

<i>Business Unit</i>	<i>Region</i>	<i>Non-wholly-owned subsidiaries</i>	
		December 31, 2016	December 31, 2015
Air&Cooling	China	1	1
Filtration	India (*****)	1	1
Suspensions	France	1	1
	Spain	1	1
	China	1	1
	India	1	1
<b>TOTAL</b>		<b>6</b>	<b>6</b>

(\*\*\*\*\*) This subsidiary works also for Air&Cooling business unit.

## 2. CONSOLIDATION PRINCIPLES AND ACCOUNTING POLICIES

The main accounting principles and standards applied in preparation of the consolidated financial statements and of the Group aggregate financial disclosures are set forth below.

These Consolidated Financial Statements have been prepared in accordance to the going concern assumption, as the Directors have verified the non-existence of financial, performance or other indicators that could give rise to doubts as to the Group's ability to meet its obligations in the foreseeable future. The risks and uncertainties relating to the business are described in the dedicated sections in the Directors' Report. A description of how the Group manages financial risks, including liquidity and capital risk, is provided in note 39.

### 2.1 Consolidation principles

The financial statements as at 31 December 2016 of the companies included in the scope of consolidation, prepared in accordance with Group accounting policies with reference to IFRS, have been used for consolidation purposes.

The scope of consolidation includes subsidiaries, joint ventures and associates.

All the companies over which the Group has the direct or indirect power to determine the relevant activities (i.e., the financial and operating policies) – in other words, those companies that determine the highest exposure to variable returns – are considered subsidiaries. Specifically, 50% owned company Iberica de Suspensiones S.L. is treated as a subsidiary because the Group controls the majority of votes of the Board of Directors, which is the corporate body tasked with deciding on the entity's relevant activities.

The assets, liabilities, costs and revenues of the individual consolidated companies are fully consolidated on a line-by-line basis, regardless of the percentage owned, while the carrying value of consolidated investments held by the Holding Company and other consolidated companies is eliminated against the related share of equity.

All intercompany balances and transactions, including unrealised profits deriving from transactions between consolidated companies, are eliminated. Unrealised losses are eliminated, except when a loss represents an impairment indicator to be recognised in the Income Statement.

The financial statements of the subsidiaries are drawn up using the currency of the primary economic environment in which they operate (“functional currency”). The consolidated financial statements are presented in Euro, the functional currency of the Holding Company and hence the currency of presentation of the consolidated financial statements of the Sogefi Group.

The procedures for translation of the financial statements expressed in foreign currency other than the Euro are the following:

- the items of the Consolidated Statement of Financial Position are translated into Euro at the year-end exchange rates;
- the Income Statement items are translated into Euro using the year’s average exchange rates;
- differences arising from the translation of equity's opening balance with year-end exchange rates are recorded in the translation reserve account, together with any difference between the net result of income statement and statement of financial position;
- whenever a subsidiary with a different functional currency from Euro is disposed of, any exchange differences included in Other comprehensive income is reclassified to the Income Statement;
- dividends paid by companies that use functional currencies other than the Euro are converted at the average exchange rate of the previous year for the company that pays the dividend and at the current exchange rate for the company that receives the dividend; exchange differences between the two amounts are recorded to the translation reserve account.

The following exchange rates have been used for translation purposes:

	2016		2015	
	<i>Average</i>	<i>12.31</i>	<i>Average</i>	<i>12.31</i>
US dollar	1.1066	1.0541	1.1091	1.0887
Pound sterling	0.8189	0.8562	0.7257	0.7340
Brazilian real	3.8616	3.4305	3.6390	4.3116
Argentine peso	16.3345	16.7476	10.2114	14.0964
Chinese renminbi	7.3497	7.3201	6.9691	7.0607
Indian rupee	74.3494	71.5820	71.1238	72.0461
New romanian Leu	4.4907	4.5391	4.4450	4.5241
Canadian dollar	1.4664	1.4188	1.4158	1.5116
Mexican peso	20.6569	21.7723	17.5623	18.9143
Hong Kong dollar	8.5903	8.1753	8.5977	8.4374

A joint venture is an entity for which strategic financial and operating decisions concerning the relevant activities of the company are made with the unanimous approval of the controlling parties.

