Asetek A/S
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Denmark

Interim Report

Third Quarter and Nine Months Ended September 30, 2019

Published October 23, 2019

Company Registration (CVR) Number 34 88 05 22

Highlights

- **Q3 revenue of $10.4 million compared with $17.4 million in Q3 2018**
- **Gross margin of 42% in Q3 and YTD, level with Q3 2018 and improved from 38% in the first nine months of 2018**
- **Q3 EBITDA adjusted of $32,000, compared with $3.0 million in Q3 2018**
- **First nine months revenue of $38.7 million and EBITDA adjusted of $3.6 million compared with $50.8 million and $6.8 million respectively in 2018**
- **Cash increased $7.6 million year-to-date, compared with $0.4 million in same period of 2018**
- **Q4 Gaming and Enthusiast revenue is expected to increase compared with Q3 2019 while decreasing vs. Q4 2018**
- **Q4 Gaming and Enthusiast gross margins expected to decline 2-3 %-points due to an inventory cleanout and a one-time final sell-out of an end-of-life product**
- **Group revenue expectation for 2019 maintained at decrease of approximately 20% compared with 2018, due to macroeconomic and industry headwinds reducing customer volumes in the second half of 2019**

Key figures

			Nine months ended		
Figures in USD (000's)	**Q3 2019**	**Q3 2018**	**30-Sep-19**	**30-Sep-18**	**2018**
Total Company:	*Unaudited*	*Unaudited*	*Unaudited*	*Unaudited*	
Revenue	10,391	17,405	38,673	50,809	67,314
Gross profit	4,360	7,273	16,285	19,219	26,172
Gross margin	*42.0%*	*41.8%*	*42.1%*	*37.8%*	*38.9%*
Operating income	(1,207)	1,953	(115)	3,235	4,419
Reconciliation from IFRS to EBITDA adjusted:					
Operating income	(1,207)	1,953	(115)	3,235	4,419
Add: Depreciation and amortization*	971	779	2,917	2,620	3,690
Add: Share based compensation	268	280	807	940	1,276
EBITDA adjusted (unaudited)	32	3,012	3,609	6,795	9,385
By Segment (Unaudited):					
Gaming and Enthusiast:					
Gaming and Enthusiast revenue	*9,552*	*16,104*	*36,592*	*47,600*	*63,030*
Gaming and Enthusiast gross margin	*42.1%*	*41.5%*	*42.5%*	*38.3%*	*39.5%*
Gaming and Enthusiast EBITDA adjusted	*2,098*	*5,390*	*10,078*	*15,305*	*20,737*
Datacenter:					
Datacenter revenue	*839*	*1,301*	*2,081*	*3,209*	*4,284*
Datacenter gross margin	*40.9%*	*45.3%*	*36.1%*	*30.5%*	*29.6%*
Datacenter EBITDA adjusted	*(864)*	*(1,387)*	*(3,539)*	*(5,734)*	*(7,338)*
Headquarters:					
*Headquarters costs***	*(1,202)*	*(991)*	*(2,930)*	*(2,776)*	*(4,014)*

**Depreciation includes $140,000 and $424,000 in Q3 2019 and first nine months of 2019, respectively, related to a lease accounting change. Refer to Note 2 - Change in Accounting Policy*

***Headquarters costs include intellectual property defense, HQ admin costs, litigation settlements; Excludes share based comp.*

Highlights

Financial results

- Asetek reported third quarter revenue of $10.4 million compared with $17.4 million in the third quarter of 2018. Revenue in the first nine months amounted to $38.7 million compared with $50.8 million in the same period of 2018. The change from the prior year reflects fewer shipments in the Gaming and Enthusiast segment, as expected in a softer market for PC's and components.
- Gross margin for the third quarter and first nine months was 42%, level with the third quarter of 2018 and up from 38% in the first nine months of 2018. The current year gross margins reflect higher ASPs on Gaming and Enthusiast products and a stronger U.S. dollar.
- Operating loss was $1.2 million and adjusted EBITDA was positive $32,000 in the third quarter of 2019, compared with operating income of $2.0 million and adjusted EBITDA of positive $3.0 million in the third quarter of 2018.
- Operating loss in the first nine months was $0.1 million and adjusted EBITDA was positive $3.6 million, compared with operating income of $3.2 million and adjusted EBITDA of positive $6.8 million in the same periods of 2018. Cash and cash equivalents increased by $7.6 million in the first nine months of 2019 compared with $0.4 million in the prior year period. Year-to-date operating expenses for 2019 included a positive effect of $0.8 million related to a favorable patent litigation settlement. Adjusted EBITDA in the third quarter and first nine months of 2019 was favorably impacted by an accounting change to IFRS 16 Leases (see Note 2 to the Financial Statements).

Operations

- Asetek's sixth generation (Gen6) high performance liquid coolers are powering an expanding range of premium gaming gear, including GIGABYTE's new AORUS CPU coolers and the ASUS Republic of Gamers (ROG) Strix LC RGB series. The 680LS all-in-one CPU cooler debuted in the new Talon gaming PC's built by custom hardware specialist Falcon Northwest. Asetek's Gen6 reliability, superior thermal performance, quiet operation and overclocking potential provide for the optimal gaming experience.
- In August, Asetek launched coolnation.com, a community forum for gamers, as well as technology enthusiasts and DIY PC builders. The site serves as an online platform for educating and engaging with others in the gaming community. In September, the Company kicked off its first gaming tournament for the Danish eSports community, "CoolNation Master Counter Strike: Global Offensive".

Financial results by segment

- Gaming and Enthusiast revenue was $9.6 million in the third quarter, compared with $16.1 million in the same period of 2018. Revenue in the first nine months was $36.6 million, compared with $47.6 million in the same period of 2018. Adjusted EBITDA was $2.1 million for the quarter and $10.1 million for the first nine months, compared with $5.4 million and $15.3 million in 2018, respectively, reflecting increased investment in the Gaming and Enthusiast segment in 2019, consistent with plans communicated at Asetek's capital markets update in March 2019.
- Data center revenue was $0.8 million in the third quarter, compared with $1.3 million in the third quarter of 2018. Revenue in the first nine months was $2.1 million, compared with $3.2 million in the same period of the prior year. Adjusted EBITDA was negative $0.9 million in the third quarter and negative $3.5 million in the first nine months of 2019, both of which are an improvement from 2018 and reflect the Company's planned reduction of segment operating expenses in 2019.

Outlook

- Consistent with the prior quarter, the Group revenue expectation for the full year 2019 is a decrease of approximately 20% compared with 2018. Customer volumes in the second half of 2019 reflect reduced demand in the DIY market segment as a result of macroeconomic and industry headwinds. Based on current revenue and cost outlook, Asetek expects to report a pre-tax profit for 2019.

