%

Under the defined benefit schemes, on reaching the retirement age of 65, employees are entitled to benefits based on their length of service. The defined benefit schemes in operation before 1995 entitle members to benefits for the first ten years’ service of 8% of the average monthly salary for the final year, plus 0.25% for each additional year of service. Together with the state pension, the company pension entitlement may not exceed 75% of the employee’s average monthly salary for the final year. Increases are no longer possible since these schemes are closed and members’ entitlements remain fixed.

Under the defined benefit scheme from January 1, 1995, members are entitled to benefits of a fixed sum per year of service depending on the member’s grade. The relevant grade for active members is the grade on retirement. This scheme was closed to new entrants on November 30, 2002.

Senior employees are also covered by the above schemes, although some have individual pension agreements within their contracts.

The following amounts are recorded in the income statement with regard to defined benefit plans:

	2009	**2008**
	EUR ’000	
Current service costs	277	281
Interest expense	2,700	2,475

Less expected return on scheme assets	(24)	(15)
Total net expense	**2,953**	**2,741**

The current service costs are shown within other expenses and the annual interest expense is shown within the interest result. Actuarial gains and losses are not recognised in the income statement but are shown in the statement of comprehensive income and taken to reserves.

The changes in the present value of the gross unfunded and funded defined benefit obligations are as follows:

	2009	2008
	EUR '000	
Present value of obligations as at Jan. 1st	**44,998**	**44,995**
Current service costs	277	281
Interest expense	2,700	2,475
Pension payments/utilisation	(2,766)	(2,725)
Actuarial (gains)/losses	3,688	(27)
Present value of obligations as at Dec. 31st	**48,897**	**44,998**

The changes in the present value of the funded plan assets are as follows:

	2009	2008
	EUR '000	
Fair market value of plan assets as at 01.01.	**433**	**276**
Expected return on scheme assets	24	15
Contributions	—	170
Actuarial gains/(losses)	(31)	(27)
Fair market value of plan assets as at 31.12.	**426**	**433**

The amount shown in the balance sheet for the Group's obligation is derived as follows:

	31.12.2009	31.12.2008	31.12.2007	31.12.2006
	EUR '000			
Present value of obligations covered by funds and not covered by funds	**48,897**	**44,998**	**44,995**	**50,538**
Less fair market value of plan assets	(426)	(433)	(276)	(118)
Present value of net obligations	48,470	44,565	44,719	50,420
Actuarial losses not yet recognised	—	—	—	—
Net liability in the balance sheet	**48,470**	**44,565**	**44,719**	**50,420**

The fair market value of the plan assets relates to asset values from reinsurance policies. The actual earnings from the plan assets are €7k loss (2008: €12k loss). No contributions are expected to be made in 2010.

(24) Other current and non-current general liability provisions

The current and non-current general liability provisions are as follows:

	31.12.2009	31.12.2008	31.12.2007
	EUR '000		
Current provisions & accruals	3,956	5,647	3,368
Non-current provisions	12,432	11,002	10,598
Total	**16,388**	**16,649**	**13,966**

(24) Other current and non-current general liability provisions

The provisions comprise:

	Personnel obligations	Warranty obligations	Obligations relating to sales	Other risks	Total
			EUR '000		
Balance at 01.01.2009	**5,480**	**1,558**	**9,551**	**60**	**16,649**
Exchange rate difference	(72)	—	(242)	—	(314)
Utilisation	(626)	(1,016)	(941)	(23)	(2,606)
Release	(37)	(27)	(247)	(20)	(331)
Creation	255	1,044	1,445	245	2,990
Balance at 31.12.2009	**5,000**	**1,559**	**9,566**	**262**	**16,388**

A provision for the German early retirement scheme ("Altersteilzeit") is included in the personnel obligations. This provision takes account of the additional costs to the company during the early retirement phase, partially offset by the reduced pay taken by employees in this scheme during the working phase. The value is based on the associated contractual obligations and is obtained from an actuarial report, calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2005 G guideline tables), discounted at 5.5%.

The personnel obligations also include provisions for long-service anniversary benefits and similar obligations, together with the introduction of a new grading system ("ERA") in Germany under which employees have not received their full pay rises as, since certain conditions have been fulfilled, these are being used to offset increased payroll costs under this agreement. These personnel provisions are determined based on the associated contractual obligations.

The provisions for warranties were recognised on the basis of past experience with regard to the Group liability for a warranty period of two years.

Provisions relating to sales include provisions for offset obligations, late delivery penalties, costs to complete and price-audits on certain projects. These provisions have been recognised in line with the probability of their incidence, based on the associated contractual obligations and the current status.

The other provisions relate to litigation risks and site decontamination costs, recognised in line with the probability of their incidence. The outcome of the litigation depends on the associated legal proceedings.

The effects of accretion and changes in discount rates were immaterial for the level of general liability provisions recognised in 2009 and 2008.

(25) Current and non-current financial liabilities

The Group does not have any bank overdrafts or loans. The Group's main financial liability is the €120 million high yield bond issued by the parent company in 2004 with a fixed interest rate of 9.25% and a maturity date of July 2011. This is recognised in the balance sheet at its amortised cost of €117,851k (2008: €116,627k), with associated accrued interest payable of €5,118k (2008: €5,118k) held within trade and other payables.

As security for Heckler & Koch GmbH's liabilities under the Bond Indenture, the subsidiaries of Heckler & Koch GmbH have entered into Supplementary Indentures and Abstract Acknowledgements of Indebtedness and have provided Subsidiary Guarantees. Heckler & Koch GmbH has also issued a €30 million Note Proceeds Loan to its US subsidiary Heckler & Koch Defense Inc. and has granted a security interest in its rights under this to the Bank of New York as trustee under the Indenture. In addition, HK Holding, Inc., the sole owner of Heckler & Koch GmbH, has granted first ranking pledges over all present and future shares in Heckler & Koch GmbH as security for the obligations under the Indenture.

Due to the restatement of 2008 and 2007 to include Suhler USA, Inc. and Heckler & Koch, Inc., the non-current iabilities include a loan of €3,418k in 2008 restated (2007 restated: €3,167k) held by Heckler & Koch, Inc. and repaid prior to its acquisition by the Group in 2009. This loan was secured over Heckler & Koch, Inc.'s accounts receivable and inventories.

The credit facilities for the Heckler & Koch Group are only for the issue of advance payment or performance guarantees, including bid bonds. The value of guarantees currently outstanding is not recognised in the balance sheet. As of December 31, 2009 we had a total of €18.9 million such guarantees outstanding, compared to €16.9 million as of December 31, 2008. As a requirement for the provision and maintenance of these and other forward-cover and guarantee lines, our guarantee-providers require us to maintain a varying level of deposits with them as security. As at December 31, 2009 we had €18.7 million such security deposits (2008 restated: €17.7 million); these pledged security deposits are included in cash and cash equivalents.

As mentioned in Note 17, the Group has acquired certain assets on finance leases, in particular computer servers. The finance lease liabilities are payable as follows:

	Future minimum lease payments 2009	Interest 2009	Present value of minimum lease payments 2009	Future minimum lease payments 2008	Interest 2008	Present value of minimum lease payments 2008
			EUR ’000			
Less than one year	87	2	86	147	8	139
Between one and five years	—	—	—	87	2	86
More than five years	—	—	—	—	—	—
Total finance lease liabilities	**87**	**2**	**86**	**234**	**10**	**224**

(26) Trade and other payables

Trade and other payables include outstanding liabilities from trade and operating costs, together with interest payable on the bond. Of these, €167k (2008: nil, 2007 restated: €13m) are shown within non-current liabilities since they are not due within twelve months; the €13m in the restated 2007 statement of financial position is the pro forma liability for the pro forma acquisition of Suhler USA, Inc. and Heckler & Koch, Inc. which did not actually take place until April 2009.

	31.12.2009	31.12.2008 restated	31.12.2007 restated
		EUR ’000	
Trade payables	19,155	25,282	35,143
Interest payable	5,118	5,118	5,118
Other payables	9,315	18,451	5,425
Total	**33,588**	**48,852**	**45,686**

The carrying value of the trade payables corresponds approximately to their fair market value.

With the exception of normal trading ownership retention clauses, the trade and other payables are not secured.

(27) Advanced and stage payments received

Advanced and stage payments received comprise payments received from customers in advance of the delivery of the associated products or services. The advance and stage payments include amounts relating to advances for construction contracts (€1,480k, 2008: nil).

Other disclosures

(28) Financial risk management

Currency risk

The Group is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Group entities, primarily the euro (EUR), but also US dollars (USD) and Sterling (GBP). The majority of both our costs and our sales are in euro, so we only have foreign exchange transaction exposure for those sales in currencies different to the associated costs. In the past, because our exposure to foreign currency translation risk was relatively small and timing of foreign currency income was relatively uncertain, the Group had a policy of only hedging foreign currency exposure in circumstances when large contracts are won. Due to the increased US business during 2009, the Group now also hedges a proportion of its expected USD income. In Q4 2009 we acquired

EUR/USD hedges whereby during 2010 $12m can be exchanged into EUR at a rate of $1.45. If, however, the rate is below this level, we do not have to exercise these options.

Group policy is not to speculate with loans or deposits in foreign currencies. Financing and investing within the Group usually take place in the appropriate functional currency and any financial instruments are purely for operating purposes.

Five small subsidiaries of Heckler & Koch GmbH are outside the Euro zone. Since the Heckler & Koch Group reporting currency is the euro, the income and expenses of these subsidiaries are converted to euro for consolidation. Changes in average foreign exchange conversion rates compared with prior periods can therefore have an effect on the consolidated results.

In addition, through these subsidiaries the Group has assets and liabilities in local currencies outside the Euro zone. The conversion of these positions to euro is also affected by fluctuations in foreign exchange conversion rates. The change in valuation of these positions is reflected in the Group reserves. The rates used for the consolidation are shown in the following table:

Currency	**Abbr.**	**Rate on balance sheet date 31.12.2009**	**Rate on balance sheet date 31.12.2008**	**Rate on balance sheet date 31.12.2007**	**Average exchange rate 2009**	**Average exchange rate 2008**
US Dollar (USA)	**USD**	1.4406	1.3917	1.4721	1.3947	1.4713
Pound (United Kingdom)........................	**GBP**	0.8881	0.9525	0.7346	0.8919	0.7962

In order to quantify the possible effects of foreign exchange rate fluctuations on the Group EBITDA, sales and equity, a sensitivity analysis has been carried out:

If the US dollar had been 10% weaker against the euro compared to the rates used for the 2009 consolidation, (i.e. had been an average of € 1 = $1.5342 and a spot of €1 = $1.5847), then 2009 sales would have been approximately €4.1 million lower, EBITDA would have been approximately €0.1 million higher and equity and reserves would have been approximately €0.6 million higher.

If the pound sterling had been 10% weaker against the euro compared to the rates used for the 2009 consolidation, (i.e. had been an average of € 1 = £0.9811 and a spot of €1 = £0.9769), then 2009 sales would have been approximately €5.9 million lower, EBITDA would have been approximately €0.1 million higher and equity and reserves would have been approximately €0.6 million lower.

Interest risk

Interest rate risk arises mainly through the financing of long-lived assets with floating rate debt, or conversely from financing short-lived assets, primarily inventories and accounts receivable with fixed rate debt. At present, given the fact that we continue to invest in mostly long-lived assets and that our only outstanding senior debt is the fixed rate Notes, we believe we have low exposure to interest rate risk until the maturity of these Notes.

The advance payment and performance guarantees we procure from banks for our customers do not require us to pay interest.

Commodity risk

Because our purchases of commodities in terms of quantities purchased are relatively small, our exposure to commodity risk is limited.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counter-party to a financial instrument fails to meet its contractual obligations, and arises principally from the Group's receivables from customers.

Trade accounts receivable

Because the vast majority of our customers are federal, state or local governmental agencies of NATO countries, our exposure to credit risk is limited. However the recent worldwide financial and economic crisis and the consequent increased sovereign budget deficits are likely to put long-term pressure on defence budgets in many of the countries we deliver to, leading to increased credit risk for certain customers. The credit ratings for some countries have been reduced, but the Group's exposure to credit risk with such countries is limited.

Our goods are sold subject to retention of title clauses so that in the event of non-payment the Group may have a secured claim and, where management is of the opinion that the risk is higher, we require letters of credit or prepayments. The Group has internal credit management processes to review and manage overdue positions and if necessary stop further deliveries or initiate legal action.

In addition, provisions are held for doubtful debts. The maximum risk is the value shown as trade accounts receivable in the balance sheet. The book values of trade accounts receivable analysed according to their aging, together with the associated provisions, are shown in Note 20.

Some of our customers limit their exposure to risks relating to our production of products through advance payment guarantees and performance guarantees.

Cash and cash equivalents

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. The Heckler & Koch Group is exposed to credit risks if the banks holding our deposits default on their obligations. To minimise this risk, the banks are selected with care and the majority of the deposits are with a German bank which is partially owned by the State of Baden-Württemberg and participates in a deposit security reserve.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The Group's approach to managing liquidity is to ensure, as far as is possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation. At present the Group does not have any credit lines set up other than for the issue of advance payment or performance guarantees, however we believe that the current cash position is more than sufficient to meet liquidity requirements until the maturity of the Notes in 2011. The Group is currently discussing refinancing options with various parties and expects to be able to refinance by July 2011.

The Heckler & Koch Group mainly generates cash through its operating activities and this is primarily used to finance capital expenditure and working capital. In 2004 additional financing was obtained through the issue of fixed rate Notes, the proceeds of which were mainly used to (1) repay shareholder loans, and (2) partially finance the purchase of management shares. The bond was also intended to (3) prefund an expansion in the US, however the anticipated contract was not awarded so that the capital expenditure was not required, leaving a significant cash balance.

The following table shows the timing of contractual payments due for financial instruments that are accounts payable, capital leases, loan interest, loan repayments or derivatives.

	Trade payables	Derivative financial liabilities	Other	Total
		EUR '000		
Balance at 31.12.2009				
Book value	19,155	828	123,460	143,443
Related payments	19,155	828	142,692	162,674
Payments due:				
– within one month	14,763	55	5,744	20,562
– between one and three months	3,894	130	24	4,048
– between three & twelve months	499	496	5,656	6,651
– between one and five years	—	146	131,267	131,413
– after more than five years	—	—	—	—

Variances between book value and related payments arise where certain non-current liabilities, in particular the bond, are held at their amortised costs. Additional information on financial liabilities is given in Note 25.

Capital management

The policy of the Executive Directors is to maintain strong capital base, to ensure investor, creditor and market confidence is sustained and to facilitate the future development of the business. To achieve this policy, a major objective of the Executive Directors is to maintain a strong credit rating and healthy capital ratios.

The Group aims to have a simple corporate and capital structure and does not have any off balance sheet financing. Performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf in the normal course of business (see Note 25).

The Group issued one simple debt instrument (High Yield Bond) that imposes certain restrictions on activities outside of the Group's core business and the Group's internal policies require that return on capital is monitored on all investments and large contract bid decisions.

Dividends to shareholders are restricted under the terms of the Bond; together with certain other transactions, they are classed as "Restricted Payments." The cumulative total of such payments, less any such investments that have been repaid, is limited to 50% of the "Cumulative Adjusted Net Income" since July 2004. In addition, such payments may not be made unless the "Consolidated Fixed Charge Coverage Ratio" for the four full fiscal quarters for which financial statements are available immediately preceding the planned payment, taken as one period, is greater than 2.5 to 1.0.

The Bond matures in 2011. The Bond was originally issued partly to finance the construction of a manufacturing facility in the United States in anticipation of a large contract award. As the contract was not awarded, the factory was not built and the cash was not used for this purpose and remained on the balance sheet in the form of bank deposits. Due to the differential between interest received on these deposits and interest paid on the Bond the company had planned on calling the Bond before maturity, using the cash on the balance sheet and a smaller financial instrument until the recent financial crisis made this more difficult than originally anticipated. The Group is currently discussing refinancing options with various parties and expects to be able to refinance by July 2011.

Neither the company nor any of its subsidiaries are subject to externally imposed capital requirements.

The Group's capital structure is as follows:

	2009 restated	2008 restated	2007 restated
		EUR '000	
Equity	**77,587**	**73,379**	**63,185**
as a percentage of total financing	23%	22%	20%
Long-term liabilities	200,196	197,842	209,516
Short-term liabilities	63,680	69,568	46,512
Debt	**263,876**	**267,409**	**256,028**
as a percentage of total financing	77%	78%	80%
Total equity & liabilities	**341,463**	**340,788**	**319,213**

(29) Additional disclosures on financial instruments

This note provides an overview of the significance of financial instruments and provides additional information on the balance sheet positions containing financial instruments.

The following table shows the book values (BV) and fair values (FV) of the financial assets:

	Cash and equivalents		Trade accounts receivable		Securities		Derivative financial instruments		Other financial instruments	
	BV	FV	BV	FV	BV	FV	BV	FV	BV	FV
						EUR '000				
Balance at 31.12.2009										
Cash & equivalents	52,133	52,133	—	—	—	—	—	—	—	—
Loans & receivables	—	—	39,625	39,625	—	—	—	—	5,534	5,534
Held to maturity	—	—	—	—	612	612	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—
Held at fair value through profit or loss	—	—	—	—	—	—	239	239	—	—
Total financial assets	**52,133**	**52,133**	**39,625**	**39,625**	**612**	**612**	**239**	**239**	**5,534**	**5,534**
Balance at 31.12.2008 (restated)										
Cash & equivalents	29,762	29,762	—	—	—	—	—	—	—	—
Loans & receivables	—	—	59,605	59,605	—	—	—	—	16,090	16,090
Held to maturity	—	—	—	—	545	545	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—

Held at fair value through profit or loss	—	—	—	—	—	—	900	900	—	—
Total financial assets (restated)	**29,762**	**29,762**	**59,605**	**59,605**	**545**	**545**	**900**	**900**	**16,090**	**16,090**
Balance at 31.12.2007 (restated)	—	—	—	—	—	—	—	—	—	—
Cash & equivalents	38,205	38,205	—	—	—	—	—	—	—	—
Loans & receivables	—	—	41,293	41,293	—	—	—	—	7,008	7,008
Held to maturity	—	—	—	—	482	482	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—
Held at fair value through profit or loss	—	—	—	—	—	—	—	—	—	—
Total financial assets (restated)	**38,205**	**38,205**	**41,293**	**41,293**	**482**	**482**	**—**	**—**	**7,008**	**7,008**

The fair values of loans and accounts receivable is believed to be equal to the book values. This is mainly due to the short terms of these instruments. The fair values of any financial instruments held to maturity are their values in an active market (see table showing fair value hierarchy, below).

The following table shows the book values (BV) and fair values (FV) of non-derivative financial liabilities:

	Trade payables		**Other financial liabilities**	
	BV	**FV**	**BV**	**FV**
		EUR '000		
Balance at 31.12.2009				
Held at cost	19,155	19,155	5,524	5,524
Held at amortised cost	—	—	117,936	124,086
Non-derivative financial liabilities	**19,155**	**19,155**	**123,460**	**129,610**
Balance at 31.12.2008 (restated)				
Held at cost	25,282	25,282	8,569	8,569
Held at amortised cost	—	—	116,852	120,224
Non-derivative financial liabilities (restated)	**25,282**	**25,282**	**125,420**	**128,793**
Balance at 31.12.2007 (restated)				
Held at cost	35,143	35,143	8,683	8,683
Held at amortised cost	—	—	115,891	115,368
Non-derivative financial liabilities (restated)	**35,143**	**35,143**	**124,574**	**124,051**

During 2009 the company entered into a cash flow forward cover hedging arrangement for a large purchase contract with USD cash flows during 2009-2011. The derivative is recognised at its fair value as determined by the partner bank (€828k liability, 2008: nil). The derivative is a perfect hedge since it enables the payments to match the related income in EUR, so changes in fair value are recognised in other comprehensive income (€828k expense, 2008: nil).

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

31.12.2009	**Level 1**	**Level 2**	**Level 3**
		EUR '000	
Derivative financial assets	—	239	—
Derivative financial liabilities	—	828	—

31.12.2008	**Level 1**	**Level 2**	**Level 3**
		EUR '000	

Derivative financial assets	—	900	—
Derivative financial liabilities	—	—	—

Net income/(expenses) due to financial instruments:

	2009	2008 restated
	EUR '000	
Financial assets held for sale	—	—
Financial assets held to maturity	3	17
Loans and receivables and financial liabilities held at cost	8	1,450
Derivatives	(946)	900

The net income/(expense) from financial assets held to maturity arises from interest received from investments in securities relating to the German early retirement scheme. The net income/(expense) from loans and receivables and financial liabilities held at cost include exchange gains and losses, impairments and reversals of previous impairments. The net income/(expense) from derivative financial instruments relates to the reversal (2008: recognition) of the unrealised profit on valuation of forward contracts to hedge USD cash flows, together with losses on valuation of options to hedge USD cash flows in 2010 (2008: nil).

The total interest income and expenses relating to financial assets and liabilities not held at fair value through profit and loss are as follows:

	2009 restated	2008 restated
	EUR '000	
Interest income (exc. for financial assets held to maturity)	1,230	2,779
Accretion of non-current liabilities	(3,923)	(3,579)
Other interest expenses	(11,655)	(11,678)

(30) Cash flow statement

The Group cash flow shows the cash inflows and outflows leading to the change in cash and cash equivalents during the year. Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. As required by IAS 7, cash flows are analysed between operating, investing and financing activities.

