Combined Management Report of ElringKlinger AG

FOR THE FINANCIAL YEAR 2019

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BATTERY SHIELD

Temperature management plays a particularly important role in the field of e-mobility. This stainless steel battery shield reliably protects the environment of the lithium-ion battery from potential thermal chain reactions. Read more in our article »The best of both worlds« in »pulse« magazine.

Overview of ElringKlinger's Activities and Structure

Operating at a global level, ElringKlinger is an independent automotive supplier and development partner to the vehicle industry. The company develops, produces, and supplies components for passenger cars and commercial vehicles regardless of the type of drive system used. Building on its innovations, ElringKlinger is helping to shape the future of mobility, reduce emissions, advance alternative drive technologies, and bring greater efficiency to the classic field of transport.

Company profile

Headquartered in Dettingen/Erms, Germany, the ElringKlinger Group is an independent, globally positioned development partner and series supplier to the automotive industry. Today[1], around 10,400 employees at 45 sites worldwide are making a committed contribution to the company founded in 1879.

Its product portfolio consists of components for the drivetrain, body, underbody, chassis, and exhaust system in passenger cars and commercial vehicles. This encompasses lightweighting concepts, sealing technology, and shielding solutions as well as battery and fuel cell systems. Among the Group's customers are the majority of the world's automobile and engine manufacturers. Marketed under the "Elring – Das Original" brand, ElringKlinger also supplies an extensive range of spare parts. The portfolio is complemented by an array of products made of high-performance plastics, which are also destined for markets beyond those covered by the automobile industry. Correspondingly, the Group's operating activities are represented primarily by the segments Original Equipment, Aftermarket, and Engineered Plastics.

Business model and core competencies

The trend toward efficient drivetrains that deliver superior driver comfort and the lowest possible – ideally zero – health-damaging and climate-changing emissions is reflected in ElringKlinger's product portfolio. Newly developed products are targeted at modern drive systems or relate to areas of the vehicle that are drivetrain-independent. ElringKlinger is thus supporting automobile manufacturers in their fast-paced efforts to meet the targets set as part of climate protection policies. In strategic terms, ElringKlinger focuses on four areas: e-mobility, lightweighting, established forms of mobility, and non-automotive applications. Within the long-standing fields encompassing cylinder-head gaskets, specialty gaskets, plastic housing modules, and shielding systems, ElringKlinger has honed its skills as a technological innovator and carved out a solid market position over a period spanning several decades. Without neglecting this mainstay, the Group is taking advantage of this experience to sharpen the focus of its portfolio on e-mobility, encompassing battery and fuel cell technology components as well as electric drive units. In the area of lightweight construction, in particular, ElringKlinger offers components made of modern materials that meet stringent requirements in regard to functionality, safety, stability, and environmental compatibility for vehicles of all drive systems.

Among ElringKlinger's core competencies are extensive know-how relating to materials and processes in the field of metal and plastics processing as well as expertise when it comes to engineering tools for efficient series production. This includes high-precision metal processing, encompassing stamping, embossing, and coating as well as a proven track record in plastic injection-molding. In the Engineered Plastics segment, ElringKlinger can draw on many years of materials, applications, and processing expertise for high-performance engineered plastics.

Economic and legal influencing factors

Demand for products in the Original Equipment segment is closely linked with global vehicle production. This, in turn, is dependent to a large extent on the direction taken by sales markets and the economy as a whole. Among the specific influencing factors are, in particular, the labor market situation

[1] As of December 31, 2019

in various regions, consumer spending patterns, fuel prices, and lending terms.

Regulations governing climate protection are considered to be a key influencing factor in terms of legislation. Due to ever-stricter emission standards, markets have seen growing demand for products that can help reduce pollutants and comply with limits set within this area. In addition, international trade conditions and customs restrictions have become increasingly important as a factor influencing global activity.

Group structure and organization

The parent company of the Group is ElringKlinger AG, which has its registered office in Dettingen/Erms, Germany. It is also the largest operating Group company and performs Group-wide management tasks. In addition to strategic management, it is responsible for the central functions of Purchasing, IT, Communication, Finance, Legal Affairs, and Human Resources. To a large extent, sales activities as well as research and development are also concentrated within the parent company.

The Management Board of ElringKlinger AG consists of four members, each with a specific area of responsibility: that of the Chief Executive Officer, the Chief Financial Officer, the Chief Operating Officer, and the Technology Officer overseeing E-Mobility.

As of December 31, 2019, the ElringKlinger Group comprised 39 fully consolidated companies in 21 countries (cf. notes, "Scope of Consolidation").

Sales markets and locations

ElringKlinger has manufacturing operations in all of the world's key vehicle markets. In total, the company is represented at 45 international locations, 39 of which are production sites. Calculated on the basis of revenue, Europe is the most important sales region with a share of 51.5% in Group revenue, followed by North America (26.1% revenue share) and Asia-Pacific (17.9% revenue share).

In the majority of cases, ElringKlinger holds a Tier 1* supplier position within the automotive industry value chain. This means that it maintains a direct line of contact with nearly all key vehicle and engine manufacturers. In the Engineered Plastics segment, which boasts a wide range of products, ElringKlinger operates as a supplier to various branches of industry.

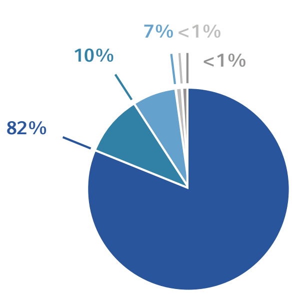
Segments and divisions

The Group's operating business is divided into five segments. They also constitute the reportable segments under IFRS:

- Original Equipment
- Aftermarket
- Engineered Plastics
- Services
- Industrial Parks

In the **Original Equipment** segment, ElringKlinger develops, manufactures, and sells products and assemblies destined for the automotive industry. It is divided into the following divisions: Lightweighting/Elastomer Technology, Shielding Technology, Specialty Gaskets, Cylinder-head Gaskets,

Group sales by segment 2019



	in EUR million	(previous year)
Original Equipment Car, truck, and engine manufacturers, automotive suppliers	**1,423**	(1,408)
Aftermarket Independent aftermarket business	**173**	(159)
Engineered Plastics Vehicle industry, mechanical engineering, medical technology	**118**	(118)
Services Vehicle manufacturers and suppliers	**9**	(10)
Industrial Parks Unspecified industries	**4**	(4)

* Cf. glossary

E-Mobility, Drivetrain, and Exhaust Gas Purification. These products are used in engine, drivetrain, exhaust system, underbody, chassis, and vehicle body applications. This segment serves both the passenger car and the commercial vehicle segment.

In the **Aftermarket** segment, ElringKlinger offers an extensive range of gaskets, gasket sets, and service parts for the repair of engines, transmissions, exhaust systems, and auxiliary units in cars and commercial vehicles. They are marketed under the "Elring – Das Original" brand. The customer base in the Aftermarket segment covers a global network of wholesalers and major group purchasing organizations. Based on revenue, the principal markets are Western and Eastern Europe, although both the Middle East and North Africa are also considered key sales regions. The markets of North America and China are gaining in significance as a result of more extensive cultivation.

The **Engineered Plastics** segment covers the development, manufacture, and sale of customized products made from various plastics. Revenue is attributable primarily to sales in the mechanical engineering sector and the medical, chemical, and energy industries as well as the vehicle industry. ElringKlinger is pushing ahead with efforts to expand its business in this segment at an international level and also operates production sites in the United States and China.

At 0.8% of Group revenue, the **Services and Industrial Parks** segments account for a relatively small proportion of business. Services include the operation of state-of-the-art engine test benches and measuring equipment for tests on engines, transmissions, and exhaust systems. The segment's customer base includes both vehicle manufacturers and automotive suppliers. This segment also includes logistics services for aftermarket sales and the catering service of a Group subsidiary. The Industrial Parks segment covers the lease and administration of industrial parks.

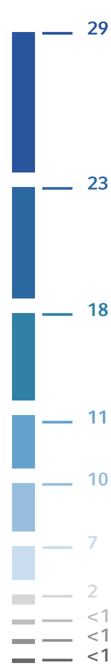
Divisions in the Original Equipment segment

The Lightweighting/Elastomer Technology division has an extensive portfolio that includes components made of thermoplastics for drivetrain, vehicle body, and underbody applications. A variety of manufacturing processes and numerous materials or material-specific innovations provide the basis for tailor-made solutions with high functional integration and/or weight savings. This area also includes hybrid technology, i.e., the combination of different materials such as plastic and metal in one product that is manufactured in a single tool sequence. The key benefits of these manufacturing technologies and material compositions include high growth potential for the division.

The Shielding Technology division develops and produces thermal, acoustic, and aerodynamic shielding systems. These specific products handle a wide range of tasks relating to temperature and acoustic management in modern motor vehicles, in addition to contributing to an aerodynamic design of the vehicle underbody. For e-mobility applications, the systems may also include electromagnetic shielding functions. On request, ElringKlinger delivers customized shielding packages for the entire vehicle – from the engine to the underbody and exhaust tract.

The product portfolio in the Specialty Gaskets division includes a broad range of gaskets for various locations in the vehicle, including batteries and electric motors as well as transmission control plates and complex formed parts engineered from sheet metal.

Group revenue by division[1] 2019
(previous year) in %



Lightweighting/ Elastomer Technology	29	(27)
Shielding Technology	23	(24)
Specialty Gaskets	18	(19)
Cylinder-head Gaskets	11	(11)
Aftermarket	10	(9)
Engineered Plastics	7	(7)
E-Mobility[2]	2	(1)
Exhaust Gas Purification	<1	(1)
Services	<1	(1)
Industrial Parks	<1	(<1)

[1] as well as the segments Aftermarket, Engineered Plastics, Services, Industrial Parks
[2] incl. Drivetrain

Metallic cylinder-head gaskets represent one of the traditional fields of business for ElringKlinger. In this field, the company has acquired decades of experience in stamping, embossing, and forming processes of metals as well as extensive know-how in coating technology.

The E-Mobility division supplies battery and fuel cell components as well as end-to-end battery and fuel cell systems.

The Drivetrain division develops and markets complete electric drive units.

As a result of the strategic product focus on other areas, the Group's activities in the Exhaust Gas Purification division have been scaled back significantly.

Internal Control Criteria

The Group mainly uses financial indicators for the purpose of managing the company. Leading indicators that are specific to the company and non-financial indicators also deliver fundamental information for corporate planning and control. The Group also continuously monitors economic forecasts and industry-specific indicators in order to be able to respond to changes in good time.

Financial control criteria

The key financial indicators used within the ElringKlinger Group are sales revenue, earnings before interest and taxes (EBIT), and return on capital employed (ROCE*). Sales revenue and EBIT are budgeted, calculated, and continually monitored for the Group, for the individual Group companies, including the parent, and for the five reportable segments and the respective divisions.

As its name suggests, ROCE measures a company's profitability and the efficiency with which its capital is employed. To calculate it, EBIT is divided by capital employed. In this context, ElringKlinger uses average capital employed during the period in question as a basis of calculation. This includes shareholders' equity, financial liabilities, and provisions for pensions. Variable remuneration for the managerial level directly below the Management Board is generally linked to the level of ROCE achieved. In financial year 2019, ElringKlinger recorded ROCE of 3.4% (2018: 5.5%).

In addition, the key indicators of operating free cash flow*, the consolidated equity ratio, and net debt*/EBITDA* are of importance for the Group.

Calculation of ROCE

in EUR million

EBIT	**61.2**	
	31.12.2019	**31.12.2018**
Equity	891.2	890.1
Financial liabilities	730.7	768.8
Provisions for pensions	148.2	124.4
Interest-bearing non-current provisions	–[1]	13.0
Total	**1,770.1**	**1,796.3**
Average capital employed	**1,783.2**	
ROCE = EBIT / average capital employed	**3.4%**	

[1] As from Jan 1, 2019, this position is no longer considered due to negligible amount

* Cf. glossary

Selected financial control criteria of the ElringKlinger Group

		Projections 2019	Actual 2019	2018	2017	2016	2015
Revenue	(in EUR million)	2–4 percentage points above global market growth[1]	1,727.0[2]	1,699.0	1,664.0	1,557.4	1,507.3
EBIT before PPA[3]	(in EUR million)	Margin of around 4 to 5%	63.2 Margin: 3.7%	100.2	141.8	140.4	140.4
ROCE		Below previous year	3.4%	5.5%	8.2%	8.7%	9.5%
Operating free cash flow	(in EUR million)	Positive	175.8	-86.2	-66.6	-3.8	-65.2
Equity ratio		40 to 50% of total equity and liabilities	41.5%	42.8%	44.0%	47.2%	48.5%
Net debt/EBITDA		Year-on-year improvement	3.3	3.7	2.7	2.3	2.2

[1] Adjusted for the effects of currencies and M&As* (organic)
[2] Revenue reported; revenue adjusted for effects of currencies and acquisitions (organic): EUR 1,708.1 million (+0.5%/market contraction 5.6%)
[3] PPA (write-downs from purchase price allocation) EUR 1.9 million (2018: EUR 4.0 million); accounted for in various functional categories of the income statement

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

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

Non-financial control criteria

Non-financial performance indicators also provide management with criteria that help to assess situations and plan measures for the future. They include personnel, quality, and environmental indicators, particularly CO_2 emissions and energy consumption. Further details can be found in the non-financial statement, which will be published by April 30 for the preceding financial year and can be accessed on the Group's website at www.elringklinger.com (Sustainability section).

Company- and market-specific leading indicators

Order intake and backlog are calculated on a regular basis and are used as indicators for capacity planning and expected revenue performance. They form an important basis for the forecast review of the remaining year in question, but also for the business plan prepared on an annual basis. Revenue budgeting and forecasting are based on planned quantities requested by customers as part of their scheduling less a safety margin and agreed product prices. Forecasts of vehicle demand and production as well as potential market price risks arising from exchange rate movements, changes in interest rates, and increases in the cost of materials are also monitored. Changes in these leading indicators may thus be identified at an early stage and appropriate measures initiated accordingly.

Research and Development

Strict limits on emissions and government incentives to buy vehicles with alternative drive systems are accelerating the transformation towards e-mobility. ElringKlinger has many years of experience in developing products for sustainable mobility. In 2019, ElringKlinger maintained its focus on research and development relating to new applications in the field of battery and fuel cell technology.

Research and development ratio just under 5%

In fiscal 2019, ElringKlinger completed a series of development projects to adapt or create new solutions not only in the E-Mobility division but also in the traditional Cylinder-head Gaskets, Specialty Gaskets, Shielding Technology, and Lightweighting/Elastomer Technology divisions. The main focus of research and development (R&D) was on translating existing know-how into new applications for both battery-electric and hydrogen-based drive systems. The company's R&D activities are highly centralized to avoid any loss of expertise. For this reason, the Group has concentrated its main development activities at the German sites operating within the Original Equipment and Engineered Plastics segments and at its US plant in Southfield, Michigan. ElringKlinger built up additional know-how during the year under review, especially in the field of battery and fuel cell technology. As a result, the number of employees working in R&D as of December 31, 2019, stood at 611 (2018: 590).

In financial year 2019, R&D spending (including capitalized development costs) came to EUR 80.8 million (2018: EUR 87.2 million). This corresponds to an R&D ratio of 4.7% (2018: 5.1%), which was within the long-term target range of around 5 to 6% (including capitalized development costs).

ElringKlinger always seeks legal protection for new developments at both a product and a process level. The centralized patents unit is tasked with protecting the company's technological expertise and intellectual property rights. The unit applied for 81 new patents in 2019 (2018: 80).

Adapting traditional know-how for the future

The pace of change in the automotive industry is unrelenting. The view among industry experts is that the market for vehicles with a combustion engine will only decline gradually as demand for alternative drive systems increases. For a while at least, battery and fuel cell systems are likely to coexist. Accordingly, at Group level, ElringKlinger's objective is to maintain its position as a reliable partner to vehicle manufacturers when it comes to applications for both the conventional and the electric market. On the one hand, ElringKlinger is working hard to optimize modern combustion engines in order to achieve further efficiency gains. At the same time, it is busy developing components, modules, and systems for battery and fuel cell applications in order to cut the emissions of next-generation vehicles to a minimum. From a strategic perspective, the battery, fuel cell, and structural lightweighting markets offer tremendous potential. In 2019, they accounted for around 8% of total revenue, largely mirroring the ratio of new vs. conventional types of powertrain in the global vehicle market.

Key R&D figures

		2019	2018
R&D costs (incl. capitalized development costs)	(in EUR million)	80.8	87.2
R&D ratio (incl. capitalized development costs)	(in %)	4.7	5.1
Capitalization ratio[1]	(in %)	20.7	12.7

[1] Capitalized development costs in relation to R&D costs, including capitalized development costs

Cylinder-head gaskets: greater standardization, less complexity

Customized cylinder-head gaskets play a key role in combustion-engine technology, especially in the case of direct-injection gasoline and diesel engines that meet the Euro 6d Temp emissions standard and higher. Based on IHS Markit estimates, the industry is likely to see a gradual downturn in annual production figures for combustion engines. For the Cylinder-head Gaskets division, this means that although the overall market will decline in the medium term, ElringKlinger will continue to provide resources for research and development as it wins new contracts. This division's focus in 2019 was on further optimizing existing technology and reducing complexity. Having amassed years of expertise in the field of embossing, forming, and coating, the division was able to provide technical know-how for the development and production of bipolar plates* and therefore worked more extensively with the Group's fuel cell experts in the period under review.

Specialty gaskets: development focus on e-mobility applications

Modern sealing systems are used wherever components are joined or located next to each other. The challenge for conventional drive systems lies in sealing different components that, in many cases, operate at very high temperatures and pressures. In 2019, among other products aimed at the market for combustion-engine vehicles, the division developed a sealing system fitted with a compact check valve for exhaust gas recirculation – optimized for installation in a confined space.

In addition, the Specialty Gaskets division focused on the development of products for alternative drive technologies, for example, to improve the cooling efficiency of battery cooling using new and adaptive cell cooling modules.

Shielding technology: delivering integrated functionality

Demand for customized shielding systems has been growing continuously for many years. This is because tightly packed units, more compact engines, increased levels of turbocharging, and minimized cooling air flows lead to ever higher temperatures in the engine compartment, underbody area, and exhaust tract. ElringKlinger incorporates additional acoustic functions into its thermal shielding systems to reduce noise and therefore make the journey more enjoyable for the occupants of electric vehicles too. The transition towards hybrid and electric vehicles has also led to an increasing focus on electromagnetic compatibility (EMC*) within the Shielding Technology division.

A new shielding system offers a solution for reducing emissions in combustion-engine vehicles. The new development actively controls operating temperatures in the exhaust tract and thus helps to ensure improved operational readiness of the vehicle's exhaust gas purification systems.

Lightweighting: hybrid solutions for a lighter vehicle

Lightweighting plays a central role in reducing vehicle emissions. Besides cutting fuel and energy consumption, other benefits, such as reduced tire abrasion, contribute to a lower environmental impact. Therefore, manufacturers pay attention to every ounce when developing new components. For this and other reasons, ElringKlinger sees lightweighting as an important strategic field for the future.

The Group's expertise in the field of lightweighting is based on many years of experience during which it has continuously expanded its portfolio of plastic components such as cam covers and oil pans to replace conventional metal parts. ElringKlinger entered the lightweighting market in 2015 with the first series production of innovative polymer-metal hybrid components. This technology is currently used to manufacture cockpit cross-car beams* and front-end carriers* and adapters. Given the very low weight of such components, they offer the potential to integrate additional functions. In 2019, the company made further design improvements, incorporated new functionality options, optimized the production process, and modified the selection of materials to improve their cost-benefit ratio for customers.

The Lightweighting/Elastomer Technology division has also developed several products for use in battery-powered vehicles. These include, for example, underbody protection for battery systems, which, compared to the aluminum previously used, offer high dielectric strength and fire resistance as well as better thermal and acoustic insulation properties.

In the area of sealing technology, ElringKlinger also offers a solution for large flanges, such as those used in battery system casings, in the form of a metal-elastomer* gasket with a jigsaw puzzle design. Another advantage of the gasket is that it occupies very little space during storage and shipping compared to its full size when assembled.

Alternative drive technologies: component, module, and system expertise

The battery and the fuel cell are two of the key technologies involved in the electrification of the powertrain. Battery-powered electric cars are more suitable for short distances, while fuel-cell-powered vehicles come into their own over longer distances because the energy density is higher, the refueling time shorter, and the range longer. ElringKlinger has been actively involved in the field of e-mobility for around twenty years. In the area of battery modules and fuel cell stacks, the Group's R&D activities are concentrated at the E-Mobility Development Center in Dettingen/Erms.

The Group entered the battery market in 2011 when it began series production of cell contact systems* for the lithium-ion batteries* used in electric and hybrid vehicles. The Group has evolved over recent years and now supplies entire systems as well as components, including both components and modules as well as complete battery systems for prismatic* and cylindrical cells. The first contracts for battery systems were secured in 2018. These are currently in the industrialization phase. In 2019, ElringKlinger also worked on refinements to its cell housing components for battery cells* and on pressure equalization units for specific applications as well as on air-input and venting elements.

