COMMENTED SLIDES / CONFERENCE CALL PRE-RELEASE Q3 2018

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Schaeffler AG
Pre-Release Key Financials Q3 2018 – FY 2018 Guidance Adjustment

Conference Call
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Herzogenaurach

Company Representatives

Klaus Rosenfeld, CEO
Dietmar Heinrich, CFO
Renata Casaro, Head of Investor Relations

Conference Call Participants

Raghav Gupta-Chaudhary - *Citigroup Inc.*
Henning Cosman - *HSBC*
Kai Alexander Mueller - *BofA Merrill Lynch*
Sascha Gommel - *Crédit Suisse AG*
Julian Radlinger - *UBS Investment Bank*
Tim Rokossa – *Deutsche Bank*
Manuel Tanzer – *equinet Bank AG*

Operator

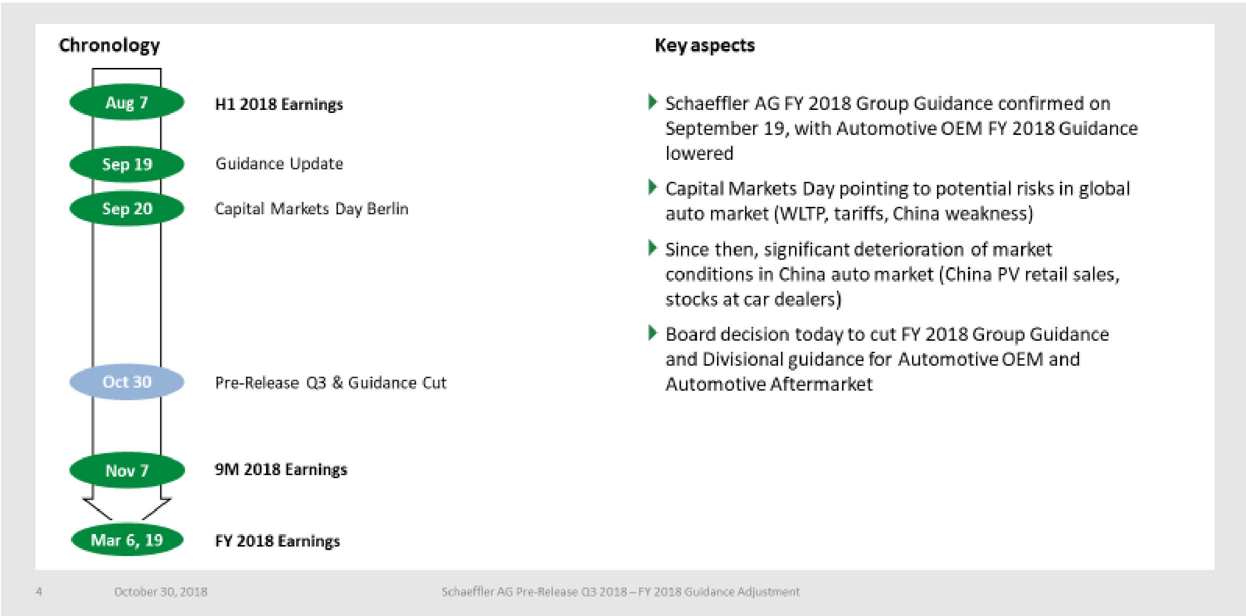
Dear ladies and gentlemen, welcome to the Schaeffler AG conference call. At our customer's request, this conference will be recorded. (Operator Instructions)
May I now hand you over to Mrs. Renata Casaro, Head of Investor Relations, who will lead you through this conference. Please go ahead, madam.

Renata Casaro

Thank you very much, operator. Good afternoon. Thank you very much for joining this conference call, which will be conducted under the disclaimer.
In the room here in Herzogenaurach are Mr. Klaus Rosenfeld, CEO of the Schaeffler AG; and Mr. Dietmar Heinrich, CFO; and the IR team. Without further ado, I pass the floor to Mr. Rosenfeld.