Cash flows from investing and financing activities are determined directly while those from operating activities are calculated indirectly from the net results. The changes in balance sheet positions used in the indirect calculation are adjusted to exclude the effects of foreign exchange rate variances and changes in the companies consolidated into the Group. The changes in the balance sheet positions shown in the cash flow are therefore different to the euro changes in the Group balance sheet.

Interest received is classified as a cash flow due to investing activities. Interest paid and payments relating to finance leases are shown as cash flows due to financing activities.

(31) Segment reporting

The Heckler & Koch Group is organised around five (prior to the acquisition of HKI: four) operating companies, four of which serve defence and law enforcement sectors, whilst the fifth (HKI) serves US civil and local law enforcement sectors. Correspondingly, the segments analysed are the site locations in Germany, Great Britain, France and the United States, with the US split further into Civil and Defense. Since these companies are separate legal entities, the figures shown for each segment are the values for the individual companies as included in the Group's consolidated figures.

The activities in reporting segment Site Location Germany relate to the design, manufacture and distribution of defence and security products together with the provision of associated services. The site located in Germany mainly supplies to Group companies and to NATO members and allies in which no Group subsidiaries are located. The Site Location Germany also has construction contract revenue, see Note 6.

The newly acquired reporting segment "USA—civil" has sales and distribution activities for civil and security products and provides related services in the US. The other reporting segments all have sales and distribution activities for defence and security products and provide related services. The sites located in the USA and France supply to these countries. The site located in Great Britain sells primarily to the United Kingdom, the British Commonwealth of Nations and also to certain other NATO allies.

(31) Segment reporting (Continued)

Operating segments

Site Location	Germany Restated		USA—Civil Restated		USA—Defense Restated		Great Britain		France		Total pre-consolidation Restated		Consolidation transactions Restated		Total Restated	
	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008	2009	2008
									EUR '000							
Net external revenues	115,519	114,830	20,690	17,509	24,099	11,339	64,351	51,314	10,088	6,000	234,748	200,992	—	—	234,748	200,992
Inter-segment revenue	68,136	48,051	165	118	562	167	945	1,081	—	—	69,808	49,417	(69,808)	(49,417)	—	—
Depreciation and amortisation	(9,351)	(9,265)	(242)	(269)	(221)	(230)	(112)	(118)	(10)	(6)	(9,937)	(9,889)	10	10	(9,927)	(9,878)
Interest income	1,519	2,973	195	472	7	8	4	103	27	7	1,753	3,563	(520)	(767)	1,233	2,796
Interest expense	(15,504)	(14,984)	(74)	(270)	(519)	(767)	—	(0)	—	—	(16,096)	(16,021)	518	765	(15,579)	(15,257)
Share of profit of associates (at equity)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Tax on income	(4,972)	(6,774)	(638)	27	(4)	(4)	(1,720)	(1,611)	(210)	(199)	(7,544)	(8,561)	274	332	(7,270)	(8,229)
Profit / (loss) after tax	18,633	12,514	1,100	(53)	(1,092)	(2,328)	4,366	4,013	401	386	23,407	14,532	(6,453)	(2,146)	16,954	12,385
Other material non-cash items																
—Impairment of assets	(500)	(4,233)	(108)	(348)	(585)	(239)	(4)	(132)	(12)	(0)	(1,208)	(4,952)	—	2,178	(1,208)	(2,774)
—Impairment losses reversed	26	688	—	33	—	—	124	132	—	—	150	853	—	—	150	853
Reportable segment assets	324,405	315,598	16,540	24,012	17,665	12,792	19,634	18,218	2,495	3,808	380,739	374,428	(39,276)	(33,640)	341,463	340,788
Investments in associates	—	13	—	—	—	—	—	—	—	—	—	13	—	—	—	13
Capital Expenditure (Capex)	(8,306)	(8,807)	—	(96)	(81)	(107)	(79)	(82)	(14)	(29)	(8,480)	(9,120)	—	—	(8,480)	(9,120)
Reportable segment liabilities	245,970	242,361	6,410	14,629	34,820	29,455	13,189	12,097	1,821	2,034	302,210	300,576	(38,335)	(33,167)	263,876	267,409

Site Location	Germany Restated		USA—Civil Restated		USA—Defense Restated		Great Britain		France		Total pre-consolidation Restated		Consolidation transactions Restated		Total Restated	
	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008	2007
									EUR '000							
Reportable segment assets	315,598	299,200	24,012	16,336	12,792	12,939	18,218	20,787	3,808	2,920	374,428	352,183	(33,640)	(32,970)	340,788	319,213
Investments in associates	13	13	—	—	—	—	—	—	—	—	13	13	—	—	13	13
Reportable segment liabilities	242,361	238,477	14,629	7,412	29,455	26,365	12,097	13,113	2,034	1,533	300,576	286,899	(33,167)	(30,871)	267,409	256,028

The above table shows the revenues and results together with the assets and liabilities of the individual Group segments. With the exception of sales from Germany to the other segments, trading between the different segments is only slight. The trade relationships between segments have been consolidated. Trade between the segments is conducted at 'arm's-length' prices, as would have been agreed with informed and willing parties outside the Group.

(31) Segment reporting

Geographical and product group segments

The value of sales made to customers in different regions of the world and the proportions of sales due to the different product groups are shown in the following tables:

		Sales	
		EUR ’000	%
Germany	2009	39,413	17%
	2008	39,170	19%
USA	2009	46,968	20%
	2008	30,811	15%
UK	2009	61,775	26%
	2008	41,070	20%
Rest of the world	2009	86,593	37%
	2008	89,941	45%
Total	2009	234,748	100%
	2008	200,992	100%
Outside Germany	2009	195,335	83%
	2008	161,822	81%

		Sales
Rifles	2009	30%
	2008	27%
Sub-machine guns & machine guns	2009	18%
	2008	25%
Pistols	2009	20%
	2008	20%
Development services	2009	1%
	2008	2%
Other products & services	2009	31%
	2008	26%
Total	2009	100%
	2008	100%

Major customers

IFRS requires customers known to be under common control to be treated as one customer. Since the Group sells to the government agencies including the law enforcement agencies and armed forces in various countries, this requirement leads to all governmental agencies in a country being treated as one single joint customer.

On this basis the Group’s major customers, to whom individually more than 10% of sales were made in 2009, are the UK governmental agencies (2009: €61m; 2008: €40m), shown within the segment Site Location Great Britain and the US federal and state agencies (2009: €27m; 2008 restated: €14m) shown mainly within the segment Site Location USA—Defense with the balance in the segment Site Location USA—Civil.

(32) Contingent liabilities and pledged assets

There are no material contingent liabilities as of December 31, 2009 or December 31, 2008. For details of pledged assets, see Notes 18 and 25.

(33) Operating leases

Our expenses include €674k (2008 restated: €606k) due to rental and €234k (2008 restated: €282k) due to other operating leases.

As at the balance sheet date, the group had outstanding obligations arising from binding operating leases that fall due as follows:

EUR ’000	31.12.2009	31.12.2008
Up to one year	323	424
More than one and up to five years	935	1,060
More than five years	249	444
Total	**1,507**	**1,928**

(34) Full-time equivalent number of employees

The workforce in the Heckler & Koch Group, as an annual average of full-time equivalents (“FTE”), was as follows:

	2009	2008 restated

Manufacturing	449	427
Research & Development	74	69
Sales & Distribution	71	68
Administration	83	89
Total FTE employees excluding apprentices	**677**	**653**
Apprentices	35	31
Total FTE employees including apprentices	**711**	**684**

(35) Personnel expenses

Personnel expenses in the reporting year came to €46,334k (2008 restated: €42,284k). Of these expenses, €3,241k (2008 restated: €3,042k) relate to employer's contributions to social security funds and similar defined contribution plans for pensions.

(36) Related party disclosures

Parent and ultimate controlling party

The Group is owned by HK Holding, Inc. which is a wholly-owned subsidiary of Heckler & Koch Beteiligungs GmbH, the ultimate parent company.

Other related party transactions

Transactions between the parent company and related parties that are its subsidiaries were eliminated in the course of consolidation and are not described in these disclosures in the Notes. Transactions with current and former members of the executive board are covered in Notes 38 and 39 respectively.

In addition, there are arm's-length business relationships between Group companies and related parties as defined by IAS 36, as follows:

- Management fees are recharged from Heckler & Koch Beteiligungs GmbH, "HKB," the indirect parent of the Group. In accordance with the Bond Indenture, these are restricted to €300k pa. At the end of the year, the Group held a net receivable of €840k from (2008: owed a net €37k to) HKB; this related to the net management fee recharges together with the administration fees and rental advances described below, and to certain licence fees for the Group.

- In 2009 the Group entered into an agreement to rent an office in London from its indirect parent company, Heckler & Koch Beteiligungs GmbH (at £212k pa). The rental for the initial term to Feb. 2010 was paid in advance and the pre-paid element is included in the net receivable above.

- The Group provides administrative services to its indirect parent company, Heckler & Koch Beteiligungs GmbH (€24k pa) and to Prochemie GmbH, formerly HK Sidearms Holding GmbH, (€18k pa) and, up until its merger with HKB in May 2009, to Suhler Jagd- & Sportwaffen Holding GmbH (€18k pa), companies partly owned by one of the ultimate shareholders of the Group.

- As in the past, the Group holds short-term loans to its indirect parent, Heckler & Koch Beteiligungs GmbH, "HKB." As a result of these activities, the Group recognised interest of €470k (2008: €876k). This company owed the Group €4,912k (2008: €4,982k) relating to loans and associated interest.

- During 2007 and 2008, HKB, the Group's ultimate parent acquired various items of antique arms and armour at auction. In 2009, these were sold to the Group to be displayed in the new training centre/museum being constructed at the manufacturing site in Germany. The items were valued by independent assessors and sold to the Group below cost (due to exchange losses) as an arm's- length transaction. The Group now holds these in plant, property and equipment at their purchase price of €379k.

- During 2009 the Group recognised €153k (2008: nil) in interest on €7,446k (2008: nil) Restricted Payments (as defined in the Bond Indenture) made to the ultimate shareholder of the Group. These restricted payments and the interest thereon were sold to HK Holding, Inc., "HKH," the direct parent of the Group and offset against the €10,150k dividend declared. The Group recognised a net payable of €2,335k (2008: receivable of €23k) against HKH relating to these transactions and to other amounts recharged for taxes, tax advice and audits.

- The Group also sells parts and assemblies to (€20,170k, 2008 restated: €16,520k), and purchases goods from (€25,470k, 2008 restated: €22,220k), HK Sidearms GmbH, a company owned by Prochemie GmbH (formerly HK Sidearms Holding GmbH). In addition, the Group provides infrastructure and administration services to (€1,257k, 2008: €1,254k) and receives licensing fees (€408k, 2008: €388k) from this company. At the end of the year this company owed the Group €3,528k (2008: €8,165k) and the Group owed this company €6,224k (2008 restated: €9,897k, 2007 restated: €4,148k) relating to these transactions.

- HK Sidearms GmbH carries on activities related to what used to be the civil business of Heckler & Koch GmbH. When the civil and military businesses were separated in 2003, a long-term loan was made to this company, secured on the inventory which it acquired simultaneously from Heckler & Koch GmbH. The Group received interest income of €24k (2008: €139k) relating to this loan. During the second quarter of 2009, this loan was repaid in full, so that the balance remaining for the loan is nil (2008: €2,500k).

- During 2008, the Group made a payment of €1,300k to Suhler Jagd- & Sportwaffen Holding GmbH relating to the re-acquisition of Heckler & Koch, Inc., the US civil market sales and distribution company for our products. During the second quarter of 2009 the transaction was completed and the balance of €11,700k was paid. The €13 million purchase price for the two US companies acquired was based on a valuation from an independent, internationally recognised appraisal firm and is shown proforma as a liability (2008 restated: €11.7m, 2007 restated: €13m) in these statements.

- Since the Group has restated the figures as if Heckler & Koch, Inc. and its holding company Suhler USA, Inc. had been acquired prior to the start of the earliest period presented, transactions between these two companies and the Group's related parties are also included in these disclosures. Prior to being acquired in April 2009, Heckler & Koch, Inc. made a loan to its then indirect parent Suhler Jagd- & Sportwaffen Holding GmbH. As a result of these activities, the Group shows interest of €193k in 2009 (2008 restated: €472k). This loan was repaid as part of the acquisition transaction so this company owed the Group nil as of December 31, 2009 (2008 restated: €7,154k, 2007 restated: €3,646k) relating to this loan.

(37) Governing bodies of the Group

Executive Board	
Martin Newton	Chief Executive Officer (until 02.09.2009)
Peter Beyerle	Director
Niels Ihloff	Director (from 20.05.2009)
Martin Lemperle	Director (from 20.05.2009)
Supervisory Board ("Beirat")	
Hans-Henning Offen	Chairman (until 31.07.2009, then resigned)
Andreas Heeschen	Chairman (from 01.08.2009)
Martin Newton	Vice Chairman (from 03.09.2009)
Keith Halsey	

(38) Remuneration of the executive and supervisory boards

The remuneration of the executive board in the financial year 2009 totalled €3,332k (2008: €1,022k) and includes a termination bonus of €1,511k (2008: nil).

During 2009 a short-term secured loan was granted to a new director as part of his relocation package. As at December 31, 2009 the company recognised a receivable of €322k relating to this loan and the interest thereon.

The supervisory board was not remunerated for the financial year 2009 (2008: €25k).

(39) Provisions for pensions and remuneration for former members of the executive board

Provisions of €10,571k (2008: €9,845k) have been set up for pension obligations to former members of the executive board, the executive boards of merged companies and their surviving dependants. The total pension payments and other remuneration paid to former members of the executive board, including payments to former members of executive boards of merged companies, amounted to €951k in 2009 (2008: €1,170k).

(40) Auditor's remuneration

	2009	2008
	EUR '000	
Audit of the financial statements	146	223
Other confirmation services	1	1
Tax services	206	104
Other services	11	9
Total	**364**	**338**

(41) Reconciliation of restatement adjustments

During the second quarter of the year, two additional US subsidiaries were acquired from an affiliated group (the US civilian distribution company "HKI" and its parent "SUI"). Since both Groups have always been under common control, we have exercised the option of restating our current and prior year figures as if this transaction had taken place at the end of 2007.

The restatement has resulted in the SUI/HKI consolidated balance sheet being added to that of the HKO Group as at December 31, 2007, with internal accounts payable/receivable consolidated out. The HKO investment made in April 2009 has been shown as if it were made in December 2007, with this amount being held as a payable until 2009; the difference between this consideration and the net equity of SUI/HKI at December 31, 2007 has been offset against Group equity (a reduction of €4,097k in 2007).

From January 1, 2008 onwards, the income statements for the SUI/HKI Group have been added to those of the HKO Group, with internal transactions (sales, cost of sales, other income/expense) consolidated out. Similarly, the cash flow statements of the two Groups have been added, with internal payments consolidated out.

The following statements show the effect of this restatement on each line.

Consolidated income statement for the year to December 31

	Original 2009	Adjust's 2009	Restated 2009	Original 2008	Adjust's 2008	Restated 2008
			EUR '000			
Revenue	224,640	10,107	234,748	185,678	15,313	200,992
Cost of sales	(147,099)	(6,464)	(153,563)	(121,646)	(11,535)	(133,181)
Gross profit	**77,541**	**3,644**	**81,185**	**64,032**	**3,778**	**67,810**
Research & development	(3,051)		(3,051)	(2,087)		(2,087)
Sales, marketing & distribution	(24,152)	(562)	(24,714)	(21,217)	(1,945)	(23,162)
Administration	(13,702)	(522)	(14,224)	(9,179)	(1,701)	(10,880)
Other operating income	6,658	(315)	6,344	9,036	(246)	8,791
Other operating expenses	(6,035)	(97)	(6,132)	(8,991)	(697)	(9,688)
Results from operating activities	**37,259**	**2,148**	**39,408**	**31,594**	**(810)**	**30,784**
Financial income	2,337	163	2,500	6,767	498	7,265
Financial expense	(17,616)	(68)	(17,684)	(17,159)	(277)	(17,435)
Net financial result	**(15,279)**	**95**	**(15,184)**	**(10,391)**	**222**	**(10,170)**
Profit before income tax	**21,980**	**2,243**	**24,224**	**21,203**	**(589)**	**20,614**
Income tax expense	(6,429)	(841)	(7,270)	(8,434)	205	(8,229)
Profit for the period	**15,551**	**1,402**	**16,954**	**12,769**	**(383)**	**12,385**
Attributable to the shareholders of Heckler & Koch GmbH	**15,551**	**1,402**	**16,954**	**12,769**	**(383)**	**12,385**

Earnings per share	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**

Consolidated statement of comprehensive income for the year to December 31

	Original 2009	**Adjust's 2009**	**Restated 2009**	**Original 2008**	**Adjust's 2008**	**Restated 2008**
			EUR '000			
Forex translation differences for foreign operations	244	447	690	(2,704)	513	(2,192)
Hedging gains/(losses)	(828)		(828)			
DBO actuarial gains/(losses)	(3,719)		(3,719)	0		0
Deferred tax	1,260		1,260	(0)		(0)
Income & expense recognised directly in equity	**(3,042)**	**447**	**(2,596)**	**(2,704)**	**513**	**(2,192)**
Profit for the period	**15,551**	**1,402**	**16,954**	**12,769**	**(383)**	**12,385**
Total comprehensive income for the period	**12,509**	**1,849**	**14,358**	**10,065**	**129**	**10,194**
Attributable to the shareholders of Heckler & Koch GmbH	12,509	1,849	14,358	10,065	129	10,194

Consolidated statement of financial position as at

	Original 31.12.09	**Adjust's 31.12.09**	**Restated 31.12.09**	**Original 31.12.08**	**Adjust's 31.12.08**	**Restated 31.12.08**	**Original 31.12.07**	**Adjust's 31.12.07**	**Restated 31.12.07**
					EUR '000				
Assets									
Property, plant & equipment	54,219		54,219	53,279	1,967	55,246	54,228	2,072	56,300
Intangible assets—goodwill	60,365		60,365	60,365		60,365	60,365		60,365
Intangible assets—other	41,190		41,190	40,548	60	40,608	38,960	98	39,058
Investments in equity accounted investees				13		13	13		13
Other investments	1		1	2,501	7,154	9,654	2,501	3,646	6,147
Deferred tax assets	6,752	27	6,779	3,053	955	4,008	3,799	605	4,404
Total non-current assets	**162,526**	**27**	**162,553**	**159,758**	**10,136**	**169,894**	**159,865**	**6,421**	**166,286**
Inventories	71,884	(78)	71,806	62,122	9,561	71,684	56,233	7,262	63,495
Prepayments for inventories	5,843		5,843	859		859	1,024		1,024
Prepayments for other current assets	1,234		1,234	510		510	806		806
Other loans, investments & derivatives	5,762		5,762	7,727	(1,300)	6,427	482		482
Current tax assets	220		220	7	251	258	1,735	53	1,788
Trade and other receivables	41,911		41,911	59,827	1,568	61,395	45,559	1,387	46,945
Cash & cash equivalents	52,133		52,133	29,737	25	29,762	37,886	320	38,205
Assets classified as "held for sale"							180		180
Total current assets	**178,988**	**(78)**	**178,910**	**160,789**	**10,106**	**170,895**	**143,905**	**9,021**	**152,927**
Total assets	**341,514**	**(51)**	**341,463**	**320,546**	**20,242**	**340,788**	**303,770**	**15,443**	**319,213**
Equity									
Share capital	25		25	25		25	25		25
Share premium	13,695		13,695	79,695		79,695	79,695		79,695
Reserves	63,918	(51)	63,867	(2,374)	(3,968)	(6,341)	(12,438)	(4,097)	(16,535)
Total equity	**77,638**	**(51)**	**77,587**	**77,346**	**(3,968)**	**73,379**	**67,282**	**(4,097)**	**63,185**
Liabilities									
Loans & borrowings due to third parties	117,851		117,851	116,627	3,418	120,045	115,523	3,167	118,690
Finance lease obligations				224		224	368		368
Derivatives									
Employee defined benefit obligations	48,470		48,470	44,565		44,565	44,719		44,719
Provisions	12,432		12,432	11,002		11,002	10,598		10,598
Trade and other payables	167		167					13,000	13,000
Deferred tax liabilities	21,275		21,275	21,932	73	22,006	22,133	8	22,141
Total non-current liabilities	**200,196**		**200,196**	**194,351**	**3,491**	**197,842**	**193,341**	**16,174**	**209,516**
Trade and other payables	33,422		33,422	28,186	20,665	48,852	29,321	3,365	32,686
Advanced & stage payments received	16,224		16,224	10,497	53	10,550	9,712	0	9,713
Deferred income	292		292	90		90	287		287
Finance lease obligations	86		86						
Derivatives	828		828						
Current income tax payable	8,874		8,874	4,428		4,428	459		459
Provisions & accruals	3,956		3,956	5,647		5,647	3,368		3,368
Total current liabilities	**63,680**		**63,680**	**48,849**	**20,718**	**69,568**	**43,147**	**3,365**	**46,512**

Total liabilities	**263,876**		**263,876**	**243,200**	**24,209**	**267,409**	**236,488**	**19,539**	**256,028**
Total equity & liabilities	**341,514**	**(51)**	**341,463**	**320,546**	**20,242**	**340,788**	**303,770**	**15,443**	**319,213**