With regard to fuel cell technology, ElringKlinger's development activities concentrated on the low-temperature fuel cell PEM* (Proton Exchange Membrane), which is designed for mobile applications. In this area, too, ElringKlinger has now established itself as a module and system manufacturer, integrating the fuel cell stack, hydrogen and air supply, cooling mechanism, power electronics, and control unit into a standardized system. In 2019, ElringKlinger worked on the industrialization of the NM5 fuel cell stack series, which can be used, for example, as a range extender* in hybrid vehicles. At the World Smart Energy Week 2019 in Tokyo, Japan, the Group unveiled the new NM12 stack series, which is suited for use in cars, commercial vehicles, and other applications on account of its power density. The stack consists of 450 layered metallic bipolar plates and has a capacity of up to 150 kWel.

ElringKlinger expanded its e-mobility portfolio in 2017 by forging a strategic partnership with the engineering specialist hofer. The Nürtingen-based company operates in the field of electric drives, and its product portfolio includes e-machines, power electronics, transmissions, thermal management/cooling, and safety concepts. ElringKlinger's contribution to the joint projects set up by the two companies lies in its experience in industrializing customer orders.

Engineered Plastics: Wide range of applications

In the Engineered Plastics segment, innovation starts with the materials used. Almost all the company's high-performance plastics, which are characterized by a high level of chemical and thermal stability, are designed to meet specific customer and industry requirements. Thanks to these properties, they can be adapted for use in other industries such as medical technology and mechanical engineering as well as the automotive sector.

The Engineered Plastics division benefits from the different trends affecting individual sectors. The Group's R&D activities in the automotive industry, for instance, focus on the transformation towards e-mobility, in the medical technology sector on miniaturization, and in the field of mechanical engineering on sensor technology.

* Cf. glossary

Macroeconomic Conditions and Business Environment

The world economy was in a poor state over the course of 2019. Persistent trade and geopolitical tensions caused uncertainty, which in turn made investment decisions more difficult and proved detrimental to global business. The manufacturing industry was most heavily affected by this malaise, while the service sector and consumer demand in large parts of the world managed to stand their ground. Key central banks around the globe counteracted these downside risks by taking a highly expansive approach in terms of monetary policy. In the majority of cases, automobile markets trended lower in 2019. Global vehicle production contracted by around 6% year on year. Particularly China, which ranks as the world's largest single market, saw its vehicle demand and production output fall by a substantial margin.

In the eurozone, domestic demand and the service sector were propped up by the extremely loose monetary policy favored by the European Central Bank. By contrast, export-driven industrial production was down in the period under review, having been adversely affected mainly by weak global demand. Germany's economy, too, was bifurcated, with GDP expanding only marginally. While consumer spending was buoyant and the construction sector continued to boom, the automobile industry struggled over the course of the year.

The US economy recorded more expansive growth compared to the European average, but it, too, lost some of its forward momentum. As was the case in Europe, companies scaled back their capital expenditure on the back of growing uncertainty, and the economy as a whole was driven largely by consumption and domestic trade. In an effort to support the economy, the US administration expanded government spending at the possible expense of further deficits in the national budget. The US Federal Reserve reduced its benchmark interest rate corridor by 75 basis points in order to underpin economic growth.

GDP growth rates

Year-on-year change (in %)	2019	2018
World	**2.9**	**3.6**
Advanced economies	1.7	2.2
Emerging and developing countries	3.7	4.5
Germany	0.5	1.5
Eurozone	1.2	1.9
USA	2.3	2.9
Brazil	1.2	1.3
China	6.1	6.6
India	4.8	6.8
Japan	1.0	0.3

Source: International Monetary Fund (January 2020)

China's economy, by contrast, showed signs of significant cooling in 2019. Efforts by the government to curb the significant expansion in corporate debt with the help of restrained lending and structural expenditure had a dampening effect. In addition, China was impacted by the economic repercussions of its trade conflict with the United States. Uncertainty in the wake of this dispute exerted downward pressure on domestic demand and trade, while also contributing to a slowdown in investment spending.

The emerging markets again recorded above-average growth rates by global standards. Having said that, the pace of growth in India slowed down more sharply in response to the crisis in its financial sector, coupled with highly restrictive lending and low consumer spending. Brazil saw a gradual improvement in its economy on the back of reforms introduced by the government.

Global vehicle market in negative territory at end of 2019

2019 proved to be a difficult year overall for the automobile industry. Vehicle markets were susceptible to trade and geopolitical developments, with the result that forecasts had to be steadily lowered in the course of the year. Having originally anticipated a slight increase in both global vehicle sales and vehicle production, at the end of the twelve-month period, new vehicle registrations were down by around 5% worldwide and automobile production had fallen by around 6% year on year.

This negative trend was attributable primarily to the market downturn in China, which had a disproportionately large impact on demand for new vehicles. As China – with 21.0 million newly registered cars in 2019 – accounts for around one-quarter of global volume, the market contraction of -9.5% had a palpable effect on the vehicle sector as a whole. Compared to 2018, the country saw a downturn in car sales by 2.2 million units, which essentially accounts for the global decline. In addition to the trade disputes with the United States, as a result of which imported goods became more expensive due to higher customs duties and hesitant Chinese consumers became increasingly anxious, the reduction in state subsidies for so-called NEVs (New Energy Vehicles* – essentially electric vehicles) also exerted downward pressure on demand. This was compounded by the transition to the stricter CN6 emission standard. Premium-class models continued to be in demand, enabling German OEMs to partially increase their sales in China.

Fewer light vehicles (passenger cars and light commercial vehicles) were produced and sold in the United States in 2019 than in the previous year. For the first time since 2014, the volume of newly registered light vehicles fell below the mark of 17 million. The overall decline of 1.4% is attributable solely to the passenger car sector, however, as continued buoyancy in sales of highly sought-after SUVs resulted in +3% within the light truck segment, which accounts for 72% of the market. In the third quarter of 2019, a protracted strike at a leading US manufacturer had an additional dampening effect.

Thanks to a strong final spurt in December, the European passenger car market (EU28 & EFTA*) recorded a slight increase of 1.2% in 2019, taking the total to 15.8 million newly registered vehicles. Germany, by far the largest EU car market, ended the year at +5.0%. France and Italy were also just within positive territory at 1.9% and 0.3% respectively, while registrations in the United Kingdom were down by 2.4% and in Spain by 4.8% on the previous year. The new EU countries, with Poland as the highest-volume market, recorded a total increase of 6.2% in newly registered passenger cars in 2019.

With the exception of Brazil, which recorded impressive growth of 7.7% in light vehicle sales, no other BRICS state was able to match the previous year's level. In India, the decline in passenger car sales of -12.7% was unexpectedly high.

Light vehicle production
Million units

Region	2019	2018	Change in %
Europe[1]	21.1	22.0	-4.0%
China[2]	24.7	26.9	-8.1%
Japan/Korea	13.1	13.2	-0.7%
Middle East & Africa	2.0	2.6	-22.3%
North America	16.3	17.0	-3.8%
South America	3.3	3.4	-4.5%
South East Asia	8.4	9.2	-8.2%
World	**88.9**	**94.2**	**-5.6%**

Source: IHS Feb. 2020
[1] Incl. Russia
[2] Greater China

CONSOLIDATED FINANCIAL STATEMENTS

* Cf. glossary

Vehicle production, which is closely linked to economic and market developments, declined across all regions in 2019.

E-mobility influenced by regulatory conditions

In 2019, registration figures for electric vehicles were still of minor significance. Compared to vehicles powered by an internal combustion engine, the cost of purchasing an electric car is often higher, which is compounded by the fact that the ranges achieved are still relatively short and charging infrastructures are as yet insufficient. Overall, it was evident that regional trends were influenced by government support measures, while consumer acceptance can vary considerably from country to country. In Europe, Norway and the Netherlands lead the way in terms of market share.

Calculated on the basis of the number of new registrations in 2019, China, the United States, and Germany are the front runners in electric mobility. According to the German industry institute Center of Automotive Management (CAM), the share of total registrations in 2019 was 4.7% in China, 1.9% in the United States, and 3.0% in Germany. In China, the market declined to a figure of 1.2 million so-called New Energy Vehicles* (NEV), which is due in part to a reduction in government subsidies. Car buyers in the United States continue to have a strong preference for vehicles with internal combustion engines, as a result of which sales of electric vehicles in 2019 actually fell by 10% to 324,000 new registrations. In Germany, on the other hand, new registrations surged by 50% to 109,000 vehicles.

Increase in sales of commercial vehicles in Europe

In the European commercial vehicle market (EU28 & EFTA*), 0.9% more medium and heavy commercial vehicles (>3.5 t) were registered in 2019 than in the previous year. Despite a market slowdown in the second half of the year, four out of five core markets – the UK (+9.5%), Germany (+4.2%), France (+1.5%), and Spain (+1.1%) – trended higher. At -7.6%, only Italy recorded a year-on-year decline. The medium-weight segment was in greater demand than +16-ton trucks. As a new generation of digital tachographs became mandatory in the EU from June onwards, purchases were brought forward in the first half of the year and demand weakened in the second half. In 2019, the North American truck market moved beyond the peak of an upward trend that spans several years. Although truck manufacturers were still able to draw on full order books in 2019 and thus recorded an increase in new registrations of heavy trucks (Class 8), there were signs of a significant market slowdown in the course of the year.

Significant Events

Syndicated loan* agreement covering EUR 350 million

In February 2019, ElringKlinger AG concluded a syndicated loan agreement with six domestic and international banks, covering a total volume of EUR 350 million. The agreement is based on a minimum term of five years and includes financial covenants* that are customary in the banking sector. The proceeds will be used by the Group to refinance existing bilateral lines of credit and for the purpose of general Group financing.

Activities in Industrial Parks segment scaled back

In the fourth quarter of 2019, ElringKlinger disposed of an industrial park in Kecskemét, Hungary. The property, which had previously been under lease, originated from the former parent company ZWL Grundbesitz und Beteiligungsgesellschaft Holding. In transacting this sale, the Group scaled back its activities in the Industrial Parks segment, which is not part of its core business, and is instead concentrating on aligning its product portfolio around e-mobility.

Sales and Earnings Performance

The ElringKlinger Group managed to increase its revenues by 1.6% in a market that shrank by 5.6% as a whole. After a difficult start, the Group saw a gradual improvement in earnings before interest and taxes (EBIT) on the back of several measures aimed at cost streamlining. Overall, the Group recorded EBIT* before purchase price allocation of EUR 63.2 million and an EBIT margin of 3.7%, which was within the targeted corridor of around 4 to 5%.

Group revenue up slightly despite difficult market conditions

The ElringKlinger Group continued on its trajectory of growth in 2019 and generated revenues of EUR 1,727.0 million (2018: EUR 1,699.0 million). This represents an increase of 1.6% or EUR 28.0 million. The effects of currency translation – primarily relating to the US dollar, but also the Mexican peso and the Swiss franc – made a significant contribution of EUR 25.1 million or 1.5%. Additionally, the Group was faced with changes to the scope of consolidation as a result of M&A* transactions relating to the sale of Hug in 2018, the effects of which amounted to EUR -6.2 million or -0.4%. In organic terms, i.e., without the effects of currencies and acquisitions, revenues were up by EUR 9.1 million or 0.5%. Thus, ElringKlinger again managed to outpace the market as a whole in 2019, calculated on the basis of global automobile production, which declined by 5.6%. In doing so, the Group exceeded its target of outperforming market growth by 2 to 4 percentage points in terms of organic sales.

Sustained revenue surge in North America

The strong performance in North America was driven by the supply of components used in vehicles for which demand in the American market was more buoyant than originally planned. In addition, the start-up of the new production plant in Fort Wayne, USA, provided the basis for a number of new product roll-outs that generated higher tool-related revenues. The associated tool revenues were billed accordingly at the start of production. Therefore, despite a downturn in the North American vehicle market (-3.8%), ElringKlinger managed to generate revenues of EUR 450.9 million (2018: EUR 360.3 million), which corresponds to year-on-year growth of 25.1%. Adjusted for currency effects, growth stood at 20.1%. With a share of 26.1% (2018: 21.2%), North America now ranks as the Group's second-largest sales region.

In the Asia-Pacific region, the strong recovery trends originally expected for the second half of the year failed to materialize within the market as a whole. Operating in this challenging climate, ElringKlinger managed to generate revenue of EUR 310.0 million (2018: EUR 314.5 million), which corresponds to a decline of 1.4%. Adjusted for currency effects, revenue was down by as much as 3.6%. This region's share of total revenue was 18.0% (2018: 18.5%).

The general malaise seen in ElringKlinger's largest sales market, the Rest of Europe, as well as Germany had a tangible impact on business. ElringKlinger recorded the biggest decline in its home market of Germany, down by 7.8%.

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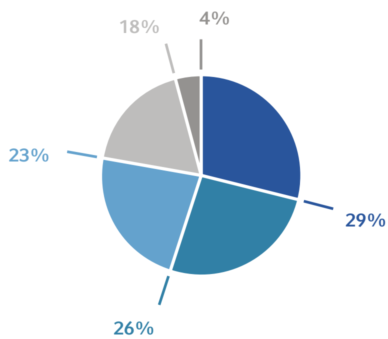
Factors influencing Group revenue

in EUR million	2019	2018	Change, absolute	Change, relative
Group revenue	**1,727.0**	**1,699.0**	**+28.0**	**+1.6%**
of which currency effects			+25.1	+1.5%
of which M&A			-6.2	-0.4%
of which organic			+9.1	+0.5%

* Cf. glossary

Group sales by region 2019



	in EUR million	(previous year)
Rest of Europe	**494.2**	(515.6)
North America	**450.9**	(360.3)
Germany	**395.0**	(428.5)
Asia-Pacific	**310.0**	(314.5)
South America and Rest of the World	**76.9**	(80.1)

Here, the Group generated sales revenue of EUR 395.0 million in the period under review (2018: EUR 428.5 million). The Group also failed to match the previous year's figure in the Rest of Europe, where revenue totaled EUR 494.2 million (2018: EUR 515.6 million). The share of total revenue attributable to the Rest of Europe fell to 28.6% (2018: 30.3%), while the share of the domestic market was down to just 22.9% (2018: 25.2%).

In South America and the rest of the world, revenues fell by 4.0% to EUR 76.9 million in 2019 (2018: EUR 80.1 million). Adjusted for currency effects, the region was down by 2.7%. This region's share of total Group revenue fell to 4.5% (2018: 4.7%).

Overall, business in the international markets continued to gain in importance, with the share of foreign sales in total Group revenue increasing from a high base to 77.1% (2018: 74.8%).

Original Equipment segment expands in strategic fields of the future

Accounting for 82.4% (2018: 82.9%) of total revenue, the Original Equipment segment is the largest segment within the ElringKlinger Group. Its performance was mixed in 2019. While the Lightweighting/Elastomer Technology and E-Mobility divisions recorded significant revenue growth, the other divisions centered around long-standing areas of business were faced with a downturn in sales. In total, segment revenues rose by 1.1% or EUR 15.7 million to EUR 1,423.4 million (2018: EUR 1,407.7 million). The segment recorded by far the largest increase of 9.4% within the Lightweighting/Elastomer Technology division in 2019. Growing by 31.7% in the year under review, the area of structural lightweighting included in this figure showed a particularly strong performance. This reflects more expansive customer demand for innovative lightweight components made of high-performance plastics.

The classic divisions focusing on cylinder-head gaskets and specialty gaskets saw a reduction in revenue by 5.6% and 2.7% respectively in 2019. At EUR 399.2 million (2018: EUR 400.1 million), the Shielding Technology division came close to matching its prior-year performance. In all three divisions, weaker market trends compared to the previous year and currency effects in particular had a negative impact on overall sales performance.

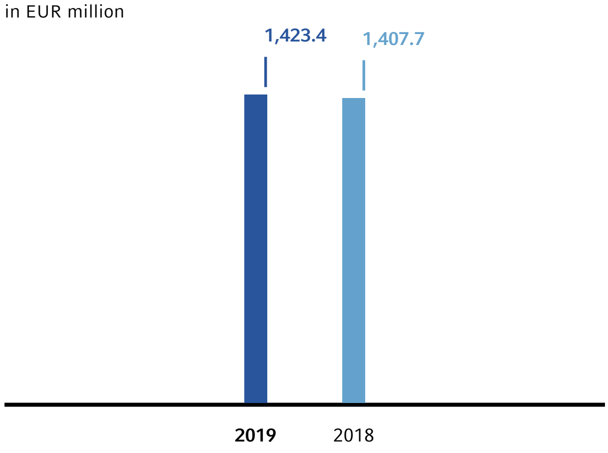
E-Mobility, a division representing the future of business in strategic terms, saw revenue grow by 9.7% to EUR 27.1 million (2018: EUR 24.7 million). ElringKlinger has established a broad technological foundation in this field with components, modules, and systems for battery and fuel cell technology as well as electric drive units. In 2019, the focus was on process optimizations relating to existing installations for the production of cell contact systems*. In addition, expenses were incurred for the commissioning of the division's new area of battery prototype construction. In the area of electric drive systems, ElringKlinger established production capacity in the United Kingdom and Germany in preparation for new orders. In total, the division therefore recorded negative earnings before interest and taxes in financial year 2019.

In the Exhaust Gas Purification division, revenue fell to EUR 10.4 million in 2019 (2018: EUR 19.6 million), as the majority of business activities in this field had previously been attributable to the Hug subgroup, which was sold in 2018.

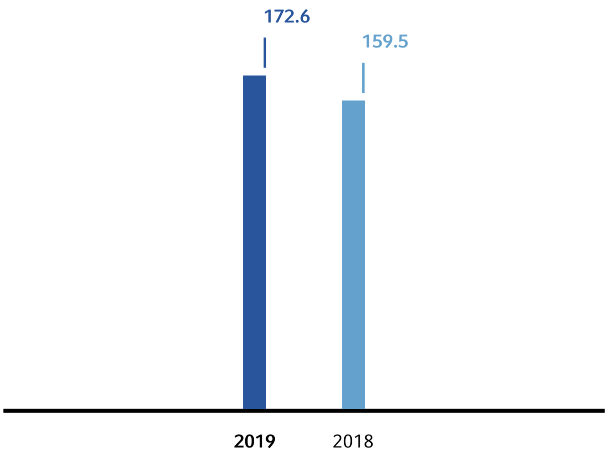
Persistently strong demand in North America again resulted in high capacity utilization at local plants in 2019. In the previous year, work began on implementing countermeasures to stabilize processes, particularly in production and logistics. Furthermore, additional production lines were installed, product prices for order renewals were adjusted to the current level, personnel received intensive training, and new employees were hired. Overall, the measures had a significant impact, with the result that noticeable improvements in earnings were recorded by the local companies in the course of the second half of the year.

Despite the positive direction taken by revenue in the strategic fields of the future, the persistently high level of capacity utilization in North America, market weakness in the traditional areas of business, and elevated commodity prices had a negative impact on earnings in the Original Equipment segment. In addition, trade conflicts led to additional customs duties in 2019, which were partially refunded. Therefore, segment earnings before interest and taxes fell to EUR 5.1 million (2018: EUR 50.7 million). The EBIT margin in this segment thus stood at 0.4% (2018: 3.6%). However, it should be noted that the prior-year figure included a one-time gain of EUR 24.5 million on the disposal of the Hug subgroup.

Sales in the Original Equipment segment
in EUR million



Sales in the Aftermarket segment
in EUR million



Strong earnings contribution by the Aftermarket segment

Despite a number of geopolitical hotspots and sluggish European markets, particularly in the first half of the year, ElringKlinger managed to increase its segment revenues by 8.2% or EUR 13.1 million to EUR 172.6 million in the year as a whole (2018: EUR 159.5 million) in the Aftermarket segment. The Aftermarket segment recorded its biggest gains in the Middle East as well as Eastern and Western Europe, whereas Germany fell short of the prior-year figure. In North America and Asia, meanwhile, ElringKlinger continued its active pursuit of market cultivation.

Segment earnings before interest and taxes rose to EUR 30.4 million (2018: EUR 24.9 million), fueled primarily by a strong flow of revenue. Correspondingly, the EBIT margin increased to 17.6% in 2019 as a whole (2018: 15.6%).