Klaus Rosenfeld

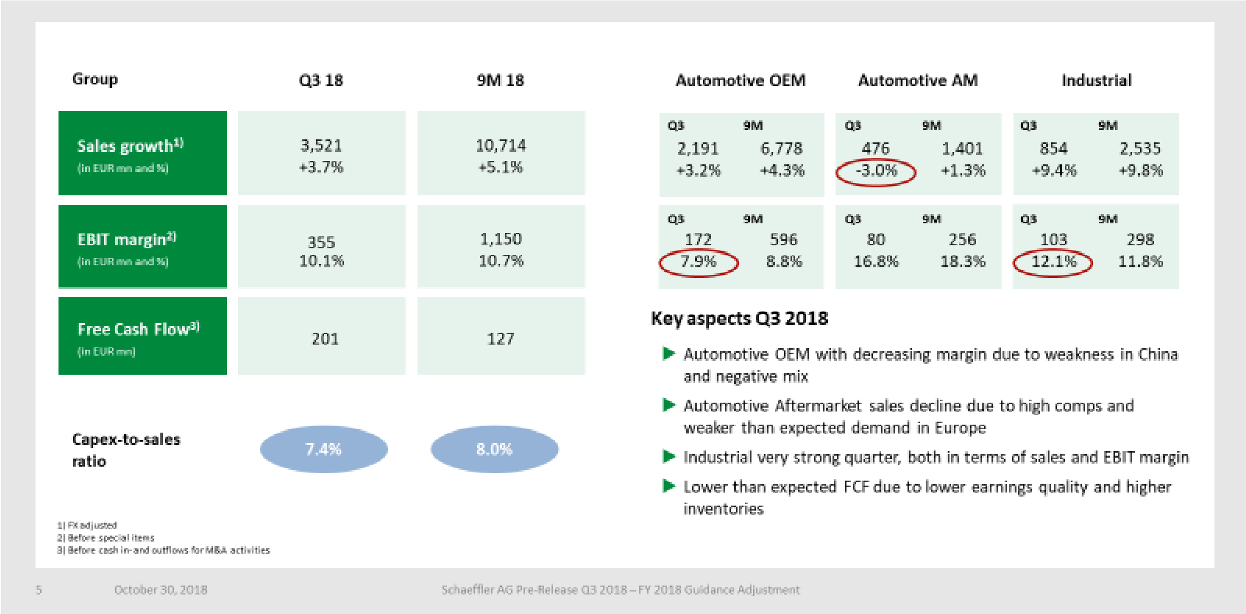
Thank you, Renata. Ladies and gentlemen, thanks for joining this call. The call is clearly unplanned, and you may wonder about the timing of this call. Let me clearly point out at the beginning that according to German regulations and capital market rules, the timing of this call was not our choice. The event that triggered the call was the finalization of our Q3 results that was discussed yesterday in the board meeting and this morning together with a latest review of our forecast, where we had incorporated the latest developments in the market. The forecast with these latest developments clearly called for a revision of the guidance also in group level. And according to the rules that I just mentioned, that had to be communicated immediately. That was the reason for the ad hoc message this morning. We invited you to this call because we want to give you a little bit of color what is behind this, and in particular, what has changed since the Capital Markets Day on the 20th of September in Berlin.



Please follow me to Page 4 of the little presentation, and you'll find the chronology and the key aspects. Just to refresh your memories on the -- one day before the Capital Markets Day, on the 19th of September, we confirmed our group guidance but lowered already at that point in time the guidance for our Automotive OEM business, from 6% to 7% to 4.5% to 5.5%. That was triggered on the divisional level by lower demand expected from Greater China and also lower demand from Europe in a situation that, at the time, was clearly also negatively impacted by the WLTP issues and by the uncertainties associated with the trading -- the trade tariff issues.

Now 6 weeks later, end of October, we are experiencing, and I think we are not the only ones, an even accelerated deterioration of the Chinese auto market that led us to further adjust the guidance for Automotive OEM from 4.5 to 5.5 percentage points to 3.5 to 4.5 percentage points. On top of that, we saw in the Q3 results an unexpected weakness in Automotive Aftermarket sales, where the forecast indicated that, that cannot be overcompensated in Q4. That led us to adjust the guidance for Automotive Aftermarket from 3% to 4% sales growth to 1.5 to 2.5 percentage points.

While our Industrial division, as you see from the presentation, performs better than expected in Q3, it also shows a favorable trend for Q4. The performance of the Industrial business was not as strong that it could overcompensate or compensate even the 2 effects that I just mentioned. And that led, much to our regret, to the fact that we have to cut our guidance for the group level. The major risk for this was the development, the market deterioration in auto OEM in Greater China.



Before I come to the explanation, what we did on the guidance, again, let me quickly use the opportunity to outline the major key performance indicators for Q3. You see on Page #5, Q3 as such, 3.7% growth was -- leads to 5.1% in the first 9 months 2018. So in the first 9 months, lower end of the previous guidance, a EBIT margin of 10.1% in Q3, leading to 10.7% in the 9 months; and then a free cash flow in the quarter of EUR 201 million based on a CapEx-to-sales ratio of 7.4%, or for the first 9 months of around 8%.

While we clearly will give more detail on Q3 on our 7th of November call, quickly on the 3 divisions and only on the numbers that are circled in red, the disappointing number in Q3 was clearly auto OEM, with 7.9% margin clearly triggered by the fact that we had these difficult market conditions in China where our business is clearly a high-margin business. Automotive Aftermarket was a minus 3% in Q3, as I said, unexpected. While the high margin and the high profitability could be maintained at 16.8% on the first 9 months, clearly still cruising above the upper end of the range. And Industrial with a strong result, both in terms of growth 9.4% and 12.1% margin, what is even better than in the previous quarters. The lower-than-expected free cash flow, and that's clearly one of the numbers that we are focused on, was due to the lower earnings quality but also to higher inventories that could not be adjusted as part of the sales development happened.

Let me add one more number that you may find interesting also, comparing this to our peers. Outperformance for the group in Automotive OEM in the first quarter [IR Note: 3rd quarter] was at 5.2% for the whole Automotive OEM business. That resulted from 5.8% outperformance in China, 7.7% outperformance in the Americas and 4.9% outperformance in Europe, while Asia Pacific is not really meaningful. So you see in that quarter, we were still running above our 4%, but we have to say in that again triggered the guidance change that our expectations for Q4, in particular from China, are below what we thought. The year will come to an end in August and when we gave you the 19th of September confirmation.