Financial review

The figures below relate to the consolidated accounts for the third quarter and first nine months of 2019, which comprise activities within the two segments Gaming and Enthusiast (previously named Desktop segment), and Data Center. The figures are unaudited.

Income Statement (Consolidated)

Asetek reported total revenue of $10.4 million in the third quarter of 2019, a decrease from $17.4 million in the third quarter of 2018. Total revenue in the first nine months of 2019 was $38.7 million compared with $50.8 million in the same period of 2018. Both periods reflect reduced unit shipments in the Gaming and Enthusiast segment due to softer market conditions.

Gaming and Enthusiast sales unit volumes for the third quarter of 2019 were 164,000, a decline of 41% from the same period of 2018 (275,000). Unit shipments for the first nine months were 629,000, a decrease of 25% from 2018. Average selling price (ASP) per unit in the third quarter decreased slightly from the same period of 2018 due to change in the product mix. ASP for the first nine months of 2019 increased from the prior year due to higher prices on high-performance products and a change in the mix of products sold.

Gross margin was 42.0% for the third quarter of 2019, level with the third quarter of 2018 (41.8%). Gross margin for the first nine months of 2019 improved to 42.1% from 37.8% in the same period of 2018. The increase reflects higher ASPs on Gaming and Enthusiast products as well as a stronger U.S. dollar in the first nine months of 2019.

Total operating expense increased to $5.6 million in the third quarter of 2019 from $5.3 million in the same period of 2018. In the first nine months of 2019, operating expense increased to $16.4 million ($16.0 million).

Operating expense included costs incurred for defense of existing intellectual property (IP) and securing new IP which increased to $0.7 million and $2.0 million in the third quarter and first nine months of 2019 ($0.6 million and $1.3 million in the respective periods of 2018). Operating expense in the first nine months of 2019 was reduced by a favorable patent litigation settlement of $0.8 million in the second quarter, reported separately as other income on the income statement.

A 6% stronger U.S. Dollar, on average, against the Danish krone (DKK) had a favorable impact on operating expense during the first nine months of 2019 compared with the same period of 2018.

Share-based compensation cost associated with warrants and options issued to employees was $0.3 million and $0.8 million in the third quarter and first nine months of 2019 ($0.3 million and $0.9 million in the respective periods of 2018).

On January 1, 2019, the Company adopted IFRS 16 Leases, which requires the recognition of operating leases on the balance sheet. The accounting change resulted in depreciation recorded of $140,000 and $424,000 in the third quarter and first nine months of 2019, respectively, that was previously considered other operating expense. Refer to Note 2 to the Financial Statements.

Finance expenses included net foreign exchange gain of $0.6 million in both the third quarter and first nine months of 2019. This compared with gains of $0.2 million and $0.3 million for the respective periods of 2018.

Asetek reported a loss before tax of $0.6 million in the third quarter and income before tax of $0.6 million in the first nine months of 2019, compared with income before tax of $2.1 million and $3.6 million for the respective periods of 2018.

Currency translation adjustment of negative $0.9 million and negative $1.0 million was included in other comprehensive income for the third quarter and first nine months of 2019 (negative translation adjustments of $0.2 million and $0.4 million in the third quarter and first nine months of 2018).

Balance Sheet (Consolidated)

Asetek's total assets at September 30, 2019 amounted to $52.1 million, up $0.7 million from December 31, 2018. Cash increased by $7.6 million and an accounting policy change resulted in $3.2 million of additional capitalized leased assets at the beginning of 2019 (see Note 2 to the Financial Statements). These increases were offset by lower trade receivables, inventory and other assets.

Total liabilities increased by $0.3 million in the first nine months of 2019, resulting from an increase of $3.2 million in capitalized lease liabilities related to an accounting change (see Note 2 to the Financial Statements), substantially offset by decreases in vendor payables and accrued liabilities.

Working capital (current assets minus current liabilities) increased by $1.1 million during the first nine months to $26.4 million at September 30, 2019. Total cash and cash equivalents was $26.3 million at September 30, 2019.

Cash Flow (Consolidated)

Net cash provided by operating activities was $10.1 million for the first nine months of 2019, compared with $2.9 million in the same period of 2018. The change from 2018 was principally due to reductions in trade receivables and inventory in the first nine months of 2019 compared with the same period of 2018.

Cash used by investing activities was $1.6 million for the first nine months of 2019, mainly related to capitalized development and additions of capital equipment. This figure compares to $2.7 million used in 2018.

Cash used by financing activities was $0.5 million in the first nine months of 2019, mainly for payments on capitalized leases. Principal payments on capitalized leases increased as a result of a change in accounting policy (see Note 2 to the Financial Statements) and due to equipment acquired under leases. In the first nine months of 2018, Cash provided by financing activities was $0.6 million, mainly reflecting proceeds from the issuance of shares following the exercise of warrants.

Net change in cash and cash equivalents was an increase of $7.6 million in the first nine months of 2019, compared with an increase of $0.4 million in the first nine months of 2018.

Income Tax

Asetek moved from USA to Denmark in 2013. However, USA – in a unilateral tax treaty override – still considers Asetek A/S a U.S. tax subject, effectively creating a double taxation situation. Asetek has approached both countries' tax authorities with the aim of resolving the double tax situation as per the double taxation treaty. However, a determination may take several years, and the authorities are not obligated to resolve the problem.

In June 2019, the U.S. released regulation for its Global Intangible Low-Taxed Income (GILTI) inclusion for U.S. taxation, effective beginning with tax year 2018. The GILTI regulation requires U.S. companies to report foreign corporation intangible income that exceeds 10% return on foreign invested assets. Under prior law, U.S. owners of foreign corporations were able to defer recognizing taxable income until there was a distribution of earnings back to U.S. owners.

Because of Asetek's U.S. tax status as described above, the applicability of the GILTI regulation to Asetek's tax liability is uncertain. As such, its effect has not been recorded in the Group financial statements. If GILTI application is required, the Company's effective income tax rate for 2018 would increase to approximately 36%. This effect would result in incremental utilization of the Company's deferred tax assets of approximately $0.6 million in 2018 but would not result in a current tax payment. The Company is working with its tax advisors to investigate and resolve this matter.