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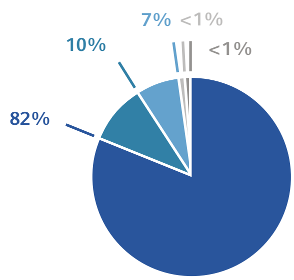
* Cf. glossary

Group sales by segment 2019

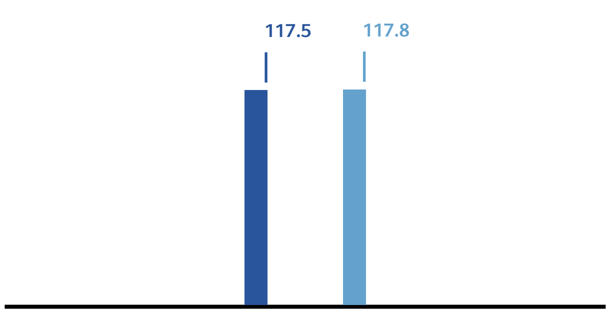


		in EUR million	(previous year)
■	**Original Equipment**	**1,423.4**	(1,407.7)
	– Lightweighting/Elastomer Technology	**494.3**	(451.7)
	– Shielding Technology	**399.2**	(400.1)
	– Specialty Gaskets	**308.5**	(317.0)
	– Cylinder-head Gaskets	**182.7**	(193.5)
	– E-Mobility	**27.1**	(24.7)
	– Exhaust Gas Purification	**10.4**	(19.6)
	– Other	**1.2**	(1.1)
■	**Aftermarket**	**172.6**	(159.5)
■	**Engineered Plastics**	**117.5**	(117.8)
■	**Services**	**9.4**	(9.7)
■	**Industrial Parks**	**4.1**	(4.3)

Engineered Plastics segment impacted by higher commodity prices

Revenues in the Engineered Plastics segment fell slightly to EUR 117.5 million (2018: EUR 117.8 million). Sales revenue was up substantially only in Asia, while all other regions saw declines. As soon as the first signs of subdued demand became apparent after nine years of continuous growth, the management initiated immediate countermeasures in the form of far-reaching cost savings. This, together with the optimization measures introduced in production, led to the first positive effects on earnings. However, due to persistently high commodity prices, it was not possible to fully offset the effects of existing cost structures. Therefore, segment earnings before interest and taxes fell to EUR 15.9 million (2018: EUR 19.5 million). Correspondingly, the EBIT margin stood at 13.5% (2018: 16.6%).

Sales in the Engineered Plastics segment
in EUR million



Earnings up after the sale of the industrial park

Neither the Industrial Parks segment nor the Services segment belongs to the core business of the ElringKlinger Group. The Services segment contributed revenue of EUR 9.4 million (2018: EUR 9.7 million) and, as in the previous year, segment earnings before interest and taxes of EUR 0.7 million. The Industrial Parks segment generated revenue of EUR 4.1 million (2018: EUR 4.3 million). As the Group's strategic focus is on the future-oriented fields of lightweighting and e-mobility, it disposed of its industrial park in Kecskemét, Hungary, in 2019. The gain of EUR 8.6 million from this divestment has been included in segment earnings before interest and taxes, which stood at EUR 9.2 million in total (2018: EUR 0.3 million).

EBIT benefits from cost-reduction measures

In financial year 2019, the management introduced an optimization program aimed at consistently reducing costs within the Group. The positive effect of the measures implemented is reflected in selling and general and administrative expenses, which were scaled back compared to the previous year, in some cases significantly, or rose at a lower rate than revenue growth. Additionally, the sites in North America and Switzerland continued to optimize their cost structures. As a result, earnings improvements were achieved in the course of 2019, even though the general conditions for a sustained improvement in earnings performance were significantly impeded by market turbulence.

Gross profit margin affected by high material expenses

Rising at a faster rate than revenue, the cost of sales increased by 5.5% to EUR 1,401.7 million in 2019 (2018: EUR 1,328.9 million). As a result, the Group's gross profit fell by 12.1% to EUR 325.3 million (2018: EUR 370.1 million). Correspondingly, the gross profit margin declined to 18.8% (21.8%).

The rise in the cost of sales was attributable, among other factors, to increased expenses from warranties, which are offset by corresponding income from insurance benefits below gross profit in other operating income. The largest proportion of the increase in the cost of sales, however, is attributable to material expenses of EUR 800.7 million (2018: EUR 747.0 million). In addition to a significant rise in tool costs, higher raw material prices also contributed to the increase in the cost-of-materials ratio to 46.4% (2018: 44.0%).

The key raw materials needed by ElringKlinger to manufacture its products include aluminum, alloyed high-grade steels (and especially chromium-nickel alloys), carbon steel, polyamide-based polymer granules, and elastomers* as well as polytetrafluoroethylene (PTFE*) in the Engineered Plastics segment. In addition, materials and components required for the production of battery and fuel cell systems are becoming increasingly important.

Commodity prices developed along different lines in the period under review. Prices on the steel market fell in 2019 due to lower world market demand. Prices for aluminum, which is required by ElringKlinger for the production of shielding parts, also trended lower. In the first half of 2019, surcharges for high-grade steel alloys, which the Group uses to manufacture gaskets, were still 6% below the 2018 level on average. However, a sharp rise in the nickel price in the second half of the year meant that alloy surcharges were on average 7% higher than in the previous year. Furthermore, strong global demand for polyamide*, which is used by ElringKlinger to produce lightweight components, drove the price up markedly in 2019.

Financial year 2019 saw staff costs within the Group rise by 2.5% to EUR 544.4 million (2018: EUR 531.2 million). Under the cost-of-sales (also referred to as function-of-expense) method, staff costs were distributed across all operational expense items in the income statement. This increase was attributable, among other reasons, to the collectively agreed pay increase for domestic companies of 4.3%, which has been in effect since the second quarter of 2018, as well as the annual collectively agreed supplemental allowance of 27.5% of a monthly salary. In total, staff costs in relation to Group revenue increased slightly to 31.5% (2018: 31.3%).

Selling expenses fell markedly in 2019 by EUR 13.1 million or 8.9% to EUR 133.4 million (2018: EUR 146.5 million). This trend clearly illustrates that the expansion, automation, and efficiency enhancement measures implemented for the purpose of addressing the issue of capacity bottlenecks at the North American plants increasingly took effect over the course of the year. In particular, ElringKlinger managed to rein back costs significantly for non-standard deliveries and freight movements compared to the previous year.

General and administrative expenses rose at a slower rate than revenue growth in the period under review, up by 1.0% to EUR 84.8 million (2018: EUR 84.0 million). The slight increase was attributable primarily to higher staff costs.

R&D ratio within the target range

In response to the far-reaching process of transformation in the automotive industry, ElringKlinger is focusing its research and development (R&D) activities primarily on solutions for alternative drive technologies. R&D expenses amounted to EUR 64.1 million in financial year 2019 (2018: EUR 76.1 million). In total, EUR 16.7 million (2018: EUR 11.1 million) in development costs were capitalized, as they met the relevant criteria for recognition. This contrasted with amortization of capitalized development costs totaling EUR 5.7 million (2018: EUR 6.2 million). Taking into account development costs capitalized by the Group, the R&D ratio, i.e., R&D costs relative to Group revenue, fell to 4.7% (2018: 5.1%).

In 2019, ElringKlinger again received government grants, primarily for research projects in the field of battery and fuel cell technology. Funds granted with regard to R&D projects and recognized in profit or loss totaled EUR 5.6 million (2018: EUR 5.3 million). In parallel, the company incurred project-related expenses at a comparable level for development work and prototyping.

* Cf. glossary

At EUR 33.5 million (2018: EUR 45.6 million), other operating income was substantially lower year on year, as expected, mainly due to the fact that this figure had been influenced by the sale of the Hug subgroup and the disposal of new enerday GmbH. The figure for the annual period under review, however, included more substantial income relating to insurance claims and compensation for damages, counterbalanced by corresponding expenses accounted for in the cost of sales. Moreover, other operating income included the gain on disposal of an industrial park in Hungary, totaling EUR 8.6 million. Other operating expenses rose to EUR 15.2 million (2018: EUR 12.8 million).

Gradual improvement in earnings over the course of the year

A major contribution to the continuous improvement over the course of the year was made by the cost-cutting program with its array of measures that helped to streamline costs. Despite the savings achieved, the Group's earnings before interest, taxes, depreciation, and amortization (EBITDA*) of EUR 181.0 million (2018: EUR 196.6 million) failed to reach the previous year's level, mainly due to the substantial material expenses in the year under review, as outlined above, and the disposal of two subsidiaries in the previous year. The initial application of IFRS 16 contributed to an increase in depreciation and amortization to EUR 119.7 million (2018: EUR 100.4 million). Thus, the ElringKlinger Group recorded earnings before interest and taxes (EBIT) of EUR 61.2 million (2018: 96.2 million). Including depreciation/amortization relating to purchase price allocation, EBIT before purchase price allocation totaled EUR 63.2 million (2018: EUR 100.2 million). This corresponds to an EBIT margin before purchase price allocation of 3.7% (2018: 5.9%). Therefore, the Group met its target of an EBIT margin before purchase price allocation of around 4 to 5%.

Net finance costs* up by EUR 5 million

As in the previous year, foreign exchange gains and losses largely offset each other in 2019. The net result for the year was a foreign exchange loss of EUR -0.2 million (2018: EUR +0.8 million). Interest expenses, on the other hand, increased, as the application of the new International Financial Reporting Standard 16 and the syndicated loan* agreement concluded in February 2019 in particular had an accretive effect. As a result, net finance costs rose to EUR -19.6 million (2018: EUR -14.7 million).

Correspondingly, earnings before taxes declined to EUR 41.7 million (2018: EUR 81.4 million).

Effective tax rate at a high level

In financial year 2019, income tax expenses rose to EUR 36.6 million (2018: EUR 33.5 million). The effective tax rate for the year increased to 88.0% (2018: 41.2%). The higher tax rate was attributable primarily to losses incurred by subsidiaries for which no deferred tax assets were recognizable. Furthermore, ElringKlinger earned most of its profits in countries whose tax rates tend to be higher than the German tax rate.

Having deducted income taxes, net income stood at EUR 5.0 million (2018: EUR 47.9 million). Net income attributable to non-controlling interests fell to EUR 0.9 million (2018: EUR 4.1 million). Eliminating these interests, net income attributable to the shareholders of ElringKlinger AG amounted to EUR 4.1 million (2018: EUR 43.8 million). Correspondingly, earnings per share* were down year on year at EUR 0.06 (2018: EUR 0.69). As of December 31, 2019, the number of shares outstanding that were entitled to a dividend remained unchanged at 63,359,990.

Suspension of the dividend

As in the previous year, the annual financial statements approved by the Supervisory Board show a net loss for the year. In order to further strengthen internal financing for the transformation process of the company, no revenue reserves were released. The annual financial statements of ElringKlinger AG as of December 31, 2018, which were prepared in accordance with the provisions of the German Commercial Code (Handelsgesetzbuch – HGB) and are relevant for the payment of dividends, showed a net loss of EUR 17.1 million as of December 31, 2019 (2018: EUR - 5.3 million). Therefore, the dividend for financial year 2019 has been suspended. The loss will be carried forward to new account.

Financial Position

With an equity ratio of 42% and substantial cash and cash equivalents, the financial position of the ElringKlinger Group remained robust as of December 31, 2019. Targeted measures had a positive effect on the balance sheet structure in financial year 2019. These include the significant reduction in net working capital[1], the disciplined management approach to investments, and the marked decline in net debt.

61% of assets are non-current

At the end of 2019, the total assets of ElringKlinger AG amounted to EUR 2,146.5 million, compared to EUR 2,079.7 million a year earlier. The year-on-year expansion is due mainly to IFRS 16 Leases, which was applied for the first time in 2019 and generally leads to an increase in total assets, as well as being attributable to currency changes. Without these effects, total assets would have been lower compared to the previous year.

As a result of IFRS 16, which has been mandatory since January 1, 2019, rights of use in regard to leased assets were capitalized under property, plant, and equipment and future lease payments were recognized as liabilities. As a result, the balance sheet total increased by EUR 45.4 million as of the changeover date of January 1, 2019. Further details are presented in the Notes to the Consolidated Financial Statements. Currency translation also resulted in an increase in total assets of around EUR 30 million due to changes in exchange rates compared to the previous year's reporting date.

At EUR 1,314.0 million, non-current assets represented a share of 61.2% of total assets as of December 31, 2019. Of these, property, plant, and equipment with a carrying amount of EUR 1,043.7 million (December 31, 2018: EUR 997.8 million) is by far the largest item. Due to the highly disciplined approach of management to new investments in financial year 2019, the Group recorded significantly fewer additions to property, plant, and equipment in 2019 than in the previous year. Adjusted for IFRS 16 items, additions from capital expenditure on property, plant, and equipment in 2019 amounted to EUR 91.9 million (2018: EUR 163.0 million), which was also slightly below the systematic depreciation of property, plant, and equipment of EUR 96.5 million (2018: EUR 87.8 million). The total additions to and depreciation of property, plant, and equipment were nearly balanced in the fiscal year so that the change compared to the previous year's reporting date essentially corresponded to the IFRS 16 effect described above. As a result of this effect, property, plant, and equipment rose by EUR 45.9 million as of December 31, 2019.

In the fourth quarter of 2019, the Group sold its industrial park in Kecskemét, Hungary (cf. "Significant Events" and details presented in the Notes to the consolidated financial statements, page 96). The corresponding real estate assets had been recognized as "Investment property" in the previous year's statement of financial position. This item of the statement of financial position includes Group assets attributable to the Industrial Parks segments, which is not part of the Group's core business. Primarily as a result of this sale, investment property declined by EUR 13.3 million to EUR 3.3 million at the end of 2019 (December 31, 2018: EUR 16.6 million).

Intangible assets increased by EUR 17.8 million year on year to EUR 208.1 million. The increase mainly includes capitalized development costs and currency changes. The main item under intangible assets is goodwill from previous M&A* activities with a carrying amount of EUR 166.3 million as of December 31, 2019.

Significant reduction in net working capital*

A large proportion of current assets constitutes working capital*, which comprises inventories, current contract assets, and trade receivables. In financial year 2019, it was reduced significantly by EUR 113.4 million to EUR 600.6 million. If trade payables and current contract liabilities are deducted

1 Inventories and current contract assets as well as trade receivables less trade payables and current contract liabilities

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* Cf. glossary

from this figure, the result is net working capital*, which represents the operating resources required for the ongoing procurement, production, and sales process. Compared to the level at the end of 2018 (EUR 568.0 million), net working capital as of December 31, 2019, was scaled back significantly by EUR 144.5 million to EUR 423.5 million.

This positive trend is the result of a comprehensive optimization program by the management with a number of different measures. Inventories were reduced at almost all manufacturing companies worldwide with the help of a more centralized approach to the management of Group-wide inventories. The plants currently under construction – specifically the facility in Fort Wayne, USA, and the sites of subsidiaries specializing in electric drive units (hofer powertrain products) – were an exception. The more pronounced reduction in tool-related items, which are generally accounted for in inventories until the start of series production, also helped to scale back stock levels. Overall, inventories were reduced by EUR 44.9 million at the end of 2019 compared to the reporting date of the previous year to a total volume of EUR 356.5 million (December 31, 2018: EUR 401.4 million). At the same time, strict receivables management, the use of factoring instruments, and not least the lack of market recovery in Asia in the second half led to an even steeper decline in trade receivables. They decreased by EUR 73.1 million year on year to EUR 233.2 million as of December 31, 2019. In addition, payment terms with suppliers were extended. This increased trade payables on the liabilities side, meaning that the Group had to raise the necessary funds at a later date. At the end of 2019, trade payables of EUR 157.1 million (December 31, 2018: EUR 135.6 million) were recognized in the Group statement of financial position.

Other current assets amounted to EUR 88.7 million as of December 31, 2019, compared to EUR 48.4 million at the prior-year reporting date. The increase is based, among other items, on retained default risks for transferred assets, an outstanding claim from a warranty case, and other receivables.

The high cash position of EUR 135.5 million at the end of 2019 (December 31, 2018: EUR 45.3 million) includes the purchase price payment from the sale of the industrial park in Hungary (EUR 21.6 million), which was made shortly before the reporting date, as well as receivables settled by customers of the Chinese subsidiaries.

The total carrying amount of current assets was EUR 832.5 million (December 31, 2018: EUR 816.3 million). This corresponded to a share of 38.8% (December 31, 2018: 39.3%) of total assets. The carrying amount reported under assets held for sale in the previous year (EUR 6.0 million) related to a property sold in 2019.

Equity ratio at 42%

Equity held by the ElringKlinger Group rose slightly year on year to EUR 891.2 million at the end of 2019 (December 31, 2018: EUR 890.1 million). The change results primarily from the allocation of net income for the period of EUR 5.0 million as well as from foreign exchange translation differences recognized in other reserves (EUR 12.7 million) and postings from the revaluation of pension provisions (EUR -15.6 million). The equity ratio was 41.5% (December 31, 2018: 42.8%) and thus still within the corridor of 40 to 50% targeted by the management.

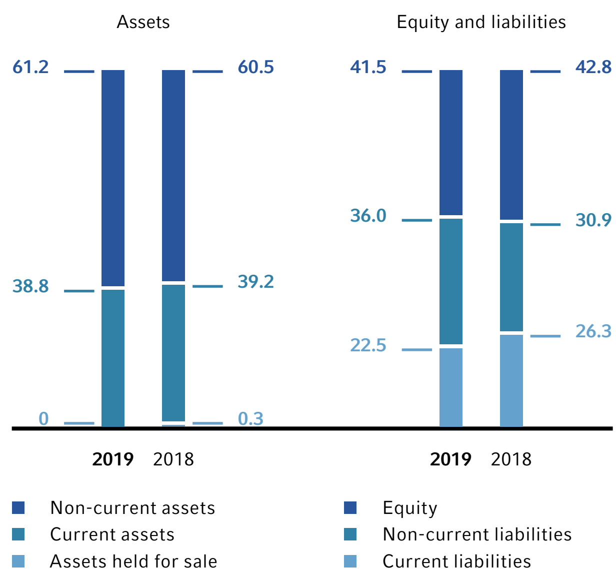
The carrying amount of pension provisions at the end of 2019 was EUR 148.2 million (December 31, 2018: EUR 124.4 million). The increase of EUR 23.8 million was mainly due to changes in parameters – including in particular lower market interest rates – on which the regular revaluation of future obligations as of the reporting date was based (cf. Note 25 in the Notes to the consolidated financial statements).

Other current and non-current provisions rose by EUR 5.8 million year on year to EUR 36.2 million (December 31, 2018: EUR 30.4 million). The largest items here are obligations relating to personnel, which are formed for partial retirement purposes, among other things, followed by warranty obligations. Provisions for warranty obligations and for obligations arising from other risks were higher compared to the previous year's reporting date.

Net debt* down significantly

The Group used the substantial cash inflow from operating activities achieved in financial year 2019 (cf. Cash Flows, page 38) to reduce its financial liabilities. Compared to the end of 2018, net debt (current and non-current financial liabilities less cash) thus fell by EUR 128.2 million to EUR 595.3 million. Financial liabilities amounted to EUR 730.7 million at the end of 2019 (December 31, 2018: EUR 768.8 million). Here, too, the effect of the application of IFRS 16 from 2019 onwards must be taken into account in a year-on-year comparison. As a result of this new accounting treatment of leasing transactions, financial liabilities increased by EUR 46.7 million.

Structure of the ElringKlinger Group's financial position
in %



Improved maturity structure through syndicated loan

In February 2019, ElringKlinger concluded a syndicated loan* agreement with six national and international banks covering a total volume of EUR 350.0 million and spanning a minimum term of five years. At the end of the year, EUR 235.3 million had been utilized. This enabled the Group to improve the maturity structure of existing financial liabilities. This is also illustrated by the fact that there was a more pronounced shift from short-term to long-term loans in financial year 2019.

Other non-current and current liabilities amounted to EUR 117.8 million at the 2019 reporting date (December 31, 2018: EUR 90.0 million) and include a number of different deferrals such as customer payments yet to be passed on and accounts receivable with credit balances. In addition, the item includes public grants that have been deferred and will be reversed to profit or loss in future periods. They include funds granted for the purpose of ensuring compliance with an energy efficiency program at the site in Dettingen/Erms, Germany, and for structural development measures at the site in Kecskemét, Hungary. The current item also includes a long-standing purchase price liability of EUR 30.3 million for the non-controlling interests of ElringKlinger Marusan Corporation, Japan.

Improvement in the level of debt

As a result of the developments described above, the level of debt (net debt in relation to EBITDA*) improved to 3.3 at the end of 2019 (December 31, 2018: 3.7) despite the effects from the first-time application of IFRS 16.

* Cf. glossary

Cash Flows

At EUR 277.6 million, net cash generated by the ElringKlinger Group from operating activities was substantial in financial year 2019. This was underpinned by a comprehensive package of measures implemented by Group management to reduce net working capital[1]. As investment spending was also scaled back substantially in the period under review, the Group recorded operating free cash flow[2] of EUR 175.8 million. Taking undrawn credit lines into account, the ElringKlinger Group's situation in terms of liquidity remains solid.

