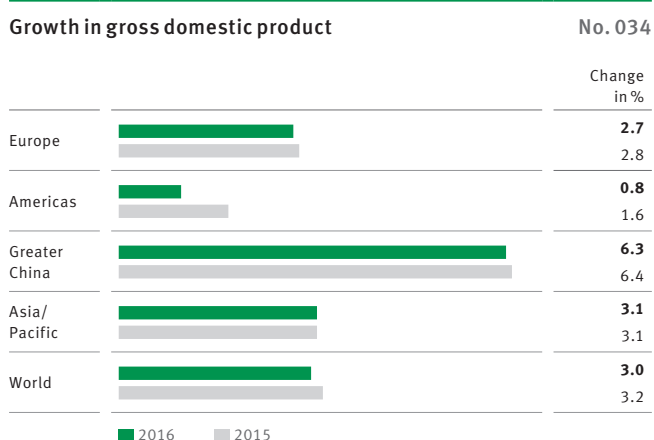


2. Report on the economic position

2.1 Economic environment

Macroeconomic environment

The global economy experienced only moderate overall growth in 2016, despite gathering speed in the latter half of 2016. Global gross domestic product for 2016 was 3.0 % higher than in the prior year (Oxford Economics, January 2017). The Euro region economy continued to recover. Its economic trend remained largely unaffected by the outcome of the referendum in the United Kingdom in favor of leaving the European Union. In the United Kingdom itself, the economy proved more robust than expected following the referendum. Economic activity in the United States improved noticeably during the latter half of 2016, following restrained growth in the first two quarters of the year.



Source: Oxford Economics (January 2017).
Real gross domestic product calculated based on purchasing power parities.
Regions reflect the regional structure of the Schaeffler Group.

In light of further positive employment data and rising inflation, the Fed raised its benchmark interest rate in December 2016. Buoyed by continued government intervention, growth in China stabilized in line with the government's annual target. In Japan, the fundamental economic momentum remained weak.

Economic growth in the Schaeffler Group's Europe region amounted to 2.7 % in 2016. The Euro region continued its economic expansion at a moderate but stabilizing pace. In the United Kingdom, growth once again exceeded that of the Euro region, despite the unexpected outcome of the referendum. Germany reported solid and steady economic growth, primarily driven by private consumption. Although the Russian economy contracted once more, there are indications that the economic situation is improving, helped especially by stabilizing raw materials prices. As in previous years, India, also part of the Europe region, continued to expand rapidly.

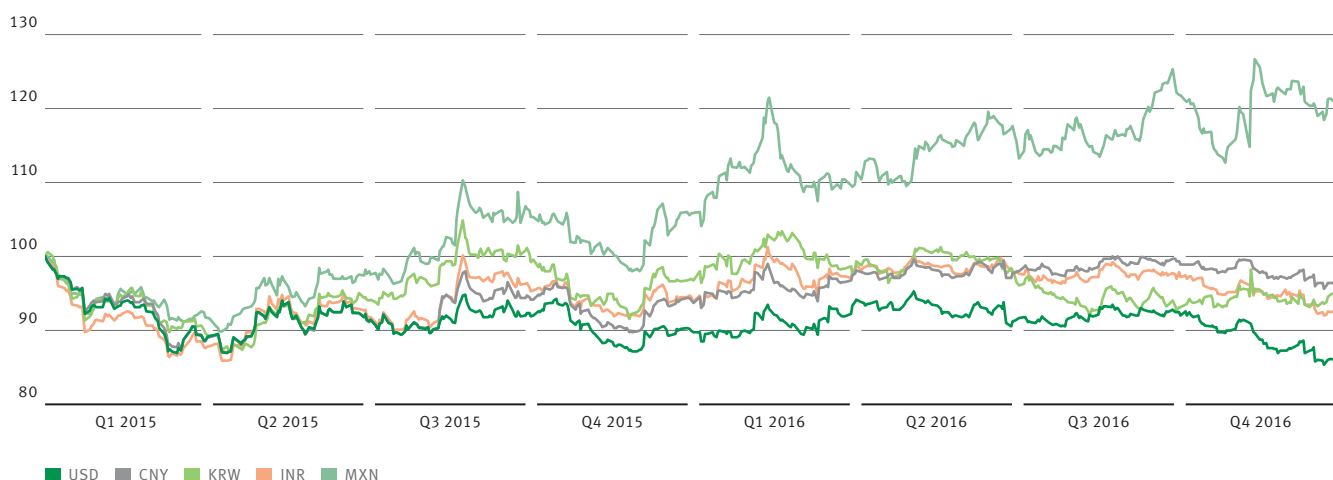
Economic growth in the Schaeffler Group's Americas region amounted to 0.8 %. Following temporarily weaker momentum in the first half of 2016, growth in gross domestic product in the U.S. dropped below the 2 % threshold for the year as a whole. The Latin American economy continued to contract; however, the recovering raw materials prices, among other things, are indications that the recession is coming to an end.