Consolidated statement of cash flows for the year to December 31

	Original 2009	Adjust's 2009	Restated 2009	Original 2008	Adjust's 2008	Restated 2008
			EUR '000			
Cash flows from operating activities						
Profit for the period	15,551	1,402	16,954	12,769	(383)	12,385
Adjustments for:						
Depreciation	8,554	82	8,636	8,208	248	8,456
Amortisation of intangible assets	1,286	5	1,291	1,400	22	1,422
Retirement losses on intangible assets	1,133		1,133			
Impairment losses on assets classified as "held for sale"				903		903
Net interest expense	14,488	(144)	14,343	12,660	(201)	12,459
Gain/loss on disposal of property, plant & equipment	310		310	(633)	81	(552)
Gain/loss on disposal of investments	1		1			
Income tax expense	6,429	841	7,270	8,434	(205)	8,229
	47,751	2,187	49,938	43,741	(440)	43,301
Change in inventories	(2,204)	1,537	(667)	(6,021)	(1,751)	(7,772)
Change in trade & other receivables	24,569	(2,802)	21,767	(17,180)	26	(17,154)
Change in prepayments	(5,691)		(5,691)	312		312
Change in trade & other payables	3,112	(3,168)	(56)	154	5,048	5,202
Change in provisions & employees' benefits	(2,824)		(2,824)	197		197
	64,713	(2,246)	62,467	21,202	2,883	24,086
Income tax paid	(5,138)	31	(5,107)	(2,024)	(225)	(2,250)
Net cash from/(used in) operating activities	59,575	(2,215)	57,361	19,178	2,658	21,836
Cash flows from investing activities						
Interest received	772	204	976	2,325	472	2,796
Proceeds from sale of property, plant & equipment	138		138	75		75
Proceeds from sale of assets held for sale				1,470		1,470
Proceeds from sale of investments	292		292	271		271
Acq'n of property, plant, equipment & intangibles	(8,480)		(8,480)	(9,024)	(96)	(9,120)
Net investment in loans	(5,494)	7,548	2,054	(4,982)	(3,124)	(8,106)
Acquisition of other investments	(10,430)	(1,886)	(12,316)	(1,633)		(1,633)
Capitalised development expenditure	(2,676)		(2,676)	(2,853)		(2,853)
Net cash from/(used in) investing activities	(25,878)	5,866	(20,012)	(14,352)	(2,748)	(17,101)
Cash flows from financing activities						
Proceeds from utilisation of US credit line	(73)	1,336	1,264		2,492	2,492
Repayment of borrowings from US credit line	268	(4,942)	(4,674)		(2,428)	(2,428)
Interest paid	(11,594)	(60)	(11,654)	(11,405)	(270)	(11,676)
Payment of finance lease liabilities	(139)		(139)	(146)		(146)
Net cash from/(used in) financing activities	(11,538)	(3,666)	(15,204)	(11,552)	(206)	(11,757)
Net inc./(dec.) in cash & cash equivalents	22,159	(14)	22,145	(6,726)	(296)	(7,022)
Cash & cash equivalents at 1st January	29,737	25	29,762	37,886	320	38,205
Effect of exchange rate fluctuations on cash held	237	(11)	227	(1,423)	2	(1,422)
Cash & cash equivalents at end of period	52,134	(0)	52,134	29,737	25	29,762

(42) Subsequent events

In March 2010 a complaint was made to the German Federal Cartel Office ("Bundeskartellamt"), by a company now managed by a former Director of Heckler and Koch GmbH. The complaint alleged that the Group had attempted to hinder the ability of the company in question to trade. Following the complaint a search was carried out at the offices of Heckler and Koch GmbH to try and uncover evidence to support this allegation. Heckler and Koch GmbH refutes the allegation completely and is cooperating with the German Federal Cartel Office in order to to clear up the accusation quickly and completely.

Oberndorf/Neckar, April 30, 2010

The Executive Board

Peter Beyerle   Niels Ihloff   Martin Lemperle

AUDITOR'S REPORT

We have audited the consolidated financial statements prepared by Heckler & Koch Beteiligungs GmbH, Oberndorf/Neckar, comprising the balance sheet, the income statement, statement of comprehensive income, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2010. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs as adopted by the EU, and the additional requirements of German commercial law pursuant to § 315a Abs. 1 HGB (and supplementary provisions of the shareholder agreement/ articles of incorporation) are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit. In addition we have been instructed to express an opinion as to whether the consolidated financial statements comply with full IFRS.

With the exception of the audit constraints presented in the following paragraph, we have carried out our audit in accordance with § 317 HGB and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (Institute of Public Auditors in Germany) (IDW). Those standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the group management report. We believe that our audit, with the exception of the following paragraph, provides a reasonable basis for our opinion.

With the exception of the following qualification, our audit has not led to any reservation: as at the balance sheet date, unsecured receivables from loans to shareholders exist in the amount of EUR 8.764. The recoverability of these receivables could not be sufficiently assessed, as the shareholders are private individuals whose asset and financial position cannot be entirely represented using authoritative audit evidence. It can therefore not be excluded that the financial statements are erroneous in this respect.

With this qualification, based on the findings of our audit, the consolidated financial statements comply with IFRSs as adopted by the EU, the additional requirements of German commercial law pursuant to section 315a (1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. With this qualification, group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Without qualifying this opinion we refer to the comments in the group management report. The section "7. Circumstances impairing the continued existence" points out that the ability of the parent company and therefore of the whole group to act as a Going Concern is endangered if

- the immediate repayment of the PIK loan is required, in the event that the covenants of the loan agreement were not and will not be adhered to;

- the dividend payments and payments from shareholders that have been reflected within the parent company liquidity schedule could not be realized;

- the repayment of the "PIK-Loans" in April 2013 will not succeed through a refinancing by shareholders or third parties.

Stuttgart, April 26, 2011

KPMG AG
Wirtschaftsprüfungsgesellschaft (Audit firm)

Dr. Kursatz	Feller
Wirtschaftsprüfer	Wirtschaftsprüfer
(Auditor)	(Auditor)

Heckler & Koch Beteiligungs GmbH

Oberndorf/Neckar

Consolidated Statements

According to IFRS

for the Financial Year

2010

CONSOLIDATED STATEMENT OF FINANCIAL POSITION

AS OF

	Note	31.12.10	31.12.09
		EUR '000	
Assets			
Property, plant & equipment	17	53,321	55,574
Intangible assets—goodwill	16	5,149	5,149
Intangible assets—other	16	18,930	17,723
Other investments	18	0	1
Deferred tax assets	15	11,095	6,779
Total non-current assets		**88,495**	**85,225**
Inventories	19	73,184	71,806
Prepayments for inventories		3,727	5,843
Prepayments for other current assets		2,070	1,525
Other loans, investments & derivatives	18,36	9,959	37,394
Current tax assets		828	222
Trade and other receivables	20,36	50,180	41,887
Cash & cash equivalents	21	55,893	52,502
Total current assets		**195,842**	**211,178**
Total assets		**284,337**	**296,403**
Equity			
Share capital		80	80
of which treasury stock		(44)	(44)
		36	36
Additional paid in capital		9,920	9,920
Reserves		(161,152)	(136,620)
Total equity	22	**(151,196)**	**(126,664)**
Liabilities			
Loans & borrowings due to third parties	25	282,321	266,923
Employee defined benefit obligations	23	52,594	48,470
Provisions	24	13,493	12,432
Trade and other payables	26	111	167
Deferred tax liabilities	15	21,288	21,790
Total non-current liabilities		**369,807**	**349,783**
Bank overdraft		0	952
Trade and other payables	26,36	41,035	37,555
Advanced & stage payments received		9,275	16,224
Deferred income		92	296
Finance lease obligations	25	0	86
Derivatives	29	40	828
Current income tax payable		7,761	12,139
Provisions & accruals	24	7,522	5,206
Total current liabilities		**65,725**	**73,285**
Total liabilities		**435,532**	**423,068**
Total equity & liabilities		**284,337**	**296,403**

CONSOLIDATED INCOME STATEMENT

FOR THE PERIOD JANUARY 1 TO DECEMBER 31

	Note	2010	2009
		EUR '000	
Revenue	6	247,244	234,748
Cost of sales	7	(144,067)	(153,563)
Gross profit		**103,178**	**81,185**
Research & development	8	(4,112)	(3,051)
Sales, marketing & distribution	9	(31,752)	(24,714)
Administration	10	(25,892)	(21,319)
Other operating income	11	7,930	8,509
Other operating expenses	12	(7,257)	(6,174)
Results from operating activities	13	**42,094**	**34,437**
Financial income		11,309	6,630
Financial expense		(66,222)	(39,089)
Net financial result	14	**(54,913)**	**(32,459)**
Profit before income tax		**(12,819)**	**1,978**
Income tax expense	15	(9,214)	(10,983)
Profit for the period		**(22,033)**	**(9,005)**
Attributable to the shareholders of Heckler & Koch Beteiligungs GmbH		**(22,033)**	**(9,005)**
Earnings per share	22	**N/A**	**N/A**

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

FOR THE PERIOD JANUARY 1 TO DECEMBER 31

	Note	2010	2009
		EUR ’000	
Forex translation differences for foreign operations		(398)	700
Hedging gains / (losses)	22	788	(828)
DBO actuarial gains / (losses)	22	(3,694)	(3,719)
Deferred tax	22	806	1,260
Other comprehensive income		**(2,498)**	**(2,586)**
Profit for the period		**(22,033)**	**(9,005)**
Total comprehensive income for the period		**(24,532)**	**(11,591)**
Attributable to the shareholders of Heckler & Koch Beteiligungs GmbH		**(24,532)**	**(11,591)**

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

FOR THE PERIOD DECEMBER 31, 2008 TO DECEMBER 31, 2010

	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Hedging Reserve	Consolidated Retained Earnings	Shareholders' Equity
				EUR '000			
As of 31.12.2008.............	36	9,920	(527)	3,662	—	(128,164)	(115,074)
Total recognised income & expense........	—	—	700	(2,688)	(598)	(9,005)	(11,591)
As of 31.12.2009.............	36	9,920	173	974	(598)	(137,169)	(126,664)
Total recognised income & expense........	—	—	(398)	(2,670)	569	(22,033)	(24,532)
As of 31.12.2010.............	36	9,920	(225)	(1,695)	(29)	(159,203)	(151,196)

CONSOLIDATED STATEMENT OF CASH FLOWS

FOR THE PERIOD JANUARY 1 TO DECEMBER 31

	Ziffer	2010	2009
		TEUR	
Cash flows from operating activities			
Profit for the period		(22,033)	(9,005)
Adjustments for:			
Depreciation		9,108	8,800
Amortisation of intangible assets	16	1,289	1,295
Retirement losses on intangible assets		1,229	1,133
Write-down/(write-back) of investments		31,737	5,742
Net interest expense	14	25,541	25,678
(Gain)/loss on disposal of property, plant & equipment		1,476	310
(Gain)/loss on disposal of investments	14	0	1
Income tax expense	15	9,214	10,983
		57,560	44,936
Change in inventories		129	(667)
Change in trade & other receivables		(213)	25,275
Change in prepayments		1,628	(5,738)
Change in trade & other payables		(7,361)	(4,779)
Change in provisions & employees' benefits	23,24	1,670	(1,696)
		53,414	57,332
Income tax paid		(18,416)	(5,236)
Net cash from/(used in) operating activities		**34,997**	**52,096**
Cash flows from investing activities			
Interest received		504	1,422
Proceeds from sale of property, plant & equipment		248	138
Proceeds from sale of investments	18	302	292
Acq'n of property, plant, equipment & intangibles	16,17	(8,646)	(8,112)
Net investment in loans	18,36	716	(6,210)
Acquisition of subsidiaries & other investments	18,36	(6,710)	(616)
Capitalised development expenditure	16	(3,388)	(2,676)
Net cash from/(used in) investing activities		**(16,974)**	**(15,762)**
Cash flows from financing activities			
Proceeds from utilisation of US/PIK credit lines	25	16,751	17,759
Repayment of US credit line and other loans	25	(2,978)	(4,674)
Interest paid		(28,887)	(27,239)
Payment of finance lease liabilities	25	(88)	(139)
Net cash from/(used in) financing activities		**(15,201)**	**(14,294)**
Net inc./(dec.) in cash & cash equivalents		**2,822**	**22,040**
Cash & cash equivalents at 1st January		52,502	30,260
Effect of exchange rate fluctuations on cash held		574	226
Other valuation adjustments to cash held		(5)	(25)
Cash & cash equivalents at 31st December	21	**55,893**	**52,502**

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR 2010

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NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR 2010

General disclosures

(1) Presentation of the consolidated financial statements

Heckler & Koch Beteiligungs GmbH, the parent company of the Group, is registered under HRB 481226 at the Stuttgart district court. The company's registered office is in Oberndorf/Neckar, Germany, and the postal address is Heckler & Koch Beteiligungs GmbH, Heckler & Koch-Str. 1, 78727 Oberndorf/Neckar, Germany. The articles of incorporation are from July 2, 2009 and the registered name of the company is Heckler & Koch Beteiligungs GmbH. The financial year is the calendar year.

The object of Heckler & Koch Beteiligungs GmbH is to invest in any way in other German and foreign companies, to acquire other German and foreign companies, in particular to invest in and acquire Heckler & Koch GmbH, Oberndorf/N., to hold, manage and sell companies and investments in companies, to determine the strategy of the company and the Group, and to manage and acquire land, buildings, leasehold rights and other assets for the above objectives.

The object of Heckler & Koch GmbH and its subsidiaries (the "Heckler & Koch Sub-Group"), which is a defining element of the Group, is the development, manufacture, marketing and distribution of defence and security products, together with the provision of related services.

(2) Executive board approval

The board of directors of Heckler & Koch Beteiligungs GmbH approved the IFRS consolidated financial statements on April 26, 2011.

(3) Statement of compliance with applicable law and IFRS

The consolidated financial statements of Heckler & Koch Beteiligungs GmbH as at December 31, 2010, have been prepared in accordance with the International Financial Reporting Standards (IFRS) of the International Accounting Standards Board (IASB) as applicable in the EU, together with interpretations of the International Financial Reporting Interpretation Committee (IFRIC) and the supplementary German commercial law regulations pursuant to § 315a (1) HGB. All IFRS's and IFRIC's which were effective for the financial year 2010 have been applied.

For the financial year 2010, the following Standards and amendments to previous Standards became effective for the first time and affected the Heckler & Koch Group's net assets, financial position, results of operations or cash flows to some extent:

IFRS 3 Business Combinations (2009)

Revised IFRS 3 has been applied prospectively from January 1, 2010. It incorporates the following changes that could be relevant to the Group:

- It now also applies to contractual business combinations and combinations of mutual companies.
- The definition of a business has been broadened—the possibility of an integrated set of activities and assets being run as a business is sufficient for this set to be defined as a business.
- Acquisition date fair value of contingent consideration must be recognised as part of the consideration transferred.
- There is now a choice of methods for valuing any non-controlling interest. This can be measured at either its proportionate interest in the fair values of the identifiable assets and liabilities of the acquiree, or at fair value.
- Transaction costs will be expensed as incurred (€45k transaction costs were expensed instead of being capitalised).

For the financial year 2010, the following Standards and amendments to previous Standards became effective for the first time and had no material effect on the Hecker & Koch Group's net assets, financial position, results of operations or cash flows:

IAS 27 Consolidated and Separate Financial Statements (amended 2008)

The amended IAS 27 requires accounting for changes in ownership interests by the Group in a subsidiary, while maintaining control, to be recognised as an equity transaction. When the Group loses control of a subsidiary, any interest retained in the former subsidiary will be measured at fair value with the gain or loss recognised in profit or loss.

IAS 39 Financial Instruments: Recognition and Measurements: Eligible Hedged Items (amended)

The amended IAS 39 clarifies the existing principles that determine whether specific risks or portions of cash flows are eligible for designation in a hedging relationship.

IFRIC 12, IFRIC 15, IFRIC 16 and IFRIC 18 were officially effective for financial years beginning on or after January 1, 2009. However on their adoption, the EU set different dates for them to become effective. These interpretations are effective for consolidated financial statements prepared in accordance with §315a HGB for the year to December 31, 2010 however they have no material effects on the Group's net assets, financial position, results of operations or cash flows.

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2010, and have not been applied in preparing these consolidated financial statements. None of these is expected to have a significant effect on the consolidated financial statements of the Group, except for IFRS 9 Financial Instruments, which becomes mandatory for the Group's 2013 consolidated financial statements and could change the classification and measurement of financial assets. The Group does not plan to adopt this standard early and the extent of the impact has not been determined.

The consolidated financial statements have been prepared in euro. Unless otherwise stated, all financial information presented in euro has been shown to the nearest thousand (€k, EUR'000). As a result, the totals in this report may vary slightly from the exact arithmetic aggregation of the figures that precede them.

For the income statement, expenses have been classified by function. In order to enhance the clarity of presentation, various items in the balance sheet and in the income statement have been aggregated.

(4) Group entities

Apart from the financial statements of Heckler & Koch Beteiligungs GmbH, the consolidated financial statements of Heckler & Koch Beteiligungs GmbH as at December 31, 2010 include the financial statements of ten (2009: ten) German and foreign subsidiaries. Subsidiaries are companies in which the parent enterprise exercises more than half the voting rights or is able to control their financial and business policy for other reasons (control relationship). Inclusion commences at the time from which the control relationship exists; it ends when the possibility of control ceases.

The following table shows a list of the subsidiaries and one joint venture included in the consolidation, together with their total equity and profit for the year figures from their financial statements, as prepared for consolidation purposes under IFRS, in their functional currencies:

		2010			2009		
	Functional Currency	**%**	**Equity**	**Profit**	**%**	**Equity**	**Profit**
Direct holdings							
HK Holding, Inc., Delaware / USA	USD '000	100%	114,159	12,146	100%	113,343	13,955
Suhler Jagd- & Sportwaffen GmbH, Germany	EUR '000	100%*	—	—	100% PF*	—	(45)
Heckler & Koch S.A., Neuchâtel, Switzerland	CHF '000	100%	63	(25)	100%	88	(24)
Indirect holdings							
Heckler & Koch GmbH, Oberndorf / Neckar	EUR '000	100%	95,930	28,664	100%	78,435	18,633
NSAF Limited, Nottingham, England	GBP '000	100%	5,453	3,679	100%	5,724	3,894
Small Arms Group Holding Inc., Ashburn VA, USA	USD '000	100%	140	(6)	100%	146	(11)
Heckler & Koch Defense Inc., Ashburn VA, USA	USD '000	100%	(15,843)	8,855	100%	(24,698)	(1,512)
Sistemas de Armamento Ibericos S.L., Madrid, Spain	EUR '000	—	—	—	50% to 12.09	25	—

Heckler & Koch France S.A.S., Paris, France	EUR ’000	100%	1,244	569	100%	674	401
Suhler USA, Inc., AL, USA	USD ’000	100%	16,884	(0)	100% PF	16,884	19
Heckler & Koch, Inc., VA & GA, USA	USD ’000	100%	14,120	(472)	100% PF	14,592	1,515
HK Sidearms GmbH, Oberndorf, Germany	EUR ’000	100% from 1.7.10	9,278	1,141	0%	—	—

* Merged with Heckler & Koch Beteiligungs GmbH May 2009

PF = whole year due to transactions under common control

As part of the restructuring undertaken in 2003 to separate the civilian and military businesses in order to reduce liability risks, Heckler & Koch GmbH (“HKO”) sold its civilian business including pistol assembly to Heckler & Koch Jagd- & Sportwaffen GmbH. In the USA the civilian business of Heckler & Koch, Inc. (“HKI”) was also isolated. Both civilian businesses were sold to a related party. Due to changes to laws in the US over the years, resulting in a significant reduction in the liability risk, this separation is no longer necessary.

In 2009 HKO re-acquired HKI and its parent company Suhler USA, Inc. (“SUI”) in a common control transaction. Since prior to the transaction both groups were ultimately controlled by the same person, figures have been presented as if the combination had occurred prior to the start of the earliest period shown (i.e. as at December 31, 2007). A detailed reconciliation is shown in Note 41 to the 2009 Consolidated Financial Statements.

The restructuring activities were completed on July 1, 2010 with the acquisition of 100% of HK Sidearms GmbH (“HKS”, formerly Heckler & Koch Jagd- & Sportwaffen GmbH). At the date of acquisition, after purchase price allocation, HKS had €8k plant, equipment and software, €281k net deferred tax assets, €2,664k inventories, €1,440k trade receivables (none impaired), €164k other assets and prepayments, €5,873k net receivables from the Heckler & Koch Group, €261k cash and cash equivalents, €1,432k tax provisions, €870k pension and other provisions and €220k payables due to third parties. The purchase price for HKS of €6.4 million was paid in full in cash.

HKS purchases parts and assemblies from HKO and sells the assembled pistols mainly to HKO and HKI. The acquisition of HKS on July 1, 2010 therefore reduced the external revenue for the Group by €9.7 million and, due to initial unrealised profit elimination, also reduced the Group’s EBITDA by around €1.0 million. If the acquisition had taken place on January 1, 2010, Group revenues for the year would have been €239.3 million. The corresponding EBITDA would have been an estimated €60.7 million, due to the unrealised profit eliminations during the first year. If the acquisition had taken place several years ago however, the EBITDA is estimated at around €62. 8 million, with the increase being due to the release of prior year unrealised profit eliminations.

