COMBINED MANAGEMENT REPORT
FOR THE FINANCIAL YEAR 2016

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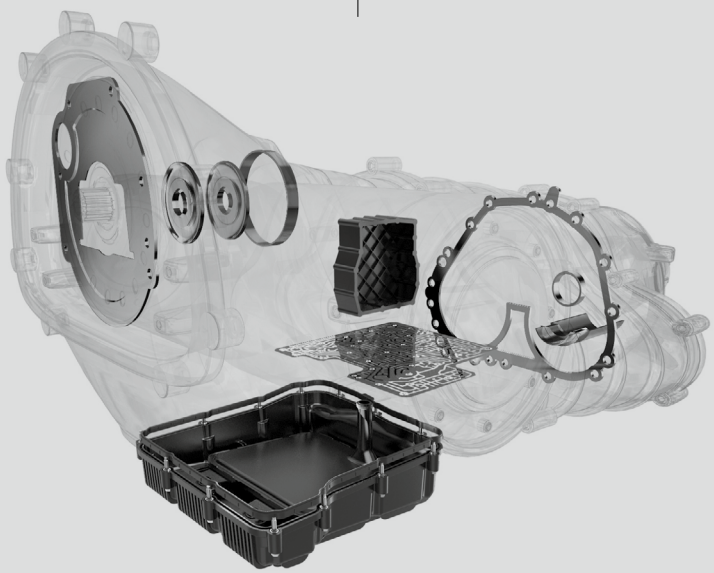


TRANSMISSION SYSTEM

- Sealing systems: Metaloseal™, metal-elastomer, elastomer, Metaloprint™, control plates in Metaloseal™ and metal/soft material sandwich design
- Thermal and acoustic shielding systems: ElroTherm™, ElroCoustic™
- Lightweight plastic components, e.g. end-shield covers, oil pans
- Topseal deep-drawn and topographic housing components
- Plastic components (PTFE, PTFE compounds/composites, PEEK, Moldflon™)

OVERVIEW OF ELRINGKLINGER'S ACTIVITIES AND STRUCTURE

ElringKlinger develops and manufactures high-tech products for current and future vehicle generations. Building on powerful innovations, the Group is committed to shaping the future of mobility and maintaining its position as a technology leader within the automotive supply industry.

Profile

ElringKlinger AG can look back on a corporate history spanning 137 years, during which time the Group has gradually evolved into an independent development partner and original equipment manufacturer with a global footprint. The Group generates around 90% of its revenue from sales to the automotive industry and within the independent aftermarket. In this field, ElringKlinger develops, produces, and markets parts and assemblies for engines, transmissions, exhaust systems, vehicle bodies, lithium-ion batteries*, and fuel cells*. The Group's portfolio includes products for all types of drive technology – from conventional combustion engines to hybrid units* and electric systems. Also serving sectors outside the automotive industry, ElringKlinger manufactures exhaust gas purification systems deployed in ships, buses, trucks, construction and agricultural machinery, locomotives, and power stations. Additionally, the Group supplies products made of the high-performance plastic PTFE, which is used in a wide range of industries. These products are tailored to individual specifications depending on the field of application and customer requirements.

As of December 31, 2016, the ElringKlinger Group was operating with 47 sites around the globe. It employed more than 8,500 people worldwide (cf. "Sustainability").

Business model and core competencies

Global megatrends such as the steady growth in population, the focus on environmental protection, and the emergence of globalization herald a new era of social interaction and create new challenges that also have an impact on the automotive industry. It is precisely these trends that are shaping the market for efficient drive systems, with the rapid growth in population and more pronounced levels of globalization prompting a surge in demand for personal mobility and the introduction of ever-stricter emission standards. This is where ElringKlinger's product portfolio comes to the fore. State-of-the-art concepts for lightweighting, downsized combustion engines, exhaust gas purification systems, and alternative drive technologies all help to reduce carbon dioxides, nitrogen oxides*, hydrocarbons, and soot particulates. ElringKlinger is playing an active part in the transition of the automobile industry towards zero-emissions mobility – with products used in battery and fuel cell systems.

The Group is committed to cementing its success in the business arena by drawing on its financial strength together with its demonstrable abilities in research and development as well as its far-reaching expertise with regard to materials and processes. ElringKlinger designs and produces the majority of tools required for high-precision metal processing (stamping, embossing, and forming) and injection-molding operations within the company itself. Deployed within extensively automated production plants, they provide the basis for products manufactured to the highest possible technological standards. Thanks to the cutting-edge design of these tools and the production methods applied by ElringKlinger, the company has also raised the bar with regard to market entry by potential competitors.

Economic and legal factors

ElringKlinger operates as a global supplier to the automotive industry. Against this background, demand for its products is driven to a certain extent by macroeconomic developments and the employment situation in the country in question. Other factors, such as movements

in the price of fuel and changes in consumer behavior, interest rates, or regulatory arrangements in different countries, can also have an adverse effect on demand within the automobile market. As experience has shown, the sale of ElringKlinger products tends to be dependent on market developments within the area of global vehicle manufacturing. Cyclical fluctuations in individual countries can usually be offset by exploiting the more favorable performance of other sales markets.

As regards the legislative environment, ever-stricter regulations in relation to applicable emission standards (Euro standard*, CAFE standard*) are to be seen as key influencing factors. They exert greater pressure on vehicle manufacturers to develop energy-efficient solutions for lower- or zero-emissions mobility. Other industries, such as the shipping sector, are also having to contend with more far-reaching regulations. Since January 2016, newly built ships have been subject to stricter standards governing nitrogen oxide emissions. Legislation governing various industries provides additional impetus for ElringKlinger's business, as the use of ElringKlinger products in specific applications can help to scale back emissions.

Group structure and organization

Headquartered in Dettingen/Erms, Germany, ElringKlinger AG is the parent company of the ElringKlinger Group. It assumes responsibility for Group-wide management tasks as well as central functions such as purchasing, information technology, communication, legal affairs, and human resources. Additionally, it oversees the strategic management of business activities.

As a result of the formation of companies in 2016 and due to the acquisitions transacted in the same period, the Group structure changed as outlined below:

- Effective from April 11, 2016, Hug Engineering AG, a 93.7% subsidiary of ElringKlinger AG, acquired a further 80.0% of the interests in COdiNOx Beheer B.V., Enschede, Netherlands, and now holds a 90.0% interest in that entity.
- Effective from June 1, 2016, ElringKlinger AG took over the business operations of tool specialist Maier Formenbau GmbH, with its registered office in Bissingen/Teck, Germany, as part of an asset deal.
- On October 31, 2016, ElringKlinger AG established the new production enterprise ElringKlinger Silicon Valley, Inc., Fremont, USA.

In total, the ElringKlinger Group comprised 43 companies as of December 31, 2016.

Additionally, on October 26, 2016, ElringKlinger AG signed a certified contract covering a strategic investment of 27.0% in the engineering company hofer AG, Nürtingen, Germany, as well as a 53.0% majority interest in the subsidiary hofer powertrain products GmbH, Nürtingen, Germany. The closing is scheduled for 2017.

Sales markets and company sites

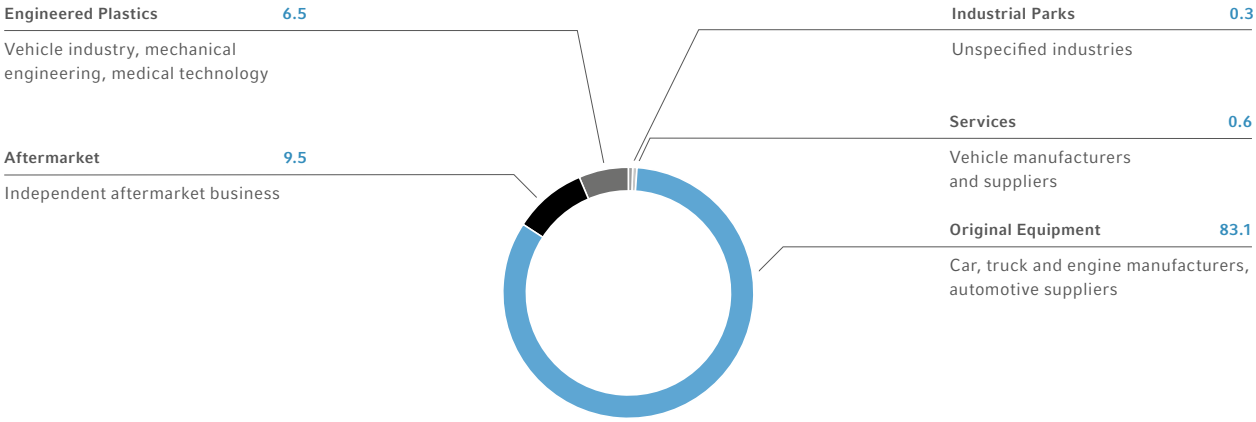
ElringKlinger operates a global network of strategically located production sites and sales offices. From there, first and foremost, the Group supplies the three largest economic areas – Europe, NAFTA, and industrialized Asia (China and Japan) – with innovative products. Additionally, the Group is also active in the emerging markets of Asia and South America. In total, the Group has more than 36 production facilities, nine sales offices, one logistics center, and one company that operates solely within the area of aftermarket sales. Almost all of the world's major vehicle and engine manufacturers are ElringKlinger customers. Therefore, in the majority of cases the Group holds a so-called Tier 1 position* within the value chain. ElringKlinger products are also marketed to automotive suppliers, particularly with regard to turbocharger systems*, exhaust technology, and transmission engineering.

WORLDWIDE

Overall, the Group operates with 36 production and 11 sales and services sites.

* Cf. glossary

ELRINGKLINGER GROUP SEGMENTS
(on the basis of sales revenue 2016) in %



Segments and divisions

The business activities of the ElringKlinger Group are divided into five segments. These also constitute the reportable segments under IFRS *.

The **Original Equipment** segment develops, manufactures, and sells products destined for the automotive industry. These include cylinder-head and specialty gaskets, lightweight plastic components and housing modules for the powertrain and the vehicle body, thermal and acoustic shielding parts for engine, transmission, and exhaust tract applications, and components for lithium-ion batteries and fuel cell systems. In addition, one of the divisions within this segment develops and produces complete exhaust gas purification systems, predominantly for applications in trucks, buses, ships, construction and agricultural machinery, and power stations.

In the **Aftermarket** segment, ElringKlinger supplies an extensive range of gaskets, gasket sets, and service parts for passenger cars and commercial vehicles. They are marketed under the "Elring – Das Original" brand. These spare parts are used in the professional repair of engines, gearboxes, and exhaust systems. Business within the Aftermarket segment is transacted primarily through a global network of wholesalers and major group purchasing organizations. Alongside Western and Eastern Europe, the key markets for this area of the business include the Middle East and North Africa. Among the key markets of the future are North America and China, where ElringKlinger is currently in the process of developing its business.

The **Engineered Plastics** segment develops, manufactures, and markets customized solutions made of high-performance plastics. Around one-third of segment revenue is attributable to sales within the automotive market, while approximately two-thirds are generated mainly in the area of mechanical engineering and from sales to the medical, chemical, and energy industries. While business is focused largely on Europe, the segment is currently targeting other regions, such as Asia and the Americas, for the purpose of driving forward expansion.

The **Services** segment provides development and assessment services for engines, transmissions, and the exhaust tract using cutting-edge testing and measurement facilities. The segment's customer base includes both vehicle manufacturers and automotive suppliers. In addition, this segment includes the areas of logistics services and catering.

The **Industrial Parks** segment encompasses the Group's industrial parks in Idstein, Germany, and in Kecskemét, Hungary. The purpose of the business is to lease and administer land and buildings.

Additionally, the segments outlined above are subdivided into eleven divisions. Seven of these divisions are assigned to the Original Equipment segment. Each

of the four remaining segments (Aftermarket, Engineered Plastics, Services, and Industrial Parks) also constitutes a separate division.

Metallic **cylinder-head gaskets** represent one of the traditional fields of business for ElringKlinger. Due to the technological maturity of these gaskets, the Group has held the position of market leader for many years now. This specific market is characterized by an oligopoly. Among the principal competitors are two corporations based in the United States. Some of the local markets include smaller regional players.

The **Specialty Gaskets** division develops and produces a number of tailor-made products, the focus being on metallic flat gaskets for various high-temperature applications relating to engines, turbochargers, transmissions, and exhaust systems. ElringKlinger ranks as one of the three leading suppliers worldwide. Competition within this field is extensive due to the extremely high level of product diversity.

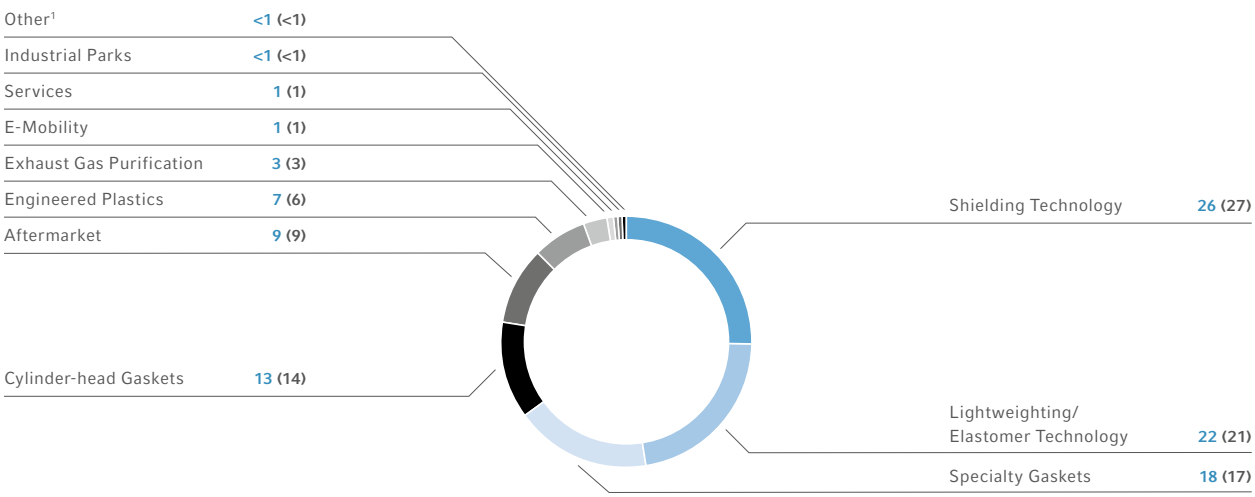
The **Shielding Technology** division encompasses thermal and acoustic shielding systems that handle a wide range of tasks relating to temperature management in modern motor vehicles. Various material compositions are used for the purpose of ensuring the best-possible management of energy flows, e.g., heat and air flow. ElringKlinger is one of the few suppliers in the world to offer complete shielding packages for both the engine as well as the underbody and the exhaust tract. In this division, too, the Group ranks as one of the top three suppliers at an international level.

The division formerly referred to as Plastic Housing Modules/Elastomer Technology is now called **Lightweighting/Elastomer Technology**. The decision to rename this area of the business was prompted mainly by the focus on newly developed lightweight products made of composite materials that are used as vehicle body components. The vehicle industry can achieve significant weight savings by replacing metal with lightweight components, e.g., made of high-performance plastic or organo sheets. In contrast to the other divisions mentioned above, the market within the area of high-performance plastics is much more fragmented.

ElringKlinger's **E-Mobility** division reflects the transition within the automotive industry toward alternative drive systems. Its focus is on cell contact systems for lithium-ion batteries, which are used in both pure electric and hybrid vehicles and are mass-produced by the company. Growth within this division is heavily dependent on demand for electric vehicles. Cell contact systems are available only from a small group of suppliers.

The **Exhaust Gas Purification** division develops and produces exhaust gas purification systems for the catalytic *

GROUP EXTERNAL SALES BY DIVISION 2016
(prior year) in %



[1] HURO Supermold S.R.L., Timisoara, Romania, and New Business Areas

* Cf. glossary

aftertreatment of mobile and stationary combustion engines as well as off-road applications. The portfolio comprises products for a number of different industries, including the commercial vehicle, shipping, and rail sector. Building on this product range, the division is well positioned in the respective target industries.

The division referred to as **Others** brings together activities relating to Tooling Technology and New Business Areas. The latter currently include ongoing projects focusing on fuel cell technology (cf. "Research and Development").

INTERNAL CONTROL CRITERIA

The Management Board of ElringKlinger AG mainly utilizes financial indicators for the purpose of governing the Group. Additionally, company-specific leading indicators and non-financial performance indicators form an important basis for key decision-making processes relating to corporate management. The aforementioned indicators are also to be seen as a foundation for the overall assessment of issues and developments that need to be evaluated within the company.

Financial control criteria

The most important financial control criteria applied within the ElringKlinger Group are sales and earnings performance as well as the Group's financial position. The key financial indicators used are sales revenue, earnings before interest and taxes (EBIT*), and return on capital employed (ROCE*). ROCE measures a company's profitability and the efficiency with which its capital is employed. These internal control criteria are planned, calculated, and continually monitored for the Group, for the individual Group companies, including the parent, and for the five reportable segments and the respective divisions.

For the purpose of calculating ROCE, EBIT is divided by average capital employed. At ElringKlinger, capital employed includes shareholders' equity, financial liabilities, provisions for pensions, and non-current provisions such as anniversary and partial-retirement provisions. The target defined by the Group is to achieve a return on capital employed of at least 15% in the medium to long term. Variable remuneration for the managerial level directly below the Management Board is generally linked to the level of ROCE achieved.

In addition, ElringKlinger takes into account other financial control criteria such as those listed below:

- Operating free cash flow*
- Equity ratio
- Potential market price risks from foreign exchange movements, interest rate changes, and increases in material costs

Operating free cash flow encompasses cash flow from operating activities less cash flow from investing activities, adjusted for payments in respect of acquisitions and for payments in respect of investments in financial assets.

The following table presents the key financial control criteria and several other control criteria used within the ElringKlinger Group. In line with the Group's capital market communications, EBIT is presented before purchase price allocation*.

SELECTED FINANCIAL CONTROL CRITERIA OF THE ELRINGKLINGER GROUP

		Guidance 2016[1]	Actual 2016	2015	2014	2013	2012	2011	2010
Sales revenue	(in EUR million)	1,583 to 1,613[2]	1,557.4[3]	1,507.3	1,325.8	1,150.1	1,127.2	1,032.8	795.7
EBIT before PPA[4]	(in EUR million)	140 to 150 ("more likely at the lower end")	140.4	140.4	162.3[5]	149.8[5]	140.9	130.6[6]	116.0
ROCE		At best, slight year-on-year improvement	8.7%	9.5%	12.4%	14.4%	13.3%	14.2%[6]	15.2%
Operating free cash flow	(in EUR million)	Slightly within negative territory (low to mid-double-digit figure in the million euro range)	-3.8	-65.2	-12.4	-4.2	8.2	-10.5	-1.9
Equity ratio		40 to 50%	47.2%	48.5%	49.7%	50.4%	50.6%	50.1%	52.7%

[1] In accordance with last quarterly financial statements of November 8, 2016; original guidance for 2016: EBIT before PPA: EUR 160 to 170 million; ROCE: "slight year-on-year improvement"; operating free cash flow: "no longer negative or only slightly within negative territory"; other target figures unchanged
[2] Equals 5 to 7% organic revenue growth (adjusted for effects of currencies and acquisitions)
[3] Revenue reported; revenue adjusted for effects of currencies and acquisitions (organic): EUR 1,578.4 million (+4.7%)
[4] PPA (write-downs from purchase price allocation) EUR 4.8 (5.2) million (accounted for in various functional categories of the income statement); calculation method applies similarly to FY 2010 to 2014
[5] Financial years adjusted for non-recurring exceptional items: 2013 by EUR -15.7 million, 2014 by EUR 4.9 million
[6] Adjusted for one-time gain from sale of Ludwigsburg industrial park (EUR 22.7 million)

Non-financial control criteria

The following HR- and quality-related indicators, which are of less significance in the context of corporate governance, are also monitored regularly and are used by management in support of its decision-making processes:

- Change in number of employees and average number of staff on sick leave
- Quality indicators and assessments such as work-related accidents and reject rates

For further details, please refer to the chapter entitled "Sustainability" or visit the corresponding section on the Group's website. The sustainability report for the 2016 financial year will be published on the Group's website (www.elringklinger.de/en/sustainability) in 2017.

Company-specific leading indicators

Information relating to order intake and backlog is reported on a regular basis and provides reliable indications of likely capacity utilization and revenue performance for the months ahead. As a leading (i.e., early) indicator that is specific to the company, this data is also seen as an important control parameter for management.

The Group's budgeting and forecasting are based on planned quantities requested by customers as part of their scheduling less a safety margin and respective agreed product prices. Additionally, the Management Board continuously tracks statistics and forecasts relating to global vehicle demand and production as well as the general economic situation. These leading indicators can provide important pointers as to the plausibility of planning. In this way, any necessity for adjustments can be identified at an early stage and suitable measures can be implemented in good time.

ElringKlinger also performs benchmark analyses on a regular basis for the purpose of assessing its own business performance in comparison with that of the industry as a whole. In this context, key indicators are compared to other, mostly listed, companies in the automotive supply sector and subsequently evaluated.

* Cf. glossary

RESEARCH AND DEVELOPMENT

ElringKlinger focused its research and development activities primarily on lightweight designs and innovative drive technologies in the past fiscal year. The company's move to develop extensive expertise in these areas – in breadth and depth – is paying dividends, especially given the current dynamics of the automotive industry. This is one of the many reasons why ElringKlinger is now a sought-after partner when it comes to finding solutions that save weight or use alternative drives. At the same time, ElringKlinger is further expanding its existing skill sets in everything to do with combustion engines, the aim being to reinforce its leading position in its various markets.

Automotive – a fast-paced industry

Much is currently afoot in the automotive sector. Drive technology in particular is undergoing a transformation fueled by stringent emission regulations already in place as well as by the introduction of new testing techniques and test cycles. This major change is also being accelerated by the high levels of emissions polluting city centers, for which traffic is largely seen as a culprit.

New testing methods are primarily being brought in because the established ones are failing to supply values that reflect real-life driving situations on the road. It used to be possible to optimize engines within a specific range of characteristics that were relevant to the cycle and thus meet the requirements. This prompted trends such as engine downsizing*, which, despite delivering positive results on the chassis dynamometer, failed to bring any such positive impact on the road. Having introduced the new tests, manufacturers are now leaning more so toward a "rightsizing*" strategy when developing their engines.

Although any more tinkering with the fleet CO_2 thresholds already set by policymakers (an average of 95 g/km from 2021 for Europe) is unlikely, sticking to these limits is certainly not going to be possible with conventional combustion engine power. This is piling more pressure on the manufacturers, who are having to introduce new drive technologies to ensure that their fleets meet the CO_2 limit and to avoid costly fines.

Manufacturers are therefore turning increasingly to alternative types of drive system and have set themselves some ambitious targets for launching hybrid and electric vehicle models over the next ten years.

KEY FIGURES R&D

	2016	2015	2014	2013	2012[1]
R&D costs (incl. capitalized development costs) (in EUR million)	74.8	71.2	66.5	65.7	65.7
R&D ratio (incl. capitalized development costs)	4.8%	4.7%	5.0%	5.7%	5.8%
Capitalization ratio[2]	9.9%	13.8%	13.8%	13.7%	12.7%

[1] Including amortization of capitalized R&D expenses – recognized in cost of sales since 2013
[2] Capitalized development costs in relation to R&D costs, including capitalized development costs

95 g / k m

is the maximum that vehicle manufacturers' fleets will be allowed to emit from 2021 onward under EU regulations. (For the purposes of comparison, the automobiles sold in Germany emitted 127 g CO_2/km in 2016.)

Given this, the general assumption for the next few years is that the demand for combustion engines will continue to rise slightly until around 2021, when hybrid and electric vehicles will take over as the growth drivers.

Talking to manufacturers from an early stage

Readying itself for the technological challenges of the industry and helping to shape trends through innovation is part of ElringKlinger's corporate philosophy. The Group's decision to invest in lightweight technology and battery components years ago is now paying off: Among its lightweighting activities, ElringKlinger's large share of the cylinder-head cover and oil sump markets is just as much a sign of successful product developments as the large-scale contracts won recently for cockpit cross-car beams and door module carriers. The Group would not be fielding as many inquiries for e-mobility products either had it not already proven its innovative and competitive strength in developing and manufacturing cell contact systems*.

The company's strong culture of innovation as well as sustainable, targeted investments are vital to ElringKlinger's sales success. In the past few years, the Group has ploughed between 5 and 6% of its revenue back into its research and development activities, with a similar figure expected for the next few years as well. The Group is thus laying the necessary foundations to keep on honing its competitive edge.

Healthy research and development ratio

R&D costs amounted to EUR 74.8 (71.2) million in the past fiscal year. At 4.8% (4.7%), the ratio was slightly below the long-term trend trajectory. Alongside the Group's long-established divisions – Cylinder-head Gaskets, Specialty Gaskets, Lightweighting/Elastomer Technology, and Shielding Technology – its New Business Areas and E-Mobility divisions also benefited. However, the amortization of capitalized R&D expenses recognized in cost of sales was higher year on year at EUR 8.4 (8.2) million.

Employees represent the most significant success factor for R&D activities. The Group employed 570 (562) R&D staff at ElringKlinger AG sites and at 18 (17) subsidiaries. Its development activities were focused mainly at the German sites forming part of the Original Equipment and Engineered Plastics segments, the Exhaust Gas Purification division's Swiss site, and the US sites near Detroit, Michigan. The other locations witnessed mainly minor development steps and modifications.

As well as pooling its organizational resources to prevent technology transfer and a "brain drain," ElringKlinger always seeks legal protection for its successful developments on both a product and a process level. Its patent unit monitors the protection of technological knowledge and intellectual property rights, in addition to applying for patents in Germany and abroad. At 68 (67), the number of patents newly applied for in 2016 was once again high.

Lightweighting – every ounce counts

When developing engine and structural components in new models, automotive manufacturers are guided by one principle above all others: The vehicle has to weigh less. This maxim applies to vehicles fitted with a combustion engine, as it facilitates compliance with the stringent emission regulations. However, the weight issue is also of crucial importance to all-electric vehicles, as it enables their range to be increased.

