

## 1.3 Group strategy and management

### Strategy “Mobility for tomorrow”

The Schaeffler Group is a global automotive and industrial supplier. Top quality, outstanding technology, and exceptionally innovative spirit form the basis for the continued success of the company. By delivering high-precision components and systems in engine, transmission, and chassis applications, as well as rolling and plain bearing solutions for a large number of industrial applications, the Schaeffler Group is already shaping “Mobility for tomorrow” to a significant degree.

On November 09, 2016, Schaeffler AG presented its strategy “Mobility for tomorrow” to the public; the strategy was developed over the course of 2016 and was approved by the Board of Managing Directors and the Supervisory Board.

#### Vision and Mission

In its mission, the Schaeffler Group describes the task it is committed to. Underlying the mission are three key concepts: Working in partnership with all customers and business partners, top-level expertise in manufacturing technology, and advanced systems know-how. The Schaeffler Group’s vision and mission mutually complement and amplify each other, with the vision describing the aspirations that will guide the group’s activities in the future.

#### Schaeffler Group mission and vision

No. 019

##### Mission

“Guided by the values of a global family business, we work closely together with our customers as true partners to deliver a compelling value proposition through our best-in-class expertise in manufacturing technology and systems know-how. In doing so, we contribute to the success of our customers, the advancement of our employees, and the prosperity of our society.”

##### Vision

“As a leader in technology, we combine a passion for innovation with the highest standards of quality to shape the future of mobility – for a world that will be cleaner, safer, and smarter.”



#### 4 Focus areas

In developing the strategy, the company identified four megatrends that will influence the business of the Schaeffler Group in the future: Climate change, urbanization, globalization,

and digitalization. The Schaeffler Group is an automotive and industrial supplier of global stature with the expertise and technology to reduce friction and thereby save energy. As such, it feels compelled to meet the challenge of helping the world tackle climate change.

This equally applies to increasing urbanization, which demands new forms of mobility. These are the reasons Schaeffler sees climate change and urbanization as two future trends that are especially important to the company and its business. Globalization is particularly relevant for the Schaeffler Group in an economic context, as is digitalization in the realm of technology. As explained within the context of the Strategic Pillars, the company sees growing digitalization as an important opportunity for further optimizing its business model in the future.

Driven by the four megatrends, Schaeffler defined four areas for action as early as 2014; being an automotive and industrial supplier with global stature, it intends to focus on these four areas for action in the future. Given the variety of the group’s products and services, and the number of industries that it supplies, this is more than a logical step – it is essential if Schaeffler wants to help shape the “Mobility of tomorrow” as a supplier. The four Focus Areas are: “Eco-friendly drives”, “urban mobility”, “interurban mobility”, and “energy chain”. They form the basis for the Schaeffler Group’s strategic direction. They also demonstrate that the company is ready and willing to use and share its knowledge and expertise across divisions.

##### (1) Eco-friendly drives

One of the primary goals of the Schaeffler Group is to develop energy-efficient drive systems with low or zero emissions. In the automotive field, this means on the one hand further optimizing conventional combustion engines, and on the other hand developing drive solutions in the area of E-Mobility, whether for vehicles with hybrid drive trains or for battery electric vehicles. Key components such as variable valve-control systems, the thermal management module, wet and dry double-clutches, and electronic control modules help reduce CO<sub>2</sub> emissions of conventional drives based on internal combustion engines. In addition, for the Schaeffler Group’s automotive customers, innovative products for the field of electric mobility, such as hybrid modules, the electric axle drive, or the wheel hub drive “E-Wheel Drive”, play an increasing role in achieving lower CO<sub>2</sub> emission targets. The same logic can be applied to modern industrial drive systems, where the Schaeffler Group’s wealth of knowledge in the automotive field is essential.

## Mobility for tomorrow

No. 020

**(2) Urban mobility**

The shift in mobility is nowhere as noticeable as it is in megacities across the globe. At the same time, it is nowhere as necessary. Cities like Moscow, Tokyo, or Shanghai experience a daily traffic volume in which fast and flexible movement is almost impossible. At the same time, more and more cities are banning cars from their downtown areas. This trend calls for new mobility solutions, whether in micro-mobility or by designing more efficient public transit. Responding to this trend, the Schaeffler Group is further expanding its product portfolio for hybrid and electric mobility. Its torque sensor bottom brackets, for instance, have positioned the Schaeffler Group as an innovative supplier in the growing e-bike market, and the “Bio-Hybrid” micro mobile and the “Torque Stick Board” nano mobile demonstrate its strong innovative ability in this area.