An associate is an entity in which the Group is able to exert a significant influence, but without being able to control its relevant activities.

Investments in joint ventures and associates are consolidated applying the equity method, which means that the results of operations of associates and any changes in Other comprehensive income of the joint ventures and associates are reflected in the consolidated Income Statement and in Consolidated Statement of Other Comprehensive Income. If the carrying value exceeds the recoverable amount, the carrying value of the

investment in the joint venture or in the associate is adjusted by booking the related loss to the Income Statement.

Company AFICO FILTERS S.A.E. owned at 17.77% as at 31 December 2016 (owned at 22.62% as at 31 December 2015) was not classified as associate due to the significant lack of Group's members in the management bodies of the company (which means the Group does not exert significant influence on the company).

## ***2.2 Business combinations***

Business combinations are recognised under the acquisition method. According to this method, the consideration transferred to a business combination is measured at fair value calculated as the aggregate of the acquisition-date fair value of the assets transferred and liabilities assumed by the Company and of the equity instruments issued in exchange for the control of the acquired entity.

On the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their acquisition-date fair value; the following items represent exception to the above and are valued according to their reference principle:

- deferred tax assets and liabilities;
- assets and liabilities relating to employee benefits;
- liabilities or equity instruments relating to share-based payments of the acquired entity or share-based payments relating to the Group, issued as a replacement of contracts of the acquired entity;
- assets held for sale and discontinued assets and liabilities.

Goodwill is measured as the surplus between the sum of the consideration transferred to the business combination, the value of non-controlling interests and the fair value of previously-held equity interest in the acquiree with respect to the fair value of the net assets transferred and liabilities assumed as at the acquisition-date. If the fair value of the net assets transferred and liabilities assumed as at the acquisition-date exceeds the sum of the consideration transferred, the value of non-controlling interests and the fair value of the previously-held equity interest in the acquiree, said surplus is immediately booked to the Income Statement as gain resulting from said transaction.

The share of non-controlling interests as at the acquisition-date may be measured at fair value or as a proportion of the fair value of net assets in the acquiree. The measurement method adopted is decided on a transaction-by-transaction basis.

## ***2.3 Accounting policies***

The following accounting policies have been applied in the financial statements as at 31 December 2016.

## **Cash and cash equivalents**

Cash and cash equivalents are those held to meet short-term cash needs, rather than for investment or other purposes. For an investment to be considered as cash or cash equivalent, it must be able to be readily converted into a known amount of cash and must be subject to an insignificant risk of change in value.

## **Inventories**

Inventories are stated at the lower of purchase or manufacturing cost, determined on a weighted average cost basis, and realisable value based on market trends, net of variable selling costs.

Manufacturing cost includes raw materials and all direct or indirect production-related expenses. Financial expenses are excluded. Obsolete and slow-moving inventories are written down according to their realisable value.

## **Receivables included in current assets**

Receivables are initially recognised at fair value of the consideration to be received, which usually corresponds to the nominal value shown on the invoice, adjusted (if necessary) to their estimated realisable value by making provision for doubtful accounts. Subsequently, receivables are measured at amortised cost, which generally corresponds to their nominal value.

Receivables assigned through without-recourse *factoring* transactions after which the related risks and benefits are definitively transferred to the assignee are derecognised from the statement of financial position at the time of transfer. Receivables assigned through recourse *factoring* transactions are not derecognised.

## **Tangible fixed assets**

Tangible fixed assets mainly relate to industrial sites. Assets are shown at historical cost, net of accumulated depreciation and accumulated impairment losses.

Cost includes related charges, together with the portion of direct and indirect expenses reasonably attributable to individual assets.

Tangible fixed assets are depreciated each month on a straight-line basis using rates that reflect the technical and economic remaining lives of the related assets.

The depreciable value is the cost of an asset less its residual value, where the residual value of an asset is the estimated value that the entity could receive currently from its disposal, if the asset was already in the condition expected at the end of its useful life net of estimated disposal costs.

Depreciation is calculated from the month that the asset becomes available for use, or when it is potentially able to provide the economic benefits expected of it.

The annual average depreciation rates applied are as follows:

	%
Land	n.a.
Industrial buildings and light constructions	2.5-12.5
Plant and machinery	7-14
Industrial and commercial equipment	10-25
Other assets	10-33.3
Assets under construction	n.a.

