MS Industrie AG

EXTRACTS from the Group's Management Report 2017

NOT LEGALLY BINDING

Important notes:
English translation for convenience purposes only
General data format is "TEUR" (Euro thousands),
i.e. TEUR 1.000 = EUR 1.000.000 or EUR 1 million

Foreword from the Executive Board on the 2017 Annual Financial Report

Dear Shareholders, Employees and Business Partners of MS Industrie AG,

Dr. Andreas Aufschnaiter

Armin Distel

Following an abatement in the year before, the Group was able in 2017 to return to its previous sustained path of organic growth, recording revenues of around **EUR 250,6 million** overall. Compared with the adjusted pure **industrial revenues** of the previous year (EUR 235,7 million), this represents an increase of around **+6,3%**. This was mainly due to the pronounced recovery of demand in the commercial vehicle sector in North America supplemented by further increases in Europe and other regions. The various key earnings figures performed especially positively, mainly as a result of the expansion in business volumes. A positive consolidated profit for the year after taxes, both adjusted and unadjusted for non-recurring items, (see detailed analysis in the Group Management Report, section 2.c) of EUR 7,0 million (previous year: both adjusted and unadjusted EUR 4,5 million) was achieved and the equity ratio rose significantly from 33,7% to 37,1%.

We would like to highlight a few crucial milestones and developments for the readers of this Annual Report which we consider to be significant in terms of assessing the financial year 2017 and the outlook:

- Business performance in the Powertrain segment (**"MS Powertrain Technology Group"**, also briefly "MS PTG") was characterised by a strong recuperation of demand in the entire **NAFTA region** since April 2017, while at the same time product demand for new diesel engines in **Europe** including Germany rose continuously again, resulting in an increase in revenues of around +3,7% overall.

- In the Ultrasonic Technology segment (**"MS Ultrasonic Technology Group"**, also briefly "MS UTG") the **construction of special machines** for our customers in the passenger car industry grew at around +13,0% in Europe and internationally, and once again we are looking at a positive order backlog for 2018.

- The new range of industry 4.0-based **ultrasonic welding machinery** products of MS UTG for the **"MS soniTOP"** brand had been presented to the market at the trade fair "K-Messe" in Düsseldorf in autumn 2016. Following this, deliveries and test installations at a large number of first reference customers from different sectors were very positive and encouraged us to step up our sales capacities in order to be able to accomplish the market expansion of the business planned for the coming years.

- Since the successful relocation to the **new production building** of **MS PTG** at the Trossingen site in 2016, we have continued to further optimize both the manufacturing equipment and the processes.

- Activities at the **Elektromotorenwerk** site in Gabrovo/Bulgaria (EMGR EAD) also continued to expand based on an enlargement of the product range and additional production steps, and the site already began delivering products directly to European customers.

- Following last year's split-up of the former MS Spaichingen GmbH entity into three entities – MS Powertrain Technologie GmbH (Trossingen), MS Ultraschall Technologie GmbH (Spaichingen) and MS Industrie Verwaltungs GmbH (Spaichingen), **segment reporting** of the MS Industrie Group has now been aligned to correspond to the three segments "MS Powertrain Technology", "MS Ultrasonic Technology" and "Services". This new structure will bring greater transparency and, at the same time, will allow a clearer and more focused approach to the market.

- The **Boards** of the two subsidiaries MS Powertrain Technologie GmbH and MS Ultraschall Technologie GmbH were reinforced with additional commercial and technical/sales capabilities with a view to the future.

- Finally, we managed to sell 94% of MS Real Estate GmbH & Co KG including its industrial property in **Spaichingen** which we leased back on a long-term flexible basis for use by MS UTG. This transaction showed tangible effects resulting in a reduction of the level of group debt and total assets, as well as a corresponding boost in the Group's equity ratio. After several years, we have now implemented the **target corporate structure** for the MS Industrie Group.

The average **order backlog** for the MS Industrie Group overall amounted to EUR 140 million in the first quarter of 2018, which was around +5% higher than as at the end of 2017 and is therefore an indication of a stable positive development for 2018. Based on the robust international economy, the encouraging market development continues in all sales markets relevant for the MS Industrie Group.

Our strategy for the year 2018 and beyond will focus on further organic growth in the MS PTG segment to be achieved mainly by winning new customers, adding new high-precision powertrain components and systems to our range and by significantly increasing the level of automation in manufacturing. In the MS UTG segment, the basis for our growth will be a large number of R&D projects in varied applications and industries. At the same time, we are pushing ahead with the enlargement of our customer base and footprint on markets worldwide.

The **MS Industrie share price** recovered and improved significantly in 2017. Against this backdrop, we were pleased to be able to raise our forecast as early as on the occasion of the publication of our Q3 numbers for 2017.

We are particularly grateful to all of the employees at the MS Industrie Group and for the efforts made in 2017 in jointly mastering the challenges we were facing and the important decisions we made to set the future course of the Group.

Yours sincerely,

Dr. Andreas Aufschnaiter

Armin Distel

Munich, 23 April, 2018

Our product portfolio

ULTRASONIC
TECHNOLOGY
GROUP

Production locations

Reputed customers around the world rely on us for our innovativeness, reliability and the premium quality of our products. We maintain production locations around the globe:

Production locations in Germany:
MS Ultraschall Technologie GmbH
in Spaichingen, Baden-Württemberg: 18,000 m²
MS Powertrain Technologie GmbH
in Trossingen-Schura, Baden-Württemberg: 16,000 m²
MS PowerTec GmbH
in Zittau, Saxony: 5,000 m²
Elektromotorenwerk Grünhain GmbH
in Grünhain-Beierfeld, Saxony: 17,000 m²

Production locations in the United States:
MS Plastic Welders, L.L.C. and
MS Precision Components, L.L.C.
in Webberville, Michigan: 16,000 m²

Production locations in Brazil:
WTP MS Ultrasonics
in Belo Horizonte: 900 m²

Production locations in China:
Shanghai MS soniTEC Co., LTD.
in Jiangyin: 4,000 m²

Production locations in Bulgaria:
EMGR EAD
in Gabrovo: 700 m²

MS Ultraschall Technologie GmbH
MS Plastic Welders, L.L.C.
WTP MS Ultrasonics
Shanghai MS soniTEC Co., LTD.

Ultrasonic custom machines (MS soniMAC)
for the automotive industry.

Ultrasonic servo presses (MS soniTOP)
for industry-independent ultrasonic applications.