**(3) Interurban mobility**

The term interurban mobility means interconnecting global centers. As globalization progresses, traffic will increase significantly worldwide over the years to come, particularly rail and air traffic, and require a large degree of flexibility. Providing modern and efficient mobility solutions presents a key challenge to both industries. The same is true for the off-highway sector, including agricultural technology, outside the cities. In this area, the Schaeffler Group and its innovative rolling bearing solutions and exceptional systems know-how are set to lead the market.

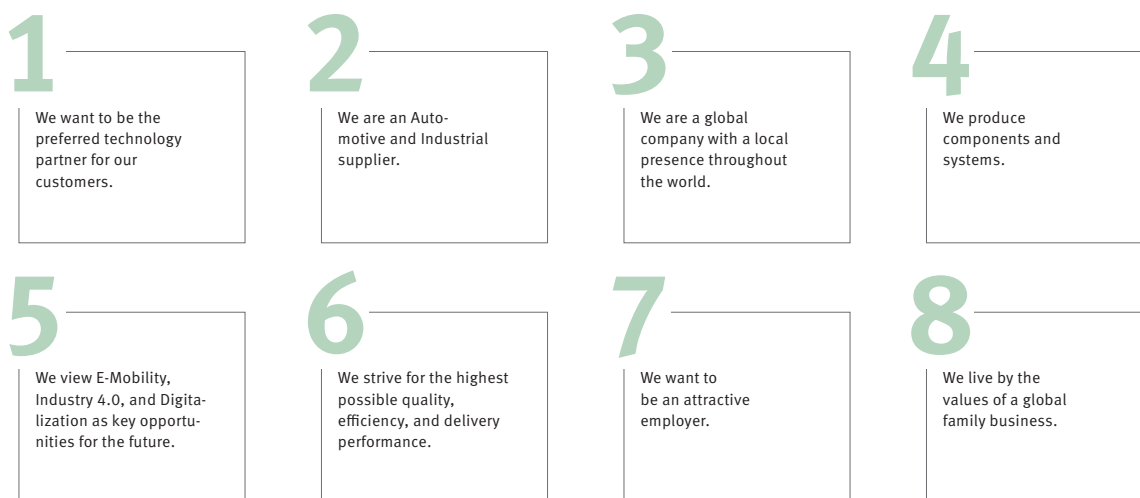
**(4) Energy chain**

Common to all of the Focus Areas mentioned above is the continuing need for the cleanest energy possible. In light of dwindling resources and significant climate challenges, worldwide demand for clean energy is growing. Schaeffler partners with the energy sector, assisting in the development of renewable energy production and focusing on wind power, hydropower, and solar power. In conventional energy generation as well, the Schaeffler Group sees opportunities for expanding its range of products and services. After all, ultimately all segments of the energy chain – from its production to its transport and conversion to energy consumption, must be optimized further. Hence, in addition to conventional energy generation, Schaeffler also offers a comprehensive portfolio of products in the field of renewable energy – from bearing solutions for wind turbines through to solutions for solar and water power.

To transform these considerations into a concrete frame of reference for its customers and business partners, employees and executives as well as family and external shareholders, the Schaeffler Group has defined further elements of its strategy “Mobility for tomorrow” based on the 4 significant megatrends and the resulting 4 Focus Areas. These elements consist of 8 Strategic Pillars defining the company’s scope for strategic action over the years to come, an excellence program comprising 16 Strategic Initiatives that will help execute the strategy, and the Financial Ambitions 2020.

## 8 Strategic pillars

No. 021



## 8 Strategic pillars

The strategy “Mobility for tomorrow” defines the company’s scope for future action and constitutes the basis for the continuous further development of the Schaeffler Group. In order to describe this scope for action in a manner that is specific and easily understood, the company has devised 8 Strategic Pillars that describe what Schaeffler wishes to achieve or further improve in the future.