Segment breakdown

*The company is reporting on two distinct segments; the **Gaming and Enthusiast** segment (previously named Desktop segment) and the **Data center** segment.*

The two segments are identified by their specific sets of products and specific sets of customers. The splitting of operating expenses between segments is based on the company's best judgment and done by using the company's employee/project time tracking system and project codes from the accounting system. Operating expenses that are not divisible by nature (rent, telecommunication expenses, etc.) have been split according to actual time spent on the two businesses, and the company's best estimate for attribution. Costs incurred for intellectual property defense, financing, foreign exchange and headquarters administration have been classified separately as headquarters costs and excluded from segment operating expenses as indicated.

Unaudited breakdown of the income statement

Operations - Third Quarter

Figures in USD (000's)	Gaming and Enthusiast		Data center	
	Q3 2019	Q3 2018	Q3 2019	Q3 2018
Revenues	9,552	16,104	839	1,301
Cost of sales	5,535	9,420	496	712
Gross Profit	4,017	6,684	343	589
Gross Margin	42.1%	41.5%	40.9%	45.3%
Total operating expenses	1,919	1,294	1,207	1,976
EBITDA adjusted	2,098	5,390	(864)	(1,387)
EBITDA margin	22.0%	33.5%	N/A	N/A

Operations - First Nine Months

Figures in USD (000's)	Gaming and Enthusiast		Data center	
	YTD 2019	YTD 2018	YTD 2019	YTD 2018
Revenues	36,592	47,600	2,081	3,209
Cost of sales	21,058	29,361	1,330	2,229
Gross Profit	15,534	18,239	751	980
Gross Margin	42.5%	38.3%	36.1%	30.5%
Total operating expenses	5,456	2,934	4,290	6,714
EBITDA, adjusted	10,078	15,305	(3,539)	(5,734)
EBITDA margin	27.5%	32.2%	N/A	N/A

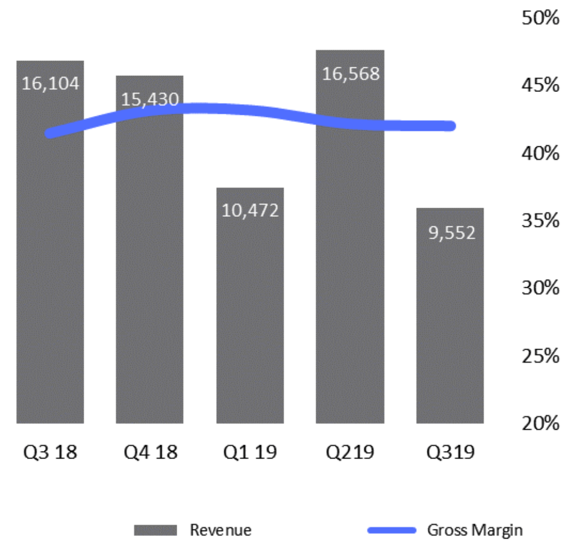
Headquarters Costs

Figures in USD (000's)	Q3 2019	Q3 2018	YTD 2019	YTD 2018
Litigation costs	661	596	2,027	1,265
Litigation settlements	-	-	(753)	-
Other headquarters costs	541	395	1,656	1,511
Total headquarters costs	1,202	991	2,930	2,776

See reconciliation to statement of comprehensive income in Key Figures on page 1.

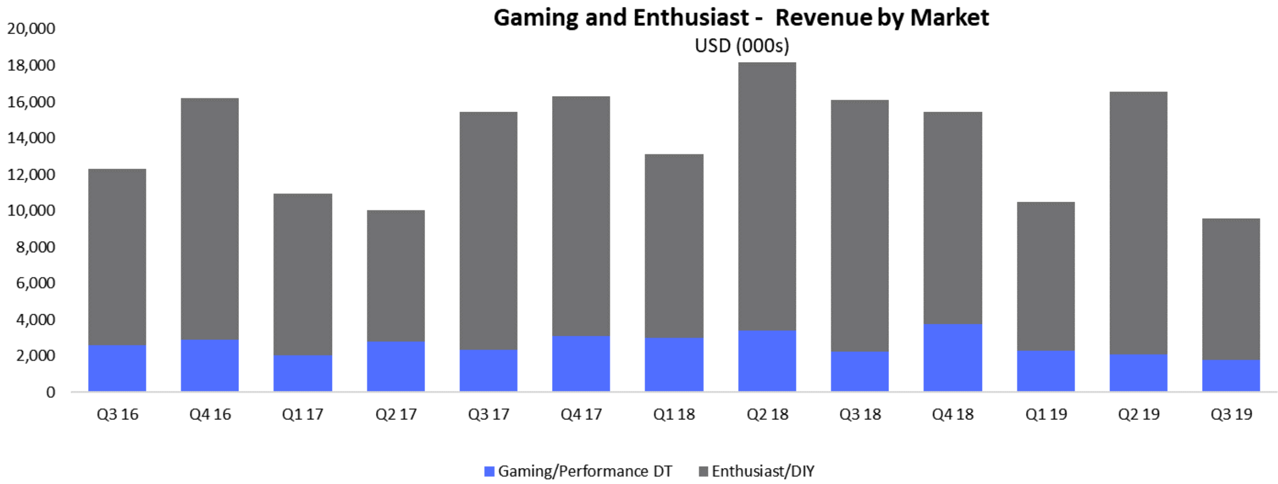
Gaming and Enthusiast financials

Gaming and Enthusiast revenue and margin development
USD (000's)



As anticipated, Asetek's Gaming and Enthusiast revenue decreased in the third quarter of 2019 due to a softer market for PC's and components. Revenue from the Enthusiast/DIY and Gaming/Performance PC markets in the third quarter comprised 81% and 19% of total Gaming and Enthusiast revenue, respectively.

Gaming and Enthusiast profitability in recent quarters has benefitted from higher average selling prices on new, high-performance products and a stronger US dollar. As a result, Gaming and Enthusiast gross margin has remained at 41% or higher over the past five quarters.



Gaming and Enthusiast market update

During the third quarter, five new Gaming and Enthusiast products began shipping, all in the Enthusiast/DIY market, including two to new customers.

Asetek's sixth generation (Gen6) high performance liquid coolers are powering an expanding range of premium gaming gear, including GIGABYTE's new AORUS CPU coolers and the ASUS Republic of Gamers (ROG) Strix LC RGB series. Asetek's Gen6 reliability, superior thermal performance, quiet operation and overclocking potential provide for the optimal gaming experience.

In August, the 680LS all-in-one CPU cooler debuted in the new Talon gaming PCs built by custom hardware specialist Falcon Northwest. Falcon chose Asetek for its advanced Gen6 pump technology, proven track record of reliability and outstanding thermal performance.