Ultrasonic systems (MS soniSYS)
for customized ultrasonic solutions.

Ultrasonic components (MS soniCOM)
for industry-independent ultrasonic applications.

Ultrasonic technology

The MS Ultrasonic Technology Group operates globally and across all industries. As a leader in innovation in the area of ultrasonic technology, it provides customisable special machines, innovative servo presses, modular systems and efficient components as powerful integrated solutions in connection and processing technology for thermoplastic materials, films and textiles as well as for cutting food.

POWERTRAIN
TECHNOLOGY
GROUP

MS Powertrain Technologie GmbH
MS PowerTec GmbH
MS Precision Components, L.L.C.

Elektromotorenwerk Grünhain GmbH
EMGR EAD

Systems

- Complete valve trains
- Rocker arms

Components

- Gear box housings
- Valve bodies

Development

of innovative and targeted cost-related valve control and engine braking systems.

Machining technology and module assembly

The MS Powertrain Technology Group has extensive knowledge for perfectly customised solutions over the entire power train. It develops, manufactures, assembles and delivers powerful systems and components for and to many well-known automobile and commercial vehicle manufacturers as well as leading engine and gear manufacturers globally. MS does this by successfully combining many years of manufacturing experience with the latest processing technologies.

Electric motors

- Capacitor motors
- Three phase A.C. motors
- Synchronous motors
- Rotors
- Stators
- Pedelec-drive for Cargo-e-mobility

Electric motor production

At our electric motor company Elektromotorenwerk Grünhain (EMGR) we offer market-leading customised drive solutions for industrial applications. Our electric motors, which are produced based on a high vertical integration, are developed in cooperation with our customers based on their specific requirements. New energy-efficient motors, drive electronics, brakes, gear elements and aluminium die-cast components are being increasingly added to our motor range.

Annual Consolidated Financial Statements 2017 - Overview of key figures

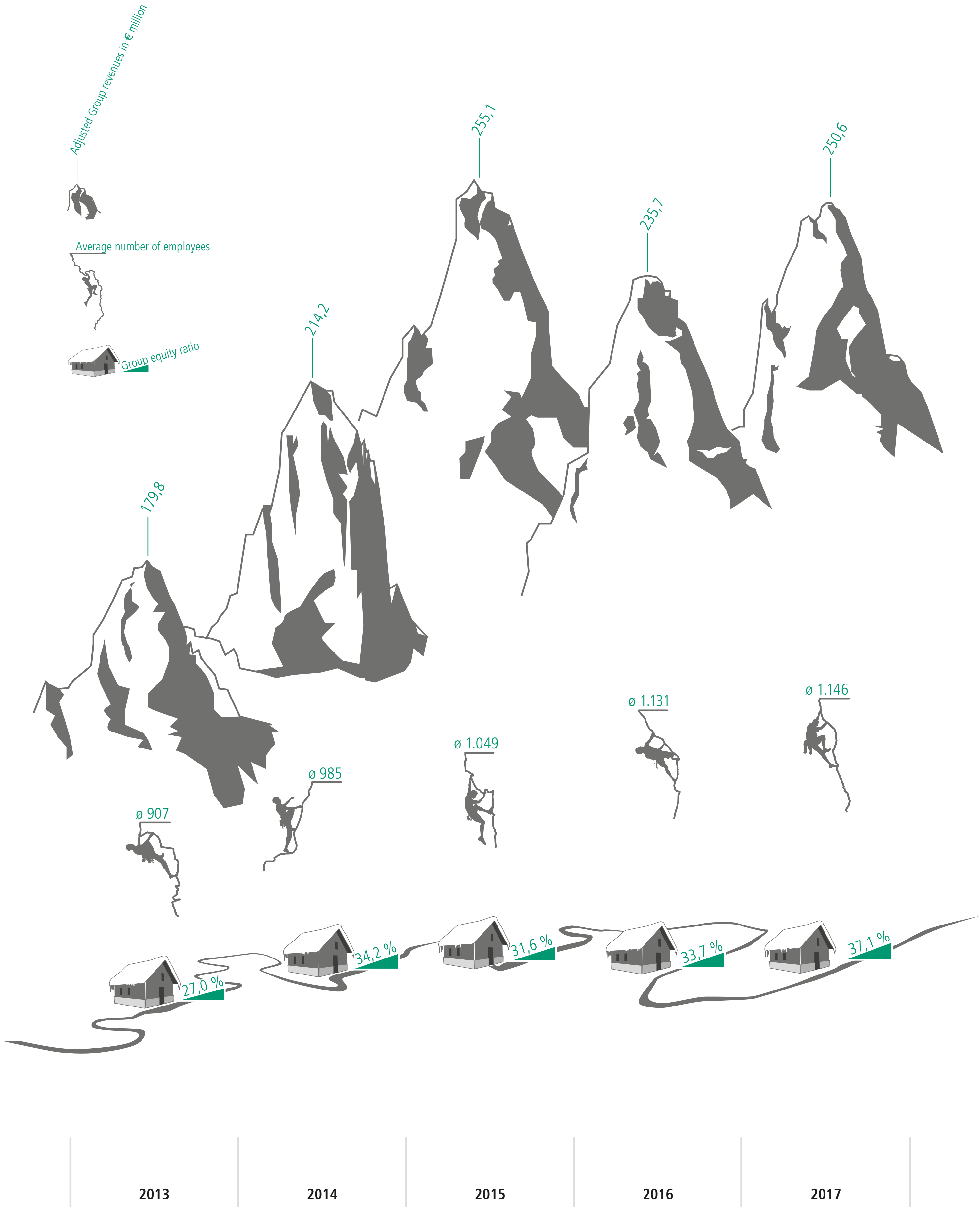
MS Industrie Group, according to IFRS, audited, in TEUR

Balance sheet key figures	31.12.2016	31.12.2017
Total assets	153.796	152.709
Equity and non-controlling interests	51.792	56.684
Equity ratio (%)	33,7 %	37,1 %
Trade receivables	25.071	27.506
Liquid funds (Cash and cash equivalents ./. Current accounts)	895	1.389
Net working capital (Inventories + Trade receivab. ./. Trade payables)	50.705	54.407

Cashflow key figures	2016	2017
Net cash generated from operating activities	7.073	5.854
Net cash used in investing activities	-7.466	1.022
Net cash used in financing activities	-441	-6.015