Land, assets under construction and payments on account are not depreciated.

Ordinary maintenance costs are charged to the Income Statement.

Maintenance costs that increase the value, functions or useful life of fixed assets are recorded directly as the increase in the value of the assets to which they refer and depreciated over their residual useful lives.

Gains or losses on the disposal of assets are calculated as the difference between the sales proceeds and the net book value of the asset and are charged to the Income Statement for the period.

Grants are shown in the Statement of Financial Position as an adjustment of the book value of the asset concerned. Grants are then recognised as income over the useful life of the asset by effectively reducing the depreciation charge each year.

#### *Assets under lease*

There are two types of leases: finance leases and operating leases.

A lease is considered a finance lease when it transfers substantially all risks and benefits incidental to ownership of the asset to the lessee.

As envisaged in IAS 17, a lease is considered a finance lease when the following elements are present, either individually or in combination:

- the contract transfers ownership of the asset to the lessee at the end of the lease term;
- the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable such that it is reasonably certain, at the inception of the lease, that it will be exercised;
- the lease term is for the major part of the useful life of the asset, even if title is not transferred;
- at the inception of the lease, the present value of the minimum lease payments is equal to at least the fair value of the asset being leased;
- the assets being leased are of such a specialised nature that only the lessee is able to use them without making major modifications.

Assets available to Group companies under contracts that fall into the category of finance leases are accounted for as tangible fixed assets at their fair value at the date of purchase or, if lower, at the present value of the minimum payments due under the lease; the corresponding liabilities to the lessor are shown in the Statement of Financial Position as financial debts. The assets are depreciated over their estimated useful lives.

Lease payments are split between the principal portion, which is booked as a reduction of financial debts, and interest. Financial expenses are charged directly to the Income Statement for the period.

Payments under operating lease contracts, on the other hand, are charged to the Income Statement on a straight-line basis over the life of the contract.

### **Intangible assets**

An intangible asset is only recognised if it is identifiable and verifiable, it is probable that it will generate economic benefits in the future and its cost can be measured reliably.

Intangible assets with a finite life are valued at purchase or production cost, net of amortisation and accumulated impairment losses.

The annual average amortisation rates applied are as follows:

	%
Development costs	20-33.3
Industrial patents and intellectual property rights, concessions, licences, trademarks	10-33.3
Customer relation	5
Trade name	5
Software	20-50
Other	20-33.3
Goodwill	n.a.
Assets under construction	n.a.

Amortisation is based on the asset's estimated useful life and begins when it is available for use.

#### *Research and development expenses*

Research expenses are charged to the income statement as incurred in accordance with IAS 38.

Development expenses relating to specific projects are capitalised when their future benefit is considered reasonably certain by virtue of a customer's commitment; they are then amortised over the entire period of future profits expected to be earned by the project in question.

Costs incurred in developing the range of after-market products are capitalised from the time a certain product is recognised to be missing from the product portfolio. Its future benefit is considered reasonably certain because the new product will be added to the product catalogue and made available to customers.

The capitalised value of the various projects is reviewed annually - or more frequently if there are particular reasons for doing so - analysing its recoverable amount to assess if there have been any impairment losses.

#### *Trademarks and licences*

Trademarks and licences are valued at cost, less amortisation and accumulated impairment losses. The cost is amortised over the shorter of the contract term and the finite useful life of the asset.

### *Customer Relations*

Customer relations represent the value of the Systèmes Moteurs Group's customer portfolio at the acquisition date as determined during the Purchase Price Allocation process.

### *Brand name*

Brand name represents the value of the "Systèmes Moteurs" brand name at the acquisition date as determined during the Purchase Price Allocation process.

### *Software*

The costs of software licences, including related charges, are capitalised and shown in the financial statements net of amortisation and any accumulated impairment losses.

It should be pointed out that a multi-year project was launched in 2011 to implement a new integrated IT system across the Group. Relating costs are capitalised by Parent Company Sogefi S.p.A., that will licence the intellectual property rights on the IT system for use by the subsidiaries involved in the implementation process receiving the payment of royalty fees. The useful life of the fixed asset is estimated at 10 years and amortisation begins when implementation at each individual company is completed.