Cash flow from operating activities increases to EUR 278 million

In financial year 2019, the ElringKlinger Group achieved substantial net cash from operating activities of EUR 277.6 million (2018: EUR 91.6 million). This dynamic upturn was fueled in particular by improvement measures aimed at optimizing net working capital (cf. Financial Position, page 35). Within the statement of cash flows, this is reflected by the change in items allocated to net working capital, i.e., primarily inventories and trade receivables and payables. Including other assets and liabilities not attributable to investing or financing activities, the resulting cash inflow amounted to EUR 150.1 million in financial year 2019, compared to cash outflow of EUR 32.0 million in the previous year.

Due to the provisions of IFRS 16, since 2019 lease payments have been allocated – at the point of time of the coresponding repayment of financial liabilities – mainly to cash flow from financing activities and no longer primarily to cash flow from operating activities as in the past. In determining the operating cash flow*, this fact is reflected particularly in higher depreciation and amortization compared to the previous year, which are eliminated. In 2019, depreciation and amortization (less write-ups) of non-current assets amounted to EUR 119.7 million (2018: EUR 100.5 million). This figure includes an amount of EUR 12.9 million (2018: EUR 0 million) relating to IFRS 16.

Significant reduction in investments

The Group had initiated an intensive investment cycle in recent years for the purpose of establishing an efficient global network of production sites. On this basis, the Group can now focus its investment activities primarily on projects in the strategic business fields of e-mobility and structural lightweighting. As a result of this disciplined investment approach, cash outflows for capital expenditure on property, plant, and equipment and investment property fell noticeably to EUR 92.2 million in 2019 (2018: EUR 163.5 million). The investment ratio (capital expenditure on property, plant, and equipment and on investment property relative to Group sales revenue) fell to 5.3% (2018: 9.6%).

One of the largest investments in 2019 was that relating to the technology center for e-mobility currently being built at the main site in Dettingen/Erms, Germany. After its completion scheduled for spring 2020, the research and development activities in battery and fuel cell* technology will be based there. Another focus of investment spending was on the North American plants, where capacity adjustments, automation, and product ramp-ups were necessary. The new plant built in Fort Wayne, USA, in financial year 2018 saw the ramp-up of serial production of thermal and acoustic shielding systems in 2019.

[1] Inventories and current contract assets as well as trade receivables less trade payables and current contract liabilities
[2] Cash flow from operating activities less cash flow from investing activities, adjusted for cash flows in respect of acquisition activities and changes in financial assets

At the German site in Thale, the introduction of series production capabilities for complete battery systems progressed over the course of the period under review. In addition to new assembly lines for battery modules and components at the site in Dettingen/Erms, Germany, other capital expenditure on property, plant, and equipment mainly related to equipment directly connected with series ramp-ups or the improvement of efficiency and operational performance.

Payments for intangible assets amounted to EUR 19.1 million (2018: EUR 15.1 million) in 2019 and included software licenses and similar rights as well as, in particular, capitalized development costs.

The Group received EUR 21.6 million from the disposal of subsidiaries (2018: EUR 56.8 million). This relates to the sale of the industrial park in Kecskemét, Hungary (cf. Significant Events and details presented in the Notes to the consolidated financial statements). The prior-year payment related to the sale of the Hug Group, Switzerland, and new enerday GmbH, Neubrandenburg.

The disposal of property, plant, and equipment, intangible assets, and investment property generated cash inflows of EUR 9.6 million for the Group in 2019 (2018: EUR 0.8 million). This includes the proceeds from land that was sold in 2019.

In total, net cash used in investing activities amounted to EUR -84.5 million, after EUR -120.7 million in the previous year.

Operating free cash flow at EUR 176 million

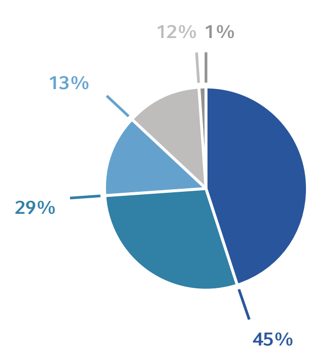
As both operating cash flow improved significantly in 2019 compared to the previous year and investment outflows decreased, operating free cash flow increased substantially to EUR 175.8 million. The prior-year figure was EUR -86.2 million.

Financing activities benefit from strengthened internal financing

The Group used the capital inflow from operating cash flow to finance capital expenditure and also to repay borrowings. On balance, funds of EUR 103.8 million were used to reduce financing activities in 2019, whereas EUR 30.0 million had to be raised in 2018. The company's financial strength was also underpinned by the fact that no dividend was paid to shareholders of ElringKlinger AG in 2019 in respect of the previous financial year (2018: EUR 31.7 million).

As of December 31, 2019, the Group had access to approved yet undrawn lines of credit totaling EUR 150.5 million (December 31, 2018: EUR 190.2 million).

Investment[1] spending by region



in EUR million		(previous year)
Germany	58	(74)
North America	37	(54)
Asia-Pacific	17	(26)
Rest of Europe	16	(19)
South America and Rest of the World	2	(6)

[1] Investments in property, plant, and equipment, investment property, and intangible assets

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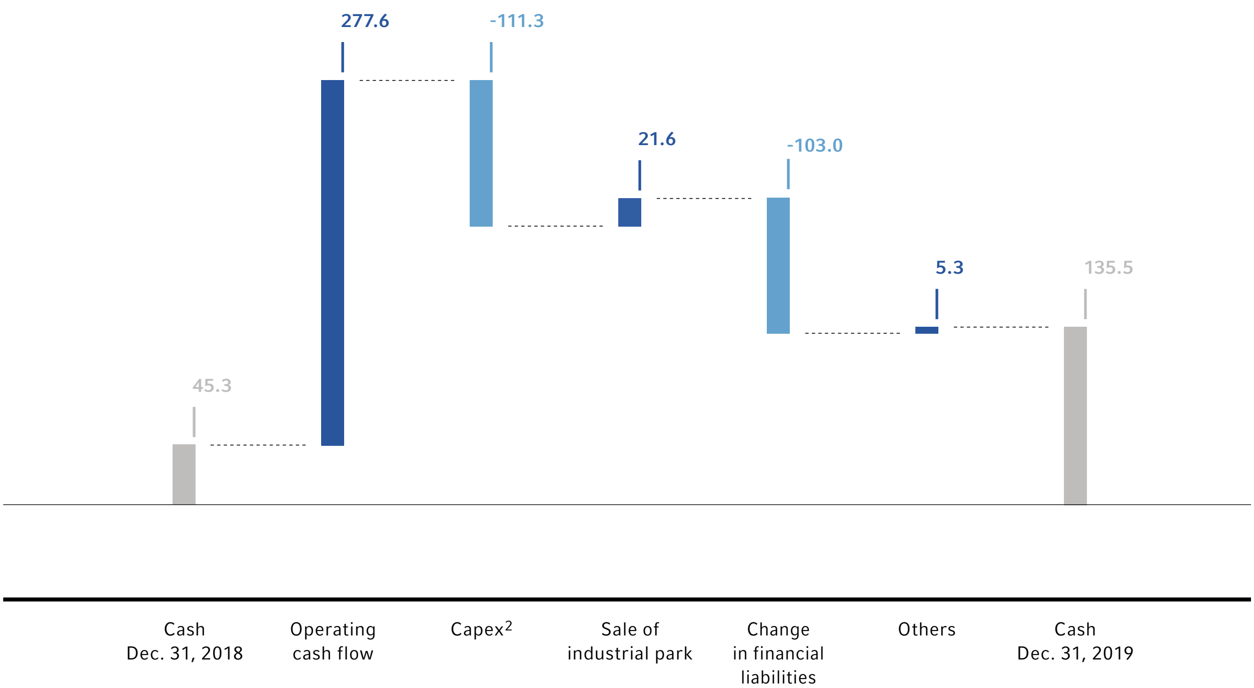
* Cf. glossary

Changes in cash 2019[1]
in EUR million



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

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

Group revenue again developed better than the global vehicle market as a whole in financial year 2019. Despite the worldwide decline in vehicle production by -5.6%, ElringKlinger increased its revenues by 1.6% in 2019, taking the total to EUR 1,727.0 million. On the cost side, the efficiency program launched at the beginning of 2019 took effect, so that additional charges such as higher customs duties and personnel costs were counteracted by cost streamlining. At EUR 63.2 million and a margin of 3.7%, earnings before interest, taxes, and purchase price allocation* (EBIT before purchase price allocation) were at the lower end of the targeted range of around 4 to 5% – an unsatisfactory result from the management's point of view, but acceptable in view of the difficult market environment.

The Group performed particularly well when it came to bolstering its financial strength in 2019. Targeted measures to optimize inventories as well as trade receivables and payables helped to free up liquidity reserves and strengthen ElringKlinger's internal financing. As a result, the Group achieved a substantial inflow of cash from operating activities, while net debt* was scaled back significantly. New investments were made with a clear focus on future-proof projects. Management will continue to pursue this disciplined approach and carefully monitor and control changes in net working capital*.

ElringKlinger was quick off the mark in its efforts to position itself favorably in a fast-paced automotive industry driven by change. As a result, the company already offers customer-specific solutions not only for classic fields of application but also for vehicles powered by alternative drive systems. In the area of novel drive technology, ElringKlinger has established a portfolio consisting of components, modules, and entire systems. This includes complete battery systems as well as fuel cell stacks ready for series production, for example. Together with the broad customer base, which includes both established and new manufacturers, and the strong global network of production sites, management believes that this forms an excellent basis for consistently solid business development.

Financial Performance, Net Assets, and Cash Flows of ElringKlinger AG

As in previous years, the management report of ElringKlinger AG and the Group management report have been brought together in a combined format. The business performance relating to ElringKlinger AG, as outlined below, is based on its annual financial statements, which have been prepared in accordance with the provisions set out in the Commercial Code (Handelsgesetzbuch – HGB*) and the additional requirements of the Stock Corporation Act (Aktiengesetz – AktG) as well as the relevant provisions set out in the company's Articles of Association.

ElringKlinger AG recorded a slight downturn in revenue in 2019, but nevertheless managed to exceed the change in global vehicle production by a good 4 percentage points. The cost streamlining program initiated in 2019 showed initial positive effects. Despite this, earnings performance was adversely affected by lower sales revenue and higher personnel expenses in the period under review.

Revenue down slightly

ElringKlinger AG failed to match the strong surge in revenue seen in the previous financial year and recorded a slight downturn of 1.6% in 2019, taking the figure to EUR 709.1 million (2018: EUR 720.5 million). As a result, the company reached the upper end of its projected target of boosting revenue by 2 to 4 percentage points above the global market growth rate (-5.6%).

Revenue generated in the Rest of Europe (without Germany), ElringKlinger AG's largest sales region, rose slightly by 0.9% to EUR 308.6 million (2018: EUR 305.8 million). The Asia-Pacific region also developed well. In a market characterized by a significant decline in vehicle production output of more than -8%, revenue increased by 3.7% to EUR 59.6 million (2018: EUR 57.5 million). At EUR 73.5 million (2018: EUR 77.3 million), by contrast, the sales region of North America was noticeably weaker than in the previous year. In total, revenue from foreign sales was up by 0.3%, taking the figure to EUR 467.3 million (2018: EUR 466.0 million). Thus, the share of foreign sales rose to 65.9% (64.7%).

In line with the current market weakness in Germany, ElringKlinger AG, too, saw revenue from domestic sales fall in the period under review, down by 5.0%. The total of EUR 241.8 million (2018: EUR 254.4 million) also includes revenues from products incorporated into vehicles and engines that are subsequently exported.

Original Equipment sees dip in revenue

The Original Equipment segment recorded a downturn in revenue of 4.2% to EUR 550.7 million in 2019 (2018: EUR 574.8 million). The segment's contribution to the total revenue generated by ElringKlinger AG fell to 77.7% (2018: 79.8%). The Shielding Technology and Cylinder-head Gaskets divisions accounted for the largest decline in revenue, whereas the Lightweighting/Elastomer Technology division continued to expand. The E-Mobility division also delivered revenue growth, recording a percentage increase from a low base.

* Cf. glossary

Significant growth in Aftermarket revenue

Overall, the Aftermarket segment moved forward dynamically despite geopolitical tensions in many regions. ElringKlinger AG saw revenues increase by 8.9% to EUR 158.3 million (2018: EUR 145.4 million). The segment's contribution to total revenue rose to 22.3% (2018: 20.2%). With the exception of Germany, Iran, and Australia, business in the Aftermarket segment continued to expand in all sales regions. ElringKlinger AG recorded particularly strong revenue growth from sales in Eastern Europe and the Middle East. Sales in both Asia and North America ended the year up – from a low base – and efforts are being made to achieve greater market penetration in these regions.

Year-on-year decline in total operating revenue

Having recorded inventory increases of EUR 4.8 million in 2018, ElringKlinger AG managed to scale back inventories by EUR 2.4 million in the reporting period due to the reduction in business volume. At the same time, other own work capitalized fell to EUR 0.2 million (2018: EUR 0.3 million). At EUR 706.9 million (2018: EUR 725.6 million), total operating revenue was down EUR 18.7 million on the prior-year figure.

Other operating income amounted to EUR 12.5 million (2018: EUR 46.9 million). This reduction was mainly due to lower income from asset disposals of EUR 0.4 million (2018: EUR 29.8 million), which primarily related to the sale of the Hug Group in financial year 2018. In addition, income from foreign exchange differences fell by EUR 2.9 million to EUR 5.5 million (2018: EUR 8.4 million).

Other operating expenses fell by EUR 10.1 million to EUR 108.5 million (2018: EUR 118.6 million). The year-on-year reduction is attributable, among other factors, to the cost streamlining program implemented by ElringKlinger AG in 2019. This had a particular impact on travel, general and administrative, and other personnel expenses, which fell significantly compared to the previous year.

Commodity prices develop along different lines

In 2019, there was a significant downturn in the price of key input materials such as aluminum and steel, which are required by ElringKlinger AG in large quantities for production. By contrast, polyamide*, a plastic material used by the Group for the production of lightweight components, was more expensive. Due to the lower volume of revenue and a reduction in tool costs, the cost of materials recorded by ElringKlinger AG fell to EUR 299.6 million (2018: EUR 326.2 million). This corresponds to a year-on-year decrease of 8.2%. The cost-of-materials ratio (cost of materials in relation to total operating revenue) thus fell to 42.4% (2018: 45.0%).

Headcount expanded in new business areas

The policy of restraint by the Group with regard to new hires also had an impact on ElringKlinger AG. Expanding by ten, the headcount at the end of the reporting period remained largely unchanged year on year at 3,367 (December 31, 2018: 3,357). A large proportion of the new hires related to the promising areas of battery and fuel cell* technology and electric drive units. In addition to the slight increase in personnel, the collectively agreed salary increase of 4.3%, which has been in effect since the second quarter of 2018, and the additional 27.5% collectively agreed annual supplemental allowance led to an increase in personnel expenses in financial year 2019. Personnel expenses rose by 3.1% to EUR 245.2 million (2018: EUR 237.9 million), thus outpacing the increase in revenue. At 34.7% (2018: 32.8%), the personnel expense ratio was significantly higher as a proportion of total operating revenue.

Significant reduction in write-downs

Systematic depreciation and amortization of intangible and tangible fixed assets remained largely unchanged year on year at EUR 36.8 million (2018: EUR 36.7 million). In 2018, the company had to make additional write-downs of receivables from affiliated companies totaling EUR 24.2 million. As a result, the overall figure for depreciation/amortization and write-downs fell by EUR 24.1 million in total in the period under review (excluding write-downs of financial assets).

Earnings before interest, taxes, and equity investments slightly up on the previous year

As outlined above, earnings generated by ElringKlinger AG were diluted by higher personnel expenses and lower other operating income in 2019. However, the significant reduction in the cost of materials and lower depreciation and amortization ultimately meant that earnings before interest, taxes, and equity investments were slightly up on the previous year at EUR 29.4 million (2018: EUR 28.9 million). This is equivalent to an EBIT margin* (as a proportion of total operating revenue) of 4.2% (2018: 4.0%). As such, the company was able to exceed its target of maintaining the margin at the same level as in 2018.

Lower net income from equity investments

Income from equity investments declined in the reporting period and amounted to EUR 30.3 million (2018:

EUR 35.0 million). Additionally, write-downs on financial assets pushed the net figure down by EUR 55.2 million (2018: EUR -53.5 million). Net income from equity investments fell to EUR -24.9 million (2018: EUR -18.5 million). Interest and similar expenses rose to EUR -16.0 million (2018: EUR -12.2 million), partly due to the conclusion of the syndicated loan* agreement in February 2019.

Post-tax profit down after higher tax expenses

As a result of negative net income from equity investments, earnings before taxes were also in negative territory at EUR -3.6 million, down on the figure of EUR 4.1 million recorded in the previous year. There was no reduction in income taxes compared to the previous year because the write-downs on financial assets are not tax-deductible. Total income taxes for 2019 amounted to EUR 13.3 million (2018: EUR 9.2 million). Income taxes include taxes relating to other periods in the amount of EUR 1.8 million (2018: EUR 0.1 million). As a result, post-tax profit at the end of the reporting period was negative at EUR -16.9 million (2018: EUR -5.1 million). After deducting other taxes, ElringKlinger AG posted a net loss of EUR 17.1 million for the financial year under review. Taking into account the loss carried forward of EUR 5.3 million from the previous year, the accumulated loss in 2019 amounts to EUR 22.4 million (2018: EUR -5.3 million).

Suspension of the dividend

As in the previous year, no reversals of revenue reserves were made in 2019, the aim being to further strengthen internal financing for the transformation process of the company. Financial year 2019 produced a net loss of EUR 17.1 million (2018: EUR -5.3 million). The Management Board and Supervisory Board have therefore jointly decided to again suspend the dividend for financial year 2019. The accumulated loss will be carried forward to new account.

Net assets of ElringKlinger AG

ElringKlinger AG's position in terms of net assets remains very solid with an equity ratio of 40.2% (2018: 40.0%). ElringKlinger AG has a twin role within the Group, as it is not only the largest manufacturing entity but also the parent company. This is reflected in the balance sheet by the fact that, alongside assets required for operating activities, it primarily includes financial assets and receivables from affiliated companies. Total assets, i.e., the balance sheet total, amounted to EUR 1,319.3 million at the end of 2019 (December 31, 2018: EUR 1,370.4 million).

Fixed assets account for 56% of total assets

Fixed assets represented 55.8% of total assets at the end of the reporting period and amounted to EUR 735.7 million (December 31, 2018: EUR 807.7 million). The year-on-year decline is essentially due to two factors. Firstly, the company's investment activities were scaled back significantly in financial year 2019 as planned, with the result that systematic depreciation exceeded the new additions from investments (EUR 25.9 million). This also takes into account a disposal of land and several disposals of assets of minor importance. As a result, tangible fixed assets decreased by EUR 15.5 million to EUR 352.2 million compared to the prior-year carrying amount.

Secondly, the carrying amount of financial assets declined, which, at EUR 375.6 million (December 31, 2018: EUR 431.4 million), accounts for around 50% of fixed assets and essentially represents interests in affiliated companies. These were reduced by EUR 55.2 million as part of the annual impairment test, as interests in five subsidiaries were impaired. There were no reversals of impairments.

Inventories primarily comprise raw materials for the production process as well as semi-finished and finished products, including stocks relating to the spare parts business. Despite the overall rise in material prices over the course of the year, total inventories were reduced slightly to EUR 147.8 million as of December 31, 2019, down from the figure of EUR 153.5 million at the prior-year reporting date.

The majority of receivables and other assets totaling EUR 417.3 million (December 31, 2018: EUR 406.5 million) are short-term loans to subsidiaries. As ElringKlinger AG is responsible for central finance and liquidity management within the Group, it generally raises the necessary external funds and makes them available to Group companies. These loans are mainly recognized in receivables from affiliated companies, which amounted to EUR 336.0 million at the end of the year (December 31, 2018: EUR 299.6 million). Trade receivables at ElringKlinger AG fell by EUR 35.5 million year on year (December 31, 2018: EUR 92.3 million) to EUR 56.8 million. The sharp decline resulted from the use of various instruments to selectively reduce capital tied up in current assets and thus scale back financing requirements.

* Cf. glossary

Equity ratio of ElringKlinger AG at 40%

ElringKlinger AG's shareholder equity totaled EUR 530.5 million as of December 31, 2019, which equates to an equity ratio of 40.2% (2018: 40.0%). As the company suspended its dividend payment for financial year 2018, the change in shareholders' equity compared to the end of the previous year (EUR 547.6 million) was attributable solely to the net loss for financial year 2019 (EUR -17.1 million).

Provisions recognized by ElringKlinger AG rose to EUR 124.2 million as of December 31, 2019 (December 31, 2018: EUR 116.8 million). The year-on-year change is mainly due to pension provisions, which account for around two-thirds and were revalued as scheduled at the end of the year on the basis of several parameters such as interest rates.

