

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.

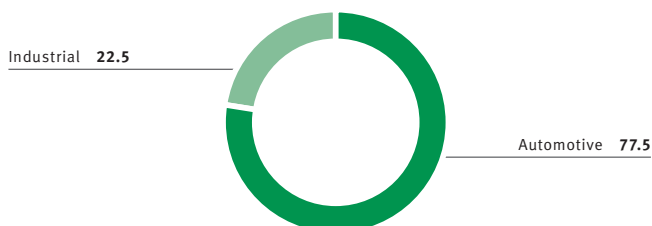
The Industrial division, on the other hand, continued to decline in a weak environment overall. Revenue decreased by 6.2 % to EUR 3,005 m (prior year: EUR 3,202 m) during the reporting period. Excluding the impact of currency translation, revenue fell by 4.8 %. The decrease affected all of the regions. 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

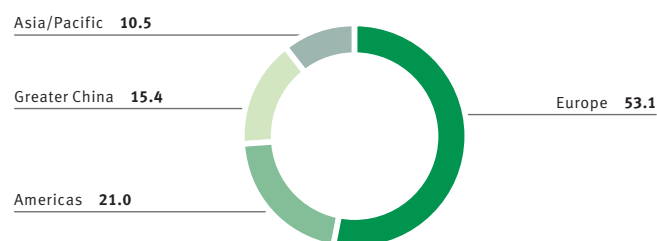
in percent



Schaeffler Group revenue
by region

No. 040

in percent by market view



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

Net income increased by 44.1 % from EUR 605 m to EUR 872 m. Excluding net income attributable to non-controlling interests of EUR 13 m (prior year: EUR 14 m), net income attributable to shareholders of the parent company amounted to EUR 859 m, 45.3 % more than in the prior year (prior year: EUR 591 m). Earnings per common share amounted to EUR 1.29 (prior year: EUR 0.88). Earnings per common non-voting share amounted to EUR 1.30 (prior year: EUR 1.28)⁴.

The Schaeffler Group generated **free cash flow** of EUR 735 m in 2016, EUR 365 m more than the prior year amount of EUR 370 m. The increase was driven by cash flows from operating activities, which rose from EUR 1,372 m to EUR 1,876 m mainly due to lower interest payments and changes in working capital. Capital expenditures (capex) rose from EUR 1,025 m to EUR 1,146 m (+11.8 %) or 8.6 % of revenue (prior year: 7.8 %) in 2016.

ROCE before special items was 21.7 %, slightly below the prior year (prior year: 22.5 %). An improvement in EBIT before special items for the last twelve months did not fully offset the increase in average capital employed, which was primarily driven by higher property, plant and equipment.

Significant events 2016

Schaeffler shares added to MDAX and STOXX Europe 600

On April 05, 2016, IHO Beteiligungs GmbH (until September 28, 2016: Schaeffler Verwaltungs GmbH) placed 94.4 million common non-voting Schaeffler AG shares in an accelerated bookbuild. Since this transaction was completed, 166 million common non-voting shares representing 100 % common non-voting share capital are widely held. The free float amounts to approximately 25 % of Schaeffler AG's total common and common non-voting share capital.

Due to the extensive volume of shares placed, the Schaeffler shares meet not only the high transparency requirements of the Prime Standard, but also the size criteria regarding market capitalization and liquidity that are relevant for inclusion in the MDAX index. Deutsche Börse included Schaeffler AG in its MDAX index effective June 20, 2016. In addition, STOXX Ltd., a subsidiary of Deutsche Börse AG, has included Schaeffler AG in its STOXX Europe 600 index. This change became effective as of the start of trading on September 19, 2016.

Annual general meeting passes resolution to pay a special dividend


Schaeffler AG's first annual general meeting since the listing, which was held on April 22, 2016, passed a resolution to pay a dividend of EUR 0.34 per common share and EUR 0.35 per common non-voting share to Schaeffler AG's shareholders for 2015. This represents a dividend of 28.9 % of net income attributable to shareholders before special items. In addition, the company paid a special dividend of EUR 0.15 per common share and per common non-voting share for 2015.

Capital structure improved

In connection with the successful refinancing transaction completed at the level of IHO Holding, a group of holding companies owned indirectly by the Schaeffler family, rating agency Moody's upgraded Schaeffler AG's company rating to Baa3 (investment grade) on September 07, 2016. Schaeffler AG received approximately EUR 1.7 bn when its loan receivable from IHO Holding was prepaid in connection with the refinancing transaction. As a result, Schaeffler AG has achieved its objective of reducing its debt to EBITDA ratio (net debt in relation to EBITDA before special items) to less than 1.5x by 2018 two years ahead of schedule and significantly increased its financial flexibility. The proceeds of the loan prepayment referred to above were used to redeem one USD-denominated bond series and two EUR-denominated bond series in October 2016.