May 2009 saw the acquisition of Suhler Jagd- und Sportwaffen Holding GmbH (SJSH) and its dormant subsidiary, Heckler & Koch S.A., by way of a second common control transaction, after which SJSH merged with Heckler & Koch Beteiligungs GmbH. Since, prior to the acquisition, both groups were ultimately controlled by the same person, figures have been presented as if the combination had occurred prior to the start of the earliest period shown in the 2009 Consolidated Financial Statements (i.e. as at December 31, 2007). A detailed reconciliation is shown in Note 41 to the 2009 Consolidated Financial Statements.

The investment in the dormant joint venture, Sistemas de Armamento Ibericos S.L., ceased during the final quarter of 2009. Prior to this, it was included in the consolidated financial statements using the equity method described in IAS 28, as permitted by IAS 31.

(5) Summary of significant accounting policies and basis of measurement

The consolidated financial statements have been prepared on a historical cost basis; where IFRS requires recognition at fair value, this has been applied.

The significant accounting policies and measurement methods applied in preparing the consolidated financial statements are described below:

Consolidation methods

The assets and liabilities of the domestic and foreign companies included in the consolidated financial statements are recognised and measured using the accounting and measurement methods that apply uniformly for the Heckler & Koch Beteiligungs Group.

On the acquisition of a company, the assets and liabilities of the subsidiaries concerned are measured at their fair value at the time of acquisition. If the acquisition costs for the participation exceed the net fair value of the identified assets and liabilities, the difference is capitalised as goodwill. If the acquisition costs are lower, the fair value of the assets and liabilities and the amount of the acquisition costs are reassessed. Any remaining negative goodwill (lucky buy) is recorded immediately in the income statement.

In subsequent periods, the associated fair value adjustments to assets and liabilities are maintained, written off or released in accordance with the corresponding assets and liabilities. Capitalised goodwill is not amortised, but is subject to an annual impairment test in accordance with IFRS 3 instead.

A business combination in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination, and that control is not transitory, is classified as being "under common control". Business combinations involving entities under common control are excluded from the scope of IFRS 3. The Group uses the book values for such acquired entities and offsets a difference between the net assets acquired and the consideration paid, if any, in equity. Providing that the entities were under common control during the comparative periods, the comparatives are restated as if the combination had been in existence throughout the reporting periods presented.

The financial year of all companies included corresponds to the financial year of the parent company.

All receivables, liabilities, sales revenues, other income and expenses, including interest and dividends, within the scope of consolidation are eliminated. Unrealised profits from intra-group supplies are eliminated from inventories or fixed assets as appropriate.

Currency translation

The Heckler & Koch Group reporting currency is the euro (€).

Foreign currency transactions are translated in the individual financial statements of Heckler & Koch Beteiligungs GmbH and its consolidated companies at the rates pertaining at the time of the transactions. As at the balance sheet date, assets and liabilities in foreign currency are measured at the spot rate on the balance sheet date. Differences arising on translation are recorded in the income statement.

The financial statements of the foreign companies are translated from their functional currencies into euro. Since subsidiaries and joint ventures operate their business independently, their functional currency is their individual local currency. In the consolidated financial statements, income and expenses from the financial statements of subsidiaries that are prepared in foreign currency are translated at the average rate for the year calculated from the daily rates. This method is used for simplicity since usually the local currency income and expenditure involved are fairly evenly spread throughout the year and consequently any potential variances are not material. Assets and liabilities are translated at the spot rate on the balance sheet date. Goodwill is treated in the same way as an asset or liability and translated at the balance sheet spot rate. Foreign currency translation variances are taken directly to the foreign currency translation reserve in equity. In the event of the disposal of a consolidated entity, associated accumulated foreign currency translation variances are recorded as part of the profit or loss on disposal.

The rates used for currency translation are shown in the table below:

Currency	Abbr.	Rate on balance sheet date 31.12.2010	Rate on balance sheet date 31.12.2009	Rate on balance sheet date 31.12.2008	Average exchange rate 2010	Average exchange rate 2009
US Dollar (USA)	**USD**	1.3362	1.4406	1.3917	1.3282	1.3947
Pound (United Kingdom)	**GBP**	0.8608	0.8881	0.9525	0.8590	0.8919
Swiss Francs	**CHF**	1.2504	1.4836	1.4850	1.3790	1.5102

Significant accounting policies

Goodwill

Goodwill is an asset representing the future economic benefits that cannot be individually identified and separately recognised from the net assets obtained through a business combination. Goodwill is allocated to the following cash generating units (segments):

EUR '000	2010	2009
Site location: Germany—Defence	4,016	4,016
Site location: France	1,133	1,133

Total	**5,149**	**5,149**

Goodwill is capitalised and subjected to an annual impairment test. If the carrying value is no longer recoverable, impairment is charged. Otherwise the prior year carrying value is retained. Any impairment charge against goodwill is not reversed, even if the valuation exceeds the carrying value.

The Group conducts an impairment test of goodwill at least annually. The recoverable value of the cash generating unit is compared with its carrying value. The recoverable value used in the calculation is the value in use. The value in use of the cash generating unit is determined by discounting future cash flows. The computation is based on the following material assumptions:

A detailed plan is made of the cash flows for the cash generating unit for the forecast period of five years. Subsequent periods are accounted for by a terminal value determined on the basis of the final year, adjusted for material one-off events during earlier years and the volume of the current order book and applying a 1% growth rate. The key assumptions for the determination of the value in use are the composition and value of sales. These assume that governments will continue to modernise their armed forces in the next few years, and are based on information over future requirements together with past experience. IAS 36.134(f) does not apply.

The discount rate used for December 31, 2010 is a uniform pre-tax cost of capital of 9.25% (2009: 9.25%); in line with the financing structure which is particularly influenced by the interest rate on the Notes.

Goodwill from acquisitions prior to January 1, 2006 has been capitalised; negative goodwill from acquisitions prior to this transition date has been offset against reserves. On divestment of a consolidated company any goodwill relating to it, other than negative goodwill, is included in the computation of the deconsolidation result.

Intangible assets

Purchased intangible assets, mainly brand names, patents, licences and software, are capitalised at acquisition cost. Internally generated intangible assets, with the exception of goodwill, are capitalised if it is sufficiently probable that a future economic benefit will flow from the use of the asset and the costs of the asset can be determined reliably. The manufacturing costs of internally generated intangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset.

(5) Summary of significant accounting policies and basis of measurement

With the exception of goodwill and trademarks, all intangible assets have finite useful lives and are amortised using the straight-line method over this period. The €8,393k for the brand name has been allocated to the Germany—Defence cash generating unit (segment) and is subject to annual impairment testing, as described for goodwill. Licences and software usually have useful lives of 10 years. Standard software usually has a useful life of 4 or 5 years. Capitalised development costs usually have useful lives of 8 years from the date that sales of the developed product commence. If the expected useful life is materially longer or shorter, the expected useful life is used.

Tangible assets

Tangible assets which will be used in the business for more than one year are capitalised and valued at acquisition or manufacturing costs less depreciation calculated using the straight-line, use-related method, together with impairment if appropriate. The manufacturing costs of internally generated tangible assets are determined on the basis of directly attributable individual costs as well as a proportion of directly allocated overheads. Financing costs for the production period are not capitalised. (Financing costs are only capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset). The permitted alternative method of revaluation is not applied.

The following useful lives are applied for scheduled depreciation Group-wide:

Category of tangible asset	years
Buildings	25 - 40
Plant and machinery	5 - 10
Tooling	3 - 5
Vehicles	6
Fixtures, fittings and office equipment	5 - 10

The useful lives and methods of depreciation are reviewed regularly in order to ensure that these are in line with the actual expected economic use.

Impairment of tangible assets and of intangible assets other than goodwill

As at each balance sheet date, if there are triggering events for impairment, material tangible assets and intangible assets are submitted to an impairment test in accordance with IAS 36. If the carrying value of an asset exceeds its recoverable amount, an impairment loss is recognised. The recoverable amount is the higher of fair value less costs to sell and value in use. If the recoverable amount for an individual asset cannot be determined, an estimate is made of the recoverable amount at the level of next higher cash generating unit.

If, in the following periods the recoverable amount exceeds the carrying value, reversal of impairment is only made for the lower of the amount necessary to (i) bring the carrying value of the asset to its recoverable amount or (ii) to restore the asset to its pre-impairment carrying amount less subsequent depreciation or amortisation that would have been recognised.

The impairment and any reversal of impairment are recorded in the income statement.

Financial instruments

As defined by IAS 32 and used in IAS 39, a financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Original financial instruments

Financial instruments held by the Group are classified as one of the following:

- financial assets at fair value through profit or loss
- loans and receivables

- held-to-maturity investments
- available-for-sale financial assets
- financial liabilities at fair value through profit or loss
- other financial liabilities, valued at amortised cost using the effective interest method.

The classification of a financial instrument is determined based on the intended principal purpose upon initial recognition. Financial assets include cash and cash equivalents, trade accounts receivable, loans receivable and derivatives that are assets held for trading. Financial liabilities include trade accounts payable, amounts owed to banks, derivatives that are liabilities held for trading and other financial liabilities.

Trade accounts receivable / payable result from the provision / receipt of goods and/or services in the normal course of business. Securities include financial instruments in the form of shares or participation in funds.

An instrument is classified at **fair value through profit or loss** if it is held for trading or is designated as such upon initial recognition. For the periods covered by these financial statements, the only financial instruments designated by the Group as held at "fair value through profit or loss" are derivatives that do not meet the requirements for hedge accounting. Upon initial recognition any attributable transaction costs are recognised in profit or loss. Financial instruments at fair value through profit or loss are measured at fair value, and any changes in the fair value are recognised in profit or loss.

Financial assets

All regulated market acquisitions and disposals of financial assets are recognised on the date of settlement (IAS 39.38).

Financial assets are recognised initially at fair value plus, in the case of a financial asset not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition.

The recoverability of financial assets that are not held at fair value through profit or loss is reviewed regularly. Objective evidence for an impairment loss is in particular the insolvency of contractual partners or their failing to comply with payment plans. If the carrying value is higher than the recoverable amount, impairment is recognised via the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively linked to an event occurring after the impairment was recognised, the previously recognised impairment loss shall be partially or completely reversed through the income statement.

The fair values of financial assets in the balance sheet are usually their market values. If market values are not readily available, the fair values are determined using recognised valuation techniques and current market parameters. Valuation methods available include using recent arm's-length transactions between knowledgeable, willing parties, recent market transactions in similar financial instruments, adjusted for factors unique to the instrument being valued, discounted cash flow analysis or option pricing models.

A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or are transferred. To qualify for derecognition, the transfer must transfer the risks and rewards of ownership of the financial asset or the contractual rights to receive the cash flows.

Loans and receivables are financial assets resulting from monetary transactions, the supply of goods or services to third parties. Current assets in this category are measured at cost and non-current assets are measured at amortised cost using the effective interest method.

Impairments to doubtful debts are mainly due to estimates and assessments of individual accounts receivable, based on the creditworthiness of individual customers. Impairment of accounts receivable is initially shown as a provision for doubtful debts. If a debt is regarded as irrecoverable, the impaired account receivable is written off.

Financial instruments are classed as "**held to maturity**" if they are non-derivative financial assets with fixed or determinable payments and fixed maturity that the Group has the positive intention and ability to hold to maturity.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss.

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits, for which the original term is less than three months. These are valued at nominal value.

Financial liabilities

Financial liabilities are mainly trade accounts payable, amounts owed to banks and other liabilities.

Financial liabilities are recognised initially at fair value less, in the case of a financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the issue.

A financial liability is derecognised when the obligation specified in the contract is discharged, or cancelled, or expires.

Financial liabilities valued at amortised cost using the effective interest method, include trade accounts payable and interest-bearing loans. These are valued at amortised cost using the effective interest method. Any profit or loss is recognised in the income statement when the liabilities are derecognised or settled.

Derivative financial instruments and hedge accounting

A derivative is a financial instrument or other contract with all three of the following characteristics: (1) its value changes in response to a specified foreign exchange rate or other variable; (2) it requires no initial payment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and (3) it is settled at a future date.

The Group only uses derivative financial instruments to manage its exposure to foreign currency translation risk arising from normal business operations. An embedded derivative must only be separated from its host contract and accounted for as a derivative if (i) the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract, (ii) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and (iii) the hybrid financial instrument is not measured at fair value through profit or loss.

In line with IAS 39, all derivatives are measured at fair value. The fair values of derivatives in the balance sheet are usually their market values. If market values are not readily available, the fair value may be determined using recognised pricing models or evidenced by bank confirmations. Changes in fair value are accounted for as described below:

Cash flow hedges

Changes in the fair value of the derivative hedging instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs. When the hedged item is a non-financial asset, the amount recognised in equity is transferred to the carrying amount of the asset when it is recognised. In other cases the amount recognised in equity is transferred to profit or loss in the same period that the hedged item affects profit or loss.

Other non-trading derivatives

If a derivative financial instrument is not designated in a qualifying hedge relationship, all changes in its fair value are recognised immediately in profit or loss.

Construction work in progress

Construction work in progress represents the total, gross, unbilled amount expected to be collected from customers for contract work performed to date. It is measured at cost plus profit recognised to date (see “recognition of income and expense—construction contracts”, below) less progress billings and recognised losses. Cost includes all expenditure related directly to the specific projects.

Construction work in progress is presented as part of trade and other receivables in the balance sheet. If payments received from customers exceed the income recognised, then the difference is presented as advance payments received in the balance sheet.

Inventories

Inventories are recognised at acquisition or manufacturing costs or, if lower, their net realisable value. Raw materials, supplies and consumables as well as merchandise are measured at their adjusted average acquisition costs. The manufacturing costs of work in progress and finished goods are determined on the basis of directly attributable individual costs as well as a proportion of production-related overheads. Manufacturing costs do not include selling expenses, general and administrative expenses or financing costs. The net realisable value is the estimated selling price less the estimated cost to completion and the estimated costs necessary to make the sale. Provisions are made to recognise impairment of slow-moving inventories or to reduce to net realisable value.

Non-current assets held for sale

Non-current assets (or disposal groups comprising assets and liabilities) that are expected to be recovered primarily through sale rather than through continuing use are classified as held for sale. These assets are held at the lower of their carrying values and their fair value less costs to sell. These assets are not depreciated.

Provisions for pensions and similar defined benefit obligations

The provisions for defined benefit obligations are computed using the projected unit credit method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with estimates of the demographic variances are also taken into consideration. The value is obtained from an actuarial report.

Actuarial gains and losses are recognised outside profit or loss, in the period in which they occur, in accordance with IAS 19.93A-D. These are shown in the statement of comprehensive income.

In determining the discount interest rates in accordance with IAS 19.78, the actuaries refer to market yields on high quality corporate bonds at the balance sheet date.

Other non-current and current provisions

Other general liability provisions are recognised when a past event gives rise to a present obligation, it is probable that the obligation will be claimed and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the expenditure required to settle the present obligation at the balance sheet date, or if the effect of the time value of money is material, the present value thereof. Reimbursement claims are recognised separately if it is virtually certain that reimbursement will be received if the Group settles the obligation.

Leases

For leasing agreements under which the Group is lessee, if the lease transfers substantially all the risks and rewards incidental to ownership of the asset (finance leases), then the assets are capitalised by the Group in accordance with IAS 17. Depreciation methods and useful lives are applied in line with similar owned assets. At the commencement of the lease term, finance leases are recognised as assets and liabilities in the balance sheets at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset.

If the lease does not transfer substantially all the risks and rewards incidental to ownership of the asset, then the assets are capitalised by the lessor (operating leases). Leasing fees for operating leases are recognised in the income statement. If material, adjustments are made to straight-line leasing fees for agreements where payment schedules are different.

Recognition of income and expense

Sale of goods and services

Revenues are measured at the fair market value of the consideration received or to be received and represent the amounts that are to be obtained for goods and services in the normal course of business. The revenues are shown after subtracting sales deductions, discounts and value added taxes.

Revenues are recorded when the associated supplies and services have been rendered, the risks and rewards of ownership have transferred to the buyer and the receipt of the payment is probable.

Construction contracts

Contract revenue includes the initial amount agreed in the contract plus any variations in contract work, claims and incentive payments to the extent that it is probable that they will result in revenue and can be measured reliably. As soon as the outcome of a construction contract can be estimated reliably, contract revenue and expenses are recognised in profit or loss in proportion to the stage of completion of the contract. The stage of completion is assessed by reference to surveys of work performed. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. An expected loss on a contract is recognised immediately in profit or loss.

Interest and other income

Interest income is accrued based on the loan outstanding and the applicable interest rate. The applicable interest rate is specified in the loan agreement and discounts the estimated future inflows of funds over the term of the financial asset to the net carrying value.

Other income is recognised in the period to which it relates, in accordance with the associated contract.

Other expenses

Other expenses are recognised on the basis of a direct link between the costs incurred and the related income in the income statement, either when the benefit is used or when the costs are caused.

Expenses for research and development

Research costs are expensed as they are incurred. Development costs are also expensed as they are incurred, unless they satisfy the criteria for recognition as internally generated intangible assets according to IAS 38.57.

Borrowing costs

Borrowing costs as defined in IAS 23 are capitalised to the extent that they are directly attributable to the acquisition, construction or production of a qualifying asset; the remaining borrowing costs are recognised as an expense in the period in which they are incurred.

Income taxes and deferred taxes

The income tax expense represents the sum of current tax expense and deferred tax expense.

The current tax expense is determined on the basis of the taxable income for the relevant year. The taxable income is different from the net income for the year shown in the income statement since it excludes expenses and income which will be tax deductible / taxable in other years or which will never be tax deductible or taxable. The liability of the Group for current tax expense is computed on the basis of the valid tax rates and regulations at the balance sheet date.

Deferred taxes are the expected tax charge or relief arising from differences between the carrying values of assets and liabilities in the Group IFRS consolidated financial statements and their values in the tax accounts of the individual companies. The balance sheet oriented liability method is applied. In general, deferred tax liabilities are recorded for all taxable temporary differences, and deferred tax assets are recorded to the extent that it is probable that taxable profits will be available for which the deductible temporary differences can be used. Such assets and liabilities are not recognised if the temporary difference arises from (i) the initial recognition of goodwill or (ii) from the initial recognition of other assets and liabilities in a transaction that affects neither the accounting profit / (loss) nor taxable profit / (loss). In addition, deferred taxes are recognised for the carry forward of unused tax losses to the extent that it is probable that it will be possible to utilise them in the future.

The carrying amount of deferred tax assets is reviewed each year at the balance sheet date and is reduced if it is no longer probable that sufficient taxable income will be available to allow the benefit of all or part of the deferred tax asset to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantively enacted by the balance sheet date.

Changes in deferred taxes are recognised in the income statement as tax income or expense unless they relate to items recognised in other comprehensive income or directly under equity; in this case the deferred taxes are recognised in other comprehensive income or in the associated equity position.

Contingent liabilities and contingent assets

Contingent liabilities are not recognised. If any are identified, they are disclosed in the notes unless the possibility of an outflow of resources embodying economic benefits is remote. Contingent assets are not recognised. They are disclosed in the notes, where an inflow of economic benefits is probable.

The use of estimates and assumptions

The preparation of the consolidated financial statements in compliance with the pronouncements of the IASB requires estimates to be made affecting the values recognised in the balance sheet, the nature and extent of contingent assets and liabilities identified at the reporting date and the value of income and expenses in the reporting period. The main assumptions and estimates for the Heckler & Koch Beteiligungs Group concern the setting of useful lives, the recoverability of accounts receivable, the valuation of inventories, the recognition and measurement of provisions and the probability of future utilisation of deferred tax assets. Changes in estimates are recognised in the income statement prospectively.

Guarantee and warranty obligations can arise from legal or contractual requirements. Provisions are recognised for the expected cost of meeting claims under guarantee or warranty obligations. Claims are particularly likely if the warranty period has not yet expired, if warranty costs have been incurred in the past or if particular warranty claims are known. The evaluation of the risk of warranty claims is based on past experience and is used in determining the level of provision required.

Provisions for litigation risks are recognised if a company in the Group is a defendant and a judgement against the defendant is more likely than not. A provision is made for the amount likely to be incurred by the company if the judgement is against it. This figure includes the payments to be made by the company, in particular compensation and settlements, as well as the expected legal expenses. If a company in the Group is a defendant and a judgement for the defendant is more likely than not, or if the company is the claimant, only litigation fees are provided for.

The use of estimates in other positions in the Group balance sheet and income statement are described in the accounting policies relating to the individual positions. In particular, these relate to: impairment of goodwill, impairment of non-current tangible and intangible assets, provisions for doubtful debts and the valuation of deferred tax assets and the pension provision.

Notes on the income statement

(6) Revenue

Net revenue increased by €12,497k to €247,244k compared with revenue of €234,748k in 2009.

The revenue of the Group was made up as follows:

	2010	2009
	EUR ’000	
Sale of goods	231,810	228,592
Sale of services	7,366	5,387
Construction contract revenue	8,856	1,699
Gross revenue	**248,032**	**235,678**
Discounts, bonuses, etc.	(788)	(931)
Net revenue	**247,244**	**234,748**

Construction contract revenue is determined by reference to the stage of completion. Since the beginning of the current construction projects, cumulative sales of €10,555k (2009: €1,699k) have been recognised.