**(1) We want to be the preferred technology partner for our customers.**

For many years now Schaeffler’s comprehensive systems know-how, cutting-edge technological expertise, and unwavering commitment to customer service have made the company a highly sought-after development partner for its customers in the automotive and industrial sectors. On this basis, the Schaeffler Group will continue to shape the mobility of the future together with its customers.

**(2) We are an Automotive and Industrial supplier.**

The Schaeffler Group is an automotive and an industrial supplier. The two divisions are united by the Schaeffler Group’s worldwide manufacturing excellence and global platform of production facilities combined with economies of scale in purchasing materials and commodities. In addition, Schaeffler’s global research network facilitates cross-divisional technological innovations. Diversification across divisions will continue to generate synergies and promote the transfer of know-how in the future.

**(3) We are a global company with a local presence throughout the world.**

With its more than 170 locations worldwide, 75 production facilities, 17 research and development centers and a tight-knit sales and service network, Schaeffler ensures that the customer always finds it close at hand. For only those who recognize and

understand the challenges confronting their customers can develop tailored solutions. And only those who maintain a local presence are able to respond quickly.

**(4) We produce components and systems.**

Schaeffler supplies components for products that facilitate and promote mobility. At the same time, the company understands and is able to deliver complex modules and complete system solutions. Schaeffler values both business segments equally. And for good reason: Those without expertise in components will not be able to handle the system.

**(5) We view E-Mobility, Industry 4.0, and Digitalization as key opportunities for the future.**

As a leading technology partner, the Schaeffler Group began engaging in the topics of E-Mobility, Industry 4.0, and digitalization years ago and has made these areas a clear priority. As a supplier, Schaeffler wants to take an active role in shaping this development for its customers and considers this a key future opportunity.

**(6) We strive for the highest possible quality, efficiency, and delivery performance.**

Quality is of paramount importance for Schaeffler. It has always had the goal to consistently ensure high quality and product safety in all applications. Another Schaeffler goal is to serve its customers with the highest-possible efficiency and delivery performance.

**(7) We want to be an attractive employer.**

The Schaeffler Group’s employees are vital for guaranteeing its success. Identifying, promoting, and retaining the best team for the Schaeffler Group in the long term is crucial for the successful realization of the company’s strategy. The Schaeffler Group is not only concerned about new employees here. Rather, it wants to be an attractive employer for all of its employees.

**(8) We live by the values of a global family business.**

The Schaeffler Group is a listed family business. A company with a strong foundation of values, established by its founders. Schaeffler particularly identifies with the corporate values “Sustainable”, “Innovative”, “Excellent”, and “Passionate”. These values form the basis for the continued success of the Schaeffler Group for the benefit and in the interest of its customers and business partners, employees and managers as well as its shareholders and family shareholders.

**Four corporate values**

No. 022

**Sustainable**  
A long-term view and continuity will foster the growth of the Schaeffler Group, thereby enabling a future worth living.

**Innovative**  
For (nearly) every problem there is a solution. If not, we will create one!

**SCHAEFFLER**

**Excellent**  
We develop solutions that are of the highest quality based on our extensive expertise.

**Passionate**  
Our biggest driver is our passion for innovative technologies and joint success with our customers.

**16 Strategic initiatives**

Any strategy is only as good as its implementation. In preparing its strategy, Schaeffler has therefore put a great deal of thought into how it can implement its strategy as efficiently and consistently as possible. Building on the positive experience the Schaeffler Group had with its first transformation program “One Schaeffler” drawn up after the change of management in October 2013 and successfully rolled out by the end of 2015, it has developed a tailor-made program of excellence which summarizes its key strategic initiatives in 5 categories. The Schaeffler Group therefore calls its excellence program “Agenda 4 plus One”.

The “Agenda 4 plus One” includes the following 5 categories: Customer focus, Operational excellence, Financial flexibility, Leadership and talent management, and – as “plus One” – Securing long-term competitiveness and value creation. The “Agenda 4 plus One” comprises 16 Strategic Initiatives that have significance worldwide and have been selected from a variety of initiatives.

**“Agenda 4 plus One” categories**

No. 023



Each initiative is the responsibility of a Member of the Executive Board as a sponsor and managed by a project manager. The stated aim is to successfully implement all initiatives by the end of 2020.