Income statement key figures	2016	2017
Revenues	237.499	250.621
Gross profit	115.091	123.964
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	18.725	22.026
Operating profit (EBIT)	6.298	8.969
Profit before income tax (EBT)	4.585	8.506
Profit for the year after non-controlling interests (EAT)	4.464	7.022
Consolidated earnings per share in EUR	0,15	0,23

Income statement key figures (adjusted for non-recurring items)	2016	2017
Revenues	235.699	250.621
Gross profit	113.915	123.924
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	18.757	21.986
Operating profit (EBIT)	6.330	8.929
Profit before income tax (EBT)	4.617	8.466
Profit for the year after non-controlling interests (EAT)	4.487	6.993
Consolidated earnings per share in EUR	0,15	0,23



Adjusted Group revenues in € million
Average number of employees
Group equity ratio
179,8
214,2
255,1
235,7
250,6
ø 907
ø 985
ø 1.049
ø 1.131
ø 1.146
27,0 %
34,2 %
31,6 %
33,7 %
37,1 %
2013
2014
2015
2016
2017

MS Industrie AG, Munich
Consolidated income statement for the financial year 2017

	2017 TEUR	2017 TEUR	2016 TEUR
Revenues			
a) Proceeds from the sale of investments and securities held as current assets	0		474
b) Revenues from industrial and real estate business	250.511		236.882
c) Revenues from consulting and commissions	110		143
		250.621	237.499
Changes in inventory of work in process and finished goods		2.571	339
Other income		5.582	5.546
		258.774	243.384
Cost of materials			
a) Disposal of investments and securities held as current assets (carrying amounts)	0		484
b) Costs of raw materials and consumables used and of goods purchased	127.231		120.867
c) Costs of services	7.579		6.942
		134.810	128.293
Personnel expense		63.629	60.508
Depreciation and amortisation expense			
a) Depreciation of property, plant and equipment and amortisation of intangible assets	12.982		12.352
b) Depreciation of investment property	75		75
		13.057	12.427
Other expense		38.309	35.858
		249.805	237.086
Operating Profit		8.969	6.298
Finance income		995	647
Finance costs		2.065	2.870
Share of profit of investments accounted for using the equity method		607	510
Profit before income tax		8.506	4.585
Income tax expense		1.546	188
Profit for the year		6.960	4.397
profit attributable to owners of the parent		7.022	4.464
profit attributable to non-controlling interests		-62	-67
		6.960	4.397
Consolidated earnings per share, in EUR			
basic, after non-controlling interests		0,23	0,15
diluted, after non-controlling interests		0,23	0,15
Number of shares, average weighting			
basic		29.893.201	29.857.674
diluted		29.893.201	29.857.674

MS Industrie AG, Munich, Consolidated statement of comprehensive income
for the financial year 2017

INDUSTRIE AG

	2017 TEUR	2016 TEUR
Profit for the year	6.960	4.397
Items that may be subsequently reclassified to profit or loss		
Change in value of available-for-sale financial assets (IAS 39)	331	-63
Currency translation differences	-2.343	345
	-2.012	282
Items that will not be reclassified to profit or loss		
Remeasurements of post employment benefit obligations	-73	-75
Actuarial gains/losses	-14	-363
Income taxes recorded in other comprehensive income	24	124
	-63	-314
Other comprehensive income for the year, net of tax	-2.075	-32
Total comprehensive income for the year	4.885	4.365
attributable to owners of the parent	4.947	4.432
attributable to non-controlling interests	-62	-67
	4.885	4.365
Consolidated earnings per share, in EUR		
basic, after non-controlling interests	0,23	0,15
diluted, after non-controlling interests	0,23	0,15
Number of shares, average weighting		
basic	29.893.201	29.857.674
diluted	29.893.201	29.857.674

MS Industrie AG, Munich

Consolidated balance sheet as at December 30, 2017

	31.12.2017 TEUR	31.12.2016 TEUR
ASSETS		
Intangible assets	3.528	4.306
Property, plant and equipment	51.150	63.126
Investment property	7.065	7.140
Investments	1.918	3.822
Investments in associates	3.192	2.613
Deferred income tax assets	86	824
Other non-current financial assets	4.734	1.540
Other non-current assets	516	515
Non-current assets	**72.189**	**83.886**
Inventories	41.847	37.666
Trade receivables	27.506	25.071
Cash and cash equivalents	8.384	4.143
Income tax assets	512	447
Other current financial assets	548	632
Other current assets	1.723	1.951
Current assets	**80.520**	**69.910**
TOTAL ASSETS	**152.709**	**153.796**
EQUITY AND LIABILITIES		
Ordinary Shares (30.00 million shares less 105,670 treasury shares)	29.894	29.892
Share premium	7.590	7.587
Statutory reserve	439	439
Retained earnings	3.931	3.929
Other reserves	2.883	4.958
Consolidated profit	12.086	5.064
Non-controlling interests	-139	-77
Equity and non-controlling interests	**56.684**	**51.792**
Non-current Borrowings	17.808	26.865
Provisions for pensions and similar obligations	1.725	1.821
Deferred income tax liabilities	922	1.927
Other non-current provisions and accruals	382	375
Other non-current financial liabilities	14.010	14.870
Other non-current liabilities	947	1.726
Non-current provisions and liabilities	**35.794**	**47.584**
Current Borrowings	26.965	19.738
Trade payables	14.946	12.032
Current income tax liabilities	0	24
Current provisions and accruals	7.029	7.551
Other current financial liabilities	7.737	9.477
Other current liabilities	3.554	5.598
Current provisions and liabilities	**60.231**	**54.420**
TOTAL EQUITY AND LIABILITIES	**152.709**	**153.796**