ElringKlinger AG used the substantial cash flow* generated from operating activities in financial year 2019 to reduce its liabilities to banks. As of December 31, 2019, these amounted to EUR 519.4 million and were thus EUR 80.1 million lower than in the previous year. Part of the existing borrowing relates to a syndicated loan concluded with six national and international banks in February 2019. Trade payables increased year on year to EUR 53.7 million (December 31, 2018: EUR 44.8 million). This reflects the fact that extended payment terms were specifically agreed with suppliers. In total, ElringKlinger AG's receivables amounted to EUR 664.4 million at the end of the reporting period (December 31, 2018: EUR 705.5 million), thus accounting for 50.4% of total liabilities. This was lower than in the previous year (51.5%).

Cash Flows* of ElringKlinger AG

Substantial operating cash flow of EUR 139 million

Although the net result of ElringKlinger AG for the period under review was lower than last year's negative net result, cash flow from operating activities, which had already been high in the previous year, at EUR 94.2 million, grew substantially to EUR 138.5 million in financial year 2019.

The year-on-year increase is mainly attributable to the lower absorption of funds in net working capital* (inventories and trade receivables less trade payables). After an improvement had already been achieved in the previous year compared to the prior-period figure, further progress was made in the past financial year. In financial year 2019, for instance, ElringKlinger AG recorded a cash inflow of EUR 53.6 million (December 31, 2018: cash outflow of EUR 7.4 million) due to the reduction in net working capital*, including changes in other assets and liabilities not attributable to investing activities. This includes above-average incoming payments from customers that are attributable to factors relating to the end of the reporting period; they also account for the comparatively high cash balance of EUR 15.0 million as of December 31, 2019 (December 31, 2018: EUR 0.1 million).

Investments scaled back significantly

ElringKlinger AG invested a total of EUR 25.9 million in tangible fixed assets in 2019, which was less than half as much as the prior-year figure of EUR 52.1 million. The company thus successfully implemented its disciplined approach to investments. This was also one of the measures taken in an effort to reduce the need for external funds. Capital expenditure was directed, among other things, at the construction of a new technology center for electromobility at the main site in Dettingen/Erms, which will commence operations in 2020. As part of the focus on electromobility within the portfolio, a large proportion of the newly acquired technical equipment was used on production and assembly lines for battery manufacture. A series production facility for complete battery systems is under construction at the plant in Thale, Germany. In addition, state-of-the-art equipment was purchased for further automation in the core area of business.

Taking into account the other matters relating to investing activities, net cash used in investing activities was EUR -20.4 million (December 31, 2018: EUR -30.6 million). This includes proceeds from the disposal of tangible fixed assets in the amount of EUR 6.9 million, including a sale of land. The prior-year figure includes cash inflows and outflows from the sale of two subsidiaries and capital increases at several subsidiaries.

As no dividend was paid in 2019 for the previous financial year (2018: EUR 31.7 million), the company used the capital surplus from operating and investing activities to repay borrowings. A total of EUR 103.3 million (December 31, 2018: EUR 63.6 million) was used in financing activities.

As of December 31, 2019, the undrawn lines of credit available to ElringKlinger AG totaled EUR 100.4 million (December 31, 2018: EUR 136.3 million).

The statement of cash flows in respect of the annual financial statements was again prepared according to the provisions set out in GAS 2.

People

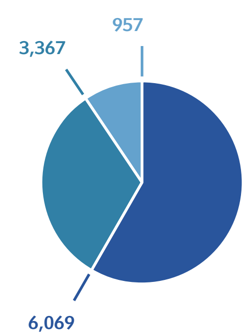
Against the backdrop of an evolving world of work, the company is experiencing a stronger and changing demand for skilled workers. ElringKlinger is committed to retaining employees with the company over the long term and uses a number of targeted measures to achieve this.

Conservative HR policy

The comprehensive cost reduction program implemented by ElringKlinger in financial year 2019 also had an impact on personnel policies in Germany and abroad. Despite revenue growth, for example, the headcount within the ElringKlinger Group fell to 10,393 (2018: 10,429) as of December 31, 2019. This equates to a slight reduction in staffing levels by 36. An average of 10,461 (2018: 10,033) people were employed by the Group in 2019. At the end of the reporting period, 3,367 (2018: 3,357) staff members were working at the sites of the parent company ElringKlinger AG (Dettingen/Erms, Gelting, Runkel, Langenzenn, Lenningen, and Thale). At the Dettingen/Erms headquarters, in particular, newly recruited employees consisted primarily of skilled workers for the new business areas of battery and fuel cell technology.

In Europe, ElringKlinger reduced its headcount in Switzerland, the United Kingdom, and Turkey, as planned. By contrast, new hires were needed in response to a high volume of business in Hungary and Spain. ElringKlinger employed around 15% of its personnel in the Asian markets. In line with the weaker economic situation in Asia compared to the previous year, the Group adjusted the number of employees slightly at most companies in this region. The North America region accounted for the largest increase in personnel. In the United States and Canada, in particular, additional employees were hired in order to respond to persistently high levels of demand. The total headcount abroad was 6,069 (2018: 6,105). As a result, the proportion of Group employees based outside Germany fell to 58.4% (2018: 58.5%), a slightly lower figure relative to the previous year. Thus, the share of staff members employed at domestic facilities was 41.6% (2018: 41.5%).

ElringKlinger Group employees worldwide
as of December 31, 2019 (previous year)



Foreign subsidiaries	**6,069**	(6,105)
ElringKlinger AG	**3,367**	(3,357)
Domestic subsidiaries	**957**	(967)

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* Cf. glossary

Headcount data for the ElringKlinger Group

		2019	2018
Absolute number of employees		10,393	10,429
of which men	(in %)	70.0	71.0
of which women	(in %)	30.0	29.0
Absolute number of employees		10,393	10,429
of which domestic	(in %)	41.6	41.5
of which abroad	(in %)	58.4	58.5
Average number of employees		10,461	10,033

Report on Opportunities and Risks

ElringKlinger has established an extensive risk management system, the aim being to identify risks at an early stage, evaluate them, and mitigate them with the help of appropriate instruments and measures. In addition to external factors, such as economic or technological factors, internal factors, such as strategic, operational, or financial factors, also influence the risk positions. The Group has a comprehensive set of instruments aimed at preventing the occurrence of such an event or, in the event of its occurrence, minimizing its impact on the company.

Risk management system

By monitoring markets, customers, and suppliers on a continual basis and maintaining detailed internal reporting and controlling processes, the company is able to gauge risk in a timely manner and seize market opportunities. The effectiveness and suitability of the risk management system itself is continually adapted and refined in accordance with new requirements as they arise.

The risk management system is made up of various tools and control systems. Among the key components are strategic Group planning and internal reporting. Planning enables potential risks to be identified and taken into account when making critical and significant decisions. All key areas within the Group are involved in strategic Group planning. Within this context, information is retrieved, collated, and evaluated in a standardized process. The Management Board bears overall responsibility. Internal reporting is used to monitor and control business performance. A key component of the risk management system is regular reporting by the management of the respective domestic and foreign Group companies as well as the divisions, which is performed on a half-yearly basis. It covers developments in all fields relevant to the Group that can affect business activity and, in particular, the continuation of the ElringKlinger Group as a going concern. The focus is primarily on changes to the economic or political situation, new regulatory requirements, technological developments, commodities markets, and internal risks. This reporting system involves identifying and evaluating all risks and subsequently drafting recommendations on how to prepare for and protect against them. The Chief Financial Officer is responsible for coordinating these activities. This approach is designed to ensure that risks are identified at an even earlier stage and measures aimed at avoiding or mitigating such risks can be implemented rapidly. The risk structure of the Group and the AG does not differ significantly overall.

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

Alongside regular reporting, internal audits are an important control mechanism and thus an essential element of the risk management system. Audits are carried out in the business and service divisions of ElringKlinger AG as well as at the Group companies. They are conducted by the Audit department in cooperation with external accountancy firms commissioned by ElringKlinger AG. The rationale behind the use of internal and external specialists is to ensure that risks are identified, statutory requirements met, internal processes reviewed, and potential for improvement recognized. The findings of such audits are compiled in reports, which are directed in particular at the Management Board and the Chairperson of the Supervisory Board's Audit Committee. The reports are evaluated, whereupon necessary measures are initiated. The execution of measures is monitored by the Management Board member whose remit covers this area; this Management Board member is also responsible for reviewing assessments conducted with regard to risk positions identified by the company. All relevant findings are discussed with the areas concerned in order to bring about improvements or rectify any weaknesses. None of the audits conducted in 2019 gave rise to any significant objections. Both statutory regulations and internal requirements were consistently met. The recommendations submitted with regard to potential areas for optimization have been put in place or are currently being implemented.

In accordance with the existing compliance system, the Chief Compliance Officer reports directly to the Chief Executive Officer. Additional Compliance Officers have been appointed for individual regions in which ElringKlinger is active; they report to the Chief Compliance Officer. The ElringKlinger Code of Conduct forms an important part of the compliance system. It sets out binding rules for all employees of the ElringKlinger Group. Among other aspects, the code covers issues such as fair competition, corruption, discrimination and the protection of confidential data. The code is distributed to all employees in the language of the country in which they are based. Staff members, and particularly management personnel, receive training relating to these issues. Training courses are held on a regular basis in order to prevent compliance-related infringements.

ElringKlinger's Whistleblower System allows employees to report any irregularities they may come across. This gives them a safe line of communication in order to pass on information on misconduct, violations of statutory provisions, and policy infringements. The Chief Compliance Officer responded to all indications of compliance-related infringements in order to investigate the circumstances and initiate requisite measures. Where evidence suggested that an infringement may have occurred, the Management Board was informed accordingly. No significant infringements were reportable for 2019. The Management Board is committed to adapting and refining the existing compliance system to changing circumstances and the possibility of evolving risk exposure.

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

Control and risk management system with regard to accounting

With regard to accounting and external financial reporting within the Group, the internal control and risk management system may be described with reference to the basic characteristics outlined below. The system is geared toward the identification, analysis, valuation, risk control, and monitoring of these activities. The structuring of the system in line with the specific requirements of the company is the responsibility of the Management Board and Supervisory Board. In accordance with the distribution of responsibilities within the company, the Finance department, which is in charge of accounting, comes under the remit of the Chief Financial Officer. This department, which also includes Corporate

Investment Management, controls accounting within the Group and ElringKlinger AG and compiles the information required for the preparation of the consolidated financial statements and the annual financial statements of ElringKlinger AG. Corporate Investment Management is responsible, in particular, for monitoring and supporting the accounting processes of the Group companies. The Group companies report to the Chief Executive Officer.

The principal risks associated with the accounting process derive from the need to provide accurate and complete information within the specified time frame. This presupposes that the requirements have been clearly communicated and the departments responsible are placed in a position where they can meet those requirements. ElringKlinger has compiled an accounting manual on the basis of International Financial Reporting Standards. All Group companies are required to apply the standards outlined in this manual as a basis of the financial reporting process. All the principal valuation standards such as those covering inventories, tools, and receivables under IFRS are specified in mandatory form in the manual. Mandatory accounting standards are also in use across the Group as a way of ensuring uniform treatment of the same issues.

All Group companies are obliged to comply with a pre-defined schedule for preparation of the Group financial statements. All Group companies are responsible for drawing up their separate financial statements in accordance with local accounting rules and the reporting packages pursuant to IFRS and the ElringKlinger accounting manual. Internal Group clearing accounts are reconciled with the help of confirmation of balances and the Group reporting system. Financial reporting by all the Group companies is conducted by means of a Group reporting system. It contains not only financial data but also information that is of importance to the Notes to the consolidated financial statements and the combined management report of the ElringKlinger Group and ElringKlinger AG. The data and information are checked by the Finance department prior to release and consolidation.

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

The risks that may affect the accounting process include, for instance, those associated with delays or errors in the entry of transactions or failure to observe the accounting manual and account allocation rules. In order to avoid mistakes, the accounting process is based on the separation of responsibilities and competencies, the automation of procedures, and plausibility checks for reporting purposes. Calculations are subject to continuous monitoring. Comprehensive and detailed checklists have to be worked through before the established reporting deadline.

The accounting process is also incorporated into the ElringKlinger Group's risk management system as a way of identifying accounting-related risks at an early stage, allowing the company to take prompt action to anticipate and address potential risks. As is the case with the other areas and functions of the Group, accounting is also subject to the investigations conducted as part of internal auditing; these are performed by external accountancy firms. Accounting processes and procedures at ElringKlinger AG and its Group companies are reviewed in the course of regular internal audits. The findings are then used to make further refinements and improvements.

Assessment of opportunities and risks

The following table presents an overview of material risks to which the ElringKlinger Group is exposed as well as key opportunities. Both the risks and the opportunities were graded according to the probability of occurrence and the potential financial impact. A probability of occurrence of 10% is considered "low," one of 40% is classified as "medium," and one of 80% is deemed "high." The potential financial impact is categorized on the basis of criteria, ranging from "insignificant" to "significant." In this context, in the event of occurrence, "insignificant" refers to a potential impact on Group earnings before interest and taxes of less than 5%, "moderate" between 5 and 10%, and "significant" in excess of 10%. These factors are identified on the basis of a gross assessment, i.e., prior to possible measures aimed at risk mitigation. The overall potential with regard to risks and opportunities in relation to the respective category is derived from the interaction of probability of occurrence and potential financial impact. The assessment of opportunities and risks was performed as of the end of the reporting period, i.e., December 31, 2019. Reporting in respect of opportunities and risks is always based on a period of one year.

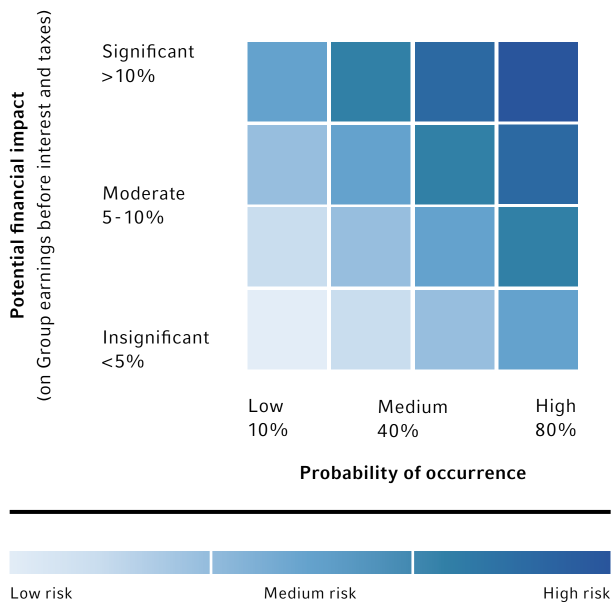
Opportunity and risk profile of the ElringKlinger Group

Type of risk/opportunity	Probability of occurrence	Potential financial impact
Economic risks		
Economic and industry risks	High	Significant
Political risks	Medium	Moderate
General internal risks		
General internal risks, work-related accidents, fire	Low	Moderate
Operational risks		
Price-related pressure/Competition	High	Moderate
Material risks/Supplier risks	Medium	Insignificant
Customer risks	Medium	Moderate
Labor cost risks	Medium	Moderate
Personnel risks	Medium	Insignificant
IT risks	Medium	Significant
Quality/Warranty risks	Medium	Insignificant
Legal risks		
Legal risks/Compliance risks	Low	Moderate
Strategic risks		
Technology risks	High	Significant
External growth/Acquisitions	Low	Moderate
Financial risks		
Bad debt loss	Low	Moderate
Liquidity and financing risks	Low	Moderate
Currency risks	Medium	Insignificant
Interest-rate risk	Low	Moderate
Use of derivative financial instruments	Low	Insignificant
Opportunities		
Climate change/Emission laws	High	Significant
Technology trends	High	Significant
Extension of product and service portfolio	High	Significant
New sales markets	High	Significant
Industry consolidation/M&A*	Medium	Moderate

CONSOLIDATED FINANCIAL STATEMENTS

* Cf. glossary

Risk matrix of the ElringKlinger Group



Economic risks

Economic and industry risks

The global vehicle markets tend to perform in line with prevailing economic trends. A substantial downturn in the economy represents a risk to demand and, ultimately, to vehicle production. This, in turn, could possibly result in lower demand for the product portfolio of the ElringKlinger Group.

Based on the Group's most recent year-end assessment, there is a risk of a general slowdown in global market growth. This is due to the expected decline in the Chinese automobile market as well as possible exceptional economic effects caused by the coronavirus, which has been spreading since the beginning of 2020 and has prompted the introduction of special protective measures for the population. Effects on the economy in general and the automotive industry in particular are likely, but their extent cannot yet be estimated at the time of writing this report. In addition, there are a number of unresolved global trade conflicts, especially between the United States and China as key economic powers.

For 2020, industry experts predict that, rather than growing, global automobile production will decline. Despite these forecasts, a sustained sharp decline in global vehicle production is not very probable based on the information currently available. ElringKlinger anticipates that global vehicle production will shrink by at least 4% in 2020 (cf. "Report on Expected Developments"). This assessment may turn out to be even more unfavorable if stronger distortions materialize in the global economy due to the coronavirus pandemic.

Due to its customer structure, ElringKlinger is not dependent on specific markets or individual manufacturers. Given its global presence with production and sales locations in 21 countries, the Group is relatively well prepared to handle potential stagnation or waning demand in specific vehicle markets. Therefore, the effects of an economic slump in a particular region can be offset at least in part. Due to its cost structures, ElringKlinger would be able to respond immediately to market conditions in the event of more severe economic turbulence. Instruments available to the company include flexitime accounts and flexible shift models as well as the option of issuing an application for short-time work. Furthermore, the company can react to changing market conditions by adjusting its staffing levels to demand patterns and by pooling the production quantities of individual plants. The central purchasing department works in close cooperation with suppliers for the purpose of continuously assessing and adjusting procurement volumes. ElringKlinger factors in economic risks to an appropriate extent at the forward planning stage. The company always takes a cautious view of each macroeconomic scenario when drawing up budgets.

The automobile industry is undergoing a far-reaching process of transformation. Autonomous driving, connectivity and, last but not least, alternative forms of propulsion are an integral part of the discussion about the mobility of the future. This gives rise to industry-specific risks, which, given ElringKlinger's product portfolio, mainly relate to the speed of change from internal combustion engines to alternative drive systems such as batteries or fuel cells*. If the speed of transition decelerates, the Group will be able to act in line with its established market position for combustion engine components. In response to a more dynamic pace of change, the company has a wide range of products for alternative drive systems in its portfolio, such as cell contact systems, pressure equalization elements, bipolar plates, disk carriers, and metal-elastomer seals for batteries.

This illustrates that the ElringKlinger Group has aligned its product range to the requirements of all types of drive systems. The Group has also responded to the risks it faces in relation to battery and fuel cell technology by establishing separate monitoring mechanisms for its new business areas within the broader risk management system.

Diesel technology continues to be a major topic of public debate. The resulting uncertainty among end consumers is having a noticeable effect on purchasing behavior: the diesel share of new vehicle registrations is significantly lower than in previous years. This does not have a major impact on ElringKlinger, as most of the company's product range is not dependent on a particular fuel type. However, it is impossible to rule out specific repercussions for the automotive industry as a whole, also as a result of the increasing number of driving bans in major German cities.

Political risks

Fundamentally, there is the potential that political decisions taken by national or international lawmakers will have a significant impact on the future business activities of the ElringKlinger Group. The same consequences can cause unstable political situations. Moreover, new laws and regulations can have a direct or indirect impact on technology trends and on the Group's sales regions.

Due to the increasingly noticeable effects of climate change, the issue of environmental protection has become more significant, especially among the younger generation. As a result, various social initiatives have formed – evolving to some extent on the back of dissatisfaction with the current lack of desire among ruling political parties to pursue change. Overall, this has raised awareness of climate change and measures to protect the earth and has become part of the social discourse. Although political attitudes vary widely, not only within European countries, but also globally, the World Economic Forum in Davos, as a multilateral institution, noted that "the near-term impacts of climate change add up to a planetary emergency that will include loss of life, social and geopolitical tensions and negative economic impacts." Failure to deal with climate change in a targeted manner is seen as the greatest risk for the next decade. Overall, political radicalization of the issue and/or far-reaching reactive measures at the expense of the automotive industry could have consequences for the entire industry.

There are numerous trouble spots around the world at the geopolitical level. The situation has deteriorated in large parts of the Middle East, especially in Syria; peace plans continue to fail. Previous protective powers are withdrawing from the region, while new ones are emerging. The balance of power is being redistributed by military measures. The North African countries, especially Libya, also remain politically unstable.

All these regions present certain sales risks for ElringKlinger. As regards the Original Equipment segment, these regions are of no particular relevance to business activities. However, North Africa and the Middle East are core regions for the Group's Aftermarket segment, which is therefore exposed to a general risk in terms of revenue. As sales in these regions are billed in euros, customers' restricted access to foreign currency could result in delayed payments or, in the worst-case scenario, lead to default on such payments.

The current disputes between the USA and both Europe and China continue to exert a negative impact on global free trade. In this context, there is a real chance that the USA may introduce new tariffs on imports of commodities and that it may go ahead with a long-standing government plan to impose punitive tariffs on imported vehicles produced by non-US manufacturers. Therefore, the political risks emanating from the customs spat and the repercussions that they may have for the automotive industry in general and, specifically, the ElringKlinger Group remain palpable.