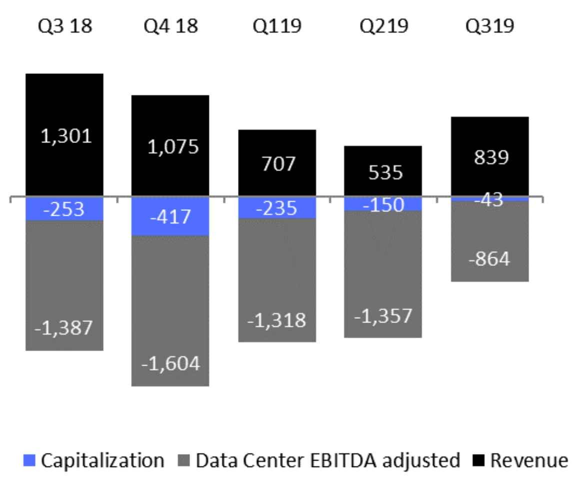
In 2019, Asetek executed a rebranding as part of its strategy to strengthen its position in the Gaming and Enthusiast market. Building on its market leadership in liquid cooling, the Company targets gamers and enthusiasts, engaging the community and implementing marketing initiatives to increase awareness of Asetek and its story of innovation in delivering the best in performance, quality and reliability. More resources have been invested in Gaming and Enthusiast product development resulting in new innovative solutions scheduled for market introduction in 2020 and beyond.

As part of this rebranding, Asetek is working with key customers on several brand-behind-the-brand initiatives to feature the Asetek logo on box packaging, websites, forums, and packaging inserts. Initiatives also include written features about Asetek on partners' websites, participation in live events and live streams to communicate the commitment to quality and reliability that the "Cooled by Asetek" mark represents. In partnership with the gaming and enthusiast community, the Company launched a new gaming/eSports academy outfitted with high-end machines and gear to provide ambitious gamers the tools required to excel. Asetek also initiated a redesign of its corporate website, which will include co-marketing activities with some of the biggest brands in gaming.

In August 2019, the Company launched coolnation.com, a community forum for gamers, as well as technology enthusiasts and DIY PC builders. The site serves as an online platform for educating and engaging with others in the gaming community. In September, the Company kicked off its first gaming tournament for the Danish eSports community, "CoolNation Master Counter Strike: Global Offensive".

Data center financials

Financial development
USD (000's)



Asetek's Data center revenue was $0.8 million in the third quarter of 2019, compared with $1.3 million in the same period of 2018. Revenue in the third quarter reflects fewer shipments to OEMs compared with the prior year quarter. Revenue variability is expected to continue while the Company generates growth of end-user adoption through its OEM partners.

Data center gross margin declined in the third quarter of 2019 compared with the same period of 2018 due to lower unit volumes. In early 2019, Asetek decided to scale back its investment in the data center business and reduced related operating expense. Gross margin and operating results are expected to continue to fluctuate until the Company grows and maintains meaningful unit volumes of revenue and production.

Data center market update

Asetek's liquid cooling technology offers a strong value proposition to high-performance computing (HPC) data centers with increased performance, higher density and lower cooling costs. Asetek's historical strategy in this market has been to focus on growing the business through OEM customers. However, growth in this segment has not met Company expectations. As such, until legislative changes are made requiring the re-use of waste heat in data centers, the Company's strategy is to continue to sell to its existing OEM partners as well as proactively work with political leaders to develop a wider understanding of the significant environmental benefits enabled by liquid cooling.

Today, Asetek has major liquid cooling installations at multiple HPC sites in North America, Asia and Europe and is liquid cooling thirteen of the world's most powerful and efficient supercomputers listed in the November 2018 Top500 and Green500, including three systems in the Top20.

Fujitsu is using Asetek's liquid cooling to remove heat from processors and other high-power components in its PRIMERGY servers to cost effectively deliver maximum performance and high cluster density. Recent projects have included the fastest supercomputer in Japan and No. 7 in the Top500, the AI Bridging Cloud Infrastructure system installed at the National Institute of Advanced Industrial Science and Technology (AIST). Another Fujitsu project is the Oakforest-PACS system, which is No. 14 in the Top500 and one of the most powerful supercomputers in Japan.

Group and segment outlook

On July 23, 2019, Asetek adjusted its Group revenue expectation for 2019 to a decline of approximately 20% compared with 2018. Customer volumes in the second half of 2019 reflect reduced demand in the DIY segment as a result of macroeconomic and industry headwinds. Based on the current revenue and cost outlook, Asetek expects to report a pre-tax profit for 2019.

Gaming and Enthusiast. The overall PC industry outlook has been negatively affected by uncertainties related to trade relations between U.S. and China, a 25% and possibly increasing tariff on U.S. imports from China, the impact from the Brexit process, and the economic development across other markets. Revenue decrease with one larger customer exceeds the decline of other OEMs, which indicates changes to product mix, vendor allocation, larger-than-average inventories or a mix thereof. Asetek's continued focus of resources to this segment, increased market share of other customers, and launch of innovative new products are expected to mitigate these effects in 2020. Factoring in macroeconomic, industry and Asetek-specific factors, the Company expects Gaming and Enthusiast revenue in 2019 to decline from the prior year. The resource consumption, as expressed in overhead expenses, is expected to increase in 2019 compared with 2018.

Fourth-quarter 2019 Enthusiast/DIY and Gaming/ Performance PC revenue is expected to increase from the level achieved in the third quarter of 2019. However, revenue is expected to decline compared with the fourth quarter of 2018. Revenue variability by quarter is expected to continue.

The Company expects Gaming and Enthusiast gross margin in the fourth quarter of 2019 to decline 2-3 %-points from the level in the third quarter of 2019, due to an inventory cleanout and a one-time final sell out of an end-of-life product.

Data center. Through partnerships with data center OEMs, Asetek anticipates continued growth in end-user adoption with deliveries to new HPC installations and shipments of less complex products. Shipments of RackCDU™ liquid cooling to our existing partners in the third quarter reflect the continued success of our partners' HPC deployments of Asetek liquid cooling.

However, data center market adoption of liquid cooling solutions takes time and is lagging Company expectations despite its strong value proposition. The Company has decided to discontinue segment revenue guidance until the Data center business more clearly develops into a meaningful business. Though Asetek anticipates long-term revenue growth in this segment, Asetek's historical investment in Data center is considered sufficient at this time and spending in 2019 has been scaled down from the prior year level. Segment revenue and operating results are expected to fluctuate.

There is an apparent need for public standards to trigger wider data center adoption of liquid cooling. Asetek is participating in targeted campaigns to influence politicians and support wider understanding of the significant environmental and circular economy benefits enabled by liquid cooling. Direct-to-chip liquid cooling enables power savings and CO_2 emission reductions from the reuse of data center waste heat and is one of, if not the most impactful and significant technologies available in the world.