MS Industrie AG, Munich

Consolidated cash flow statement 2017

	2017 TEUR	2016 TEUR
Profit for the year	6.960	4.397
Income tax expense (recognised through profit and loss)	1.546	188
Finance income (recognised through profit and loss)	-995	60
Finance costs (recognised through profit and loss)	2.065	2.163
Depreciation of property, plant and equipment and amortisation of intangible assets	12.982	12.352
Depreciation of investment property	75	75
Material non-cash other expenses (+) or income (-):		
Losses/gains (-) on investments accounted for using the equity method	-607	-510
Losses/gains (-) on disposal of property, plant and equipment and intangible assets	-4	37
Losses/gains (-) on disposal of investments held for sale	-311	10
Losses/gains (-) on deconsolidation	-1.379	0
Increase/decrease (-) in inventories, trade receivables and other assets not assigned to investing or financing activities	-7.037	2.777
Increase/decrease (-) in trade payables and other liabilities not assigned to investing or financing activities	-4.133	-11.290
Interest received	110	87
Interest paid	-1.952	-2.649
Income tax received	115	762
Income tax paid	-1.581	-1.386
Net cash generated from operating activities	**5.854**	**7.073**
Proceeds from sale of property, plant and equipment and intangible assets	15	552
Purchases of property, plant and equipment and intangible assets	-7.117	-8.084
Proceeds from disposal of fully consolidated subsidaries less cash and cash equivalents transferred under the sale	1.247	0
Disposal of borrowings due to deconsolidation	4.339	0
Proceeds from disposals of investments held for sale	3.089	474
Purchase of investments	-79	-409
Payments made for the granting of borrowings	-533	-50
Proceeds received from investments	61	51
Net cash used in investing activities	**1.022**	**-7.466**
Proceeds from issuance of debt-equivalent bonds	0	200
Repayments of debt-equivalent bonds	0	-23.300
Proceeds from borrowings	5.547	42.643
Repayments of borrowings	-6.655	-19.945
Proceeds from finance lease transactions	693	5.275
Payments made for finance lease transactions	-5.600	-5.327
Proceeds received from the sale of treasury shares	0	13
Net cash used in financing activities	**-6.015**	**-441**
Net increase / decrease in liquid funds	**861**	**-834**
Exchange gains / losses on liquid funds	**-367**	**149**
Liquid funds at beginning of period	895	1.580
Liquid funds at end of period	**1.389**	**895**

MS Industrie AG, Munich

EXTRACTS from the Group's management report for the financial year 2017

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1. Report on the economic situation

1.a. Macroeconomic and industry-related environment

The somewhat uncertain framework conditions still prevailing in the eurozone continued to adversely affect economic development and events on the financial markets over the past year. Nevertheless, the German economy once again proved to be stable overall throughout 2017 according to the report published by the Federal Statistical Office in Wiesbaden in January 2018. At 2,2% (compared to 1,9% in 2016), the German economy showed the strongest price-adjusted growth of the gross domestic product (GDP) in six years. The manufacturing sector (excluding the construction sector), which again accounted for a good quarter of the overall gross value added, grew moderately by 2,5%. Thanks to record employment and further wage increases, consumer spending provided momentum to the economy in the past year. Consumption was again higher than in the previous year - private consumption increased by a total of 3,8%, public consumer demand increased by a total of 3,7%. In total, consumer spending increased by 3,7%. Despite the uncertainty about future economic trends, businesses felt encouraged to increase their capital spending. Expenditure on plant and machinery rose by 4,9% year on year, following a 4,3% increase in 2016. Once again, the German economy benefited above all from a strong domestic demand. German foreign trade also gained further momentum on an annual average in 2017: Germany exported 4,7% more goods and services on a price-adjusted basis than it did in 2016.[1]

Thus, the German economy proved to be able once again in 2017 to assert itself in a challenging global economic environment and also continued its moderate growth towards the end of 2017: after price, seasonal and calendar adjustments, the gross domestic product was 0,6% higher in the fourth quarter than in the previous quarter.[2] Overall, Germany's economy continued to be characterised by solid and constant economic growth in 2017.

In the USA and Canada – together still forming one of MS Industrie AG's most important sales markets outside the EU accounting for a 35,2% (previous year: 32,2%) share in the Group's revenues – economic development was at the same level as in Germany with real-term growth in GDP of around 2,2% [3], due in part to the fact that in the USA a positive economic sentiment, in particular in anticipation of the tax reform adopted in autumn 2017 and the foreseeable end of the FED's zero-interest policy, were triggers for additional corporate investments.

In this global economic environment, the exchange rate of the US dollar to the euro fluctuated between values of 1,05 and 1,20 US dollars over the course of 2017. As at year end, the value of the euro was 1,20 US dollars, i.e. significantly higher than at the beginning of the year (1,05 US dollars).

Demand in the "Powertrain Technology" segment was clearly on the rise overall in Germany and Europe at around +3,2%[4]. The US commercial vehicle market proved to be much stronger than in the previous year, too, and this applies particularly to one of our main customers in the US, Detroit Diesel Corporation ("DDC"), a supplier of engines for truck brands such as "Freightliner" and "Western Star".[5]

MS Industrie AG is a group which, through its internationally active operating subsidiaries, operates primarily in the industry sector (subgroup MS Technologie Group GmbH and Elektromotorenwerk Grünhain GmbH plus subsidiaries) as well as in the services sector and was therefore exposed to the general economic environment described above and the situation in the relevant sectors as prevailing in the financial year 2017.

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[1] Source: German Federal Statistical Office, Press release No. 11 of 11 January 2018.

[2] Source: German Federal Statistical Office, Press release No. 44 of 14 February 2018.

[3] Source: Statista, USA: Growth of real GDP, as at: 19 January 2018.

[4] Source: "ACEA", commercial vehicle registrations, 25 January 2018.

[5] Source: Internal analyses.

1.b. Business development

The financial year 2017 was characterised by a marked increase in sales over the previous year, in particular at the Group's US site (in the main thanks to a pronounced recovery of truck sales owing to the positive economic development in the US). During the 2017 financial year, average order book levels in the "Powertrain" core segment were ranging clearly above the all-time low of the previous year, which had mainly been caused by non-recurring effects relating to the US economy. This also applies to revenues generated by the two segments "Powertrain" and "Ultrasonic", both consistently exceeding not only the all-time low of the previous year but also planned values.

Since the Group is a supplier of heavy combustion engines, the demand for our products is particularly dependent on truck registration figures. The North American market in particular, an important sales region for MS Industrie AG, had suffered a slump in "Class 8" registration figures in the 2016 financial year. The previous year's drop in demand of -35% at our US-American site can be described as an extreme development. Particularly in the second half of the year, the volumes delivered were very low. Overall, the revenue drop in the US was compensated by growth in Europe and in the ultrasonic technology business during the first three quarters of the year 2016, but no longer in the fourth quarter, so that for the whole financial year 2016, adjusted industrial revenues declined by around -8% compared to 2015. Orders for heavy duty commercial vehicles ("Class 8") picked up again in the NAFTA region in 2017, from over 10.000 units per month at the beginning of the financial year to an average of more than 20.000 units per month in November/December 2017. Just like towards the end of the previous year, a gradual recovery may be anticipated. Past experience has shown that recoveries of this kind tend to develop their positive effect on MS Industrie AG with a time lag of about six months.[6]

Just like in recent years, the order books of the Ultrasonic Technology Group are well filled at the beginning of the year 2018 and the order situation in the "Powertrain" core segment may be described as good. The machine park and equipment at the three German MS sites in Trossingen, Spaichingen and Zittau has been upgraded and extended considerably in the course of 2017. These positive developments have already had a positive impact on volumes reflected by an increase in the corresponding key figures for the financial year.

