Supervisory Board report

» Dr.-Ing. Klaus Probst,
Chairman of the Supervisory Board

Dear Sir or Madam,

The Supervisory Board of LEONI AG dealt in depth with the situation and performance of the group of companies in fiscal 2018.

We diligently and dutifully fulfilled our tasks in accordance with statutory requirements, the provisions of the Company's Articles of Association, the German Corporate Governance Code and our rules of procedure, continuously advising the Board of Directors on its management of the Company and overseeing its work.

The collaboration between the Supervisory Board and the Board of Directors was at all times constructive, open and defined by mutual trust. The Board of Directors informed us regularly, immediately and comprehensively, both in writing and verbally, about all matters pertinent to LEONI. In particular, this included the strategy, planning, operating performance as well as the Group's current situation including its risk situation. The Board of Directors explained any deviation in business performance from the prepared planning in detail and involved the Supervisory Board in decisions of material importance. This also applied to the time after this reporting period ended when an unexpectedly sharp deterioration of earnings became evident.

We discussed all important matters thoroughly during our meetings of the Supervisory Board. The Board of Directors provided us with corresponding, comprehensive written reports in advance. The Supervisory Board's approval was obtained so far as this was required for certain measures in accordance with the rules of procedure. Key matters subject to approval included various investment projects, the establishment of a joint venture as well as authorisation for a new financing plan, which comprised a large syndicated loan and issuing more borrower's note loans. These decisions were on each occasion preceded by in-depth discussions, which were normally based on a corresponding submission or presentation from the Board of Directors.

The Board of Directors and the Supervisory Board also kept in close touch at all times outside their meetings. The chairmen of both boards consulted regularly, also at short notice and as warranted by events, on any matters requiring agreement. The number of fixed dates was raised significantly to onboard the new CEO. The entire Supervisory Board was informed in detail of the content of these discussions during its next meeting at the latest.

Main topics of discussion by the Supervisory Board

The Supervisory Board held six regular meetings during the 2018 financial year; specifically, on 30 January, 15 March, 3 May, 20 July, 18 September and 13 December. In addition, it met in an executive session to discuss matters without the members of the Board of Directors on 26 November 2018.

The employee representatives held a preliminary discussion prior to each Supervisory Board meeting. The shareholder representatives also held prior discussions on 3 May and 13 December 2018. The Supervisory Board was quorate on each occasion. One member had excused their absence from each of the three regular meetings and in one session a member could only participate part of the time for an important reason.

Apart from the executive session, 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. These topics included deliberations on Board of Directors matters, further clearing up of the fraud case uncovered in 2016 as well as the Supervisory Board's efficiency audit.

The matters discussed during the scheduled meetings regularly included the general business situation of the Group and both divisions, the financial situation based on the income statement and the balance sheet as well as key investments and development in terms of the number of employees. In particular, we considered the performance in terms of earnings and cash flow that fell significantly short of expectations from the third quarter as well as the necessary reactions. The Board of Directors launched a performance and strategy programme (VALUE 21) that we discussed thoroughly on the Strategy Committee, but also during our meeting on 13 December 2018. The programme is focused on operations as well as on measures to improve earnings quality and the liquidity situation. Yet, in the same vein, the programme also has a strategic dimension. Above all, this includes limiting growth in the Wiring Systems Division to a degree that is organisationally and financially attainable as well as proactively managing portfolios with respect to the two divisions' various business areas more than in the past. Both of the programme's aspects will occupy us even more in the upcoming reporting period.

Another key topic involved the Supervisory Board's efficiency audit, which was carried out with outside support during the year under report and which yielded various recommendations for action, which were geared to streamlining the Board's work and preparing for decision-making by the entire Board. In addition, there were such other measures as the introduction of a planning calendar, an annual strategy seminar and a Corporate Office. Specific implementation of these measures was approved during the executive session. Further details on this topic can be found in the Corporate Governance report.