Intellectual Property

Asetek holds a portfolio of intellectual property (IP) rights including patents providing competitive advantages and high barriers to entry for competitors. Currently Asetek has pending patent and utility model applications worldwide, with additional applications under preparation.

As part of efforts to build and maintain its market share, the Company continues to closely review and assess all competitive offerings for infringement of its patents. The Company has strengthened its intellectual property platform and competitiveness via several positive lawsuit outcomes in prior years.

The Company is involved in various ongoing legal disputes, including the following matters:

In 2015, CoolIT Systems, Inc. ("CoolIT") paid Asetek $1.8 million to settle Asetek's suit against CoolIT for infringement of Asetek's '362 and '764 patents (filed in the Northern District of California). In January 2019, Asetek filed a new patent infringement lawsuit against CoolIT in the same court accusing more recent CoolIT products that were not at issue in the earlier litigation. Asetek's complaint seeks judgment that CoolIT infringes Asetek's '362 and '764 patents as well as Asetek's U.S. Patent Nos. 9,733,681; 10,078,354; and 10,078,355. CoolIT has filed counterclaims asserting infringement of three CoolIT patents, which Asetek denies. The litigation is at its initial stages and no trial date has been set.

In September 2016, Asetek filed two patent infringement lawsuits against CoolerMaster Shanghai and its distributor Shenzhen Xinhua in Shenzhen City accusing various CoolerMaster products of infringing Asetek's Chinese Patent 201210266143.8. In October 2018, the court ruled in Asetek's favor on both cases, entering an injunction against CoolerMaster and awarding RMB1 Million in damages. CoolerMaster appealed the judgment to a higher court, and oral arguments were heard on this appeal in March 2019. Coolermaster also initiated an action to invalidate Asetek's patent in the Beijing IP Court; a trial on this matter in September 2019 is awaiting decision by the court. In June 2019, CoolerMaster filed an invalidation request on the same Asetek Chinese patent with the China National Intellectual Property Administration. These cases are in their early stages.

In April 2016, Asetek initiated patent infringement proceedings against CoolerMaster and Coolergiant before the District Court The Hague, pertaining to commerce in The Netherlands. In the case against CoolerMaster, the Court dismissed Asetek's claim. Asetek appealed the decision and will subsequently submit its grounds for appeal. The case against Coolergiant has been stayed, pending final judgment in the CoolerMaster case.

In 2017, Coolergiant GmbH filed suit against Asetek Danmark A/S in Mannheim District Court requesting declaration of non-infringement in Germany of an Asetek patent. The Company disputed the allegations and filed counterclaim motions. In November 2018, the Court ruled that the named Coolergiant products infringe on Asetek's patent and granted Asetek claims for injunctive relief, rendering of accounts, recall and destruction. Coolergiant has appealed the decision and initiated an action to nullify Asetek's patent. The appeal and nullify actions are pending. In June 2019, Asetek initiated a contempt of court proceeding for Coolergiant's failure to meet its obligations associated with the Court ruling.

Risk Factors

The Company has historically incurred operating losses and is in the development stages of its Data center business.

The Company's revenue growth is dependent on the market acceptance of its Data center offerings and the release of new products from server OEM customers to facilitate its trial system deployments. Revenue in the Gaming and Enthusiast segment is subject to fluctuations and is dependent, in part, on the popularity and new releases of end user products by Asetek's customers.

In the first nine months of 2019, two customers in the Enthusiast/DIY segment accounted for 36% and 25% of total revenue. In the event of a loss of such significant customers, replacement of revenue streams would be difficult for Asetek to achieve in the short term. The Company is working with its other Enthusiast/DIY customers to grow their respective market shares and order volumes.

The U.S. has imposed a 25% tariff on imports of goods manufactured in China, which include Asetek products. The existence of the tariff, and the likelihood that the tariff may increase, has contributed to the uncertainties in the Gaming & Enthusiast market and the decline in Asetek's revenue in 2019. The Company continues to work to minimize the impact of the tariff on Asetek and its customers.

Asetek relies upon suppliers and partners to supply products and services at competitive prices. Asetek's Gaming and Enthusiast products have been historically assembled in China by a single contract manufacturer which may be difficult to substitute in the short term if the need should arise.

Asetek has filed and defended lawsuits against competitors for patent infringement. While some of the recent cases have been settled or dismissed, some may continue, and new cases may be initiated. Such cases may proceed for an extended period and could potentially lead to an unfavorable outcome to Asetek. Asetek has incurred significant legal costs associated with litigation and may continue to do so in the future to the extent management believes it is necessary to protect intellectual property.

Asetek moved from USA to Denmark in 2013. However, USA – in a unilateral tax treaty override – still considers Asetek A/S a U.S. tax subject, effectively creating a double taxation situation. Asetek has approached both countries' tax authorities with the aim of resolving the double tax situation as per the double taxation treaty. However, a determination may take several years, and the authorities are not obligated to resolve the problem. In addition, new U.S. regulations on taxation of foreign earnings beginning in 2018 may increase Asetek's tax liability. The Company is working with its tax advisors to investigate and resolve these matters.

Asetek operates internationally in Denmark, USA, China, and Taiwan and is subject to foreign exchange risk. As of September 30, 2019, its principal cash holdings are maintained in deposit accounts in U.S. dollars and Danish krone.

A more thorough elaboration on risk factors can be found in the Company's Annual Report for 2018, available from the Company's website: www.asetek.com

Condensed Interim Financial Statements

Consolidated Statement of Comprehensive Income

			Nine months ended		
Figures in USD (000's)	Q3 2019	Q3 2018	30-Sep-19	30-Sep-18	2018
	Unaudited	*Unaudited*	*Unaudited*	*Unaudited*	
Revenue	$ 10,391	$ 17,405	$ 38,673	$ 50,809	$ 67,314
Cost of sales	6,031	10,132	22,388	31,590	41,142
Gross profit	4,360	7,273	16,285	19,219	26,172
Research and development	1,241	1,225	3,696	3,784	4,764
Selling, general and administrative	4,326	4,095	13,457	12,200	16,989
Other expense (income)	-	-	(753)	-	-
Total operating expenses	5,567	5,320	16,400	15,984	21,753
Operating income	(1,207)	1,953	(115)	3,235	4,419
Foreign exchange (loss) gain	551	150	589	344	342
Finance income (costs)	55	20	159	63	109
Total financial income (expenses)	606	170	748	407	451
Income before tax	(601)	2,123	633	3,642	4,870
Income tax (expense) benefit	127	(499)	(181)	(837)	(1,198)
Income for the period	(474)	1,624	452	2,805	3,672
Other comprehensive income items that may be reclassified to profit or loss in subsequent periods:					
Foreign currency translation adjustments	(909)	(182)	(1,003)	(353)	(169)
Total comprehensive income	$ (1,383)	$ 1,442	$ (551)	$ 2,452	$ 3,503
Income per share (in USD):					
Basic	$ (0.02)	$ 0.06	$ 0.02	$ 0.11	$ 0.14
Diluted	$ (0.02)	$ 0.06	$ 0.02	$ 0.11	$ 0.14

These financial statements should be read in conjunction with the accompanying notes.

