

## Corporate governance report

# SUSTAINABLE VALUE CREATION AND EFFICIENT COLLABORATION

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Corporate governance stands for responsible corporate leadership and management aimed at increasing the shareholder value in the long term; purposeful and efficient collaboration between the Management Board and the Supervisory Board; consideration for the interests of shareholders and employees; transparency and responsibility in all corporate decision making; as well as appropriate risk treatment. LPKF follows the German Corporate Governance Code.

The actions of the LPKF Group's management and supervisory bodies are guided by the principles of responsible and good corporate governance. The Management Board reports on issues of corporate governance in this chapter – also on behalf of the Supervisory Board – pursuant to both Article 3.10 of the German Corporate Governance Code and Article 289a (1) of the German Commercial Code (Handelsgesetzbuch – HGB). This chapter also contains the statement on corporate governance pursuant to Section 289a HGB. For the remuneration report, please see page 64 of the combined management report.

## Statement on corporate governance

### 1. PROCEDURES OF THE MANAGEMENT BOARD AND THE SUPERVISORY BOARD



*The Management Board and the Supervisory Board work together closely and in an atmosphere of trust.*

LPKF AG is an enterprise incorporated according to German law, on which the German Corporate Governance Code is based. The dual management system comprising the Management Board and the Supervisory Board as corporate bodies, both of which have distinct responsibilities, is a fundamental element of German corporate law. The Management Board and the Supervisory Board of LPKF AG work together closely and in an atmosphere of trust in managing and supervising the Company. The Management Board of LPKF AG consists of four members. They are responsible for managing the Company's business in the interests of the Company and with the aim of creating sustainable value.

*The Supervisory Board advises and monitors the Management Board with regard to its management of the Company.*

The Supervisory Board advises and monitors the Management Board with regard to its management of the Company. The Supervisory Board is integrated in corporate strategy and planning, as well as all aspects of fundamental importance to the Company. The rules of procedure require the Management Board to obtain the approval of the Supervisory Board for significant business transactions. The Chairman of the Supervisory Board coordinates the work of the Supervisory Board, chairs its meetings and represents the Supervisory Board externally.

The Management Board informs the Supervisory Board in a timely and comprehensive manner – both in writing and at regular meetings – of the Group's planning, performance and situation, including risk management and compliance. Extraordinary Supervisory Board meetings are convened as necessary in connection with material events. The Supervisory Board adopted rules of procedure for its own work.

For all members of its Management Board and Supervisory Board, LPKF AG has taken out a D&O insurance policy subject to a deductible corresponding to 10% of the damage but no more than one-and-a-half times the fixed annual remuneration.

The Supervisory Board of LPKF AG consists of three members. At the most recent Supervisory Board election during the Annual General Meeting on 5 June 2014, the Supervisory Board members were elected individually as recommended by the German Corporate Governance Code. All election proposals concerning potential Supervisory Board members shall consider the expertise, abilities and professional experience that are required for carrying out the respective tasks as well as issues of diversity.

According to Article 5.4.1 GCGC, the corporate governance report shall disclose the specific objectives of the Supervisory Board with regard to its composition in view of the Company's international activities, potential conflicts of interest, an age limit to be specified for Supervisory Board members, the independence of Supervisory Board members and diversity, the latter particularly in terms of an adequate proportion of women, and the status of implementation.

*The Supervisory Board has defined goals regarding its composition.*

To this end, the Supervisory Board in its meeting on 13 November 2012 formulated the following objectives regarding its composition:

**a) Addressing the international nature of the Company's activities**

The international activities of LPKF Laser & Electronics AG have been reflected to date in the participation of shareholder representatives in the Supervisory Board and will continue to be addressed in the future in nominations of candidates by the Supervisory Board to the Annual General Meeting. In addition to the ability to speak and write English, the measure here is the professional experience acquired in other German and foreign companies with international operations, whether in management or supervisory bodies, and the understanding of global economic issues. The criterion of internationality does not stipulate that the Supervisory Board's composition include one or more Supervisory Board members holding foreign citizenship. Instead, German citizens can also contribute this desired experience.

**b) Avoiding potential conflicts of interest**

Potential conflicts of interest should be avoided as early as when the Supervisory Board nominates candidates to the Annual General Meeting. With the exception of the Supervisory Board's Deputy Chairman, who was Chairman of the Management Board of LPKF AG until December 2008, no former LPKF Management Board members sit on the Supervisory Board. In addition, when candidates are proposed to the Annual General Meeting, attention is paid to ensuring that the relevant candidate does not hold a management or advisory position or a position on the supervisory body of competitor companies, suppliers, creditors or clients in order to prevent conflicts of interest from the start. If conflicts of interest arise during a Supervisory Board member's term, the respective Supervisory Board member must disclose this to the Supervisory Board to the attention of the Chairman. In the event of material, not just temporary, conflicts of interest, the member must step down from his or her position.