(6) Revenue

Breakdown by customer location:

	2010	2009
	EUR '000	
Domestic (Germany)	42,999	39,472
Foreign (rest of the world)	205,033	196,206
Gross revenue	**248,032**	**235,678**
Discounts, bonuses, etc.	(788)	(931)
Net revenue	**247,244**	**234,748**

(7) Cost of sales

The cost of sales decreased by €9,496k to €144,067k compared with €153,563k cost of sales in 2009. The cost of sales includes materials and production labour and overhead expenses relating to the revenue. Within cost of sales are €8,856k (2009: €1,699k) expenses relating to construction contract revenue. Since the beginning of the current construction projects, cumulative costs of sales of €10,555k (2009: €1,699k) have been recognised.

(8) Research and development expenses

Research and development expenses increased by €1,061k to €4,112k compared with €3,051k in 2009. Research and development expenses comprise those personnel expenses and depreciation relating to these activities, together with the costs of test materials and tools that do not meet the criteria for capitalisation under IAS 38, together with the amortisation and retirement of capitalised development costs.

(9) Sales, marketing & distribution expenses

Sales, marketing & distribution expenses increased by €7,039k to €31,752k compared with €24,714k in 2009. The selling expenses mainly comprise personnel expenses, material and marketing costs as well as depreciation relating to the sales function and project related costs.

(10) Administration expenses

General administration expenses include personnel expenses and office overhead costs as well as the depreciation relating to the administration function. They increased by €4,573k to €25,892k compared with €21,319k in 2009.

(11) Other operating income

	2010	2009
	EUR '000	
Release and utilisation of provisions	3,117	2,937
Income from the provision of administration services	1,051	1,577
Profit on disposal of non-current assets	95	29
Licence fee income	864	1,065
Fuel sales to employees	1,259	1,111
Other	1,545	1,791
Total	**7,930**	**8,509**

The other operating income includes out-of-period income of €1,491k (2009: €1,081k). This is due to income from the release of provisions and accruals €1,145k (2009: €1,052k), gains on disposals of non-current assets €95k (2009: €29k) and income from refunds etc. €251k (2009: nil).

(12) Other operating expenses

	2010	2009
	EUR '000	

Create provision for doubtful debts & write off of bad debts	(274)	(470)
Loss on disposal of non-current assets	(1,570)	(339)
Other taxes	(372)	(270)
Creation of general liability provisions	(2,779)	(2,104)
Other	(2,262)	(2,992)
Total	**(7,257)**	**(6,174)**

The other operating expenses include out-of-period expenses of €1,928k (2009: €920k). These are mainly due to losses on the disposal of non-current assets, doubtful and bad debts and credit-notes relating to prior years.

(13) Analysis of expenses by nature, showing EBITDA

The income statement shows operating expenses analysed by function; the following table shows EBITDA and operating profit with expenses analysed by nature:

	2010	2009
	EUR '000	
Net sales	247,244	234,748
Material costs and movement in inventories	(106,094)	(113,525)
Capitalised costs	2,511	1,639
Other operating income	7,930	8,509
Payroll	(49,359)	(47,385)
Other operating expenses	(49,737)	(39,429)
EBITDA	**52,496**	**44,556**
Depreciation and amortisation	(10,402)	(10,119)
Results from operating activities	**42,094**	**34,437**
Write-down of investments (HKB)	(33,106)	(5,717)
Interest income (HKB)	4,930	4,306
Income from securities (HKB)	1,374	—
HKB Group Operating EBITDA	25,689	43,120

No definition of EBITDA is given in IFRS; various methods can therefore be used to determine EBITDA.

(14) Financial result

	2010	2009
	EUR '000	
Financial income		
Interest	6,669	4,875
Gains on valuation of derivative financial instruments	42	—
Gains on translation of foreign currencies	3,224	1,755
Gains on investments and securities	1,374	—
Total financial income	**11,309**	**6,630**
Financial expenses		
Interest	(28,117)	(26,169)
Accretion of non-current liabilities	(4,131)	(3,923)
Losses on valuation of derivative financial instruments	—	(946)
Losses on translation of foreign currencies	(661)	(1,871)
Losses on valuation of investments	(33,106)	(5,717)
Other	(207)	(464)
Total financial expense	**(66,222)**	**(39,089)**
Financial result	**(54,913)**	**(32,459)**

Interest income includes interest on short-term loans and on bank balances and tax refunds. The gains and losses on valuation of derivative financial instruments relate to forward cover contracts and options intended to reduce exposure to currency risk on expected USD cash-flows. The gains and losses on translation of foreign currencies include gains and losses on utilisation of forward cover contracts, in addition to translation differences for items not covered by such arrangements. The accretion of non-current liabilities relates to defined benefit and other long-term provisions and the bond. Gains and losses arising from the valuation of investments result from the release of or additions to impairments on financial assets. Other financial expenses relate to guarantee costs.

(15) Income taxes

The income tax expense comprises:

	2010	2009
	EUR '000	
Current tax income/(expense)	(11,985)	(12,832)
Deferred tax income/(expense)	2,771	1,849
Tax expense in income statement	**(9,214)**	**(10,983)**

Income taxes include German corporation tax ("Körperschaftsteuer"), trade income tax ("Gewerbesteuer") and associated reunification surcharges ("Solidaritätszuschlag") for the German companies, together with similar income taxes for the foreign subsidiaries.

The companies in Germany have a calculated statutory tax rate of 27.7% (2009: 27.7%). Foreign taxation is calculated at the rates valid in each country; these vary between 28% and 36% (2009: between 28% and 38%).

Deferred taxes are calculated on the basis of statutory tax rates, which have been enacted as of the balance sheet date in each country, or of tax rates that are expected to be in place on realisation.

The following table shows a reconciliation of the expected tax using the current statutory tax rate for the parent company of 27.7% and the actual income tax shown for the Group.

	2010	2009
	EUR '000	
Profit/(loss) before tax	(12,819)	1,978
Expected tax rate (current German statutory rate)	**27.7%**	**27.7%**
Expected tax expense	**3,554**	**(548)**
Adjustments to expected tax expense due to:		
– change in tax rates	(3,034)	(201)
– non-tax-deductible expenses	(12,963)	(6,154)
– utilisation of tax losses that had not been capitalised	451	—
– taxes relating to other periods	901	(3,273)
– differences in foreign tax rates	(1,251)	(786)
– change in valuation adjustments for tax losses c/f	(2,084)	(499)
– change in valuation adjustments for temporary diff.	(100)	(236)
– other effects	5,313	714
Actual tax expense	**(9,214)**	**(10,983)**
Effective tax rate	**(71.9)%**	**555.2%**

Deferred tax relates to the following positions:

Balance Sheet Item	Deferred tax assets 31.12.2010	Deferred tax assets 31.12.2009	Deferred tax liabilities 31.12.2010	Deferred tax liabilities 31.12.2009
		EUR '000		
Intangible non-current assets	—	—	11,509	11,193
Investments in subsidiaries	—	—	—	—
Tangible non-current assets	15	8	4,213	4,974
Inventories	3,473	1,512	—	—
Trade accounts receivable	16	98	425	444
Other current assets	1,846	73	2,357	4,536
Employee defined benefit obligations	3,893	2,829	—	—
Other non-current provisions	747	1,563	—	—
Non-current financial liabilities	—	—	220	596
Other non-current liabilities	—	251	—	—
Current provisions	77	43	25	—
Trade accounts payable	1,008	402	—	—
Other current financial liabilities	—	—	—	—
Other current liabilities	11	—	2,539	47
Carryforward of unused tax losses	9	(0)	—	—
Total	**11,095**	**6,779**	**21,288**	**21,790**

During 2010, an increase in deferred tax assets of €1,024k (2009: €1,031k) was recognised directly in equity since this increase related to the actuarial variances on defined benefit schemes. A decrease in deferred tax assets of €218k (2009: increase of €229k) was recognised directly in equity since this decrease related to valuation differences on effective hedging instruments. The changes arising from translation differences for foreign operations were recognised as such in the other profit or loss. Apart from these, all other changes in deferred tax assets and liabilities were recognised in the income statement:

Balance Sheet Item	**Deferred Tax 31.12.2008**	**Recognised in profit or loss**	**Recognised in other comprehensive income**	**Deferred Tax 31.12.2009**	**Recognised in profit or loss**	**Recognised in other comprehensive income**	**Deferred Tax 31.12.2010**
				EUR ’000			
Intangible non-current assets	(10,990)	(202)	—	(11,193)	(317)	—	(11,509)
Investments in subsidiaries	—	—	—	—	—	—	—
Tangible non-current assets	(5,605)	636	3	(4,966)	772	(4)	(4,199)
Inventories	1,097	433	(19)	1,512	782	43	3,473
Trade accounts receivable	75	(418)	(4)	(346)	(70)	8	(409)
Other current assets	(4,438)	(42)	17	(4,463)	3,995	(43)	(511)
Employee defined benefit obligations	1,815	(17)	1,031	2,829	6	1,024	3,893
Other non-current provisions	645	918	—	1,563	(874)	—	747
Non-current financial liabilities	(935)	339	—	(596)	376	—	(220)
Other non-current liabilities	58	(36)	229	251	(38)	(218)	—
Current provisions	—	45	(1)	43	5	3	52
Trade accounts payable	(36)	439	0	402	605	—	1,008
Other current financial liabilities	—	—	—	—	—	—	—
Other current liabilities	115	(162)	(0)	(47)	(2,481)	—	(2,528)
Carryforward of unused tax losses	83	(83)	(0)	(0)	9	(0)	9
Total	**(18,115)**	**1,849**	**1,255**	**(15,010)**	**2,771**	**813**	**(10,193)**

Deferred tax assets €9k (2009: € 0), relating to unused losses carried forward by one of our operations in the US have been recognised. Utilisation of these tax assets is covered by the amount recorded for deductible temporary differences. Potential deferred tax assets of €2,254k (2009: €4,597k) resulting from unused tax losses carried forward by one of our operations in the USA have not been recognised. In addition, valuation adjustments of €2,233k (2009: €2,133k) have been made against potential deferred tax assets relating to temporary differences arising in this operation in the US. Potential deferred tax assets of €8,579k (2009: €6,510k) resulting from unused tax losses carried forward by the parent company have not been recognised. For HK Holding, Inc., there is a difference in the carrying amount of the investment in accordance with the IFRS consolidated financial statements (2010: €96,407k; 2009: €77,587k) and the corresponding tax base in the US (2010: €112,238k; 2009: €82,139k) due in part to undistributed profits. As it is probable that these temporary differences will not reverse in the foreseeable future, the deferred tax assets (with a tax rate of 35%) were not recognised in the Group (IAS 12.39).

Notes on the balance sheet

(16) Intangible assets

	Development costs (self-generated)	Goodwill (acquired)	Trade marks Patents, licences, software (acquired)	Total
		EUR ’000		
Net carrying value at 01.01.2009	**7,850**	**5,149**	**9,295**	**22,294**
Acquisition/manufacturing costs				
Balance at 01.01.2009	**11,464**	**6,649**	**22,433**	**40,546**
Effect of movement in exchange rates	—	—	(18)	(18)
Additions	2,676	—	337	3,013
Reclassifications	—	—	—	—
Disposals/retirements	(1,133)	—	(920)	(2,053)
Balance at 31.12.2009	**13,007**	**6,649**	**21,832**	**41,489**
Amortisation & depreciation				
Balance at 01.01.2009	**(3,614)**	**(1,500)**	**(13,138)**	**(18,252)**
Effect of movement in exchange rates	—	—	10	10
Amortisation for the year	(1,032)	—	(262)	(1,295)
Impairment	—	—	—	—
Reclassifications	—	—	—	—
Disposals	—	—	920	920
Balance at 31.12.2009	**(4,646)**	**(1,500)**	**(12,470)**	**(18,617)**
Net carrying value at 31.12.2009	**8,361**	**5,149**	**9,362**	**22,872**
Acquisition/manufacturing costs				
Balance at 01.01.2010	**13,007**	**6,649**	**21,832**	**41,489**
Effect of movement in exchange rates	—	—	35	35
Additions	3,388	—	321	3,709
Reclassifications	—	—	22	22
Disposals/retirements	(1,229)	—	(21)	(1,250)
Balance at 31.12.2010	**15,166**	**6,649**	**22,188**	**44,003**
Amortisation & depreciation				
Balance at 01.01.2010	**(4,646)**	**(1,500)**	**(12,470)**	**(18,617)**
Effect of movement in exchange rates	—	—	(18)	(18)
Amortisation for the year	(990)	—	(300)	(1,289)
Impairment	—	—	—	—
Reclassifications	—	—	(22)	(22)
Disposals	—	—	21	21
Balance at 31.12.2010	**(5,636)**	**(1,500)**	**(12,789)**	**(19,925)**
Net carrying value at 31.12.2010	**9,531**	**5,149**	**9,399**	**24,078**

As described in Note 5, goodwill and other intangible assets with indefinite lives are subject to annual impairment testing. Goodwill is allocated to the individual companies within the Group, which represent the segments and are the lowest level within the Heckler & Koch Beteiligungs Group at which goodwill is monitored for internal management purposes.

As shown above, aggregate goodwill is unchanged from the previous year at €5,149k. This is the portion of the net book value of goodwill, through acquisitions from independent third parties, at which it was held under German GAAP at the date of transition to IFRS (January 1, 2006) as shown in the Heckler & Koch Sub-Group’s consolidated financial statements (excluding trademarks). Originally, the parent company of this Sub-Group was called Heckler & Koch Wehrtechnik Holding GmbH. This company acquired the design, manufacturing and distribution company, Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003 and in 2004 the two companies were merged and renamed Heckler & Koch GmbH. As a result, the Group has goodwill of €4,016k allocated to the merged company Heckler & Koch GmbH. The balance of €1,133k is allocated to Heckler & Koch France SAS since this relates to its acquisition in 2004. Goodwill relates to the value of the companies in operation and is therefore treated as being of indefinite life. On the acquisition of Heckler & Koch Gesellschaft mit beschränkter Haftung, at the end of 2003, the trademark was also recognised as an intangible asset (2010: €8,393k, 2009: €8,393k) and allocated to the merged Heckler & Koch GmbH. The Group's reputation is associated with this trademark so that, like goodwill, it is also treated as being of indefinite life. These intangible assets are material to the Group's financial statements in accordance with IAS 38.122 (b).

NSAF Ltd was acquired for less than its equity value and the negative goodwill arising from this transaction is included in the Group's retained earnings. The US subsidiaries Small Arms Group Holding Inc. and Heckler & Koch Defense Inc. were founded by the Group and have no goodwill allocated to them. The acquisition of the US subsidiaries Suhler USA, Inc. and Heckler & Koch, Inc. and the Swiss subsidiary, Heckler & Koch S.A., were through transactions under common control and the Group's figures have been restated as if these transactions took place prior to the beginning of the earliest period shown; consequently the difference between the price paid and the net assets acquired has been offset against equity rather than being shown as goodwill.

HK Sidearms GmbH was acquired in July 2010 for €6.4 million, which was less than its equity and reserves. During the purchase price allocation, its inventories were reduced to their value to the Group by eliminating the Heckler & Koch GmbH profits from before the acquisition that were included in them. The remaining difference was allocated to reduce the Heckler & Koch, Inc. inventories, since these include HK Sidearms GmbH profits from before its acquisition. The intangible non-current assets acquired with HKS (€22k) and the associated cumulative amortisation (€22k) are shown in the "reclassifications" rows above.

Since the Group is privately owned, and similar companies have not been bought or sold regularly on an active market during the past year, it was not possible to base impairment tests on market value. Impairment tests were therefore based on value in use determined by discounting future cash flows projected based on actual operating results and the first five years of the annual ten year business plans.

The amortisation and impairment of intangible assets is included in the following income statement positions:

	2010	2009
	EUR '000	
Cost of sales	81	54
Research and development	999	1,046
Sales, marketing & distribution	1	22
Administration	209	172
Other expense	—	—
Total amortisation	**1,289**	**1,295**

As at December 31, 2010 the Group had a balance of €85k (2009: €41k) on order for intangible assets.

(17) Property, plant and equipment

	Land and buildings	Plant and machinery	Fixtures, fittings and other assets	Assets under construction	Total
			EUR '000		
Net carrying value at 01.01.2009	**26,477**	**20,303**	**9,658**	**695**	**57,133**
Acquisition/manufacturing costs					
Balance at 01.01.2009	**32,617**	**50,253**	**42,200**	**695**	**125,764**
Effect of movement in exchange rates	(57)	(29)	4	—	(81)
Additions	2,085	3,773	1,780	138	7,775
Reclassifications	51	551	93	(695)	—
Disposals	(23)	(1,929)	(3,161)	—	(5,114)
Balance at 31.12.2009	**34,672**	**52,618**	**40,916**	**138**	**128,344**
Amortisation & depreciation					
Balance at 01.01.2009	**(6,140)**	**(29,950)**	**(32,542)**	**—**	**(68,631)**
Effect of movement in exchange rates	(5)	6	(5)	—	(5)
Depreciation for the year	(1,161)	(4,745)	(2,894)	—	(8,800)
Impairment	—	—	—	—	—
Reclassifications	—	(1)	1	—	—
Disposals	17	1,929	2,720	—	4,666
Balance at 31.12.2009	**(7,290)**	**(32,761)**	**(32,720)**	**—**	**(72,770)**
Net carrying value at 31.12.2009	**27,383**	**19,857**	**8,196**	**138**	**55,574**

Acquisition/manufacturing costs					
Balance at 01.01.2010	**34,672**	**52,618**	**40,916**	**138**	**128,344**
Effect of movement in exchange rates	214	64	81	(0)	359
Additions	930	4,707	2,420	269	8,326
Reclassifications	17	118	84	(135)	84
Disposals	(1,758)	(4,631)	(906)	—	(7,296)
Balance at 31.12.2010	**34,075**	**52,875**	**42,595**	**272**	**129,817**
Amortisation & depreciation					
Balance at 01.01.2010	**(7,290)**	**(32,761)**	**(32,720)**	**—**	**(72,770)**
Effect of movement in exchange rates	(45)	(13)	(56)	—	(114)
Depreciation for the year	(1,912)	(4,634)	(2,561)	—	(9,108)
Impairment	—	—	—	—	—
Reclassifications	—	—	(76)	—	(76)
Disposals	754	4,036	781	—	5,572
Balance at 31.12.2010	**(8,493)**	**(33,371)**	**(34,632)**	**—**	**(76,496)**
Net carrying value at 31.12.2010	**25,582**	**19,504**	**7,963**	**272**	**53,321**

During 2010 there were no reclassifications of assets from property, plant and equipment to held for sale.

The fixtures, fittings and other assets acquired with HKS on July 1, 2010 (€84k) and the associated cumulative amortisation (€76k) are shown in the "reclassifications" rows above.

The asset group "fixtures, fittings and other assets" includes net carrying values of nil (2009: €79k) for certain assets acquired on finance leases, in particular computer servers. See Note 25 for details of the lease obligations and the reconciliation between the total minimum lease payments at the balance sheet date and their present values.

As at December 31, 2010 the Group had a balance of €1,413k (2009: €655k) on order for tangible non-current assets (excluding amounts shown in the above table under assets in course of construction).

(18) Investments in equity accounted investees, other non-current investments and current loans, investments and derivatives

The Group has granted loans to various third parties and related parties. Some of these loans include embedded derivatives, which are recognised at fair value through profit or loss. Because of impairments to the underlying contracts, all embedded derivatives have been recognised at nil since 2008.

1. Investments in and loans to the WOLF Garten group including embedded derivatives

In the past the Group has invested in shares of and loans to the Wolf Group. Collateral for the loans to Wolf Group companies was furnished in the form of land charge certificates and by the pledging of shares in Wolf—Garten Holding AG, Switzerland. This collateral may only be sold or used as collateral in another transaction in the event of delinquent payment.

Since the first companies of the Wolf Garten Group petitioned to open winding-up proceedings in January 2009, followed by other companies during the first quarter of 2009, an impairment loss was recognised as at December 31, 2008 for the entire investment of €380k and the € 40.3 million loan receivable. A fair value of €0 was therefore recognised and retained in 2009 and 2010. The official receiver in Oensingen, Switzerland, reported on February 22, 2010 that the Swiss Wolf Group had been wound up. According to the official receiver, HKB cannot expect any payment. €13,093k gross (nil net) in loan and interest receivables from the companies of the Swiss Wolf Group were therefore derecognised in 2010.

The Heckler & Koch Beteiligungs Group also holds an investment in Waipuna Ltd., which cooperates with Wolf. Due to the insolvency of the Wolf Group in 2009, the investment in Waipuna Ltd. was recognised in the financial statements for 2008 at a fair value of €0m. The impairment loss in 2008 amounted to €398k, which was recognised in the financial result. Since the situation has remained unchanged, the fair value of nil was retained in 2009 and 2010.

The insolvency proceedings for the Wolf Group in Germany are still in progress. The official receiver has reported that HKB's claims were rejected in the claim verification process. Based on the latest information, it can be assumed that HKB will not recover its loan receivable.

2. Loans to Vezla Ltd.

Vezla Ltd. is an investment firm engaged in the buying and selling of equities, primarily of listed companies. Based on its good investment track record, Vezla Ltd. was able to increase its investment activity at the start of 2008 through loans from Heckler & Koch Beteiligungs GmbH. In 2008 many of these investments were negatively affected by the turmoil in the global financial markets, resulting in an total loss on Vezla Ltd.'s portfolio. Heckler & Koch Beteiligungs GmbH therefore recognised an impairment on the entire €16.4 million in loans to Vezla Ltd. as at December 31, 2008.

On October 28, 2009, Vezla Ltd. and HKB agreed a grace period for repayment of the loans, including interest, until Vezla Ltd.'s business recovered (as measured by bilaterally agreed terms and conditions). The impairment loss remains recognised in full as Vezla Ltd. has failed to reach the lower limit defined for the grace period.