“Agenda 4 plus One” will be implemented according to the successfully established project management approach of the program “One Schaeffler”. This approach makes certain that the design, implementation and management of initiatives carried out follow standard rules and criteria, and are supported and accompanied by an independent program organization under the jurisdiction of the Chief Executive Officer.

**16 Strategic initiatives**

No. 024



## Financial Ambitions 2020

The Schaeffler Group has set itself challenging targets for 2020. The company intends to grow its revenue – excluding the impact of currency translation and external growth – by an average of 4 to 6 % p.a. and to achieve an EBIT margin before special items of 12 to 13 %. On this basis, the Schaeffler Group wants to achieve free cash flow of around EUR 900 m by 2020, excluding external growth. Furthermore, the group intends to increase its earnings per share excluding external growth to around EUR 2.00 in 2020. In addition to these operational indicators, it is critically important for the success of the Schaeffler Group to further improve its financial flexibility and the quality of its balance sheet. For this purpose the company has set itself the task of managing the net-debt-to-equity ratio – known as the gearing ratio, the quotient of the two variables – to be less than 75 % by 2020. Moreover, the group is planning to pay out dividends amounting to 30–40 % of the annual net income to its shareholders. Summarizing the Financial Ambitions 2020, the Schaeffler Group wants to maintain and secure in the long term the investment grade rating gained in 2016 as the basis for further growth strategies.

### Financial Ambitions 2020

No. 025

Revenue growth <sup>1)</sup>	Ø 4–6 % p. a. at constant currency
EBIT margin	12–13 % p. a. before special items
Free cash flow <sup>1)</sup>	~ EUR 900 m in 2020
Earnings per share <sup>1)</sup>	~ EUR 2.00 per share in 2020
Gearing ratio <sup>2)</sup>	< 75 % in 2020
Dividend <sup>3)</sup>	30–40 % of net income

<sup>1)</sup> Excluding external growth.

<sup>2)</sup> Net-debt-to-equity ratio (excluding pensions).

<sup>3)</sup> Payout ratio based on net income.

Market assumptions:

Automotive sector: Global growth in passenger vehicle production of 2 %

Industrial sector: Low single-digit growth in global industrial production

All these ambitions can ultimately be merged into one key objective: The Schaeffler Group wants to continue to grow profitably and create sustainable value.

## M&A strategy

Following the successful realignment of its capital structure and its renewed financial flexibility resulting from the reduced level of debt, the Schaeffler Group will no longer rely only on purely organic growth. The company will generally focus on acquisitions related to the future-oriented fields of E-Mobility, Industry 4.0, and digitalization. Smaller acquisitions will serve to expand and strengthen our expertise.

In order to appropriately manage the risks of such an acquisition strategy and to enable long-term active portfolio management, the Schaeffler Group will optimize its group structure and establish a professional M&A process.

In this vein, Schaeffler acquired electric motor manufacturer Compact Dynamics GmbH from SEMIKRON International GmbH at the end of 2016 with a view to strengthening the company's expertise in order to expand its E-mobility activities. At the same time, Schaeffler and SEMIKRON have entered into a cooperation agreement in the field of power electronics. On the other hand, Schaeffler has actively streamlined its production portfolio by disposing of its fine blanking activities in Switzerland and selling Schaeffler Motorelemente AG & Co. KG in Magdeburg.

## Strategy communication

Starting from the results of the Strategy Dialog in mid-July 2016, Schaeffler gathered suggestions and recommendations on strategy considerations from approximately 300 international senior managers in eight "Global Challenge and Feedback Meetings". The strategy "Mobility for tomorrow" and the "Agenda 4 plus One" excellence program were approved by the Supervisory Board at its meeting in October 2016.

Following that, the strategy "Mobility for tomorrow" was presented to the public for the first time on November 09, 2016. The Board of Managing Directors also explained the strategy in person to management and employees at international townhall meetings. This was supported by extensive further communication, especially in the form of a strategy brochure and various focal points in the company's online and print communication. On this basis, the company's strategy and future direction is currently being communicated to individual customers and business partners.

