

## Supervisory Board report

Dear Sir or Madam,

The Supervisory Board of LEONI AG in fiscal 2016 dealt in depth with the situation and performance of the group of companies. It conscientiously and very diligently fulfilled its duties in accordance with statutory requirements, the provisions of the Company's Articles of Association, the German Corporate Governance Code and its rules of procedure, standing at the Board of Directors' side, providing advice as well as assisting and monitoring its work at all times.

Particular challenges characterised the financial year. First, the focus was on reorganising the Wiring Systems Division, which made substantial progress in 2016. In tandem with these operational tasks, the Supervisory Board, with the support of external advisors, initiated a review in the Wiring Systems Division to analyse the reasons for the major efficiency problems at a plant in Romania that arose in the autumn of 2015 and the ensuing slump in fiscal 2015 profits. Furthermore, fiscal 2016 was marked by a fraud case that was uncovered in August 2016, when criminals used electronic communications channels and falsified documents and identities to arrange cash transfers to accounts outside Germany, causing a loss of around € 40 million. Here, too, the Supervisory Board – likewise with the help of external advisors – took measures to clarify the situation as well as to analyse and evaluate the causes. Details can be found in section headed 'Main topics of discussion by the Supervisory Board'.

### In-depth cooperation between the Board of Directors and the Supervisory Board

The collaboration between the Supervisory Board and the Board of Directors was at all times constructive, open and defined by mutual trust and was strengthened substantially during the year under report. The reorganisation of the Wiring Systems Division and the work to address the fraud case necessitated in-depth discussions on the given situation. In addition to the usual written reports the Board of Directors made available ahead of the Supervisory Board meetings, the Supervisory Board requested additional information particularly in relation to the reorganisation of the Wiring Systems Division, on information management, on the internal control and risk management system and on compliance. It consisted of ongoing updates in order to track the status and progress of the transformation process in the Wiring Systems Division initiated by the Board of Directors. Secondly, it was aimed at finding out more about the topics and challenges faced in information management, the internal control and risk management system and in compliance, particularly against the backdrop of the fraud case. This enabled the Supervisory Board to assess how the Board of Directors develops these systems and compliance further in order to counter any existing risks appropriately. The Supervisory Board also received in-depth and detailed reports on the strategy of the Group and the two divisions, particularly with a view to digitization.



Dr. Werner Rupp

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The Board of Directors informed the Supervisory Board regularly, immediately and comprehensively about all other matters pertinent to LEONI, especially involving planning as well as the Group's operating performance and status including its risk situation. Deviation in business performance from the prepared planning and targets was explained in detail. The Board of Directors also involved the Supervisory Board in decisions of material importance.

All topics were discussed in detail during the Supervisory Board's meetings. The Supervisory Board's approval was obtained where this was required for certain measures in accordance with the rules of procedure. Decisions were always made following an in-depth discussion, usually on the basis of a submission or presentation by the Board of Directors. In addition, the catalogue of transactions requiring approval was supplemented with decisions about setting and amending the organisational guiding principles of the Group and the divisions and the signing of employment and termination contracts with managing directors of the two divisions.

The Supervisory Board also at all times kept in close touch with the Board of Directors outside the meetings. In addition, the chairmen of the two boards consulted on matters requiring agreement at short notice, both regularly on a fixed day every month and also as warranted by events, substantially more often than in the previous year. The entire Supervisory Board was informed in detail of the content of these discussions during its next meeting at the latest. There were no conflicts of interest involving Supervisory Board members in relation to the exercise of their office during the period under report.

#### **Changes in Board of Directors membership**

During its meeting on 29 January 2016, the Supervisory Board appointed Bruno Fankhauser as new member of the Board of Directors with responsibility for the Wire & Cable Solutions Division effective 1 February 2016. His mandate on the Board of Directors initially expires on 31 December 2018. Bruno Fankhauser took over management of the Swiss cable company Studer in 2004 and joined the LEONI Group via its takeover of Studer. From 2008 until he joined LEONI's Board of Directors, he was a member of the Executive Board of the Wire & Cable Solutions Division with responsibility for a business group.