Growth in the Schaeffler Group's Greater China region came in at 6.3 %, once more falling behind the growth rate of the prior year. The reason for the decline was the continuing gradual slowdown in momentum in China, where gross domestic product leveled off at the 6.7 % growth rate targeted by the government.

Currency market trends

No. 035

EUR against selected currencies in percent (12/31/2014 = 100)



Source: Bloomberg.

The economy in the Schaeffler Group’s Asia/Pacific region grew by 3.1 %. In Japan, growth in gross domestic product was weak, while South Korea achieved a slightly higher growth rate than in the prior year. The Indonesian economy proved very dynamic.

In the currency markets, the Euro experienced a mix of trends against foreign currencies significant to the Schaeffler Group. The average rate for the year of the common European currency held its own against the U.S. Dollar. However, the Euro rose slightly against the Chinese Renminbi, the South Korean Won, the Indian Rupee, and the Mexican Peso in terms of the annual average exchange rate.

See Notes to the consolidated financial statements, chapter entitled “Summary of significant accounting policies” – “Foreign currency translation” for further detail.

Sector-specific environment

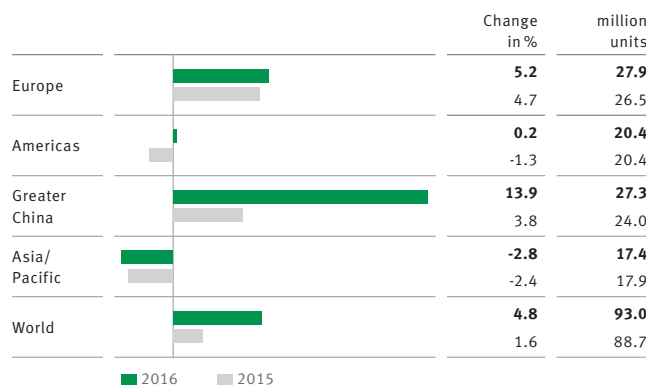
Automobile production

The global business with manufacturers of passenger cars and commercial vehicles represents the group’s most important market segment. Global automobile production, measured as the number of vehicles produced, increased considerably, growing 4.8 % to approximately 93.0 million passenger cars and light commercial vehicles in 2016 (IHS, February 2017).

The Europe region grew significantly by 5.2 %. While India, Spain, France and the United Kingdom saw above-average growth, Germany expanded only slightly. The Americas region experienced a flat trend, growing by 0.2 %. While the U.S. did achieve a slight growth rate of 1.2 %, Latin America once again reported a significant decline. Automobile production in the Greater China region grew very rapidly at 13.9 %, due, among other things, to tax incentives provided by the Chinese government. The Asia/Pacific region contracted once more, with automobile production falling 2.8 % short of the prior year. The largest decline was reported by South Korea.