The subject matter of the reporting period's first meeting on 30 January 2018 included, alongside regular agenda items, approval to set up a fourth LEONI facility in Mexico. Another key item involved the appointment to the vacant position of Chief Executive Officer following the departure of Dieter Bellé effective 31 January 2018. Having previously carried out a widespread selection process considering both internal and external candidates, we decided to fill the position with an outsider and to focus on a candidate with whom final talks about the succession based on predetermined parameters were to be held by the next meeting. At the same time, we approved a new, interim allocation of responsibilities for the period from 1 February 2018 until the future CEO assumed office. This decision divided the departments among the three remaining members, establishing that they were to manage the Company with equal authority. Chief Financial Officer Karl Gadesmann was appointed as acting spokesman for the Board of Directors and as Labour Director. We furthermore extended the mandate of Board member Bruno Fankhauser, whose contract would have expired at the end of 2018, until 31 December 2023. Elements of Board of Directors compensation were a further discussion point: we determined the targets for the short-term component of 2018 Board of Directors compensation. We furthermore decided upon the regular review of Board of Directors compensation to make adjustments to Board member contracts, which ensure equal treatment of the Board members as well as in their compensation and retirement benefit. With respect to its composition, the Supervisory Board approved changes to its competence profile and discussed amendments to the diversity concept for the Board of Directors and the Supervisory Board. We also sought information on the status of the Internal Control System; of risk management and of the Internal Audit and Compliance departments, of the trend in selling and administrative costs within the LEONI Group as well as the process for selecting the auditors as of the 2019 financial year. In addition, we looked at the oneLEONI project, which is intended to pool Group-wide skills and responsibility and serves, in division-overarching initiatives, to harmonise and standardise key processes as well as the progress in various projects of the IT department.

During the Supervisory Board's meeting on 15 March 2018, the members appointed Aldo Kamper as the new Chief Executive Officer of LEONI AG effective 1 October 2018. It was furthermore agreed to conduct talks with him about possibly assuming office sooner. Moreover, presentation, scrutiny and adoption of the financial statements and the summarised management report for LEONI AG and the Group for the 2017 financial year constituted a focal point of this meeting. Both sets of statements were approved without any objection after detailed deliberation. The Supervisory Board also discussed the 2017 annual report including the Supervisory Board report, the Corporate Governance report and the compensation report as well as the dividend proposal and the agenda for the Annual General Meeting on 3 May 2018. The Board also decided to carry out the pending efficiency audit with external support and to mandate Ernst & Young as the chosen consultants. Further items involved the risk aggregation for the years 2018 through 2022, the performance of Program Management and the pending, major projects of the Wiring Systems Division as well as the new financing plan for the LEONI Group, whereupon we approved signing of a syndicated loan by circular resolution at the end of May 2018. The Board of Directors also informed us on the status of the (meanwhile retracted) lawsuit against the election of Dr Klaus Probst as a member of the Company's Supervisory Board by shareholders at the 2017 Annual General Meeting, licence management and various organisational changes within LEONI AG.

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The third regular meeting of the Supervisory Board took place on 3 May 2018 after the Annual General Meeting. Primarily, we dealt with the strategic development of the Wire & Cable Solutions Division and approved the establishment of a joint venture for production of single-mode fibers. We furthermore authorised an increase in the amount to be invested in the Factory of the Future and the total allowance for additions to tangible assets in the 2018 financial year. In addition, we decided on a new version of the rules of procedure for the Board of Directors and on optimisation of our corporate governance with respect to decision-making and implementation. Detailed in this respect can be found in the Corporate Governance report.

