

# **Press Release for the Financial Year 2003 MAHLE Group**

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## **1. Business Environment/Economic Situation in the Automotive Industry**

### Modest Economic Growth in Major Countries

In 2003, the world economy was again dominated by unsatisfactory economic conditions. The repercussions of the terrorist attacks of September 11, 2001, the war in Iraq, and the SARS respiratory disease complicated the situation. All these factors led to a loss in consumer and investor confidence. Consequently, the global economy grew by only approx. 2 percent. However, in the final months of the year under review, there were positive signs of overall economy. Growth was expected in the USA and Japan, whether increased growth can be sustained.

Economic development in Japan proved to be surprisingly strong. Despite continuing deflation, the gross domestic product was 2.7 percent up on in the previous year. Following a previous year increase of 0.2 percent, this is a very positive development with the driving force behind the trend shifting from overseas to domestic demand.

China was the powerhouse behind the Asian region; its national economy being the only major one in the world to record continuously high percentage growth rates.

By contrast, growth in the Eurozone failed to meet expectations. While the countries acceding to the EU were able to achieve increasing growth rates, the increase in the gross domestic product of the current EU member states was down from 0.9 to 0.5 percent. With a growth rate declining from 0.2 percent in 2002 to stagnation level in the year under review, Germany was unable to escape this general trend. However, the discussion that began in 2003 concerning European taxation and social policies gives cause to hope that the reforms, which from our point of view are so essential for economic growth, will soon be implemented.

Besides the effects of widely varying world economic development, the divergent interest policies pursued by the central banks and the behavior of financial investors resulted in a clear shift in world currency exchange rates, involving the frequent devaluation of leading currencies against the Euro. While the US Dollar lost 20.4 percent of its value against the Euro in the course of 2003, there was a significant loss in value of the Japanese Yen (- 8.6 percent), the Polish Zloty (-16.9 percent) and the Pound Sterling (- 8.3 percent). For all international companies presenting consolidated accounts in Euro, this resulted in negative effects on sales, profits, and equity capital composition.

### Stagnation in the World Automotive Market

The effects on the automotive industry of what was largely a weak economic situation varied greatly from region to region. On a global level, production of passenger cars and light commercial vehicles increased by 1.2 percent to 57.8 million vehicles, while the production of medium-weight commercial vehicles and trucks increased by 2 percent to 1.6 million units.

The world's biggest commercial vehicle market, the Asia/Pacific region, continued its three-year growth trend with the production of 728,000 vehicles (+ 4.9 percent). The production of passenger cars and light commercial vehicles was also up, increasing by 5.5 percent to 19.5 million units. Weak exports were more than compensated for by lively regional demand. Japan recorded a decline in production figures, in contrast to the other Asian countries, due largely to the relocation of production to North America, Europe, and countries with low labor costs; overall, domestic production was down 1.2 percent on the previous year.

In the NAFTA region, a decline in sales of passenger cars and light commercial vehicles was recorded, despite the incentives of price reductions and financing options. Production was down by 2.6 percent to 15.9 million units – an even greater decline than in sales figures, as im-

port brands captured a larger share of the market. Even allowing for the very low level of the previous year, production figures for commercial vehicles could still not be maintained; overall, these were down by 3 percent.

## Worldwide Automobile Production

	Number in 1000s			
	2002	2002	2003	2003
	Pass. cars & light coms.	Commercial vehicles	Pass. cars & light coms.	Commercial vehicles
<b>America</b>	<b>18.260</b>	<b>430</b>	<b>17.827</b>	<b>426</b>
- NAFTA	16.365	368	15.937	357
- South America	1.895	62	1.890	69
<b>Asia/Pacific</b>	<b>18.503</b>	<b>694</b>	<b>19.511</b>	<b>728</b>
- Japan	10.021	170	9.877	196
- China	2.795	407	3.629	397
<b>Europe</b>	<b>19.386</b>	<b>447</b>	<b>19.427</b>	<b>449</b>
- Germany	5.335	124	5.299	125
<b>Other countries</b>	<b>951</b>	<b>0</b>	<b>1.023</b>	<b>0</b>

Source: Global Insight Automotive World Car Industry Report (Pass. cars and light coms. (< 6 t))

The decline in Europe was minor by comparison. Production of passenger cars and light commercial vehicles stagnated at 19.4 million units. The European commercial vehicle market, which had been in decline over the previous two years, even managed to record a slight increase in production figures in 2003, rising by 0.4 percent to 449,000 units. Production figures for the German automotive industry remained constant at 5.4 million vehicles, benefiting from a receptive Eastern European market and increased exports in the premium segment. Every second vehicle in the premium category is now exported to North America.