Consolidated Balance Sheet

Figures in USD (000's)		30 Sept 2019		31 Dec 2018
ASSETS		*Unaudited*		
Non-current assets				
Intangible assets	$	2,094	$	2,414
Property and equipment		6,266		4,103
Deferred income tax assets		7,132		7,458
Other assets		294		309
Total non-current assets		15,786		14,284
Current assets				
Inventory		2,124		2,862
Trade receivables and other		7,888		15,625
Cash and cash equivalents		26,261		18,627
Total current assets		36,273		37,114
Total assets	$	52,059	$	51,398
EQUITY AND LIABILITIES				
Equity				
Share capital	$	422	$	422
Retained earnings		39,022		37,704
Translation and other reserves		(170)		832
Total equity		39,274		38,958
Non-current liabilities				
Long-term debt		2,905		641
Total non-current liabilities		2,905		641
Current liabilities				
Short-term debt		1,434		980
Accrued liabilities		1,636		2,185
Accrued compensation & employee benefits		1,285		1,512
Trade payables		5,525		7,122
Total current liabilities		9,880		11,799
Total liabilities		12,785		12,440
Total equity and liabilities	$	52,059	$	51,398

These financial statements should be read in conjunction with the accompanying notes.

Consolidated Statement of Changes in Equity

Unaudited

Figures in USD (000's)	Share capital	Translation reserves	Other reserves	Retained earnings	Total
Equity at January 1, 2019	$ 422	$ 836	$ (4)	$ 37,704	$ 38,958
Total comprehensive income - nine months ended Sept 30, 2019					
Income for the period	-	-	-	452	452
Foreign currency translation adjustments	-	(1,003)	-	-	(1,003)
Total comprehensive income - nine months ended Sept 30, 2019	-	(1,003)	-	452	(551)
Transactions with owners - nine months ended Sept 30, 2019					
Shares issued	-	-	1	59	60
Share based payment expense	-	-	-	807	807
Transactions with owners - nine months ended Sept 30, 2019	-	-	1	866	867
Equity at September 30, 2019	$ 422	$ (167)	$ (3)	$ 39,022	$ 39,274

Equity at January 1, 2018	$ 419	$ 1,005	$ (6)	$ 31,976	$ 33,394
Total comprehensive income - nine months ended Sept 30, 2018					
Income for the period	-	-	-	2,805	2,805
Foreign currency translation adjustments	-	(353)	-	-	(353)
Total comprehensive income - nine months ended Sept 30, 2018	-	(353)	-	2,805	2,452
Transactions with owners - nine months ended Sept 30, 2018					
Shares issued	3	-	2	780	785
Share based payment expense	-	-	-	940	940
Transactions with owners - nine months ended Sept 30, 2018	3	-	2	1,720	1,725
Equity at September 30, 2018	$ 422	$ 652	$ (4)	$ 36,501	$ 37,571

These financial statements should be read in conjunction with the accompanying notes.

Consolidated Cash Flow Statement

Figures in USD (000's)	Nine months ended 30 Sept 2019	Nine months ended 30 Sept 2018	2018
	Unaudited	*Unaudited*	
Cash flows from operating activities			
Income for the period	$ 452	$ 2,805	$ 3,672
Depreciation and amortization	2,917	2,620	3,690
Finance income	(282)	(137)	(205)
Finance costs	124	74	96
Income tax expense (benefit)	181	837	1,198
Cash receipt (payment) for income tax	(147)	(14)	(118)
Share based payments expense	807	940	1,276
Changes in trade receivables, inventories, other assets	7,915	(663)	(3,502)
Changes in trade payables and accrued liabilities	(1,818)	(3,557)	(2,264)
Net cash provided by (used in) operating activities	10,149	2,905	3,843
Cash flows from investing activities			
Additions to intangible assets	(1,013)	(1,124)	(1,745)
Purchase of property and equipment	(565)	(1,565)	(1,914)
Net cash used in investing activities	(1,578)	(2,689)	(3,659)
Cash flows from financing activities			
Funds drawn (paid) against line of credit	17	20	(6)
Proceeds from issuance of share capital	58	784	782
Principal payments on capitalized leases	(585)	(220)	(321)
Net cash provided by (used in) financing activities	(510)	584	455
Effect of exchange rate changes on cash and cash equivalents	(427)	(400)	(410)
Net changes in cash and cash equivalents	7,634	400	229
Cash and cash equivalents at beginning of period	18,627	18,398	18,398
Cash and cash equivalents at end of period	$ 26,261	$ 18,798	$ 18,627
Supplemental disclosures -			
Property and equipment acquired under leases	$ 259	$ 133	$ 134

These financial statements should be read in conjunction with the accompanying notes.

Notes to the quarterly financial statements

1. General information

Asetek A/S ('the Company'), and its subsidiaries (together, 'Asetek Group', 'the Group' or 'Asetek') designs, develops and markets thermal management solutions used in computers and data center servers. The Group's core products utilize liquid cooling technology to provide improved performance, acoustics and energy efficiency. The Company is based in Aalborg, Denmark with offices in USA, China and Taiwan. The Company's shares trade on the Oslo Stock Exchange under the symbol 'ASETEK'.

These condensed consolidated financial statements for the quarter and nine months ended September 30, 2019 have been prepared on a historical cost convention in accordance with International Accounting Standard 34 (IAS 34) 'Interim Financial Reporting' as adopted by the European Union (EU) and do not include all of the information and disclosure required in the annual consolidated financial statements. These statements should be read in conjunction with the Asetek A/S 2018 Annual Report.

The accounting policies adopted in preparation of these condensed consolidated financial statements are consistent with those followed in the preparation of the Company's annual consolidated financial statements for the year ended December 31, 2018, except for the implementation of the new standards IFRS 16 Leases and IFRIC 23 Uncertainty over Income Tax Treatments, as described in Note 2 and Note 7, respectively.

The Group operates in an industry where seasonal or cyclical variations in total sales are not normally experienced during the financial year.