3 New Guidance FY 2018

New Guidance FY 2018 – Automotive OEM triggers downward revision

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	Group Guidance		Divisional Guidance		
	Old[4]	New[5]	Automotive OEM	Automotive AM	Industrial
Sales growth[1] (in %)	+5-6%	+4-5%	+3.5-4.5% (before 4.5-5.5%)	+1.5-2.5% (before 3-4%)	+8-9%
EBIT margin[2] (in %)	10.5-11.5%	9.5-10.5%	8-8.5% (before 8.5-9.5%)	17-17.5% (before 16.5-17.5%)	10.5-11.0% (before 10-11%)
Free Cash Flow[3] (in EUR mn)	EUR ~450 mn	EUR ~300 mn			

Market assumptions[5]

- Automotive: Global Light Vehicle production growth **revised down from around 2% to around 0.5%**
- Automotive Aftermarket: Stable growth in the global vehicle population and a nearly unchanged average vehicle age
- Industrial: Similar growth rate of industrial production in 2018 compared to 2017

1) FX adjusted
2) Before special items
3) Before cash in- and outflows for M&A activities
4) As of September 19, 2018
5) As of October 30, 2018

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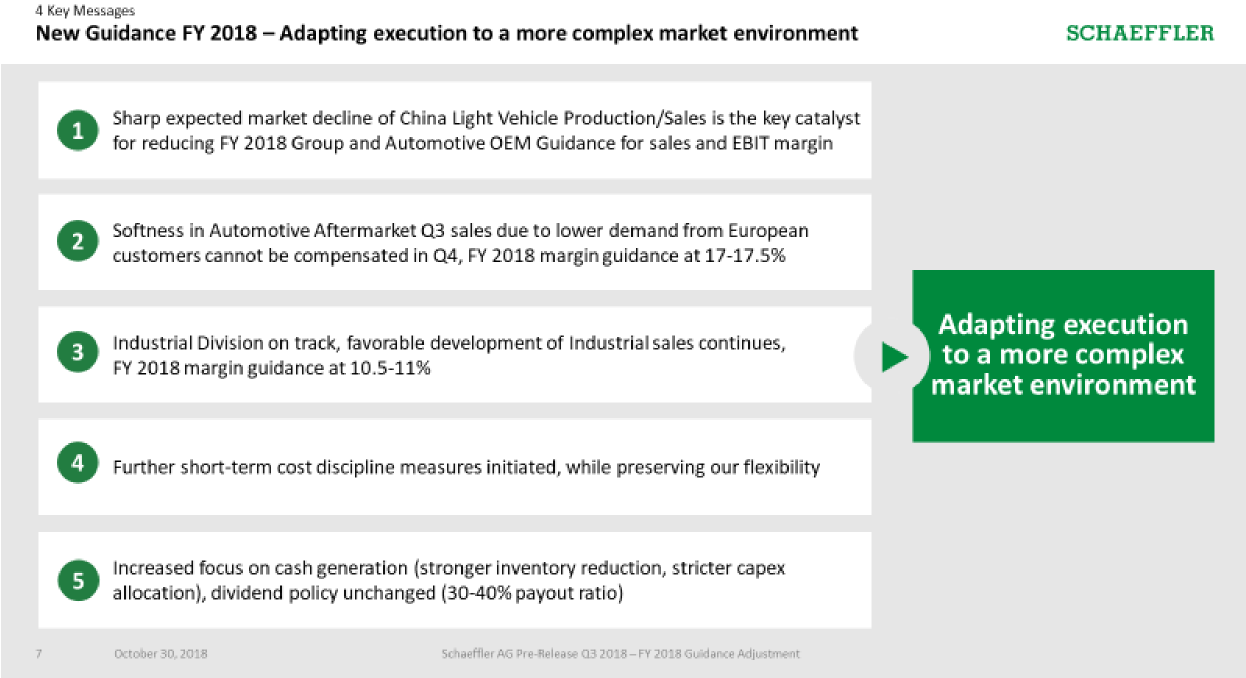
Let me go to Page #6. Here you see the new guidance figures listed and give you some color how this all can be explained. You see on the sales guidance, more or less, you all know that we are typically guidance -- guiding to the midpoint of the range on the sales side. You see that it's basically 1% less sales growth. You can easily calculate what that means in terms of overall sales. And the predominant part of that comes from China OEM. Also Automotive Aftermarket contributed a smaller 2-digit-million number, and then there's some positive effect from other businesses.

On the EBIT margin side, also, 1 percentage point down. There, the -- you have to take into account that we already, in 8+4 forecast, 19th of September, we were rather pointing to the lower end of the guidance. Here, the explanation for the reduction comes, on the one hand, from the Chinese impact, also from the automotive aftermarket impact. But clearly, there are also some negative mix impacts from other areas. I think the most important figure here than free cash flow, the minus 3 -- sorry, the 300, around 300 is EUR 150 million cut. You can look at this as follows.

There's clearly the impact from the profitability, from the EBITDA. That explains a significant part. Then there is an equal part that comes from inventory. And we have a slight compensating effect because we are, as we promised, reducing CapEx as we speak and think we will end the year with a CapEx-to-sales ratio close to 8%.



Let me sum this up and then go directly to your questions. Sharp decline and sharp expected decline in Q4 for the China light vehicle production sales is a key catalyst for this unfortunate guidance cut for -- on the group level and for auto OEM. The softness in Q3, lower demand from European customers and Automotive Aftermarket contributed to this. We can compensate this, but we still think that the margin guidance will come at 17 to 17.5. The Industrial division is definitely on track. We see a favorable development, not only in Q3, but we also expect that here we will end the year at the upper end of our guidance.

Let me quickly comment on what we have been doing as a management team. We have clearly initiated, when we saw this further deterioration, short-term cost discipline measures. Just to give you an example, we have agreed with all our plants in Germany, 10 closing days from now onwards, that some of them starts tomorrow. That will clearly help us to secure the guidance. At the same time, it's difficult to predict what's going to happen next. You saw some of the rumors yesterday. We think we need to preserve our flexibility when the market turns. There are clearly some signs that things could also go on the other direction, so we are putting in step-by-step these measures. Let me also say this upfront, such a situation clearly also triggers a discussion as do we need to go further in terms of restructuring measures for the automotive OEM side? We have been -- or we have built a track record on the industrial side. We have not made a decision, but you can be rest assured that we are clearly looking at more aggravated measures, if necessary, also on the Automotive OEM side.