Production in Brazil reflected the overall figures for South America (1.9 million units). The production of passenger cars and light commercial vehicles has been stagnant over the last three years at 1.6 million units. The program adopted last summer by the Brazilian government for reduced taxation on the purchase of automobiles had little noticeable effect, especially as the measures were discontinued at the end of November 2003.

## 2. Business Development in 2003

### a) Group Changes

Major additions to the consolidation group were the MAHLE Izumi Group, the leading Japanese manufacturer of diesel pistons, the German ZNF Maschinenfabrik Spandau GmbH & Co. OHG, a MAHLE majority joint venture with BMW for the production of camshafts as well as Tennex Korea, a subsidiary of our MAHLE Tennex Group in Japan.

### b) Exchange Rate Development

Shifts in the structure of world currencies had a negative effect on Group sales denominated in Euro, the most damaging effect resulting from the increase in value of the Euro against the US Dollar, the Japanese Yen and the Brazilian Real. The positive effects of first-time consolidations (EUR 233.9 million) more than compensated for the negative effect of currency exchange rates (EUR –193.9 million). After taking these factors into account, organic growth in the year under review amounted to 4.4 percent, thus enabling the MAHLE Group to buck the negative trend in the automotive market with positive sales generated by its own efforts, and to improve its market position.

### c) Sales

In the fiscal year 2003, MAHLE achieved a sales increase of 5.7 percent versus the previous year. Sales development of the MAHLE Group was, on the one hand, affected by the global automotive market, but it was, on the other hand, also considerably affected by the organic and acquisition-related growth of the Group. At constant exchange rates, sales would have grown by a total of 12 percent.

### Business Unit Pistons and Engine Components

The Pistons and Engine Components Business Unit extended its position as market leader, increasing sales by EUR 123.3 million (+ 8.4 percent) over the previous year. The newly integrated companies contributed EUR 153 million (+ 10.5 percent) to this figure, while the exchange rate influences brought about by the US Dollar, the Japanese Yen and the Brazilian Real led to a reduction in sales of EUR 119.2 million (- 8.2 percent). Overall, the Business Unit recorded sales growth of EUR 89.5 million (+ 6.2 percent), allowing for the effects of currency exchange rates and consolidation.

### Business Unit Filter Systems

The Filter Systems Business Unit successfully strengthened its activities in Europe, with nearly all Group companies achieving increased sales. In the NAFTA region local currency sales also increased. However, changes in exchange rates resulted in lower Euro sales. Overall sales for the Business Unit fell by EUR 20.2 million (- 1.7 percent).

Increased sales of EUR 5.3 million (+ 0.5 percent) resulting from acquisitions and organic growth of EUR 36.3 million (+ 3.1 percent) were offset by sales figures of EUR 58.4 million (- 4.9 percent), adversely impacted by exchange rate developments.

### Business Unit Valve Train Systems

Increased sales of EUR 73.4 million in the Valve Train Systems Business Unit were due largely to the inclusion of ZNF Maschinenfabrik Spandau GmbH & Co. OHG, Germany, in the Group which contributed sales of EUR 75.7 million, making the MAHLE Group the biggest supplier of ready-to-install camshafts in Europe.

Activities in the South American market and changes in comparative currency values between the Brazilian Real, the US Dollar and the Euro led to a fall in Euro sales of EUR 15.3 million (- 3.6 percent). Allowing for the effects of consolidation and exchange rate fluctuations, organic growth came to EUR 13 million (+ 3 percent).

#### d) Financial and Profit Situation

MAHLE Group's net income for the year was up slightly on the previous year by EUR 14.1 million to EUR 95.2 million. The operating profits of the Group's various Business Units exhibited a very mixed pattern during the year under review. While a number of German plants encountered serious problems, most of the foreign companies – especially those overseas – exceeded results for the previous year in local currency. For some German locations, we have therefore included major expenditures in the result for 2003, earmarked for restructuring as a precautionary measure. The need to make adjustments to the Group's cost structure is also manifested in the personnel expense, which could not be optimized in comparison to the previous year. Mainly due to acquisitions, currency and price variations the material cost ratio increased from 41.2 to 42.8 percent.

The Group's financial result declined by EUR 1.9 million. Adjustments to currency exchange rates on the whole had a very unfavorable effect on Group earnings. The balance sheet total in 2003 increased by EUR 126.4 million to EUR 2,347.9 million, with continued major capital expenditure on the assets side producing a slight increase in fixed assets. The biggest increase, however, was determined by an increase in liquid funds. In contrast, liabilities to banks increased in comparison with the previous year following the conclusion of long-term credit agreements in an effort to benefit from current low interest rates while retaining scope for strategic capital spending.