To further convey the strategy to all employees, a comprehensive roll-out plan was prepared for 2017 in order to embed the core elements of the strategy – 4 Focus Areas, 8 Strategic Pillars, 16 Strategic Initiatives and the Corporate Values and Leadership Principles – within the company in a uniform manner for the long term.

## Strategy and planning process

Since 2015, the Schaeffler Group goes through a newly developed annual strategy and planning process comprising three key components, (1) the Technology Dialog, (2) the Strategy Dialog, and (3) the Budgeting Dialog, which sequentially build on each other. As part of this process, the strategy “Mobility for tomorrow” was refined and developed in an extensive dialog with the group’s senior management and the Schaeffler AG Supervisory Board in 2016.

The Technology Dialog takes place in February of each year and primarily deals with the megatrends and the resulting impact on technology and innovation. The time frame considered is 5 to 10 years into the future. Based on the information developed, an “Innovation Radar” is approved containing and prioritizing the initiatives aimed at securing the Schaeffler Group’s profitable growth over a period of five to ten years. However, this requires investing in intangible assets and property, plant and equipment and starting research and development activities early on. The initiatives approved in the Technology Dialog are further refined during preparation for the Strategy Dialog.

The Strategy Dialog takes place mid-year. It focuses on the Schaeffler Group’s business strategy (incl. indicative business plan) for the coming 5 years, the substrategies for the divisions with their strategic business units, the regions, and the functions. A detailed market analysis and an analysis of the initial internal position represent the starting point. Building on these, strategic initiatives are developed from which an indicative business plan can be derived. As part of the process,

the various substrategies are coordinated with each other, prioritized, and added to where necessary.

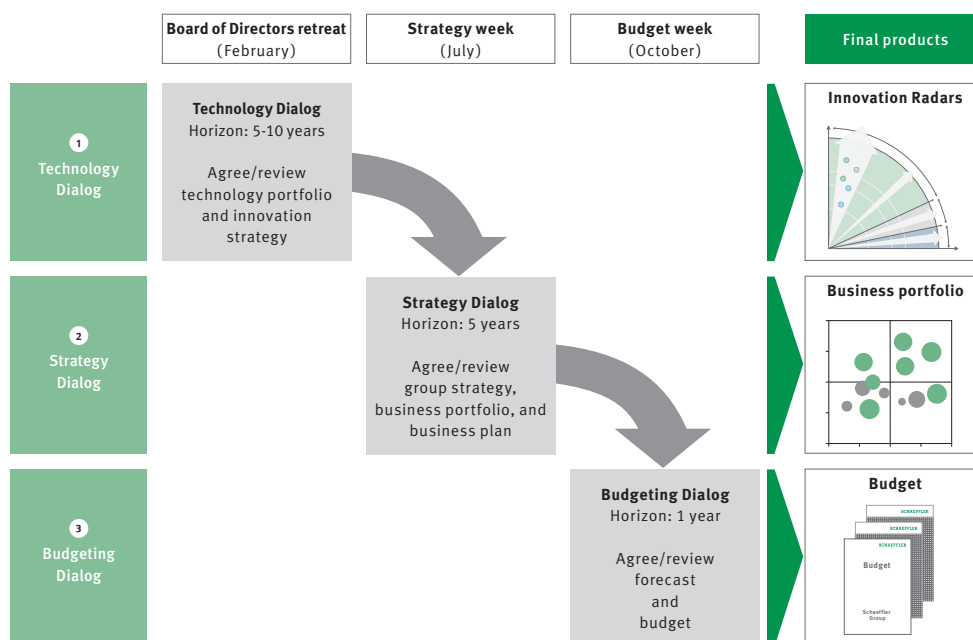
In the 2016 Strategy Dialog, approximately 400 different initiatives of the divisions, regions, and functions were identified and then evaluated and categorized. Initiatives of paramount importance for the Schaeffler Group were combined in the “Agenda 4 plus One” excellence program. The remaining initiatives are implemented and followed-up at the level of the divisions, regions, and functions. This is generally done using the “Agenda 4 plus One” format, and as a result the groupwide program is mirrored, in whole or in part, and populated with various individual initiatives at the level of the various organizational units.