Let me confirm what we said during the Capital Markets Day. It's clearly time to focus more on cash generation, stronger inventory reduction or more -- stricter CapEx allocation. Synchronizing this with a challenging market environment is always a big management task. You can always do better, but I can assure you that we have our hands upon the wheels. And I would also like to say there's no reason to believe that we will change our dividend policy. The payout ratio, 30% to 40%, is what I can clearly confirm for today. The challenge for us here as a management team is to adapt our execution to this more complex market environment. The changes in China were bigger than what we expected. And we will work hard to make sure that the year comes inside the guidance and that we adjust our strategy execution for the year to come in a professional manner.

That's what I have to say. I leave this now to your questions.

QUESTIONS AND ANSWERS

Raghav Gupta-Chaudhary - Citigroup Inc

It's Raghav Gupta from Citi. Then I've got 2 questions, one on 2020 free cash flow and the second on China. You reiterated the 2020 free cash flow guidance at your CMD, which was clearly based on improving profitability and your various cost initiatives. You built your bridge from the 2017 free cash flow of EUR 488 million, yet you're only going to deliver EUR 300 million in '18. So I was just wondering if you could talk a little bit about your confidence in being able to hit that EUR 900 million number, which I think is important for investors. Let me ask the second question, and perhaps you can kind of take them both. Automated margins, clearly, OE margins reached a new low in Q3. You're attributing the majority of the weakness to China, it sounds like. Can you offer an indication kind of what your profitability is in China versus Europe. You said it's higher. Can you kind of quantify that a little bit?

Klaus Rosenfeld

Thank you, Raghav, for the questions. Let me first answer the question on the free cash flow. You all know during our Capital Markets Day, we had this debate about the difference between ambitions and targets, and we said targets are what we confirm. With the situation we have now, the EUR 900 million that were already stretched in September was even more stretched. But if I can only say at the moment, we have not made a decision so far to change anything going forward. 2020 is something that we will comment on when we are prepared for the next plan. So the only thing I can say is, your observation is right. With a lower base to reach EUR 900 million is clearly more stretched, but please understand I'm not at a position to give you any new target at the moment. We don't want to constantly change this. I can tell you the ambition in this management team is still there to show that we can also, across the cycle and across a midterm perspective, improve our free cash flow generation. The ingredients are there, but at the moment, the market environment doesn't really support us. In terms of China profitability, please understand, we don't disclose our Chinese profitability. But what you know is that gross margins in China have been always above the average of the other regions. And that is why it's so difficult if a company like ours that has a significant market share in China is hit by these dramatic downturns, and that also clearly impacts then the EBIT side. But again, we're disclosing sales by business division and not by regions. It depends -- China, I think, is known to you. And that has explained also the EBIT cut. But also let me be clear here, it's not only China, it's also mix issues elsewhere, and it also has to do with the way how we deal with remnant costs. A tanker like ours can't be turned in a day and therefore, we have this mismatch between costs that we incur. I would also like to point out, we are committed to further invest into our E-Mobility strategy. You all know that, that is something that, at least for the time being, doesn't -- cannot happen at a margin level in our core businesses. So that also clearly has an impact here. That's what I can say at the moment on the profitability.

Raghav Gupta-Chaudhary - Citigroup Inc
And if I can also -- if I can ask one follow-up in terms of -- can you remind us what your exposure is to the China locals? And if you're able to also just describe on how their approach to negotiations varies compared to the international.

Klaus Rosenfeld
The exposure to the local Chinese is about 1/3, and it's increasing as we speak. You all know from previous conversations, and in particular, the U.S. carmakers have had a very bad time in the U.S. -- in China in the previous weeks and months. The negotiation power of the local Chinese has increased, but it depends product by product and line by line. We are clearly experiencing that there are demands, but also in this situation, I can say the long-term customer relationship counts.

Henning Cosman - HSBC
I also wanted to explore the first question, the building blocks of the margin in Q3 again. You now said there were mix issues elsewhere as well. I think when you talked about the regional outperformance for Automotive OE, I think you gave us a number around 5%. Did I understood that correctly? So if you outperformed in China by around 5%, that means in organic growth terms, you were roughly flat, right? So flat year-over-year still led to that significant margin contraction. So I just wanted to explore how that stacks up, if that's okay.

Klaus Rosenfeld
Sure. I mean, I can repeat the numbers because they're not on the deck. For the whole group, Q3 2018, growth rate in Automotive OEM, as we disclosed, 3.2%,

versus a production growth light vehicles of minus 2%, according to the latest IHS figures. That gives you the 5.2%. The outperformance in the previous quarters was 1.9 and 3.5. So on average, we are not really at the 4%, but at least not far away from that. If you break down the number, the 5.2% into 4 regions, the outperformance in Europe was plus 4.9%, with a sales growth of 1.6% versus a market down 3.3%. In the Americas, the market was up in that quarter 2.2%, and we had growth of nearly 10%, 9.9%, thus the 7.8% outperformance. And in China, the equivalent numbers were minus 3.3% market down, and our growth was 2.5%. And if you just sort of recall what happened in the year also with our growth numbers for the Automotive OEM China business, we have grown 2-digit in the first quarter. We have grown even more in the second quarter. We are now giving you 2.5%. And with the market development that we are seeing and expecting for Q4, that will, by all means, the negative number for the market, we think we can still protect a little bit of that and outperform there as well. But it is very difficult to say at the moment what's happening. What we hear from dealers, what we hear from our main customers, the locals and the globals, is really a drastic drop in the demand to be expected. And that led to the whole situation. It's not a -- it doesn't change our overall market position, but it's something that we have to expect for the fourth quarter.