* Cf. glossary

With ElringKlinger having begun replacing conventional metal engine components with high-performance plastics more than 15 years ago, the Group has joined forces over the past few years with a premium German manufacturer to develop innovative polymer/metal hybrid parts for vehicle bodywork. This involves combining hydroforming* with plastic injection-molding so that extremely lightweight components can be made in just a single step. To this end, ElringKlinger has designed a combination tool that makes the end product just as unique as the production method. Lightweight parts such as these hydroformed products can reduce overall weight by up to 40 percent compared with standard structural components, depending on the applications being integrated. Hydroforming technology is currently being used for cockpit cross-car beams, front-end carriers, and front-end adapters. More potential vehicle-based applications are being considered in order to leverage the sizeable market potential that this technology offers.

ElringKlinger has devised a similarly innovative concept that involves combining organo sheets* with plastic injection-molding and that enables substantial improvements in resilience and rigidity compared with conventional plastics. A high-volume order for door module carriers using this technology was won in the past fiscal year, with series production scheduled to commence in 2017. This combination could conceivably also suit other vehicle-based applications such as battery mountings, seat pans, and spare tire recesses.

Shielding technology – thermal, acoustic, and aerodynamic

Underbody paneling made using innovative pressed textiles can also help to reduce a vehicle's weight compared with earlier models, in addition to insulating noise and vibrations and improving handling by cutting air resistance. Development projects under way in these areas are utilizing the properties of the material. For instance, various semi-finished parts made of plastic can be thermoformed and lined with metallic surfaces to create heat protection components. Some major projects were launched during the past fiscal year for premium manufacturers in the NAFTA region.

Alongside thermal and aerodynamic functionality, the aspect of acoustics is also becoming increasingly important in the field of shielding technology. Manufacturers are striving to integrate acoustic functions into shielding parts that have a thermal effect. ElringKlinger has carried out development work in this area to actively control a vehicle's acoustics. This includes, for instance, modifying hole sizes or the percentage of the surface area given over to perforations in line with the customer's requirements in order to prevent or support certain vibrations and frequencies. This, together with the growing number of customer inquiries worldwide, has been one of the motives behind realigning the development organization in this division and expanding it worldwide.

Battery systems enabling emission-free power

The current transformation in the automotive sector has seen manufacturers gradually adopt quantifiable targets for developing and marketing new models of electric vehicle. These moves and the extensive support being afforded to the electric drive system in China are increasingly translating into new inquiries for ElringKlinger.

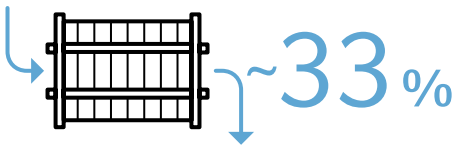
Although the E-Mobility division has not yet put in a satisfactory performance, with consumers reluctant to embrace electric vehicles, ElringKlinger has nevertheless carved out a good reputation in this area as a development partner and supplier of battery components. Development experience gained over nearly eight years has been poured into projects to develop cell contact systems for lithium-ion batteries and battery modules for European and North American customers. From a technical perspective, an innovative design for cell voltage taps was successfully brought to series production, making the systems' fully automatic production process even more efficient.

Another main focus of R&D activities in the past financial year lay on expanding the product range: Working together with a Chinese partner on battery cells, the company will now be in a position to offer a battery module for electric vehicles. In view of the increased demand for e-mobility solutions anticipated over the next few years, ElringKlinger can look forward to some very attractive market opportunities.

Efficient energy from fuel cells

ElringKlinger has been investing in fuel cell technology for nearly 20 years now, working on long-term projects involving the PEMFC* low-temperature fuel cell as well as its high-temperature counterpart, the SOFC.* While the latter delivers significant benefits in combination with hydrocarbon-based fuels, the former is primarily suited to applications that use hydrogen. Development work in this area continued over the past fiscal year in a bid to accelerate the system compatibility of both types of cell.

SOFC systems boast higher electrical efficiency than diesel generators, for instance, and are easy to control via integrated routers. They are suited to a wide range of applications, including cogeneration* in houses and apartment blocks. They can also be used when setting up mobile telecommunications systems, wind turbines, or pipelines, not requiring any maintenance all year round – including in continuous operation. In other words, they have a role to play wherever there is no conventional electricity infrastructure in place. They can also serve a purpose on boats or in motorhomes, as their compact design makes them easy to integrate. Improving these systems through software upgrades and getting the series-manufactured product certified for biogas applications as well were two key R&D priorities during the past fiscal year.



is the electrical efficiency of SOFC fuel cells
with a power output of less than 1 kW.
(For the purposes of comparison, diesel generators
in this power range achieve 15% at best.)

PEMFC systems require a hydrogen supply, something that is only now being developed gradually. In principle, however, the PEMFC could potentially be an ideal enhancement to all-electric vehicles in the future. Particularly on long journeys or in commercial vehicles, all-electric batteries are at a disadvantage because of their long charging times and heavy weight. An automobile powered by fuel cells can be filled up with hydrogen in three minutes, for example. Depending on the running requirements, therefore, the future will see standard electric vehicles joined by fuel-cell vehicles as well as electric vehicles fitted with fuel-cell range extenders. The first vehicles from some Korean and Japanese manufacturers are already in series production, with one of their German counterparts set to follow suit late this year. However, it will be eight to ten years at the earliest before the technology enjoys widespread use across the board.

With its patented designs for metallic bipolar plates*, its plastic media modules, and its own fuel cell stacks*, ElringKlinger is ideally placed to meet the major technological change expected in the PEMFC segment. The company's PEM fuel cells are already being used in applications including forklifts and municipal vehicles.

Refining gaskets and sealing systems

Despite the transformation process that is producing hybrid and electric drives, the level of performance required of cylinder-head and specialty gaskets remains high. Frequent load changes, elevated temperatures, and high pressures continue to dictate the requirements made of combustion engines.

Manufacturers are increasingly turning to EGR* systems to better meet emission regulations, creating a need for sophisticated filter gaskets to protect turbochargers from damage. This is where ElringKlinger's expertise in gaskets comes in. Alongside insulating turbochargers with shielding components, therefore, the company has focused its development activities on sealing systems with a valve function for EGR and CO_2

* Cf. glossary

compressor applications and on an improved methodology for simulating the sealing assembly in order to optimize the design of the cylinder-head gasket in light of changing load spectra. A key product innovation in this field is the stamped folded stopper*, which was launched in 2016 and which is set to be used in the latest-generation engines from a global vehicle manufacturer.

Both hybrid and all-electric vehicles will continue to contain automatic transmissions that will require the Specialty Gaskets division to come up with solutions of varying complexity, something that the products developed in 2016 clearly illustrate. For instance, ElringKlinger utilized its product expertise to develop internal and external clutch plate carriers for the automatic transmission in a new electric vehicle produced by a premium German manufacturer. In addition, coating solutions are currently in development that will also enable sealing systems for IP protection classes* as required in electric drives.

Exhaust gas purification – driven by emission regulations

ElringKlinger's Swiss subsidiary Hug Engineering AG (Hug) develops and sells solutions for reducing exhaust emissions from combustion engines, concentrating on attractive niche markets. Its activities focus on retrofitting solutions for commercial vehicles and construction machinery as well as mobile off-road applications for locomotives and ships and stationary applications for power plants and greenhouses. They are being guided by new standards for exhaust emissions or by innovative products that are accelerating the introduction of new standards – again, in the off-road segment in particular.

This includes, for instance, heavy-oil engines, whose particulate emissions have never been regulated because no corresponding technology has yet made it onto the market. Hug is in a position to close this gap by developing a system that enables the removal of soot and ash particles from the exhaust gases emitted by engines of this kind. The corresponding development work is being undertaken as part of a project funded by the Horizon 2020 initiative. Horizon 2020 is an EU funding program aimed at fostering scientific excellence, driving forward innovation, and strengthening Europe's industrial competitiveness.

The mobiclean™ R Dynamic is an innovative exhaust gas purification system fitted with a fully automatic, actively regenerating filter system that helps to reduce soot emissions. The system comprises a diesel particulate filter, a burner, control components, and data loggers*, and has a compact design that makes it easy to integrate in vehicles. Although ideally suited to machinery with high soot emissions that spend long periods idling or on standby, this innovative product could also be used in vehicles in developing countries that use fuels with a high sulfur content.

In the shipbuilding and rail sector, the focus in the past fiscal year was on developing high-temperature-resistant SCR* catalytic converters for high-speed, high-performance engines. The dosing concept used in urea dosing systems in stationary power plant engines was developed further in order to meet the most stringent NO_X conversion requirements under variable loads.

Similar to the Group's other divisions, Hug makes use of government and institutional funding to undertake high-risk development projects. Working together with two partners, for instance, it is developing exhaust gas purification systems that reduce both noise and emissions in a single solution.

Plastics expertise

The first main focus of R&D activities in the Engineered Plastics segment was on developing new materials based on fully fluorinated substances, especially high-performance plastics that can be thermoplastically processed and used in thermal management systems, transmissions, or gears. The second involved launching the new Speedflon rotary shaft seal, which improves leak-tightness and minimizes friction in applications that rotate extremely fast, such as turbochargers or electric motors.

MACROECONOMIC CONDITIONS AND SECTOR ENVIRONMENT

The world economy showed subdued growth in 2016. According to preliminary estimates issued by the International Monetary Fund (IMF), the gross domestic product (GDP) rose by 3.1% at a global level, which represents a slight slowdown in growth compared to the prior-year figure (3.2%). This less pronounced rate of expansion was attributable primarily to developments in the United States and Western Europe, whereas the emerging and developing countries as a whole showed forward momentum. Recording global growth of around 4% in terms of sales volume, the automobile industry put in an encouraging performance in 2016. In this context, Western Europe, China, and India were among the key growth regions. Operating from a position of strength, the US market experienced a slight lull during the period under review. At present, the market segment covering vehicles equipped with alternative drive systems is still very small.

Multiple economic influences

The global economy was exposed to a number of influencing factors over the course of 2016, some which were conducive to growth while others proved less favorable. Among the key elements were oil and energy prices, which, while edging up slightly in the period under review, nevertheless remained relatively low. At the same time, the world's major central banks continued to pursue an expansionary monetary policy. China's economy showed signs of a slowdown, which had repercussions for other regions, while geopolitical hotspots in the Middle East also caused some turbulence. The outcome of the Brexit referendum in the United Kingdom in June 2016 and the presidential election in the United States in November 2016, two key political events in the period under review, caused a degree of uncertainty but initially had little impact on the wider economy. Emerging countries with a strong focus on raw material exports benefited from the fact that the majority of commodity prices trended slightly higher in 2016 after years of languishing in the doldrums.

While GDP growth in the eurozone ended up being slightly lower than in the previous year, it remained stable over the course of the twelve-month period at an annual rate of change of 1.7%. This was underpinned by low interest rates and an improvement within the labor market as well as the value of the euro, which remained relatively low in relation to other currencies.

Recording above-average growth compared to other European economies, Germany again cemented its position as an anchor of stability. In this context, the main impetus came from continued buoyancy with regard to private and public-sector consumption. Having initially lost some of their momentum, German exports ultimately managed to reach a new annual high.

After a sluggish first half, the US economy gathered pace over the remainder of the year. The domestic economy in the United States benefited in particular from strong consumer demand, which was attributable in no small part to solid employment figures and favorable financing. By contrast, the processing industry came under pressure, with the energy sector bearing the brunt due to its dependence on commodity prices.

Returning to a position of stability in 2016, the Chinese economy ended up precisely within the range of 6.5 to 7.0% targeted by the central government. India also put in an encouraging performance, although growth was driven primarily by private and government spending. In Japan, by contrast, torpid domestic demand stifled any visible form of economic upturn.

Economic performance in the emerging countries dependent on commodity exports improved slightly. However, the larger economies of Brazil and Russia again fell short of their prior-year figures.

* Cf. glossary

GDP GROWTH RATES

Year-on-year change in %	2015[1]	2016
World	3.2	3.1
Germany	1.5	1.7
Eurozone	2.0	1.7
USA	2.6	1.6
Brazil	-3.8	-3.5
China	6.9	6.7
India	7.6	6.6
Japan	1.2	0.9

Source: International Monetary Fund (January 2017)
*Prior-year figure changed in accordance with data applicable as of publication date of January 16, 2017

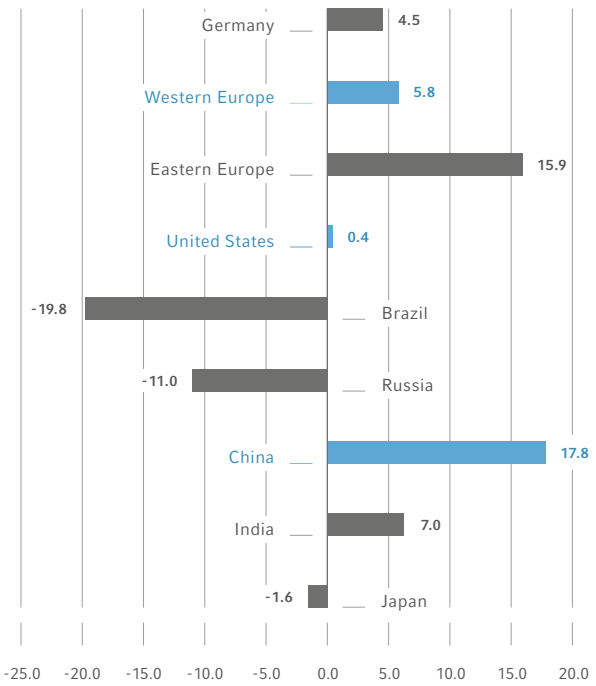
Automobile market exceeds expectations in 2016

According to data published by the VDA (Association of the Automotive Industry, Germany), the global car market expanded by around 4% to 81.6 million units in 2016, thereby moving beyond the mark of 80 million for the very first time. Thus, the overall performance of the automobile industry was encouraging, not only when viewed against the backdrop of original VDA estimates that had pointed to growth of around 2% in terms of sales volume.

Market studies suggest that global production output of passenger cars and light commercial vehicles ("light vehicles") expanded at a slightly faster rate than vehicle sales. Growth was supported primarily by Europe, China, and India, while the US market showed signs of faltering, as anticipated.

The level of demand for new cars in Western and Eastern Europe came as a welcome surprise, particularly in the first half of 2016, which in some cases saw sales expand by double figures year on year. By the end of the year 14.0 million new passenger cars had been registered in Western Europe alone. Led by Italy and Spain, all of the top-five markets – accounting for around 80% of the Western European vehicle market – were in positive territory. In last place, the United Kingdom recorded growth of 2.3%. Buoyed by the solid performance of its economy as a whole, Germany recorded strong demand for new cars in the year under review. Here, new car registrations stood at 3.4 million units in 2016, the highest level since 2010. Due to stagnant exports, domestic production output was up only marginally on the prior-year figure. In total, 4.4 million of the 5.7 million cars produced in Germany were destined for export markets in 2016.

NEW CAR REGISTRATIONS 2016
Year-on-year change (in %)



Source: VDA (January 2017)

In the United States, the light vehicle market – encompassing passenger cars, SUVs, and pickup trucks – retained much of its buoyancy in 2016. SUVs and pickups, which tend to be equipped with more powerful engines, again proved to be more popular among buyers than conventional passenger cars. Boasting a figure of 17.5 million new registrations, the US market just managed to exceed its previous record of 17.4 million vehicles achieved in 2015.

China, the world's largest individual car market, saw sales expand at a surprisingly dynamic rate, particularly in the second half of the year. Sales were underpinned to some extent by tax breaks for those buying small vehicles. Vehicle sales rose sharply in India, too, whereas Japan was yet again faced with a downturn. On a slightly more positive note, the malaise affecting Brazil and Russia in recent years was not quite as severe in 2016.

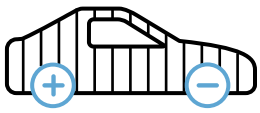
Electromobility – market share still negligible in 2016

2016 saw a change in strategy within the automotive industry. Car makers began to focus more closely on hybrid- and e-mobility, which included the medium-term prospect of a number of new models being launched onto the market. In the year under review, however, sales of such vehicles remained insignificant. Electric vehicles (all-electric and plug-in hybrids) account for less than 2% of new car sales in the key automobile markets. At 336,000 units, the majority of new electric vehicles were sold in China, followed by Europe with around 212,000 cars. The United States recorded electric vehicle sales of approx. 157,000 units in 2016. In Germany, meanwhile, no more than 25,200 new electric cars made their way onto the road, despite a purchase incentive of up to 4,000 euros having been introduced in July 2016.

Truck market with significant regional variations

The world's major commercial vehicle markets developed along radically different lines in 2016. Western Europe displayed the highest level of growth, with market volume expanding by 10.1% in 2016 and new registrations of mid-sized and heavy trucks (>3.5 t) reaching a figure of approx. 545,000. Having said that, the market lost some of its forward momentum in 2016 compared to the surge in demand witnessed in 2015 as a result of catch-up effects. The percentage increase in Eastern Europe was more pronounced. However, this was based on a lower absolute sales volume (2016: 129.9 thousand new registrations).

29 %

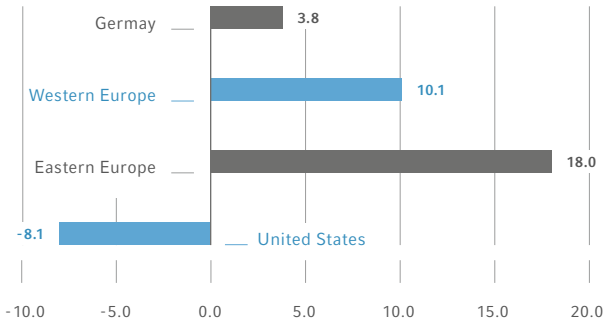


ELECTRIC VEHICLES

In Norway, electric cars accounted for 29% of new vehicle registrations in 2016 – by far the highest rate compared to other countries: China 1.8%, USA 0.9%, Germany 0.8% (Source: CAM)

As expected, the US truck market showed signs of cooling on the back of significant sales figures recorded in the previous years. The lower propensity to invest was attributable to market saturation and the weakness of the industrial sector. The segment covering Class 8 trucks was down 22.5% on the prior year, a particularly dire performance. Contracting even further, Brazil's commercial vehicle market was also faced with difficulties in 2016.

NEW REGISTRATIONS OF MEDIUM AND HEAVY TRUCKS IN 2016
Year-on-year change (in %)



Source: ACEA, Automotive News Data Center (January 2017)

SIGNIFICANT EVENTS

Among the significant events for the ElringKlinger Group in the 2016 financial year were the acquisition of additional ownership interests by the ElringKlinger subsidiary Hug Engineering in COdiNOx Beheer B.V., Enschede, Netherlands, and the takeover of business operations of Maier Formenbau GmbH, Bissingen/Teck, Germany. Additionally, the 2016 financial year saw the acquisition of further interests in the subsidiary new enerday GmbH, Neubrandenburg, Germany, the establishment of a subsidiary by the name of ElringKlinger Silicon Valley, Inc., Fremont, USA, the resignation of Management Board member Karl Schmauder, and the change in index membership of ElringKlinger's stock.

ElringKlinger increases stake in new enerday

Effective from February 18, 2016, ElringKlinger AG acquired an additional 5.0% of the ownership interests in its subsidiary new enerday GmbH, Neubrandenburg, Germany. Since then, it holds 80.0% of the interests in the fuel cell system specialist. This is in keeping with ElringKlinger AG's continued strategy of scaling back non-controlling interests within the Group to the largest extent possible.

Karl Schmauder resigns from Management Board

Effective from February 23, 2016, Karl Schmauder, member of the Management Board of ElringKlinger AG, stepped down from his role as a Management Board executive. Mr. Schmauder was appointed to the Management Board of ElringKlinger AG in 2005. Up to the date of resignation, he was responsible for Original Equipment Sales and New Business Areas. The Management Board of ElringKlinger currently consists of three members: Alongside Dr. Stefan Wolf in the role of CEO, Theo Becker as COO responsible for Production and Technology and Thomas Jessulat in his capacity as CFO remain as members of the Group's highest governing body. Dr. Stefan Wolf has taken over the area of Original Equipment Sales. New Business Areas is overseen by Theo Becker.

New index membership for ElringKlinger stock

At its meeting on March 3, 2016, Deutsche Börse resolved on changes to the composition of its stock market indices. Formerly listed in the MDAX, ElringKlinger AG had to leave the aforementioned index and joined the SDAX effective from March 21, 2016. The composition of indices for the German stock market is governed by two key criteria: market capitalization of free float and average trading volume of the shares in question.

Hug Engineering expands ownership interest in COdiNOx

Hug Engineering AG, a 93.7% subsidiary of ElringKlinger AG based in Elsau, Switzerland, acquired a further 80.0% of the interests in COdiNOx Beheer B.V., Enschede, Netherlands, effective from April 11, 2016, and now holds a 90.0% interest in that entity.

The acquisition of the aforementioned interests was concluded after the subsidiaries of COdiNOx Beheer B.V. had been merged into the parent company. The company now trades as Hug Engineering B.V. The acquisition of the distribution and service company is aimed at exploiting synergies and leveraging growth potential for Hug exhaust gas purification systems, in addition to unlocking new markets.

ElringKlinger takes over business operations of Maier Formenbau

Effective from June 1, 2016, ElringKlinger AG took over the business operations of tool specialist Maier Formenbau GmbH, with its registered office in Bissingen/Teck, Germany, as part of an asset deal.

Maier Formenbau specializes in the production and repair of technically complex injection-molding tools. In completing this takeover, ElringKlinger extended its

existing competencies and capacity levels within the area of tooling. The additional resources are to be used primarily for the purpose of developing and producing tools for the Shielding Technology division.

Establishment of ElringKlinger Silicon Valley

ElringKlinger Silicon Valley, Inc., Fremont, USA, was founded effective from October 31, 2016. ElringKlinger AG holds 100.0% of the ownership interests.

SALES AND EARNINGS PERFORMANCE

Over the course of 2016, the ElringKlinger Group generated strong growth in many of the regions covered by its business, with sales revenue expanding by 3.3% in total to EUR 1,557.4 (1,507.3) million. Benefiting from solid market conditions and steady improvements at a Swiss subsidiary, ElringKlinger was able to emulate its prior-year performance in respect of earnings before interest and taxes (EBIT).

Buoyant sales in final quarter

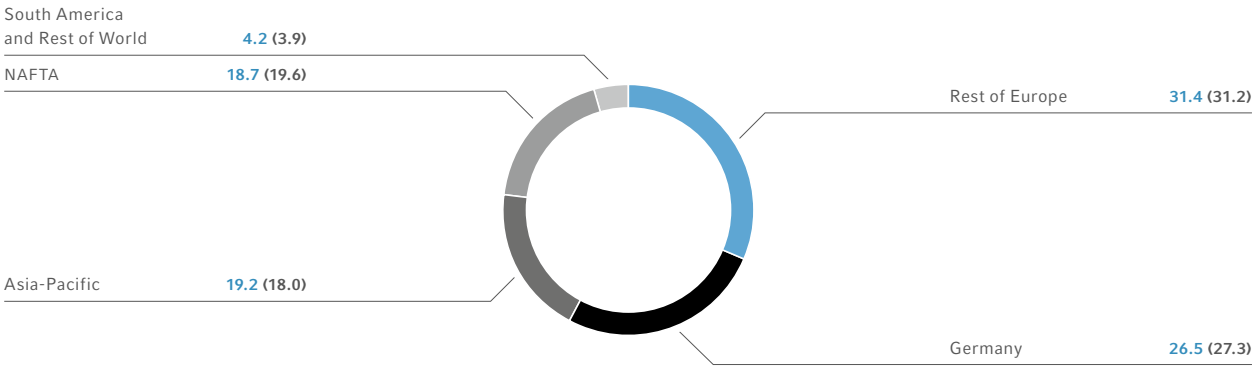
The 2016 financial year saw Group sales revenue expand by EUR 50.1 million, or 3.3%, to EUR 1,557.4 (1,507.3) million. Taking into account the effects of currencies and acquisitions, revenue grew by EUR 71.1 million or 4.7% organically. In this context, Group sales revenue was diluted by EUR 33.4 million, i.e., -2.2%, as a result of exchange rate movements. Contraction in this area was attributable primarily to the direction taken by the Mexican peso, Chinese yuan, and British pound. The acquisition-related effects on revenue from the first-time inclusion of ElringKlinger Automotive Manufacturing, Inc., Southfield, USA, as of February 14, 2015, were equivalent to EUR 4.9 million. The Dutch sales company COdiNOx Beheer B.V., Enschede, Netherlands, was fully consolidated within the Group having been renamed Hug Engineering B.V. effective from April 11, 2016. In addition, ElringKlinger took over the business operations of tool specialist Maier Formenbau GmbH, Bissingen/Teck, Germany, as part of an asset deal that came into effect on June 1, 2016. In total, the acquired entities contributed EUR 12.4 million, or 0.8%, to sales revenue.

The first half of 2016 saw sales perform well at an organic level, while the final quarter produced decent revenue growth of 5.1%. By contrast, the weaker third quarter (+2.5% organic revenue growth), which was impacted by factors of a temporary nature, had a dampening effect on annual growth as a whole. ElringKlinger recorded organic revenue growth of close to 5% in 2016. In relation to the guidance figure of projected revenue growth of between 5 and 7% (rounded) annually, ElringKlinger thus managed to reach the lower end of the target range.

In 2016, the revenue contribution from tool-related billings was down by EUR 10.7 million year on year. Compared to serial production business, revenue associated with tools tends to generate lower earnings for the Group.

Originally, the Group's EBIT forecast for the year as a whole (before purchase price allocation) had stood at EUR 160 to 170 million. Due to capacity constraints within one of the Group's divisions and delays in efforts to migrate production to Hungary, the guidance figure was revised downward over the course of the year to between EUR 140 and 150 million. On publishing its report for the first nine months of the financial year, the Group then put in more precise terms its earnings forecast for the annual period, projecting a figure at the lower end of the aforementioned target range. Recording EBIT, before purchase price allocation, of EUR 140.4 (140.4) million, the Group completed the financial year within the projected earnings corridor.

GROUP SALES BY REGION 2016
(prior year) in %



Sales revenue for the Group underpinned by favorable market conditions

Excluding currency effects, the ElringKlinger Group made further gains in all of its sales regions over the course of the 2016 financial year and thus managed to exceed its prior-year figures. Annual growth was driven primarily by the regions encompassing Asia-Pacific and the Rest of Europe.