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On 20 July 2018, the Supervisory Board again obtained information on the status of the oneLEONI project, realignment of the Corporate Strategy, Corporate Taxes and Corporate Process Management departments, the latest developments concerning diversity and succession management, the new, global power-of-attorney guideline as well as the LEONI OnFire programme, which aims to create a more agile corporate culture. Prior to the meeting, an agreement was furthermore reached with Aldo Kamper's existing employer on his earlier departure, whereupon it was decided to bring his appointment forward to 1 September 2018 as well as to end Karl Gadesmann's temporary role and the interim allocation of responsibilities on the Board of Directors as of that date. The Supervisory Board also received update on the implementation status of the actions recommended by the BDO consulting firm, which it had commissioned to conduct a review of the Corporate Finance and Treasury departments because of the fraud case uncovered in August 2016. In addition, we once again addressed licence management and approval for certain personnel-related decisions made by the Board of Directors at the level of senior management (Level 1 of the Group-wide grading system). We adopted an amendment to the rules of procedure for the Board of Directors to make the latter part of the duties of the Personnel Committee in future cases. Finally, we learned about the initial suggestions arising from the efficiency audit with Ernst & Young.

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During the Supervisory Board's meeting on 18 September 2018, which was held at our facility in Kitzingen, Germany, the Board approved the new allocation of responsibilities presented by the Board of Directors. Details in this respect can be found in the Corporate Governance report. We also approved the placement of borrower's note loans to increase financial flexibility. Based on the Audit Committee's recommendation for selection, the Supervisory Board furthermore decided to propose Deloitte GmbH Wirtschaftsprüfungsgesellschaft as auditors for fiscal 2019 to shareholders at the 2019 Annual General Meeting. Additional items included an update on the joint venture authorised in May 2018, on the status of clearing up the fraud case, on the Sustainability Report, on the Safety, Health & Environment department, on implementation of the suggestions in the BDO report for action with respect to the 2016 fraud case, on Iran-related business as well as on the performance of the LEONI share and its switch from the MDAX to the SDAX. Finally, we discussed Ernst & Young's closing report on the efficiency audit and the resulting conclusions, and we obtained an initial preview of work on a holistic Group strategy.

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During the executive session, which was held on 26 November 2018, we decided on measures to apply the actions recommended by Ernst & Young arising from the Supervisory Board's efficiency audit. Information in this respect can be found in the Corporate Governance report.

The main focus of the Supervisory Board's meeting of 13 December 2018 was on the planning for fiscal 2019, the medium-term planning for 2020 and the subsequent years as well as the investment planning for 2019. Following comprehensive and constructive discussion, the members of the Board of Directors and of the Supervisory Board agreed to revise the presented planning as well as the medium-term planning by the January meeting to thereby take into account the latest knowledge of market and performance developments. Similarly, setting of the targets for fiscal 2019 Board of Directors compensation was postponed to the next meeting as this would be extrapolated from the corresponding planning. At the same time and following constructive discussion, we approved 90 percent of the amount of investment proposed for the 2019 financial year to be able to decide on the remaining share once the planning was finalised. Another focal point involved the CEO's first status report on preparing the VALUE 21 performance and strategy programme, which we subsequently discussed thoroughly. Upon the Audit Committee's recommendation, the Supervisory Board also approved the report by Ernst & Young on the findings of the audit of LEONI AG's systems to adhere to requirements concerning the signing of financial derivatives in accordance with Section 20 (1) of the German Securities Trading Act (WpHG) 2017 in its previous version and decided to update the Company's declaration pertaining to the German Corporate Governance Code pursuant to Section 161 of the German Public Stock Corporation Act (AktG). This is included in the statement on Corporate Governance. We also agreed to updates to the diversity concept for the Board of Directors and the Supervisory Board as well as amendment of the competence profile and the targets for composition of the Supervisory Board. Additional resolutions concerned the gender ratio and fulfilment of the target quotas for the Board of Directors and the Supervisory Board. Information in this regard is contained in the statement on Corporate Governance. There were also

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planned changes to the management board of a division and amendments to our rules of procedure, which resulted from the prior resolutions on the diversity concept and the competence profile as well as the findings of the external efficiency audit, such as revision of the Strategy Committee's role. The latter included new composition of the committee, which we carried out in a corresponding election. Further information on this is contained in the Corporate Governance report and the section on the Supervisory Board and Board of Directors. Another topic, finally, involved the Board of Directors' reporting on the status of the IDW audits PS 980, 981, 982 and 983 in the Compliance, Risk Management, Internal Control System and Internal Audit departments.

