Continental Media Webcast: Fiscal 2017

Comments of the Chairman of the Executive Board
of Continental Aktiengesellschaft,
Dr. Elmar Degenhart,
and the company's Chief Financial Officer,
Wolfgang Schäfer,
on the occasion of the
Continental Media Webcast: Fiscal 2017
on March 8, 2018

Check against delivery!

Please note that all statements are preliminary numbers that still need to be approved or determined by the Supervisory Board.

Wolfgang Schäfer, CFO:

Ladies and Gentlemen,

2017 was a fiscal year of strong growth and profitability for us!

We surpassed our targets for the year:

We increased our sales by 8.1 percent in organic terms – that is, adjusted for exchange-rate effects and changes in the scope of consolidation. This means that we once again grew faster than the markets in which we operate. There was an increase of 8.5 percent to €44 billion.

Growth in our operating result kept pace with this despite the negative effects from raw material costs and amounted to €4.6 billion, 11.4 percent higher than the previous year's figure. Negative effects from raw-material costs totaled more than €450 million in 2017. We thus achieved an EBIT margin of 10.4 percent. By way of comparison, in 2016 the figure was10.1 percent.

Adjusted EBIT was more than €4.7 billion, up 10.1 percent on the figure for 2016. The adjusted EBIT margin was 10.9 percent, higher than the comparative EBIT margin for the previous year. This figure was 10.6 percent.

We have developed our business units:

The automotive business grew strongly in 2017, as expected.

Market growth, especially in Europe, was therefore a great tailwind. Production of passenger cars and light commercial vehicles increased by 2 percent to 95.1 million units worldwide in 2017.

What was essential, however, was that we experienced considerably stronger and more profitable growth than the market once again. With sales of €26.6 billion, our Automotive divisions recorded organic growth of 9.3 percent. The adjusted EBIT margin was 8.4 percent.

Let me give you an example of our strong growth in the automotive sector:

Advanced driver assistance systems. Last year, sales of these systems to our customers around the world increased by 41 percent compared with 2016. These systems help prevent accidents, thereby increasing road safety.

In summary, Continental continued to improve its market position in 2017. Our technological strength is the reason for our success. Likewise, this excellent positioning when it comes to technologically demanding products is the prerequisite for our growth in the coming years.

This is best confirmed by the high number of incoming orders for the Automotive Group, which is 50 percent higher than its current sales level.

Now let’s move on to our business with technology products made of rubber, the Rubber Group:

The price trend for natural and synthetic rubber reversed in 2017. The tailwind of previous years became a headwind over the past year. Negative effects from price rises on the commodities markets amounted to over €450 million.

The Tire division’s sales went up by 5.7 percent to €11.3 billion. Before exchange-rate effects and changes in the scope of consolidation, sales rose by 5.3 percent. This was helped by the good winter tire business and the renewed increase in sales volume in China. Overall, we further developed our global market position.

The adjusted EBIT margin was 19 percent after 21.4 percent in 2016. Negative effects from rising raw material prices are reflected in this figure.

Sales in the ContiTech division grew by 14.4 percent to €6.2 billion. The first-time consolidation of the Hornschuch Group was an important contributing factor. Even before these effects, organic sales growth was a remarkable 8.1 percent. This was contributed to by sales growth in the industry segment and increased demand in the mining and oil production business in particular. In addition, sales in both automotive original equipment and the replacement business increased significantly in comparison to the previous year.

The adjusted return on sales of 8.8 percent was lower than the previous year’s figure, which can be accounted for primarily by negative effects from increased raw material costs.

Overall, Continental has a rock solid financial basis. In other words, we are in excellent shape!

We further reduced net indebtedness by €750 million to €2 billion. This puts net indebtedness in relation to equity (or the gearing ratio) at 12.6 percent.

Equity increased to€16.3 billion. This is a new record high and corresponds to an equity ratio of 43.5 percent.

With a profit after taxes of €3 billion, we also achieved a new record high net income for our shareholders. Profit per share increased to €14.92.

The Executive Board is therefore proposing to increase the dividend by 25 cents to €4.50. This corresponds to a total payout of €900 million or a dividend payout ratio of 30.2 percent. So we are planning on making the sixth increase in a row!

Now moving on to the outlook:

The start to the current fiscal year has confirmed our expectations. We are reaffirming our outlook from early January.