The final quarter of the financial year in particular saw a sizeable increase in ElringKlinger's sales revenue. The momentum of growth was more pronounced in the Asia-Pacific region, while the German market also improved visibly. In total, sales revenue generated in the fourth quarter of 2016 was up 4.4% on the figure recorded in the same period a year ago. From an organic perspective growth stood at 5.1%.

In 2016, ElringKlinger recorded 31.4% (31.2%) of Group revenue within its key sales market in the region comprising the Rest of Europe. Although this proportion of revenue generated in Europe (excluding Germany) increased only marginally in percentage terms as a result of stronger expansion within other growth markets, the region nevertheless developed very well during the period under review. Revenue from sales in this region rose by 4.0% to EUR 489.1 (470.3) million. For the first time, this figure includes Hug Engineering B.V., Enschede, Netherlands, an entity which was fully consolidated in April 2016. The increase in revenue was also attributable to the strong performance seen within vehicle markets throughout Western Europe.

Germany's vehicle market also continued to expand during 2016. Reflecting this upward trend, ElringKlinger's revenue from domestic sales rose by EUR 0.8 million to EUR 412.3 (411.5) million. Some of the ElringKlinger components supplied to German customers are fitted to vehicles or engines destined for foreign markets. The percentage share of domestic sales in relation to Group revenue declined to 26.5% (27.3%).

With sales revenue standing at EUR 292.0 (296.4) million, the region encompassing NAFTA was down slightly year on year. This was in line with expectations, given the strong rates of growth seen in previous years. Excluding currency effects, however, the region saw sales revenue expand by 3.0%, despite stagnation within the US vehicle market over the course of 2016. After two buoyant quarters in the first half of the year, sales revenue in the second half was down 5.2% on the strong figure posted for the same period a year ago. However, it should be noted that the prior-year figure had included substantial tool-related revenue from the sale of hydroforming tools. This region accounted for 18.7% (19.6%) of Group revenue in 2016.

The region encompassing South America and the Rest of the World developed very well in the second half of 2016. With the economic recession in Brazil showing no signs of relenting, car owners were less willing to invest in new vehicles, instead opting for repairs. This had a positive impact on ElringKlinger's aftermarket sales at a Group level, which had already been performing well. Furthermore, the South African subsidiary was also able to lift its sales. In total, revenues

in the 2016 financial year increased by 11.7% to EUR 65.1 (58.3) million. Excluding currency effects, revenue was up by as much as 14.6% on the prior-year figure. This region's share of total Group revenue rose to 4.2% (3.9%).

The most pronounced level of revenue growth was recorded in the region covering Asia-Pacific, where ElringKlinger saw the share of sales in total Group revenue increase by 1.2 percentage points to 19.2% (18.0%). With a substantial increase of 10.5%, this region generated revenue of EUR 299.0 (270.7) million for ElringKlinger in 2016. Demand in the world's largest automobile market has reached a very high level, although China's automotive sector did lose some of its forward momentum in 2016. The calmer pace seen within the car market did not apply to the fourth quarter of 2016, however, which saw ElringKlinger lift its sales revenue by 16.4% compared to the fourth quarter of 2015. This surge in business was attributable to a visible pre-emptive effect in China. Here, the rate of value-added tax (a form of sales tax) on small-engine vehicles, which had been lowered in October 2015, was raised again effective from the beginning of 2017. Additionally, the fourth quarter included relatively high tool-related revenues.

The percentage share of foreign sales in relation to Group revenue rose yet again in 2016, with the figure increasing to 73.5% (72.7%). ElringKlinger was quick off the mark when it came to investing in its global infrastructure. As a result, business within the international markets is becoming increasingly important.

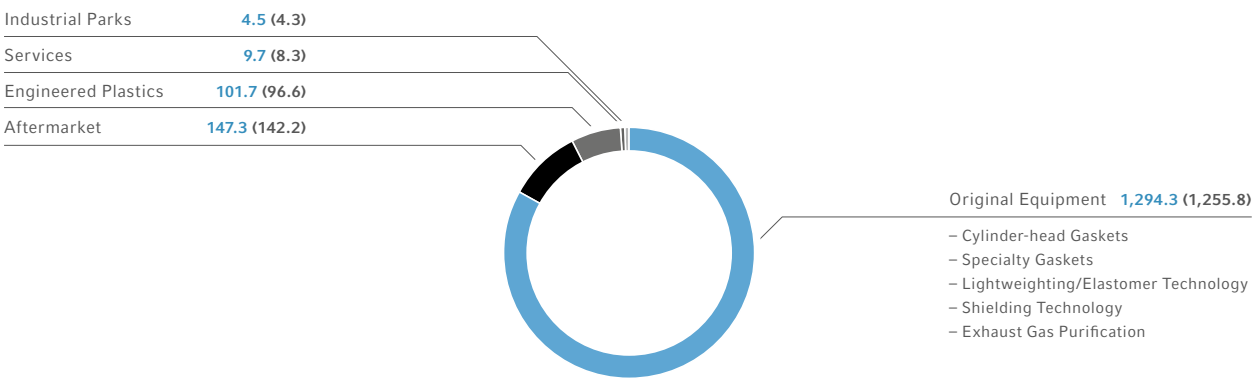
Mixed performance in Original Equipment segment

ElringKlinger expanded its Original Equipment sales revenue by 3.1% to EUR 1,294.3 (1,255.8) million in the period under review. In structural terms, the Original Equipment segment benefited from growing demand among customers for lightweight products made of high-performance plastic. This is illustrated clearly by the sales performance of the Lightweighting/Elastomer Technology division, which exceeded the previous year's figure by 7.1%. The Group saw further growth in the Specialty Gaskets division, fueled by the downsizing of current generations of engine, which requires a larger number of specialty gaskets. Only the Cylinder-head Gaskets division was unable to match its performance of the previous year, as a relatively large amount of blanket agreements came to an end. In the majority of cases, new follow-on business within this area was still in its infancy.

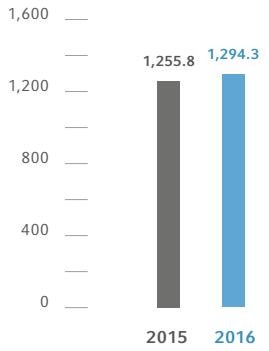
Substantial fixed operating costs for Shielding Technology

Within the Shielding Technology division capacity constraints experienced back in 2015 again produced exceptional charges in the first half of 2016 – totaling around EUR 11 (34) million. As a result of the trailing effects associated with measures to expand capacity levels and delays in the process of migrating products to a manufacturing facility in Hungary, the Swiss-based company involved in these measures again had to operate with substantial fixed costs in the second half of 2016. This was due to the fact that action plans aimed at raising efficiency levels, e.g., by scaling back storage space rented from third parties, had not yet been

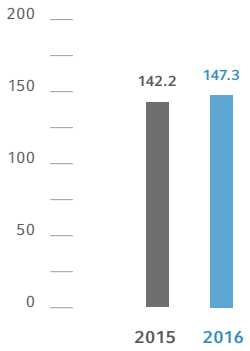
GROUP SALES BY SEGMENT 2016
(prior year) in EUR million



SALES IN THE ORIGINAL EQUIPMENT SEGMENT
in € million



SALES IN THE AFTERMARKET SEGMENT
in € million



executed to the extent originally planned. The fourth quarter of 2016 produced the first visibly positive effects for ElringKlinger with regard to this issue. In this context, the majority of machines transferred to the site in Hungary were put into operation. What is more, two-shift operations commenced at the site, thus producing the first revenue streams in this area. At the same time, the Group received further approvals from customers for the relocation of manufacturing for specific products. Over the coming three years, these measures will lead to a significant reduction in the substantial fixed operating costs incurred by this division.

E-Mobility gains further momentum

The transition towards all-electric vehicles gathered pace in 2016. Although sales figures fell short of expectations, there was a clear commitment among car makers in 2016 to the idea of emission-free mobility. This included strategic decisions with regard to the future routes to be taken.

ElringKlinger generated revenue of EUR 12.4 (11.0) million in 2016 from the sale of components for energy storage systems. Thanks to the measures implemented for the purpose of cost streamlining, the Group managed to scale back its loss before interest and taxes to EUR 4.1 (-5.1) million.

Project-driven business in Exhaust Gas Purification division

Within the Exhaust Gas Purification division, which produces exhaust treatment systems mainly for industrial applications and ships, revenues and earnings tend to fluctuate more noticeably than in the case of ElringKlinger's conventional series production business. After a sustained dip in demand with regard to exhaust gas purification systems used in natural gas power plants as well as in respect of projects centered around inland waterway vessels and construction machinery, the division managed to complete the 2016 financial year not only with a gain in revenue but also with growth in earnings. This was fueled by a particularly strong performance in the fourth quarter.

Due to the various dilutive effects on earnings within the Shielding Technology and E-Mobility divisions as well as the year-on-year decline in earnings contributed by the Cylinder-head Gaskets division, earnings before interest and taxes fell to EUR 88.9 (91.2) million in the 2016 financial year.

Sustained success for Aftermarket business in Eastern Europe

The Aftermarket segment, which mainly comprises the company's spare parts portfolio consisting of cylinder-head gaskets and gasket sets, saw sales revenue increase by 3.6% to EUR 147.3 (142.2) million. Among the regions generating the highest sales revenue were Germany as well as Eastern and Western Europe together with the Middle East.

In Western Europe, the Aftermarket segment benefited from its strong market presence across the entire region. As in the past, circumstances in the regions affected by geopolitical turbulence were anything but consistent. On the one hand, limited access to refinancing often

translated into consumer reticence. On the other hand, the segment benefited from an ageing vehicle stock in all regions covered – with growing demand for replacement parts. While Eastern Europe and Africa recorded double-digit growth rates, sales in the Middle East fell short of the prior-year figure. Elsewhere, ElringKlinger succeeded in boosting its revenues in the South American vehicle market amid a languishing economy.

Asia-Pacific is to be seen as a key market for the future. With revenues expanding by a double-digit figure, business in this segment continued to flourish in fiscal 2016. The higher volume of vehicles in the Asian market again proved to be a major growth driver, as this fuels demand for spare parts in the medium term. ElringKlinger is strengthening its regional presence and investing in storage facilities required at a local level. Thus, the company is pursuing its strategy of establishing a distribution network in Asia as rapidly as possible.

ElringKlinger maintained the strong position held within its domestic market and expanded its business at a steady rate on the back of marginal growth in the previous year. In total, around 13% (approx. 13%) of sales revenue generated within the Aftermarket segment was attributable to Germany.

Outpacing revenue growth in 2016, the Aftermarket segment made a positive contribution to Group earnings. Earnings before interest and taxes rose by 8.2% overall to EUR 30.5 (28.2) million.

Significant growth in Engineered Plastics segment

The Engineered Plastics segment specializes in processing the high-performance plastic PTFE * (polytetrafluoroethylene). It also focuses on the associated application technology. Alongside its business dealings with the automotive industry, this segment also has a strong focus on sectors such as mechanical and plant engineering, medical devices, and chemical technology.

In fiscal 2016, the Engineered Plastics segment recorded revenue growth of 5.3%, taking the figure to EUR 101.7 (96.6) million. By cultivating major new PTFE markets, ElringKlinger widened the scope of its sales activities, which had previously been focused heavily on the Central European region. Asia produced the first success stories, where the sales company in Qingdao, China, made a major contribution to the surge in revenue. The NAFTA region, by contrast, was unable to emulate the previous year's solid performance in 2016. Revenue from domestic sales, however, continued to expand.

Standards of cleanliness with regard to sensitive products are becoming increasingly strict in a wide range of industrial sectors. Having introduced a Class 8 cleanroom, ElringKlinger is now in a position to manufacture components under controlled conditions and in accordance with stringent cleanliness standards. In achieving the certification needed for the manufacture of medical products in 2016, the company has paved the way for an expansion of this segment's portfolio of products used in medical devices. The move to a newly built facility led to a corresponding increase in expenses in 2016. On completion, the new production premises also prompted a rise in depreciation. Despite growth in revenues, material expenses were scaled back year on year, primarily as a result of low commodity prices.

The Engineered Plastics segment recorded earnings before interest and taxes of EUR 14.9 million, up from EUR 13.2 million in the previous year. Correspondingly, the EBIT margin rose to 14.7% (13.7%).

Industrial Parks

ElringKlinger's rental income from the industrial parks in Idstein, Germany, and Kecskemét-Kadafalva, Hungary, amounted to EUR 4.5 (4.3) million. As part of the industrial park in Hungary is currently being used by the Group itself and the industrial park in Idstein underwent a refurbishment, the Industrial Parks segment posted a slight loss of EUR 0.3 (previous year: profit of 0.7) million in 2016.

Revenue growth in Services segment

This segment encompasses services provided by Elring Klinger Motortechnik GmbH, Idstein, Germany, KOCHWERK Catering GmbH, Dettingen/Erms, Germany, and ElringKlinger Logistic Service GmbH, Ergenzingen, Germany. Sales revenue generated in this segment rose year on year to a total of EUR 9.7 (8.3) million. Elring Klinger Motortechnik GmbH achieved double-digit growth rates in revenues and earnings. However, this only partially offset the contraction in

* Cf. glossary

earnings recorded by the other two companies within this segment. What is more, the bottom-line result posted by ElringKlinger Logistic Service GmbH also included charges relating to higher rental expense.

Gross profit margin up slightly

The cost of sales rose at a slower rate than revenue growth in fiscal 2016, up by 2.5% to EUR 1,161.5 (1,133.0) million. This includes a large proportion of the exceptional charges of around EUR 11 million attributable to the Original Equipment segment in the first half of 2016. On this basis, gross profit grew by EUR 21.6 million, or 5.8%, in the financial year 2016 as a whole. This is reflected in a higher gross profit margin of 25.4% (24.8%) compared to the previous year.

The cost of materials was accounted for in full within the cost of sales. Material-related expenses were down 2.0% year on year at EUR 630.1 (643.2) million, primarily as a result of lower tool costs. Correspondingly, the cost-of-materials ratio (materials expense as a proportion of Group sales revenue) fell to 40.5% (42.7%).

The month of June saw a one-time increase in wages and salaries of EUR 150 for each staff member employed under collective agreements, while as from July 2016 collective wages and salaries rose by 2.8%. Additionally, the employee headcount was up by 8.6%. These factors in combination took staff costs to EUR 446.0 million, up from the figure recorded in the previous year (EUR 416.7 million). On a per capita basis, the staff bonus for personnel at ElringKlinger AG, ElringKlinger Kunststofftechnik GmbH, and Elring Klinger Motortechnik GmbH, remained unchanged year on year at EUR 1,600 (1,600). However, due to the higher headcount, the overall bonus payment was slightly higher at EUR 5.7 (5.6) million, which had a corresponding impact on total staff costs. Staff costs were distributed across all operational expense items within the income statement.

Selling expenses amounted to EUR 120.4 (116.0) million. The slight year-on-year increase of 3.8% is attributable largely to the expansion in business and the higher headcount. The Group also recorded an increase in its general and administrative expenses in 2016, up by 7.1% to EUR 74.2 (69.3) million. As discussed in detail in the compensation report, this item included outstanding salary payments for former member of the Management Board Karl Schmauder, which were recognized in profit and loss as early as the first quarter. Additionally, ElringKlinger made a point of expanding its staffing levels in central administrative and control functions in order to be able to exploit synergies more effectively.

Expansion in research and development activities

Research and development (R&D) provides the basis for the Group's future success. Expenses associated with this area of activity rose to EUR 67.4 (61.4) million in the 2016 financial year. Taking capitalized development costs into account, ElringKlinger spent a total of EUR 74.8 (71.2) million on development projects. This corresponds to an R&D ratio of 4.8% (4.7%). Alongside investments in technology and innovation, the high level of R&D expenses is necessary, in the opinion of the Group's management, in order to be able to play an active role in the automotive industry as it evolves. While capitalized development costs amounted to EUR 7.4 (9.8) million, systematic amortization totaled EUR 8.4 (8.2) million. The resulting negative effect on earnings was equivalent to EUR -1.0 (+1.6) million. Government grants were used for research projects in the field of battery technology and also, for example, in the area of fuel cell technology. In 2016, they totaled EUR 6.8 (7.8) million. In parallel, the company incurred project-related expenses at a comparable level for development work and prototyping.

At EUR 20.0 (20.1) million, other operating income was comparable to the figure recorded a year ago. This item includes the sale of real estate for an amount at the lower end of the single-digit million range. By contrast, the prior-year figure had included a one-off payment received from an insurer, counterbalanced by corresponding expenses accounted for in the cost of sales. Other operating expenses rose by EUR 6.0 million to EUR 18.4 (12.4) million. Alongside an increase in other taxes (not taxes on income), this was attributable to higher expenses in respect of damage events.

EBIT within most recent guidance range

Revenue growth was sufficiently high to cover total costs (cost of sales, selling expenses, general and administrative expenses, and R&D costs as well as other operating expenses less depreciation, amortization, and write-downs) in full in fiscal 2016. They rose by EUR 41.6 million in the period under review, up from EUR 1,304.6 million to EUR 1,346.2 million. On this basis, earnings before interest, taxes, depreciation, and amortization (EBITDA*) rose by 3.8% to EUR 231.2 (222.8) million.

The increase in depreciation and amortization in the reporting period was attributable to the extensive expansion measures put in place during the previous years. Additionally, the higher figure reflects wide-ranging replacement investments implemented for the purpose of raising efficiency levels in production. In total, depreciation and amortization rose by 9.4% to EUR 95.7 (87.5) million in the 2016 financial year. Depreciation/amortization and write-downs of property, plant, and equipment increased by EUR 6.7 million to EUR 76.6 (69.9) million.

Group EBIT before purchase price allocation was on a par with the previous year at EUR 140.4 (140.4) million. The percentage share of earnings before interest and taxes in sales revenue (EBIT margin*) was 9.0% (9.3%). In summary, the decline in ElringKlinger's EBIT margin was attributable to several factors. Alongside capacity constraints affecting one of the business units, higher staff costs and R&D expenses were the key drivers in the financial year under review.

Foreign exchange gains down markedly

Net finance costs* rose by EUR 5.0 million in the 2016 financial year, taking the figure to EUR 11.5 (6.5) million. Viewed individually, foreign exchange gains were substantially lower in the period under review. At the same time, foreign exchange losses were down on the prior-year figure. Against this backdrop, the net result of currency translation fell to EUR 0.5 (3.2) million. As regards the net interest loss of EUR 13.9 (11.6) million, higher net debt* in particular resulted in more sizeable interest expenses.

Consequently, Group earnings before taxes totaled EUR 124.1 (128.8) million.

Higher tax expense impacts on net income

Income tax expenses rose by EUR 8.5 million to EUR 41.5 (33.0) million in the 2016 financial year. In this context, the effective tax rate increased from 25.6% in 2015 to 33.4% in the period under review. This sizeable increase was driven by a number of factors. They included current taxes attributable to other accounting periods, which were the result of a retrospective adjustment to, among other things, carrying amounts of items in the statement of financial position (EUR 3.1 million). Additionally, the Group recorded deferred tax expenses of EUR 1.7 million attributable to other accounting periods, which were due, for example, to changes to the tax rate compared to the previous year. Finally, tax loss carryforwards not recognized as assets were higher in the period under review; by contrast, the previous financial year had included loss carryforwards eligible for recognition as assets.

After the deduction of taxes, the ElringKlinger Group saw its net income for the 2016 financial year fall to EUR 82.6 (95.8) million. The earnings improvements recorded in the Exhaust Gas Purification division and the Engineered Plastics segment in the fourth quarter of 2016 meant that non-controlling interests remained largely unchanged year on year at EUR 4.1 (4.2) million. Without these interests, net income totaled EUR 78.6 (91.6) million. On this basis, earnings per share* for the 2016 financial year stood at EUR 1.24 (1.45). As of December 31, 2016, the number of shares outstanding that were entitled to a dividend remained unchanged at 63,359,990.

Dividend proposal of EUR 0.50 per share

The Management Board and the Supervisory Board of the ElringKlinger Group will propose to the Annual General Meeting on May 16, 2017, a dividend of EUR 0.50 (0.55) per share for the 2016 financial year. This corresponds to a dividend distribution of EUR 31.7 (34.8) million in total. The dividend ratio stands at 40.3%, compared to 38.0% in the previous year. This dividend ratio is at the upper end of the range specified in the Group's dividend policy, as part of which between 30 and 40% of Group net income after non-controlling interests shall be distributed to shareholders, depending on the company's operating performance.

* Cf. glossary

FINANCIAL POSITION

With an equity ratio of 47.2%, the ElringKlinger Group was again very solid as of December 31, 2016, in terms of its financial position. In response to the organic growth in business, the Group expanded its investments in property, plant, and equipment over the course of the 2016 financial year. This led to an increase in non-current assets in particular. They accounted for 62% of the balance sheet total. Net working capital (inventories and trade receivables less trade payables) remained stable at EUR 524.6 million.

Total assets expand to EUR 1,878 million

Total assets rose by 6.4% to reach EUR 1,878.2 (1,765.8) million as of December 31, 2016. In this area, the increase in property, plant, and equipment made the most sizeable impact. Driven by more expansive investments within the Group, this item rose by EUR 90.0 million year on year to EUR 917.3 (827.3) million (cf. "Cash Flows" section).

The carrying amount of intangible assets fell slightly to EUR 212.4 (213.5) million. Based on the outcome of impairment testing carried out at the end of the reporting period with regard to goodwill, no adjustments to carrying amounts were required.

Inventory levels remain stable

Compared to the figure recorded at the end of fiscal 2015, working capital (inventories and trade receivables) rose by 3.1% to EUR 627.9 (609.1) million. On a positive note, with the exception of items relating to tools to be sold on, other inventories and trade receivables changed only marginally in total. Generally, tool-related stock accounted for in inventories continues to be recognized in this item until tools have been sold on to the customer. There is a direct correlation between the volume of such tool-related stock and growth in business dealings or the number of new ramp-ups planned. Excluding tools, as of December 31, 2016, inventories were just 1.2% up on the figure recorded at the end of 2015. When also eliminating the acquisition-induced increase (EUR 2.4 million), the overall volume of inventories was stable.

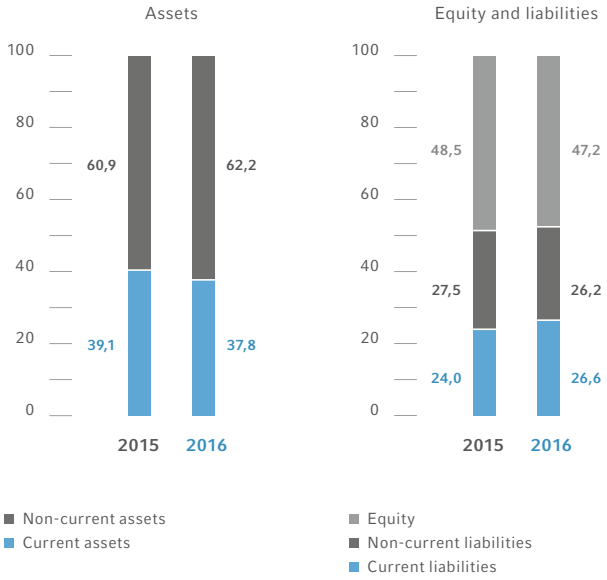
Trade receivables rose by 4.3% to EUR 299.5 (287.2) million as of December 31, 2016. At EUR 524.6 (523.2) million, net working capital (trade receivables and inventories less trade payables) remained largely unchanged year on year. ElringKlinger was unable to meet its original target of reducing this figure by EUR 20 to 30 million. Here, too, the relatively high level of tool-related inventories as of December 31, 2016, as discussed earlier, proved to be an influencing factor.

At the end of the financial year, other current assets totaled EUR 39.2 (30.7) million. The year-on-year increase was attributable primarily to current taxes, particularly sales tax, as well as short-term time deposits. Cash and cash equivalents moved in the opposite direction, totaling EUR 39.4 (48.9) million at the end of the year.

Total assets were up only marginally by EUR 10.7 million as a result of acquisitions. These acquisitions consisted of the purchase, effective from April 2016, of interests in COdiNOx Beheer B.V., a Dutch subsidiary of Swiss-based Group entity Hug, as well as the takeover, effective from June 1, 2016, of the business operations of tool specialist Maier Formenbau GmbH, Bissingen/Teck, Germany, as part of an asset deal.

Likewise, currency translation had no significant impact on the statement of financial position.

BALANCE SHEET STRUCTURE OF THE ELRINGKLINGER GROUP
in %



Equity ratio at 47.2%

As of December 31, 2016, equity accounted for by the ElringKlinger Group rose to EUR 886.4 (855.7) million. At 47.2% (48.5%) it continued to represent a high proportion of the balance sheet total and was within the range of 40 to 50% targeted by the Group.

The allocation of EUR 82.6 (95.8) million from net income for 2016 led to an increase in equity by an equivalent amount. The dividend distribution accounted for by the Group in respect of fiscal 2015, totaling EUR 37.7 (35.9) million, had a contrary effect. In this context, revenue reserves saw an inflow from net income attributable to the shareholders of ElringKlinger AG of EUR 78.6 (91.6) million and an outflow for dividend payments of EUR 34.8 (34.8) million.

Other reserves included actuarial losses in connection with the remeasurement of pension provisions as well as foreign exchange translation differences. In total, they diluted equity by EUR -14.1 million in the financial year under review (previous year: increase by EUR 24.9 million). The lower equity ratio was attributable in part to this dilutive effect.

Pension provisions up following remeasurement

Provisions for pensions were higher as of December 31, 2016, mainly due to a fall in discount rates and the thus resulting actuarial present value of future Group obligations. They rose by EUR 17.9 million to EUR 136.6 (118.7) million. To a large extent this allocation was accounted for in other comprehensive income and thus directly in equity without affecting profit or loss.

The slight increase in other non-current and current provisions to a figure of EUR 13.6 (12.3) million and EUR 17.3 (16.4) million respectively is attributable largely to personnel-related obligations, e.g., partial retirement.