Most of the investments to support growth at all sites of the Group had already been completed in the previous year. This means that any additional requirement for capital expenditure in the coming years will be much below the average of recent years, unless any unforeseen new large-scale orders would involve increased investment. In parallel we continue to expect a constant increase in capacity utilisation in the individual production areas.

We are once again entirely satisfied with the operating performance at the different earnings levels given the initially only slow pick-up of sales volumes in the US in the first half of 2017 and the considerable structural adjustments in Germany with the new organisational, management and communication structure established in 2017 after the successful split-up into several entities of the former MS Spaichingen GmbH implemented in 2016.

The developments of the past financial year in detail:

The MS Technologie Group (MS) recorded subgroup revenues of around EUR 232 million compared to EUR 218 million in the previous year. MS operates predominantly in two market segments: "Powertrain Technology" (mechanical assemblies and components for the automotive industry, particularly commercial vehicles) and "Ultrasonic Technology" (special machines for the automotive industry as well as ultrasonic welding and sealing systems and components, including for the packaging industry). MS is one of the few "single-source suppliers" in the automotive supply sector, especially to customers in the commercial vehicle market, and continues to maintain long-term supply agreements with its main customers.

[6] Source: Internal analyses.

With revenues of around EUR 19 million in the financial year 2017, and also around EUR 19 million in 2016, Elektromotorenwerk Grünhain GmbH (EMGR), including its new Bulgarian subsidiary, achieved revenues roughly on previous-year levels and an annual result according to HGB (German Commercial Code) for the past financial year before profit transfer / loss absorption of TEUR -160 (previous year: TEUR +4) despite a once again weaker economy towards the end of the year. EMGR is a successful manufacturer of customised electric motors in a variety of designs and of related products maintaining its own aluminium die-casting foundry. Besides meeting internal demands, the foundry also supplies external clients, mostly from the automotive industry but also in the field of heating systems. The production of custom-developed electric motors for applications in the bicycle and tricycle sectors has commenced as planned in 2017, even if production figures are still low.

The financial situation of the Group continues to be in good order. Given a slight reduction in total assets of 0,7% the equity ratio rose considerably from 33,7% in the previous year to 37,1% in 2017. The main reason for the increase in the equity ratio in 2017 over the previous year is the positive consolidated total comprehensive income for the year of EUR 4,9 million (previous year: EUR 4,4 million), with slightly reduced total assets.

With a slight increase in adjusted revenues, a clearly improved operating profit and a clearly improved financial result, the earnings situation before and after adjustment for non-recurring items is characterised by pre- and post-tax profit that are again on a considerably higher level than in the previous year. Income tax for the financial year 2017 is influenced in the amount of EUR 0,8 million by deferred tax income arising in the USA due to the tax reform adopted there in December 2017. Already in the previous year, income tax expenses had been influenced by the positive non-recurring effect of tax credits in the USA (so-called "R&D credits") in the amount of EUR 0,6 million.

In summary, we can state that we have all reason to be satisfied with the economic position of the MS Industrie Group as at the balance sheet date. Our confidence is bolstered by the good order situation currently reported by all the operating subsidiaries in the Group including our US-American subsidiaries – despite the continued global economic uncertainties.

Previous year's projections were exceeded substantially, in particular thanks to the recovery of sales volumes in the core segment "Powertrain" in the US along with the general upturn in the underlying market. In the 2017 Group Management Report we projected a slight increase in the Group's adjusted consolidated revenues of around 1% to around EUR 240 million. In fact, adjusted revenues rose by around 6% to around EUR 251 million in the reporting period. This means that the previous year's projection of a slight revenue increase of around 1% to around EUR 240 million was exceeded substantially. For the financial year 2017 we had anticipated an essentially unchanged EBITDA, a clear improvement in the Group's key earnings figures EBIT and EBT, a slight increase in EBIT margin and a slight decline in gross margin, while earnings per share from continuing operations (excluding non-recurring items) were expected to remain essentially unchanged with a significant increase in Group equity. Following elimination of non-recurring items which have had an impact on the results for the respective financial years, all of these expectations have materialised or were even substantially exceeded thanks to the positive development of the market (for further information on the development, see Section 2.c. Status of the Group further below). In addition, we had expected that cash flow from operating activities (excluding non-recurring items) would develop somewhat better than in the previous year. Unfortunately, this expectation has not materialised. No significant changes had been anticipated for cash flow from investing activities compared to the previous year. This expectation, based on deliberate considerations, was not met. A number of steps had been initiated with the intention to further reduce the debt-to-equity ratio and to significantly increase the equity ratio according to previous year's plans. Both expectations have materialised (for further information on the development, see Section 1.c. Status of the Group further below).

In the previous year we had anticipated for the MS Technologie Group that the 2016 annual result would stabilise in the financial year 2017.This objective was exceeded. In the financial year 2017, the MS Technologie Group assumed for planning purposes that revenues in the "Powertrain Technology" segment would continue at the same level as in 2016. The "Ultrasonic Technology" segment assumed for its planning that the order backlog would remain the same with revenues rising slightly compared to 2016. Both expectations have materialised or have been substantially exceeded.

Especially after the good performance of the electric motor business in the previous year, the management of Elektromotorenwerk Grünhain GmbH, Grünhain-Beierfeld (EMGR), an entity which is active in the "Powertrain - Electric" business, had anticipated an even more positive business development for 2017 with revenues further increasing and a positive annual result. Unfortunately, both expectations did not materialise.

In terms of the development of non-financial performance indicators, the forecast in the previous year's report was that the MS Industrie Group would do everything to continue fulfilling all relevant environmental standards and to continue in its attempts to keep staff turnover as low as possible using staff retention programs. Based on the planned, constant revenue growth, there were originally no plans to hire new staff in 2017, in particular specialists and managers, however, additional temporary agency workers were employed. Despite the fact that strong volume growth failed to materialise – as already anticipated in the annual planning – headcount was increased moderately in the course of the financial year, in order to be able to respond swiftly to volume increases anticipated again for the future. These are measures with which the company intends and has always intended to counteract a shortage of skilled workers and to prepare future managers for demanding tasks in a targeted manner.