3. Loan to Aquamax S.A.

In 2007, the Group extended a loan to Aquamax S.A. to help finance the retrofitting of a ship, secured by its entry in the ship register. This collateral may only be sold or used as collateral in another transaction in the event of delinquent payment. As market opportunities have dried up following the economic crisis, the project was stopped and the loan written down in full. The recognised assets of Aquamax S.A. are so insignificant that they can satisfy neither the financing bank nor Heckler & Koch Beteiligungs GmbH. A fair value of €0 for the loan receivable including accrued interest was recognised in 2008 and this entire impairment loss was retained up to and including 2010. The value of the loan including interest as at December 31, 2010 is €12,290k; in 2010, the interest income for the current year was matched by an impairment charge of €531k (2009: €536k) recognised in the financial result.

4. Loans to Aviamax GmbH and Aviamax Aviation Ltd.

The Group extended loans to Aviamax GmbH and Aviamax Aviation Ltd. to help fund their investments in aircraft. In 2009, the entire €3,748k in remaining loan and interest receivables had to be written down after it became obvious that the market would remain in a protracted slump after the financial and economic crisis and that the price of the aircraft would remain low. In 2010, €575k impairment was recognised on the interest income and foreign currency translation differences for the current year and recognised as finance cost.

Winding up proceedings were instituted against the assets of Aviamax GmbH on September 2, 2010. The entire €1,719k in loan and interest receivables are therefore uncollectible. The winding up proceedings are still under way. The impairment loss has been retained.

The loan to Aviamax Aviation Ltd. for €2,603k (as at December 31, 2010) including interest and foreign currency translation differences is expected to be uncollectible. One of the company's aircraft was sold in October 2010. The proceeds on the sale did not cover the portion of the asset financed by the leasing company. Repayment of the loan by Aviamax Aviation Ltd. is not possible now or in the near future. The receivable has therefore been impaired in full.

5. Loan to Moraun S.A.

On November 6, 2008, HKB extended a loan to Moraun Investment S.A. Luxembourg (Moraun S.A.) for €2,925k. Moraun S.A. was unable to repay the loan to schedule on October 31, 2009; following a partial payment of €600k, they were given until February 28, 2010 to pay the remainder. In spite of repeated promises to repay the loan on time, the loan remained unpaid as at February 28, 2010. After being told that legal steps would be taken, Moraun S.A. surprisingly made a counterclaim based on a damage claim from Armatix GmbH against Heckler & Koch GmbH on the grounds of alleged anticompetitive conduct. These damage claims are unfounded and were rejected by Heckler & Koch GmbH.

In order to assert its claim for payment, HKB brought an action before the District Court of Stuttgart on March 12, 2010, which froze Moraun's accounts. These measures led to a settlement whereby Moraun repaid the € 3.0 million in principal and interest less a €56k reduction on July 21, 2010. The €1.4 million impairment loss was partly offset against the reduction on the loan and interest receivable, with the balance being reversed.

Taken as a whole, the write-downs in 'Other investments' explained in points 1 to 5 have resulted in an expense in the financial result of about €33.1 million for 2010 (2009: about €5.7m).

Other investments

The Group held a €13k investment in a dormant joint venture that was consolidated at equity in 2008 and was liquidated in 2009. A loss of €1k on liquidation was recognised in other expenses in 2009 and a cash receipt of €12k is included in investment activities in 2010.

The other non-current investments relate to the remaining balance not yet due on long-term loans.

The Heckler & Koch Group shows certain securities within other loans, investments and derivatives (2010: €933k, 2009: €612k). This investment is required by German law and these securities are pledged in full to secure claims relating to the German company's early retirement scheme "Altersteilzeit."

As at December 31, 2010, the Group held €40,684k (2009: € 35,111k) in short-term loans including interest to its shareholder Andreas Heeschen and €55k (2009: €0) in short-term loans including interest to its shareholder Keith Halsey; no separate collateral was held. Although the borrower is willing and able to repay the loan in the medium term, € 32 million impairment was recognised (2009: nil) at the reporting date in accordance with the imparity principle. As the shareholders are private individuals, the auditors engaged to audit the 2010 financial statements have insufficient information to enable them to determine whether these loan receivables are impaired; this has been commented on accordingly in the auditor's opinion.

Other than embedded derivatives, the Group only has derivative financial instruments relating to forward exchange and option contracts for USD/EUR. Unless hedge accounting applies, these are held at fair value through profit or loss (2010: €262k, 2009: €239k).

(19) Inventories and prepayments for inventories

	31/12/2010	31/12/2009
	EUR '000	
Raw materials, consumables and supplies	21,551	19,937
Work in progress	33,357	29,891
Finished goods and merchandise	18,276	21,978
Total	**73,184**	**71,806**

Under inventories, provisions of €13,055k (2009: €10,496k) have been made to account for marketability risks and slow-moving items. These provisions reduce certain items of inventory to carrying values in line with their fair values (less costs to sell) of €14,396k (2009: €14,127k).

Impairment losses of €86k (2009: €124k) recorded in prior years have been reversed within material expenses following increases in net realisable value due to the reassessment of saleability of certain items and the disposal of other items at higher values than their carrying values. A write-down of inventories of €1,972k (2009: €2,078k) was recognised as an expense.

(20) Trade and other receivables and prepayments for inventories

	31/12/2010	31/12/2009
	EUR '000	
Trade accounts receivable	48,286	39,263
Prepayments for inventories	3,727	5,843
Other assets	1,895	2,624
Total	**53,908**	**47,730**

The carrying values of trade accounts receivable and other receivables correspond to their fair market values. Trade accounts receivable include amounts due from the parent and indirect parent of the Group and are not interest-bearing; they usually have due dates between 30 and 90 days. These receivables also include amounts relating to construction contract revenue (€1,398k, 2009: €1,529k).

The other receivables are mainly for VAT & similar tax claims against various countries arising in the normal course of business.

Prepayments for inventories include €1,398k (2009: €2,686k) relating to advances paid for construction contracts (PoC).

If there is an indication that a receivable may be impaired, at the latest if it becomes over 180 days overdue, the possibility of impairment is reviewed by the finance, sales and legal departments. Provisions of € 141k (2009: €958k) have been made for individual doubtful debt risks within trade accounts receivable. The provision for doubtful trade accounts receivable has had the following movements during the reporting period:

	2010	2009
	EUR '000	
Opening balance January 1st	958	1,043
Creations	219	123
Release/utilisation	(1,065)	(195)
Effects of foreign currency conversion	29	(12)
Closing balance December 31st	**141**	**958**

All expenses from impairment (or income from reversal of impairment) of trade receivables is shown under other operating expenses (or income.

The aging of financial instruments that are trade accounts receivable is as follows:

	31/12/2010	31/12/2009
	EUR '000	

Not overdue:	**38,607**	**29,633**
Overdue:		
—within 30 days	6,565	5,241
—between 30 and 60 days	806	2,067
—between 60 and 90 days	606	60
—between 90 and 180 days	962	551
—after more than 180 days	840	1,713
Total:	**9,779**	**9,631**
Net trade accounts receivable	**48,286**	**39,263**

As at the balance sheet date, no evidence had been identified to suggest that any of the accounts receivable that were neither overdue nor impaired were doubtful.

(21) Cash and cash equivalents

The position cash and cash equivalents includes cash balances, cheques, bank balances on current accounts and short-term deposits, the original term of which is less than three months. These are valued at nominal value.

(22) Shareholders' equity

The following reconciliation of movement in capital and reserves shows the changes in the individual items of equity in the Group:

	Share Capital	Additional Paid in Capital	Translation Reserve	Reserve for Defined Benefit Obligations	Hedging Reserve	Consolidated Retained Earnings	Shareholders' Equity
				EUR '000			
As of 31.12.2008	**36**	**9,920**	**(527)**	**3,662**	**—**	**(128,164)**	**(115,074)**
Total recognised income & expense	—	—	700	(2,688)	(598)	(9,005)	(11,591)
As of 31.12.2009	**36**	**9,920**	**173**	**974**	**(598)**	**(137,169)**	**(126,664)**
Total recognised income & expense	—	—	(398)	(2,670)	569	(22,033)	(24,532)
As of 31.12.2010	**36**	**9,920**	**(225)**	**(1,695)**	**(29)**	**(159,203)**	**(151,196)**

The share capital shown is the nominal capital of the parent company Heckler & Koch Beteiligungs GmbH. Since it is a German limited company ("GmbH"), the subscribed capital is not divided into shares. The nominal capital of Heckler & Koch Beteiligungs GmbH is €80k. Under a notarised equity sale and transfer agreement, dated November 23, 2007, the parent company acquired 55.38% (par value €44.3k) of its own equity. The purchase price was €82,000k and was based on an enterprise valuation from IVAS GmbH, limited to the value of the proportion of the free equity and reserves determined from the interim statement of financial position as at the acquisition date.

The additional paid in capital arises from additional capital contributions from the shareholders.

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of foreign operations.

The reserve for defined benefit obligations comprises the cumulative actuarial gains and losses arising on the employee defined benefit obligation provisions, net of tax. The net decrease is due to actuarial losses of €3,694k (2009: €3,719k) net of €1,024k (2009: €1,031k) deferred taxes.

The hedging reserve comprises the cumulative gains and losses arising on the recognition of fair value movements on effective hedging instruments as defined by IAS 39. In 2010 there was a gain of €788k (2009: €828k loss) net of €218k (2009: €229k) deferred taxes.

The consolidated retained earnings/cumulative losses include a reduction of €62,333k arising from the effects of the transition to IFRS on January 1, 2008, mainly due to the valuation difference on the acquisition of treasury stock in November 2007 described above. An additional reduction of €2,857k arose from the difference between acquisition prices and associated net assets for the common control transactions involving the acquisition of Suhler USA, Inc., that took place in April 2009, and Suhler Jagd- und Sportwaffen Holding GmbH, that took place in May 2009, but have been shown as if they had taken place prior to the beginning of 2008. The consolidated retained earnings/cumulative losses, both currently and in the prior year, include neither profits nor losses relating to construction contracts.

Under the German limited liability companies act (GmbHG), the distributable dividend is determined by the retained earnings in the annual financial statements of Heckler & Koch Beteiligungs GmbH drawn up in accordance with the German commercial code (HGB), adjusted for certain non-distributable items. The executive board of the parent company, Heckler & Koch Beteiligungs GmbH, will propose to the shareholders meeting to add the loss for the year as at December 31, 2010 to the cumulative losses.

(23) Provisions for pensions and similar employee defined benefit obligations

The pension schemes at the foreign companies are defined contribution plans, while Heckler & Koch GmbH and HK Sidearms GmbH have both defined benefit and defined contribution plans. The defined benefit schemes for employees were most recently closed to new entrants in 2002.

Under the **Defined Contribution Plans** the company pays contributions to state or private pension schemes on the basis of statutory or contractual obligations or on a voluntary basis. Having paid the contributions, the company has no further obligations. The current contribution payments are shown as pension expense for the relevant year; for the Group, they amounted to a total of €3,254k (2009: €3,259k).

The **Defined Benefit Plans** are accounted for in the Group by setting up provisions for pensions, retirement and death benefits determined by the Projected Unit Credit Method in accordance with IAS 19. Under this method, in addition to the pensions and vested rights known at the balance sheet date, expected future increases in pensions and salaries, with realistic estimates of the demographic variables, are also taken into consideration. The value is obtained from an actuarial report calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2005 G guideline tables).

The main assumptions are:

Measurement at	**31.12.2010**	**31.12.2009**
Discount rate	4.65%	5.00%
Increase in entitlement of active pension expectants	0.00%	0.00%
Future pension increase p.a.	2.00%	1.75%

Under the defined benefit schemes, on reaching the retirement age of 65, employees are entitled to benefits based on their length of service. The defined benefit schemes in operation before 1995 entitle members to benefits for the first ten years' service of 8% of the average monthly salary for the final year, plus 0.25% for each additional year of service. Together with the state pension, the company pension entitlement may not exceed 75% of the employee's average monthly gross salary for the final year. Increases are no longer possible since these schemes are closed and members' entitlements remain fixed.

Under the defined benefit scheme from January 1, 1995, members are entitled to benefits of a fixed sum per year of service depending on the member's grade. The relevant grade for active members is the grade on retirement. This scheme was closed to new entrants on November 30, 2002.

Senior employees are also covered by the above schemes, although some have individual pension agreements within their contracts. In these cases, the level of entitlements depends on the contractual agreement.

The following amounts are recorded in the income statement with regard to defined benefit plans:

	2010	**2009**
	EUR '000	
Current service costs	313	277
Interest expense	2,457	2,700
Less expected return on scheme assets	(21)	(24)
Total net expense	**2,748**	**2,953**

The current service costs are shown within other expenses and the annual interest expense is shown within the interest result. Actuarial gains and losses are recognised in the statement of comprehensive income and taken to reserves.

The changes in the present value of the gross unfunded and funded defined benefit obligations are as follows:

	2010	**2009**
	EUR '000	
Present value of obligations as at Jan. 1st	**48,897**	**44,998**

Current service costs	313	277
Interest expense	2,457	2,700
Pension payments/utilisation	(2,866)	(2,766)
Actuarial (gains)/losses	3,669	3,688
Present value of obligations as at Dec. 31st	**52,960**	**48,897**

The changes in the present value of the funded plan assets are as follows:

	2010	2009
	EUR ’000	
Fair market value of plan assets as at 01.01	**426**	**433**
Expected return on scheme assets	21	24
Reclassification of credit note balance to advances paid	(57)	—
Actuarial gains/(losses)	(25)	(31)
Fair market value of plan assets as at 31.12.	**366**	**426**

The fair market value of the plan assets relates to asset values from reinsurance policies. The expected long-term returns from these plan assets are calculated with 5.0% (2009: 5.5%). These are based on the past interest level for long-term retirement plans (for example life insurance policies). The actual earnings from the plan assets are €4k loss (2009: €7k loss). Contributions of around €30k are expected to be made in 2011.

(23) Provisions for pensions and similar employee defined benefit obligations

The amount shown in the balance sheet for the Group's obligation is derived as follows:

	31.12.2010	31.12.2009	31.12.2008	01.01.2008
	EUR '000			
Present value of obligations covered by funds and not covered by funds	**52,960**	**48,897**	**44,998**	**44,995**
Less fair market value of plan assets	(366)	(426)	(433)	(276)
Present value of net obligations	52,594	48,470	44,565	44,719
Actuarial losses not yet recognised	—	—	—	—
Net liability in the balance sheet	**52,594**	**48,470**	**44,565**	**44,719**

(24) Other current and non-current general liability provisions

The current and non-current general liability provisions are as follows:

	31/12/2010	31/12/2009
	EUR '000	
Current provisions & accruals	7,522	5,206
Non-current provisions	13,493	12,432
Total	**21,015**	**17,638**

The provisions comprise:

	Personnel obligations	Warranty obligations	Obligations relating to sales	Other risks	Total
	EUR '000				
Balance at 01.01.2010	**5,000**	**1,559**	**9,566**	**1,512**	**17,638**
Exchange rate difference	359	—	99	—	457
Utilisation	1,226	(488)	(201)	(702)	(165)
Release	(112)	—	(902)	(20)	(1,035)
Creation	1,339	1,894	453	433	4,120
Balance at 31.12.2010	**7,812**	**2,966**	**9,014**	**1,223**	**21,015**

Provisions for the German early retirement scheme ("Altersteilzeit") are included in the personnel obligations. These provisions take account of the additional costs to the company during the early retirement phase, partially offset by the reduced pay taken by employees in this scheme during the working phase. The value is based on the associated contractual obligations and is obtained from actuarial reports, calculated using biometric actuarial assumptions (Prof. Dr. Klaus Heubeck's 2005 G guideline tables), discounted at 5.5%. There are no material uncertainties with regard to the value of these provisions. The early retirement scheme agreements usually cover four years. In the first two years the provision is created; the outflows of economic benefits occur in the last two years.

The personnel obligations also include provisions for long-service anniversary benefits, similar obligations and termination. These personnel provisions are determined based on the associated contractual obligations and the outflows of economic benefits are generally expected within twelve months, although the anniversary benefits (€461k, 2009: €523k) will be paid out over forty years. There are no material uncertainties with regard to the value of these provisions.

The provisions for warranties were recognised on the basis of past experience with regard to the Group liability for a warranty period of two years. Accordingly the outflows of economic benefits are expected within two years. There are no material uncertainties with regard to the value of these provisions.

Provisions relating to sales obligations include provisions for offset obligations, late delivery penalties, costs to complete and price-audits on certain projects. These provisions have been recognised in line with the probability of their incidence, based on the associated contractual obligations and the current status and the outflows of economic benefits are generally expected within twelve months, with offset compensation payments falling due after up to ten years. There are no material uncertainties with regard to the value of these provisions.

The other provisions relate mainly to litigation risks, recognised in line with the probability of their incidence. The outcome of the litigation depends on the associated legal proceedings and accordingly these provisions are based on particular uncertainties. The outflows of economic benefits are generally expected within twelve months.

The effects of accretion and changes in discount rates were material for the valuations of certain non-current general liability provisions. The financial result includes €1,161k (2009: €0k) net income due to discounting and accreting these other non-current provisions, leading to a reduction in the value recognised for these provisions.

(25) Current and non-current financial liabilities

The Group does not have any bank overdrafts or loans. It has two main financial liabilities: a PIK loan and a high yield bond.

The PIK loan for an original amount of €100 million was issued by the parent company in 2006, with interest charged at the EURIBOR rate + 8%, and since September 2009 at the EURIBOR rate +10%, and maturing in April 2013. HKB acquired participations in this PIK loan and nets these assets with the corresponding liabilities. Interest due can either be paid on a quarterly basis or added to the loan; the company has regularly availed itself of the latter option. Accordingly the net loan liability increased to €163,114k (2009: €149,073k). The net accrued interest of €3,931k (2009: € 3,514k) is recognised within the other liabilities.

The shares in HK Holding, Inc., the parent company of Heckler & Koch GmbH, have been provided as collateral to secure Heckler & Koch Beteiligungs GmbH's liabilities arising from the PIK loan. Through the consolidation, these shares, which are carried at €92 million in the separate financial statements, are not included in the consolidated statement of financial position; instead, they are replaced by the assets and liabilities of the consolidated entity.

The PIK loan agreement contains rules on the usage of funds and sets down half-year reporting obligations. A breach of the PIK loan conditions ("default") enables the lenders to have the administrative agent Merrill Lynch issue a formal notice of default requiring the fulfilment of the obligations. If the default is not remedied within 30 days of this notice, the administrative agent can declare an event of default so that the loan can be accelerated and made immediately due and payable.

In 2009, Merrill Lynch issued a series of formal notices of default to the borrower, Heckler & Koch Beteiligungs GmbH, based on breaches of the PIK loan conditions. In two instances, the borrower remedied the breaches, which were based solely on defaults in respect of timing; in two other cases, it submitted written evidence that no breach of the PIK loan conditions had taken place. The PIK loan agreement expressly states that, if the conditions are breached, the administrative agent can declare an event of default and make the loan immediately due and payable. At no time whatsoever did Merrill Lynch declare an event of default.

On November 18, 2009, a group of PIK lenders (the hedge funds CMF Cayman Ltd., Redwood Master Fund Ltd., Stark Master Fund Ltd., D.E.Shaw Laminar Portfolios, L.L.C.) and loan agent Merrill Lynch brought an action against Heckler & Koch Beteiligungs GmbH before the New York State Supreme Court. They accused Heckler & Koch Beteiligungs GmbH of having breached various conditions and obligations under the loan agreement of March 23, 2006 for €100 million. On February 3, 2010, they broadened the complaint with an action against Heckler & Koch Beteiligungs GmbH's shareholders for money had and received.

The action and broadened action qualify as actions for a declaratory judgment under German law. The plaintiffs asked for a court ruling that HKB was in breach of the PIK loan conditions and in breach of contract and that the situation had not been remedied. The court was also asked to rule that Merrill Lynch, as the administrative agent under the PIK loan agreement, follow the instructions of the PIK lenders and declare an event of default so the PIK loan could be made due and payable as soon as possible. It was also requested, in the broadened action, that HKB and its shareholders, Heeschen and Halsey, immediately repay the amounts owed to the plaintiffs, i.e. the PIK lenders, including the cost of legal advice incurred in conjunction with HKB's alleged breaches of contract.

HKB finds the allegations unfounded and rejects them. Kirkland & Ellis, attorneys for the defendant, filed a motion to dismiss with the New York Supreme Court on March 12, 2010 with the following reasoning:

There is no cause of action, as there is no event of default. Such would be, according to the PIK loan agreement, a mandatory condition to making the loan immediately due and payable. In addition, an event of default can, under the PIK loan agreement, only be declared by the administrative agent (Merrill Lynch). If the administrative agent manifestly does not carry out the lenders' instructions to declare an event of default, the lenders can bring an action against the administrative agent, but not the borrower; in as much, the defendant is not the proper party with respect to the plaintiff's claim.

On April 13, 2010, the claim was heard by the New York Supreme Court in the presence of the attorneys for the plaintiffs and the defendant.

As expected, the claim was rejected in August 2010 as inadmissible.

The high yield bond for €120 million was issued by subsidiary Heckler & Koch GmbH in 2004 at a fixed rate of interest of 9.25%, and matures in July 2011. This bond is carried at its amortised cost of €119,207k (2009: €117,851k). The €5,118k (2009: €5,118k) in accrued interest is recognised within the other liabilities.