On the liabilities side, accruals for pensions increased. Despite the improved equity situation, the results for the year under report meant that

the previous year's equity ratio of 39.9 percent could not be maintained. The decline to 38.3 percent is due solely to equity effects caused by the conversion of the balance sheets of MAHLE subsidiaries in North and South America and Asia drawn up in foreign currencies, as well as by an extension of the balance sheet resulting from financing activities.

#### e) Investments

At EUR 230.7 million, capital expenditure on fixed assets (without additions to assets resulting from the consolidation of new companies) were once again greatly in excess of depreciation of EUR 216.2 million.

#### Business Unit Pistons and Engine Components

Capital expenditure by the Pistons and Engine Components Business Unit amounted to EUR 114.7 million, with main focal points in Germany being the expansion of the motorsports plant in Fellbach and the automation of FERROTHERM<sup>®</sup> piston production and forgings for high-performance pistons at the Rottweil plant. Capital expenditure was also made on developing a new piston foundry in Poland and on the installation of other machining lines there. In the NAFTA region, a large proportion of capital expenditure was devoted to new production installations for machining steel pistons (MONOTHERM<sup>®</sup>) and to expanding capacity for machining connecting rods. Compared with this activity, capital expenditure in South America was largely accounted for by rationalization measures, and by the replacement of an existing plant.

### Business Unit Filter Systems

In the Filter Systems Business Unit, capital expenditure amounted to a total of EUR 61.8 million. Expenditure in Europe was mostly on rationalization projects and the expansion of existing sites in order to increase production capacity for air and liquid filters and air intake modules. In the other world regions, capital expenditure focused on rationalization and restructuring, and on the expansion of production capacity.

### Business Unit Valve Train Systems

Capital expenditure by the Valve Train Systems Business Unit amounted to EUR 49.9 million, significantly above the previous year level for the (EUR 37.8 million). This resulted mainly from the construction of new sites, with expenditure being made on the new location for camshaft production in Brandenburg, Germany, and on the future sites for valve manufacture.

### f) Headcount

At year end 2003, the MAHLE Group employed 30,646 people, 1,524 (+5.2 percent) more than at the beginning of the year.

This increase is due mainly to the Group's newly consolidated companies; the headcount in Asia increased in particular through the acquisition of the MAHLE Izumi Group.

### Headcount by Regions

	2002	2003
Europe	53.1 percent	51.6 percent
America	37.6 percent	36.3 percent
Asia/Pacific	9.3 percent	12.1 percent

### Adaptation of staffing levels in German locations

To recover the competitiveness of the German MAHLE activities, a restructuring program for several German locations was already decided last year. It involves a reduction of approximately 650 jobs. This restructuring program is covered by various agreements on reconciliation of interests and social plans in the locations Markgröningen, Alzenau, Bad Homburg, and Lorch. The reduction of jobs also includes the staff cuts planned for the location Stuttgart in the current year.

### 3. New Corporate Organization

During the past years our industry underwent a crucial change. The world and its markets moved even closer together. Our customers line up increasingly across the continents and work on world platforms and world engines.

Based on the previous Group structure, the market requirements could no longer be met in the best possible way. Thus a fundamental restructuring of the Group's organization was agreed before year end 2003. It was decided to replace the three historically-grown, locally-managed Business Units with separate market responsibilities by five globally-organized Product Lines for the OEM business. In addition, a profit center organization is planned for different areas.

With this new structure, we have formed the basis for an improved customer orientation and for more efficiency within the company. Furthermore our market position is reinforced, thus allowing us to meet future challenges. In addition, we can react faster and more flexibly to the requirements of the market and our customers.

The Product Lines are as follows:

- Piston Systems
- Cylinder Components
- Valve Train Systems
- Air Management Systems
- Liquid Management Systems

Internationally-acting sales, development and procurement departments, which are centrally responsible for all Product Lines, are to provide major synergy and cost-reduction potentials. Leanly-organized Group services departments were combined into an own entity to ensure the required cost transparency of the operative units.

Profit Centers were created for the following areas:

- Aftermarket
- Large Engine Components
- Small Engine Components
- Motorsports
- Industrial Filtration

Despite the ever-growing competitive pressure we are confidently looking ahead. We do not only lead in terms of product technology but also through our global positioning in the market. Our investments in Research and Development will continue to support the technologically leading role of MAHLE. And we continue to pursue our aim to make MAHLE the globally leading partner of the automotive and engine industry in all areas of its core competences.