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An unexpectedly sharp deterioration of earnings became apparent after the period under report ended, which prompted us immediately upon finding this out to work hard on addressing cause and effect as well as applying instant actions and other measures going beyond the VALUE 21 programme discussed to date.

Work of the committees
The Supervisory Board of LEONI AG formed an Audit Committee, a Personnel Committee, a Nomination Committee and a Strategy Committee. 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 composition of the committees is described in the section headed Supervisory Board and Board of Directors, while the Corporate Governance report provides information on the duties of the committees. Decision-making powers of the Supervisory Board are transferred to the committees to the extent permitted by law. In addition, there is the Arbitration Committee in compliance with Section 27 (3) of Germany's Co-determination Act (MitbestG). The committee chairmen reported regularly on their work during the Supervisory Board meetings.

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The **Audit Committee** convened for six regular meetings and one extraordinary meeting during the year under report. It dealt in depth with the 2017 financial statements and consolidated financial statements, the management and quarterly reports, the findings of the audit as well as the six-month report and prepared for nomination of the auditors for the 2018 financial year. Other topics covered the oversight and approval of permissible non-auditing services, the status of the external audit of the Governance, Risk and Compliance departments, the non-financial Group information statement, the findings of the IT audit as well as application of the new General Data Protection Regulation. The committee also once again addressed the actions recommended by the BDO consulting firm, which was commissioned by the Supervisory Board in 2016 because of the fraud case, and prepared the decision-making on the change of auditors for the 2019 financial year. It furthermore obtained up-to-date reports from the departments for Compliance, Information Security, Internal Control System, Risk Management, Taxes as well as safety at work, health and environmental protection at LEONI.

The **Personnel Committee** met on four occasions in 2018, one of which in the form of a conference call. Primarily, the committee worked on the appointment of a new chief executive officer.

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The **Strategy Committee** held three meetings during the past financial year. The principal topic was the strategy of the Group and of the two divisions. The committee furthermore worked on the strategic footprint planning of the Wiring Systems Division and the Wire & Cable Solutions Division's strategy in the data center market. Another focal point involved review of the committee's position and remit, which ultimately led to proposing to the Supervisory Board that, among other things, the responsibilities of the Strategy Committee be more explicit and that this be embedded in the rules of procedure. During its final meeting, members thoroughly discussed the new, annual strategy process, the introduction of a Group-wide M&A process, the Corporate Development Plan for the 2019 financial year as well as the VALUE 21 performance and strategy programme.

There was no cause for either a meeting of the **Nomination Committee** or convening of the **Arbitration Committee** pursuant to Section 27 (3) of Germany's Co-determination Act (MitbestG) during the reporting period.

Corporate Governance and Declaration of Conformity

The Supervisory Board again dealt in detail with Corporate Governance at LEONI, taking the German Corporate Governance Code as its guide, during the year under report. The Declaration of Conformity pursuant to Section 161 of the German Stock Corporation Act was updated in December 2018. With one exception, 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. This is included in the Corporate Governance report and statement on Corporate Governance.

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Audit of the annual financial statements

Upon the proposal by the Supervisory Board, which followed an Audit Committee recommendation, the Annual General Meeting of LEONI AG's shareholders on 3 May 2018 appointed Ernst & Young GmbH auditing company of Stuttgart as auditors for the 2018 financial year. The company audited and granted an unqualified certificate for the 2018 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 the LEONI Group since 1987. The auditors responsible pursuant to Section 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). Ernst & Young had confirmed to the Chairman of the Supervisory Board and to the Audit Committee, before the Supervisory Board proposed the firm as auditors at the Annual General Meeting, that there are no circumstances that might compromise their independence or raise doubts about their independence. Ernst & Young also declared the extent to which, in the preceding financial year, services for the Company other than the audit were either performed or contractually agreed for the subsequent year.