Net debt rises to EUR 539 million

Company growth was funded to a large extent by cash flow from operating activities in 2016. For most of the additional funds needed, the Group took out short term bank loans. As a result, the Group's net debt (current and non-current financial liabilities less cash) rose by EUR 52.0 million to EUR 538.8 (486.8) million. Overall, non-current financial liabilities fell slightly to EUR 320.8 (326.1) million, whereas current financial liabilities increased to EUR 257.4 (209.6) million.

Trade payables amounted to EUR 103.2 (85.9) million as of December 31, 2016. The year-on-year increase was attributable to more expansive business and a rise in payables due to more extensive investment activities.

As of December 31, 2016, other current liabilities amounted to EUR 96.5 (93.3) million. As in the previous year, the largest item (EUR 32.9 million) accounted for in other current liabilities is a put option for non-controlling interests in ElringKlinger Marusan Corporation.

Current and non-current liabilities accounted for 52.8% (51.5%) of total Group equity and liabilities.

CASH FLOWS

The ElringKlinger Group's financial situation in terms of liquidity is very solid. The Group expanded net cash from operating activities substantially in the 2016 financial year, up by EUR 52.4 million to EUR 175.7 million. While operating free cash flow also improved significantly, it was still slightly within negative territory as a result of the high outflow of cash for investing activities. In addition, the Group has sufficient reserves in the form of cash and open lines of credit.

Cash flow from operating activities up substantially

In the 2016 financial year, the ElringKlinger Group managed to improve its net cash from operating activities by a substantial margin, up from EUR 123.3 million a year ago to EUR 175.7 million. In this context, earnings before taxes, which form the basis for the generation of cash, were down year on year at EUR 124.1 (128.8) million.

The positive direction taken in terms of liquidity was attributable mainly to the year-on-year improvement regarding funds tied up within net working capital (inventories and trade receivables less trade payables). This was also due to a strong focus by the company's management on efforts to optimize inventories and trade receivables. At the same time, it should be noted that some of the inventories of finished goods were up temporarily at the end of 2015 due to technology change-overs in production. These inventory levels were scaled back to a normal level in 2016.

Within the statement of cash flows*, cash absorbed or released in respect of net working capital is reflected in the items presented as "Change in inventories, trade receivables, and other assets not attributable to investing or financing activities" and "Change in trade payables and other liabilities not attributable to investing or financing activities." Overall, this produced a cash outflow of EUR 3.7 million, which was considerably less than in the previous financial year (EUR 45.9 million).

In the previous year, the change in provisions, amounting to EUR -7.8 million, had had a dilutive effect. At EUR 0.01 million in fiscal 2016, the effect of this item was negligible in the period under review.

In 2016, income taxes paid amounted to EUR 43.6 (39.4) million. At EUR -11.3 (-9.2) million, the net amount of interest paid and received was also up year on year. The item comprising "other non-cash expenses and income" is influenced primarily by currency effects and stood at EUR 1.7 (-2.2) million.

High level of investment

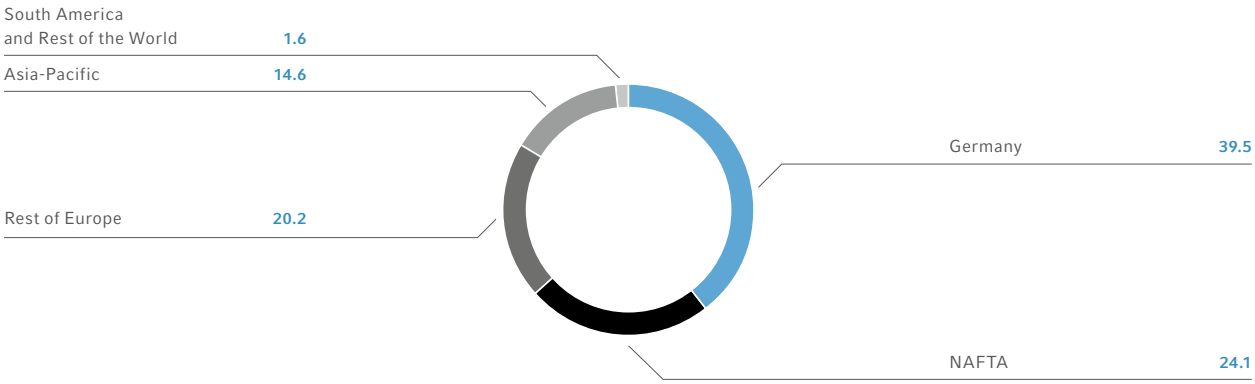
Payments made in connection with investments in property, plant, and equipment as well as investment property amounted to EUR 171.3 (176.1) million in 2016. The Group's investment ratio (payments for property, plant, and equipment, and investment property relative to Group sales revenue) was 11.0% (11.7%).

As regards investment spending, therefore, the ElringKlinger Group recorded a figure that was slightly better than the target projected for the 2016 financial year. Management had estimated capital expenditure comparable to the high level seen in the previous year, i.e., above the medium-term range of 7 to 9% of revenue targeted by the company.

The increase in investment spending in line with corporate planning was prompted by organic growth and the associated ramp-ups required for new products as well as expansion measures. Capital expenditure also reflects efforts to align the product portfolio with current trends seen in the automotive industry, such as lightweighting and alternative drive systems. Around 90% of investment spending was thus directed at the Original Equipment segment.

The proportion of expenditure relating to projects at sites in Germany was around 40%, which corresponds to EUR 72.2 (69.0) million. Investment around the globe was as follows:

INVESTMENT* SPENDING BY REGION
in %



* Investments in property, plant, and equipment, investment property, and intangible assets

Among the largest projects within the domestic market is the construction of a new logistics center for the Lightweighting/Elastomer Technology division at the site in Dettingen/Erms, Germany. Building work for this facility commenced in July 2016. ElringKlinger AG also purchased additional production machinery within all the divisions. The focus was on the production of plastic housing modules, for which several injection molding machines and assembly lines were bought by the company, as well as specialty gaskets, where purchases included a new system for the manufacture of heat-resistant V-ring gaskets. Alongside investments at the main site, larger purchases were also directed at the facilities in Gelting (Specialty Gaskets division), Ergenzingen (ElringKlinger Logistic Service GmbH, i.e., Services division), and Langenzenn (Shielding Technology division). At ElringKlinger Kunststofftechnik GmbH in Bietigheim-Bissingen, Germany, further payments were made in 2016 for production equipment needed in connection with the move to a new building.

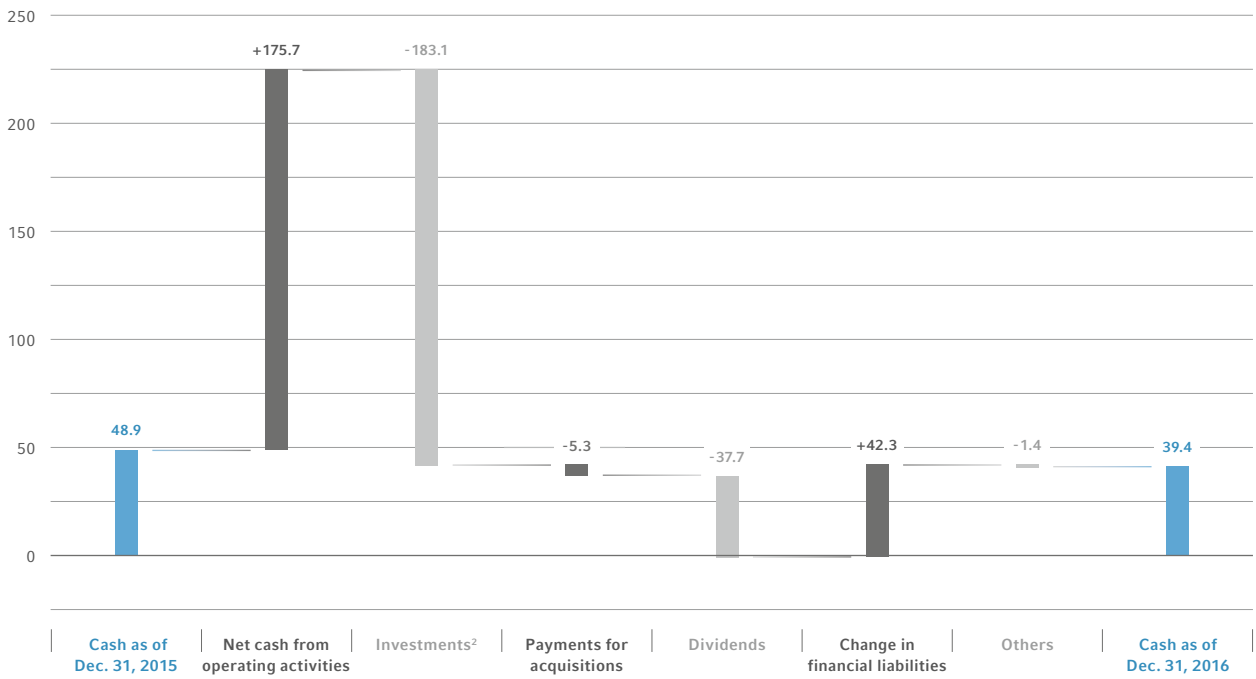
Initial payments were made in fiscal 2016 with regard to a new plant in Kecskemét, Hungary, construction work on which is to commence in 2017. Other key investments in the region covering the "Rest of Europe" related to building work completed in November 2016 on a new plant in Turkey as well as capital expenditure aimed at expanding operations at ElringKlinger Meillor SAS in Nantiat, France. The investments and measures implemented for the purpose of rectifying capacity bottlenecks at a subsidiary in Switzerland were also sizeable.

The focus of major purchases in the NAFTA region was on the sites in Buford, USA, and Toluca, Mexico. These Investments included production machinery for newly developed lightweight underbody components made of glass-fiber-reinforced thermoplastics. At ElringKlinger Automotive Manufacturing, Inc., Southfield, USA, further funds were invested in the optimization and start-up of production following the company's move to the new site in Southfield.

The Chinese subsidiary ElringKlinger China, Ltd., Suzhou, China, opened a new, state-of-the-art plant in 2016. Alongside cockpit cross-car beams manufactured on the basis of hybrid technology (lightweight components made of polymer and metal), the site also mass-produces, among other things, thermal shielding parts and lightweight plastic modules. The second Chinese production plant, located in Changchun, also saw a number of large-scale investments in new production machinery.

* Cf. glossary

CHANGES IN CASH 2016[1]
in € million



[1] Does not correspond to IAS 7 presentation
[2] Investments in property, plant and equipment, investment property, and intangible assets

Capital expenditure on intangible assets amounted to EUR 11.8 (13.7) million within the ElringKlinger Group. This figure includes capitalized R&D costs of EUR 7.4 (9.8) million.

The acquisition of a further ownership interest in COdiNOx Beheer B.V., Enschede, Netherlands, as well as the takeover of business operations at Maier Formenbau GmbH, Bissingen/Teck, Germany, as part of an asset deal accounted for payments totaling EUR 5.3 million. In the previous year, by contrast, payments of EUR 24.2 million had been made for the acquisition of the entity now known as ElringKlinger Automotive Manufacturing, Inc., Southfield, USA.

The proceeds from the disposal of non-current assets were attributable to a number of measures at various Group companies. In total, they (excluding disposals of financial assets amounting to EUR 0.5 million) stood at EUR 3.1 (0.8) million.

Overall, net cash used in investing activities amounted to EUR 189.7 (212.7) million in 2014.

Operating free cash flow (cash flow from operating activities less cash flow from investing activities, adjusted for payments in respect of acquisitions and investments in financial assets) improved markedly to reach EUR -3.8 (-65.2) million. Thus, the Group met its original forecast, which had been specified as "no longer negative or only slightly within negative territory" and had subsequently been defined more precisely as "slightly within negative territory" on publication of the financial results for the second quarter of 2016.

Cash flow from financing activities

Distributions made to shareholders and non-controlling interests amounted to EUR 37.7 (35.9) million in 2016 and were attributable to the dividend of EUR 0.55 (0.55) per share payable in respect of the preceding financial year. Due to changes relating to the non-controlling interests in equity (i.e., minority interests), the aggregate distributions for 2015 and 2016 differed.

The ElringKlinger Group recorded a net cash inflow of EUR 42.3 (105.4) million from financial loans taken out and financial loans repaid as well as the change in short-term loans and monies invested.

In total, cash flow from financing activities amounted to EUR 4.5 (65.3) million.

At the end of the reporting period cash and cash equivalents stood at EUR 39.4 (48.9) million.

As of December 31, 2016, the Group also had at its disposal approved yet undrawn lines of credit totaling around EUR 122.2 (98.9) million.

Overall assessment by the Management Board of the financial position, financial performance, and cash flows of the Group

In summary, the Management Board considers the financial position, financial performance, and cash flows of both the parent company ElringKlinger AG and the Group as satisfactory in respect of the 2016 financial year. The Group managed to achieve a new all-time high in respect of sales. Despite the above-mentioned capacity constraints and the thus resulting expenses incurred by a business unit in Switzerland, the Group recorded an EBIT margin (before purchase price allocation) of 9.0%. Yet again, this figure can be considered high – also in comparison with levels recorded in the industry as a whole.

In the opinion of Group management, the Group's assets structure and its equity ratio of 47.2% provide a good basis when it comes to financing further growth. This is complemented by solid earnings power at an operating level and an improvement in operating free cash flow.

The Group has a broad customer structure and is planning a number of new product launches. To an increasing extent, it has also been aligning its product portfolio with the megatrends currently seen in the automotive industry. Taken together, this provides a good basis for sustained business development in the future.

Viewed as a whole, the ElringKlinger Group has the necessary financial foundations to pursue its pioneering technological route and realize its growth targets for revenue and earnings, and to maintain this momentum in the long term.

FINANCIAL PERFORMANCE, NET ASSETS, AND CASH FLOWS OF ELRINGKLINGER AG

As in previous years, the management report of ElringKlinger AG and the Group management report have been brought together in a combined format. The business performance for ElringKlinger AG, as outlined below, is based on its annual financial statements, which have been prepared in accordance with the provisions set out in the Commercial Code (Handelsgesetzbuch) and the additional requirements of the Stock Corporation Act (Aktiengesetz). Changes attributable to the Accounting Directive Implementation Act (Bilanzrichtlinie-Umsetzungsgesetz – BilRUG*) that came into force in July 2015 have been taken into account in the 2016 financial statements for the first time. This has no impact on the prior-year figures.

Sales and Earnings Performance of ElringKlinger AG

Revenue growth continues

ElringKlinger AG managed to lift its sales revenue by 5.0% to EUR 622.2 (592.4) million in the 2016 financial year. In this context, 2.2 percentage points of growth were attributable to the positive direction taken by ElringKlinger AG at an operating level and favorable developments in the associated sales markets. By contrast, 2.8 percentage points of growth were due to the first-time application of the Accounting Directive Implementation Act (Bilanzrichtlinie-Umsetzungsgesetz – BilRUG), which extends the definition of sales revenue. Among other aspects, this includes the recategorization of revenues that had previously been accounted for in other operating income. Thus, ElringKlinger AG slightly exceeded the upper threshold for revenue growth (range of between 0 and 2%) projected in its 2015 annual report.

Foreign sales rose by 6.1% to EUR 398.8 (376.0) million in 2016. ElringKlinger AG's performance within the European sales market (excluding Germany) deserves special mention. Here, the company generated growth of 7.1% (+8.5%) in the period under review. While Asia-Pacific and South America managed to maintain the solid levels recorded a year ago, revenues generated in the NAFTA region fell short of the strong sales figures achieved in the previous annual period. The percentage share of foreign sales in relation to total revenue grew to 64.1% (63.5%).

Revenue growth was also fueled by domestic business in 2016. Here, ElringKlinger generated revenue of EUR 223.4 (216.4) million, which represents an increase of 3.2%. Domestic business usually also includes revenues associated with the supply of components for vehicles and engines that are manufactured in Germany but subsequently exported.

Growing sales volumes for Original Equipment

The Original Equipment segment recorded growth of 4.8% in the financial year under review. Revenue increased to EUR 484.8 (462.4) million and accounted for around 77.9% (78.1%) of total sales at ElringKlinger AG. Looking at the individual divisions within the area of Original Equipment segment, the most visible revenue growth in absolute terms came from sales in the areas of Specialty Gaskets and Shielding Technology.

Aftermarket business remains growth driver

The Aftermarket segment put in another strong performance during the period under review. Recording growth of 5.8%, taking revenue to EUR 137.0 (129.5) million, this segment accounted for 22.0% (21.9%) of total sales at ElringKlinger AG. Markets in Eastern Europe and Africa developed particularly well. The growing number of German-made vehicles owned in these regions are serviced with spare parts supplied by ElringKlinger. At the same time, revenues generated in South America were up substantially year on year.

Further improvement in total operating revenue

In response to the overall volume of business, inventories of finished goods and work in progress had to be expanded slightly in 2016, up by 0.9 (1.8) million. Work performed by the enterprise and capitalized rose to EUR 1.3 (0.6) million. Total operating revenue, i.e., revenue +/- inventory changes +/- work performed by the enterprise and capitalized, increased by 5.0% to EUR 624.3 (594.7) million.

Due in part to the first-time application of the Accounting Directive Implementation Act (Bilanzrichtlinie-Umsetzungsgesetz – BilRUG), other operating income fell by 59.5% to EUR 18.5 (45.7) million in the reporting period. This figure includes write-ups of EUR 6.5 (2.8) million in respect of financial assets. They were attributable to a tangible improvement in sales and earnings performance at three subsidiaries of ElringKlinger AG.

Cost-of-materials ratio down markedly

The total cost of materials was EUR 272.6 (281.0) million in the 2016 financial year. Expenses relating to purchased services, which had risen in the previous year as part of efforts to counteract capacity constraints within the Shielding Technology division, were scaled back slightly in 2016. Commodity prices were low in general during 2016. At the same time, measures aimed at inventory streamlining produced the first positive results. In combination, these factors contributed to the reduction in the cost-of-materials ratio (cost of materials in relation to total operating revenue). It fell by 3.6 percentage points to 43.7% (47.3%).

Actuarial interest rate up again

Personnel expenses rose by 4.4% to EUR 180.6 (173.0) million in the 2016 financial year. This was attributable to a number of factors. As of December 31, 2016, the company's headcount was up by 4.3% to 2,682 (2,572). This, in turn, also resulted in slightly higher payments in respect of the staff profit-sharing bonus, despite the fact that the per capita bonus was unchanged year on year at EUR 1,600. Furthermore, the one-off payment in June 2016 of EUR 150 for all employees in Germany covered by the collective bargaining agreement and the collective wage increase of 2.8% that came into effect on July 1, 2016, led to higher wages and salaries. This, in turn, prompted a rise in personnel expenses.

Contrary to the effects associated with the increase in expenses outlined above, the market saw a rise in the actuarial interest rate. After an adjustment to the basis of calculation from an average figure of seven years to an average figure of ten years, it is based on the interest rate spectrum of federal bonds. After a significant increase in expenses for retirement benefits in 2015, this expense item was thus scaled back by EUR 5.1 million in total in the period under review. Overall, the corresponding line item referred to in the income statement as "social security and other benefit costs" fell to EUR 28.5 (31.6) million. In conjunction with the accretive effects that the Accounting Directive Implementation Act (Bilanzrichtlinie-Umsetzungsgesetz – BilRUG) had on sales revenue, this meant that the figure representing personnel expenses in relation to total operating revenue decreased to 28.9% (29.1%) despite higher personnel expenses.

Other operating expenses amounted to EUR 83.6 (87.0) million. The prior-year figure had included higher expenses relating to warranty incidents, which had been counterbalanced by corresponding income.

Depreciation and amortization higher after investments

Infrastructure and automation projects completed in 2016 prompted an increase in amortization and depreciation of intangible fixed assets and tangible fixed assets to EUR 31.2 (28.2) million.

Improvement in earnings before interest and taxes

In 2016, ElringKlinger managed to exceed the profitability figure (earnings before interest and taxes) that had been projected in its 2015 annual report as likely to remain stable or decline slightly year on year. ElringKlinger AG was able to more than offset higher personnel expenses with growth in revenue and savings achieved with regard to material expenses. In the 2016 financial year, earnings before interest and taxes rose by 4.9% to EUR 74.8 (71.3) million.

Marked increase in income from equity investments

Current income from subsidiaries rose by EUR 3.4 million to EUR 18.9 (15.5) million. Engineered Plastics and Exhaust Gas Purification, in particular, proved to be solid growth drivers in 2016. The net effect on earnings of write-ups and write-downs of financial assets was positive (previous year: negative) at EUR 0.5 (-4.0) million.

* Cf. glossary

In total, income from equity investments improved significantly year on year and stood at EUR 19.4 (11.5) million.

Net interest loss slightly up year on year

Due to the favorable level of interest rates, the negative net interest result rose just slightly to EUR -7.3 (-6.9) million despite higher net debt.

Net income grows by 7%

Income taxes amounted to EUR 21.4 (18.1) million in 2016. Correspondingly, the tax rate (income taxes in relation to earnings before taxes) rose to 26.6% (24.8%).

Due to the higher level of income from equity investments, the rise in post-tax profit, up by 7.7% to EUR 59.0 (54.8) million, was more pronounced than in the case of earnings before interest and taxes. Having deducted other taxes, ElringKlinger AG posted net income of EUR 58.8 (54.8) million for the 2016 financial year.

Proposed dividend of EUR 0.50

After allocating EUR 27.1 (19.9) million to other revenue reserves, the net retained earnings (i.e., distributable profit) of ElringKlinger AG, from which dividend payments are distributed, were lower at EUR 31.7 (34.8) million.

In view of this, the Management Board and Supervisory Board will propose to the Annual General Meeting resolving on the 2016 financial year a dividend of EUR 0.50 (0.55) per share. Calculated on the basis of net income of ElringKlinger AG, the dividend ratio is 53.9% (63.5%).

Net Assets of ElringKlinger AG

When assessing ElringKlinger AG's net assets it should be noted that these are influenced by the company's operating activities as well as by its role as a holding company within the Group. The latter is reflected in particular in its financial assets, which primarily consist of interests in and loans to affiliated companies. Overall, with an equity ratio of around 50% and positive net cash from operating activities, ElringKlinger AG remained solid in terms of its financial position and cash flows as of December 31, 2016.

Total assets increased by EUR 63.2 million to EUR 1,116.8 (1,053.6) million as of December 31, 2016. This was attributable mainly to an expansion in tangible fixed assets as well as interests in affiliated companies and receivables from affiliated companies. Adding EUR 2.4 million to assets, the business operations taken over as part of an asset deal relating to the tool specialist Maier Formenbau GmbH, Bissingen/Teck, Germany, had no sizeable effect on net assets.

The significant increase in tangible fixed assets by EUR 26.7 million is a reflection of more pronounced investment activity at ElringKlinger AG in response to its growth in business. This also includes the largest project initiated in 2016: a new logistics center to be created for the Lightweighting/Elastomer Technology division at the company's site in Dettingen/Erms. Among the additions to assets were also new production lines within various divisions and at a number of different sites of ElringKlinger AG. Investments in this area were centered on production ramp-ups or the creation of additional capacity as well as on further automation.

Interests in affiliated companies rose by EUR 13.8 million to EUR 415.8 (402.0) million as of December 31, 2016. This was attributable to capital increases at two subsidiaries: ElringKlinger USA, Inc., Buford, USA, and ElringKlinger Automotive Components (India) Pvt. Ltd., Ranjangaon, India. Additionally, write-ups and write-downs relating to interests in affiliated companies were accounted for in this item as part of annual impairment testing.

Loans to affiliated companies fell to EUR 31.7 (36.9) million as of December 31, 2016. By contrast, however, the company recorded an increase in short-term loans to Group subsidiaries, which are accounted for – under current assets – in the item referred to as receivables from affiliated companies. The latter rose to EUR 118.5 (90.3) million as of December 31, 2016.

At the end of the 2016 financial year inventories amounted to EUR 125.8 (125.6) million, a figure comparable to

that posted a year ago. With the exception of prepayments – amounting to EUR 6.5 (2.2) million – for machinery and equipment, the majority of which is to be sold on to Group subsidiaries, other inventories at ElringKlinger AG were scaled back slightly year on year.

Fixed assets and current assets accounted for 70.0% (71.0%) and 29.8% (28.9%) of total assets respectively at the end of the reporting period. Additionally, there was a small amount of prepaid expenses.

Equity ratio of ElringKlinger AG at 50%

Shareholders' equity at ElringKlinger AG was up at EUR 556.1 (532.1) million as of December 31, 2016. This encompassed an outflow of EUR 34.8 million attributable to the dividend payment in respect of the 2015 financial year as well as the posting of EUR 58.8 million in net income for 2016. At 49.8% (50.5%), the equity ratio remained at a high level.

Provisions rose to EUR 109.9 (104.2) million as of December 31, 2016. The year-on-year increase was mainly due to higher provisions for taxes. The largest item with regard to provisions relates to provisions for taxes and similar obligations, with a carrying amount of EUR 65.9 (65.8) million as of December 31, 2016.

Liabilities to banks were expanded, primarily for the purpose of financial transactions with affiliated companies. As of December 31, 2016, they totaled EUR 383.6 (342.1) million. Overall, liabilities attributable to ElringKlinger AG stood at EUR 447.2 (410.2) million. They accounted for 40.0% (38.9%) of the balance sheet total.

Cash Flows of ElringKlinger AG

Further improvement in cash flow

ElringKlinger AG saw its cash flow from operating activities improve by EUR 20.6 million to EUR 105.4 (84.8) million in the 2016 financial year. The year-on-year increase was driven in particular by pre-tax profit, which was up by EUR 7.4 million, as well as the reduction in funds tied up in inventories. Cash flow from operating activities was also boosted by the decline in trade receivables from affiliated companies. The statement of cash flows was again prepared according to the provisions set out in GAS 2.

Net cash used in investing activities amounted to EUR 65.4 (82.1) million in 2016. In this area, the majority of net cash used was for investments in tangible fixed assets amounting to EUR 54.5 (43.8) million. The above-mentioned capital increases at two subsidiaries were reflected in a cash outflow for investments in financial assets totaling EUR 13.7 (51.7) million. Among other things, the prior-year figure had included a cash outflow relating to the acquisition of the company now trading as ElringKlinger Automotive Manufacturing, Inc., Southfield, USA.