Despite the UK's withdrawal from the European Union ("Brexit"), which has now been concluded, specific uncertainties remain. The question of "regulated or unregulated withdrawal" has now been replaced by the open question of concluding a trade agreement in order to settle the economic relationship between the EU and the United Kingdom on a lasting basis. As there continues to be uncertainty with regard to a conclusion within the transitional period before the end of 2020, there is still a risk that cannot be clearly assessed. While the ElringKlinger Group is undoubtedly affected by the issue of Brexit, given its existing customer relationships and UK-based operations, the overall extent of risk exposure associated with its UK subsidiary is considered manageable in relation to the Group as a whole.

* Cf. glossary

General internal risks

General internal risks, work-related accidents, fire

The general internal risks that are not connected directly to the business model of the ElringKlinger Group include, in particular, work-related accidents and the risk of fires at production facilities.

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

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

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

Operational risks

Price-related pressure/Competition

As a supplier to the automotive industry, ElringKlinger operates in a business environment that is generally considered to be highly competitive. Customers tend to demand price discounts as part of regular negotiations. For the Group, this pressure is a significant risk, especially against the backdrop of rising commodity prices and/or potential tariff-related price increases.

In view of its abilities as an innovator and its position in the market, the ElringKlinger Group considers itself relatively well positioned as a supplier. However, requests for price reductions have become customary in the industry, and ElringKlinger is not completely immune to such demands. With a view to counteracting sustained price-related pressure, ElringKlinger's focus is on developing products with technological USPs and positioning itself in niche markets. Any remaining pressure on prices has to be offset to the largest extent possible by raising efficiency levels in production.

Competition in the automotive supply industry is intense. In this context, new competitors looking to penetrate the market are confronted with significant barriers to entry, as the business model and product portfolio of the ElringKlinger Group call for specialist expertise and competencies in materials processing, tool production, and process management (cf. "Overview of ElringKlinger's Activities and Structure").

Substantial investments would be needed by potential market entrants to establish the requisite plant technology. The machinery used by ElringKlinger is usually designed according to company specifications, i.e., it is not available as a standardized solution on the market. To be financially viable, it is essential that plants produce large volumes as part of manufacturing operations. Experience has shown that initial orders placed with new suppliers tend to be relatively small in scale. However, these volumes are not sufficiently high to cover the costs.

Thanks to its global production network, the ElringKlinger Group is in a good position to react flexibly and supply much of its product portfolio from alternative locations and regions should this become necessary due to the make-up of those products or if requested by customers.

Material risks/Supplier risks

Overall, the prices of raw materials used by ElringKlinger are at an elevated level compared to previous years. This is partly due to the global trade conflicts involving short-term and drastic tariff increases on cross-border raw material transports. In this context, there are still potential risks of punitive, countervailing, or compensatory duties (anti-dumping and countervailing duties*) on raw materials imported into the USA. The risks created by excessive rises in material prices would have a direct and – depending on the extent of any such increases – potentially considerable impact on the Group.

ElringKlinger's central procurement unit works continuously to identify and implement optimization measures in order to counter the risks associated with rises in the cost of input materials. These measures include improving and standardizing internal processes across the Group and conducting ongoing reviews of procedures for selecting and approving suppliers. In addition, ElringKlinger responds actively to constantly increasing material prices by optimizing the design of its products and improving its manufacturing processes.

In its negotiations with its raw material suppliers, ElringKlinger generally concludes contractual agreements that are as long term as possible. Any additional quantities required are procured at prevailing market prices. Alloys such as nickel are exclusively traded on the stock exchange and cannot be fixed in framework agreements. In order to respond to the high level of raw material prices in financial year 2019 and be prepared for possible price declines, contracts with shorter terms were also agreed.

As part of a range of measures to reduce its dependence on material price rises over the medium to long term, ElringKlinger negotiates cost escalation clauses in its customer contracts. If this is not possible, price rises that exceed cost estimates have to be passed on to customers where this is considered possible. This involves a risk that additional costs cannot be passed on in full or only with some delay. Fundamentally, instruments are also used to hedge against the risk of commodity prices.

Although high material prices have an adverse impact on the Group's earnings, ElringKlinger benefits from the same high prices when it sells the metal residues produced during stamping processes. All metal residues are recycled and sold by the Group's in-house scrap management unit. Potential cost increases can be offset, at least in part, by the proceeds from scrap sold in this way.

As part of its risk assessment, ElringKlinger monitors not only trends relating to material prices but also the actual availability of materials. In order to mitigate risks associated with bottlenecks or non-deliveries to the largest extent possible, ElringKlinger relies on close collaboration with its suppliers over the long term. The Group makes a point of planning its material requirements well in advance and is committed to a multi-supplier strategy in order to mitigate the risk of production-related disruption or downtime due to disruptions within the supply chain. To the largest extent possible, ElringKlinger develops alternatives for commodities and materials that are either in short supply or subject to severe fluctuations in price.

Alongside the materials needed for its traditional product portfolio (e.g., alloyed high-grade steel, C-steel, aluminum, polyamides, and elastomers), the Group uses other types of commodities and materials for battery and fuel cell components and systems in its new business areas. With regard to these inputs, it is difficult to estimate future volumes, price movements, and supplier structures based on the information currently available, partly because of the lack of certainty over future demand for vehicles with alternative drive systems. ElringKlinger counters this uncertainty and therefore minimizes its exposure to risk by minimizing its own inventories and by also requesting these input materials as required from the supplier's consignment warehouse, i.e., the supplier retains ownership of the goods until they are requested by ElringKlinger. Furthermore, escalation clauses are used for the material price, which are synchronized between Sales and Purchasing.

To assess material risks, the inventories held by the Group are regularly reviewed with regard to their turnover rate. Stocks with a low turnover rate are evaluated to determine whether they should be used, sold, or scrapped.

Customer risks

A sudden decline in demand faced by one or several key customers may pose the risk of a substantial reduction in demand for ElringKlinger components to be installed in the respective vehicles and/or engines.

* Cf. glossary

In order to minimize the company's dependence on individual customers, also with a view to alleviating potential pricing pressure, ElringKlinger has continuously extended its customer base in recent years.

The structure of ElringKlinger's customer base is also changing as a result of the industry-wide transition from combustion engines to alternative drive systems: Increasingly, established manufacturers are being challenged by innovative new competitors focusing exclusively on vehicle models with alternative drive systems and/or entirely new mobility concepts. Many of these new industry players are start-ups. It is difficult to predict whether such challengers will succeed. This depends on their development capacity and their ability to negotiate adequate financing. Consequently, some of these new manufacturers may fail to break into the market if they cannot secure continued financing and/or fail to generate sufficient demand or acceptance among potential customers.

As a consequence, ElringKlinger may lose existing development projects or orders secured from such players. In addition, the company may potentially be adversely affected in financial terms in the form of expense items. The Group has established business relationships with several customers in this category and therefore classifies the corresponding projects as being exposed to the risks outlined above. In these cases, ElringKlinger counters the increased counterparty risk with a risk-minimizing customer strategy. Among other things, the aim is to agree payment terms that correspond largely to project progression and therefore cover any investment and development amounts outstanding.

Labor cost risks

At 41.6% (2018: 41.5%), a significant share of the Group's overall workforce is employed at sites in Germany. Fundamentally, persistent wage increases at a domestic level or the reduction in working hours covered by collective bargaining agreements could have a visibly negative impact on the earnings performance of the Group. Therefore, as illustrated by the progression of staff cost ratios at German sites, the competitive position of ElringKlinger AG would deteriorate further in relation to its international peers. The next round of collective bargaining will take place in 2020; the current collective agreement ends on March 31, 2020. If the trade unions aim to push through comparatively high wage agreements, Germany as an industrial location will continue to suffer noticeably.

The level of labor costs in emerging countries such as China, South Korea, India, and Turkey, where on average around 15% (2018: around 14%) of ElringKlinger's workforce is employed, is well below the Group average. A positive aspect is that both revenue and staffing levels in these regions are expanding at a faster rate than in Germany. In these markets too, however, the dynamics of wage development are to be viewed critically with regard to the financial performance of the regional companies.

In the event of an unexpectedly strong downturn in customer demand, the staff cost ratio may increase dramatically. Capacity constraints caused by a possible outage of machinery may also result in higher staff costs (temporary labor, night-shifts, and weekend work). ElringKlinger has a number of instruments at its disposal with regard to strategic HR planning (such as working time accounts, shift systems, and temporary employment contracts) that allow the company to respond rapidly and flexibly to such scenarios.

The Group has offset the more pronounced wage costs seen in recent years by making substantial capital investments and implementing continuous measures aimed at raising efficiency levels in production in order to safeguard its international competitiveness and retain jobs in the domestic market.

Personnel risks

The far-reaching transformation process in the automotive industry requires qualified and motivated employees. They provide the know-how and are a key success factor for an automotive supplier like ElringKlinger. It is of importance that any risk of losing expertise through workforce fluctuation be mitigated to the greatest extent possible. Staff turnover rates are to be kept at a low percentage level in the low-double-digit range by establishing a socially balanced and motivating working environment.

At the same time, it is important to attract qualified personnel to the Group. This is comparatively difficult at some locations and in certain specialist areas of the Group. ElringKlinger has conducted targeted recruitment campaigns for some years to ensure that it is able to compete successfully in the difficult search for next-generation talent. The company attends career fairs, where it showcases itself as an attractive employer to graduates. It also meets the needs of university and college students by offering internships and thesis topics in order to retain their services in the long term. Furthermore, the Group has taken on young people as technical and commercial apprentices to secure talent for the future. In order to retain staff in the long term, ElringKlinger offers internal and external training courses and programs for personal advancement.

IT risks

In the digital age, companies' IT infrastructure is constantly exposed to potential risks such as cybercrime and hacking attacks. The confidentiality, integrity, and availability of data are considered to be a precious commodity. Protection within this area requires an increasing number of preventative and corrective measures. Any disruption to IT systems and application software can lead to tangible delays to individual processes – from the handling of purchase orders and ongoing production control through to activities in the supply chain. Such a scenario would have a negative impact on operations, which may also affect revenue and earnings. Successful attacks by Trojans, which cannot be ruled out in principle and always represent a potential threat, would have similar effects.

The Group aims to minimize these risks by maintaining an IT infrastructure divided into a strategic and an operational unit. Data that is of importance to operational processes is always stored twice or redundant systems are deployed. Additional back-up systems and bridging solutions are also in place to deal with potential risks for specific projects and processes. In addition, employees are constantly sensitized and trained for malware or Trojan attacks through simulation measures.

The company's headquarters in Dettingen/Erms, Germany, has two data centers operating independently of each other. For security reasons, these data centers are accommodated in different buildings, i.e., at two separate locations. In taking this approach, the company protects itself against system failure and data loss. Furthermore, all data pertaining to the international sites is backed up at a central location.

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

Quality/Warranty risks

As a manufacturing company and supplier to the automotive sector, ElringKlinger is exposed to the warranty and product liability risks generally associated with this industry. The supply of non-compliant components may necessitate an exchange or recall of such parts, with corresponding costs and claims for damages. Furthermore, this may damage the company's reputation over the long term.

In this context, the development of entirely new products for fields of application beyond the automobile industry or in the area of alternative drive technologies is associated with further potential risks.

ElringKlinger uses appropriate quality assurance systems to prevent and mitigate the aforementioned risks. As an element of the Group-wide risk management system, significant quality and warranty risks are covered to a large extent by insurance policies, e.g., product liability insurance. The type and scope of insurance coverage is regularly reviewed and adjusted if necessary. Where possible, agreements on limitation of liability are also concluded between ElringKlinger and the contracting party in question.

There are isolated risks within the Group with regard to inadequate product quality. In order to minimize these risks, ElringKlinger has introduced a variety of improvement measures at project and process levels. Cases of deficient quality are tackled, for example, by tightening up procurement specifications for input materials and by continuously upgrading production equipment and increasing the level of automation. The Group also optimizes its logistics processes.

Legal risks

Legal risks/Compliance risks

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

The structure of the compliance system was outlined earlier in the description of the risk management system. Risks can occur at both the parent company and the subsidiaries as a result of unlawful actions. In view of the compliance system instruments put in place and the ElringKlinger culture applied and embraced by the company, the probability of occurrence in respect of significant infringements can be classified as low but cannot be ruled out entirely. The financial effects on Group earnings are difficult to specify; depending on the respective case, they may reach a scale that could be considered significant.

Strategic risks

Technology risks

The business model of the ElringKlinger Group is based on a culture of excellence in innovation and the principle of technology leadership. The company's operations are tailored to the development of products that are technologically sophisticated and to the manufacture of such goods at a high level of productivity. On this basis, the Group aims to achieve long-term growth rates above the market average (cf. "Overview of ElringKlinger's Activities and Structure").

At around 5 to 6% of its total Group revenue, ElringKlinger invests a substantial sum in research and development in order to develop new technologies and innovations. Furthermore, substantial investments have been channeled into the expansion of the Group's technology portfolio in recent years. ElringKlinger protects significant technologies and processes in the form of property rights and patents in order to combat the risk of damages caused by me-too products and imitations.

The company focuses its R&D activities firmly on key areas of interest currently driving the automotive industry, namely the optimization of vehicle weight by means of lightweight structural components and the development of alternative drive technologies. ElringKlinger positioned itself within the market for alternative drive systems at an early stage and with considerable capital expenditure, be it in the field of battery technology or fuel cell solutions.

The technology risks of significance to the ElringKlinger Group consist of unforeseeable changes in the area of drive technologies as well as excessively stringent legislation with regard to emission standards that do not correspond to the transformation process scenarios anticipated to date. Even if, as planned, the E-Mobility business area generates a greater contribution to total Group revenue over the next few years, any abrupt shift in technology or further tightening of the regulations on CO_2 emissions would have a substantial impact on revenue from the Group's traditional business areas. In turn, this would lead to severe pressure on prices. ElringKlinger counters these risks by consistently expanding its product portfolio, which, in addition to traditional combustion engine components, also includes components, modules, and systems for alternative drive technologies such as batteries or fuel cells.

External growth/Acquisitions

ElringKlinger is generally receptive to complementary acquisitions and targeted takeovers in order to enter new technology fields or to better cultivate regional markets. Acquisitions are fundamentally associated with the risk that the acquired entities may fall short of specified targets or fail to meet them in the planned time frame. This may necessitate unforeseen restructuring measures that – at least temporarily – would exert downward pressure on the Group's profit margin. In addition, the level of new investment required in this area may be higher than originally planned. This, in turn, would lead to more substantial funding requirements. Technology purchases also pose the fundamental risk that the performance originally expected by the company may not be achievable in full or to the extent desired. Thus, there is a risk that the products may ultimately fail to meet customer expectations.

Prior to an acquisition, ElringKlinger invariably conducts extensive due diligence investigations. As a matter of principle, all projects are also reviewed by a company and/or external team of experts. Financial plans and technical details are checked and evaluated thoroughly for plausibility. As part of mandatory annual impairment tests, it may be necessary to recognize impairment losses in connection with goodwill or investees, which would in turn adversely affect annual Group earnings.

Similarly, risk exposure also occurs in the context of divestments already made or potentially yet to be made with regard to subsidiaries and/or areas of business.

Financial risks

Bad debt loss

Overall, the risk of bad debts among customers in the Group's Original Equipment segment is classified as moderate. The risk of substantial bad debt losses attributable to individual customers is mitigated by a broadly diversified customer base.

Compared to the OEM segment, there is a higher risk of bad debts in the Aftermarket business area due to activities in the core sales regions of North Africa, Eastern Europe, and the Middle East. However, the customer base is much more diversified thanks to a larger number of customers. The ElringKlinger Group counters impending bad debt losses in the aftermarket business by making advance payments as a condition of payment or by taking out trade credit insurance.

Liquidity and financing risks

The company may be exposed to liquidity and financing risks if it cannot meet its financial obligations (e.g., to repay loans) and generate enough cash to cover its ongoing capital requirements and therefore continue to operate, and/or if it is unable to refinance its activities.

The Group's financing requirements are largely determined by the company's growth and the development of new technologies. In recent years, it has been possible to obtain credit on relatively favorable market terms. If, in the future, rating agencies were to downgrade the automotive industry as a whole in response to a generally less favorable risk profile, credit terms for the sector and ultimately also for ElringKlinger would be adversely affected. Against this backdrop, despite relatively low market interest rates and the industry's continued ability to generate healthy levels of revenue, the company is constantly exposed to an implicit financing risk.

Thanks to its strong balance sheet, the ability of the ElringKlinger Group to refinance itself remains solid. At 41.5% (2018: 42.8%), the equity ratio still lies within the Group's medium-term target corridor of 40–50% of total assets. The debt factor (net debt* in relation to EBITDA*) in the period under review was 3.3, which is an improvement on the prior-year figure (3.7). At the year end, the Group's undrawn credit lines totaled EUR 150.5 million (2018: EUR 190.2 million).

At the end of the reporting period, the loan agreements of the ElringKlinger Group mainly included standard bank contractual clauses relating to compliance with certain financial requirements (financial covenants*). As of December 31, 2019, no circumstances were present that would have justified the exercise of unilateral termination rights by banks. In the opinion of the Management Board, these are also not to be expected in financial year 2020. The company has identified no immediate risks that could jeopardize the financing of major projects planned by ElringKlinger or prevent the company from meeting its payment deadlines. From today's perspective, financing risks that could jeopardize the company's existence as a going concern can be ruled out.

Currency risks

ElringKlinger is automatically exposed to currency risks by virtue of its global operations. These include local currency surpluses at certain Group companies and intra-Group loans. Local currency surpluses are largely minimized through natural hedging*, i.e., in almost all sales regions, the majority of costs and revenues are denominated in the same currency. Intra-Group financing risks are gradually eliminated by shifting the loans into the same currency zone.

ElringKlinger is also exposed to currency translation risks when local results are consolidated in the Group currency. Therefore, changes in the average exchange rates can have an accretive or a dilutive effect on the Group's revenue and earnings.

* Cf. glossary

Exchange rate movements also have an impact on the net finance result. These factors are mainly associated with the funding of Group entities by the parent company as well as with the measurement of accounts receivable and payable.

In order to limit currency risks, ElringKlinger employs hedging instruments depending on necessity and the risk profile. A summary of the quantitative impact of an appreciation or a depreciation of the euro against the key international Group currencies on the comprehensive income of the ElringKlinger Group can be found in the sensitivity analysis contained in the Notes to the consolidated financial statements.

Interest-rate risk

The ElringKlinger Group funds itself through cash flow* generated from operating activities as well as through borrowings from banks. A detailed overview of current and non-current financial liabilities categorized by maturity as of December 31, 2019, can be found in the Notes to the consolidated financial statements.

The bonded loan (Schuldscheindarlehen) granted in 2017 was used to optimize the term structure of the Group's interest expenses and therefore make them easier to plan. In total, a volume of EUR 200 million was issued in tranches covering maturities of five, seven, and ten years and with an average rate of interest of 1.23%. In addition, a syndicated loan* agreement was concluded with six domestic and international banks in February 2019, covering a sum of EUR 350 million over a minimum term of five years. The current level of interest rates within the market is low when viewed over an extended period of time. A marked increase in interest rates would feed into variable rate loans and would ultimately also have an impact on ElringKlinger's net finance result. To a large extent, however, fixed interest rates have been agreed in respect of the financing liabilities of the ElringKlinger Group (cf. notes: "Non-current and current financial liabilities").

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

Use of derivative financial instruments

ElringKlinger only makes use of derivative financial instruments in isolated cases, e.g., for the purpose of protecting the company against price fluctuations relating to high-grade steel alloys (particularly nickel). Where hedging contracts are employed as a protective instrument against commodity price volatility, they are always based on the actual quantity of physical materials required by the company.

Opportunities

Climate change/Emission laws

Debate surrounding climate change and environmental protection has intensified in recent months and has become an issue that is of importance to society as a whole. In many areas of life, particularly in Europe, there is evidence of heightened awareness in politics, business, and the population – whether through stricter environmental regulations, a greater focus on environmental indicators or sustainable projects, or through broad-based protest movements for eco-friendly action.

This also affects the automobile industry. The reduction of emissions continues to be at the heart of the transformation process, which is also influenced by environmental factors such as sustainability relating to drive technology. The European Union is subject to strict emission regulations that are more far-reaching than those in many other regions of the world. In the EU, cars and light commercial vehicles have been subject to CO_2 regulation since 2009. The EU Commission has specified that average fleet emissions of CO_2 must be reduced to 95 g/km or below by 2021. Should these requirements not be met by the specified dates, car manufacturers face severe fines.