During its meeting on 22 March 2016, the Supervisory Board appointed Karl Gadesmann as the new Chief Financial Officer. Mr Gadesmann took office on 1 October 2016 and was appointed for an initial term lasting until 31 December 2019. Karl Gadesmann is a proven financial expert and has comprehensive expertise in the car and commercial vehicle industry. He was a member of the executive board and CFO of the Dräxlmaier Group, an automotive component supplier specialising in wiring systems and interior trim, from 2013 until joining LEONI. Previously he worked in senior positions at MAN Truck & Bus AG and Volkswagen AG.

On 29 July 2016, the Supervisory Board at an extraordinary meeting approved an agreement with Dr Frank Hiller concerning his amicable departure from the Board of Directors effective 31 December 2016. The Supervisory Board thanks Dr Hiller for his work at LEONI. At the same meeting the Supervisory Board appointed the graduate engineer Martin Stüttem with experience of the international automotive supply industry as new member of the Board of Directors with responsibility for the Wiring Systems Division. He has extensive expertise in production technology and product development and has held various leading positions at international automotive supplier Faurecia since 2010. Mr Stüttem will take office on 1 April 2017. His mandate on the Board of Directors initially expires on 31 December 2020.

#### **Changes in Supervisory Board membership**

At the Annual General Meeting on 4 May 2016, Prof. Dr Christian Rödl, who had been a member of the board by judicial appointment since 22 December 2015, was elected to the Supervisory Board and thus confirmed in office. His appointment expires at the close of the Annual General Meeting that approves discharge for fiscal year 2016.

#### **Main topics of discussion by the Supervisory Board**

The Supervisory Board held seven regular and two extraordinary meetings during the 2016 financial year. The regular meetings were held on 29 January, 22 March, 4 May, 26 July, 27 July, 20 September and 8 December. The meetings on 4 May and 8 December were additionally preceded by a meeting of the shareholder representatives held on the same day. On 29 July 2016 and 26 October 2016, the Supervisory Board held extraordinary meetings to discuss and decide on personnel matters.

The Supervisory Board had a quorum on each occasion. One member excused his/her absence from two meetings. All members of the Board of Directors attended each of the meetings so far as these did not cover topics requiring that they absent themselves. This included the deliberations on the changes in the Board of Directors' membership, contract and compensation matters of the Board of Directors and deliberations on the reasons for the difficulties experienced in the Wiring Systems Division and the fraud case. The employee representatives held a preliminary discussion prior to each Supervisory Board meeting.

The topics that were discussed during the regular meetings included financial, capital investment and human resource planning, the operating targets, the effectiveness of risk management as well as current trends in the economy and the business. The reorganisation of the Wiring Systems Division was also a recurring topic. The Supervisory Board chairman received regular information from the external consulting firm that supports the Board of Directors and subsequently reported to the Board on the progress of the reorganisation. The Supervisory Board thus convinced itself in the course of 2016 that the reorganisation measures taken by the Board of Directors were suitable to tackle the structural difficulties in the Wiring Systems Division.

In its first meeting during the period under report on 29 January 2016, the Supervisory Board discussed the regular topics but also dealt in depth with the findings of the efficiency audit of its work carried out in 2015 and decided on the corresponding measures, which included an increase in the frequency of meetings. It was decided to increase the number of regular Supervisory Board meetings to a minimum of six per year, with one meeting set aside for corporate strategy. For the Audit Committee, a minimum of five and for the Personnel Committee and Strategy Committee a minimum of three meetings each per annum were agreed.

At the meeting of the Supervisory Board on 22 March 2016, the focus was on the presentation and adoption of the consolidated financial statements and of the annual financial statements of LEONI AG for fiscal 2015. Both sets of statements were approved without any objection after detailed deliberation. Furthermore, it decided the agenda for the Annual General Meeting on 4 May 2016. Additional topics included the analysis and optimisation of the cost structures in the holding company and the divisions as impelled by the Board of Directors. As part of the information on the efficiency of the risk management system established by the Group, the Board of Directors presented the risk aggregation for the years 2016 to 2020. Moreover, the Supervisory Board approved the establishment of two new plants of the Wiring Systems Division in Mexico and Ukraine.