Net cash used in financing activities totaled EUR 40.1 (2.8) million as of December 31, 2016, and was dominated by the provision of short-term loans to affiliated companies. The borrowing/repayment of loans and time deposits relating to affiliated companies produced a net outflow of EUR 46.2 (22.4) million.

The full separate financial statements of ElringKlinger AG (in accordance with the German Commercial Code HGB*) have been published online at www.elringklinger.de/investor/2016-gbag-en.pdf.

* Cf. glossary

SUSTAINABILITY

ElringKlinger takes its responsibilities seriously with regard to sustainability, which forms an integral part of its corporate philosophy. This is why the Group decided in 2016 to remove much of the reporting content dealing with corporate social responsibility from its annual report and instead elaborate on the topic within the sustainability report it produces each year. The sustainability report for the 2016 financial year will be published on the Group's website (www.elringklinger.de/en/sustainability) in 2017.

Workforce expanded further

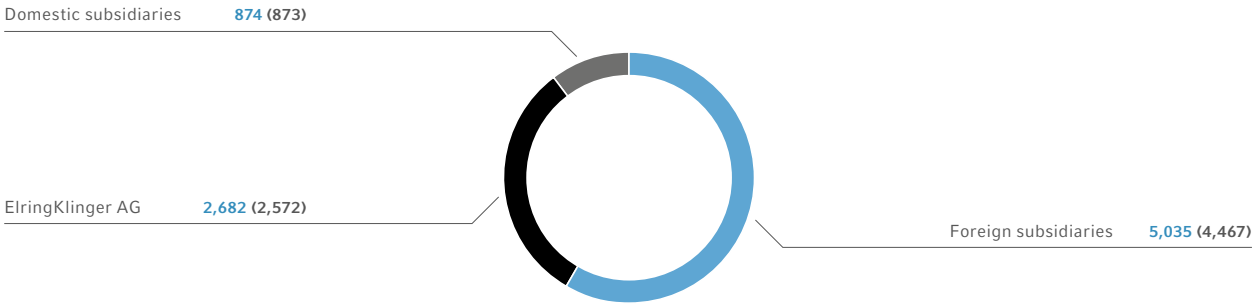
As of December 31, 2016, ElringKlinger employed 8,591 (7,912) people worldwide. This represents an increase of 8.6% or 679 employees. As a result of the takeover of the business operations of toolmaking specialist Maier Formenbau GmbH in Bissingen/Teck, Germany, as part of an asset deal, 41 new employees joined the Group in June 2016. Overall, the proportion of the workforce based in Germany grew by 3.2%. This equated to 111 employees, giving a total headcount of 3,556 (3,445).

The Group expanded its headcount much more strongly outside of Germany. The largest increase in employee numbers in absolute terms was seen in the Rest of Europe and North America regions. In 2016, new positions were created predominantly at the production sites in Mexico, the United States, Switzerland, and Turkey. The expansion activities were due both to increased output volumes for existing products and new product ramp-ups. As a result of the takeover of the Dutch distribution and service business COdiNOx Beheer B.V. by Hug Engineering AG, ElringKlinger's subsidiary based in Elsau, Switzerland, 19 new employees joined the Group. At year end, a total of 28 employees were working at ElringKlinger Hungary Kft. in Kecskemét, Hungary, a company established in 2015. By December 31, 2016, the proportion of the workforce based outside Germany had grown to 58.6% (56.5%). This meant that the proportion of the workforce based outside the country had increased by 12.7% or 568 employees, giving a total headcount of 5,035 (4,467).

Workplace health and safety

ElringKlinger places great emphasis on a safe, healthy, and productive working environment. Regular preventive training courses help to foster an enhanced awareness of occupational safety issues within the Group. ElringKlinger conducts thorough investigations of every accident at work and adopts comprehensive improvement measures across the whole business. The Group is of the firm opinion that all workplace accidents and

ELRINGKLINGER GROUP EMPLOYEES WORLDWIDE
as of Dec. 31, 2016 (prior year)



occupational illnesses are avoidable and aspires to the clear objective of "zero accidents." In 2016, the Group came a step closer to achieving that goal by reducing the number of job-related accidents that result in more than three days off work by 16.8% to 223 (268) accidents.

The focus of the company's health and safety management program in 2016 was on implementing preventive measures aimed at creating as healthy a workplace as possible. ElringKlinger ran training courses and seminars in which, for example, managers were given advice and ideas on "Managing Healthily." They were made aware of ways to optimize employee workloads and to nurture their coworkers' individual strengths. Good working conditions have a positive impact on both the health and motivation of team members. The average number of sickness days taken per Group employee thus remained constant at 10 (10).

THE ELRINGKLINGER GROUP – KEY HR INDICATORS

	2016	2015
Absolute number of employees	8,591	7,912
Of which men	72.1%	71.6%
Of which women	27.9%	28.4%
Absolute number of employees	8,591	7,912
Of which domestic	41.4%	43.5%
Of which abroad	58.6%	56.5%
Average number of employees	8,322	7,653
Work-related accidents leading to more than 3 days off work	223	268
Average number of sick days per employee	10	10

PROCUREMENT AND SUPPLIER MANAGEMENT

In order to manufacture its products, ElringKlinger purchases raw materials, goods, and services on a large scale every year. A Group-wide procurement management structure ensures that all relevant inputs are available at the right time and price and in the appropriate quantities. The company's partnership-based cooperation with its suppliers is just as important as quality and Group-wide security of supply.

Organized on the basis of a centralized structure, Global Purchasing is located at ElringKlinger's headquarters in Dettingen/Erms, Germany. It is responsible for assuring supplies to the various sites and businesses. Specialists with product and market experience deploy strategic requirement management techniques to support optimal procurement processes. In doing this, they make use of the close-knit international network that the Group has developed for itself. Three Regional Purchasing Managers have exclusive responsibility for the Americas, Europe/Africa, and Asia territories. They collaborate closely with the strategic buyers and quality managers at a global level, in addition to assisting subsidiaries with the procurement of merchandise and raw materials, consumables, and supplies. The proactive management of global purchase volumes enables the Group to benefit from economies of scale.

Thanks to the high degree of integration that characterizes the purchasing organization, raw materials and services can be obtained at competitive prices. Alongside staff costs, materials represent the largest cost item for ElringKlinger. In 2016, materials accounted for 54.2% (56.8%) of the Group's cost of sales, while the cost-of-materials ratio amounted to 40.5% (42.7%).

The most important raw materials used within the ElringKlinger Group in 2016 included alloyed high-grade steels (especially chromium-nickel alloys), carbon steel, aluminum, polyamide-based* plastic granulate, elastomers, and – in the Engineered Plastics segment – polytetrafluoroethylene (PTFE*). Also gaining importance is the purchase of components used for the manufacture of complete systems, e.g., in the Lightweighting/Elastomer Technology and Shielding Technology divisions.

Group-wide standardization and integration activities

In 2016, Materials Management was involved in a number of different projects aimed at integrating procurement operations more closely with global inventory management. For this purpose, a SAP-based purchasing project control system was implemented at almost all ElringKlinger plants.

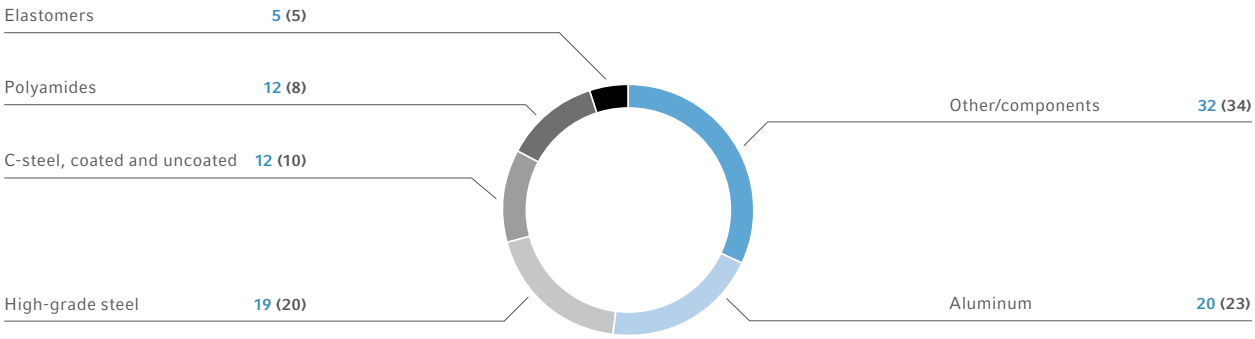
The central team responsible for developing suppliers introduced a "knowledge store" in 2016, to which local quality managers could turn for supplier-related questions on ElringKlinger's requirements globally. To support this approach, ElringKlinger appointed two Supplier Managers in Asia and the Americas with responsibility for the application of and compliance with ElringKlinger's procurement standards at the local subsidiaries. The two managers also assist with the development of new suppliers.

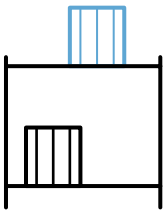
As a matter of principle, new suppliers are selected by the global purchasing team, validated in cooperation with the company's worldwide supply-chain management, and audited on the basis of international ISO standards. At the same time, all suppliers are obliged to comply with company-specific quality and environmental guidelines as well as the ElringKlinger Code of Ethics. The central purchasing and supplier management team conducts regular quality and cost analyses at existing suppliers.

ElringKlinger endeavors to avoid becoming overdependent on individual suppliers as far as possible, notwithstanding its policy of bundling multiple requirements. In 2016, the company's top 30 suppliers accounted for 19% (20%) of total volumes purchased.

The company-wide standardization process was also rolled out to goods inwards inspections and complaints management. Clear process descriptions ensure that the raw materials, consumables, and supplies used across the Group for production purposes are delivered free of defects in every case.

BREAKDOWN OF RAW MATERIALS USED IN 2016
(prior year) in %





20%

INVENTORY LEVELS REDUCED

In 2016, ElringKlinger made substantial progress in optimizing inventory levels for its Aftermarket division, despite the increase in sales revenue.

Scheduling strategy shows its first results

The Group has set itself the goal of keeping inventory levels as low as possible in all material categories and at all company sites. To facilitate this, ElringKlinger is increasingly using just-in-time deliveries and Kanban systems. As early as 2016, the new scheduling and planning strategy allowed some initial locations to benefit from improved inventory levels. The strategy relies on optimized parameters such as a standardized intelligent system for classifying procurement and production materials and the cost-efficient specification of batch sizes.

Growth in production volumes leads to increased demand for raw materials, consumables, and supplies

At year end, purchase volumes amounted to EUR 1,030.3 (1,029.3) million. This includes raw materials, consumables, and supplies, as well as merchandise for the independent Aftermarket segment and investments in land, real estate, and property, plant, and equipment. The increase is primarily due to the expansion of production capacity as a result of increased revenues.

Blanket agreements secure price frameworks and material supplies

ElringKlinger bundles its requirements internationally so that it can negotiate framework (i.e., blanket) agreements with suppliers for its main material groups. This enables the Group to protect itself to the maximum degree from volatile raw material prices, to guarantee security of supply, and to limit foreign exchange risks. In most cases, such agreements have terms of at least one year. Exceptions to this are the frequently shorter contract durations that apply to C-steel and plastic granulate.

Purchase prices increase in 2016

In 2016, there was evidence of an upward trend in the price of many raw materials. For instance, the market saw an increase in the global price of precision stainless steel, which is used for the manufacture of cylinder-head and specialty gaskets. This increase was primarily due to the antidumping measures imposed by the EU on steel imports from China and Russia and the associated constraints on supply. In fiscal 2016 this led to temporarily longer procurement schedules. Group Purchasing covered any peaks in demand by using additional suppliers that were able to provide the raw material in the short term at generally higher prices. In addition, the year also saw an increase in the related alloy surcharge for high-grade steels. This is exclusively traded on the stock exchange and cannot be fixed in framework agreements. For aluminum, which is used for products in the Shielding Technology segment, prices rose by close to 12% between January and December 2016. This was, however, counterbalanced by a substantial reduction over the same period in the premium payable for processing of the raw material. In respect of polyamide, an engineering plastic that ElringKlinger requires to an increasing degree for the production of lightweight components, higher oil prices did not have an excessive impact, as oil is only one of the many components used in the manufacture of polyamide.

Raw material prices affect scrap sales positively

Using a centralized waste metal management system, ElringKlinger recovers and sells off metal residues that are the by-product of its various manufacturing processes. In 2016, the Group's proceeds from scrap sales amounted to EUR 27.7 (28.8) million.

Energy requirement contracted up to 2019

ElringKlinger fulfills most of its electricity and gas needs by means of long-term supply agreements. In 2016, the Group was able to agree longer-term contracts with its existing suppliers that will last up to and including 2019 for both electricity and gas. The Group can draw on the energy it needs in flexible tranches depending on the energy prices currently prevailing in the market.

* Cf. glossary

The Group fulfills some of its electricity needs by operating its own combined heat and power (CHP) units. At its Dettingen/Erms and Bietigheim-Bissingen sites, for example, the excess heat produced is used for the purpose of process cooling and for air-conditioning systems. In 2016, the CHP units at Dettingen/Erms and Bietigheim-Bissingen produced 9,323.9 (8,838.8) MWh of electricity.

REPORT ON OPPORTUNITIES AND RISKS

Risk management system

ElringKlinger has established an extensive risk management system for the purpose of identifying risk at an early stage. By monitoring markets, customers, and suppliers on a continual basis and maintaining detailed internal reporting and controlling processes, the company is able to gauge risk in a timely manner and seize market opportunities as they arise. The efficiency and suitability of the risk management system itself is continually adapted and optimized in accordance with new requirements as they arise (cf. page 91 in this chapter).

The risk management system is made up of various tools and control systems. Among the key components are strategic corporate planning and internal reporting. Planning enables potential risks to be identified and taken into account when making critical and far-reaching decisions. All key areas within the company are involved in strategic Group planning. Within this context, information is retrieved, collated, and evaluated in a standardized process. The Management Board bears full responsibility. Internal reporting is used to monitor and control business performance. A key component of the risk management system is regular reporting by the management of the respective domestic and foreign Group companies as well as the divisions, which is performed on a half-yearly basis. It covers developments in all fields relevant to the company that can affect business activity and, in particular, the continuation of the ElringKlinger Group as a going concern. The focus is primarily on changes to the economic or political situation, new regulatory requirements, technological developments, commodities markets, and internal risks. This reporting system involves identifying and evaluating all risks and subsequently drafting recommendations on how to prepare for and protect against them. The Chief Financial Officer is responsible for coordinating these activities. This approach is designed to ensure that risks are identified at an even earlier stage and measures aimed at avoiding or mitigating such risks can be implemented even faster.

The Management Board assesses the aggregate risk and submits regular and comprehensive reports on its findings to the Supervisory Board and the Audit Committee. Another important aspect of the centralized risk and quality management system deployed at the ElringKlinger Group is that of tracking the implementation of defined measures. The company considers risk management to be an all-embracing activity that encompasses not only the identification and assessment of risk, as outlined above, but also a system of preventive measures and contingency planning that has proven to be very effective.

Alongside regular reporting, internal audits are an important control mechanism and thus an essential element of the risk management system. Audits are carried out in the business and service divisions of ElringKlinger AG as well as at the Group companies. These audits are conducted by accountancy firms commissioned by ElringKlinger AG. The rationale behind the appointment of external specialists is to ensure that risks are identified, statutory requirements are met, internal processes are reviewed, and potential for improvement is recognized. The findings of such audits are compiled in reports, which are directed in particular at the Management Board and the Chairperson of the Audit Committee within the Supervisory Board. The reports are evaluated, whereupon necessary measures are initiated. Execution of these measures is controlled by the Management Board member whose remit covers this area. All relevant findings are discussed with the areas concerned in order to bring

about improvements or rectify any weaknesses. During the 2016 financial year audits were conducted at eight subsidiaries as well as four business and service divisions of ElringKlinger AG. None of the audits conducted within this context gave rise to any significant objectives. Both statutory regulations and internal requirements were consistently met. The recommendations submitted with regard to potential areas for optimization have been put in place or are currently being implemented. Additionally, more staff members were assigned to the Internal Audit department in order to ensure the continuous development of this function as an integral element within the risk management and governance system.

In accordance with the existing compliance system, the Chief Compliance Officer reports directly to the Chief Executive Officer. Additional Compliance Officers have been appointed for individual regions in which ElringKlinger is active; they report to the Chief Compliance Officer. The code of conduct forms an important part of the compliance system. It sets out binding rules for all employees of the ElringKlinger Group. Among other aspects, the code covers issues such as fair competition, corruption, discrimination, and the protection of confidential data. The code is distributed to all employees in the language of the country in which they are based. Staff members, and particularly management personnel, receive training relating to these issues. As part of training events conducted over the course of 2016 employees from Sales and Purchasing were instructed extensively on the legal requirements relating to the granting and acceptance of gifts/gratuities as well as on competition and anti-trust laws. These training seminars will be continued in 2017, particularly for personnel at foreign investees. Additionally, in 2016 the management of ElringKlinger AG received training with regard to statutory provisions governing insider dealing in particular. This is to be seen in the context of the enactment of the Market Abuse Regulation. The Chief Compliance Officer responded to all indications of compliance-related infringements in order to investigate the circumstances and initiate requisite measures. Where evidence suggested that an infringement may have occurred, the Management Board was informed accordingly. However, no significant infringements were reportable for 2016. Beyond this, the Management Board is committed to adapting the existing compliance system to changing circumstances and the possibility of evolving risk exposure. For instance, a status analysis was conducted by an auditing firm with regard to the compliance system, which also included an evaluation. Recommendations for action resulting from this assessment have been or are being implemented.

In order to reduce the liability risk from potential damage and any associated losses, the company has taken out appropriate insurance policies. The suitability of these policies, which also cover the Group companies, is subjected to regular review with regard to the actual risks covered and the level of cover provided. Where necessary, the policies are then amended.

Control and risk management system with regard to accounting

With regard to accounting and external financial reporting within the Group, the internal control and risk management system may be described with reference to the following basic characteristics. The system is geared toward the identification, analysis, valuation, risk control, and monitoring of these activities. The structuring of the system in line with the specific requirements of the company is the responsibility of the Management Board and Supervisory Board. In accordance with the distribution of responsibilities within the company, the Finance department, which is in charge of accounting, comes under the remit of the Chief Financial Officer. This department, which also includes Controlling Affiliated Companies, controls accounting within the Group and ElringKlinger AG and compiles the information required for the preparation of the consolidated financial statements and the annual financial statements of ElringKlinger AG. The department Controlling Affiliated Companies is responsible, in particular, for monitoring and supporting the accounting processes of the Group companies. The Group companies report to the Chief Executive Officer.

The principal risks associated with the accounting process derive from the need to provide accurate and complete information within the specified time frame. This presupposes that the requirements have been clearly communicated and the departments responsible are placed in a position where they can meet those requirements.

ElringKlinger has compiled an accounting manual on the basis of International Financial Reporting Standards. All Group companies are required to apply the standards outlined in this manual as a basis of the financial reporting process. All the principal valuation standards such as those covering inventories, tools, and receivables under IFRS are specified in mandatory form within the manual. Mandatory accounting standards are also in use across the Group as a way of ensuring uniform treatment of the same issues.

All Group companies are obliged to comply with a predefined schedule for preparation of the Group financial statements. The same applies to the annual financial statements of ElringKlinger AG. Each Group company is responsible for drawing up its separate financial statements in accordance with local accounting rules and the reporting packages pursuant to IFRS, with the exception of the German Group companies, whose financial statements are prepared by the Accounts department at ElringKlinger AG. A reconciliation of balances is conducted in respect of internal Group clearing accounts. Financial reporting by the Group companies is conducted via a separate database containing not only financial data but also information that is of importance to the notes to the consolidated financial statements and the combined management report of the ElringKlinger Group and ElringKlinger AG. The data and information are checked prior to release and consolidation in the respective centralized departments.

SAP is used by all the German and the majority of the foreign subsidiaries within the ElringKlinger Group. As for the other companies, various IT systems are currently in use. SAP is to be introduced at other key companies within the Group. All implemented systems feature hierarchical access systems; all clearances are documented in the system. For companies that use SAP, access rights are managed centrally according to established rules. Access decisions are the responsibility of the Chief Financial Officer. Local management makes decisions on access in those companies that use other systems.

Among the risks that may affect the accounting process are, for instance, those associated with delays or errors in the entry of transactions or failure to observe the accounting manual and account allocation rules. In order to avoid mistakes, the accounting process is based on the separation of responsibilities and competencies, the automation of procedures, and plausibility checks for reporting purposes. Calculations are subject to continuous monitoring. Comprehensive and detailed checklists have to be worked through before the established reporting deadline. The accounting process is also incorporated into the ElringKlinger Group's risk management system as a way of identifying accounting-related risks at an early stage, allowing the company to take prompt action to anticipate and address potential risks.

As is the case with the other areas and functions of the company, accounting is also subject to the investigations conducted as part of internal auditing; these are performed by accountancy firms. Accounting processes and procedures at ElringKlinger AG and its Group companies are reviewed in the course of regular internal audits. The findings are then used to make further refinements and improvements. For more information, please refer to the description of the risk management system.

Assessment of opportunities and risks

The following table presents an overview of material risks to which the ElringKlinger Group is exposed as well as key opportunities. Both the risks and the opportunities were graded according to the probability of occurrence and the potential financial impact. A probability of occurrence of 10% is considered "low," one of 40% is classified as "medium," and one of 80% is deemed "high." The potential financial impact is categorized on the basis of criteria, ranging from "insignificant" to "significant". In this context, in the event of occurrence "insignificant" refers to a potential impact on Group earnings before taxes of less than 5%, "moderate" between 5 and 10%, and "significant" in

excess of 10%. These factors are identified on the basis of a gross assessment, i.e., prior to possible measures aimed at risk mitigation. The overall potential with regard to risks and opportunities in relation to the respective category is derived from the interaction of probability of occurrence and potential financial impact. Reporting in respect of opportunities and risks is always based on a period of one year.

OPPORTUNITY AND RISK PROFILE OF THE ELRINGKLINGER GROUP

	Probability of occurrence			Potential financial impact		
Type of risk/opportunity	low	medium	high	insignificant	moderate	significant
RISKS						
Economic risks						
Economic and industry risks	x					x
Political risks		x			x	
General internal risks						
General internal risks, work-related accidents, fire	x				x	
Operational risks						
Price-related pressure/Competition			x		x	
Material risks/Supplier risks	x					x
Customer risks	x				x	
Labor cost risks		x			x	
Personnel risks		x		x		
IT risks	x				x	
Quality/Warranty risks		x			x	
Legal risks						
Legal risks/Compliance risks	x				x	
Strategic risks						
Technology risks			x			x
External growth/Acquisitions	x				x	
Financial risks						
Bad debt loss	x				x	
Liquidity and financing risks	x				x	
Currency risks			x		x	
Interest-rate risks	x				x	
Use of derivative financial instruments	x			x		
OPPORTUNITIES						
Climate change/Emission laws			x			x
Technology trends/New emissions regulations			x			x
Extension of product and service portfolio			x			x
New sales markets			x			x
Industry consolidation/M&A		x			x	

Economic risks

Economic and industry risks

The performance of global vehicle markets tends to be closely correlated with the prevailing economic situation. This applies to the truck segment even more so than to business within the area of passenger cars. Against this background, weaker economic performance always carries the risk that demand for vehicles – and therefore in the short to medium term also vehicle production – will decline. This, in turn, would result in lower demand for ElringKlinger components.

Based on the latest assessment, risks relating to economic performance lie particularly in the protracted weakness in growth experienced by Brazil and Japan. Russia, whose vehicle market is of little significance to ElringKlinger's business, may see a return to economic stability in 2017. Even when considering factors such as the consolidation of growth in China, the prospect of Brexit, and the lengthy recession in some parts of Latin America, a marked downturn in the world economy would on the whole appear unlikely. The International Monetary Fund has forecast global economic growth of 3.4% for 2017.

Based on general projections, the automobile industry as a whole can look forward to a positive performance in 2017. While markets in North America and Europe are expected to remain stable at a high level, China in particular, but also the other emerging markets, should provide impetus for growth. Fundamentally, growth will shift away from the established markets to the emerging and developing countries. Given its global presence with production and sales locations in the growth regions of the future, the Group is well placed to handle potential stagnation or waning demand in the traditional vehicle markets.

From today's perspective, a severe slump in vehicle production – comparable to the one seen in the crisis years of 2008/2009 – would not appear to be very likely. As regards global vehicle sales in 2017, ElringKlinger is working on the assumption of projected growth in the region of approx. 2% (cf. "Report on Expected Developments," page 114 et seqq.).

ElringKlinger has established a global presence. Benefiting from a broad customer base, it is not dependent on specific markets or individual manufacturers. Thanks to its global positioning with a diversified customer base, the effects of an economic slump in a particular region can be offset at least in part. Due to its flexible cost structures, ElringKlinger would be able to respond immediately to market conditions in the event of more severe economic turbulence. Instruments available to the company include flexitime accounts and flexible shift models as well as the option of issuing an application for short-time work. Furthermore, the company can react to changing market conditions by adjusting its staffing levels to demand patterns and by pooling the production quantities of individual plants. The central purchasing department would work in close cooperation with suppliers for the purpose of assessing and adjusting procurement volumes in a timely manner.

ElringKlinger factors in economic risks to an appropriate extent at the forward planning stage. When drawing up budgets, ElringKlinger takes a cautious view of the underlying macroeconomic scenario.

Political risks

Fundamentally, there is the potential that political decisions taken by national or European lawmakers will have a significant impact on the future business activities of the ElringKlinger Group, e.g., with regard to technological trends or sales regions.

The political situation in wide parts of the Middle East and North Africa as well as in some regions on the border to Russia remains extremely uncertain. Sales regions in these crisis hotspots are among those associated with risk in respect of ElringKlinger's business dealings. As regards the Original Equipment segment, these regions are of no particular direct relevance to business activities. By contrast, the Aftermarket segment is exposed to the risk of a loss in revenue; revenue from sales in the aforementioned regions in 2016 was a figure in the middle of the double-digit million euro range. As sales in these regions are usually billed in US dollars or euros, customers' restricted access to foreign currency could result in delayed payments or, in the worst-case scenario, to default on such payments.

