

II. Financial Control System

Our Group companies operate in fiercely competitive markets and in an extremely challenging sectoral environment. Against this backdrop, the Group's autonomous development and the ongoing improvement of cost structures and process efficiency are imperative. We pursue these goals with the aid of a comprehensive 360° Concept elaborated in the 2015 Annual Report and by way of the following management and control instruments:

- return on capital employed (ROCE),
- Profit Improvement Program (PIP) and
- individual objectives agreed with executives and non-tariff employees.

Along with ROCE, the Salzgitter Group uses sales and earnings before taxes as its key financial performance indicators. In this context, sales are defined as external sales, namely the proportion of overall sales generated by transactions with companies outside the consolidated group of Salzgitter AG (SZAG). Other parameters of control include order intake, shipment volumes and the development of the cash flow.

Management and control system applied within the company – ROCE

The quantitative, performance-related target set for the Group consists of a return on capital employed (ROCE) of at least 12% over an economic cycle that we generally define as a period of five years. ROCE shows the relationship of EBIT to capital employed and measures the return on capital employed:

$$\text{ROCE (annualized)} = \frac{\text{EBIT I}}{\text{Capital employed}} \times 100 \%$$

EBIT I (earnings before interest and taxes), used in the calculation of ROCE, is the result before taxes and interest expenses, adjusted for the interest portion of transfers to pension provisions. Interest income remains part of EBIT I as it is considered to be part of ordinary activities and therefore contributes to the return on capital employed.

| In € m | 2016 | 2015 ¹⁾ |
|--|-------------|--------------------|
| EBT | 53.2 | 4.1 |
| + Interest expenses | 94.6 | 113.2 |
| - Interest expenses for pension provisions | -51.2 | -47.7 |
| = EBIT I | 96.6 | 69.5 |

¹⁾ Restatement because of a correction of the stock value

Capital employed is interest-bearing equity and debt.

We calculate this ratio by deducting pension provisions and non-interest-bearing balance sheet items from the total assets:

| In € m | 2016 | 2015 ¹⁾ |
|---|--------------|--------------------|
| Total assets | 8,450 | 8,228 |
| - Pension provisions | -2,449 | -2,327 |
| - Other provisions excluding provision for income taxes | -538 | -607 |
| - Liabilities excluding bonds, bank liabilities and notes payable, liabilities from finance leasing and forfaiting, derivatives | -1,524 | -1,374 |
| - Deferred tax claims | -355 | -300 |
| = Capital employed | 3,584 | 3,620 |

¹⁾Restatement because of a correction of the stock value

Pension provisions and related interest expenses are eliminated in the calculation of ROCE as these components cannot be influenced by management decisions in the short to medium term.

The figures used for the calculation of the ratios are taken from the consolidated financial statements (including discontinued operations). We use reporting date-related figures from the financial statements for our calculations.

Since the ROCE target (12%) is to be achieved within the Group as an average over the economic cycle, it is more of a medium to long-term target. We derive specific strategic objectives from this target for each individual business unit and company. These objectives are taken account of in medium-term planning – in an updated form whenever necessary. In 2016 we generated an ROCE of 2.7% (previous year: 1.9%).

Profit Improvement Program (PIP)

We view the sustainable improvement of the Group's competitiveness as one of our permanent management tasks to be achieved by optimizing our value chain processes on an ongoing basis. We place special emphasis here on the systematic and consistent leverage of the existing potential in all our business units. To this end, we introduced the Profit Improvement Program (PIP) as a groupwide, uniform management instrument into the Salzgitter Group back in 1996.

PIP combines all the explicitly defined measures designed to improve the performance and results of the Group's companies, the prerequisite being that the impact of these measures is measurable and assessable, based on a set of financial ratios. All projects are subject to a stringently systematic procedure for measuring success to which binding and standardized assessment criteria are applicable.

In order to achieve our goals, we have launched a number of programs as part of the continual profit improvements in recent years. The "Salzgitter AG 2015" Group program launched in 2012, for instance, as well as the supplementary and ongoing measures that have been combined under the name of "FitStructure SZAG" since the end of 2016, place emphasis on reducing costs and enhancing efficiency. The "Salzgitter AG 2021" corporate strategy, also approved at the end of 2016, is aimed first and foremost at organic growth in high-margin product segments and at raising the proportion of sales in business apart from steel from currently 40% to 50%. All activities under these programs comply with the aforementioned assessment criteria.

Agreeing individual objectives with executives and non-tariff employees

Agreeing objectives connects up the corporate goals with the personal aspirations of each individual employee. Salzgitter AG divides these objectives up into individual targets for executives and non-tariff employees and a collective, quantitative component which reflects the Group's structure. This quantitative component comprises a proportion that serves the purpose throughout the Group of achieving Group's goal of a ROCE of at least 12%. In addition, objectives for the business units and the associated companies are derived for each Group company depending on how services are integrated and the specific role within the respective business unit. The individual component of the targets is agreed between employee and superior, with the personal goals being drawn from the objectives of the organization unit next up in the hierarchy. Attention is paid to ensuring that the interaction between the various targets of all the employees has a positive impact on achieving the overall results of the Group.