The agenda of the meeting on 4 May 2016 included the second tranche of the capital expenditure applied for by the Board of Directors for fiscal 2016, which the Supervisory Board approved after in-depth discussion. In addition, we deliberated the interim report for the first quarter of 2016. The meeting also focused on the reorganisation and further development of the compliance function, as decided on in the previous year, and the discussion of recent developments in this area. The discussions were based on written submissions by the Board of Directors setting out, among other things, the restatement of the targets, the restructuring and strengthening of the organisational structure and the setting of responsibilities. Further information on this topic can be found in the Corporate Governance report. On the basis of the submissions by the Board of Directors, the Supervisory Board convinced itself of the efficiency of the targeted measures. During its meeting on 4 May 2016, the Supervisory Board also decided to initiate, with the support of external advisors, an investigation into the major efficiency problems at a plant in Romania that arose in the autumn of 2015 in order to uncover the causes and monitor their remedy.

On 26 and 27 July 2016, the Supervisory Board convened at subsidiary LEONI Special Cables in Friesoythe in order to get an impression of the special cable production in the Wire & Cable Solutions Division.

On the first day of the meeting, the Supervisory Board discussed M&A and location-specific issues and approved the acquisition of a 51 percent stake in Chinese wiring systems producer Wuhan Hengtong Automotive and the establishment of another Wiring Systems Division plant in Serbia. Moreover, the implications of new provisions of capital market legislation were discussed. The second day of the meeting focused on the strategy of the Group and the two corporate divisions. In particular, the Supervisory Board sought information on the further strategic development of the Wire & Cable Solutions Division to become a leading solutions provider of intelligent and secure energy transmission and data management systems and on the issues of automation and electromobility, which are of importance for the Wiring Systems Division.

In the further course of the year the activities of the Supervisory Board were marked largely by the work on the fraud case mentioned at the outset. Immediately after the fraud was uncovered in August, the Supervisory Board Chairman sought detailed reports on the matter and on the immediate measures taken to recoup the funds, on securing damages for the loss from insurers and on how to prevent such a occurrences happening in the future. At an extraordinary meeting of the Audit Committee that was convened immediately on 12 September 2016, the further steps were discussed together with the Board of Directors and a project team put together to process this case. The project team was commissioned to establish a full picture with the help of external advisors and to determine the circumstances that made the fraud possible, to establish how exactly the fraud happened and what measures are required to avoid similar cases in the future. In addition, the Board of Directors arranged for an analysis of the financial organisation with a similar objective, also with external support. The relevant findings were communicated to both the Board of Directors and the Supervisory Board. Independently thereof, the Supervisory Board commissioned its own external consultant who advises the Supervisory Board in the light of recent findings on all legally required issues from the Board's perspective and who additionally also reviews and assesses the internal control system and risk management on the Board's behalf.

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The discussion of the causes and consequences of the fraud case was also the focal point of the Supervisory Board meeting on 20 September 2016, during which the Supervisory Board discussed the progress of the investigations initiated by the Board and the external advisors reported on their work. In addition, during this meeting the Supervisory Board discussed the half-year financial report, approved a budget for the implementation of the 'Factory of the Future' project in Roth and initiated the annual efficiency audit of its work by means of a questionnaire.

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During its meeting on 8 December 2016, the Supervisory Board decided to update the declaration pertaining to the Code pursuant to Article 161 of the German Stock Corporation Act. Further details are contained in the Corporate Governance report. Other important topics during the last meeting of the year under report were the compensation for members of the Board of Directors and the discussion about the recent findings on the fraud case with the involvement of the Supervisory Board's external advisor. The Supervisory Board expects an evaluation of the results supplemented with findings from the analysis of the financial organisation commissioned by the Board of Directors as well as the examination of the internal control system and risk management report to become available by summer 2017. In addition, at this meeting the findings from the investigation of the efficiency problems at a plant in Romania that arose in the previous year and the associated slump in profits were discussed. A final statement by the commissioned external advisor on this topic is also expected in 2017.