In December 2018, even lower limits were adopted as from 2021. According to this agreement, the CO_2 emissions of vehicles newly registered in 2025 are to be reduced by a further 15% throughout the EU compared to 2021. In the period up to 2030, the figure is to be scaled back by 37.5% compared to 2021. Statutory limits on emissions are also being tightened up even in North America and Asia. China and Japan aim to limit emissions to 117 g/km and 105 g/km respectively by 2020. The United States have set a fleet target of 121 g/km to be reached by 2020. Furthermore, many emerging countries tend to look at the Euro standards as a basis for their own policy making. For example, India has set an average limit of 113 g/km of CO_2. This comes into force in 2022.

For the ElringKlinger Group, this legislative framework offers business potential for the coming years. The trend toward fuel-efficient, low-emission engines is further heightening the requirements for sealing technology and shielding systems. This translates into greater demand for products that help manufacturers to meet the more stringent standards.

Hybrid vehicles, i. e., the combination of a combustion engine and an electric motor, are gaining market share. Many car makers are extending their product portfolio to include such hybrids, the aim being to achieve the strict CO_2 limits applied to their vehicle fleets. For ElringKlinger, hybrid concepts open up the opportunity to generate higher revenue per vehicle. In addition to the components installed in the combustion engine, hybrid vehicles can also be supplied with parts for the battery-electric section of the drivetrain, such as cell contact systems or pressure equalization modules.

Government subsidies can boost sales of vehicles powered by alternative drives. For example, the German federal government is currently subsidizing pure electric vehicles with funds ranging from EUR 5,000 to EUR 6,000, while incentives for hybrid vehicles are between EUR 3,750 and EUR 4,500. In order to bring electric mobility to the mass market, the Federal Cabinet has adopted a master plan for the nation's recharging infrastructure for up to 10 million vehicles by 2030. The aforementioned purchase incentives and efforts to improve the general infrastructure for e-mobility solutions are designed to prompt a sea change in consumer behavior and boost sales of cars powered by alternative drive systems.

In order to limit pollutant and greenhouse gas emissions in pursuit of climate protection and the promotion of sustainable drive technologies, more and more countries in Europe are proposing to ban classic combustion engines from a certain date. In Sweden, for example, the government is looking to prohibit the sale of new cars with combustion engines after 2030. Denmark plans to take the same approach as from 2030. In Norway, meanwhile, new cars powered by fossil fuels will no longer be registered from 2025. France, by contrast, is looking to implement this policy in 2040, while the United Kingdom plans to introduce such measures in 2035. Even China, the world's biggest vehicle market, is preparing to phase out combustion engines. Effective from 2019, car makers are obliged by law to ensure that at least 10% of their newly registered vehicles are equipped with an alternative drive system.

The shift towards battery technology in the automotive industry continues to accelerate. Gradually, models are being introduced to the market that are either partially or fully electrically powered. Further progress in the development of battery technology, e.g., to improve vehicle range and bring down the price, would help to stimulate demand and persuade buyers to invest in electric vehicles. ElringKlinger would benefit directly from growing sales in the e-mobility market as its product portfolio includes a range of components for battery-powered vehicles. In fact, the company's E-Mobility unit has been supplying various car makers and automotive suppliers with series products for battery-driven and hybrid models for some years.

Fuel cell technology also plays an important role when it comes to alternative powertrains. In the truck and bus sector, in particular, fuel cells are set to become more prominent in the medium term. In contrast to battery technology, the fuel cell offers the advantage of extended range. What is more, the hydrogen required for these drive systems can be distributed via the existing network of service stations. ElringKlinger was quick off the mark in its efforts to embrace fuel cell technology and now supplies various components as well as complete fuel cell stacks and systems. In view of the fact that the vehicle fuel cell market is still in the process of evolving, the ElringKlinger Group sees considerable sales potential for the coming years. After an initial ramp-up phase over the next few years, the company expects to achieve more in-depth market penetration from 2025 onwards.

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

Technology trends

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

* Cf. glossary

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

If the shift occurs more rapidly than currently forecast, the Group can market its existing portfolio of products covering different areas of alternative drive technology and harness the transition to boost its revenue. The battery components and systems, fuel cell stacks* and systems, and complete electric drive units developed by ElringKlinger are ready for full market rollout.

Extension of the product and service portfolio

The majority of the divisions within the Group are well positioned to apply their decades-long expertise and existing know-how in materials and processes for the purpose of transforming the product range or expanding the portfolio in a targeted manner.

The possibilities open to the Group have already been discussed extensively in the chapter on Research and Development. By way of example, these include the Group's expertise in the design of new lightweight materials and in alternative drive technologies for battery and fuel cell systems. Beyond the automotive industry, new opportunities are presenting themselves continuously for the Engineered Plastics division and PTFE components, e.g., in the industrial sector as a whole or in the area of medical technology.

All the Group's divisions are working proactively on the expansion of their product and service portfolios with a view to meeting the organic revenue growth target that exceeds global expansion in automobile production.

New sales markets

Opportunities for significant revenue and earnings growth in the coming years are offered by additional incoming orders, including high-volume orders, especially for the two promising pillars of electromobility, i.e., fuel cell and battery technology, and structural lightweight construction. First and foremost in this context is the Chinese vehicle market, where numerous initiatives for the development of battery and fuel-cell-powered vehicles have emerged, partly as a result of government subsidy policies. Also due to existing projects in this region, the Group sees the potential for considerable growth in sales volumes in the coming years.

There are also opportunities for further expansion in the Aftermarket business, particularly by tapping new sales regions in North America and Asia. Trading under the "Elring – Das Original" brand, for instance, the Aftermarket segment within the ElringKlinger Group has been ratcheting up its activities in Asia. The Group has also systematically improved the processes and structures in its Aftermarket business in North America.

For the Engineered Plastics segment, with its product portfolio based around the high-performance plastic PTFE, future growth potential is also opening up in the Asian and US markets.

Industry consolidation/M&A*

In the medium term, globalization poses significant challenges for many small and medium-sized enterprises that currently have either an insufficient international presence or none whatsoever. They have to invest more in research and development due to the far-reaching transformation process and are increasingly confronted with financing risks due to the numerous changes seen within the markets, e.g., in relation to customer structures or their own share of value added. It can therefore be assumed that consolidation in the supply industry will continue in the coming years. Against this backdrop, the risk of insolvencies cannot be ruled out.

For the ElringKlinger Group, this continues to offer opportunities to extend its technology portfolio through targeted acquisitions or to establish a stronger competitive position through consolidation of individual product groups. In some cases, competitors also exit the market without the influence of consolidation processes. ElringKlinger will continue to monitor the market systematically in order to identify potential opportunities for acquisitions as early as possible and pursue them where this is deemed appropriate and financially viable. There is a good chance that ElringKlinger will pursue growth opportunities through acquisitions in the coming years, insofar as they are related to the field of new drive technologies. The Group is focused on future-oriented areas of business, whereas further acquisitions relating to the classic fields of business centered around combustion engine technology are unlikely. The associated financial impact is difficult to quantify in advance. It could range from insignificant to very significant when measured on the basis of revenue and earnings contributions to the Group.

Overall assessment of risks and opportunities

The conclusion drawn by the Management Board from scrutinizing the opportunities and risks in their entirety is that the situation of the ElringKlinger Group in respect of risk exposure remains similar to that of the previous year, despite some changes in general conditions that have a direct impact on the automotive industry. Some of the risks to which the Group is exposed are of a geopolitical or external nature, and ElringKlinger therefore has either no or a very limited capacity to control these risks in an active manner. When weighing the relevance of risk in respect of the possible impact on Group earnings, the principal risks to which the ElringKlinger Group is exposed are, in particular, a sudden global slump in the market, an unexpected transformation scenario in relation to drive technology, as well as external attacks on the IT infrastructure. In addition, the worldwide spread of the coronavirus has prompted special protective measures, which are also leading to production shutdowns and interrupted supply chains. Economic and industry-specific effects are probable, although their extent cannot be estimated at present.

Economic conditions in Europe, North America, and much of Asia remain solid, even though growth in China is returning to more normal levels compared to recent years. By contrast, the political situation in large parts of the Middle East remains a source of risk. The ongoing global trade dispute between the USA and China as well as unresolved trade relations following the United Kingdom's withdrawal from the European Union must be regarded as political risks with the capacity to exert a direct impact on the ElringKlinger Group. Additionally, specific strategic and operational risks continue to exist within the Group. They include financial opportunities and risks associated with exchange rate fluctuations. Prices for raw materials of relevance to the Group are also at a high level. The process of transition seen within the automotive industry has meant changes to ElringKlinger's product portfolio. Products in the area of structural lightweighting and electromobility, which are considered promising fields for the future in strategic terms, are gaining in importance, while conventional products associated primarily with the combustion engine will become less relevant in the years ahead.

Drawing on the risk management system outlined above and its flexible cost structure, if necessary, the ElringKlinger Group is in a position to respond promptly to any risks that may arise by implementing the corresponding risk management arrangements. The entity makes a point of not exposing itself to risks that may jeopardize the existence of the ElringKlinger Group. The Group's solid financial position and its continued ability to raise additional funds provides a protective shield in respect of ElringKlinger and its business model even in the event of a protracted market crisis, of which there are no indications at present, however.

The principal opportunities for the company relate to the technological trend toward fuel-efficient or emission-free drive systems, which is inextricably linked to the issue of climate change and a global drive toward stricter emission laws. The company invested at an early stage in areas such as battery and fuel cell technology that offer considerable potential going forward. Benefiting from products targeted at alternative drive systems and power supply as well as a number of new concepts in the field of lightweight construction, the Group can look forward to opportunities for growth around the globe.

There are currently no identifiable risks that could jeopardize the future existence of the company as a going concern, either in isolation or in conjunction with other factors. The Group is well positioned to actively seize any opportunities arising from long-term technology trends. Against the backdrop of a manageable risk profile, the ElringKlinger Group remains well positioned to continue outpacing global market growth in the coming years.

* Cf. glossary

Compensation report

Compensation structure for members of the Management Board

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

Management Board compensation for financial year 2019 is presented in accordance with the provisions set out in two different standards: first, the applicable financial reporting standards (GAS 17) and secondly, the German Corporate Governance* Code in the version of February 7, 2017.

System of compensation

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

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

Fixed annual salary

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

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

LTI I is a variable component of compensation that is based on the average Group EBIT (Group earnings before interest and taxes) of the last three financial years. The Management Board receives a percentage share of the three-year mean. LTI I is limited to a maximum of three times the amount of fixed compensation in the financial year in question. Payment of LTI I for a financial year ended takes place upon approval of the separate and consolidated financial statements by the Supervisory Board in the subsequent year. On termination of the appointment as a Board member, either at the request of the Management Board member in question or for good cause, entitlements to the variable compensation components of LTI I shall lapse as soon as the termination of said Board appointment comes into legal effect.

Long-term incentive II (LTI II)

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

EVA = (EBIT x (1 – T)) – (WACC x Capital Invested)

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

The second component is computed by multiplying Group WACC by capital invested. The weighted average cost of capital (WACC) is calculated with the help of the basic interest rate, the market risk premium, and the beta factor. The beta factor represents the individual risk of a share in relation to the market index. It is determined as an average value of all the peer group companies. The credit spread for borrowing costs, as the premium on the risk-free basic interest rate, was derived from a peer group rating. Capital invested is calculated on the basis of Group equity plus net financial liabilities (i. e., net debt*) as of January 1 of the financial year.

90% of the LTI II amount is paid out to the member of the Management Board in question, after the end of the three-year benefit period, in the subsequent year. Using the remaining 10% of the LTI II amount, the company purchases shares in ElringKlinger AG on behalf and for account of the Management Board member in question. The Management Board member is prohibited from accessing these shares for a further three years. Dividends and subscription rights are at the disposal of the Management Board member. The maximum amount granted from LTI II has been set at twice the amount of fixed compensation.

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

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

Fringe benefits

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

D&O insurance

The members of the Management Board are covered by the Group's existing directors' and officers' liability insurance (D&O insurance). The agreed deductible corresponds to the minimum deductible set out in Section 93 (2) sentence 3 AktG (German Stock Corporation Act) in the applicable version.

Retirement pension

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

If a member of the Management Board acts in a manner that is grossly negligent or displays gross negligence in his failure to act in specific instances and such actions or failures to act would result in significant damages to the Group, all entitlements to a retirement pension shall lapse; the same shall apply if the member of the Management Board enters the service of an entity that is in direct competition with the company. The contracts include provisions governing surviving dependents' benefits. If a member of the Management Board dies during the period in which the employment contract is applicable or once the retirement benefits become due, his widow or dependent children shall receive a widow's or orphan's pension. The widow's pension amounts to 50% of the retirement pension of the deceased. The orphan's pension amounts to 20% of the widow's pension to the extent that a widow's pension is payable simultaneously and 40% of the widow's pension to the extent that no widow's pension is payable.

The widow's or orphan's pensions shall not exceed 60% of the amount to which the deceased would have been entitled if he had entered into retirement on the day of his death.

Review and adjustment of compensation

The salary components are to be reviewed by the company's Supervisory Board every two years. The Supervisory Board has the right to grant the Management Board special

* Cf. glossary

remuneration for exceptional accomplishments. The Supervisory Board is also authorized to reduce the Management Board's total compensation to an appropriate level if the company's situation deteriorates to such an extent that continued payment of the former remuneration would be unreasonable.

Severance pay cap

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

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

Loans to Management Board members

No advances were granted to members of the Management Board in 2019. In the previous year, an advance of EUR 50k was granted to the Chief Executive Officer (CEO), which was offset in the month in which the bonus payment was made. The company provided no guarantees or similar commitments.

Management Board compensation in 2019

Management Board compensation for financial year 2019 has been presented pursuant to the applicable financial reporting standards (GAS 17) as well as in accordance with the recommendations of the German Corporate Governance Code in the version dated February 7, 2017. Average EBIT of the years 2017–2019 totaling EUR 98,244k was used as a basis for calculating LTI I. Of this, the respective members of the Management Board receive the following percentage shares:

- Dr. Wolf 0.80%
- Becker 0.60%
- Drews 0.40%
- Jessulat 0.40%

Based on the calculation of the Economic Value Added (EVA) bonus (LTI II), no compensation is payable for financial year 2019, as the targeted return is below the Group WACC.

Management Board compensation 2019 pursuant to financial reporting standard GAS 17

Total Management Board compensation in accordance with Section 314 (1) no. 6a sentence 1 to 4 HGB (German Commercial Code) is presented in the table below.

	Dr. Stefan Wolf		Theo Becker		Reiner Drews		Thomas Jessulat		Total	
in EUR k	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Short-term compensation										
Fixed compensation	593	613	485	449	299	226	365	367	1,742	1,655
Variable performance-related compensation	786	981	589	736	393	369	393	490	2,161	2,576
Total	**1,379**	**1,594**	**1,074**	**1,185**	**692**	**595**	**758**	**857**	**3,903**	**4,231**
Long-term compensation										
Long-term performance-related compensation	0	0	0	0	0	0	0	0	0	0
Total	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
Total compensation	**1,379**	**1,594**	**1,074**	**1,185**	**692**	**595**	**758**	**857**	**3,903**	**4,231**

Pension obligations

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

	Dr. Stefan Wolf		Theo Becker		Reiner Drews		Thomas Jessulat		Total	
in EUR k	2019	2018	2019	2018	2019	2018	2019	2018	2019	2018
Current service cost	258	268	168	176	205	162	207	206	838	812
Present value (DBO)	6,897	5,601	4,951	4,058	462	151	1,026	615	13,336	10,425

Management Board compensation pursuant to the German Corporate Governance Code

The following presentation of compensation granted to and received by the Management Board members for financial year 2019 is based on the recommendations of the German Corporate Governance Code (GCGC) in the version dated February 7, 2017.

The following table presents benefits granted to the members of the Management Board in respect of financial year 2019, as disclosable under the provisions of the German Corporate Governance Code:

Benefits granted (Pursuant to GCGC)

	Dr. Stefan Wolf				Theo Becker			
in EUR k	2019	Min. 2019	Max. 2019	2018	2019	Min. 2019	Max. 2019	2018
Non-performance-based compensation								
Fixed annual salary	556	556	556	558	432	432	432	432
Fringe benefits	37	37	37	55	53	53	53	17
Total	**593**	**593**	**593**	**613**	**485**	**485**	**485**	**449**
Performance-based compensation								
One-year variable compensation	786	0	1,674	981	589	0	1,296	736
Multi-year variable compensation 2016–2018	0	0	0	0	0	0	0	0
Multi-year variable compensation 2017–2019	0	0	0	0	0	0	0	0
Multi-year variable compensation 2018–2020	0	0	0	0	0	0	0	0
Multi-year variable compensation 2019–2021	0	0	1,116	0	0	0	864	0
Total	**786**	**0**	**2,790**	**981**	**589**	**0**	**2,160**	**736**
Service cost	258	258	258	268	168	168	168	176
Total compensation	**1,637**	**851**	**3,641**	**1,862**	**1,242**	**653**	**2,813**	**1,361**

In contrast to GAS 17, the table presents long-term compensation granted in 2019 for LTI II. In addition, the minimum and maximum amounts achievable have been listed. The benefit expense, which is presented in the form of the current service cost in the above table, has been included in total compensation.

The following table presents the allocation in/for financial year 2019. As regards fixed annual salary, fringe benefits, the annual management bonus, and LTI II 2019, the table presents the allocation for financial year 2019.

Allocation pursuant to GCGC

	Dr. Stefan Wolf		Theo Becker	
in EUR k	2019	2018	2019	2018
Non-performance-based compensation				
Fixed annual salary	556	558	432	432
Fringe benefits	37	55	53	17
Total	**593**	**613**	**485**	**449**
Performance-based compensation				
One-year variable compensation	786	981	589	736
Multi-year variable compensation 2016–2018	0	0	0	0
Multi-year variable compensation 2017–2019	0	0	0	0
Total	**786**	**981**	**589**	**736**
Service cost	258	268	168	176
Total compensation	**1,637**	**1,862**	**1,242**	**1,361**

	Reiner Drews				Thomas Jessulat				Total			
	2019	Min. 2019	Max. 2019	2018	2019	Min. 2019	Max. 2019	2018	2019	Min. 2019	Max. 2019	2018
	288	288	288	216	317	317	317	317	1,593	1,593	1,593	1,523
	11	11	11	10	48	48	48	50	149	149	149	132
	299	**299**	**299**	**226**	**365**	**365**	**365**	**367**	**1,742**	**1,742**	**1,742**	**1,655**
	393	0	864	369	393	0	950	490	2,161	0	4,784	2,576
	0	0	0	0	0	0	0	0	0	0	0	0
	0	0	0	0	0	0	0	0	0	0	0	0
	0	0	0	0	0	0	0	0	0	0	0	0
	0	0	576	0	0	0	634	0	0	0	3,190	0
	393	**0**	**1,440**	**369**	**393**	**0**	**1,584**	**490**	**2,161**	**0**	**7,974**	**2,576**
	205	205	205	162	207	207	207	206	838	838	838	812
	897	**504**	**1,944**	**757**	**965**	**572**	**2,156**	**1,063**	**4,741**	**2,580**	**10,554**	**5,043**

	Reiner Drews		Thomas Jessulat		Total	
	2019	2018	2019	2018	2019	2018
	288	216	317	317	1,593	1,523
	11	10	48	50	149	132
	299	**226**	**365**	**367**	**1,742**	**1,655**
	393	369	393	490	2,161	2,576
	0	0	0	0	0	0
	0	0	0	0	0	0
	393	**369**	**393**	**490**	**2,161**	**2,576**
	205	162	207	206	838	812
	897	**757**	**965**	**1,063**	**4,741**	**5,043**

Compensation structure for members of the Supervisory Board

Supervisory Board compensation is governed by the provisions set out in Section 13 of the Articles of Association of ElringKlinger AG. The level of compensation is determined by the Annual General Meeting. Within this context, the most recent resolution was passed on May 13, 2015. In accordance with the requirements of the German Corporate Governance Code, compensation is divided into a fixed and a variable component. The members of the Supervisory Board receive fixed compensation of EUR 20 k (2018: EUR 20 k) for each full financial year they have served on the Supervisory Board. Additionally, the members of the Supervisory Board receive a lump-sum payment of EUR 1 k for each Supervisory Board meeting they attend as well as fixed compensation of EUR 4 k for membership of a committee. The variable component of compensation is based on average IFRS Group earnings before taxes in respect of the last three financial years and is calculated as 0.02% of the aforementioned amount. As of financial year 2015, it is limited to EUR 40 k per member of the Supervisory Board.