We are naturally hedged against some of the considerable exchange-rate fluctuations we are currently seeing because we mostly produce locally for local markets – exchange-rate effects impact sales and earnings to a similar degree. There is therefore barely any impact on the return on sales.

We are able to deal with fluctuations on the commodities markets as well. We anticipate additional negative effects of around €50 million in fiscal 2018. This can be explained by further price increases for synthetic and natural rubber.

As far as the global production of passenger cars and light commercial vehicles is concerned, we currently expect a moderate increase of more than 1 percent to 96.5 million vehicles. We are expecting growth impulses from Asia and Europe in particular.

For fiscal 2018, we expect an increase in sales to approximately €47 billion before exchange-rate effects. For the Automotive Group this equates to expected sales of roughly €28.5 billion.

We therefore want to grow considerably faster than our markets once again. The adjusted EBIT margin is expected to be around 8.5 percent. For the Rubber Group, we expect sales of €18.5 billion and an adjusted EBIT margin of around 15 percent.

We thus anticipate a consolidated adjusted EBIT margin in the region of 10.5 percent.

Ladies and gentlemen, in summary, this means that we will be continuing our profitable growth course in 2018!

Dr. Elmar Degenhart, CEO:

Ladies and gentlemen, there you have it: We are in top form financially! Not only this, we are also a technological pioneer because we are at the forefront of all future-related mobility issues.

We are continuously investing in the technologies of tomorrow. Capital expenditure and research and development expenses totaling nearly €6 billion last year are testament to this. And this is really paying off for us. One indication of this is our incoming orders in the Automotive Group: We reached a new record high of just under €40 billion in 2017. Our tires are also in global demand – in the past fiscal year we sold a record number of some 155 million car and truck tires. This means that drivers around the world are safe on the road. They will also be particularly comfortable if they use our seat coverings, for example. In total, the surface materials we produced last year would cover nearly 37,000 soccer fields.

There could be no clearer expression of our customers' appreciation for our solutions.

It is the same story for the three global mobility megatrends: Our innovative technologies and the intelligent use of software, electronics, and sensor technology are allowing us to make automated and autonomous driving, along with vehicle connectivity and electrification, a reality. We are also developing new business areas and customer groups in innovative mobility services.

Enhanced with software and intelligent sensors, our products and services keep traffic and goods flowing worldwide – from industrial systems, robots, drones, or cars.

In the case of fully automated driving, for instance, our sensors (including cameras, radar, and lidar) monitor the area surrounding the vehicle. This technology is already functioning in these early stages and will continue to be relevant in the future when fully automated driving will be a technological reality. Between 1999 and today, Continental has sold more than 60 million of these sensors altogether – and this number will continue to rise rapidly.

This makes us one of the world's leading suppliers of advanced driver assistance systems. By 2020, we expect to significantly increase our sales in this area from their current level of €1.6 billion to around €2.5 billion.

Electric mobility will become an important part of the combination of drive systems. Continental is one of the few system suppliers that can offer full electrification of the powertrain from one source – from the electric motor and the power electronics to the energy and thermal management systems, through to charging technology.

We are therefore systematically unlocking the growth potential of electrification.

At the same time, we are harnessing the growth potential offered by combustion engines as it cannot be stressed enough that the combustion engine has not yet peaked.

Currently, diesel is at the center of public interest. We view driving bans critically because, as a technology company, we think in terms of solutions and not restrictions. More intelligent traffic flows and the use of alternative drives are efficient ways of reducing emissions. But now some consumers in German cities are being made to suffer. We are continuing our efforts to develop low-emission, clean drive systems for all classes of vehicle. We do, after all, already have the necessary technology.

There is no doubt that the importance of diesel will decline. However, it is also clear that gasoline and diesel engines alike will still be needed in the future, particularly to power heavy cars and trucks.

Continental is not dependent on the diesel technology business, which accounts for less than 2 percent of our total sales.

Today's vehicles can already significantly undercut future emissions standards thanks to highly flexible injection systems, 48-volt hybrid technology, exhaust-gas aftertreatment and electrically heated catalysts. We provide the appropriate solutions for this.

An important transitional technology on the way toward fully electrical driving is 48-volt technology. In the fast-growing market of 48-volt mild hybrid systems, we will be a one-stop shop for the complete electric drive in the future, including battery systems. As we announced just yesterday, we have formed a joint venture with Chinese automotive supplier CITC. The joint venture, in which we will have a majority holding, should be operational by mid-2018 and will operate worldwide from its base in China.