### *Goodwill*

Goodwill resulting from business combinations is initially recognised at cost as at the acquisition-date, as detailed in the paragraph above entitled "Business combinations". Goodwill is not amortised but is tested annually for impairment, or more frequently if specific events or changed circumstances indicate a potential loss in value. Unlike other intangible assets, reversal of an impairment loss is not allowed for goodwill.

For impairment test purposes, goodwill was allocated to each of the Cash Generating Units (CGU) due to benefit from the acquisition.

The Sogefi Group currently encompasses five CGUs: Filtration (previously named "Engine Systems – Fluid Filters"), Air&Cooling (previously named "Engine Systems – Air Intake and Cooling"), Car Suspension, Industrial Vehicles Suspension and Precision Springs.

The goodwill currently on the books only concerns the Filtration, Air&Cooling CGUs and the Car Suspension CGU.

### *Intangible assets with an indefinite useful life*

Intangible assets with an indefinite useful life are not amortised, but are tested annually for impairment, or more frequently if there is an indication that the asset may have suffered a loss in value. As at 31 December 2016, the Group has no intangible assets with an indefinite useful life.

## **Impairment losses of tangible and intangible fixed assets**

If there are indications of possible losses in value, tangible and intangible fixed assets are subjected to impairment test, estimating the asset's recoverable amount and comparing it with its net book value. If the recoverable amount is less than the book value, the latter is reduced accordingly. This reduction constitutes an impairment loss, which is booked to the income statement.

For goodwill and any other intangible fixed assets with indefinite useful life, an impairment test is carried out at least once a year.

With the exception of goodwill, if a previous writedown is no longer justified, a new recoverable amount is estimated, providing it is not higher than what the carrying value would have been if the writedown had never been made. This reversal is also booked to the Income Statement.

### **Equity investments in other companies and other securities**

In accordance with IAS 39, equity investments in entities other than subsidiaries, joint ventures and associates are classified as financial assets available for sale which are measured at fair value, except in situations where the market price or fair value cannot be reliably determined. In this case the cost method is used.

Gains and losses deriving from fair value adjustments are booked to a specific item in Other comprehensive income. In the case of objective evidence that an asset suffered an impairment loss or it is sold, the gains and losses previously recognised under Other Comprehensive Income are reclassified to the Income Statement.

For a more complete discussion of the principles regarding financial assets, reference should be made to the note specifically prepared on this matter (paragraph 3 "Financial assets").

### **Non-current assets held for sale**

Under IFRS 5 "Non-current assets held for sale and discontinued operations", providing the relevant requirements are met, non-current assets whose book value will be recovered principally by selling them rather than by using them on a continuous basis, have to be classified as being held for sale and valued at the lower of book value or fair value net of any selling costs. From the date they are classified as non-current assets held for sale, their depreciation is suspended.

### **Loans**

Loans are initially recognised at cost, represented by the fair value received, net of related loan origination charges.

After initial recognition, loans are measured at amortised cost by applying the effective interest rate method.

The amortised cost is calculated taking account of issuing costs and any discount or premium envisaged at the time of settlement.

### **Derivatives**

For accounting purposes, the treatment of derivative financial instruments depends on whether a derivative is speculative in nature or whether it can be considered a hedging instrument.

All derivatives are initially recognised in the Statement of Financial Position at cost as this represents their fair value. Subsequently, all derivatives are measured at fair value.

Any changes in the fair value of derivatives that are not designated for hedge accounting are booked to the Income Statement (under "Financial expenses (income), net").

Derivatives that can be booked under the hedge accounting are classified as:

- fair value hedges if they are meant to cover the risk of changes in the market value of the underlying assets or liabilities;
- cash flow hedges if they are taken out to hedge the risk of fluctuations in the cash flows deriving from an existing asset or liability, or from a future transaction that is highly probable.

For derivatives classified as fair value hedges, the gains and losses that arise on determining their fair value and the gains and losses that derive from adjusting the underlying hedged items to their fair value are booked to the Income Statement (for the hedged risk).