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

Supervisory Board compensation in 2019

In the period under review, total compensation for the Supervisory Board of ElringKlinger AG was EUR 589 k (2018: EUR 672 k). In addition, travel expenses totaling EUR 2 k (2018: EUR 4 k) were reimbursed. Compensation payable to the individual members of the Supervisory Board was as follows:

	Fixed compensation		Variable compensation		Total compensation	
In EUR k	2019	2018	2019	2018	2019	2018
Klaus Eberhardt	70	68	30	44	100	112
Markus Siegers	46	44	23	33	69	77
Nadine Boguslawski	25	23	15	22	40	45
Armin Diez	29	28	15	22	44	50
Pasquale Formisano	24	24	15	22	39	46
Rita Forst	25	24	15	22	40	46
Andreas Wilhelm Kraut	23	24	15	22	38	46
Gerald Müller	25	24	15	22	40	46
Paula Monteiro-Munz	29	28	15	22	44	50
Prof. Hans-Ulrich Sachs	25	24	15	22	40	46
Gabriele Sons	33	32	15	22	48	54
Manfred Strauß	32	32	15	22	47	54
Total compensation	**386**	**375**	**203**	**297**	**589**	**672**

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

Details in accordance with Sections 289a(1) and 315a of the German Commercial Code (HGB*),

particularly with regard to share capital and disclosure of potential takeover obstacles

As of December 31, 2019, the nominal capital of ElringKlinger AG was EUR 63,359,990, divided into 63,359,990 registered shares, each furnished with one vote. The notional interest in the company's nominal capital is EUR 1.00 per registered share. Profits are distributed in accordance with Section 60 of the German Stock Corporation Act (Aktiengesetz – AktG) in conjunction with Section 23 no. 1 of the Articles of Association.

The persons or entities with a direct and/or indirect interest in capital who, according to the details of the Stock Register, held voting rights in excess of 10% as of December 31, 2019, are presented in the table below. These relate solely to interests attributable to family ownership.

Lechler Beteiligungs GmbH, Stuttgart, Germany	Total of 28.991%, of which indirectly 18.960%
KWL Beteiligungs-GmbH, Neuhausen auf den Fildern, Germany	Total of 28.991%, of which indirectly 28.986%
Klaus Lechler Beteiligungs-GmbH, Neuhausen auf den Fildern, Germany	Total of 28.991%, of which indirectly 18.990%
Elrena GmbH, Basel, Switzerland	Total of 28.991%, of which indirectly 20.075%
Eroca AG, Basel, Switzerland	Total of 28.991%, of which indirectly 28.991%
Lechler GmbH, Metzingen, Germany	Total of 10.013%

No shareholder is equipped with special rights constituting controlling powers.

ElringKlinger does not operate any employee profit-sharing schemes.

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

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

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

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

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

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

Corporate Governance Statement

The Corporate Governance* Statement pursuant to Section 315d in conjunction with Section 289f of the German Commercial Code (Handelsgesetzbuch – HGB*) has been published on the ElringKlinger website at https://www.elringklinger.de/en/company/corporate-governance/corporate-governance-statement.

* Cf. glossary

Combined Non-Financial Report

For financial year 2019, ElringKlinger has prepared a separate non-financial report for the exchange-listed parent company ElringKlinger AG in accordance with Section 289b HGB*, which has been combined with the separate non-financial Group report pursuant to Section 315b HGB. The combined non-financial report of ElringKlinger for financial year 2019 will be published by April 30, 2020, on the corporate website at www.elringklinger.com/2019-nfb-en.

Report on Expected Developments

After decelerated growth within the global economy as a whole in 2019, markets are unlikely to see any upturn in 2020, particularly due to the effects of the coronavirus pandemic that has been apparent since early 2020. In January 2020, the International Monetary Fund (IMF) was still expecting global gross domestic product (GDP) to rise by 3.3% in the current year. At the end of February, however, it revised downward this estimate by 0.1 percentage points. In the meantime, it can be assumed that the adverse effects are likely to be even more pronounced. Global vehicle production, which according to original forecasts was expected to decline slightly in 2020, will also see a more significant downturn as a result of the coronavirus crisis. ElringKlinger anticipates a decline in global vehicle production of at least 4%.

Outlook – Market and Sector

Sluggish recovery of global economy

Without the possible effects of the coronavirus on the business sector, which are difficult to assess at present, analysts believed there was evidence to suggest a moderate upward trend in the global economy. The Phase 1 trade agreement concluded between the United States and China in January 2020 and the UK's withdrawal from the European Union (EU) effective from January 31, 2020, provided some initial relief. At present, however, it is impossible to predict whether the recovery of the manufacturing industry will materialize to the extent originally anticipated. Many administrations are currently adopting a package of measures to support the economy and counter the negative consequences of the coronavirus pandemic. Governments have announced that they will provide further cash injections, thereby extending the ultra-loose monetary policy and favourable financing terms adopted by the world's key central banks. At the time of preparing this report it is not possible to reliably estimate the extent to which potential catch-up trends in the further course of the year and government countermeasures will take effect. Other risks include a renewed escalation in trade disputes and geopolitical tensions as well as anti-government protests in emerging markets. Despite the fact that the United Kingdom has already withdrawn from the EU, there are still unresolved issues regarding the specific shape of future trade relations between the UK and the EU.

GDP growth projections

Year-on-year change in %	2019	Projections 2020	Projections 2021
World	**2.9**	**3.2**	**3.4**
Advanced economies	1.7	1.6	1.6
Emerging and developing countries	3.7	4.4	4.6
Germany	0.5	1.1	1.4
Eurozone	1.2	1.3	1.4
USA	2.3	2.0	1.7
Brazil	1.2	2.2	2.3
China	6.1	5.6	5.8
India	4.8	5.8	6.5
Japan	1.0	0.7	0.5

Source: International Monetary Fund (Jan. 2020; in conjunction with statements from Feb. 2020)

Growth forecasts for the individual countries differ considerably in some cases. Whereas the US economy was expected to weaken somewhat based on initial forecasts, the rate of growth in the eurozone and also in Germany was likely to pick up slightly. In Asia, and primarily China, the epidemic is expected to have a noticeable impact. Overall, the emerging and developing countries are again likely to expand at more pronounced rates in 2020.

Car market bottoms out in 2020

Global automobile production looks set to fall for the second year in succession in 2020. Following the outbreak of the coronavirus pandemic in the first quarter of 2020, distortions in global demand are to be expected, at least in regional and seasonal terms. In February 2020, the German industry association VDA forecast a contraction of around 3% within the global passenger car market, taking the figure of new registrations to 78.2 million units in 2020. ElringKlinger anticipates a decline of at least 4% in global vehicle production.

The downward growth trajectory within the market also reflects difficult economic, political, and regulatory conditions with which the automotive industry is having to contend alongside the fundamental transition witnessed in the world of mobility. In the European Union, for example, a new average fleet restriction of 95 g/km CO_2 emissions for newly registered passenger cars will apply from the end of 2020 as part of CO_2 legislation. Compared with the limit of 130 g/km in force until then, this regulation represents a major change that harbors the potential for noticeable distortions in the demand for vehicle models and drive systems, but also in seasonal terms due to possible supply bottlenecks. As a consequence, all forecasts relating to the likely direction taken by the vehicle industry in Europe are subject to significant uncertainty. However, alongside more efficient combustion engines, it is likely that the market will experience a boost in e-mobility, especially in Europe. Global demand for electromobility is influenced by government regulations and subsidies as well as the growing range of models offered by manufacturers.

For Europe (EU + EFTA), the VDA anticipates a market decline in new passenger car registrations of around 3% to 15.4 million units. This includes a downturn of 3% for the United Kingdom, which is subject to additional downside risks due to the as yet unresolved issues surrounding post-Brexit trade relations. Furthermore, the markets of Germany (-6%), France (-3%), Italy (-2%), and Spain (-3%) are expected to be positioned below the levels of 2019. In the United States, meanwhile, the association predicts a decline of 3% to 16.5 million new light vehicles, mainly prompted by a cyclical downturn. China is likely to see its vehicle market decline for a third consecutive year in 2020, possibly by 7% according to industry experts, particularly on the back of what appears to be a sharp downturn in the first quarter of 2020.

With regard to vehicle production, analysts expect volumes to decline yet again in most of the regions, while in Brazil more light vehicles are likely to be produced again than last year. Following plant closures in parts of China due to the virus pandemic, the first quarter of 2020 in particular will see a significant decline there.

* Cf. glossary

Waning momentum in commercial vehicle markets

In Western Europe, the truck market showed signs of a cyclical downturn at the end of 2019, with a further decline expected in 2020. The US market for commercial vehicles, which has enjoyed several years of dynamic growth, is also expected to be well below the previous year's level in 2020. After several years of malaise, Brazil saw a substantial recovery in 2019, which is expected to continue in 2020.

Outlook – Company

Challenging market conditions

Market conditions will remain difficult in the current financial year. Alongside the effects of the far-reaching process of transformation within the industry, the vehicle sector will also have to contend with the anticipated economic slowdown, which will again be reflected in automobile production output. In addition, the economic effects of the coronavirus, which has been keeping global markets on tenterhooks in the first half of the year, will impact global growth in automobile production. The New Year vacation in China was extended, production facilities of vehicle manufacturers and suppliers were temporarily shut down, and supply chains were interrupted. During the first quarter of 2020, the coronavirus spread to Europe and North America, where extensive measures have now been taken to contain and slow down the pandemic. Border controls have been reintroduced, public life has been severely restricted, and in some cases a state of emergency has been declared. Both global economic interdependencies and the cross-border spread of the virus are expected to have a significant impact on the world economy, which will be difficult to reverse in the course of the year.

The other influencing factors that heighten the degree of political and, above all, economic uncertainty are thus almost relegated to the sidelines: trade conflicts have yet to be resolved, tariffs on cars are still a distinct threat, the conclusion of a trade agreement with the United Kingdom awaits conclusion, and commodity prices in general remain high. And last but not least, by the end of 2020 the strict CO_2 emission guidelines will take full effect in the EU.

Market conditions are very challenging in view of these influencing factors. Therefore, the task of issuing accurate and meaningful forecasts remains difficult. These uncertainties are further exacerbated by the strong dynamics of the coronavirus pandemic.

Intensive research and development efforts

Innovatory prowess and a commitment to best-in-class technology are part of ElringKlinger's DNA. The Group invariably aims to develop solutions that are tailored closely to customer needs. With this in mind, and against the backdrop of technological change, it plans to channel around 5 to 6% of Group revenue (having taken capitalization into account) into its research and development efforts.

Order books robust to date

Despite the failure of global automobile markets to recover, ElringKlinger's order books remained solid in the period under review. The company's products make it a sought-after partner within the industry. In the financial year just ended, order intake, i.e., the volume of units requested by customers as part of their production scheduling, increased slightly by EUR 1.9 million to EUR 1,737.2 million. Excluding favorable currency effects, order intake would have been EUR 1,696.9 million. Order backlog rose marginally by EUR 10.2 million or 1.0% to EUR 1,030.3 million. This includes currency translation effects of 1.2 percentage points. However, due to the closure of plants by numerous manufacturers, the order situation is expected to deteriorate in the course of the year.

Revenue trend roughly at market level

Against the background of the very high degree of uncertainty relating to both general economic effects and industry-specific developments, the market is faced with a wide range of possible scenarios. Having considered both risks and opportunities, the Group assumes from today's perspective that, in organic terms, revenue in fiscal 2020 will develop at approximately the same level as the market. ElringKlinger concurs with expert estimates that point to a decline in global automobile production by at least 4% in 2020. In the medium term, the Group expects to expand at a faster rate, organically, than global market growth.

Given the raft of influencing factors and growing uncertainty, currency effects are very difficult to predict. Acquisitions cannot be ruled out for the current financial year, as management assesses such opportunities continuously. In this case, the emphasis is on companies that either complement the existing product portfolio in an appropriate manner or allow improved market access. It is unlikely, however, that the scope of such transactions will exceed that of previous activities by a considerable extent. From today's perspective, it is also impossible to rule out divestments within subsegments that are not part of the Group's core business.

Various influencing factors

In recent years, the price of commodities used by the Group has risen significantly in some cases. In fiscal 2020, the overall level is expected to remain high, even if the price of some raw materials is likely to fall. At the same time, more intense trade conflicts could have a detrimental effect.

While the headcount at German sites will remain largely unchanged as planned, the company expects the number of employees to increase slightly overall, also due to ramp-ups, e.g., at the site in Fort Wayne, USA. As part of the cost-cutting program, it is planned to keep personnel costs more or less stable throughout the Group despite the slight expansion. In this context, the focus will be on cost awareness and process optimization. Optimization will be supported by the implementation of the same production standards at all locations in order to harmonize processes and avoid inefficiencies.

Stable earnings performance

In response to persistently strong demand, improvements in cost structures are being sought at the North American sites in particular, the aim being to unlock positive earnings potential. This contrasts with the effects of an anticipated economic slowdown and the global spread of the coronavirus. Additionally, the Group will no longer have the benefit of proceeds from the sale of real estate, as was the case in 2019. Taking these factors into account, the Group had initially expected to achieve an EBIT margin before purchase price allocation* in fiscal 2020 that was roughly at the level recorded in the previous year.

However, the strong dynamics of the coronavirus pandemic meant that numerous manufacturers in Europe and North America had announced or already implemented plant closures during the finalization of this report. As a result, ElringKlinger AG, too, had to adjust its production in line with requirements. The duration of plant closures by manufacturers cannot be predicted at the time of compiling this report. The same applies to potentially more extensive measures in the ensuing weeks – also from a political perspective. In view of these considerable uncertainties and significant dynamics, the economic effects on the Group cannot currently be determined with sufficient reliability and accuracy.

The Group still anticipates that it will be in a position to gradually improve its EBIT margin before purchase price allocation in the medium term.

Targeted investments

Following the global expansion of the Group's production network in recent years, investments (in property, plant, and equipment and investment property) were scaled back significantly compared with previous years. With the investment ratio (as a percentage of Group revenue) – excluding additions from the application of IFRS 16 – standing at 5.3%, the Group fully met its target of a figure below 9%. In pursuing this disciplined approach, the Group will continue to actively manage growth in its long-standing areas of business in order to unlock the growth potential associated with strategic fields of the future. ElringKlinger always conducts thorough assessments concerning the necessity, timing of execution, and funding requirements of such measures. Essentially, ElringKlinger will maintain its policy of disciplined investment spending. The Group therefore anticipates an investment ratio (as a percentage of Group revenue) of less than 7% for the current financial year.

Low level of working capital

The Group's net working capital* essentially comprises inventories as well as trade receivables and payables. It should be noted that inventory levels are expanded by tools which the Group has already manufactured and used for the first time for prototypes, but which have not yet been invoiced to customers as part of series production. The measures taken last year to extend payment terms on the liabilities side, optimize inventories, and reduce receivables will be continued in the coming year. In view of this, the Group expects the net working capital ratio (net working capital as a percentage of Group revenue) to remain roughly at the previous year's level (2019: 24.5%). In the medium term, the level of net working capital as a percentage of consolidated revenue is expected to be around 25%.

* Cf. glossary

Operating free cash flow* remains in positive territory

Having improved its operating free cash flow by more than EUR 250 million in the financial year just ended, the Group will continue its approach of optimizing net working capital and managing capital expenditure in a disciplined manner. At the same time, the Group expects earnings to remain at a stable level. Overall, the Group had therefore initially anticipated that operating free cash flow would again be in positive territory in 2020, reaching a figure in the double-digit million euro range. However, the uncertainties in the wake of the coronavirus pandemic are significant. As a result of plant closures by numerous manufacturers, cash flow is also expected to be impaired. However, in view of the considerable uncertainties and strong dynamics, it is currently not possible to determine these effects with sufficient reliability and accuracy.

In the medium term, the Group will be looking to record positive operating free cash flow.

Lower net financial liabilities

Benefiting from the syndicated loan* agreement, ElringKlinger managed to improve its maturity structure significantly in the year just ended. In addition, the Group used operating free cash flow, which was well within positive territory, to scale back its net financial liabilities by a considerable margin. At the same time, EBITDA* was marginally affected compared to the previous year. As a result, the ratio of net debt* to EBITDA was noticeably reduced to 3.3.

Essentially, the Group also expects positive operating free cash flow for the current year, which it plans to use mainly for the repayment of financial liabilities. In combination with earnings matching the prior-year level, the Group had initially anticipated a slight year-on-year improvement in this area. However, due to plant closures by manufacturers in the wake of the coronavirus pandemic, ElringKlinger was also forced to adjust its production in line with demand. In view of the considerable uncertainties and strong dynamics, the economic effects on the Group cannot currently be determined with sufficient reliability and accuracy. Factoring in the extensive measures being implemented, the ratio is likely to remain below 2.0 in the medium term.

As regards its equity ratio, the Group remains committed in the short to medium term to a target range of 40 to 50% – a corridor within which it has been moving for several years.

Slight improvement in return on capital employed

The Group uses return of capital employed (ROCE*) to measure its profitability and the efficiency with which its capital is used. As regards the 2020 financial year, the Group expects ROCE to improve slightly year on year against the backdrop of its projected earnings performance and challenging market conditions. The medium-term plan is to improve ROCE compared with the respective prior-period figures.

Original Equipment segment

At 80%+ of Group revenue, Original Equipment represents the largest segment within the Group based on sales revenue. As regards its product portfolio, the segment is heavily dependent on the automobile market. Taking into account the uncertainties associated with an economy-driven market, high commodity prices, and the effects of the coronavirus, organic revenue growth can therefore be expected to remain at the level of global automotive production. The EBIT margin of this segment is likely to be below that of the Group average.

Engineered Plastics segment

Business relating to high-performance plastics is expected to generate further revenue growth. This is also to be seen against the backdrop of the continued cultivation of the North American and Asian markets. The EBIT margin will remain at a level that is well above the Group average.

Aftermarket segment

On the back of expansive revenue from the Original Equipment segment in North America and China over recent years, the Aftermarket segment can look forward to more considerable potential with its "Elring – Das Original" brand. Therefore, revenue is likely to grow slightly. The EBIT margin will remain well above the Group average.

Parent company ElringKlinger AG

With a revenue share of more than two-thirds, the parent company ElringKlinger AG continues to play a prominent role within the Group. This will also be the case in the current financial year. The sites operated by the parent company – alongside fundamentally robust business within well-established areas – will see strong growth in the fields considered promising for the future in strategic terms, such as e-mobility and structural lightweighting. Production of a battery system will commence at the Thale site, and a technology center has been set up at the Group's headquarters in Dettingen/Erms, which is also being prepared for the series production of fuel cell modules and systems. Overall, the direction taken by sales revenue within the parent company is expected to be roughly at market level in 2020.

Order backlog remains solid, although the first instances of an economic slowdown have become visible. At the end of 2019 the company had an order backlog of EUR 391.3 million (December 31, 2018: EUR 399.2 million).

While the company will benefit from the positive impact of cost savings, it will also have to contend with the aforementioned economic effects as well as persistently high commodity prices and ramp-up costs for serial production within the area of battery and fuel cell technology. Especially against the background of the anticipated downturn in the economy – also given the impact of the coronavirus – no improvement in earnings is expected in 2020. On the contrary, under these assumptions it is more likely that the EBIT margin will stand at a level below that of the previous year.

* Cf. glossary

Outlook for 2020

The following table reflects the outlook for the 2020 financial year as originally estimated by the Group up to the extensive plant closures by numerous manufacturers in the wake of the coronavirus pandemic. In response, ElringKlinger was also forced to adjust its production in line with demand.

The duration of plant closures by manufacturers cannot be predicted at the time of compiling this report. The same applies to potentially more extensive measures in the ensuing weeks – also from a political perspective. In view of these considerable uncertainties and significant dynamics, the economic effects on the Group cannot currently be determined with sufficient reliability and accuracy.

OUTLOOK 2020

Significant financial control criteria		**Actual 2019**
Sales revenue	Organic growth roughly at global market level. Assumption: market downturn of at least 4%	Organically +0.5% Market: -5.6%
EBIT	Margin before purchase price allocation roughly at prior-year level	3.7%
ROCE	Slight year-on-year improvement	3.4%
Other control criteria and indicators		
R&D costs	Around 5 to 6% of Group revenue (incl. capitalization)	4.7%
Investments (in property, plant, and equipment and investment property)	Under 7% of Group revenue	5.3%
Net working capital	Roughly at prior-year level (in % of Group revenue)	24.5%
Operating free cash flow	Positive in double-digit million euro range	EUR 175.8 million
Equity ratio	40 to 50% of total assets	41.5%
Net debt/EBITDA	Year-on-year improvement	3.3

MEDIUM-TERM TARGETS		**Actual 2019**
Sales revenue	In organic terms, faster in relation to global market growth	Organically +0.5%
EBIT	Gradual improvement in margin before purchase price allocation	3.7%
ROCE	Year-on-year improvement	3.4%
R&D costs	Around 5 to 6% of Group revenue (incl. capitalization)	4.7%
Investments (in property, plant, and equipment and investment property)	Continuation of disciplined approach	5.3%
Net working capital	Around 25% of Group revenue	24.5%
Operating free cash flow	Positive	EUR 175.8 million
Equity ratio	40 to 50% of total assets	41.5%
Net debt/EBITDA	Under 2.0	3.3

Dettingen/Erms, March 25, 2020
The Management Board

Dr. Stefan Wolf
CEO

Theo Becker

Thomas Jessulat

Reiner Drews