Lithium-ion cells are an efficient, sophisticated, and cost-effective technology for the small 48-volt batteries in these mild hybrid systems. High-voltage batteries for all-electric vehicles, on the other hand, require a development leap in cell technology. This is the only way we will achieve a high enough energy density and performance at a competitive cost. Solid-state battery cells could allow us to make this breakthrough. For this reason, I would like to stress once again that if solid-state technology lives up to our expectations, we would keep our option open to get into production of these innovative battery cells.

As we have already said, we would expect such a decision to yield an attractive return on capital employed.

Efficient and intelligent traffic is created not only through electrification but also vehicle connectivity. We have already connected a total of more than 33 million vehicles worldwide with our technology.

Take for instance our electronic horizon. This highly accurate digital road map makes trucks drive more efficiently. Since it was brought to market in 2012, this Continental technology has reduced fuel consumption by over 760 million liters.

Our tires are also connected. More and more of our passenger and truck tires are fitted with sensors that weigh just a few grams. They measure air pressure inside the tire itself ensuring greater safety, less rolling resistance, and enhanced efficiency.

On account of its capacity for innovation, Continental – more than any other company worldwide – is synonymous with safe, clean, and intelligent mobility. One of our greatest strengths is our many continuous technology chains under one roof, so we can fall back on a high degree of expertise for our solutions – from contact with the road right through to the human-machine interface in the cockpit. This is all the more important now that cars are not made up of technical standalone solutions.

Current – and especially future – solutions require connected thinking. Connectivity at all levels is the buzzword, now more than ever. And this is precisely where our first-rate expertise lies. From tiny, delicate sensors through to the comprehensive safety architecture for automated and autonomous driving. From interior materials through to the highly integrated electric powertrain. From turbochargers through to cyber security.

And we need to be in this top condition in view of the transformation in the automotive industry.

Fast-paced technological transformation requires a very high degree of flexibility and agility. That is why we are examining how we can gear our organization toward rapid growth and maximum value creation in the long term. We are currently assessing our options. A plan is yet to be finalized.

Our great advantage is that we are able to shape this transformation from a position of strength – both technologically and financially.

Change has been a constant part of our company's history, which spans almost 150 years. In the past 20 years alone, Continental has transformed from a purely tire manufacturing business and industrial partner into a global technology company.

Over the past few years, we have developed and strengthened the shared underlying values of Continental. We have thus provided the key foundation for successfully shaping the transformation within our industries and safeguarding the future success of our organization.

This foundation and the aim of value creation continue to form the core of our Continental values alliance. This holds true for all companies in which our corporation has a majority holding, irrespective of their legal or organizational makeup.

By the middle of the year, we want to have formulated a plan for a possible organizational change that could be ready for approval. The hope being that this will enable us to utilize our technological strengths even more effectively.

In this respect, we take the concerns and demands of our employee representatives very seriously. Which is why we conduct talks at company level with the corporate works council. This is a clear sign of the mutual intention to shape our successful future. After all, we are taking on the responsibility for the advancement of our company together. Any possible organizational change will of course be implemented in coordination with the social partners.

We are striving to achieve the best possible organization for greater value creation, while keeping in mind all of our stakeholders – especially our highly motivated employees.

I feel it is particularly important to emphasize that our plans for the future are aiming to shape the company's rapid and profitable growth! By 2025 we have the capacity to grow our business organically to reach a potential sales level in excess of €65 billion.

This is why our plans for the future organization explicitly do not make any reference to restructuring. Instead, we want to gear our organizational setup for the future because there are major opportunities for rapid and profitable growth at hand. We want to make the most of these opportunities to create value. So we will act in a calm and prudent manner. We will not be hasty, instead focusing on the aims we want to achieve! Now is the right time: In this way, we are making our organization fit for the future.

We have every reason to be optimistic: By 2030, we want to be among the top 3 companies in all our industries. To achieve this, we will continue to improve our performance in the areas of quality, innovation and financial results. Our employees will have all the more reason to be proud – proud of their performance, and proud of working for the most attractive and modern employer.

In a nutshell, this simply means that we are growing profitably and at an above-average rate. We are financially in excellent shape and technologically pioneering. We are tackling the transformation in our industries vigorously and purposefully from this position of strength!