Following Britain's referendum vote in June 2016 to leave the European Union (Brexit) and the decision by

the House of Commons in February 2017 to trigger the Article 50 clause for formal Brexit negotiations with the EU, the political risks with regard to unity within Europe have become more pronounced. Given the importance of the UK vehicle market, the second-largest European sales market in 2016, the referendum in favor of Brexit will also have an impact on large parts of the automotive industry. However, ElringKlinger does not anticipate any significant repercussions for its own business. Based in Redcar, United Kingdom, the subsidiary Elring Klinger (Great Britain) Ltd. produces almost entirely for the local market. Its revenue share, calculated in relation to Group revenue for the 2016 financial year, was around 2%. Additionally, Elring Parts Ltd., based in Gateshead, United Kingdom, operates as a sales location for the company's aftermarket business in Britain.

The change in government in the United States, coinciding with policy announcements touching on a number of issues, has caused widespread uncertainty. Given the importance of the United States, the political stance taken by the new administration has global ramifications. The new policy adopted by the US government with a view to strengthening its own industry and its domestic market could have a direct impact on Germany's export-driven economy and in particular on vehicle manufacturers and automotive suppliers. In the first few weeks following his inauguration the newly elected president announced the possibility of an import tariff on cars produced outside of the United States. This policy is aimed at protecting the domestic market against Mexican imports. Addressing the country's leading representatives of the business community, he has frequently suggested that new production sites should be established in the United States rather than locating such plants in Mexico. Alongside three production sites in the United States, the ElringKlinger Group also operates a plant in Mexico. The subsidiary ElringKlinger México, S.A. de C.V. is based in Toluca and produces components mainly destined for the local market. At around 2.4%, the share of Group revenue from the sale of products imported from Mexico to the United States in 2016 is relatively small. Another positive aspect is that the terms of delivery specified in the majority of sales agreements are "ex works."

Thanks to its global presence, the Group is in the favorable position of being able to serve local markets and react with a certain degree of flexibility to changes in legislation and other political decisions. In its overall assessment, therefore, ElringKlinger is of the opinion that risk emanating from the political environment remains moderate as regards the possible financial impact on the Group.

General internal risks

General internal risks, work-related accidents, fire

Among the general internal risks that are not connected directly to the business model of the ElringKlinger Group are, primarily, work-related accidents and the risk of fire.

By applying preventative measures such as the implementation of safety standards applicable throughout the Group and the provision of safety briefings for personnel, ElringKlinger endeavors to mitigate the risk of work-related accidents to the largest extent possible. Where an accident does occur, however, the reasons and circumstances are investigated in depth and existing safety standards are adjusted accordingly in order to maintain a consistently high level of protection.

The risk of a fire occurring at operating sites is considered to be comparatively low. However, it cannot be ruled out entirely. Alongside the risk of personal injury, a fire – with the associated downtime of operations – poses the risk of substantial damage to property and significant costs for the repurchase of machinery and equipment. Production downtime and disruption to the supply of customers, however, can be ruled out to a large extent, as ElringKlinger is able to draw on its international manufacturing network for the purpose of offsetting a capacity shortfall through production at an alternative site within the Group.

The Group addresses the possible financial impact of fire damage well in advance through appropriate fire protection insurance policies. Insurance appraisers compile fire protection reports at all of the Group's operating plants. The suggestions included in the reports with regard to fire protection improvements are analyzed and implemented accordingly.

Based on the information presented above, on the whole ElringKlinger considers the probability of occurrence of general internal risks emanating from work-related accidents or fire to be low.

Operational risks

Price-related pressure/Competition

As a supplier to the automotive industry, ElringKlinger operates in a business environment that is generally considered to be highly competitive. Customers tend to demand price discounts as part of regular negotiations. Therefore, intense pressure on prices is to be seen as one of the largest individual risks to which the company is exposed. In the wake of Dieselgate this aspect has become even more pronounced.

In view of its exceptional abilities as an innovator and its strong position within the market, ElringKlinger is relatively well placed as a supplier. However, requests for price reductions have become customary within this industry, and ElringKlinger is not completely immune to such demands. In order to relieve price-related pressures to the largest extent possible, ElringKlinger develops products with technological USPs and focuses on niche markets. The remaining downward pressure on prices has to be offset by efficiency gains in production.

The competitive forces within the automotive supply industry are extremely pronounced. The barriers to market entry for new competitors are relatively high, as the business model applied by the ElringKlinger Group is based on a number of special core competencies relating to materials processing, tool production, and process management (cf. "Overview of ElringKlinger's Activities and Structure," page 52 et seqq.). What is more, substantial investments would be needed by potential market entrants to establish the requisite plant technology. The machinery used by ElringKlinger is usually designed according to company specifications, i.e., it is not available as a standardized solution within the marketplace. To be financially viable, it is essential that plants produce large volumes. Experience has shown, however, that initial orders placed with new suppliers tend to be relatively small in scale; these volumes are not sufficiently high to cover costs.

In some cases, a precondition made by manufacturers prior to awarding a contract to ElringKlinger is that the products in question should be supplied from Eastern Europe. In this context, pricing as well as shorter distances to production sites operated by vehicle and engine manufacturers play a key role. At present, a new, highly automated production plant is being built at the Group site in Kecskemét, Hungary. From the end of 2017 onward, this site will be responsible for the serial production of door module carriers made of organo sheets, a fiber-reinforced composite. Established in 2015, the subsidiary ElringKlinger Hungary Kft. is headquartered in Kecskemét-Kadafalva. Since 2016, it has been supplying serial components to plants in Hungary operated by German OEMs as well as to other customers in Europe. Elsewhere in Eastern Europe, ElringKlinger also operates a subsidiary specializing in tool construction – HURO Supermold S.R.L., Timisoara, Romania.

Additionally, through its international manufacturing network the Group is able at any time to supply from plants with lower proportions of labor cost such as Brazil, India, Mexico, or Turkey to the extent that this is required in view of product composition or is requested by the customer. At the end of 2016, for instance, ElringKlinger inaugurated a new plant located in the Turkish city of Bursa. The company has been represented in Turkey since 2009. The new facility was required because of the steady expansion in production output. At the same time, it is to be seen as a response by ElringKlinger to the growing importance of Turkey as a production site for the automotive industry.

Material risks/Supplier risks

At 54.2%, material-related expense accounts for the largest proportion of cost of sales within the ElringKlinger Group. Therefore, the direction taken by material prices is of particular significance to the company.

The raw materials primarily used within the ElringKlinger Group include alloyed high-grade steels, C-steel, aluminum, and polymer granules (cf. "Procurement and supplier management," page 85 et seqq.). Prices relating to alloy surcharges (nickel, chromium, molybdenum) are subject to extreme volatility. They are added to the price of high-grade steel and cannot be fixed by contractual agreements.

In its negotiations with its raw material suppliers ElringKlinger generally concludes agreements that are as long term as possible. Any additional quantities required are procured at prevailing market prices.

ElringKlinger works continuously on optimized product designs, improvements to production processes, and the qualification of new suppliers.

Looking ahead to 2017, ElringKlinger anticipates that prices payable for commodities will increase. The steel market is expected to see prices rise as a result of reductions in supply due to duties imposed on steel imports from China and Russia. The increase is also evident in the rising prices relating to alloy surcharges for high-grade steels. Over the course of the year, prices for aluminum and plastic granules, by contrast, are likely to be at a level that is comparable to that seen in the preceding year. On the whole, however, the risk of substantial price increases can be considered manageable, particularly in view of the fact that many raw material suppliers have seen an expansion in procurement volumes.

In some cases, ElringKlinger agrees cost escalation clauses with its customers. Where such clauses have not been negotiated in advance, upstream price rises that exceed cost estimates have to be passed on to customers. This involves a fundamental risk that higher costs cannot be passed on in full or only with some delay.

ElringKlinger collects metal-based waste produced throughout the Group as part of its stamping processes and sells this waste via its own scrap metal trading unit. Potential cost increases can be offset, at least in part, by the proceeds from scrap sold in this way.

As part of a regular process of risk assessment, ElringKlinger monitors not only trends relating to material prices but also the actual availability of materials. In order to limit associated bottlenecks or non-deliveries to the largest extent possible, ElringKlinger relies on close collaboration with its suppliers over the long term. The Group makes a point of planning its material requirements well in advance and pursues a multi-supplier strategy. It qualifies and approves at least two suppliers with regard to significant materials and bought-in parts. Medium-sized and smaller suppliers are thoroughly assessed and monitored with regard to their financial strength, liquidity, and insurance cover; they also have to undergo extensive audits at regular intervals. In fiscal 2016, the 30 principal suppliers used by the Group accounted for over 19% (around 20%) of its purchasing volume. To the largest extent possible, ElringKlinger develops alternatives for commodities and materials that are either in short supply or that are subject to severe fluctuations in price.

In summary, the probability of occurrence in respect of material and supplier risks can be considered as being low. By contrast, the associated financial impact would be significant.

Customer risks

A sudden decline in demand faced by individual customers of particular importance to the company may pose the risk, in turn, of a substantial reduction in the scheduled quantities of ElringKlinger components to be installed in their vehicles and/or engines.

In view of the Dieselgate, the aspect of customer risk has fundamentally become more significant. Due to ElringKlinger's extensive product portfolio, which is not generally restricted to a specific type of drive system, and its diversified customer base, this is not expected to have a material impact on the Group.

In order to limit the company's dependence on individual customers, but also with a view to alleviating potential pricing pressure, the ElringKlinger Group has continuously extended its customer base in recent years. In the 2016 financial year, the company's top three customers accounted for around 27% (around 27%) of Group revenue. The largest individual customer contributed 11.0% (11.7%) to sales revenue.

Labor cost risks

Alongside cost of materials, labor costs constitute the largest expense item for the ElringKlinger Group. In the 2016 financial year, they accounted for 26.1% (25.2%) of the cost of sales.

At 41.4% (43.5%), a significant proportion of the Group's overall workforce is employed at sites in Germany. Persistent wage increases at a domestic level could have a visibly negative impact on earnings performance within the Group in the coming years. Therefore, as illustrated by the progression of staff

cost ratios at German sites, the competitive position of ElringKlinger AG would deteriorate further in relation to its international peers.

Collective wage negotiations between employers and the trade union have resulted in relatively substantial wage agreements in recent years. These costs represent an increasing burden on Germany as an industrial location. The collective wage increases agreed in Germany over the last three years were 2.2% from May 2014, 3.4% from April 2015, and 2.8% from July 2016. Effective from April 1, 2017, wages will increase by a further 2.0%.

By contrast, the level of labor costs in emerging countries such as China, South Korea, India or Turkey, where almost 16% (almost 15%) of ElringKlinger's workforce is employed, continues to be below the Group average. On a positive note, sales revenue and staffing levels in the aforementioned regions are expanding at a more pronounced rate than in Germany. In these markets too, however, the dynamics of wage development remain a latent risk to the company's financial performance.

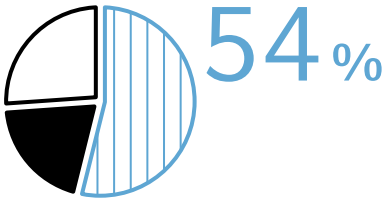
If customer demand were to decline sharply and unexpectedly, the staff cost ratio may increase dramatically. ElringKlinger has a number of instruments at its disposal with regard to strategic HR planning (such as working time accounts, shift systems, and temporary employment contracts) that allow the company to respond rapidly and flexibly in an emergency. Within the ElringKlinger Group, the proportion of employees with temporary contracts as of December 31, 2016, was 18.2% (19.9%).

Taking all factors into account, the direction taken by labor costs is to be seen as a moderate risk to which the ElringKlinger Group is exposed. The Group offsets higher wage costs by making substantial capital investments and implementing continuous measures aimed at raising efficiency levels in production in order to safeguard its international competitiveness and retain jobs in the domestic market.

Personnel risks

The employees of ElringKlinger are a key source of expertise and a significant factor in the Group's success. Therefore, it is of importance to the Group that any risk of losing expertise through staff exits is mitigated to the greatest extent possible. Staff turnover rates, which have been hovering at a percentage level in the mid-single digit range in recent years, are to be kept low by creating a socially balanced and motivating working environment. In order to counteract the effects of staff exits, specialist expertise and skills are developed, wherever possible, within the respective teams, rather than concentrating such knowledge among individual staff members.

The age structure of the Group's workforce reveals a balanced mix: Approximately 54% of employees are aged between 30 and 50, while around 26% are younger than 30. Therefore, the risk of overaging is comparatively small.



WELL-BALANCED AGE STRUCTURE

At approx. 54%, the majority of the workforce at the ElringKlinger Group is aged between 30 and 50. The proportion of employees aged under 30 is around 26%. The 50+ age group accounts for 20% of the workforce.

The growing lack of specialist staff within the labor market as a whole also affects ElringKlinger. Some of the sites operating within the Group are now finding it more difficult to attract qualified personnel with specialized skills. In order to address this issue in a proactive manner, ElringKlinger follows a systematic program of university/college marketing for the purpose of HR recruitment. The company attends career fairs, where it showcases itself as an attractive employer to graduates. It also meets the needs of university and college students by offering internships and thesis topics. With a view to nurturing talent for the future, the Group also takes on young people as technical and

commercial apprentices. In order to retain skilled personnel and managers within the company in the long term, ElringKlinger offers training courses and programs for personal advancement.

The probability of occurrence with regard to the personnel risks outlined above is considered to be medium; ElringKlinger has classified the associated financial impact as immaterial.

IT risks

In the digital age, companies' IT infrastructure is constantly exposed to potential risks such as data loss, hacking, or virus attacks. The confidentiality, integrity, and availability of data are considered to be a precious commodity. Protection within this area requires an increasing number of preventative and corrective measures. Any disruption to IT systems and application software can lead to visible process-related delays in order handling, in production control, and in the supply chain. This would have an adverse effect on revenue as well as costs.

ElringKlinger is committed to mitigating these risks to the largest extent possible. For instance, data that are of importance to operational processes are always stored twice or redundant systems are deployed. Where specific projects or processes are associated with potential risks, the company introduces additional backup systems or transitional solutions for the purpose of risk mitigation.

Additionally, the company's headquarters in Dettingen/Erms has two data centers operating independently of each other. They are accommodated at physically separate locations. This approach offers the best possible protection against system failure and data loss. Furthermore, all data pertaining to the international sites are backed up at a central location.

Staff access to confidential data is controlled by means of scalable access authorizations. State-of-the-art security software applications are used for the purpose of protecting the company against unauthorized access via external sources.

Overall, the risks relating to information technology are classified as low. The associated financial impact would be moderate.

Quality/Warranty risks

As a manufacturing company and supplier to the automotive industry, ElringKlinger is exposed to the usual warranty and liability risks seen within this sector. The supply of non-compliant components may necessitate an exchange or recall of such parts, which could lead to costs and claims for damages. Furthermore, this may damage the company's reputation over the long term. Specific individual risks currently exist with regard to quality issues within the Original Equipment segment; the possible financial impact can be considered moderate. In this context, the development of entirely new products for fields of application beyond the automobile industry or in the area of alternative drive technology is associated with further potential risks.

ElringKlinger uses appropriate quality assurance systems to prevent and mitigate the aforementioned risks. As an element of the Group-wide risk management system, quality and warranty risks are covered to a large extent by insurance policies, e.g., product liability insurance. Insurance coverage is reviewed at least once a year and adjusted where necessary. Additionally, where possible, agreements on limitation of liability are concluded between ElringKlinger and the contracting party in question.

Legal risks

Legal risks/Compliance risks

Beyond the risks already discussed in the section dealing with warranty risks, the ElringKlinger Group is exposed to further legal risks attributable to its business model and the size of the Group. These risks are covered to a large extent by insurance policies, which are an element of the risk management system. Furthermore, ElringKlinger addresses its exposure to legal risks by recognizing appropriate provisions in its separate and consolidated financial statements. Compared with the previous year, there were no other significant risks in the period under review. Likewise, ElringKlinger is at present not exposed to any significant litigation risks.

The structure of the compliance system was outlined earlier in the description of the risk management system. Risks can occur at both the parent company and the subsidiaries as a result of unlawful actions. In view of the compliance system instruments put in place and the ElringKlinger culture applied and embraced by the company, the probability of occurrence in respect of significant infringements can be classified as low but cannot be ruled out entirely. The financial effects on Group earnings are difficult to specify; depending on the respective case, they may reach a scale that could be considered significant. For instance, one of the Group's foreign subsidiaries is likely to face a fine at the lower end of the single-digit million range following investigations into an isolated issue dating back several years in connection with regulations governing market competition. Appropriate provisions have been made in the balance sheet.

Strategic risks

Technology risks

The business model of the ElringKlinger Group is based on a culture of excellence in innovation and technology leadership. The company's operations are tailored to the development of products that are technologically sophisticated and to the manufacture of such goods at a high level of productivity. Over the long term it has recorded growth rates that are above the industry average (cf. "Overview of ElringKlinger's Activities and Structure," page 52 et seqq.).

If ElringKlinger were to fail to identify and pursue significant technological developments in good time, the Group may lose its vantage point as a pioneer. In the medium term, this could jeopardize its strong position as a development partner to the vehicle industry. In turn, this would have a detrimental effect on the Group's sales and earnings performance in the medium to long term. Annually, ElringKlinger invests around 5% (around 5%) of Group sales revenue in research and development – a figure that exceeds the industry average by a considerable margin. Additionally, substantial investments have been channeled into the expansion of the Group's technology portfolio in recent years. ElringKlinger protects significant technologies and processes in the form of property rights and patents in order to combat the risk of damages caused by me-too products and imitations.

The company focuses its R&D activities firmly on an area that is of particular importance to the automotive industry, i.e., optimization of the conventional combustion engine and the development of alternative drive technologies. ElringKlinger is one of just a few suppliers worldwide to have taken the lead in positioning itself within the market with a range of new products tailored to the requirements of e-mobility – be it in the area of battery or fuel cell technology. However, as the revenue contribution made by these new divisions is relatively low at present, rapid and extensive technological change within this area poses the risk of substantial loss of revenue in its classic areas of business; this would lead to heightened pressure on prices.

Based on today's knowledge, the Group believes that change within the industry in terms of drive systems – from the conventional combustion engine via hybrid drives as a bridging technology through to pure electric solutions – is unlikely to be abrupt. Rather, this transition is expected to be gradual in nature, covering an extensive period of several years, even though this area is being driven by considerable momentum at present. Despite this, the aggregated probability of occurrence is deemed to be high. The possible financial impact would be significant.

External growth/Acquisitions

The automotive supply industry is still in a process of consolidation. For ElringKlinger, essentially, this opens up the possibility of complementary acquisitions with a focus on technology as well as targeted corporate

takeovers, the aim being to enter regional markets and penetrate new fields of technology faster.

In the case of acquisitions, fundamentally, ElringKlinger faces the risk that the acquired entities may fall short of specified targets or fail to meet them in the planned time frame. This may necessitate unforeseen restructuring measures, which – at least temporarily – would exert downward pressure on the Group's profit margin. In addition, the level of new investment required in this area may be higher than originally planned. This, in turn, would lead to more substantial funding requirements. Additionally, technology purchases pose the fundamental risk that the performance originally expected by the company may not be fully achievable. Thus, there is a risk that the products may ultimately fail to meet customer expectations.

Prior to an acquisition, ElringKlinger invariably conducts extensive due diligence investigations. As a matter of principle, all projects are also reviewed by a company and/or external team of experts. Financial plans and technical details are checked thoroughly for plausibility and are evaluated accordingly.

ElringKlinger makes a point of only entering into acquisitions if there is the prospect that the EBIT margin of the Group as a whole can be achieved in the medium term. At the same time, the overall financial risk of a transaction must in no way jeopardize ElringKlinger AG's ability to offer a dividend, even when factoring in the effects of an unfavorable scenario.

As part of mandatory annual impairment tests, it may be necessary to recognize impairment losses in connection with goodwill or investees, which would in turn adversely affect annual Group earnings.

ElringKlinger considers as predominantly low the probability of risks occurring in connection with acquisitions. The associated financial impact is categorized as moderate.

Financial risks

Bad debt loss

On balance, the risk of Original Equipment customers defaulting on payments is considered relatively low for ElringKlinger, given the solid performance of the industry as a whole in North America, Western Europe, and large parts of Asia. The risk of substantial bad debt losses attributable to individual customers is mitigated by a broadly diversified customer base. In the event of an insolvency of one of the three single biggest customers, which at present is considered unlikely, the default risk in respect of accounts receivable would have amounted to between EUR 11.9 and 27.2 million (between EUR 14.8 and 28.1 million) as of December 31, 2016.

Within the Aftermarket segment the risk of bad debt losses is considered to be higher than in the case of Original Equipment. However, this risk is also much more diversified due to the significant number of customers served in this segment.

Liquidity and financing risks

Since the financial crisis – and against the backdrop of more stringent directives governing capital requirements – banks have imposed tighter restrictions on lending. At the same time, corporate expansion and the development of new technologies necessitate sizeable investments, generally leading to more substantial funding requirements. If rating agencies were to downgrade the automotive industry as a whole in response to a less favorable risk profile, credit terms for the sector and ultimately also for ElringKlinger may be adversely affected.

Despite improved earnings in the industry as a whole and extremely low interest rates, the latent risks associated with financing remain. The risk of insolvencies, particularly with regard to smaller automotive supply companies that are not operating at an international level, can still not be ruled out entirely.

Thanks to its very solid equity ratio of 47.2% (48.5%), the refinancing situation of the ElringKlinger Group is considered to be non-critical. The Group's debt factor (net debt in relation to EBITDA) stands at 2.3 (2.2). In the financial year 2016, the Group generated cash flow from operating activities of EUR 175.7 (123.3) million. This largely covered the company's financing requirements for higher working capital as well as for investments in property, plant, and equipment. Additionally, the Group has access to undrawn credit lines totaling EUR 122.2 (98.8) million. As of December 31, 2016, no

circumstances were present that would have justified the exercise of unilateral termination rights by banks.

There are currently no identifiable risks that might jeopardize the financing of planned major projects or prevent the company from meeting its payment deadlines. From today's perspective, financing risks that might jeopardize the company's existence as a going concern can be ruled out.

Currency risks

The monetary policies adopted by the world's principal central banks and the divergence in economic performance within the respective regions have resulted in greater exchange rate volatility when viewed across an extended time frame. This applies to the exchange rate between the euro and the US dollar (USD) as well as between the euro and the majority of currencies of the emerging markets and the Swiss franc (CHF).

Compared with the industry as a whole, the ElringKlinger Group is exposed to limited currency risks relating to transactions. In almost all the company's sales regions, both costs and revenues are largely denominated in the same currency (natural hedging *).

Currency risks also exist when translating revenue, earnings, and expenses of the international subsidiaries into the Group currency, i.e., the euro. Therefore, changes in the average exchange rates can have an accretive or dilutive effect on the Group's revenue and earnings. Overall, the negative effect of foreign currency translation on revenue in the financial year 2016 was equivalent to EUR 33.4 million. On balance, the opportunities for more expansive revenues and earnings as a result of foreign currency translation should outweigh the downside risks in 2017.

Exchange rate movements also have an impact on the net finance result. They are mainly associated with the funding of Group entities by the parent company as well as with the measurement of accounts receivable and payable. In the 2016 financial year, the Group recorded a net foreign exchange gain of EUR 0.5 (3.2) million.

A summary of the quantitative impact of an appreciation or a depreciation of the euro against the key Group currencies can be found in the sensitivity analysis contained in the notes to the consolidated financial statements.

As a result of the currency-related change in competitive factors underlying the Swiss operations of Hug Engineering AG, Elsau, as well as ElringKlinger Abschirmtechnik (Schweiz) AG, Sevelen, projects may alternatively be awarded to ElringKlinger Group sites located in the eurozone. However, as key competitors of ElringKlinger Abschirmtechnik (Schweiz) AG have production facilities in Switzerland, this risk is currently still considered to be negligible. Currency risk has been further reduced due to the fact that the purchasing volumes of Hug Engineering AG were changed over to euro in the majority of cases.

In its overall assessment, ElringKlinger essentially considers the probability of occurrence of currency risks as being high; the possible financial impact on the Group would be moderate.

Interest-rate risks

The ElringKlinger Group funds itself through cash flow generated from operating activities as well as through borrowings from banks. A detailed overview of current and non-current financial liabilities categorized by maturity as of December 31, 2016, can be found in the notes to the consolidated financial statements.

The current level of interest rates within the market is low when viewed over an extended period of time. A marked increase in interest rates would feed into variable rate loans and would ultimately also have an impact on the net financial result of the ElringKlinger Group. To a large extent, however, fixed interest rates have been agreed in respect of the financing liabilities of the ElringKlinger Group (cf. Notes: "Non-current and current financial liabilities").

Please also refer to the notes to the consolidated financial statements for a sensitivity analysis; it outlines the impact of a change in market interest rates on the earnings of the ElringKlinger Group.

Use of derivative financial instruments

ElringKlinger only uses derivative financial instruments in isolated cases, e.g., for the purpose of protecting the company against price fluctuations relating to high-grade steel alloys (particularly nickel). Where

hedging contracts are employed as a protective instrument against commodity price volatility, they are always based on the actual quantity of physical materials required by the company.

Operating on a rolling basis, ElringKlinger again hedged some of its requirements of alloyed high-grade steels in the 2016 financial year. This was done by means of nickel forward contracts.

Opportunities

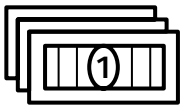
Climate change/Emission laws

The main objective currently being pursued by the automotive industry is to cut emissions. This applies not only to CO_2 but also to other harmful components such as soot particles, nitrogen oxides, and hydrocarbons. The European Union is known to have some of the strictest emission standards worldwide. According to legislation passed by the EU Commission, the level of CO_2 emitted by new vehicles must be reduced from 130 g/km at present to 95 g/km by 2021. This limit will have to be met by 90% of each manufacturer's vehicle fleet as early as 2020 and by the whole fleet from 2021 onwards. What is more, emission levels are to be scaled back further in future, with Brussels discussing even lower thresholds of between 75 and 65 g/km for the year 2025. The United States and the People's Republic of China have also seen increasingly ambitious emissions targets. In the United States, the aim is to reduce CO_2 emissions to 132 g/km by 2021. The Chinese government has stipulated a reduction in CO_2 emissions to 117 g/km by 2020. Furthermore, emerging countries such as India tend to look at the strict Euro standards as a basis for their own policy making.