2. Change in accounting policy – Leases

On January 1, 2019, the Group adopted IFRS 16 Leases on a modified retrospective basis without restatement of the prior year, as permitted under the standard. Upon adoption of IFRS 16, Asetek recognized lease liabilities in relation to leases which had previously been classified as operating leases under the principles of IAS 17 Leases. These liabilities were measured at the present value of the remaining lease payments, discounted using the lessee's incremental borrowing rate as of January 1, 2019. The weighted average incremental borrowing rate applied to lease liabilities was 3.0%. The associated right-of-use assets for the leases were measured at the amount equal to the lease liability, adjusted by the amount of any prepaid or accrued lease payments relating to that lease recognized in the balance sheet as of December 31, 2018. For leases previously classified as finance leases, the Group recognized the carrying amount of the lease asset and lease liability at the date of initial application. The Company has elected not to apply IFRS 16 recognition on short-term and low value leases, as permitted under the standard. Asetek has elected not to reassess whether a contract is a lease at the date of initial application. Instead, for contracts entered into before the transition date the Group relied on its assessment made applying IAS 17 and IFRIC 4 *Determining whether an Arrangement contains a Lease.*

Through 2018, leases of property, plant and equipment were classified as either finance or operating leases. Payments made under operating leases were charged to profit or loss on a straight-line basis over the period of the lease. From January 1, 2019, leases are recognized as a right-of-use asset and a corresponding liability at the date at which the leased asset is available for use by the Group. Assets and liabilities arising from a lease are initially measured on a present value basis. Lease liabilities include the net present value of: fixed lease payments, amounts expected to be payable under residual value guarantees, any purchase options that are reasonably expected to be exercised, and any penalties for termination reflected in the lease term. Each lease payment is allocated between the liability and finance cost. The finance cost is charged to profit or loss over the lease period to reflect a constant periodic rate of interest on the remaining balance of the liability for each period.

Asetek leases equipment, its principal office facilities and some motor vehicles. Contracts are typically for fixed periods of five years or more for office facilities, five years for equipment, and two years or less for motor vehicles. The leased asset is depreciated over the shorter of the asset's useful life and the lease term on a straight-line basis.

As a result of this change in accounting policy, the Group's lease liabilities and corresponding leased assets recorded on the balance sheet increased by $3.2 million as of January 1, 2019, when compared with the balance at December 31, 2018. In the first nine months of 2019, the accounting change resulted in recognition of depreciation expense of $424,000 and finance cost of $67,000. These increases are substantially offset by a reduction in associated facilities and automobile expense for the same period. Cash flow from operating activities increased by $378,000 and cash flow from financing activities decreased by $378,000 in the first nine months of 2019 as a result of this change in accounting policy.

	(USD 000's)
Operating lease commitments disclosed at December 31, 2018	3,376
Discounted using the incremental borrowing rate at January 1, 2019	3,227
Add: finance lease liabilities recognized at December 31, 2018	879
Less: short-term leases recognized on a straight-line basis as expense	(4)
Lease liability recognized at January 1, 2019	4,102

Lease liabilities:	December 31, 2018	January 1, 2019
Current lease liabilities	239	751
Non-current lease liabilities	640	3,351
Total lease liabilities	879	4,102

Leased assets:	December 31, 2018	January 1, 2019
Properties	-	3,204
Machinery and equipment	1,538	1,538
Motor vehicles	-	19
Gross value, leased assets	1,538	4,761
Less: accumulated depreciation	(839)	(839)
Net value, leased assets	699	3,922

3. Equity

In September 2019, the Company granted a total of 494,900 equity options to employees. Each option has an exercise price of NOK24.70 per share and becomes exercisable gradually over a period of four years. Using the Black-Scholes pricing model, the estimated fair value of these options granted is approximately $0.6 million. The fair value was calculated using the following assumptions: risk-free interest rate of 1.49% to 1.51%; expected volatility of approximately 55%; expected option life of 3.5 to 5.5 years; dividend yield of 0%.

At September 30, 2019, there were 25.6 million common shares outstanding and 0.2 million shares in treasury. Treasury shares may be used to fulfill a portion of share options and warrants outstanding which total approximately 2.6 million. Share capital increased by approximately $60,000 in the first nine months 2019 ($0.8 million in the first nine months of 2018) as a result of funds received from employee exercises of warrants and options. Share based payment expense associated with total warrants and options outstanding was $0.8 million and $0.9 million in the nine months ended September 30, 2019 and 2018, respectively.

4. Intangible assets

The Group's business includes a significant element of research and development activity. Under IAS 38, there is a requirement to capitalize and amortize development spend to match costs to expected benefits from projects deemed to be commercially viable. Costs capitalized are recorded on the balance sheet as intangible assets, net of amortization. In the first nine months of 2019, the Company capitalized approximately $1.0 million of development costs and recorded amortization of approximately $1.3 million (capitalized costs of $1.1 million and amortization of $1.5 million in the first nine months of 2018).

5. Earnings (losses) per share

IAS 33 requires disclosure of basic and diluted earnings per share for entities whose shares are publicly traded. Basic earnings per share is calculated by dividing the profit or loss attributable to equity holders of the Company by the weighted average number of common shares outstanding during the period. Diluted earnings per share is calculated by adjusting the number of common shares outstanding used in the Basic calculation for the effect of dilutive equity instruments, which include options, warrants and debt or preferred shares that are convertible to common shares, to the extent their inclusion in the calculation would be dilutive.

Third Quarter

	Q3 2019	Q3 2018
Income attributable to equity holders of the Company (USD 000's)	$ (474)	$ 1,624
Weighted average number of common shares outstanding (000's)	25,601	25,499
Basic income per share	$ (0.02)	$ 0.06
Weighted average number of common shares oustanding (000's)	25,601	25,499
Instruments with dilutive effect:		
Warrants and options	-	940
Weighted average number of common shares oustanding, diluted	25,601	26,439
Diluted income per share	$ (0.02)	$ 0.06

First Nine Months

	Nine months ended	
	30-Sep-19	30-Sep-18
Income attributable to equity holders of the Company (USD 000's)	$ 452	$ 2,805
Weighted average number of common shares outstanding (000's)	25,576	25,402
Basic income per share	$ 0.02	$ 0.11
Weighted average number of common shares oustanding	25,576	25,402
Instruments with dilutive effect:		
Warrants and options	459	1,055
Weighted average number of common shares oustanding, diluted	26,035	26,457
Diluted income per share	$ 0.02	$ 0.11

Warrants and options are excluded from the calculation of diluted loss per share for the third quarter of 2019 because the effect of including them would be anti-dilutive.