Ongoing, individual job training and development is regarded as a matter of great importance within the Group. The company had also planned to maintain customer satisfaction at the existing high level at least and to further increase the already very high level of innovative strength, and to ensure a constant delivery performance in all segments and product lines. All this has been implemented as planned: research and development spending was slightly reduced in the year under review from EUR 4,1 million to EUR 3,7 million, but remains at a very high level just like in previous years, the Group maintained its ability to deliver at all times and customer satisfaction continues to be very high.

1.c. Status of the Group

Earnings situation

The essential key figures of our Group are presented and explained in the following with a comparison with the previous year. The earnings situation before adjustment for non-recurring items is provided first of all below:

Before adjustments for non-recurring items:	1.1. to 31.12.2017		1.1. to 31.12.2016		Difference	
	TEUR	%	TEUR	%	TEUR	%
Revenues	**250.621**	**100,0**	**237.499**	**100,0**	**13.122**	**5,5**
Other income	5.582	2,2	5.546	2,3	36	0,6
Cost of materials (incl. changes in inventory)	132.239	52,8	127.954	53,9	4.285	3,3
Gross profit	**123.964**	**49,5**	**115.091**	**48,5**	**8.873**	**7,7**
Personnel expense	63.629	25,4	60.508	25,5	3.121	5,2
Other expenses	38.309	15,3	35.858	15,1	2.451	6,8
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	**22.026**	**8,8**	**18.725**	**7,9**	**3.301**	**17,6**
Depreciation and amortisation expense	13.057	5,2	12.427	5,2	630	5,1
Operating profit (EBIT)	**8.969**	**3,6**	**6.298**	**2,7**	**2.671**	**42,4**
Finance costs, net	-1.070	-0,4	-2.223	-0,9	1.153	-51,9
Share of profit of investments accounted for using the equity method	607	0,2	510	0,2	97	19,0
Consolidated profit before income tax (EBT)	**8.506**	**3,4**	**4.585**	**1,9**	**3.921**	**85,5**
Income tax (expense)	1.546	0,6	188	0,1	1.358	722,4
Consolidated profit for the year before non-controlling interests (EAT)	**6.960**	**2,8**	**4.397**	**1,9**	**2.563**	**58,3**
Profit attributable to non-controlling interests	-62	0,0	-67	0,0	5	-7,5
Consolidated profit for the year after non-controlling interests (EAT)	**7.022**	**2,8**	**4.464**	**1,9**	**2.558**	**57,3**

In the previous year, key revenues and earnings figures were still affected by non-recurring items. Their effect on the Group's key figures is presented in the following reconciliations.

Non-recurring items with an influence on profit and loss in the previous year essentially involved reimbursements for currency losses from procurement transactions with set suppliers that occurred during the financial year 2015 and the financial year 2016, amounting to EUR +0,5 million net (EUR +1,8 million in revenues, EUR -1,3 million cost of materials) and reimbursements for costs incurred in 2015 from the insolvency of one supplier, amounting to around EUR +0,7 million (cost of materials), and external relocation costs for moving the "Powertrain" business of the MS Technologie Group to the new production premises in Trossingen, amounting to around EUR -1,2 million. These non-recurring items were not matched with any corresponding substantial income or expenses in the year under review. All amounts before taxes. In summary, the changes in the key earnings figures adjusted for non-recurring items (of the previous year) are therefore as follows:

	1.1. to 31.12.2017		1.1. to 31.12.2016		Difference, adjusted	
	Adjusted	Adjusted	Adjusted	Adjusted	16 / 17	16 / 17
	TEUR	%	TEUR	%	TEUR	%
Revenues	250.621	100,0	235.699	100,0	14.922	6,3
Gross profit	123.924	49,4	113.915	48,3	10.009	8,8
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	21.986	8,8	18.757	8,0	3.229	17,2
Operating profit (EBIT)	8.929	3,6	6.330	2,7	2.599	41,1
Consolidated profit before income tax (EBT)	8.466	3,4	4.617	2,0	3.849	83,4
Consolidated profit for the year before non-controlling interests (EAT)	6.931	2,8	4.420	1,9	2.511	56,8
Consolidated profit for the year after non-controlling interests (EAT)	6.993	2,8	4.487	1,9	2.506	55,9

The reconciliation of the unadjusted key figures with the adjusted key figures is as follows in 2017:

	1.1. to 31.12.2017			
	Before Adjustments	Effect of Adjustments	Adjusted	Adjusted
	TEUR	TEUR	TEUR	%
Revenues	250.621	0	250.621	100,0
Gross profit	123.964	-40	123.924	49,4
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	22.026	-40	21.986	8,8
Operating profit (EBIT)	8.969	-40	8.929	3,6
Consolidated profit before income tax (EBT)	8.506	-40	8.466	3,4
Consolidated profit for the year before non-controlling interests (EAT)	6.960	-29	6.931	2,8
Consolidated profit for the year after non-controlling interests (EAT)	7.022	-29	6.993	2,8

The reconciliation of the unadjusted key figures with the adjusted key figures in the previous year 2016 is as follows:

	1.1. to 31.12.2016			
	Before Adjustments	Effect of Adjustments	Adjusted	Adjusted
	TEUR	TEUR	TEUR	%
Revenues	**237.499**	**-1.800**	**235.699**	**100,0**
Gross profit	**115.091**	**-1.176**	**113.915**	**48,3**
Earnings before interest, taxes, depreciation and amortisation (EBITDA)	**18.725**	**32**	**18.757**	**8,0**
Operating profit (EBIT)	**6.298**	**32**	**6.330**	**2,7**
Consolidated profit before income tax (EBT)	**4.585**	**32**	**4.617**	**2,0**
Consolidated profit for the year before non-controlling interests (EAT)	**4.397**	**23**	**4.420**	**1,9**
Consolidated profit for the year after non-controlling interests (EAT)	**4.464**	**23**	**4.487**	**1,9**

After a marked decline of around 7,6% in the previous year, adjusted revenues rose again in the reporting period by around 6,3% to around EUR 250,6 million. As a result, the previous year's forecast of a slight increase in revenues by around 1,0% to around EUR 240,0 million was clearly exceeded. The strong growth in revenues is mainly attributable to the US business of the MS Industrie Group, in particular the "Powertrain" segment, which had been expected to grow. The increase in revenues and the associated positive annual result projected in the previous year for the "Powertrain / Electric motors" sub-segment has not materialised unfortunately. The revenues generated by Elektromotorenwerk Grünhain GmbH in 2017 were slightly below the previous year's level; the result before profit transfer / loss absorption therefore turned negative and was clearly below the result of the previous year.