**c) Specifying an age limit**

The age limit for members of the Supervisory Board was set at under 70 years at the time of election by resolution of the Supervisory Board on 22 January 2014.

**d) Independence of Supervisory Board members**

The Supervisory Board, currently with three members, must have at least two members who are independent within the meaning of the German Corporate Governance Code.

**e) Diversity**

The composition of the Supervisory Board of LPKF Laser & Electronics AG should reflect as broad as possible a spectrum of professional expertise and experience in various areas relevant to the Company. In filling future vacancies, the Supervisory Board will continue to also seek out suitable female candidates in view of the functional objectives of the Supervisory Board. Assuming equal qualifications, female candidates will be given preference.

*Both the Management Board and the Supervisory Board are obliged to observe the corporate interests of LPKF AG.*

Both the Management Board and the Supervisory Board are obliged to observe the corporate interests of LPKF AG. There were no conflicts of interest in the financial year just ended that would have had to be disclosed to the Supervisory Board without delay. No member of the Management Board held more than three appointments to the supervisory boards of listed stock corporations not belonging to the Group.

The status of implementation of the objectives regarding the composition of the Supervisory Board outlined in a) to e) above is as follows:

The objectives relating to a) "Addressing the international nature of the Company's activities," b) Avoiding potential conflicts of interest," c) "Specifying an age limit," and d) "Independence of Supervisory Board members" have already been achieved. The Supervisory Board will take objective e) "Diversity (including an acceptable proportion of women on the Supervisory Board)" into account when nominating candidates to replace Supervisory Board members whose terms are ending and step up the search for suitable female candidates. The term of office of the Supervisory Board members is five years, and the current term ends with the Annual General Meeting in 2019.

**2. CORPORATE GOVERNANCE REPORT**

LPKF implements the recommendations and suggestions of the German Corporate Governance Code (GCGC) apart from a few exceptions. The Management Board and the Supervisory Board jointly issued the 2015 Declaration of Compliance on 23 March 2015 pursuant to Section 161 German Stock Corporation Act (Aktiengesetz). The Declaration is permanently made public on LPKF AG's website.

**Declaration of Compliance of LPKF Laser & Electronics AG for the 2015 financial year with the Corporate Governance Code in accordance with Section 161 German Stock Corporation Act (Aktiengesetz)**

The Management Board and the Supervisory Board of LPKF Laser & Electronics AG declare that since the last time the declaration was modified during the year on 5 June 2014 the recommendations of the Government Commission on the German Corporate Governance Code (GCGC) as amended on 13 May 2013 and as amended on 24 June 2014, have been observed. LPKF will continue to comply with these recommendations. The following exceptions apply:

### **No severance pay cap agreed for Directors' contracts in case of premature termination of a Director's contract (Article 4.2.3 (4) and (5) GCGC)**

Because they only run for three years, the Directors' contracts do not contain a cap on severance pay. If a Director's contract is terminated prematurely without cause, remuneration is limited to no more than the remaining contractual period. The Supervisory Board therefore considers it unnecessary to include in the Directors' contracts a cap on severance pay amounting to two years remuneration.

### **Formation of Supervisory Board committees (Article 5.3.1 and 5.3.2 GCGC)**

Given that it has three members as required by German stock corporation law, the Supervisory Board of LPKF Laser & Electronics AG does not form any committees.

## **3. SHAREHOLDERS AND ANNUAL GENERAL MEETING**

The shareholders of LPKF AG exercise their co-determination and control rights at the Annual General Meeting, which takes place at least once per year. It resolves all matters determined by law with binding effect on all shareholders and the Company. Each share grants one vote at the Annual General Meeting.



*Every shareholder has the right to participate in the Annual General Meeting.*

Every shareholder who registers in due time has the right to participate in the Annual General Meeting. Shareholders who cannot or do not want to attend in person have the option of appointing a bank, a shareholders' association, the proxies appointed by LPKF AG who are bound by instructions, or any other agent as their proxy to exercise their voting right.

The notice of the Annual General Meeting as well as the reports and information required for the resolutions are published in accordance with the requirements of German corporate law and are also made available on LPKF AG's website in both German and English.