Henning Cosman - HSBC

Yes. So maybe I can rephrase it. So I think you just confirmed that you had organic growth in China, but it led to a margin contraction anyway, right? So I'm trying to explore the negative operating leverage, if you like. So is it correct to assume then that your cost structures were set up for higher growth and you weren't flexible enough in the very short term to reduce the cost base to the adjusted demand? Is that fair?

Klaus Rosenfeld

Correct. This is 100% correct. You have -- let's say, if you attribute the downgrade that we have given in terms of sales, and that's 1 percentage point of the sort of guidance number. If you would take that over the overall year number for annual sales, you get to approximately what we are expecting to lose. The predominant part of this comes from lower growth in China, okay? And therefore, you have to calculate the operating leverage in China that kicks in. Clearly, in China, we were geared for more growth. Clearly, we are more flexibility there than in Germany maybe, but also we have ramp-up costs that were incurred that couldn't be stopped because we're not going to stop now certain things that we may see to come back in the next year. That's why I said we need to preserve the flexibility here. Cutting into the structure now more heavily in a situation where things can turn quite fast, and we all have experienced with China in Q1 or Q2, would be wrong. So the operating hit or the operating leverage hits quite hard in China. But you can't explain the whole sort of reduction of the guidance for the margin only from China. There's a little bit of a loss also in our profitability because of the aftermarket softness that was unexpected. And also in Europe, we had some of the mix issues that contributed to this. That's my message.

Henning Cosman - HSBC
Okay. Understood. And then maybe finally, for next year and 2020, can you give us a bit of comfort around the building blocks of the recovery? Were some of these things reversed? Is it all attributable to reincreased flexibility? Because consensus as it is now has obviously a very material margin expansion in '19 and '20 compared to what the new midpoint of your profitability in auto OE is now for this year. Just so that we can understand if that's still realistic or similar to the free cash flow that looks very stretched in your view in the meantime.

Klaus Rosenfeld
Well, Henning, I would love to give you these estimates, and I would love to share what I could share. But it is absolutely premature to share anything with you on 2019. We first have to weather the storm now in the fourth quarter. We have tried to put the guidance now in a way that the lower end is really conservative, that this gives us a solid floor going forward. But don't ask me what's going to happen in Q1 2019. It's definitely premature. It would not be responsible to share any number at the moment, because we need to revisit what's going to happen now in the next weeks and months. Let's get through the Q4 and then come out with something that is a proper guidance for 2019.

Kai Alexander Mueller - BofA Merrill Lynch
Yes. Sorry, maybe to jump back -- I understand you don't want to give color on 2019 in terms of your own profitability and targets. But in terms of the market, you've obviously taken down your market forecast this year from 2% to 0.5%. How do you believe in terms of your conversations with the OEMs how that develops going into 2019?

Klaus Rosenfeld

Well, normally we look at IHS numbers. And when you see how the IHS numbers fluctuate, that is also here quite a big range of what's going to happen. Also here, I would like to refrain from any indication. What I can say, I think globally, we're not in a crisis situation. What we are seeing is again the significant deterioration in China, and China is about, whatever, 30% of the global market. But don't forget, you see it from the outperformance that we have in the United States. There is also market growth possible, but there's a lot of unpredictable things at the moment that creates a pretty complex environment. Once again, we will do what we can to adjust for this environment, but that's not an easy task. And therefore, please forgive me. I'm not going to give you my estimate at the moment for 2019.

Kai Alexander Mueller - BofA Merrill Lynch

Okay. And then we touched on Q4 China, and you said obviously the weakness to continue from what you've seen in Q3. If I missed it, do you have a number in your head in terms of the production growth overall for the market that you expect for the quarter? And then the second part is, on that question, we've obviously heard a few OEMs now talking about adding shifts in Europe in light -- to catch up from some of those production headwinds they've been having in Q3. Are you seeing some of that coming through in October and maybe into November in terms of the European production actually picking up better than you'd thought?

Klaus Rosenfeld

Well, I think what we are seeing is -- and let me answer this in a little bit broader sense, we're seeing a continued positive development in industrial. We think that the softness in Q3 in Automotive Aftermarket is, to some extent, a onetime temporary effect. I think Q4 will tend to be better than Q3. So that may catch up some of the issues that we had in Q3. And in terms of what we are seeing for October and November, it still indicates a very mixed picture. The key question is how far will China go down. There are -- all our market intelligence in China tells us it can be a very difficult quarter, even lower at 10% or even 15% of the market. What that means for us is it will be negative growth in Q4. How far that will go, we need to wait. If we are through, more or less through October, but November and December still has to come. Don't forget, there's no Christmas in China. They have new year later than we have, or Christmas later than we have, so December will be a very decisive month for the overall performance of the Schaeffler Group.

Kai Alexander Mueller - BofA Merrill Lynch
Okay. And then just to come back to the point on your free cash flow guidance. You mentioned one of the metrics, EBITDA, as well as your inventorylevels. Where is that? Is that inventories in the Aftermarket business given your sales growth results weaker? And just we've obviously seen in the past quite often these inventory write-downs in the fourth quarter. Is that something as a risk as well? Should these inventories not shift by the end of the year?