In geographic terms, revenues again developed quite heterogeneously: While there was a slight decline in industrial revenues of around 4,0% in the domestic market – still the market with the highest revenues, exports to the second-strongest foreign market, the EU, rose again by around 12,6%. In the North America/Canada region, which remains the strongest foreign market with 35,2% of consolidated revenues, revenues increased by around 16,2%.

Adjusted revenues include primarily the revenues of the MS Technologie Group of TEUR 231.944 (previous year: TEUR 216.412). They also include the revenues of the Elektromotorenwerk Grünhain Group of TEUR 18.561 (previous year: TEUR 18.664).

Other operating income includes in particular income from the reversal of provisions and other accruals as well as other income generated in prior periods totalling TEUR 1.685 (previous year: TEUR 1.945) and exchange rate gains of the MS Technologie Group in the amount of TEUR 2.086 (previous year: TEUR 1.201).

The gross margin (revenues including changes in inventory plus other operating income minus cost of materials) as a percentage of revenues is 49,5% in the financial year 2017 (previous year: 48,5%). The increase in gross margin is all the more remarkable because in the previous year reimbursements had been made for currency losses from procurement transactions with set suppliers that had occurred during the financial year 2015, amounting to EUR +0,5 million net, and reimbursements for costs incurred in 2015 from the insolvency of one supplier amounting to around EUR +0,7 million.

The minor decrease in the cost of materials ratio to 52,8% (previous year: 53,9%) is, as explained above, also primarily due to the changes in the product mix of the "Powertrain Technology" segment (fewer material-intensive product groups).

Personnel expenses rose year-on-year by around 5,2%, i.e. more or less proportionately to revenues, with the average headcount increased by around 1,3% to 1.146 permanent employees (excluding temporary agency workers and trainees) (previous year: 1.131 employees).

As a result, earnings before interest, tax, depreciation and amortisation and impairment (EBITDA) were EUR 22,0 million (previous year: EUR 18,7 million). The EBITDA adjusted for non-recurring items is almost identical at EUR 22,0 million (previous year: EUR 18,8 million). Thus, EBITDA after adjustment for non-recurring items is more or less unchanged in 2017, thus exceeding expectations. The main reason for this is the market recovery in the USA, which had been firmly projected in the previous year and considerably eased the situation with regard to fixed cost allocation.

Depreciation and amortisation in the financial year 2017 slightly increased by around 5,1% from TEUR 12.427 to TEUR 13.057, in line with expectations.

Based on the substantial expansion in the Group's revenues and increased personnel expenses, increased depreciation and amortisation and significantly higher other operating expenses, the profit from ordinary activities (EBIT) was positive in the financial year 2017 at EUR 9,0 million (previous year: EUR 6,3 million). Adjusted EBIT excluding non-recurring items was EUR 8,9 million in 2017 (previous year: EUR 6,3 million). Thus, the previous year's forecast of a significant increase in EBIT adjusted for non-recurring items was also met in 2017.

The EBIT margin as a percentage of revenues is around 3,6% in the financial year 2017 (previous year: 2,7%). As described above, the higher EBIT margin can be explained by the fact that fixed costs did not rise proportionately with the slight growth in revenues.

The net financial result improved again by around 51,9% on the previous year, mainly because of the scheduled repayment in mid-July 2016 of the 23 million EUR-bond issued by former MS Spaichingen GmbH bearing an interest of 7,25%. After repayment of the bond, the long-term financing was restructured in collaboration with the principal banks on the basis of very attractive interest rates. On a full-year basis, interest savings of around Euro 1,3 million p. a. arise, their full effect showing for the first time in the financial year 2017. The net financial result includes finance income amounting to TEUR 995 (previous year: TEUR 647) and finance costs amounting to TEUR 2.065 (previous year: TEUR 2.870).

Finance income results partly, in the amount of TEUR 427 (previous year: TEUR 252), from the market valuation of financial derivatives, especially the fair value measurement of interest rate swaps.

Finance costs include EUR 1,7 million attributable to the MS Technologie Group (previous year: EUR 2,5 million).

The share of profit of investments accounted for using the equity method in the financial year 2017 amounted to TEUR 606 (previous year: TEUR 462) from the "at equity" valuation of the Beno Immobilien Group, Starnberg, and TEUR 59 (previous year: TEUR -66) from the "at equity" valuation of Shanghai MS soniTEC Co., Ltd., China and TEUR -58 (previous year: TEUR 114) from the "at equity" valuation of WTP Ultrasonic Industria e Comercio de Maquinas Ltda., Contagem City, Brazil.

Consolidated profit before income tax (EBT) is EUR 8,5 million. In the previous year the Group generated a pre-tax profit of EUR 4,6 million. The EBT adjusted for non-recurring items was EUR 8,5 million in 2017 (previous year: EUR 4,6 million). Thus, the previous year's forecast of a significant increase in pre-tax profit, before and after adjustment for non-recurring items, was also exceeded.

Consolidated profit for the year after non-controlling interests (EAT) was EUR 7,0 million in 2017 (previous year: EUR 4,4 million). Adjusted EAT excluding non-recurring items was EUR 7,0 million in the financial year 2017 (previous year: EUR 4,5 million). The strong cut in corporation tax from 35% to 21% under the tax reform in the USA had a positive impact of around EUR 0,8 million on EAT in the financial year 2017.

Rounded consolidated earnings per share – without adjustment for non-recurring items – rose from EUR 0,15 per share in the previous year to EUR 0,23 per share in the financial year 2017. Adjusted consolidated earnings per share after elimination of non-recurring items are also EUR 0,23 per share (previous year: EUR 0,15 per share). Thus, consolidated earnings per share from continuing operations – after adjustment for non-recurring items – remained more or less unchanged as projected in the previous year.

Cash Situation

Principles and objectives of financial management

Ensuring financial flexibility is the highest priority in the Group's financing strategy. This flexibility is achieved through a wide selection of financial instruments and a high diversification of investors or financial institutions. The maturity profile of the Group's liabilities features a wide spread of maturities with a high proportion of medium and long-term financing. Market capacity, investor diversification, flexibility, credit requirements and the existing maturity profile are all taken into account in selecting financial instruments.