#### Work of the committees

The Supervisory Board of LEONI AG formed an Audit Committee, a Personnel Committee, a Nomination Committee and a Strategy Committee. In addition, there is the Arbitration Committee in compliance with Article 27 (3) of Germany's Co-determination Act. These governance bodies prepare the topics to be addressed by the entire Supervisory Board and the resolutions on which the Board is to vote during its meetings. The committee chairmen reported on the work of their committees during the Supervisory Board meetings.

- In 2016, the **Audit Committee** convened for a total of five regular meetings and the above-mentioned extraordinary meeting. It dealt in detail with the 2015 financial statements and consolidated financial statements, the management reports and the auditor's report, it prepared for nomination of the auditors for the 2016 financial year and dealt in depth with the upcoming quarterly reports as well as the half-year report. A principal focus during the meetings held after the fraud case was uncovered concerned the many different measures designed to work through the fraud and to avoid similar occurrences in the future. The Audit Committee drafted extensive questionnaires for the Board of Directors and the responsible project team in order to obtain the full picture, it prepared the commissioning of its own external expert for the evaluation of events in the fraud case and deliberated in depth on the further procedure with the Board of Directors and the project team responsible for clearing up the case. Responsible parties from Compliance, Finance, IT Security, Legal and Risk Management departments and the commercial managers of the two divisions were involved in the process. Furthermore, the Audit Committee discussed the reports commissioned by the Board of Directors to shed light on the fraud and the associated analysis of the financial organisation. The Supervisory Board was informed of the relevant findings.

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Furthermore, the Audit Committee dealt with the continuous development of risk management and compliance. All told, it shared the view of the Board of Directors, that both divisions should be strengthened and developed to help them make an efficient contribution to the success of the LEONI group of companies. In addition, the committee members discussed the fresh challenges resulting from the EU's reform of audits, the status of the ongoing company audit, the efficiency of the internal control system and of internal auditing and acquisition of the majority stake in Chinese wiring systems producer Wuhan Hengtong Automotive.

- **The Personnel Committee** held eight meetings during the year under report. Its deliberations focused on the search for candidates for the vacant posts, the amendments to the rules of procedure and the compensation for members of the Board of Directors.
  
- **The Nomination Committee** held four meetings in 2016 in order to prepare the nomination of suitable candidates on the shareholder side for the upcoming Supervisory Board elections in 2017. In its rules of procedure, the Supervisory Board defined a requirements profile some time ago, which was updated in 2016. Based on this requirements profile, the Nomination Committee, partly with external help, identified suitable candidates: some already form part of the Supervisory Board while others are proposed for election for the first time. During the search the specialist knowledge, in particular, of the current Supervisory Board members played a role; this knowledge should continue to be represented in order to fulfil the requirements profile. Moreover, the Nomination Committee believes that the knowledge of the company and experience gained from previous activities on the Supervisory Board that the current Supervisory Board members contribute are important factors for the future composition of the Supervisory Board. The nomination of current office holders is designed to ensure continuity in the work of the Supervisory Board, which assumes high importance in light of the current situation of LEONI AG and the upcoming challenges.

Specific technical knowledge that is not yet fully represented on the Supervisory Board but is due to be added on account of the requirements profile was decisive in the selection of the external candidates. As a result of this selection process, the target structure was further optimised in the Supervisory Board's view. Detailed talks were held with external candidates about the activities of, and requirements for, Supervisory Board members. The Nomination Committee then issued a recommendation to the Supervisory Board on the basis of these findings.

- **The Strategy Committee** met three times during the year under report, on all occasions together with the Board of Directors. It dealt in depth with the strategy of the Group and the two divisions, the reorganisation of the Wiring Systems Division, strategic IT issues and the challenges and opportunities of digitization for LEONI.

Convening of the **Arbitration Committee** pursuant to Article 27 (3) of Germany's Co-determination Act was not required in the past financial year.