The results of the Strategy Dialog form the starting point for deriving the top-down objectives for the coming budget year. In the subsequent bottom-up process, the objectives are broken down in detail, validated on a bottom-up basis and the overall plan adjusted if necessary. During the Budgeting Dialog in October, the Executive Board approves the detailed budget for the first planning year.

The results of the strategy and planning process are presented and approved at the following meeting of Schaeffler AG’s Supervisory Board. The results of the planning process represent the starting point for the key financial performance indicators discussed in the report on expected developments and become part of the agreed objectives of the Managing Directors and management.

### Strategy and planning process

No. 026



## Group management

Schaeffler AG's Board of Managing Directors is directly responsible for managing the Schaeffler Group, setting objectives and the strategic direction, and managing the implementation of the growth strategy. The Supervisory Board of Schaeffler AG appoints, supervises, and advises the Board of Managing Directors.

In 2016, the Schaeffler Group's management utilized a three-dimensional matrix organization consisting of two divisions, five functions and four regions to manage the group's business activities. In the context of this matrix organization, the Schaeffler Group's business is primarily managed based on the Automotive and Industrial divisions. The Automotive division business is divided into the four business divisions Engine Systems, Transmission Systems, Chassis Systems, and Automotive Aftermarket, which operate as profit centers. Management of the Industrial division is primarily based on regions. On this basis, the Europe, Americas, Greater China, and Asia/Pacific regions operate as profit centers responsible for the Industrial business in their respective markets.

The Schaeffler Group's internal management system consists of the annual budget developed based on the strategic framework specified by the Board of Managing Directors, ongoing monitoring and management of financial performance indicators, regular meetings of the Board of Managing Directors and of management, as well as reports provided to the Supervisory Board of Schaeffler AG. Ongoing monitoring and management is based on a comprehensive system of standardized reports on net assets, financial position, and earnings. Discussions at the meetings of the Board of Managing Directors and of management address the results of operations, including the achievement of targets and objectives, as well as the outlook for the year as a whole and any action that may be required.

## Value-based management

The Schaeffler Group manages its business portfolio based on value. The most significant measures used are the strategic performance indicators ROCE (return on capital employed)<sup>1</sup> and Schaeffler Value Added (SVA)<sup>2</sup>. ROCE represents the relationship of EBIT to average capital employed (capital employed) and measures earnings generated in relation to capital employed. As the ROCE performance indicator measures long-term performance, it is not used to manage the Schaeffler Group's operations. Schaeffler Value Added, which is closely linked to ROCE is calculated as EBIT less the cost of capital. It represents a key performance criterion within the framework governing the variable short-term remuneration of the Board of Managing Directors and the remuneration at the next-lower levels of management.

 See chapter entitled "Value management" for further detail.

## Schaeffler Group performance indicators

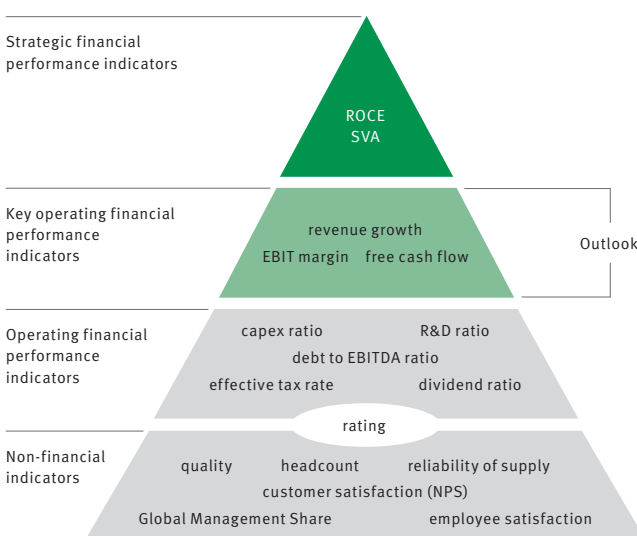
The performance of the Schaeffler Group's business is based on a long-term growth strategy. Group management ensures that the Schaeffler Group is growing profitably while utilizing capital efficiently. Therefore, significant emphasis is placed on the performance indicators revenue growth and EBIT margin. Traditionally, the Schaeffler Group's growth has been financed from internal sources. The primary performance indicator of the group's ability to generate internal financing is free cash flow.