Automobile production

No. 036

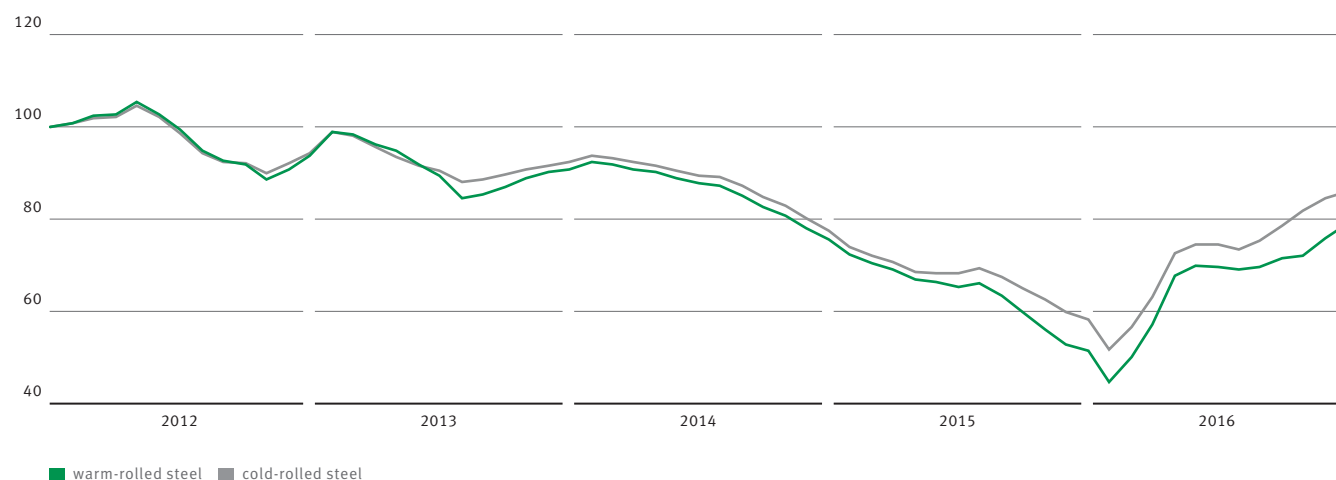


Source: IHS (February 2017). Regions reflect the regional structure of the Schaeffler Group.

Prices of selected steels

No. 037

in percent (12/31/2011 = 100)



Source: Warm- and cold-rolled coil Europe from IHS (\$/metric ton).

Industrial production

Preliminary figures indicate that global industrial production, measured as gross value added based on constant prices and exchange rates, grew only slightly by 1.8 % in 2016 (Oxford Economics, December 2016).

Europe region industrial production increased by 1.9 %. While Germany experienced only a slight growth rate, India reported considerable growth in industrial production. The Americas region (-1.5 %) experienced a contraction as industrial production declined below the prior year level, in the NAFTA countries as

well as in Latin America. The Greater China region saw considerable growth of 5.4 %; however, this rate was once again lower than in the prior year. Industrial production in the Asia/Pacific region gained 1.4 % on the prior year, with a decline in Japan being offset by increases in South Korea, Indonesia, and Australia, among others.

Procurement markets

The Schaeffler Group uses various materials, especially various types of steel, aluminum, zinc, as well as plastics and lubricants. Commodity market price trends generally affect the company’s cost via changes in the cost to manufacturers and suppliers, which, depending on the terms of the relevant contracts, can be passed along to the Schaeffler Group to varying degrees and in some instances with some delay.

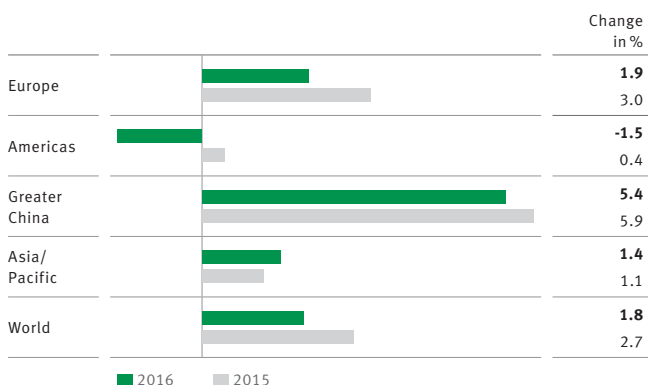
Prices in the procurement markets for all significant input materials increased during the year. However, comparing annual averages to prior year provides a mixed view.

Depending on the source region, average prices for cold- and hot-rolled steel increased by between approximately 5 to just under 20 % compared to prior year. The price of metallurgical coal, an important input material for steel and especially carbon-based castings, rose by approximately 50 %.

Aluminum is primarily used for pressure die castings and stamped and bent parts, while applications for zinc include

Industrial production

No. 038



Source: Oxford Economics (December 2016). Real gross value added in divisions 05 to 39 of the NACE Rev. 2 system. Regions reflect the regional structure of the Schaeffler Group.

coating mechanical components. Copper is mainly required for use in electric motors and mechatronic components. The average price of aluminum for the year declined by a good 3 %, the average copper price by just under 12 %. The price of zinc, on the other hand, was a good 6 % higher than the prior year average.