## 4. The MAHLE Engine

The Product Lines Piston Systems, Cylinder Components, Valve Train Systems, Air Management Systems and Liquid Management Systems develop and manufacture individual modules and systems.

To demonstrate its system capability and know-how regarding a complete engine, MAHLE has, for the first time ever, developed its own complete engine. Last year, MAHLE designed and built a straight high-speed three-cylinder four-stroke engine for Formula SAE (Society of Automotive Engineers), a racing formula for prospective engineers of vehicle and engine construction. The architecture of this aluminum engine is totally new.

According to the rules of Formula SAE, an output of approximately 60 kW is expected from a displacement of 609 cm<sup>3</sup>. To achieve a high specific output despite the mandatory intake restrictor, a tuned intake system with four-valve technology, two overhead camshafts and intake manifold fuel injection was developed.

Light-weight concepts of crankshaft, connecting rod and piston allow low oscillating masses and thus a quick engine response. Cross-flow cooling in the cylinder head provides a uniform thermal load.

The crankshaft is axially supplied with lubricating oil from the front. This relieves the oil pump and improves the lubrication of the connecting rod bearings. An extremely flat oil sump allows a small engine height and thus a low position of center of gravity in the vehicle. The engine is rigidly seated in the vehicle because of its supporting function and therefore equipped with a balance shaft to compensate for the first-order tilting moments.

## New Knowledge

MAHLE's "quantum leap" from component manufacturer to engine developer is not a declaration of intent to extend this activity to a commercial level. It is rather a possibility to gain new knowledge on the total system of an engine.

The commitment in Formula SAE is based on the close contacts with the academic institutions with which MAHLE cooperates intensely when it comes to research and development projects. In particular, MAHLE has a very close relation with Aachen University, which has an excellent reputation in engine and vehicle construction.

The decision of the university to compete in Formula SAE triggered MAHLE's commitment – for good reasons. First of all, there is hardly a component manufacturer more capable of constructing a complete engine. Basically the crankshaft and the cylinder head are the only components missing in MAHLE's product portfolio. Secondly, MAHLE has a leading position as component supplier to motorsports, especially Formula 1.

At the same time the commitment is a good opportunity to encourage prospective engineers and familiarize them with the company. Because, according to all forecasts, a substantial shortage of young engineers is to be expected in the future. Thus the MAHLE engine is an important contribution to the encouragement of engineers of the next generations.

Furthermore MAHLE uses the potential to release synergies by building its own engine. MAHLE internal project planning deliberately involved as many levels as possible of the R&D departments.

## 5. Outlook 2004

Overall, we expect a slight improvement in the global economy as various indicators point to an upturn in 2004. The markets in the USA and China will play a major part here, as these countries start to pull other national economies along with them in their slipstream. The development of the German economy depends on export opportunities and on the effect of urgently required political reforms.

Within the context of overall economic development, the economic outlook for the automotive industry is brighter on the whole, and a slight increase in production figures can be expected worldwide. This improvement in the industry will also affect the development of business in the MAHLE Group; in general, we can expect a significant expansion of business activities, calculated in the currency of each respective country.

### Worldwide Automobile Production

Number in 1000s

	2003	2003	2004	2004
	Pass. cars & light coms.	Commercial vehicles	Pass. cars & light coms.	Commercial vehicles
<b>America</b>	<b>17.827</b>	<b>426</b>	<b>18.517</b>	<b>547</b>
- NAFTA	15.937	357	16.357	445
- South America	1.890	69	2.160	75
<b>Asia/Pacific</b>	<b>19.511</b>	<b>728</b>	<b>20.246</b>	<b>698</b>
- Japan	9.877	196	9.499	190
- China	3.629	397	4.200	334
<b>Europe</b>	<b>19.427</b>	<b>449</b>	<b>20.004</b>	<b>468</b>
- Germany	5.299	125	5.446	130
<b>Other Countries</b>	<b>1.023</b>	<b>0</b>	<b>1.076</b>	<b>0</b>

Source: Global Insight Automotive World Car Industry Report (Pass. cars and light coms. (< 6 t))

Based on agreements concluded in previous years, in January 2004 MAHLE increased its holding in MAHLE Brockhaus GmbH to a majority interest; acquisition of the whole company is planned for 2005.

Continued growth in the Asian region will contribute to the expansion of business activities. With the acquisition, and first-time consolidation, of a third piston company in China, MAHLE already took a major step in this direction in 2003. In addition, all business units are currently examining further projects in Asia. We assume that some of these will be implemented in the new fiscal year.

In view of the restructuring measures introduced in Germany and the improved world market situation, the MAHLE Group can expect a positive earnings situation in 2004.