#### **Corporate Governance and Declaration of Conformity**

Again in fiscal 2016, the Supervisory Board dealt in detail with Corporate Governance at LEONI, taking the German Corporate Governance Code as its guide. The Declaration of Conformity pursuant to Article 161 of the German Stock Corporation Act was updated in December 2016. With two exceptions, LEONI fulfils all the recommendations of the Code in its current version. Further details can be found in the current version of the Declaration of Conformity.

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#### **Audit of the annual financial statements**

The Annual General Meeting of LEONI AG's shareholders on 4 May 2016 appointed Ernst & Young GmbH auditing company of Stuttgart as auditors for the 2016 financial year. Ernst & Young audited and granted an unqualified certificate for the 2016 financial statements and the management report of LEONI AG as well as the consolidated financial statements and the Group management report. Ernst & Young have been auditors for LEONI AG since the year 2000 and auditors for the LEONI Group since 1987. The auditors responsible pursuant to Article 319a (1) Sentence 4 of the German Commercial Code (HGB) were Udo Schuberth (starting with the 2013 financial statements) and Gero Schütz (starting with the 2012 financial statements).

The financial statements and the management report of LEONI AG were prepared in accordance with the provisions of the German Commercial Code. The consolidated financial statements and the Group management report were drawn up in accordance with the International Financial Reporting Standards (IFRS) as they apply in the European Union, and additionally in accordance with the commercial law provisions of Article 315a (1) of the German Commercial Code (HGB). The auditors conducted the audit in accordance with Article 317 HGB while observing the German principles of true and fair annual accounting of the Institute of Public Auditors in Germany, Incorporated Association (IDW), and with regard to the consolidated financial statements while additionally observing the International Standards on Auditing (ISA). The auditors stated that the management reports described the situation of LEONI AG and of the Group as well as the future risks and rewards in an appropriate manner and also gave the quality of the risk management system a favourable verdict.

The annual financial statements of the Company and of the Group, the management reports and the audit reports were available to all members of the Supervisory Board in good time. The Audit Committee pre-examined these documents during its meeting on 14 March 2017. At the regular meeting of the Supervisory Board on 22 March 2017 the Chairman of the Audit Committee reported on the pre-examination. These financial statements and reports were then comprehensively discussed by the Supervisory Board. The auditing company's representatives took part in both meetings, reported on the findings of their audits and were available to provide additional information. The Supervisory Board declared itself convinced that the reports by the auditing company and the auditors of the consolidated financial statements meet the statutory requirements. In particular, the Supervisory Board shares the assessment of the Board of Directors expressed in the management reports. With respect to the accounting process, the auditing company's representatives confirmed the effectiveness of the risk management and internal control system to the Supervisory Board. The auditors gave written assurance, furthermore, that they did not perform any significant services other than to audit the financial statements of LEONI AG during the year under report and that there are no circumstances that might compromise their independence.

The Supervisory Board approves the findings of the audit of the financial statements. The final result of the audits by the Audit Committee and the Audit Committee's own examination of the annual financial statements and management reports of LEONI AG and the Group did not give rise to any objections. The Supervisory Board approved the annual financial statements of LEONI AG and the consolidated financial statements for fiscal 2016 as prepared by the Board of Directors. The financial statements of LEONI AG have thus been duly adopted. The Supervisory Board supports the Board of Directors' proposal to pay out a dividend of € 0.50 per share for fiscal 2016.

#### **Thanks to the Board of Directors and staff**

The Supervisory Board thanks all members of the Board of Directors as well as staff for their good work in the past financial year – a year in which the extensive changes in the Wiring Systems Division, the strategic realignment of the Wire & Cable Solutions Division and the implications of the fraud case once again resulted in particular challenges. The Supervisory Board wishes the Board of Directors and all employees much success as they confront the upcoming tasks. We are convinced that our Company will return to sustained growth and will thus justify the trust you have placed in LEONI.

Nuremberg, 22 March 2017



Dr Werner Rupp  
Chairman of the Supervisory Board