As security for Heckler & Koch GmbH's liabilities under the Bond Indenture, the subsidiaries of Heckler & Koch GmbH have entered into Supplemental Indentures and Abstract Acknowledgements of Indebtedness and have provided Subsidiary Guarantees. Heckler & Koch GmbH has also issued a €30 million Note Proceeds Loan to its US subsidiary Heckler & Koch Defense Inc. and has granted a security interest in its rights under this to the Bank of New York as trustee under the Indenture. In addition, HK Holding, Inc., the sole owner of Heckler & Koch GmbH, has granted first ranking pledges over all present and future shares in Heckler & Koch GmbH as security for the obligations under the Indenture.

The bond for €120 million matures in July 2011. For reinancing purposes, Heckler & Koch GmbH engaged Close Brothers Seydler Bank AG (CBSB), Frankfurt am Main, to prepare the issue of a new corporate bond. The company intends to repay part of the existing bond from its own funds. The new bond is intended to be placed for a reduced total of €100 million with a term of between five and seven years and offered to institutional investors in Germany and the rest of Europe as well as, probably, German private investors. Given the sound fundamental data and the company's recent positive trend in business as well as the favourable market environment at present, the management is confident that the bond can be placed successfully. Funding the existing bond by issuing a new HKO corporate bond is a cornerstone of the future financial structure of parent company Heckler & Koch Beteiligungs GmbH (HKB), which gives its unreserved support; although other options, including the early repayment of HKB's PIK loan. are being explored.

Considering the favourable market environment at the time, Citibank was engaged for the issue of a high yield bond, with which both the soon to mature HKO bond and the PIK loan maturing in April 2013 could be refinanced early. The feasibility of this option will depend on the receptiveness of the market and the conditions.

The credit facilities for the Heckler & Koch Group are only for the issue by banks of advance payment or performance guarantees, including bid bonds. The value of guarantees currently outstanding is not recognised in the balance sheet. As of December 31, 2010 we had a total of €17.3 million such guarantees outstanding, compared to €19.2 million as of December 31, 2009. As a requirement for the provision and maintenance of these and other forward-cover and guarantee lines, our guarantee-providers require us to maintain a varying level of deposits with them as security. As at December 31, 2010 we had €18.5 million such security deposits (2009: €19.0 million); these pledged security deposits are included in cash and cash equivalents.

As mentioned in Note 17, the Group acquired certain assets on finance leases, in particular computer servers. The finance lease liabilities are payable as follows:

	Future minimum lease payments 2010	Interest 2010	Present value of minimum lease payments 2010	Future minimum lease payments 2009	Interest 2009	Present value of minimum lease payments 2009
			EUR '000			
Less than one year	—	—	—	87	2	86
Between one and five years	—	—	—	—	—	—
More than five years	—	—	—	—	—	—
Total finance lease liabilities	**—**	**—**	**—**	**87**	**2**	**86**

(26) Trade and other payables

Trade and other payables include outstanding liabilities from trade and operating costs, together with interest payable on the bond. Of these, €111k (2009: €167k) are shown within non-current liabilities since they are not due within twelve months.

	31/12/2010	31/12/2009
	EUR '000	
Trade payables	26,317	22,047

Interest payable	9,069	8,652
Other payables	5,761	7,022
Total	**41,146**	**37,722**

The carrying value of the trade payables corresponds approximately to their fair market value.

With the exception of normal trading ownership retention clauses, the trade and other payables are not secured.

(27) Advanced and stage payments received

Advanced and stage payments received comprise payments received from customers in advance of the delivery of the associated products or services. The advance and stage payments include amounts relating to advances for construction contracts (€708k, 2009: €1,480k).

Other disclosures

(28) Financial risk management

Currency risk

The Group is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of Group entities, primarily the euro (EUR), but also US dollars (USD) and Sterling (GBP). The majority of both our costs and our sales are in euro, so we only have foreign exchange transaction exposure for those sales in currencies different to the associated costs. Group policy is to cover a proportion of the expected USD ($) income and the associated foreign exchange transaction exposure with hedging transactions. As at December 31, 2010 we had forward cover contracts for a total of $12m.

Group policy is not to speculate with loans or deposits in foreign currencies. Financing and investing within the Group usually take place in the appropriate functional currency and any financial instruments are purely for operating purposes. Contrary to Group policy, Heckler & Koch Beteiligungs GmbH granted loans in foreign currency (USD) in 2007. Apart from one, all of these loans were repaid in 2008 without any loss. The remaining loan was held in 2009 and 2010 at a fair value of nil, as it had become uncollectible in the meantime. In future, no new loans in foreign currency, with corresponding foreign currency risk, will be granted at Group level either; instead, the general Group policy shall be followed.

Seven subsidiaries of Heckler & Koch Beteiligungs GmbH are outside the Euro zone. Since the Heckler & Koch Beteiligungs Group reporting currency is the euro, the income and expenses of these subsidiaries are converted to euro for consolidation. Changes in average foreign exchange conversion rates compared with prior periods can therefore have an effect on the consolidated results.

In addition, through these subsidiaries the Group has assets and liabilities in local currencies outside the Euro zone. The conversion of these positions to euro is also affected by fluctuations in foreign exchange conversion rates. The change in valuation of these positions is reflected in the Group reserves.

The rates used for the consolidation are shown in the following table:

Currency	Abbr.	Rate on balance sheet date 31.12.2010	Rate on balance sheet date 31.12.2009	Rate on balance sheet date 31.12.2008	Average exchange rate 2010	Average exchange rate 2009
US Dollar (USA)	**USD**	1.3362	1.4406	1.3917	1.3282	1.3947
Pound (United Kingdom)	**GBP**	0.8608	0.8881	0.9525	0.8590	0.8919
Swiss Francs	**CHF**	1.2504	1.4836	1.4850	1.3790	1.5102

In order to quantify the possible effects of foreign exchange rate fluctuations on the Group EBITDA, sales and equity, a sensitivity analysis has been carried out:

If the US dollar had been 10% weaker against the euro compared to the rates used for the 2010 consolidation, (i.e. had been an average of €1 = $1.4610 and a spot of €1 = $1.4698), then 2010 sales would have been approximately €4.0 million lower, EBITDA would have been approximately €1.5 million lower and equity and reserves would have been approximately €3.6 million lower.

If the pound sterling had been 10% weaker against the euro compared to the rates used for the 2010 consolidation, (i.e. had been an average of €1 = £0.9449 and a spot of €1 = £0.9468), then 2010 sales would have been approximately €1.4 million lower, EBITDA would have been approximately €0.5 million lower and equity and reserves would have been approximately €0.1 million higher.

Interest rate risk

Interest rate risk is the risk that the fair value or the future cash flows of a financial instrument may change depending on market interest rates. The Group has two interest-bearing liabilities: (i) a €120 million bond which matures in July 2011 and has a fixed interest rate of 9.25%, and (ii) a PIK loan for €100 million plus accrued interest, which matures in April 2013 and is subject to interest at the EURIBOR rate plus a 10% spread. The fair value of the bond is dependent on market interest rates but the related cash flows are fixed.

For the PIK loan, the amount repayable upon maturity depends on changes in market interest rates. The advance payment guarantees or performance bonds, which our banks provide to our customers, are not interest-bearing.

If the EURIBOR rate on the four dates when the PIK interest rate was fixed in 2009 were 1 percentage point higher than the interest rates used in 2010 (January from 0.685% to 1.685%; April from 0.642% to 1.642%; July from 0.827% to 1.827% and October from 0.982% to 1.982%), revenue and EBITDA would have remained the same and equity and the reserves would have been about €1.6 million lower. The difference affects interest income and expenses only, as no material tax effect is expected because of the limit on deductibility of interest for tax calculation rules.

If the EURIBOR rate on the four dates when the PIK interest rate was fixed in 2009 were a maximum of 1 percentage point lower than the interest rates used in 2009 (January from 0.685% to 0%; April from 0.642% to 0%; July from 0.827% to 0% and October from 0.982% to 0%), revenue and EBITDA would have remained the same and equity and the reserves would have been about € 1.2 million higher. The difference affects interest income and expenses only, as no material tax effect is expected because of the limit on deductibility of interest for tax calculation rules.

In December 2010, Close Brothers Seydler Bank AG was engaged to prepare the issue of a new corporate bond for €100 million, which would be added along with the cash funds to repay the current bond. The funding process is expected to be completed by the end of the second quarter of 2011.

As the interest rate for this financing is not fixed at present, this increases the Heckler & Koch Group’s exposure to interest rate risks. However the interest rate is expected to be less than 9.25% and therefore less than for the current bond. The optional high yield bond—total refinancing referred to in Note 25 also includes an interest rate risk, yet here too, expectations are that the overall interest expense will be lower than with the present financing structure. At any rate, the long-term clarity on financing conditions will have a positive effect.

Commodity risk

Because our purchases of commodities in terms of quantities purchased are relatively small, our exposure to commodity risk is limited.

Credit risk

Credit risk is the risk of financial loss to the Group if a customer or counter-party to a financial instrument fails to meet its contractual obligations. Credit risk in the operating Sub-Group arises principally from the trade receivables and, in HKB, from loan and interest receivables.

Trade accounts receivable

Because the vast majority of our customers are federal, state or local governmental agencies of NATO countries, our exposure to credit risk is limited. However the recent worldwide financial and economic crisis and the consequent increased sovereign budget deficits are likely to put long-term pressure on defence budgets in many of the countries we deliver to, leading to increased credit risk for certain customers. Rating agencies have reduced the credit ratings for some countries, but the Group does not have accounts receivable from less credit-worthy countries.

Our goods are sold subject to retention of title clauses so that in the event of non-payment the Group may have a secured claim. Where management is of the opinion that the risk is not sufficiently secured by the retention of title clauses, we require letters of credit or prepayments. The Group has internal credit management processes to review and manage overdue positions and if necessary stop further deliveries or initiate legal action.

In addition, provisions are held for doubtful debts. The maximum risk is the value shown as trade accounts receivable in the balance sheet. The book values of trade accounts receivable analysed according to their aging, together with the associated provisions, are shown in Note 20. Risk concentrations arise for financial instruments of a similar nature, which react similarly to economic and other changes. Risk concentrations are determined per counterparty, with all of a country's authorities being treated as one counterparty. The largest risk concentration for trade receivables and other assets as at December, 31, 2010 is €18.1 million owed by one counterparty, €0.2 million of which is past due.

Some of our customers cover the risk of potential damage arising from a breach of production or delivery terms on our part through advance payment guarantees and performance bonds.

Loan and interest receivables

Some of the loans are impaired; see Note 18. The risk exposure is limited to the carrying amount as at the reporting date. Risk concentrations arise for financial instruments of a similar nature, which react similarly to economic and other changes. Risk concentrations are determined per counterparty. The largest risk concentration for loan and interest receivables as at December 31, 2010 is €8.7 million owed by one counterparty.

Cash and cash equivalents

Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. The Heckler & Koch Beteiligungs Group is exposed to credit risks if the banks holding our deposits default on their obligations. To minimise this risk, the banks are selected with care and the majority of the deposits are with a German bank which is partially owned by the State of Baden-Württemberg and participates in a deposit security reserve. The risk exposure is limited to the carrying amount as at the reporting date.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to meet its financial obligations as they fall due. The target of the Group's approach to managing liquidity is to ensure that there will always be sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to the Group's reputation.

The Heckler & Koch GmbH Sub-Group mainly generates cash through its operating activities and this is primarily used to finance capital expenditure and working capital. In 2004 additional financing was obtained through the issue of fixed rate Notes, the proceeds of which were mainly used to (1) repay shareholder loans, and (2) partially finance the purchase of minority interests. The bond was also intended to (3) pre-fund an expansion in the US, however the anticipated contract was not awarded so that the capital expenditure was not required, leaving a significant cash balance.

At present the Heckler & Koch Group does not have any credit lines set up other than for the issue by banks of advance payment or performance guarantees, however we believe that the current cash position is more than sufficient to meet liquidity requirements until the maturity of the Notes in July 2011. The requirement that the bond be refinanced in July 2011 presents the greatest liquidity risk for the Group at present. As explained in Note 25, in December 2010 the Close Brothers Seydler Bank was given a mandate to prepare the issue of a new bond, expected to be for €100 million. Based on a study of the market, the receptivity appears to be good. This process is expected to be complete by the end of the second quarter of 2011.

In November 2010, Standard & Poor's downgraded the rating for Heckler & Koch GmbH from B- negative to CCC+ negative; in December 2010, Moody's also altered the rating from B2 to B3 They cited the incomplete refinancing for the €120 million bond falling due in July 2011 as the main reason. For the same reason, Standard & Poor's further downgraded the rating to CCC- in February 2011 and in March 2011 Moody's downgraded the company's rating to Caa1. Although a downgrade is detrimental to the conditions of the funding sought by the Group, we do not see this as a threat to obtaining follow-up financing. The company expects that when the funding is complete, Standard & Poor's and Moody's will upgrade the company's rating.

Heckler & Koch Beteiligungs GmbH's €100 million PIK loan, on the books since April 2006, plus accrued interest over the entire term of the loan, must be paid by April 7, 2013. The ability to repay the loan and accrued interest (€167 million as at December 31, 2010) using the company's interest-bearing assets is limited to a small proportion, the earnings power and financial strength of the Group and therefore the defence division will be required as well. As reported in Note 25, the premature repayment of the PIK loan and its funding through a high yield bond is an option.

The following table shows the timing of contractual payments due for financial instruments that are accounts payable, capital leases, loan interest, loan repayments or derivatives.

	Trade payables	Derivative financial liabilities	Other	Total
		EUR ’000		
Balance at 31.12.2010				
Book value	26,317	40	291,560	317,917
Related payments	26,415	40	346,267	372,722
Payments due:				
—within one month	17,467	6	5,551	23,024
—between one and three months	7,061	34	—	7,095
—between three & twelve months	1,887	—	125,606	127,492
—between one and five years	—	—	215,111	215,111
—after more than five years	—	—	—	—

Variances between book value and related payments arise where certain non-current liabilities, in particular the bond, are held at their amortised costs. Additional information on financial liabilities is given in Note 25. The PIK loan agreement contains rules on the usage of funds and sets out half-year reporting obligations. A breach of the PIK loan conditions (“default”) enables the lender to have administrative agent Merrill Lynch issue a formal notice of default. If the default is not remedied within 30 days after notice thereof, the loan can be accelerated and made immediately due and payable. This concerns €167,045k in principal and interest; the expected payments of €215,000k in the table above are presented as falling due between one and five years. These are determined using an average interest rate of 11.1%, and assume no premature interest payments.

Capital management

The policy of the Executive Directors of the Heckler & Koch GmbH Sub-Group is to maintain strong capital base in order to ensure investor, creditor and market confidence is sustained and thereby to facilitate and support future business development. To achieve this policy, it is necessary to maintain a strong credit rating and healthy capital ratios. The rating downgrades from Standard & Poor’s in February 2011 to CCC- and from Moody’s in March 2011 to Caa1 are due to the fact that refinancing for the bond has not yet been finalised. The company expects that leading rating agencies will upgrade the rating once refinancing has been finalised.

The Group aims to have a simple corporate and capital structure and does not have any off balance sheet financing. In the normal course of business, performance and advance payment guarantees are issued to our customers by banks and insurers on our behalf (see Note 25). Group policy requires that the return be determined for all large contract bid decisions.

Debt financing is largely long-term in nature being through the €120 million Heckler & Koch GmbH bond and the €100 million PIK loan taken out by Heckler & Koch Beteiligungs GmbH. There is also the interest accrued on the PIK loan, amounting to €72.2 million as at the end of the reporting period. Based on the contractual definition, this is recognised as €68.1 million loan principal and €4.1 million interest payable. In addition, PIK loan participations were purchased in January 2008 and May 2010. This reduces the net liability by €5.1 million (2009: €2.0 million) and, accordingly, also the net interest expense for this loan.

The aim of HKB’s financial management is to service future interest payments and the repayment of principal to schedule. According to the terms of the corporate bond, the Heckler & Koch GmbH Sub-Group may only distribute dividends to HKB under very limited conditions. In order to reduce interest expenses, it is intended to reorganise the financial structure at the individual company level as well as at Group level. All funding options are being examined. In order to benefit from the low interest rate level at present, the full or partial premature repayment of the PIK loan is conceivable.

Dividends to shareholders are restricted under the terms of the PIK loan; together with certain other transactions, they are classed as “Restricted Payments”. The cumulative total of such payments is limited to:

- €35m
- plus the cash inflow from the disposal of certain of HKB’s assets that were recognised as at December 31, 2005.
- plus payments received in relation to HKB’s loan receivables and similar assets that were recognised as at December 31, 2005.

- plus payments received in relation to loans and similar investments, which were made in accordance with this clause.

Neither the parent company nor any of its subsidiaries are subject to externally imposed capital requirements.

The Group's capital structure is as follows:

	2010	2009
	EUR '000	
Equity	**(151,196)**	**(126,664)**
as a percentage of total financing	−53%	−43%
Long-term liabilities	369,807	349,783
Short-term liabilities	65,725	73,285
Debt	**435,532**	**423,068**
as a percentage of total financing	153%	143%
Total equity & liabilities	**284,337**	**296,403**

(29) Additional disclosures on financial instruments

This note provides an overview of the significance of financial instruments and provides additional information on the balance sheet positions containing financial instruments.

The following table shows the book values (BV) and fair values (FV) of the financial assets:

	Cash and equivalents		Trade accounts receivable		Securities		Derivative financial instruments		Other financial instruments	
	BV	FV	BV	FV	BV	FV	BV	FV	BV	FV
	EUR '000									
Balance at 31.12.2010										
Cash & equivalents	55,893	55,893	—	—	—	—	—	—	—	—
Loans & receivables	—	—	48,286	48,286	—	—	—	—	19,651	19,651
Held to maturity	—	—	—	—	933	933	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—
Held at fair value through profit or loss	—	—	—	—	—	—	262	262	—	—
Total financial assets	**55,893**	**55,893**	**48,286**	**48,286**	**933**	**933**	**262**	**262**	**19,651**	**19,651**
Balance at 31.12.2009										
Cash & equivalents	52,502	52,502	—	—	—	—	—	—	—	—
Loans & receivables	—	—	39,263	39,263	—	—	—	—	47,152	47,152
Held to maturity	—	—	—	—	612	612	—	—	—	—
Held for trading	—	—	—	—	—	—	—	—	—	—
Available for sale	—	—	—	—	—	—	—	—	—	—
Held at fair value through profit or loss	—	—	—	—	—	—	239	239	—	—
Total financial assets	**52,502**	**52,502**	**39,263**	**39,263**	**612**	**612**	**239**	**239**	**47,152**	**47,152**

The fair values of loans and accounts receivable is believed to be equal to the book values. This is mainly due to the short terms of these instruments. The financial instruments held to maturity are participations in funds by which there is not material variance between book and fair value. "Other financial instruments" are mainly loan and interest receivables. During the reporting period there were no reclassifications of financial assets or transfers of financial assets that did not qualify for derecognition.

The following table shows the book values (BV) and fair values (FV) of financial liabilities:

	Trade payables		Finance lease liabilities		Derivative liabilities		Other financial liabilities	
	BV	FV	BV	FV	BV	FV	BV	FV
	EUR '000							
Balance at 31.12.2010								
Held at amortised cost	26,317	26,317	—	—	—	—	291,560	284,739
Held for trading	—	—	—	—	—	—	—	—
Held at fair value	—	—	—	—	40	40	—	—
Financial liabilities	**26,317**	**26,317**	**—**	**—**	**40**	**40**	**291,560**	**284,739**
Balance at 31.12.2009								
Held at amortised cost	22,047	22,047	86	86	—	—	276,936	277,313

Held for trading	—	—	—	—	—	—	—	—
Held at fair value	—	—	—	—	828	828	—	—
Financial liabilities	**22,047**	**22,047**	**86**	**86**	**828**	**828**	**276,936**	**277,313**

The other financial liabilities mainly relate to the PIK loan, the bond and the interest liability for these.

During 2009, Heckler & Koch GmbH entered into a cash flow forward cover hedging arrangement for a large purchase contract with USD cash flows during 2009-2011. The derivative is recognised at its fair value as determined by the partner bank (€40k, 2009: €828k). The derivative is a perfect hedge since it enables the payments to match the related EUR receipts, so changes in fair value are recognised in other comprehensive income (€788k income, 2009: €828k expense).

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices)
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs)

31.12.2010	**Level 1**	**Level 2**	**Level 3**
		EUR ’000	
Derivative financial assets	—	262	—
Derivative financial liabilities	—	40	—

31.12.2009	**Level 1**	**Level 2**	**Level 3**
		EUR ’000	
Derivative financial assets	—	239	—
Derivative financial liabilities	—	828	—

The financial instruments recognised at fair value in accordance with the valuation technique at level 3 comprise embedded derivatives in the loan contracts. Because of impairments to the underlying contracts, these embedded derivatives have been recognised as nil since 2008.

Net income/(expenses) due to financial instruments:

	2010	**2009**
	EUR ’000	
Financial assets held for trading	—	—
Financial assets held to maturity	—	—
Loans and receivables and financial liabilities held at cost	(30,786)	(5,613)
Held at fair value	42	(946)

The net income/(expense) from loans and receivables and financial liabilities held at cost include exchange gains and losses, impairments and reversals of previous impairments. The net income/(expense) from financial instruments held at fair value (derivatives) relates to the recognition of (1) the valuation changes for forward contracts to hedge USD cash flows (2010: €277k income; 2009: €897k expense), and (2) losses on the valuation of options to hedge USD cash flows in 2010 (€235k; 2009: €49k).