6. Transactions with related parties

The Company's CEO serves as Chairman of the Board for a vendor that supplies information technology services to the Company. In the first nine months of 2019, the Group purchased services totaling approximately $402,000 ($426,000 in the first nine months of 2018) from this vendor. At September 30, 2019 and 2018, the Group had outstanding payables to this vendor of $20,000 and $45,000 respectively.

7. New accounting standard –Income tax

In June 2018, the International Accounting Standards Board (IASB) issued IFRS interpretation IFRIC 23 — Uncertainty over Income Tax Treatments. This standard clarifies how to apply the recognition and measurement requirements of International Accounting Standard 12, *Income Taxes,* when there is uncertainty in income tax treatments. According to IFRIC 23, an entity must determine the probability of the relevant tax authority accepting each tax treatment used in their income tax filing, including considering the expected value of the tax treatment when determining taxable profit (tax loss), tax bases, unused tax losses, unused tax credits and tax rates. The effective date for adoption of IFRIC 23 is annual periods beginning on or after January 1, 2019, though early adoption is permitted. The Company adopted IFRIC 23 as of January 1, 2019, and its adoption does not have a material impact on the consolidated financial statements.

8. Income tax and deferred tax asset

The Company recognizes deferred income tax assets only to the extent that the realization of the tax benefit to offset future tax liabilities is considered to be probable. As of September 30, 2019, the Company has deferred tax assets of $7.1 million, representing the value of the estimated amount of net operating losses that will be utilized to offset future taxable income. In future periods, management will continue to assess the probability of realization of the assets' value and adjust the valuation in accordance with IAS 12. Refer to the Asetek A/S 2018 Annual Report regarding critical accounting estimates and assumptions.

In June 2019, the U.S. released regulation for its Global Intangible Low-Taxed Income (GILTI) inclusion for U.S. taxation, effective beginning with tax year 2018. The GILTI regulation requires U.S. companies to report foreign corporation intangible income that exceeds 10% return on foreign invested assets. Under prior law, U.S. owners of foreign corporations were able to defer recognizing taxable income until there was a distribution of earnings back to U.S. owners.

Because of Asetek's status as a Denmark-based corporation and also a U.S. tax subject, the applicability of the GILTI regulation to Asetek's tax liability is uncertain. As such, its effect has not been recorded in the Group financial statements. If GILTI application is required, the Company's effective income tax rate for 2018 would increase to approximately 36%. This effect would result in incremental utilization of the Company's deferred tax assets of approximately $0.6 million in 2018 but would not result in a current tax payment. The Company is working with its tax advisors to investigate and resolve this matter.

9. Other (expense) income

The Company recognized other income of $0.8 million related to settlements received from intellectual property litigation in the second quarter of 2019. Income from such settlements are reported as an offset to operating expense in the Consolidated Statement of Comprehensive Income.

10. Segment reporting

The Company disaggregates revenue based on business segments and the markets within each business segment, as follows:

Revenue Disaggregation:

Figures in USD (000's)	Q3 2019	Q3 2018	YTD 2019	YTD 2018
Gaming and Enthusiast segment:				
Enthusiast/DIY	7,767	13,887	30,419	38,771
Gaming/Performance PCs	1,785	2,217	6,173	8,829
Data center segment:				
OEM	839	1,263	1,767	3,089
Government	-	38	314	120
Total revenue	10,391	17,405	38,673	50,809

Unaudited breakdown of the income statement

Operations - Third Quarter

Figures in USD (000's)	Gaming and Enthusiast		Data center	
	Q3 2019	Q3 2018	Q3 2019	Q3 2018
Revenues	9,552	16,104	839	1,301
Cost of sales	5,535	9,420	496	712
Gross Profit	4,017	6,684	343	589
Gross Margin	42.1%	41.5%	40.9%	45.3%
Total operating expenses	1,919	1,294	1,207	1,976
EBITDA adjusted	2,098	5,390	(864)	(1,387)
EBITDA margin	22.0%	33.5%	N/A	N/A

Operations - First Nine Months

Figures in USD (000's)	Gaming and Enthusiast		Data center	
	YTD 2019	YTD 2018	YTD 2019	YTD 2018
Revenues	36,592	47,600	2,081	3,209
Cost of sales	21,058	29,361	1,330	2,229
Gross Profit	15,534	18,239	751	980
Gross Margin	42.5%	38.3%	36.1%	30.5%
Total operating expenses	5,456	2,934	4,290	6,714
EBITDA, adjusted	10,078	15,305	(3,539)	(5,734)
EBITDA margin	27.5%	32.2%	N/A	N/A

Headquarters Costs

Figures in USD (000's)	Q3 2019	Q3 2018	YTD 2019	YTD 2018
Litigation costs	661	596	2,027	1,265
Litigation settlements	-	-	(753)	-
Other headquarters costs	541	395	1,656	1,511
Total headquarters costs	1,202	991	2,930	2,776

See reconciliation to statement of comprehensive income in Key Figures on page 1.

Reconciliation to Operating Income

Figures in USD (000's)	Q3 2019	Q3 2018	YTD 2019	YTD 2018
EBITDA, adjusted - Gaming and Enthusiast	2,098	5,390	10,078	15,305
EBITDA, adjusted - Data center	(864)	(1,387)	(3,539)	(5,734)
Headquarters costs	(1,202)	(991)	(2,930)	(2,776)
Share based compensation	(268)	(280)	(807)	(940)
Depreciation and amortization	(971)	(779)	(2,917)	(2,620)
Operating income	(1,207)	1,953	(115)	3,235

Statement by the Board of Directors and Management

The Board of Directors and the Management have considered and adopted the Interim Report of Asetek A/S for the period 1 January – 30 September 2019. The Interim Report is presented in accordance with the International Accounting Standard IAS 34 on Interim Financial Reporting and additional Danish disclosure requirements. The accounting policies applied in the Interim Report are unchanged from those applied in the Group's Annual Report for 2018, except as noted in Note 1.

We consider the accounting policies appropriate, the accounting estimates reasonable and the overall presentation of the Interim Report adequate. Accordingly, we believe that the Interim Report gives a true and fair view of Asetek's consolidated financial position, results of operations and cash flows for the period.

In our opinion, the Interim Report includes a true and fair account of the matters addressed and describes the most significant risks and elements of uncertainty facing Asetek. The Interim Report has not been audited or reviewed by the auditors.

Asetek A/S
Aalborg, 22 October 2019

Management:

André S. Eriksen
CEO

Peter Dam Madsen
CFO

Board of Directors:

Jukka Pertola
Chairman

Chris J. Christopher
Vice chairman

Maria Hjorth
Member

Jørgen Smidt
Member

Erik Damsgaard
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