Klaus Rosenfeld
Kai, let me hand over that question to Dietmar.

Dietmar Heinrich
Kai, first of all, the Aftermarket is a little bit of an influence, but it's mainly coming from Automotive OEM and also from the Industrial side. We have plans to reduce the inventories towards the year-end, but with still lower demand that we see on the auto OE side, then that will be shifted then also into 2019. The plans are there. And Klaus already mentioned that we initiated a couple of closing days to take place within this year, but also in the beginning of next year. So that will also help to further reduce then the inventories.

Kai Alexander Mueller - BofA Merrill Lynch
Okay. And these are inventories for your own input materials or finished goods as well?

Dietmar Heinrich
It's both.

Kai Alexander Mueller - BofA Merrill Lynch
Okay. So you had cancellations, I would think? Because otherwise you wouldn't produce this.

Dietmar Heinrich

Yes. Some of the demand cuts came by short notice, so that we already had thing ready to deliver.

Sascha Gommel - Crédit Suisse AG

I also want to come back to the kind of full year guidance cuts/implied Q4 performance. I struggle to understand why you're also so negative on the profitability in Aftermarket and Industrial, given what we've seen in the first 9 months and also what we've seen in Q3. I was just wondering if you could also give some color on that. I understand automotive given China, but I struggle a bit to understand why you are so cautious on the other 2 as well. Then my second question would be on your free cash flow. How can you make sure that this inventory issue can be resolved in the short term? Is it only production cuts? Or are you also implementing more special programs in order to tie to that? Because my understanding is that working capital has been an issue for quite a while now. And then 2 follow-ups. Can you explain the mix issues a bit more, what that exactly is and how that evolves over the next 2 quarters or so? And then lastly, on China. I remember you had quite a couple of ramp-ups planned for this year. Do you think they're only delayed? Or could some of them even be canceled altogether?

Klaus Rosenfeld

Thank you, Sascha. Let me take the first and the last question, and then Dietmar take the other 2. In terms of the ramp-ups, we think there's no reason to believe that they are completely canceled. They are delayed. I mean, there are -- some of them have started production. Some of them are close to start to SOP, so that is from our point of view a question of delaying them. In terms of the implicit guidance for the 2 smaller divisions, we pointed out with the guidance for Industrial that was 10% to 11% before. We narrowed the range to 10.5% to 11%. And I think can clearly say, we are hopeful that we can meet that at the upper end with up to 12.1% in Q3. There's definitely a solid possibility here. And with Aftermarket, the same. However, don't forget, in the Aftermarket, there was a one-off effect in Q2 that clearly supports the margin. But also here, we narrowed it to 17.7% to 7.5% (sic) [17.0% to 17.5%]. And I think it's possible that we end here at the upper end. Dietmar, you want to take the other 2 ones?

Dietmar Heinrich

Yes. Regarding, Sascha, your questions that were related to free cash flow and inventory. So already explained that we are going to close the factories for a couple of days, so that will help. We also looked into our purchases and already started to reduce the purchases of materials and components as well, so adjusted. And then the Automotive Aftermarket will have a positive influence coming from actually then realizing higher sales now growth in Q4 that is implicit in the guidance now for the full year.

Klaus Rosenfeld

Let me add to that, that was the next question. Let me answer this. Clearly, what we see on inventories is not what we'd like to see. We would like to see a more agile development there, but it's a long value chain that we have. And with the AD plans that we have that all also are somehow intertwined and with things with Industrial and some indicators still not being completely separated -- completely integrated, there are some issues that we need to tackle. That's a question of how much of this can be handled towards year-end. The measure to put in closing dates, forced closing dates, is clearly something that helps on the inventory side. We need to see how this pays off and how much of that will then impact the Q1 2019. That's a function of some of these structural measures. But I can assure you that here, we have the highest focus at the moment. We get weekly reportings. We see what's going on. And this mix, because don't forget, Industrial is also overperforming, and they sometimes need plans apart from plans where we cannot just simply say we stop here and accelerate somewhere else. So it's a little bit of complex situation there. But again, this is something that will be followed through also into the next year. You wanted to ..

Sascha Gommel - Crédit Suisse AG

Can I quickly follow up on one thing? The automotive margin is quite low, and you were mentioning that you're looking at the situation. Now what would you make desired on a more comprehensive restructuring program? Because I look at your guidance, and you cut your revenue by EUR 140 million and your EBIT by EUR 160 million at the midpoint. So it's kind of -- it really raises a question about your cost base in my view. And I think it worries a little bit to see that the margin, where it goes, and therefore, I would be interested if you see any trigger for that restructuring.

Klaus Rosenfeld

What I -- to implement and initiate a restructuring program is something that needs a responsible management team that thinks about how this restructuring program should look like. As we told you, the decision to bring down the guidance was a decision that came very quickly because of the faster deterioration of the Chinese market than we expected. And we have now initiated short-term measures. I can say, again, we're clearly looking at possibilities what to do on top of what we're doing already. You saw on the Capital Markets Day, CORE I, CORE II. You saw BCT. You saw shared services and other measures. Now let's not rush into something like this. The most important thing is that this is -- if it's necessary, designed well, and that is executed in sort of steps that really result in a sustainable improvement of profitability. And it's premature to give you anything today, rush into anything. But I can tell you, this is clearly something that is on the table that we're looking at. And as soon as we have something to report, we will report that to you.