For the ElringKlinger Group this legislative framework offers considerable potential with regard to development and revenue growth over the coming years. The trend towards increasingly fuel-efficient engines places greater demands on gasket technology and shielding systems. For ElringKlinger, this opens up additional sales opportunities and new markets for highly heat-resistant specialty gaskets and shielding components, such as those required for turbochargers and in exhaust systems but also in the area of lightweight construction.

Hybrid vehicles, i.e., the combination of a combustion engine and electric motor, are gaining market share. Many car makers are extending their product portfolio to include hybrids, the aim being to achieve the strict CO_2 limits applied to their vehicle fleets. For ElringKlinger, hybrid concepts open up the opportunity to generate higher revenue per vehicle. Alongside components installed in combustion engines, hybrids provide the company with the chance to market pressure equalization modules or cell contact systems for the battery unit of the powertrain.

4,000 €



SUBSIDY

In July 2016 the German government launched a program offering a EUR 4,000 subsidy to buyers of electric cars. The subsidy available for cars with hybrid or fuel cell drives is EUR 3,000.

In May 2016 a state-funded incentive scheme was introduced in Germany with a view to meeting the federal government's stated goal of one million new electric vehicles on the road by 2020. The subsidy available for pure electric vehicles is EUR 4,000 (from 2018: EUR 3,000), while buyers of cars equipped with hybrid or fuel cell technology can save EUR 3,000 (from 2018: EUR 2,000). The subsidy will remain in place up to 2019 or until the EUR 1.2 billion incentive fund has been used up. Another federal government subsidy program, set up to expand the network of recharging points for electric cars in Germany, was given the green light by the European Union at the beginning of 2017. The plan is to invest EUR 300 million over the next four years on the installation of 15,000 recharging points throughout Germany. These financial incentives could prompt many consumers to rethink their purchasing behavior and therefore boost sales of electrically powered cars. Further advances in battery technology could increase the range of electric vehicles and make them more attractive to potential buyers. ElringKlinger would benefit directly from higher sales

* Cf. glossary

volumes in the electric vehicle market, as the company's E-Mobility division supplies various car makers.

Outside the automotive industry, too, there is a growing focus on the issue of emissions reduction. Stationary and marine engines as well as construction machinery are subject to stricter emissions regulations. These niche markets hold significant potential for the systems produced by ElringKlinger's Exhaust Gas Purification division.

The revenue and earnings potential associated with the issue of greenhouse gas reduction can be categorized as significant for the ElringKlinger Group. The potential for ElringKlinger to exploit these market opportunities in the medium term, at the latest, by drawing on its existing product portfolio and R&D expertise is considered highly probable.

Technology trends/New emissions regulations

As a result of increasingly strict international emissions standards, the probability of the technology trends outlined above actually coming to fruition is classed by the ElringKinger Group as high. The industry will have to focus on more efficient engines, lightweight engineering, and the use of alternative drive technology if it is to have any chance of meeting the ambitious CO_2 targets set by policymakers.

Insofar as ElringKlinger continues to succeed in developing new solutions to tackle these issues and rolling them out onto the market by utilizing its existing expertise relating to materials processing, tooling, and development and production processes, the prospects for revenue and earnings growth of the Group can be categorized as significant.

Extension of product and service portfolio

The majority of the divisions within the Group are well placed to apply their existing expertise relating to materials and processes proactively for the purpose of complementing the range with new products and expanding the portfolio in a targeted manner.

The specific opportunities available to the Group have already been discussed extensively in the chapter on Research and Development. At this point, it is worth highlighting ElringKlinger's expertise centered around new material concepts in the area of lightweighting as well as alternative drive and power supply technologies relating to battery technology and fuel cells. Emissions standards have also become stricter beyond the automotive industry, which increasingly is opening up interesting niche markets in the area of exhaust gas purification. New opportunities are also presenting themselves continuously for the Engineered Plastics division and its PTFE components used in the industrial sector as a whole as well as in the area of medical technology.

All the Group's divisions are working proactively on the expansion of their product and service portfolios with a view to meeting the organic growth target of between 2 and 4 percentage points above the global increase in automobile production.

New sales markets

In the coming years, moving into new regional sales markets with existing ElringKlinger products may present opportunities for significant revenue and earnings growth. In this context, the ASEAN region may be cited as a prime example. In most of the BRIC states, the Group still has the opportunity to expand its sales volumes by manufacturing all product groups locally and selling them in the regional markets.

There are opportunities for further growth in the Aftermarket business by widening the product range and harnessing the potential of new sales regions. Trading under the "Elring – Das Original" brand, the Aftermarket segment within the ElringKlinger Group is ratcheting up its activities in Asia. There was a continued focus on measures to access and penetrate the Chinese spare parts market in the face of competition from a large number of locally based providers. The Group is also systematically expanding its Aftermarket business in North America.

Industry consolidation/M&A

Measured on the basis of production output, it is expected that growth in the automotive industry in the coming years will be driven primarily by Asia and North America. Looking ahead, this trend poses significant challenges for many small and medium-sized enterprises that currently have either an insufficient international presence or none whatsoever. What is more, suppliers are having to take on responsibility for an increasingly large proportion of value creation relating to new vehicle production. They are faced

with substantial investments in research and development, in addition to being exposed to more extensive financing risks. Against this backdrop, the market will be faced with the possible risk of insolvencies. The present wave of consolidation within the automotive supply industry therefore looks set to persist over the coming years.

For the ElringKlinger Group, this scenario offers additional opportunities to extend its technology portfolio through targeted acquisitions. In some cases, competitors also exit the market without the influence of consolidation processes. ElringKlinger will continue to monitor the market systematically in order to identify potential opportunities for acquisitions as early as possible and pursue them where this is deemed appropriate and financially viable. Over the next few years, it is quite likely that ElringKlinger will exploit further growth opportunities through acquisitions. The associated financial impact of such acquisitions is difficult to quantify in advance. It may range from insignificant to indeed significant when measured on the basis of revenue and earnings contributions to the Group.

Overall assessment of risks and opportunities

The conclusion drawn by the Management Board from scrutinizing the opportunities and risks in their entirety is that the situation of the ElringKlinger Group in respect of risk exposure is similar to that seen in the previous year. Some of the risks to which the Group is exposed are of a geopolitical or external nature, and ElringKlinger's capacity to control these risks in an active manner is extremely limited. When weighing the relevance of risk in respect of the possible impact on Group earnings, the principal risks to which the ElringKlinger Group is exposed are a sudden global slump in the market, rapid technological change in drive systems, and a dramatic surge in commodity prices.

Macroeconomic conditions in Western Europe, North America, and China are currently stable. By contrast, the political and economic situation in Russia and the Middle East as well as the economic situation in Brazil continue to be a source of risk. The strategic risks remain unchanged. The financial opportunities and risks due to foreign exchange fluctuations remain at an elevated level.

Drawing on the risk management system outlined above and its flexible cost structure, if necessary the ElringKlinger Group is in a position to respond promptly to any risks that may arise by implementing the corresponding risk management arrangements. The company makes a point of deliberately not exposing itself to risks that may jeopardize the existence of the ElringKlinger Group or its ability to offer a dividend. The Group's solid financial position, as reflected in an equity ratio of 47.2% (48.5%) and the ability to obtain new financing, provides a protective shield in respect of ElringKlinger and its business model even in the event of a protracted market crisis, of which, however, there are no indications at present.

The principal opportunities for the Group relate to the technological trend towards vehicle drive systems with greater fuel efficiency and lower emissions. In turn, this trend is inextricably linked to the issue of climate change and a global drive towards stricter emission laws. Benefiting from products targeted at alternative drive systems and power supply as well as a number of new concepts in the field of lightweight construction, the Group can look forward to opportunities for growth around the globe.

There are currently no identifiable risks that might jeopardize the future existence of the company as a going concern, either in isolation or in conjunction with other factors. The Group is well positioned to actively seize any opportunities arising from long-term technology trends and ongoing industry consolidation. Against the backdrop of a manageable risk profile, the ElringKlinger Group remains well positioned to continue outpacing global automobile production by 2 to 4 percentage points in the coming years.

COMPENSATION REPORT

Compensation structure for members of the Management Board

Contracts for members of the Management Board are drawn up by the Personnel Committee of the Supervisory Board, negotiated with the respective members of the Management Board, and concluded following approval by the entire Supervisory Board. The Personnel Committee reviews the level of compensation at predefined intervals and advises the Supervisory Board on appropriate adjustments where required. These recommendations are decided upon by the full Supervisory Board. The recommendations take into account the size and international operations of the company, its economic and financial situation, its prospects for the future, the level and structure of management board compensation offered by similar companies, and the compensation structure in place in other areas of the company. In addition, the duties and performance of each member of the Management Board are taken into consideration. Compensation is set at a level that ensures it is competitive within the market for highly qualified managers and provides an incentive for successful work in a corporate structure with a strong focus on performance and achievement. If requested by the company, the Management Board members also take on responsibilities in affiliated entities. The Management Board members receive no additional compensation for such activities.

Management Board compensation for the 2016 financial year is presented in accordance with the provisions set out in two different standards: first, the applicable financial reporting standards (GAS 17) and, secondly, the German Corporate Governance Code in the version of May 5, 2015.

Compensation system up to December 31, 2013

The compensation system applicable up to December 31, 2013, was replaced as of January 1, 2014. Only the stock appreciation rights allocated to members of the Management Board as part of long-term variable compensation remain in place until the end of the vesting or exercise periods. Holders of stock appreciation rights were entitled to a cash-settled payment. Stock appreciation rights were not furnished with any entitlements to shares in ElringKlinger AG. On February 1 of each year – commencing in 2013 – 30,000 stock appreciation rights were to be allocated to each member of the Management Board. The grant price is computed as the arithmetic mean of the market price of ElringKlinger shares in the last sixty stock exchange trading days prior to the grant date. An essential precondition for the allocation of stock appreciation rights was the personal investment by the Management Board members, in shares of ElringKlinger AG, of one-tenth of the overall number of stock appreciation rights granted. The vesting period of the stock appreciation rights is four years. On completion of the vesting period, the Management Board member is entitled to request redemption of the stock appreciation rights within another two years. The redemption price is determined on the basis of the average market price of ElringKlinger AG shares over the last sixty stock exchange trading days prior to the request for redemption. Redemption of the stock appreciation rights can only be requested if the redemption price is 25% higher than the grant price. The redemption price as a whole is limited per tranche to the amount of two fixed annual salaries at the time of redemption. Provisions are recognized in consideration of expected future obligations.

Compensation system as from January 1, 2014

The compensation system applicable as from January 1, 2014, includes fixed and variable components. It comprises:

1. Annual fixed salary
2. Long-term incentive I (LTI I)
3. Long-term incentive II (LTI II)
4. Fringe benefits
5. D&O insurance
6. Retirement pension

Fixed annual salary

The fixed annual salary is a cash payment in respect of the current financial year; it takes into account the area of responsibility of the Management Board member in question and is paid in twelve monthly installments.

Long-term incentive I (LTI I) (annual management bonus)

LTI I is a variable component of compensation that is based on the average Group EBIT (Group earnings

before interest and taxes) of the last three financial years. The Management Board receives a percentage share of the three-year mean. The long-term incentive I corresponds to the principles previously applied to the annual management bonus and is granted as compensation for services performed in respect of one financial year. LTI I is limited to a maximum of three times the amount of fixed compensation in the financial year in question. Payment of LTI I for a financial year ended occurs on approval of the separate and consolidated financial statements by the Supervisory Board in the subsequent year. On termination of the appointment as a Board member either at the request of the Management Board member in question or for good cause, entitlements to the variable compensation components of LTI I shall lapse as soon as the termination of said Board appointment comes into legal effect.

ILLUSTRATIVE CALCULATION LTI I

		EBIT average	193,000,000
in EUR		Variable compensation	Cap Fixed salary 2016 *3
Dr. Wolf	0.80%	**1,544,000**	**1,521,000**
Becker	0.60%	**1,158,000**	**1,179,000**
Jessulat	0.40%	**772,000**	**864,000**
Total		**3,474,000**	**3,564,000**

Long-term incentive II (LTI II)

The so-called Economic Value Added (EVA) bonus is granted to the Management Board as a constituent element of variable Management Board compensation that focuses on positive corporate performance over the long term. LTI II creates a long-term incentive for the Management Board to make a committed contribution to the success of the company. LTI II is a bonus based on the economic value added to the ElringKlinger Group. The Management Board receives a percentage of the economic value added calculated in respect of the company. The EVA bonus corresponds to the percentage of average economic value added in respect of three financial years. The annual economic value added is calculated according to the following formula:

$$EVA = (EBIT \times (1 - T)) - (WACC \times \text{Capital Invested})$$

The first component is calculated on the basis of Group earnings before interest and taxes (Group EBIT) in respect of the financial year as well as the average Group tax rate.

The second component is computed by multiplying Group WACC by capital invested. The weighted average cost of capital (WACC) is calculated with the help of the basic interest rate, the market risk premium, and the beta factor. The beta factor represents the individual risk of a share in relation to the market index. It is determined as an average value of all the peer group companies. The credit spread for borrowing costs, as the premium on the risk-free basic interest rate, was derived from a peer group rating. Capital invested is calculated on the basis of Group equity plus net financial liabilities (i.e., net debt) as of January 1 of the financial year. 90% of the LTI II amount is paid out to the member of the Management Board in question in the subsequent year. Using the remaining 10% of the LTI II amount, the company purchases shares in ElringKlinger AG on behalf and account of the Management Board member in question. The Management Board member is prohibited from accessing these shares for a period of three years. Dividends and subscription rights are at the disposal of the Management Board member. The maximum amount granted from LTI II has been set at twice the amount of fixed compensation.

If a member of the Management Board enters the service of the company during the financial year and is not in employment for the company for a full twelve-month period, LTI II is reduced pro rata temporis.

On termination of a contract of service, the Management Board member in question may access the shares only after a period of twelve months subsequent to said termination. On termination of the appointment as a Board member either at the request of the Management Board member in question or for good cause, entitlements becoming applicable in the future in respect of the variable compensation components of LTI II shall lapse.

ILLUSTRATIVE CALCULATION LTI II

in EUR		EVA mean value Variable compensation	79,500,000 Cap Fixed salary 2016 *2
Dr. Wolf	1.25%	**993,750**	**1,014,000**
Becker	1.00%	**795,000**	**786,000**
Jessulat	0.40%	**318,000**	**576,000**
Total		**2,106,750**	**2,376,000**

Fringe benefits

The taxable fringe benefits awarded to Management Board members mainly encompass the provision of a company car and mobile phone and communication devices as well as expense allowances and insurance benefits.

D&O insurance

The members of the Management Board are covered by the Group's existing directors' and officers' liability insurance (D&O insurance). The agreed deductible corresponds to the minimum deductible set out in Section 193 (2) sentence 3 AktG (German Stock Corporation Act) in the applicable version.

Retirement pension

The contracts of the Management Board members of ElringKlinger AG include commitments in respect of an annual retirement pension that is measured as a percentage of pensionable income. The entitlement to a retirement pension becomes applicable as soon as the contract of service has ended, but not before the individual has reached the age of 63. This entitlement also becomes applicable as soon as the Management Board member has reached the age that entitles him to receive full statutory pension benefits as well as in the event of occupational disability. The percentage is dependent on the number of years of service as a Management Board member. Existing entitlements in respect of time spent as a salaried employee of the company are not factored in to this calculation and continue to apply. The percentage rate is between 2.5% and 3.2% of the last monthly fixed salary prior to leaving the company in respect of each full year of service. This percentage rate can rise to a maximum of 45%.

If a member of the Management Board acts in a manner that is grossly negligent or displays gross negligence in his failure to act in specific instances and such actions or failures to act would result in significant damages to the Group, all entitlements to a retirement pension shall lapse; the same shall apply if the member of the Management Board enters the service of an entity that is in direct competition with the company.

The contracts include provisions governing surviving dependents' benefits. If a member of the Management Board dies during the period in which the employment contract is applicable or once the retirement benefits become due, his widow or dependent children shall receive a widow's or orphan's pension. The widow's pension amounts to 50% of the retirement pension of the deceased. The orphan's pension amounts to 20% of the widow's pension to the extent that a widow's pension is payable simultaneously and 40% of the widow's pension to the extent that no widow's pension is payable.

The widow's or orphan's pensions shall not exceed 60% of the amount to which the deceased would have

been entitled if he had entered into retirement on the day of his death.

Review and adjustment of compensation

The salary components are to be reviewed by the company's Supervisory Board every two years. The Supervisory Board has the right to grant the Management Board special remuneration for exceptional accomplishments. The Supervisory Board is also authorized to reduce the Management Board's total compensation to an appropriate level if the company's situation deteriorates to such an extent that continued payment of the former remuneration would be unreasonable.

Severance pay cap

In the event of premature termination of the contract of service without good cause, any payments potentially to be agreed with the Management Board member shall not exceed the amount equivalent to two years' annual compensation ("severance pay cap") and the amount equivalent to compensation payable in respect of the remaining term of this contract of service.

In the event of a change of control, any potential severance payment to be agreed by the parties shall not exceed 150% of the severance pay cap.

Loans to Management Board members

No advances or loans were granted to members of the Management Board of ElringKlinger AG in 2015 or 2016. Likewise, the company provided no guarantees or similar commitments.

Management Board compensation 2016

Management Board compensation for the 2016 financial year has been presented pursuant to the applicable financial reporting standards (GAS 17) as well as in accordance with the recommendations of the German Corporate Governance Code in the version dated May 5, 2015.

Management Board compensation 2016 pursuant to financial reporting standard GAS 17

Total Management Board compensation in accordance with Section 314 (1) no. 6a sentence 1 to 4 HGB (German Commercial Code) is presented in the table below. The amounts specified in respect of Karl Schmauder relate to the period up to the discontinuation of his services as a Management Board member on February 23, 2016. For further details, please refer to "Resignation of Management Board member."

	Dr. Stefan Wolf		Theo Becker		Thomas Jessulat		Karl Schmauder		Total	
in EUR k	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Short-term compensation										
Fixed compensation	556	554	418	418	0	313	413	69	1,387	1,354
Variable performance-related compensation	1,182	1,127	888	845	0	562	888	141	2,958	2,675
Total	**1,738**	**1,681**	**1,306**	**1,263**	**0**	**875**	**1,301**	**210**	**4,345**	**4,029**
Long-term compensation										
Long-term performance-related compensation	452	253	362	202	0	81	362	0	1,176	536
Total	**452**	**253**	**362**	**202**	**0**	**81**	**362**	**0**	**1,176**	**536**
Total compensation	**2,190**	**1,934**	**1,668**	**1,465**	**0**	**956**	**1,663**	**210**	**5,521**	**4,565**

Pension obligations

The current service cost as well as the present value (DBO) of the pension provisions are as follows:

	Dr. Stefan Wolf		Theo Becker		Thomas Jessulat		Karl Schmauder		Total	
in EUR k	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016
Current service cost	238	218	153	144	0	150	132	20	523	532
Present value (DBO)	3,995	5,023	3,025	3,720	0	150	4,007	–	11,027	8,893

The present value of the pension provision for Mr. Schmauder as of December 31, 2016, was included in the disclosures relating to pension provisions for former members of the Management Board.

Management Board compensation pursuant to the German Corporate Governance Code

The following presentation of compensation granted to and received by the Management Board members in respect of the 2016 financial year is based on the recommendations of the German Corporate Governance Code in the version dated May 5, 2015. The presentation uses the "model tables" recommended by the Code. The amounts specified in the table in respect of Karl Schmauder relate to the period up to the discontinuation of his services as a Management Board member on February 23, 2016.

The following table presents benefits granted to the members of the Management Board in respect of the 2016 financial year, as disclosable under the provisions of the German Corporate Governance Code:

BENEFITS GRANTED (PURSUANT TO GCGC)

	Dr. Stefan Wolf				Theo Becker			
in EUR k	2015	2016	Min. 2016	Max. 2016	2015	2016	Min. 2016	Max. 2016
Non-performance-based compensation								
Fixed annual salary	507	507	507	507	393	393	393	393
Fringe benefits	49	47	47	47	25	25	25	25
Total	**556**	**554**	**554**	**554**	**418**	**418**	**418**	**418**
Performance-based compensation								
One-year variable compensation	1,182	1,127	0	1,521	888	845	0	1,179
Multi-year variable share-based compensation 2013–2017	0	0	0	0	0	0	0	0
Multi-year variable compensation 2014–2016	0	0	0	0	0	0	0	0
Multi-year variable compensation 2015–2017	447	0	0	0	357	0	0	0
Multi-year variable compensation 2016–2018	0	110	0	1,014	0	88	0	786
Total	**1,629**	**1,237**	**0**	**2,535**	**1,245**	**933**	**0**	**1,965**
Service cost	238	218	218	218	153	144	144	144
Total compensation	**2,423**	**2,009**	**772**	**3,307**	**1,816**	**1,495**	**562**	**2,527**

In contrast to GAS 17, the table presents long-term compensation granted in 2016 for LTI II. In addition, the minimum and maximum amounts achievable have been listed. The benefit expense, which is presented in the form of the current service cost in the above table, has been included in total compensation.

	Thomas Jessulat				Karl Schmauder				Total			
	2015	2016	Min. 2016	Max. 2016	2015	2016	Min. 2016	Max. 2016	2015	2016	Min. 2016	Max. 2016
	0	288	288	288	393	66	66	66	1,293	1,254	1,254	1,254
	0	25	25	25	20	3	3	3	94	100	100	100
	0	**313**	**313**	**313**	**413**	**69**	**69**	**69**	**1,387**	**1,354**	**1,354**	**1,354**
	0	562	0	864	888	141	0	198	2,958	2,675	0	3,762
	0	0	0	0	0	0	0	0	0	0	0	0
	0	81	0	576	0	0	0	0	0	81	0	576
	0	41	0	576	357	0	0	0	1,161	41	0	576
	0	35	0	576	0	0	0	132	0	233	0	2,508
	0	**719**	**0**	**2,592**	**1,245**	**141**	**0**	**330**	**4,119**	**3,030**	**0**	**7,422**
	0	150	150	150	132	20	20	20	523	532	532	532
	0	**1,182**	**463**	**3,055**	**1,790**	**230**	**89**	**419**	**6,029**	**4,916**	**1,886**	**9,308**

The following table presents the allocation in/for the 2016 financial year. As regards fixed annual salary, fringe benefits, annual management bonus, and LTI II 2016, the table presents the allocation for the 2016 financial year.

ALLOCATION PURSUANT TO GCGC

	Dr. Stefan Wolf		Theo Becker	
in EUR k	2015	2016	2015	2016
Non-performance-based compensation				
Fixed annual salary	507	507	393	393
Fringe benefits	49	47	25	25
Total	**556**	**554**	**418**	**418**
Performance-based compensation				
One-year variable compensation	1,182	1,127	888	845
Multi-year variable compensation 2013–2015	452	0	362	0
Multi-year variable compensation 2014–2016	0	253	0	202
Total	**1,634**	**1,380**	**1,250**	**1,047**
Service cost	238	218	153	144
Total compensation	**2,428**	**2,152**	**1,821**	**1,609**

Resignation of Management Board member

Management Board member Karl Schmauder stepped down from his post with immediate effect on February 23, 2016. The separation agreement ("Aufhebungsvereinbarung" governed by German law) reached between the respective parties includes the immediate suspension of Mr. Schmauder, with ongoing compensation being payable up to the regular expiration of his contract of service on January 31, 2018. Entitlements in respect of LTI I for the financial years 2016 to 2017 were granted in full, while entitlements in respect of LTI I for the financial year 2018 were granted on a pro-rata basis. Entitlements in respect of LTI II for the tranches 2014–2016 and 2015–2017 were granted in full. LTI II for the tranche 2016–2018 shall be granted on a pro-rata basis. Retirement benefit rights granted to Mr. Schmauder shall remain valid. Remuneration payable subsequent to February 23, 2016, pursuant to Section 314 (1) no. 6a sentence 6 dd of the German Commercial Code (Handelsgesetzbuch – HGB), amounting to EUR 2,743k, comprises non-performance-based compensation (EUR 788k, of which EUR 343k paid in 2016) and performance-based compensation (EUR 1,955k, of which EUR 917k in respect of the 2016 financial year).

	Thomas Jessulat		Karl Schmauder		Total	
	2015	2016	2015	2016	2015	2016
	0	288	393	66	1,293	1,254
	0	25	20	3	94	100
	0	**313**	**413**	**69**	**1,387**	**1,354**
	0	562	888	141	2,958	2,675
	0	0	362	0	1,176	0
	0	81	0	0	0	536
	0	**643**	**1,250**	**141**	**4,134**	**3,211**
	0	150	132	20	523	532
	0	**1,106**	**1,795**	**230**	**6,044**	**5,097**

Compensation structure for members of the Supervisory Board

Supervisory Board compensation is governed by the provisions set out in Section 13 of the Articles of Association of ElringKlinger AG. The compensation structure relating to the Supervisory Board was adjusted in the reporting period. The level of compensation is determined by the Annual General Meeting. Within this context, the most recent resolution was passed on May 13, 2015. In accordance with the requirements of the German Corporate Governance Code, compensation is divided into a fixed and a variable component. The members of the Supervisory Board receive fixed compensation of EUR 20k (prev. year: EUR 20k) for each full financial year they have served on the Supervisory Board. Additionally, the members of the Supervisory Board receive a lump-sum payment of EUR 1k for each Supervisory Board meeting they attend as well as fixed compensation of EUR 4k for membership of a committee. The variable component of compensation is based on average IFRS Group earnings before taxes in respect of the last three financial years and is calculated as 0.02% of the aforementioned amount. As of the 2015 financial year, it is limited to EUR 40k per member of the Supervisory Board.

The role of the Supervisory Board Chairman and that of his Deputy are taken into consideration when determining the level of compensation. The Chairman of the Supervisory Board receives two times and the Deputy Chairman one-and-a-half times the compensation paid to other Supervisory Board members. Expenses incurred by the Supervisory Board members are reimbursed to an appropriate extent. Supervisory Board members who have not held the post for a full financial year receive a pro rata amount of fixed and variable compensation.