Program "CORE"

On November 07, 2016, the Board of Managing Directors of Schaeffler AG decided to step up its efficiency measures aimed at revitalizing the Industrial division. Following the first wave of cost reduction measures comprising the program "CORE", which focus on Germany and have largely been implemented, the second wave of measures initiated in November 2016 also covers regions outside of Germany as well as functional areas that are not directly part of the Industrial division. The measures are designed to improve the results of the entire Industrial division for the long-term by further streamlining its structure and reducing production and administrative costs.


 See chapter entitled "Business activities" – Divisions for further detail.

Strategy "Mobility for tomorrow"

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.

⁴ Earnings per share were calculated in accordance with IAS 33. As the common non-voting shares newly issued in October 2015 (66 million shares) participated in profits for the entire year 2015, earnings per common non-voting share for 2015 were calculated using proportionate net income based on 166 million common non-voting shares.

Based on 4 significant megatrends and the resulting Focus Areas (1) eco-friendly drives, (2) urban mobility, (3) interurban mobility, and (4) energy chain, Schaeffler has defined the other elements of its strategy “Mobility for tomorrow”. These elements consist of 8 Strategic Pillars defining the company’s scope for strategic action over the years to come, the excellence program “Agenda 4 plus One” comprising 16 Strategic Initiatives that will help execute the strategy, and the Financial Ambitions 2020.

 For further detail on the strategy “Mobility for tomorrow” at: www.schaeffler.com

 See chapter entitled “Group strategy and management” for further detail.

Business portfolio adjusted

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.

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. Compact Dynamics GmbH based in Starnberg, Germany, is a development specialist in the field of innovative electric drive concepts with a focus on high-performance drives and integrated lightweight construction in small volume production and motor sport applications. At the same time, Schaeffler and SEMIKRON agreed to cooperate on developing power electronics systems and integrating power electronics components. The acquisition and the collaboration expand Schaeffler’s expertise in the field of electric motors and power electronics for developing and manufacturing electric drives, opening up new opportunities for growth. On the other hand, Schaeffler has proactively streamlined its production portfolio by disposing of its fine blanking activities in Switzerland and selling Schaeffler Motorenelemente AG & Co. KG in Magdeburg.

Changes in Board membership

At its meeting on March 11, 2016, Schaeffler AG’s Supervisory Board appointed Matthias Zink to the Board of Managing Directors of Schaeffler AG and the position of Co-CEO of the Automotive division effective January 01, 2017. Matthias Zink will succeed Norbert Indlekofer, whose contract was not extended at his own request. The Supervisory Board also decided to extend the contract of Prof. Dr. Peter Pleus, also Co-CEO of the Automotive division, by a further two years until December 31, 2018.

Results of operations compared to outlook 2016

The Schaeffler Group has achieved its outlook for 2016.

Comparison to outlook 2016

No. 041

	Actual 2015	Outlook 2016	Actual 2016
Revenue growth compared with prior year ¹⁾	3.5 %	3 to 5 %	3.4 %
EBIT margin before special items	12.7 %	12 to 13 %	12.7 %
Free cash flow	EUR 370 m	~ EUR 600 m	EUR 735 m

¹⁾ Excluding the impact of currency translation.

The Schaeffler Group had issued guidance regarding revenue growth of 3 to 5 % for 2016, excluding the impact of currency translation. This guidance was based on the expectation that its Automotive division would continue to grow faster than global automobile production of passenger cars and light commercial vehicles in 2016. The company also assumed that its Industrial division would experience flat or slightly declining revenue levels in 2016, as the economic environment in certain sectors was still strained. Excluding the impact of currency translation, the Schaeffler Group’s revenue grew by 3.4 % in 2016. Thus, Schaeffler has met its revenue target for 2016. Excluding the impact of currency translation, the Automotive division increased its revenue by 6.0 % from 2015, outpacing the global production of passenger cars and light commercial vehicles which grew by 4.8 % in 2016. The Industrial division, on the other hand, reported a decline in revenue of 4.8 % in 2016, excluding the impact of currency translation.

The Schaeffler Group generated an EBIT margin before special items of 12.7 % in 2016. Thus, the return for 2016 remained high, falling in the top third of the range of 12 to 13 % contained in the outlook.

Free cash flow for 2016 amounted to EUR 735 m, considerably higher than the outlook for 2016 of approximately EUR 600 m. The reason was improved cash flow from operations.