Julian Radlinger

So this is going to be kind of similar to many that have been asked already, and I apologize for that. But clearly, given that the revenue base in 2018 is now lower than previously, looking at next year, you're, of course, going to have to reduce cost and also CapEx somewhere more than you have previously planned just to keep your margin and the free cash flow steady, all else equal. So my question is, generally speaking, can you give us an idea where you could cut cost and CapEx quickest? And in what areas are you least willing to do that? For example, I mean, how far would you be willing to reduce your R&D investments into E-Mobility if the environment remains challenging or it becomes even more challenging? In which other areas which you would be able to intervene quickest or cut some slack?

Klaus Rosenfeld

Now let me talk about the CapEx first. And when we say cut CapEx, what are we talking about is cutting gross CapEx. Because if you see that is the predominant part of our CapEx, what we will grow at a lower pace, we'll then adjust CapEx accordingly. I think the best number I can give you at the moment, we said 6% to 8% should be the range after Capital Market Day 2018. That's what I would like to reiterate. And that could be that we delay a plant extension, that we become more cautious on real estate investments, that we say in certain areas that obviously have not the potential to grow as fast as we thought, we'll cut back. We are typically very cautious on replacement CapEx. That is always the last thing we want to do.

But thinking about that, on the growth side, it's clearly those areas are the most other ones. You can also think about rationalization CapEx, but that is also something where you have to be quite careful because rationalizing CapEx is -- normally has a business case in terms of how can -- what can we do to optimize cost. That goes hand-in-hand. In terms of cost cutting, from my point of view, there are 2 elements here. Those areas in the functions that have grown faster than growth rates will clearly come under scrutiny when I look at central functions. You can, in any case, always look for profitability programs, efficiency gains starting from small things like travel expense, marketing things and so on. There's always something that you can do. But again, we are not in the position today that we have some things on the table where we would give you a full program. We want to do this as we have done before in a transparent manner. We have built a track record. You see it from Industrials back to 12% because of these measures. And therefore, as something as this becomes necessary and we're looking at this at the moment, we'll do the same things in Automotive OEM, and I'm confident that there are areas to tackle to stabilize the overall margin.

Tim Rokossa - Deutsche Bank AG

It's Tim from Deutsche Bank. The main question to me really today is on timing and on your internal reporting. You now have had quite a few profit warnings since the IPO. Autos is autos. You are a very global company. There will always be something going on. The problems on China and WLTP, they're out of your hand, really. So to me, it's a question about the speed in which you understand what's actually going on and how fast you can react to this. And this time, for example, we had multiple warnings already in the sector over the last 3 weeks. It's felt almost for exactly the same reasons. Pretty much like we were now ready to move on a little bit, and now you come with this warning. Do you agree that you probably have to improve and pick up in the pace of your internal reporting? And if you do agree, how do you ensure that's going to happen? That would be my first question. And the second one is, it's probably tough to really get to, but obviously, it would be very nice to understand if the problems that we are seeing in Europe right now are really just temporary WLTP issues or if the underlying situation is also a bit tougher and demand is slightly lower. Do you have a view on that when you talk to your customers?

Klaus Rosenfeld
Thanks, Tim, for the 2 points. Let me tackle the first one. You can always improve reporting. You can always improve the quality and the speed of information flows and how you build your and draw your conclusions from this. There's clearly something. The year was a -- this year was clearly something that was challenging in that respect. Just to recall, in February, we came out with a prerelease to adjust for a consensus that was going too high. You can call this a profit warning. We thought it was responsible to react in this way. There was then, again, call it a profit warning. In September, we adjusted the Automotive guidance also, from my point of view, given -- driven by market development, not by Schaeffler-specific issues. And now, as explained, situation is aggravated. The deteriorating situation in China triggered now also a change from cut of the group guidance. It's a fact of life that this is something where we have to follow the rules. We have followed the rules. We have reacted as soon as we had the information on the table, as soon as we had a forecast. We're doing monthly forecasts where we try to incorporate all the information we get also from the regions and build a proper base. It sounds from the outside, it looks a little bit like erratic, but it's not. And I can tell you, making sure that we manage's through these complex environments in a responsible manner, also taking into account your concerns, is one of my key priorities going forward. Yes, I don't have the perfect system in terms of visibility. I can't predict every little movement. Clearly, we are investing into something that we call global reporting. No one has real time. It's all about judgments when it comes to forecast. I regret this impression that this left. I would like to have something different, and I can only assure you again we'll do what we can to make sure that you are informed and as speedy as we can about the developments we are incurring.

Tim Rokossa - Deutsche Bank AG
Let me -- maybe a follow-up to that. Because don't get me wrong, right, if China production is down 10% in Q4 or more, then we would probably see a lot more warnings by some of your other competitors out there. So the question to me is also in that respect has -- were the last 3 weeks so difficult for you that you are now making these adjustments? Or is the view that you are taking on the November and December numbers so much worse than what you have previously expected? What was the main reason that caused you to change this?