Presentation and analysis of the financial position

	2017 TEUR	2016 TEUR
Net cash generated from operating activities	5.854	7.073
Net cash used in investing activities	1.022	-7.466
Net cash used in financing activities	-6.015	-441
Net increase / decrease in cash and cash equivalents	**861**	**-834**
Exchange gains/losses on liquid funds	-367	149
Liquid funds at beginning of period	895	1.580
Liquid funds at end of period	**1.389**	**895**

The increase in liquid funds is mainly due to the positive cash flow generated from investing activities, which in conjunction with the positive cash flow from operating activities offset the anticipated negative cash flow from financing activities.

The reduced cash flow from operating activities reflects in particular the decline in cash flow from operations of MS Industrie Group in 2017 due to the expansion of working capital in the financial year. Cash flow used in investing activities was positive due to planned investment activities by the MS Industrie Group, but also due to the sales transaction related to "MS Real Estate GmbH & Co. KG, Spaichingen" and the proceeds from disposals of investments held for sale. Part of the investments of the financial year have been realised by means of a finance lease (EUR 2,2 million) which did not affect cash flow at the time the investment was made.

The previous year's forecast of a slight improvement in cash flow from operating activities (excluding non-recurring items) has unfortunately not materialised.

As at 31 December 2017, cash and cash equivalents amount to EUR 8,4 million (previous year: EUR 4,1 million). In addition, unused current account credit facilities of EUR 11,8 million are available (previous year: EUR 22,5 million) and current assets (EUR 80,5 million) exceed current liabilities (EUR 60,2 million) by EUR 20,3 million as at the balance sheet date.

Bank borrowings as at the balance sheet date are EUR 44,8 million of which EUR 23,9 million are subject to certain financial covenants. Unused credit facilities amount to EUR 11,8 million including EUR 4,6 million which were provided with financial covenants.

Financial Situation

The essential changes to the Group's financial situation can be seen in the following illustration:

	31.12.2017		31.12.2016		Difference	
	TEUR	%	TEUR	%	TEUR	%
ASSETS						
Deferred income tax assets	86	0,1	824	0,5	-738	-89,6
Other non-current assets	72.103	47,2	83.062	54,0	-10.959	-13,2
Current assets	80.520	52,7	69.910	45,5	10.610	15,2
Total assets	**152.709**	**100,0**	**153.796**	**100,0**	**-1.087**	**-0,7**

	31.12.2017		31.12.2016		Changes	
	TEUR	%	TEUR	%	TEUR	%
EQUITY AND LIABILITIES						
Equity and non-controlling interests	56.684	37,1	51.792	33,7	4.892	9,4
Deferred income tax liabilities	922	0,6	1.927	1,2	-1.005	-52,2
Other debt	95.103	62,3	100.077	65,1	-4.974	-5,0
Total equity and liabilities	**152.709**	**100,0**	**153.796**	**100,0**	**-1.087**	**-0,7**

Non-current assets in our Group decreased by around 13,9% in the financial year 2017 to a share of around 47,3% of total assets (previous year: around 54,5%), a change which is not insignificant. The decrease in non-current assets is mainly the result of the scheduled amortisation of intangible assets and depreciation of plant and machinery as well as the disposal of real estate no longer considered strategically important, such as the industrial property in Spaichingen. Set against this is primarily the planned capital expenditure in the financial year.

The investment volume for 2017 as originally planned for the MS Technologie Group was at a total of around EUR 7,7 million, with around EUR 5,4 million accounted for by the three German sites and EUR 2,2 million by the US location in Webberville. The actual investment volume for 2017 for the MS Technologie Group was larger, at a total of around EUR 9,0 million, with a volume of around EUR 7,4 million invested at the three German sites and EUR 1,6 million at the location in Webberville. Actual capital expenditure deviated from the investment plans in the main because increased replacement investments were pending and replacement investments could not be postponed to subsequent periods.

The marked increase in current assets of around 15,2% is mainly due to growth of around 11,1% in inventories as well as an increase in cash and cash equivalents and accounts receivable. As a proportion of total assets, the percentage share of current assets of around 52,7% (previous year: around 45,5%) slightly increased towards the end of the financial year.

Net working capital (inventories and trade accounts receivable minus trade accounts payable) as at 31 December 2017 is EUR 54,4 million (previous year: EUR 50,7 million) and thus rose by around 7,3% year on year.

Compared to 31 December 2016, equity increased in absolute terms by EUR 4,9 million to EUR 56,7 million. This is primarily attributable to the Group's total comprehensive income for the year of EUR 4,9 million. The Group's equity ratio showed a significant increase compared to 31 December 2016; with total assets reduced by 0,7 % the equity ratio is at around 37,1% as at the balance sheet date (31 December 2016: 33,7%). The higher equity ratio is mainly attributable to the Group's total comprehensive income for the year. It confirms the previous year's forecast of a significant increase in the equity ratio in 2017.

Other debt in the Group was slightly down by around 5,0% to EUR 95,1 million. As a result, with total assets decreasing by around 0,7%, the debt-to-equity ratio has significantly decreased in 2017 as projected in the previous year's forecast.

The Group's net debt ratio (defined as net liabilities/equity) was down from 82,0% as at the end of 2016 to 64,2% as at the end of the financial year 2017.

Non-controlling interests as at 31 December 2017 are TEUR -139 (previous year: TEUR -77). The non-controlling interests are completely attributable to the subsidiary of Elektromotorenwerk Grünhain GmbH in Bulgaria.

General statement on business performance and financial situation

The financial year 2017 was still characterised by the Group's focus on the two business segments "Powertrain Technology" and "Ultrasonic Technology" and further measures for the disposal of investments which are no longer strategically relevant.

The cash situation as at the end of 2017 and beginning of 2018 can still be described as sound, with significant available credit lines. All of the subsidiaries continue to be able to meet their payment obligations from ordinary activities in full.

Since the Group was able also in 2017 to generate a positive consolidated total comprehensive income for the year, equity including non-controlling interests increased in absolute terms. The financial situation continues to be in good order, based on an equity ratio of 37,1% (previous year: 33,7%).

Operating business in all operating subsidiaries in the first half of the financial year 2018 has developed according to plan until the date of preparation of these consolidated financial statements. Hence, the Group's financial, cash and earnings situation was also sound when the present Group Management Report for 2017 was prepared.

Munich, 20 April 2018

MS Industrie AG

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