The provisions of the German Commercial Code were applied to prepare the financial statements and the management report of LEONI AG. The International Financial Reporting Standards (IFRS) as they apply in the European Union as well as, additionally, the commercial law provisions under Section 315e (1) of the German Commercial Code (HGB) were applied to prepare the consolidated financial statements and the Group management report. The audit was conducted in accordance with Section 317 of the German Commercial Code (HGB) while observing the German principles of true and fair annual accounting of the Institute of Public Auditors in Germany, Incorporated Association (IDW). The auditors stated that the management reports appropriately describe the situation of LEONI AG and of the Group as well as the opportunities for and risks to future performance. The review of the risk management system as part of the audit found that the Board of Directors has taken suitable measures in keeping with those required under Section 91 (2) of the German Stock Corporation Act (AktG) to set up a monitoring system, and that this monitoring system is suited to early detection of developments that might threaten the Company's continued existence.

As part of its review, the Supervisory Board also reviewed the non-financial Group information statement that was to be prepared pursuant to Section 315b of the German Commercial Code (HGB) and found that it fulfils the existing requirements and no objections are to be raised. An external audit had previously confirmed that nothing was found that might cause the auditors to conclude that the non-financial Group information statement was not prepared in all material respects in accordance with Section 315c of the German Commercial Code (HGB).

The annual financial statements of the Company and of the Group, the management reports (including the non-financial Group statement) 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 27 February 2019 and reported to the Supervisory Board in this regard during the latter's regular meeting on 28 February 2019. We subsequently discussed the financial statements and reports in depth. The auditing company's representatives took part in both meetings, provided information on the findings of their audits and were available to provide additional information. In particular, the findings of key audit matters for LEONI AG and the Group were presented: (I) recoverability of loans to associated companies and of receivables from associated companies, (II) Impairment test of goodwill and intangible assets and property, plant and equipment as well as (III) Income taxes – Recognition and measurement of deferred tax assets. The audit did not give rise to any objections.

The Supervisory Board approved the findings of the audit of the financial statements. The final result of the audits by the Audit Committee and the Supervisory Board of the annual financial statements and management reports of LEONI AG and the Group did not give rise to any objections. We approved the annual financial statements of LEONI AG and the consolidated financial statements for fiscal 2018 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' suggestion to deviate from the Company's previous dividend policy and propose to shareholders at the 2019 Annual General Meeting not to pay out a dividend from the distributable profit of LEONI AG for the 2018 financial year.

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Dieter Bellé, LEONI AG's Chief Financial Officer from the year 2000 and its Chief Executive Officer from 2015, left the Company on 31 January 2018 with the Supervisory Board's agreement. We once again thank him sincerely for his many years of successful work for and his great commitment to the Company. The Supervisory Board appointed Aldo Kamper as LEONI AG's new CEO on 15 March 2018. Kamper, who has an MBA as well as profound experience in the industrial and automotive segments, assumed his office on 1 September 2018. CFO Karl Gadesmann took on the role of spokesperson for the Board of Directors and Labour Director on an interim basis from 1 February to 31 August 2018. The Supervisory Board expressly thanks him for this additional commitment.

On 13 December 2018, Carmen Schwarz resigned her mandate as a member of LEONI AG's Supervisory Board by mutual agreement effective 13 January 2019. She is to be succeeded by Janine Heide, secretary of the IG Metall trade union at its Aachen office and resident in Bad Camberg. The application for her judicial appointment pursuant to Section 104 of the German Stock Corporation Act (AktG) was submitted to the Nuremberg local court on 19 December 2018. Janine Heide was appointed a member of the Supervisory Board as an employee representative (trade union representative) by a resolution on 15 January 2019. The Supervisory Board thanks Carmen Schwarz for her commitment and her personal dedication as member of the Supervisory Board. At the same time, it wishes Janine Heide every success in her new job.

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 commitment in the 2018 financial year, which presented LEONI with major challenges. In 2019, our Company will once again be operating in a demanding setting and will be additionally challenged by our newly launched VALUE 21 performance and strategy programme. The Supervisory Board wishes the Board of Directors and all members of staff every success with these impending tasks.

Nuremberg, 28 February 2019

Dr Klaus Probst
Chairman of the Supervisory Board