The Schaeffler Group focuses on continually monitoring and optimizing the following three key financial operating performance indicators to measure the economic performance of its business:

- Revenue growth
- EBIT margin
- Free cash flow

### Key performance indicators

No. 027



Operating decisions are based on these three key financial operating performance indicators, as is the outlook. The Board of Managing Directors also continually monitors additional financial operating performance indicators including the capex ratio, R&D ratio, debt to EBITDA ratio, effective tax rate and payout ratio.

All financial indicators are calculated on a monthly basis using standardized reports on earnings, financial position, and net assets. These reports contain a comparison of budget vs. actual as well as a prior year comparison. The comparison of budget vs. actual is based on the annual budget flowing from the integrated

<sup>1</sup> Ratio of EBIT to average capital employed (property, plant and equipment + intangible assets + working capital).

<sup>2</sup> EBIT less cost of capital (average capital employed x pre-tax weighted average cost of capital).

operating budget embedded in a longer-range strategic corporate plan established by the Board of Managing Directors.

The management remuneration system takes these financial performance indicators into account in determining variable short- and long-term remuneration.

In addition to the financial performance indicators, management monitors additional key non-financial indicators. Such indicators are calculated using standardized reports during the year and include: quality, headcount, reliability of supply, customer satisfaction (net promoter score, NPS), Global Management Share, employee satisfaction, and rating.

### Remuneration model

The Schaeffler Group aims to consistently align its corporate values, strategies, structure, management model, and brand image with each other and to focus the entire organization on common goals. A consistent performance-based remuneration system is key to achieving this aim.

When Schaeffler AG's common non-voting shares were listed in October 2015, the remuneration system was adjusted retroactively to January 01, 2015 and consistently oriented toward the Schaeffler Value Added/increasing shareholder value and free cash flow targets. In a subsequent step, the company adjusted the remuneration system for its top executives, applying the same considerations underlying the remuneration system for the Board of Managing Directors. The new remuneration system was introduced with retroactive effect from January 01, 2016.

The targets largely represent the strategic and key financial operating performance indicators, with the latter in turn representing the key performance indicators reflected in the annual outlook. As a result, operating targets are designed to be congruent with the measures comprising the outlook. Shareholders' interests are reflected in the remuneration system by taking into account Schaeffler Value Added (performance criterion for variable short-term remuneration) and the increase in the share price (key component of variable long-term remuneration).

The realignment is designed to create a modern, attractive and motivating remuneration system that is consistent with the values of a global family business and whose key performance measures reflect both the current year's performance and the long-term and sustainable value added.

## 1.4 Employees

Its employees represent one of the key pillars of the Schaeffler Group's success. Their technical knowledge, skills and commitment secure the continuous progress of the company and are essential to the Schaeffler Group's current and future success. The objective of the company's human resources activities is to identify, support, and retain the best employees for the long term in order to safeguard Schaeffler's competitive position.

### HR strategy

In 2016, the Schaeffler Group reassessed its strategic areas within Human Resources (HR) and prepared the HR Roadmap 2020 comprising strategically coordinated initiatives. An overarching HR vision and mission underlying the day-to-day operations were developed, creating a unified identity for the HR function. HR's innovative ability is strongly driven by digitalization, demographics, and diversity and these issues are embedded in the human resources strategy.

At the core of the HR strategy, there are five pillars HR employs to directly support operations:

- Strategic human resources planning process
- Employer branding & recruiting
- Talent management
- Leadership and corporate values
- Training & learning

### Strategic human resources planning process

The strategic human resources planning process integrates the Schaeffler Group's strategic human resources activities into its Strategy and Technology Dialog.

It forms a robust basis for determining quantitative and qualitative staffing requirements for the medium to long-term planning period. Being able to quickly and efficiently determine long-term global staffing requirements is essential for responding to significant changes, such as in the E-Mobility, digitalization, and increasing globalization growth areas.

A pilot project for the hybrid and clutch systems business units uses the results of the strategic human resources planning process as a basis for deciding what actions are required, for instance internal and external recruiting, qualification programs, or in- or outsourcing strategies. These actions enable the Schaeffler Group to identify and actively mitigate risks related to excess personnel or a shortage of staff.