Klaus Rosenfeld

It's definitely the last one. Look, we're doing monthly forecast. We've done an 8+4. You see maybe later than others because they have faster reporting systems. That could be an issue. I don't know what others do there, but we have built our views that led us into the Capital Markets Day that is on the August numbers and a forecast for the last 4 months. We are now 6 weeks later. We have September numbers, where we have seen also in Europe a soft European market and a very difficult market in China that was still, as you saw, 10.7% in the first 9 months. It's definitely within sight the range of 10.5% to 11.5%. Also growth is with more than 5% within the range. It's all about the expectation for the fourth quarter. And again, that's a decision where you have to take adjustment call and say what's going to happen. And we wanted to protect the downside. If I now be very brave and say we'll be inside the guidance and come back in February with something where I'm the only one who is not within the guidance because everyone has cut before, maybe only 2 weeks before, then that would be a very negative outcome. It's all about what kind of forecast you have. And again, I accept the challenge and also your recommendations to try to steer more practically. But we have changed from quarterly forecast to monthly forecast. We have daily sales that we're watching. I get all these data on my desk in trying to make our opinion together with Dietmar. We have, more or less, daily conversations on where we we're going. We have insight on what happens in the regions. I don't know what the others have, but I can assure you, this is, to the best of our knowledge, both going to happen in the fourth quarter in a very complex environment where it's difficult to read what the real trends will be. Also for 2019, we have some views, but I'm -- we need to do more to see how these views can be substantiated and what's going on.

Tim Rokossa - Deutsche Bank AG

So if we do see tax cuts in China and demand should not be -- or production should not be minus 10% but actually better than that, it's fair to assume that you should do substantially better than your revised guidance now?

Klaus Rosenfeld

Well, that's clearly something that is possible. I have, when the news came yesterday from Bloomberg, immediately called the CEOs in China and said, "What does that mean? Have you any information, any confirmation from the authorities in China on this?" We have asked, how does this compare to what happened in October 2015, because also there, there was this idea of cutting bets by half, 10%

to 5%. At the time, that helped. You also remember that they, to some extent, you took this away later on. From my point of view, in the situation we have, that is really a difficult and complex situation. The most important thing is that you have the flexibility. We are not betting on anything like this at the moment. It will not -- even if it comes, it will not impact our fourth quarter. It would be completely wrong now to sit here and sort of indicate to you, yes, Q4 will be helped by some measures in China. I don't think that, that is the case. And therefore, we said even after the news yesterday that is not confirmed, let's stay the course here. Let's make sure that we bring this down to a level that is a good floor for the rest of the year and then think about what are we going to do in 2019.

Tim Rokossa - Deutsche Bank AG

Okay. Fair enough, very clear. And on the European side?

Klaus Rosenfeld

Sorry, I missed that question.

Tim Rokossa - Deutsche Bank AG

Is the -- do you think this is primarily WLTP temporary? Or do you feel that demand underlying is also a little bit lower?

Klaus Rosenfeld

Look we told you on the Capital Markets Day, as Matthias mentioned that, that is one of the things that clearly is a concern. But the change in guidance from our forecast 8+4 to the forecast 9+3, what we did now, is not triggered by WLTP. We said at that time it's an issue. It will not clearly impact us massively. It's lasting a little bit longer. The sentiment is also, in Europe, not really very positive. But this -- the WLTP thing is not a factor that drove the guidance down. It's China.

Manuel Tanzer - equinet Bank AG

I have 3 left. The first one, could you specify the one-offs that are in the EBIT? If I saw it correctly, the reported EBIT is at EUR 371 million or EUR 376 million versus EUR 355 million adjusted. The second one, can you confirm that your underlying combustion engine margin is still healthy. So it's a pure China topic right now with cost overruns? And the third one is more like a thought process. So if I look at China right now, I already have all the costs for the ramp-ups, but major projects are delayed. Can I assume they are delayed into 2019? Now with the potential incentive program in 2019 and those projects already ramped up and delayed into 2019, shouldn't that have a very significant swing factor for Automotive OEM next year? Can you confirm that logic?

Klaus Rosenfeld
No, and because your first question, that is something that we will explain in more detail in our interim report that you will receive on the 7th of November. But I can give you the logic this EUR 21 million has, more or less, come from the fact that one of the legal cases was cleared and that's a provision that was built for this legal case had to be reversed. So it explains why the reported EBIT is higher than the EBITs before special impact, was a case that is now settled to our benefit. In terms of the swing in China now from any measure whatsoever, again, premature from my point of view. If you've seen these kinds of situations before, China is difficult to predict in certain areas. Yes, if the Chinese car production kicks in again and sales grew, then that has normally also a positive effect on us. But I can't quantify this at the moment. And you mentioned the combustion engine. Again, we don't report according to combustion engine versus E-Mobility. But what I can say is some of the issues that also drove the margin down in Q3 and have an impact there has to do with the changing mix in terms of diesel versus gasoline. There are some adjustments necessary also on our side, so there are the smaller issues. And generally, we stay with our E-Mobility strategy. We'll not sort of stop to invest there, whether it's OpEx or CapEx. That is critical because our customers think long term. And when you see, in particular, the Germans, there's plenty of opportunity at that front.

Manuel Tanzer - equinet Bank AG
If I may, just a follow-up. You have -- you said there would be record ramp-ups in H2 this year, that you would be very back-end loaded. Now we have these major project delays in China. Can you give us a rough idea of how large these project is just to have an idea of what could come incrementally now in 2019?

Klaus Rosenfeld

May I suggest that we defer that question to the 7th of November and then give you a little bit more color there? Because all we wanted to share with you the -- and on the 7th of November, because you're all that interested in Automotive OEM, we will have Matthias, who is in Japan at the moment, Matthias think of the call. Renata and myself, we decided this, this morning. It will give you hopefully also a little bit more additional information on these very specific questions.

Renata Casaro

Thank you very much.

Operator

As there are no further questions, I hand back to Ms. Casaro.

Renata Casaro

Thank you, operator. Sorry about that. Thank you very much for taking the time for this call, and looking forward to having you again on the 7th of November. Goodbye.

Klaus Rosenfeld

Thank you very much. Bye-bye.