## **4. RISK MANAGEMENT**

The responsible handling of business risks is an integral part of all good corporate governance. The Management Board of LPKF AG is supported in its work by a comprehensive Group-wide reporting and control system that makes it possible to record, assess and manage risks of this kind. This system is continuously refined, adjusted to changing parameters, and audited by the auditors of the financial statements. The Management Board informs the Supervisory Board on a regular basis of existing risks and their development. The risk report contains details of the LPKF Group's risk management. The risk report is part of the Group management report and contains the report on the accounting-related internal control and risk management system pursuant to the German Commercial Code.

## **5. TRANSPARENCY**

LPKF regularly, immediately and simultaneously informs the participants in the financial markets and interested members of the public about the commercial situation of the Group and any new facts. The annual report, the half-yearly financial report and the quarterly financial reports are published within the specified deadlines. Press releases, and ad hoc announcements where stipulated, provide information on current events and new developments. All of the information is published in printed form and via suitable electronic media such as email and the Internet. The www.lpkf.com website also provides comprehensive information on the LPKF Group and LPKF shares.

A financial calendar lists the scheduled dates for the most important regular events and publications such as the Annual General Meeting, annual report and quarterly financial reports. The calendar is published well in advance of the scheduled events and is made available permanently on the LPKF AG website.

## 6. SHARE TRANSACTIONS OF MEMBERS OF THE COMPANY'S CORPORATE BODIES

Reportable directors' dealings involving the sale or purchase of the Company's shares by members of LPKF AG's corporate bodies were published on the Company's website and reported to the competent supervisory authorities. A listing of the shares held by members of the Company's corporate bodies is shown in the remuneration report.

## 7. ACCOUNTING AND AUDITING

*The consolidated and annual financial statements were audited by PwC.*

LPKF AG prepares its consolidated financial statements and its interim consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS) as applicable in the European Union. The annual financial statements of LPKF AG are prepared in accordance with the German Commercial Code. The consolidated financial statements are prepared by the Management Board, audited by the auditor of the financial statements and reviewed by the Supervisory Board. The interim reports and the half-yearly financial reports are discussed by the Supervisory Board and the Management Board before publication. The consolidated financial statements and the annual financial statements of LPKF AG were audited by PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Hannover, the auditor elected by the 2014 Annual General Meeting. The audit reports were signed by German public auditors Helmut Schäfer (since the 2009 annual financial statements) and Prof. Dr. Mathias Schellhorn (since the 2013 annual financial statements). The audits were conducted in accordance with German auditing standards and taking the generally accepted German standards for the audit of financial statements promulgated by the Institute of Public Auditors (IDW) into account. The International Standards on Auditing were also taken into account. The audits also assessed the risk management and compliance with the reporting obligations defined for proper corporate governance pursuant to Section 161 German Stock Corporation Act.

LPKF AG also entered into a contract with the auditor pursuant to which they must notify the Supervisory Board immediately, while the audit is in progress, of any grounds for excluding them, any partiality on their part as well as any material findings and events. Nothing of this nature arose in the course of the audit covering the 2014 financial year.

## 8. COMPLIANCE – PRINCIPLES GOVERNING CORPORATE ACTIONS AND BUSINESS ACTIVITIES

*LPKF employees worldwide are bound by the compliance guidelines.*

Acting in compliance with the principles of corporate, environmental and social sustainability in accordance with applicable law is an indispensable element of LPKF's corporate culture. This includes trust, respect and integrity in interactions with other people, values expressed in exemplary behavior vis-à-vis employees, business partners, shareholders and the public. LPKF's understanding of compliance includes observing all laws, statutes and the Articles of Incorporation, complying with internal regulations, and honoring voluntary obligations.

LPKF AG considers it particularly important to build a compliance structure for the Group that makes compliance guidelines binding on all LPKF employees worldwide and is suitable for effectively preventing compliance violations for the benefit of the Group as a whole.

A training plan for employees was developed in connection with the Group-wide compliance code to familiarize employees with the goal of this code of conduct and to guarantee uniform ethical and legal standards throughout the entire Group. Specific measures and rules are also part of the training.

*A Compliance Manual for the entire Group was adopted.*


Together with an auditing firm, a compliance risk assessment was conducted which analyzed and assessed the Group's risk areas and discussed key strategic aspects of compliance management. A Compliance Manual was adopted which governs the areas of responsibility and authority, and workflows/processes of the compliance organization of LPKF Laser & Electronics AG and all of its subsidiaries (together the LPKF Group) as well as descriptions of the roles of all technical officers.

The Compliance Office holds regular meetings to discuss current topics, some times in the presence of the technical officers.

Internal auditing, which is performed by an international audit firm functioning as a third-party service provider, plays a key role in the compliance organization. The relevant audits are also used to update the internal control system.



Dr. Ingo Bretthauer



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