Supervisory Board compensation 2016

In the period under review, total compensation for the Supervisory Board of ElringKlinger AG was EUR 741k (2015: EUR 774k). Additionally, travel expenses totaling EUR 2k (2015: EUR 0k) were reimbursed. Compensation payable to the individual members of the Supervisory Board was as follows:

	Fixed compensation		Variable compensation		Total compensation	
in EUR k	2016	2015	2016	2015	2016	2015
Walter Herwarth Lechler	68	68	54	57	122	125
Markus Siegers	44	41	41	43	85	84
Gert Bauer	0	10	0	10	0	20
Ernst Blinzinger	24	16	27	18	51	34
Nadine Boguslawski	24	16	27	18	51	34
Armin Diez	28	28	27	29	55	57
Klaus Eberhardt	32	32	27	29	59	61
Pasquale Formisano	24	24	27	29	51	53
Rita Forst	24	16	27	18	51	34
Dr. Margarete Haase	0	8	0	10	0	18
Paula Monteiro-Munz	28	28	27	29	55	57
Prof. Hans-Ulrich Sachs	24	24	27	29	51	53
Gabriele Sons	32	32	27	41	59	73
Manfred Strauß	24	24	27	29	51	53
Gerhard Wick	0	8	0	10	0	18
Total	**376**	**375**	**365**	**399**	**741**	**774**

Variable compensation presented above reflects accrued expense based on average IFRS Group earnings before taxes in the last three financial years.

DETAILS ACCORDING TO SECTION 289 (4) AND SECTION 315 (4) OF THE GERMAN COMMERCIAL CODE (HGB), PARTICULARLY WITH REGARD TO SHARE CAPITAL AND DISCLOSURE OF POTENTIAL TAKEOVER OBSTACLES

As of December 31, 2016, the nominal capital of ElringKlinger AG was EUR 63,359,990, divided into 63,359,990 registered shares, each furnished with one vote. The notional interest in the company's nominal capital is EUR 1.00 per registered share. Profits are distributed in accordance with Section 60 of the German Stock Corporation Act (Aktiengesetz – AktG) in conjunction with Section 23 no. 1 of the Articles of Association.

The Management Board is not aware of any restrictions or agreements between shareholders concerning voting rights or the transfer of shares.

The persons or entities with a direct interest in capital who, according to the details of the Stock Register, held voting rights in excess of 10% as of December 31, 2016, are presented in the table below. These relate solely to interests attributable to family ownership.

Walter H. Lechler, Stuttgart, Germany	Total of 22.059% (of which 10.013% is attributable to him under Section 22 of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG*)
Lechler Beteiligungs-GmbH, Stuttgart, Germany	10.031%
Eroca AG, Basel, Switzerland	Total of 19.930% (of which 9.928% is attributable to it under Section 22 of the German Securities Trading Act (Wertpapierhandelsgesetz – WpHG*)

No shareholder is equipped with special rights constituting controlling powers.

ElringKlinger does not operate any employee profit-sharing schemes.

The number of Management Board members is determined by the Supervisory Board (Section 7 of the Articles of Association). The appointment and removal of Management Board members is performed in accordance with Sections 84 and 85 of the German Stock Corporation Act (Aktiengesetz – AktG). The Articles of Association contain no regulations that could be considered non-compliant with the provisions set out by law as regards the conditions applicable to the appointment or removal of Management Board members.

As stipulated by Section 179 of the Stock Corporation Act in conjunction with Section 20 of the Articles of Association, all amendments to the Articles of Association require a resolution of the Annual General Meeting with a majority of three-quarters.

The Management Board is authorized to buy back company shares up to a total amount of 10% of share capital existing at the date on which this resolution was passed (May 13, 2015). This authorization remains valid until May 13, 2020.

Details relating to authorized capital and the utilization of authorized capital are included in the Notes.

ElringKlinger has not entered into any agreements containing a change of control provision that would apply in the event of a takeover bid.

There are no compensation agreements with members of the Management Board or employees in the event of a takeover bid.

* Cf. glossary

CORPORATE GOVERNANCE STATEMENT PURSUANT TO SECTION 289A HGB

The Corporate Governance Statement pursuant to Section 289a of the German Commercial Code (Handelsgesetzbuch – HGB) is part of the combined management report and has been published on the ElringKlinger website at www.elringklinger.de/en/company/corporate-governance/declaration-of-conformity.

REPORT ON EXPECTED DEVELOPMENTS

Outlook – Market and Sector

Despite a number of uncertainties, economists have presented an optimistic outlook for business in 2017. According to estimates issued by the International Monetary Fund (IMF), the world economy is set to expand by 3.4% – a moderate but nevertheless slightly more dynamic rate of growth. The global car market is also expected to continue growth. Based on data published by Germany's VDA, the Association of the Automotive Industry, global sales are likely to rise by 2% to around 84 million vehicles. The wind of change sweeping through the automotive industry has gathered pace. While the number of vehicles equipped with a combustion engine looks set to increase in the medium term, from 2020 onward the market for electric cars is expected to become increasingly buoyant.

Data presented by the IMF suggests that the emerging countries and the United States will form the main driving force behind global economic development. With estimated growth of 4.5% in GDP, the combined rate of expansion of the emerging economies is again expected to be higher than that of the industrialized nations (1.9%). Alongside geopolitical uncertainties, the associated risks include a potential widening of global imbalances, sharp exchange rate movements, and inadequate progress on reforms in heavily indebted advanced economies and some of the emerging countries, with the latter also having to contend with an outflow of capital and high corporate debt. At present, the policy stance of the incoming US administration and its global ramifications are less predictable.

The economy of the euro area as a whole will continue to be supported by an expansive monetary policy adopted by the European Central Bank, but also by an upturn in global demand. This is likely to counteract to some extent the challenges associated with the planned exit of the United Kingdom from the European Union, high levels of debt, and uncertainty as to the outcome of upcoming elections in some Member States. Domestic demand in Germany is expected to lose some of its momentum, but the German economy will nevertheless remain on track.

Following the change in government in the United States, the US economy is likely to see a more pronounced upturn on the back of investment programs announced by the new administration. Additionally, it would appear likely that oil prices will rise and that US monetary policy will continue to pursue a route leading toward normalization. In Brazil, meanwhile, after years of growth reversal there are first, albeit as yet weak, signs of an upturn in 2017.

The most substantial contribution to growth for the global economy as a whole is expected to come from the large emerging countries in Asia. Bolstered by government measures to stimulate the economy, China will again see an expansion in economic output. India, too, is expected to maintain its trajectory of growth. After years of malaise, Japan's economy is again unlikely to produce any signs of improvement.

GDP GROWTH PROJECTIONS

Year-on-year change in %	2016	Projections 2017	Projections 2018
World	3.1	3.4	3.6
Germany	1.7	1.5	1.5
Eurozone	1.7	1.6	1.6
USA	1.6	2.3	2.5
Brazil	-3.5	0.2	1.5
China	6.7	6.5	6.0
India	6.6	7.2	7.7
Japan	0.9	0.8	0.5

Source: International Monetary Fund (January 2017)

Vehicle market in 2017: slower but steady growth

After a good performance in 2016 the overall outlook for the global car market remains positive for 2017. According to market experts, the global volume of newly sold cars will exceed the prior-year figure by approx. 1 to 2%. Germany's automotive industry association (VDA) has predicted growth of about 2%, taking the overall volume to around 84 million new vehicles. ElringKlinger is also working on the assumption of slight growth in the region of 1 to 2%.

With new vehicle registrations estimated at 14 million units, Western Europe is expected to remain stable at a level comparable to that seen in 2016. Southern Europe is said to have the greatest growth potential with regard to new vehicle sales. By contrast, the first repercussions of the Brexit referendum may produce a marked downturn in the UK car market, with the VDA predicting a contraction of around 8%. Germany is expected to see its market volume reach heights similar to those recorded in 2016. Domestic production output is also likely to match the solid levels already achieved in this area. According to VDA forecasts, German exports may decline marginally by 2%, while foreign production output by German car makers is likely to grow by 3% – having exceeded the mark of 10 million units in 2016 for the very first time.

The US market, which boasted recorded sales of around 17.5 million light vehicles (cars and light commercial vehicles) for the second year in succession in 2016, is expected to put in an equally good performance in 2017. Potentially stimulating measures introduced by the US government could provide greater buoyancy for demand, but this is likely to be counterbalanced by the decelerating effects of higher interest rates and firmer oil prices. Having said that, optimistic forecasts suggest that further market growth is possible.

The world's largest individual market, China, which now accounts for almost 30% of the global market as a whole, will continue to expand in 2017, albeit at a less pronounced rate of growth. The VDA has predicted growth of 5%, taking the total figure to 24.2 million vehicles. The tax incentives that have been in place since October 2015 with regard to small-engine cars will continue to apply in a downscaled form in 2017. The thriving car market in India is expected to perform more sluggishly in the first half of 2017. This, however, is likely to be followed by a more substantial upturn in the second six months of the year. The forecast for Japan suggests, at most, a marginal increase in sales volumes for 2017.

The protracted recession experienced by the car markets in Brazil and Russia is gradually coming to an end. Russia is expected to see a slight upturn. After a contraction of around 20% in 2016, Brazil should at the very least be able to emulate its prior-year performance.

As regards alternative drive systems, ElringKlinger anticipates that the automobile industry will initially focus in particular on further efficiency gains for combustion engines as well as on hybridization, while at the same time driving forward R&D relating to all-electric vehicles or ones powered by fuel cells. Research within the area of CO_2-neutral fuels, whose production only requires as much CO_2 as is subsequently emitted, may provide a long-term solution for the combustion engine. According to market studies, demand for vehicles fitted with a combustion engine will continue to rise in the short term – reaching an apex of an estimated 90 million engines in the year 2020/21. Germany's Center of Automotive Management (CAM) predicts that the global number of new electric vehicles (pure electric and plug-in hybrids) will have grown by between 2.5 and 6.0% by the same time. CAM forecasts that the electric vehicle market will expand visibly from 2020 onward, fueled by a product offensive by global car makers as well as by the technical innovations achieved by then and the prevailing market conditions. By 2025, their share of global vehicle sales is expected to have grown to a level of 12 to 25%. In this context, the various markets are likely to progress along different lines. China, already the largest single market for electric vehicles, is well placed to retain its leading role, particularly in view of measures planned by the country's central government.

AROUND 100 E-CAR MODELS

are to be launched by German manufacturers by 2020 according to current plans – at present 30 different models are on sale. From 2019, an electric drive will feature in virtually all model ranges (source: VDA).

No impetus within major truck markets in 2017

The key commercial vehicle markets in Western Europe and the United States are likely to be faced with a challenging year. Having lost more and more of its momentum in 2016, the Western European truck market is likely to see a further slowdown. This forecast is underpinned by the fact that demand for replacements has now been satisfied after years of solid growth and the first adverse effects of the UK's planned exit from the European Union are soon likely to be felt. For Germany, the VDA has predicted a further slight growth in truck sales on the back of the record levels seen in 2016.

Despite a return to stability in terms of order intake towards the end of 2016, the North American truck market will have to contend with a futher downturn in business in 2017. The segment covering heavy Class 8 trucks is expected to decline by 10 to 15%, whereas demand for mid-sized trucks (Class 5–7) may remain stable.

Outlook – Group

Significant dynamism in automotive industry

Developments over the course of the financial year just ended, such as the outcome of the Brexit referendum and economic policy announcements made by the newly elected US administration, have led to heightened uncertainty within the wider economy. Added to this are structural dynamics caused by external factors in the form of ever-stricter emissions standards, new measuring methods, or technological advancement. They have enveloped the entire automotive industry. According to studies, the market will see not only a further rise in the number of vehicles produced around the globe but also a shift in focus towards vehicles powered by alternative drive systems, such as hybrids and all-electric vehicles. There remains uncertainty as to the extent and speed of this transition. Therefore, deriving projections for the company itself is difficult. Fundamentally, however, ElringKlinger predicts that growth within the global vehicle markets will remain solid, without being accompanied by any particularly significant factors that may impact on the world economy.

Sustained efforts in research and development

Drawing on its broad portfolio of innovative products, ElringKlinger is very well positioned when it comes to embracing the inevitable transition of drive technologies. In order to be able to defend this vantage point in profitable niche markets well into the future, the Group remains committed to channeling around 5 to 6% of its revenue (having accounted for capitalization) into efforts within the field of research and development.

Revenue growth fueled by buoyant orders

Brimming order books prove that ElringKlinger is a sought-after partner and supplier. In the financial year just ended order intake, i.e., the unit volumes requested by customers as part of their production scheduling, was expanded by EUR 78.4 million, or 4.9%, to EUR 1,693.7 million. Excluding currency effects, the growth figure within this area was as high as EUR 126.0 million or 7.8%. As a result, order backlog at the end of the year was up by EUR 136.3 million, or 17.1%, taking the figure to EUR 932.5 million (FX-adjusted: by EUR 143.8 million, or 18.1%, to EUR 940.0 million).

With expectations underpinned by this substantial order backlog, the Management Board of ElringKlinger anticipates that it will be in a position to further expand sales revenue, depending on the direction taken by the global automobile markets. This is supported above all by planned ramp-ups in connection with high-volume orders within the Lightweighting/Elastomer Technology division, sustained buoyancy in orders within the Shielding Technology division, and a robust performance within the other areas of business. Overall, therefore, the Group is expecting to exceed by 2 to 4 percentage points the projected rate of expansion in global vehicle production, calculated on the basis of the Group's annual organic revenue growth in the short and medium term. ElringKlinger's forecast for 2017 suggests that the global automobile market will expand by 1 to 2% year on year. Based on medium-term market projections of 2% p.a. on average, the Management Board predicts that this upward trend could help to drive ElringKlinger's annual revenue, for the first time, to a figure in the region of EUR 2 billion by the year 2020.

Given the complexity of influencing factors, the effects associated with foreign exchange rates are difficult to predict. In the financial year just ended the direction taken by exchange rates had an adverse effect on sales revenues as a result of factors relating to currency translation. Given the geopolitical and economic challenges ahead, e.g., Brexit negotiations, a more protectionist stance worldwide, or a greater risk of terrorist attacks, it is conceivable that the same may occur in 2017.

Acquisitions are again a possibility in the 2017 financial year, with management reviewing its options on a continual basis. The focus here is on enterprises that underpin ElringKlinger's positioning particularly in the area of new drive technologies. Essentially, corporate targets should either suitably complement the existing product portfolio or facilitate improved market entry. It is unlikely that the scope of such transactions will exceed that of previous activities by a considerable extent.

Higher prices on commodity markets

Among the key determinants of the cost of sales are expenses relating to materials and personnel. While ElringKlinger enters into long-term supply agreements as a fundamental hedge against short-term market fluctuations, it is not completely immune to sustained price trends in particular. Due to the reductions in

supply resulting from the duties imposed on steel imports from China and Russia, rising prices are again expected in the steel market in 2017. The increase is also evident in the rising prices of the alloy surcharges for high-grade steels. As far as aluminum is concerned, ElringKlinger expects prices to remain stable in 2017. As regards the procurement of plastic granules, which are used in the Lightweighting/Elastomer Technology division, the Group also anticipates that prices will increase in the second half of 2017 in the wake of a potential rise in oil prices. Therefore, compared to 2016, the overall cost of materials is expected to rise during the current financial year.

Headcount up as a result of sustained growth

The level of revenue growth targeted by ElringKlinger will necessitate an expansion in the personnel base. In this context, the Group is committed to ensuring that any increase in staffing levels is handled in such a way as to ensure that costs are streamlined and processes are optimized. The aim here is to keep the percentage increase in the Group's headcount below its percentage growth in revenue. Given the production ramp-ups planned for the new sites in the United States, Hungary, and China, these countries in particular are expected to see an expansion in staffing levels.

Striving for earnings improvement

ElringKlinger is expecting to see an improvement in earnings before interest and taxes (EBIT) for the current financial year. This will be driven by two key factors in particular. First, the higher levels of revenue anticipated by the company should have a positive impact on earnings. Secondly, it would appear likely that the measures introduced by the Management Board have brought stability to the earnings performance of the Swiss subsidiary affected by capacity constraints. In particular, the decision to transfer certain areas of production from Switzerland to Hungary should provide the Swiss site with the necessary room for maneuver when it comes to optimizing gradually its level of fixed operating costs over the coming three years. The Group estimates that the positive effect on earnings will be around EUR 10 million in the current financial year, with this projection being dependent on customer approvals that have yet to be obtained and the thus resulting speed of migration. In total, the EBIT margin (before purchase price allocation) is expected to be around 9 to 10% in 2017.

Supported by an improvement in earnings at the Swiss subsidiary, the steady increase in revenue anticipated by the company, and an evolving product mix, the Group will see its earnings performance strengthen further in the years ahead. With this in mind, the Group is targeting an EBIT margin (before purchase price allocation) of around 13% in the medium term.

Targeted investments

ElringKlinger has been expanding its global production network in recent years, the aim being to exploit as rapidly as possible any opportunities arising from globalization within the automotive supply sector. Against this backdrop, the investment ratio (investments in property, plant, and equipment and in investment property relative to Group sales revenue) was relatively high again in 2016, reaching a level of 11.0% (11.7%). As for the 2017 financial year, ElringKlinger will be looking to scale back this ratio slightly. In this context, the company is committed to a thorough assessment of all measures as regards their necessity, the timing of execution, and the funding required. In the medium term, the Group plans to reduce its investment ratio to around 9%.

In 2016, work commenced on the construction of a new logistics facility at the Group headquarters in Dettingen/Erms, Germany, for the purpose of freeing up space for additional production lines in the existing buildings. Operations at the new facility are scheduled to begin in mid-2017. At the same time, the Group is expanding its production capacity in Kecskemét, Hungary. Alongside shielding parts, a new factory to be established at this site will manufacture, from the end of 2017 onward, door module carriers for the compact-class vehicle produced by a global car company. To meet the requirements of this large-scale order, a production plant will also be established in central China, while the site in Mexico is to be expanded.

In the NAFTA region, the Group established a new site in Fremont, USA, during the financial year just ended. Production of cross-car beams, the focus of a second large-volume contract, will commence at this site in mid-2017. Thanks to its diversified network covering a total of five production sites in the NAFTA region, the Group is also able to respond with a certain degree of flexibility to protectionist developments in North America and any repercussions that may result.

Optimized working capital

The strategic decision to integrate tool engineering within the Group is to be seen as an important factor in ElringKlinger's success. As a result, the company is in a position to implement innovative methods of process engineering in a manner that is cost-effective and tailored precisely to its requirements. At the same time, this competitive advantage has an impact on the Group's working capital insofar as tools that have been produced and deployed for the first time but have yet to be billed have an accretive effect on inventory levels. In terms of industry comparisons, this produces a relatively high ratio with regard to working capital. Irrespective of this, the company has initiated measures aimed at optimizing its procurement processes and stock volumes. This program, in conjunction with consistent receivables management, will have a positive impact on net working capital (inventories and trade receivables less trade payables) in 2017 and will produce a slight improvement in the corresponding ratio (as a percentage of Group sales revenue). In the medium term the Group plans to improve this ratio by 1 to 2 percentage points compared to fiscal 2016.

Positive free cash flow in sight

Against the backdrop of relatively large investments and the strain on earnings at the Swiss subsidiary, in particular, operating free cash flow has had little chance of gathering momentum in recent years, although the financial year just ended did produce a tangible improvement within this area. The Group is confident that measures implemented for the purpose of optimizing the structure of fixed costs at the Swiss subsidiary, together with its projections for profitable revenue growth, will pave the way for a sustained improvement in earnings. At the same time, the company anticipates that the financial efficiency programs put in place will lead to a reduction in its net working capital ratio. Therefore, operating free cash flow is expected to increase further. Taking these factors into account, ElringKlinger expects operating free cash flow to be just within positive territory in 2017.

Slight improvement in ROCE likely

Due to revenue growth, capital employed will be higher in the current financial year. As the Group also anticipates an improvement in earnings, there is every chance that its return on capital employed (ROCE*) will increase slightly compared to 2016. ElringKlinger continues to have its sights set on a level of 15% in the medium to long term.

Growth-induced debt

As regards its funding policy, the Group applies the principle of operating with a range of different maturities in respect of its liabilities in order to be able to react flexibly to interest rate changes or to financing requirements. As a result of growth, net financial liabilities, which stood at EUR 538.8 million as of December 31, 2016, will again expand slightly (before acquisitions) in the current financial year.

Ultimately, the Group anticipates that its equity ratio, which amounted to 47.2% at the end of 2016, will not change significantly in 2017. The Group assumes that it will remain well within the short- and medium-term target range of 40 to 50%.

Original Equipment segment: further revenue growth

More than 80% of Group sales revenue is generated within the Original Equipment segment. While the Cylinder-head Gaskets division is likely to stagnate somewhat in terms of revenue in 2017, the Lightweighting/Elastomer Technology division is expected to produce structural revenue growth that should be visibly higher than that estimated for the Group, with ramp-ups for new large-volume orders alone providing a noticeable boost. In the medium term, too, this division will expand at an above-average rate. The Specialty Gaskets division should see a moderate increase in revenue, while the Shielding Technology division is expected to grow at a rate comparable more or less to that estimated for the Group as a whole.

Overall, therefore, the Original Equipment segment is likely to see its revenue expand – both in the current financial year and in the medium term – by a figure that is 2 to 4 percentage points higher than the rate of growth in global vehicle production. As the individual divisions contribute to segment earnings to varying degrees, the company anticipates that the margin within this segment as a whole will be slightly below the Group average.

* Cf. glossary

Engineered Plastics segment: growth in various markets

Operating with a broad portfolio of products, the Engineered Plastics segment serves a wide range of industries. Alongside the automotive sector, it also supplies customers in the area of medical technology, mechanical engineering, chemicals, and aerospace. Therefore, the revenue forecast for this segment is based on projections for a wide range of target markets. In a fundamentally volatile market environment the segment will be targeting growth at a level comparable to that estimated for the Group as a whole. In this context, the Group anticipates that the European markets will provide the greatest forward momentum in terms of absolute figures, while the Chinese and US markets are likely to generate strong percentage growth. The thus resulting earnings contribution in particular should lead to a slight improvement in EBIT for 2017.

Aftermarket segment: expansion into new markets

Within the Aftermarket segment, the regions of Germany, the Rest of Europe, and the Middle East account for the largest share of revenue. Over the course of many years, the company has worked hard at establishing a strong position in its home market of Germany by driving forward the "Elring – Das Original" brand. The aim is to expand further not only at a domestic level but also in other European countries. Efforts to implement this strategy, however, are being hampered to some extent by the steady rise in competition.

In Eastern Europe the segment is benefiting from the higher average age of vehicle fleets as well as subdued consumer spending on new cars, particularly with Russia and the neighboring countries having suffered a period of economic malaise in the wake of regional conflicts. A further depreciation of the local currencies in Russia and Ukraine could have an additional impact on revenue, whereas the large proportion of models sold by Western car makers may act as a supportive element when it comes to aftermarket business in the other Eastern European countries.

Aftermarket sales in the Middle East are being driven by the relatively high average age of vehicles and the severe stresses and strains to which such vehicles are exposed. However, geopolitical challenges and the relatively low price of oil are slightly detrimental to business in a market environment that, essentially, can be considered favorable. Indeed, the economic performance of this region as a whole is being dampened by the two factors outlined above.

Expansion in the Asian markets – particularly in China – and in North America offers significant short- and medium potential for growth within the Aftermarket segment. Until now, ElringKlinger's aftermarket business has been represented only to a small extent or, indeed, not at all in these sales regions. At the same time, the automobile markets in these regions in particular have grown substantially in recent years. Therefore, market entry or expansion would allow the company to tap into nascent maintenance cycles that are associated with such structural growth.

Overall, the Aftermarket segment is targeting revenue growth of around 4% in 2017. In line with the trend seen in recent years, its EBIT margin is expected to lie above the Group average.

Parent company ElringKlinger AG: slight growth in revenue

The parent company ElringKlinger AG accounts for about one-third of Group sales revenue. As global growth is being supported mainly by the Asian automobile markets, while the North American market is consolidating its position at a high level, the Group looks set to expand primarily through its foreign subsidiaries. Revenue growth attributable to the parent company, by contrast, is likely to be 3 to 5 percentage points above global market growth in 2017. This growth is underpinned by solid order books. Order backlog as of December 31, 2016, stood at EUR 342.4 million, up on the prior-year figure of EUR 318.8 million.

Additional sales revenue as well as productivity gains are expected to have a positive impact on earnings, even though factors such as approved wage increases and projected increases in material-related costs will in turn have a dampening effect on earnings. Overall, the parent company's EBIT margin is likely to be at a level similar to that recorded in 2016.

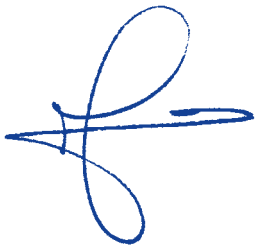
GROUP GUIDANCE SUMMARY:

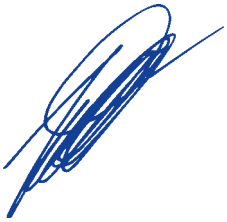
Outlook for 2017		Actual 2016
Significant financial control criteria:		
Sales revenue	Organic growth of 2 to 4 percentage points above global market growth	2 percentage points above market
EBIT	Margin before purchase price allocation of around 9 to 10%	9.0%
ROCE	Slight year-on-year improvement	8.7%
Other control criteria and indicators		
R&D costs	Around 5 to 6% of Group revenue when accounting for capitalization	4.8%
Investments*	Below prior-year level (as ratio in % of Group revenue)	11.0%
Net working capital	Below prior-year level (as ratio in % of Group revenue)	33.7%
Operating free cash flow	In slightly positive territory	EUR -3.8 million
Equity ratio	40 to 50% of total assets	47.2%

Medium-term targets		Actual 2016
Sales revenue	Organic growth of 2 to 4 percentage points above global market growth	2 percentage points above market
EBIT	Margin before purchase price allocation of around 13%	9.0%
ROCE	15%	8.7%
Investments*	Around 9% of Group revenue	11.0%
Net working capital	Improvement in ratio (in % of Group revenue) by 1 to 2 percentage points compared to 2016	33.7%
Equity ratio	40 to 50% of total assets	47.2%

* Investments in property, plant, and equipment and investment property

Dettingen/Erms, March 23, 2017
The Management Board





Dr. Stefan Wolf
CEO

Theo Becker

Thomas Jessulat