The total interest income and expenses relating to financial assets and liabilities not held at fair value through profit and loss are as follows:

	2010	**2009**
	EUR ’000	
Interest income	5,202	4,875
Accretion of non-current liabilities	(4,131)	(3,923)
Other interest expenses	(28,324)	(26,632)

(30) Cash flow statement

The Group cash flow shows the cash inflows and outflows leading to the change in cash and cash equivalents during the year. Cash and cash equivalents include cash balances, cheques, bank balances on current accounts and short-term deposits. As required by IAS 7, cash flows are analysed between operating, investing and financing activities.

Cash flows from investing and financing activities are determined directly while those from operating activities are calculated indirectly from the net results. The changes in balance sheet positions used in the indirect calculation are adjusted to exclude the effects of foreign exchange rate variances and changes in the companies consolidated into the Group. The changes in the balance sheet positions shown in the cash flow are therefore different to the euro changes in the Group balance sheet.

Interest received is classified as a cash flow due to investing activities. Interest paid and payments relating to finance leases are shown as cash flows due to financing activities. In order to make this information more useful to users, the quarterly reclassification of interest payable into loans payable is presented for the PIK loan as interest payments through receipt of additional loans, even though in this particular case the interest is offset.

(31) Segment reporting

The organisation and reporting structure of the Heckler & Koch Beteiligungs Group is marked by its division into two lines of business: the Heckler & Koch GmbH defence Sub-Group and the other investment activities of Heckler & Koch Beteiligungs GmbH.

The Heckler & Koch Sub-Group is organised around six (prior to the acquisition of HKS: five) operating companies, four of which serve defence and law enforcement sectors, whilst the fifth (HKI) serves US civil and local law enforcement sectors and the sixth (HKS) serves the German civilian market in addition to serving other Group companies. Correspondingly, the segments analysed are the site locations in Germany, split into Defence and Civil, Great Britain, France and the United States, with the US also split into Civil and Defense. Since these companies are each legal entities, the figures shown for each segment are the values for the companies as included in the Heckler & Koch Group's consolidated figures.

The activities in reporting segment Site Location Germany—Defence relate to the design, manufacture and distribution of defence and security products together with the provision of associated services. The site location Germany—Defence mainly supplies to Group companies and to NATO members and allies in which no Group subsidiaries are located. Site Location Germany—Defence also has construction contract revenue, see Note 6.

The newly acquired reporting segment "Germany—Civil" assembles pistols for the reporting segments "Germany—Defence" and "USA—civil" and has sales and distribution activities for civil and security products in Germany. The reporting segment "USA—civil" has sales and distribution activities for civil and security products and provides related services in the US. The other reporting segments all have sales and distribution activities for defence and security products and provide related services. The sites located in the USA and France supply to these countries. The site located in Great Britain sells primarily to the United Kingdom, the British Commonwealth of Nations and also to certain other NATO allies.

The "Other holding activities" reporting segment relates to Heckler & Koch Beteiligungs GmbH and its investments and holdings outside the Heckler & Koch GmbH Sub-Group. These include the granting of loans and making of other long and short-term financial investments. As this reporting segment contains several companies, the figures reflect the amounts recognised for individual companies in the consolidated financial statements as well as certain consolidation adjustments within the segment.

(31) Segment reporting (Continued)

Operating segments

Segment	Germany—Defence		Germany—Civil		USA—Civil		USA—Defense		Great Britain		France		Other Holding Activities		Total pre-consolidation		Consolidation transactions		HKB Group	
	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009	2010	2009
											EUR ’000									
Net external revenues	138,819	115,519	738	—	14,894	20,690	26,255	24,099	57,268	64,351	9,272	10,088	—	—	247,244	234,748	—	—	247,244	234,748
Inter-segment revenue	73,324	68,136	13,533	—	705	165	299	562	257	945	—	—	—	—	88,119	69,808	(88,119)	(69,808)	—	—
Depreciation and amortisation	(8,847)	(9,351)	(3)	—	(248)	(242)	(213)	(221)	(104)	(112)	(11)	(10)	(980)	(168)	(10,407)	(10,105)	10	10	(10,397)	(10,095)
Interest income	2,464	1,519	0	—	5	195	3	7	3	4	22	27	4,931	4,306	7,427	6,059	(758)	(1,184)	6,669	4,875
Interest expense	(15,603)	(15,504)	(6)	—	—	(74)	(500)	(519)	(1)	—	(14)	—	(17,090)	(15,656)	(33,215)	(31,753)	759	1,197	(32,455)	(30,556)
Share of profit of associates (at equity)	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Tax on income	(10,564)	(4,972)	(416)	—	221	(638)	2	(4)	(1,675)	(1,720)	(289)	(210)	955	(3,713)	(11,766)	(11,257)	2,552	274	(9,214)	(10,983)
Profit/(loss) after tax	28,664	18,633	1,141	—	(355)	1,100	6,663	(1,092)	4,283	4,366	569	401	(34,756)	(5,816)	6,209	17,591	(28,243)	(26,596)	(22,033)	(9,005)
Other material non-cash items																				
—Impairment of assets	(124)	(500)	—	—	(45)	(108)	(19)	(585)	(181)	(4)	(1)	(12)	(33,167)	(6,078)	(33,537)	(7,286)	—	—	(33,537)	(7,286)
—Impairment losses reversed	—	26	—	—	25	—	5	—	76	124	—	—	1,374	655	1,480	805	—	—	1,480	805
Non-current assets other than financial instruments and deferred tax assets	148,503	148,374	38	—	1,615	1,724	1,550	1,489	206	270	29	39	(91,741)	(90,676)	60,200	61,219	17,200	17,227	77,400	78,446
Investments in associates	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—	—
Capital Expenditure (Capex)	(8,403)	(8,306)	(33)	—	(5)	—	(172)	(81)	(31)	(79)	(1)	(14)	(2)	(11)	(8,646)	(8,491)	—	379	(8,646)	(8,112)
Reportable segment liabilities	250,276	245,970	7,062	—	12,887	6,410	28,429	34,820	5,443	13,189	1,460	1,821	180,108	170,186	485,664	472,396	(50,132)	(49,329)	435,532	423,068

The above table shows the revenues and results together with the assets and liabilities of the individual Group segments. With the exception of sales from both German segments to the other segments, trading between the different segments is only slight. The trade relationships between segments have been consolidated. Trade between the segments is conducted at ‘arm’s-length’ prices, as would have been agreed with informed and willing parties outside the Group.

(31) Segment reporting

Geographical and product group segments

The value of sales made to customers in different regions of the world and the proportions of sales due to the different product groups are shown in the following tables:

		Sales EUR '000	Sales %
Germany	2010	42,864	17%
	2009	39,413	17%
USA	2010	42,931	17%
	2009	46,968	20%
UK	2010	52,513	21%
	2009	61,775	26%
Rest of the world	2010	108,936	44%
	2009	86,593	37%
Total	2010	247,244	100%
	2009	234,748	100%
Outside Germany	2010	204,380	83%
	2009	195,335	83%

		Sales
Rifles	2010	21%
	2009	30%
Sub-machine guns & machine guns	2010	14%
	2009	18%
Pistols	2010	15%
	2009	20%
Development services	2010	2%
	2009	1%
Other products & services	2010	48%
	2009	31%
Total	2010	100%
	2009	100%

Major customers

IFRS requires customers known to be under common control to be treated as one customer. Since the Group sells to the government agencies, which include the law enforcement agencies and armed forces, in various countries, this requirement leads to all governmental agencies in a particular country being treated as one single joint customer.

On this basis the Group's major customers, to whom individually more than 10% of sales were made in 2009, are the governmental authorities of Saudi Arabia (2010: €54 million; 2009: €11 million) and the German governmental authorities (2010: €25 million; 2009: €14 million), which are shown in the segment Site Location Germany—Defence, the UK governmental agencies (2010: €52 million; 2009: €61 million), shown within the segment Site Location Great Britain and the US federal and state agencies (2010: €27 million; 2009: €27 million) shown mainly within the segment Site Location USA—Defense with the balance in the segment Site Location USA—Civil.

(32) Contingent liabilities and pledged assets

There are no material contingent liabilities as of December 31, 2010 or December 31, 2009. For details of pledged assets, see Notes 18 and 25.

(33) Operating leases

Group expenses include €3,049k (2009: €1,926k) due to rental and €304k (2009: €298k) due to other operating leases.

As at the balance sheet date, the Group had outstanding obligations arising from binding operating leases that fall due as follows:

	31.12.2010	31.12.2009
	EUR '000	
Up to one year	449	1,721
More than one and up to five years	1,418	6,337
More than five years	192	4,595
Total	**2,059**	**12,653**

(34) Full-time equivalent number of employees

The workforce in the Heckler & Koch Beteiligungs Group, as an annual average of full-time equivalents ("FTE"), was as follows:

	2010	2009
Manufacturing	445	449
Research & Development	72	74
Sales & Distribution	72	71
Administration	89	87
Total FTE employees excluding apprentices	**678**	**681**
Apprentices	41	35
Total FTE employees including apprentices	**719**	**715**

(35) Personnel expenses

Personnel expenses in the reporting year came to €49,359k (2009: € 47,385k). Of these expenses, €3,254k (2009: €3,259k) relate to employer's contributions to social security funds and similar defined contribution plans for pensions.

(36) Related party disclosures

Parent and ultimate controlling party

Heckler & Koch Beteiligungs GmbH is the parent company of the Heckler & Koch Group and is owned by private investors. It has an investment through HK Holding, Inc. in Heckler & Koch GmbH's defence group.

Other related party transactions

Transactions between the parent company and related parties that are its subsidiaries were eliminated in the course of consolidation and are not described in these disclosures in the Notes. Transactions with current and former members of the executive board are covered in Note 38 respectively.

In addition, there are arm's-length business relationships between Group companies and related parties as defined by IAS 36, as follows:

- The Group provides administrative services to Prochemie GmbH, formerly HK Sidearms Holding GmbH (2010: €378k; 2009: €288k), a company partly owned by one of the shareholders of the Group.

- In mid-2010 the Group acquired HK Sidearms GmbH ("HKS") for €6.4 million from Prochemie GmbH, a related party. The purchase price was based on a valuation from an independent, internationally recognised appraisal firm. The HKS figures are included within the consolidated financial statements from July 2010.

- Until June 2010, HK Sidearms GmbH ("HKS") was a subsidiary of Prochemie GmbH (formerly HK Sidearms Holding GmbH); since July 2010 it is within the Heckler & Koch Group. Up until the acquisition in July 2010, the Group sold parts and assemblies to HKS (€9,501k; 2009 full year: €20,170k) and purchased goods from HKS (€13,492k; 2009 full year: €25,470). In addition until the acquisition in July 2010, the Group provided infrastructure and administration services to (€649k, 2009 full year: €1,257k) and received licensing fees (€239k, 2009 full year: €408k) from this company. From July 2010 this company is included in the Group with the usual consolidating adjustments; however in 2009 the Group recognised a receivable of €3,528k and a payable of €6,224k against this company relating to these transactions.

- On January 1, 2008, an open-ended, unsecured loan was granted to shareholder Keith Halsey. In September 2009, the €8,205k balance on the loan was transferred to another shareholder. In 2010, new payments under this loan were made to Mr. Keith Halsey, and the Group recorded €2k (2009: €743k) in interest income from this loan. As at the end of the reporting period, he owed the Group €55k (2009: nil) in relation to these transactions.

- In 2009, Suhler Jagd- & Sportwaffen GmbH (SJSH) was purchased by Heckler & Koch Beteiligungs GmbH (HKB), and both companies were merged with HKB. Mr. Heeschen granted loans to SJSH prior to its acquisition. The Group therefore owes €14k (2009: €14k) in interest to Mr. Andreas Heeschen in relation to these transactions. This interest payable is netted with the existing interest receivable (Note 38). Because of the adjustment to the figures to present them as if the acquisition of SJSH had occurred prior to the end of 2007, the Group recorded €1k (2010: nil) in interest expense for 2009 in relation to the loans from Andreas Heeschen, which were repaid prior to the acquisition.

- The Group granted loans to the Wolf-Garten group, the majority of which is held by a shareholder of Heckler & Koch Beteiligungs GmbH (see Note 18). The loans are classified as financial assets held for trading. The embedded derivatives arising from the profit-sharing clauses have been recognised at nil since December 2008. In 2010, the Group recorded no interest income (2009: nil) on this loan as the main receivable is uncollectible and therefore completely impaired. Because of the poor business trend of the Wolf-Garten group, the loan and interest receivables have also been recognised at nil since the end of 2008. The impairment was retained in 2009 and 2010. €13,093k gross (nil net) in loan and interest receivables from the companies of the Swiss Wolf group were derecognised in 2010 after the insolvency proceedings were completed. The Group has recognised € 27,253k (2009: €40,346k) in gross assets and nil (2009: nil) in net assets for the remaining loan and interest receivables from the Wolf-Garten group.

Collateral for the loans and interest owed by the Wolf group was assigned to Heckler & Koch Beteiligungs GmbH by Deutsche Bank AG in the form of €23.0 million in land charge certificates and by €14.3 million in shares pledged by Wolf Beteiligungs GmbH on November 7, 2005. All of the German companies of the Wolf group are still in the process of being wound up. It is unlikely that this collateral will be sufficient to satisfy Heckler & Koch Beteiligungs GmbH.

- In 2010, the Group recognised €19k (2009: €277k) in rental income from Wolf Garten GmbH & Co. KG, a Wolf-Garten group company. As at the end of the reporting period, it owed the Group €1,106k (2009: €1,049k) in relation to this transaction. Because of the winding up proceedings described above, the Group has written down €57k (2009: €320k) on the rent receivable and recognised this loss in other operating expenses.

- The Group granted a loan to Aviamax GmbH, the majority of which is held by HKB’s shareholders, to help fund its investment in an aircraft. In 2010, the Group recognised €64k (2009: €77k) in interest income from this loan. Because of the global economic crisis and its repercussions for the aircraft market, this loan and the resulting interest receivable had to be written down in the full amount of €1,719k (2009: €1,655k). €64k in interest for 2010 was written down and therefore recognised as both finance income and expense. The Group has recognised €1,719k (2009: €1,655k) in gross assets and €0 (2009: €0) in net assets for these loan and interest receivables.

As at August 5, 2008 the investment object was assigned to Heckler & Koch Beteiligungs GmbH as collateral for the loan. Because of the market situation for aircraft, it is unlikely that this collateral will be sufficient to satisfy Heckler & Koch Beteiligungs GmbH.

- The Group granted a loan in USD to Aviamax Aviation Ltd., the majority of which is held by HKB’s shareholders, to help fund its investment in an aircraft. In 2010, the Group recognised €119k (2009: €104k) interest income from the loan and an income of €250k for exchange rate differences (2009: expense of €65k). Because of the global economic crisis and its repercussions for the aircraft market, this loan and the resulting interest receivable had to be written down in the full amount of €2,093k in 2009. This impairment loss was recognised as finance expense. The Group has recognised €2,603k (2009: €2,093k) in gross assets and nil (2009: nil) in net assets for these loan and interest receivables.

As at August 5, 2008 the investment object was assigned to Heckler & Koch Beteiligungs GmbH as collateral for the loan. The loan is not contested, but it is uncollectible. The investment object was sold in October 2010; because of the difficult market situation, the proceeds on the sale covered only the portion of the asset financed by the leasing company. It is unrealistic that this collateral will be sufficient to satisfy Heckler & Koch Beteiligungs GmbH.

- The Group extended a loan to Aquamax S.A., the majority of which has been held by one of HKB’s shareholders since 2008, to help finance the retrofitting of a charter ship. The loan receivable from Aquamax S.A. was eliminated in 2007 in the consolidated balance sheet as Aquamax was part of the Group. Following its sale in 2008, the company is no longer consolidated and the loan receivable, including accrued interest, was recognised in the consolidated statement of financial position as a receivable. Because the economic crisis had also hit the ship market, the receivable was stated at a fair value of nil. This fair value remained unchanged as at the end of 2009, as the realisation of this receivable was still unlikely. The impairment loss recognised in finance expense and, in line with the interest income for the year, amounts to €531k in 2010 (€536k in 2009). Given the market situation, repayment of the loan, including accrued interest, is unlikely. The recognised assets of Aquamax S.A. are so insignificant that they can satisfy neither the main financing institution nor Heckler & Koch Beteiligungs GmbH.

- Vezla Ltd. is an investment firm engaged in the buying and selling of equities, primarily of listed companies. Based on its good investment track record, Vezla Ltd. was able to increase its investment activity at the start of 2008 through loans from Heckler & Koch Beteiligungs GmbH. In 2008 many of these investments were negatively affected by the turmoil in the global financial markets, resulting in an total loss on Vezla Ltd.'s portfolio. Heckler & Koch Beteiligungs GmbH therefore recognised an impairment on the entire €16.4 million in loans to Vezla Ltd. as at December 31, 2008.

On October 28, 2009, Vezla Ltd. and HKB agreed a grace period for repayment of the loans, including interest, until Vezla Ltd.'s business recovered (as measured by bilaterally agreed terms and conditions). The impairment loss remains recognised in full as Vezla Ltd. has failed to reach the lower limit defined for the grace period.

(37) Governing bodies of the Group

Executive Board

Andreas Heeschen	Director
Hanns-Friedrich Begemann	Director
Wilhelm Haaga	Director

(38) Remuneration of the executive board

The remuneration of the executive board in the financial year 2010 totalled €928k (2009: €928k). In addition the directors have been awarded bonuses totalling €2,000k for 2010, which have not yet been paid out.

On January 1, 2008, an open-ended, unsecured loan was granted to shareholder and director Andreas Heeschen. The interest rate is variable and is adjusted every half-year. The rate was 11.0% for the first half of 2010 and 11.5% for the second half. This resulted in interest income of € 4,069k (2009: €2,367k). As at September 17, 2009, €8,205k in loan receivables of the Group against another shareholder (Note 36) were transferred to this loan. A short-term loan extended to Mr. Heeschen by a group company in 2009 resulted in interest income of nil (2009: €153k) in. As at December 31, 2010, €40,684k (2009: €35,111k) in loan and interest receivables from Mr. Heeschen was recognised in the balance sheet under loans, investments and derivatives (Note 18). Although the borrower is willing and able to repay the loan in the medium term, € 32,000k impairment was recognised (2009: nil) as at the reporting date in accordance with the imparity principle.

As the shareholders are private individuals, the auditors engaged to audit the 2010 financial statements have insufficient information to enable them to determine whether these loan receivables are impaired; this has been commented on accordingly in the auditor's opinion.

Heckler & Koch Beteiligungs GmbH has had a contract with Andreas Heeschen for the provision of advisory services since January 2005. In 2010, the Group recorded €24k in expenses relating to advisory services (2009: €7k in income from refunds of advisory services and out-of-pocket expenses). At the end of the reporting period, the Group recognised a € 25k (2009: nil) receivable from these transactions.

In July 2009, Heckler & Koch Beteiligungs GmbH and its director, Hanns-Friedrich Begemann, entered an agreement whereby office space and human resources would be allocated to Mr. Begemann for his own use. In 2010, the Group recognised €34k (2009: €50k) income resulting from this arrangement. At the end of the reporting period, the Group recognised a receivable of nil (2009: nil) from this contractual relationship.

(39) Auditor's remuneration

	2010	2009
	EUR '000	
Audit of the financial statements	309	398
Other confirmation services	—	1
Tax services	304	274
Other services	464	11
Total	**1,076**	**684**

(40) Subsequent events

In accordance with the bond and PIK loan terms and the provisions of commercial and company law, in March 2011 HKO granted two shareholders of the Heckler & Koch Beteiligungs Group secured loans of €1.5 million each with nine month terms.

As previously mentioned, the €120 million HKO bond maturing on July 15, 2011 will be funded with a new corporate bond for €100 million. Close Brothers Seydler Bank was engaged for the placement. Independently of this, HKB had already engaged Citibank in May 2010 to sound out the market prospects for a high yield bond for about

€280 million, which could be used to pay the HKO bond upon maturity and the PIK loan prior to maturity. Given the current market situation, this alternative is a real option. Led by Citibank, the documents and steps necessary for placing a high yield bond are presently being prepared in cooperation with Close Brothers Seydler Bank. Its implementation will, however, depend on a market study and the potential interest rates. In both funding options under consideration, the overall concept includes an increase in the Group's equity at HKB level in the near future.

Between the balance sheet date of December 31, 2010 and the date on which these consolidated financial statements were approved, there have been political changes in countries of Northern Africa and the Middle East, in which the existing feudalistic structures are being questioned and in part removed. This also affects NATO allies in these regions and therefore also markets and sales potential of Heckler & Koch. A negative effect on the trading position and financial situation of the Heckler & Koch Group may be expected but is not clear at this time.

No other material operating or structural changes or transactions have occurred in the Heckler & Koch Beteiligungs Group prior to the approval of these consolidated financial statements.

Oberndorf/Neckar, April 26, 2011

The Executive Board

Andreas Heeschen Wilhelm Haaga Hanns-Friedrich Begemann

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Heckler & Koch GmbH

9.50% Senior Secured Notes due 2018

OFFERING MEMORANDUM

May 17, 2011

Sole Global Coordinator and Bookrunner

Citi

Joint Lead Manager

Close Brothers Seydler Bank AG