Apart from steel and non-ferrous metals, the Schaeffler Group also uses plastics and lubricants to manufacture rolling bearings and automotive components. For instance, plastics are used to produce cages for rolling bearings and lubricants are used to reduce friction in components and as preservatives. Plastics and lubricants are often made based on crude oil. Although the crude oil price increased significantly toward the end of the year due to the OPEC agreeing to limit production volumes, its annual average was still more than 10 % below the prior year average. Based on the ICIS Global Petrochemical Index (IPEX), average prices of processed petrochemical products, including the plastics used by the Schaeffler Group, dropped by approximately 4 % compared to the prior year average.

2.2 Course of business

Overview of results of operations 2016

The Schaeffler Group continued moving along its successful course in 2016. Despite the uncertain market environment, the Schaeffler Group continued to grow profitably, maintained its consistently high earnings quality, and significantly increased its free cash flow. The main driver of this performance was the strong Automotive business, which grew faster than the market, i.e. global automobile production of passenger cars and light commercial vehicles. The measures to improve efficiency and reduce costs in the Industrial division were executed as planned.

The Schaeffler Group's **revenue** increased by 1.2 % to EUR 13,338 m (prior year: EUR 13,179 m). Numerous currencies weakening against the Euro had an unfavorable effect on the company's revenue trend in 2016. Excluding the impact of currency translation, revenue rose by 3.4 %. From a regional perspective, strong demand in Greater China was the main contributor to this growth.

Automotive division revenue increased by 3.6 % to EUR 10,333 m (prior year: EUR 9,977 m) in 2016. Excluding the impact of currency translation, revenue grew by 6.0 %. Global production volumes of passenger cars and light commercial vehicles increased by 4.8 % from the prior year comparison period. Thus, the Automotive division's business outpaced the rise in global automobile production, primarily due to the increasing value of Schaeffler products installed per vehicle. The Automotive division benefitted from its strong business with customers, which was buoyed especially by the favorable trend in the Greater China region. The Aftermarket was also very successful.

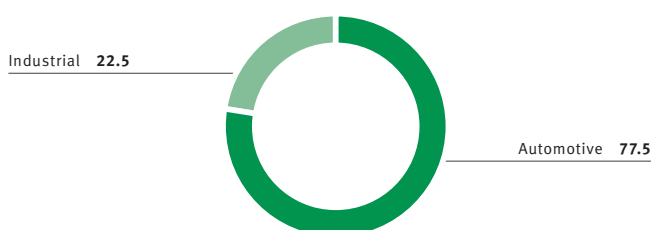
The Industrial division, on the other hand, continued to decline in a weak environment overall. Revenue decreased by 6.2 % to EUR 3,005 m (prior year: EUR 3,202 m) during the reporting period. Excluding the impact of currency translation, revenue fell by 4.8 %. The decrease affected all of the regions. The Greater China region experienced a double-digit decline in revenue, primarily due to weak investing activity in several important sectors.

The Schaeffler Group's **EBIT** grew by EUR 154 m or 11.0 % to EUR 1,556 m (prior year: EUR 1,402 m) during the reporting period, resulting in an EBIT margin of 11.7 % (prior year: 10.6 %). Before special items³ of EUR 144 m, EBIT amounted to EUR 1,700 m (prior year: EUR 1,676 m). The company's EBIT margin before special items was 12.7 % (prior year: 12.7 %). The decline in the Industrial division's margin to 7.0 % (prior year: 9.5 %) was offset by the operating strength of the Automotive division. This division improved its EBIT margin before special items to 14.4 % (prior year: 13.8 %).

Schaeffler Group revenue
by division

No. 039

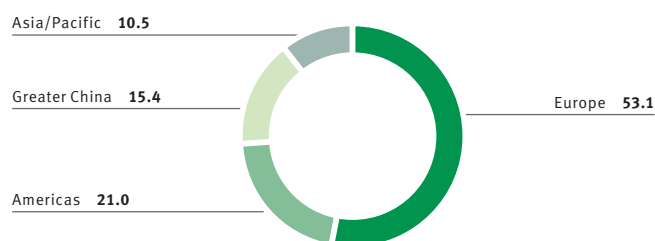
in percent



Schaeffler Group revenue
by region

No. 040

in percent by market view



³ Please refer to page 48 for the definition of special items.