For those classified as cash flow hedges, used for example, to hedge medium/long-term loans at floating rates, gains and losses that arise from their valuation at fair value are booked directly to Other comprehensive income for the part that effectively hedges the risk for which they were taken out. The portion booked to Other comprehensive income will be reclassified to the Income Statement (under the item “Financial expenses (income), net” in the period) when the hedged assets and liabilities impact the costs and revenues of the period.

When an instrument is determined to be an ineffective hedge, the hedging relationship is discontinued and the following amounts are booked to Income Statement (under the item “Financial expenses (income), net”):

- the change in fair value of the derivative since the date the hedge last proved effective is immediately recognised in the Income Statement;
- the reserve previously booked to Other Comprehensive Income is recognised in the Income Statement over the same period of time as the differentials relating to the underlying item hedged previously (if the hedged item is still booked to the Consolidated Statement of Financial Position of the Group).

Note that the Group has adopted a specific procedure for managing derivative financial instruments as part of an overall risk management policy.

### **Trade and other payables**

Payables are initially recognised at fair value of the consideration to be paid and subsequently at amortised cost, which generally corresponds to their nominal value.

### **Provisions for risks and charges**

Provisions for risks and charges are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resource embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

On the other hand, no provision is made in the case of risks for which there is only a possibility that a liability may arise. In this case, the risk is disclosed in the notes on commitments and risks without making any provision.

Provisions relating to corporate reorganizations are only set aside once they have been approved and raised a valid expectation to the parties involved.

### **Post-retirement and similar employee benefits**

Group employees have defined-benefit and/or defined-contribution pension plans, depending on the conditions and local practices of the countries in which the group operates.

The Group's responsibility is to finance the pension funds for the defined-benefit plans (including the employment termination indemnities currently applicable in Italy) and the annual cost recognised in the Income Statement are calculated on the basis of actuarial valuations that use the projected unit credit method.

The liability relating to benefits to be recognised on termination of employment recorded in the Consolidated Statement of Financial Position represents the present value of the defined-benefit obligation, less the fair value of the plan assets. Any net assets determined are recognised at the lowest of their value and the present value of available repayments and reductions of future contribution to the plan.

Pursuant to the amendment to IAS 19 "Employee Benefits" effective as from 1 January 2013, the Group recognises actuarial gains and losses and books them to "Other comprehensive income" immediately, so that the full net amount of the provisions for the defined benefits (net of plan assets) is recognised in the Consolidated Statement of Financial Position. The amendment further requires any changes in the defined benefit provision and plan assets over the previous period to be subdivided into three components: the cost components of work performed during the reporting period must be recognised in the Income Statement as service costs; net interest costs calculated by applying the appropriate discount rate to the opening balance of defined benefit provision net of assets must be booked to Income Statement as net financial expenses and the actuarial gains and losses resulting from the remeasurement of assets and liabilities must be booked to "Other comprehensive income". In addition, the return on assets included in net financial expenses must be calculated using the discount rate applicable to liabilities and no longer the expected return on the assets. The difference between actual return on plan assets and the return calculated as described above is booked to "Other comprehensive income".

In the event of an amendment to the plan that changes the benefits relating to past service or in the event of the application of a new plan relating to past service, the costs relating to past service are booked to the Income Statement (under service costs). In the event of an amendment to the plan that significantly reduces the number of employees involved in the plan or that changes the clauses of the plan in such a way that a significant part of future service due to employees will no longer accrue the same benefits or will accrue them but to a lesser extent, the profit or loss relating to said reduction is immediately booked to the Income Statement (under service costs).

All of the costs and income resulting from the measurement of funds for pension plans are booked to the Income Statement by functional area of destination, with the exception of the financial component relating to non-financed defined-benefit plans, which is included in Financial expenses.

The costs relating to defined-contribution plans are booked to the Income Statement when incurred.

#### *Other long-term benefits*

Other long-term employee benefits relate to the French subsidiaries and include “Jubilee or other long-service benefits” that are not expected to be paid fully within the twelve months following the end of the reporting period during which the employee has rendered service for those benefits.

The valuation of other long-term benefits usually does not present the same degree of uncertainty as post-employment benefits. This is why IAS 19 requires a simplified method of accounting for such benefits. Unlike the accounting method required for post-employment benefits, this method (which requires actuarial valuation) does not require discounting effects to be taken to Other comprehensive income.

#### *Phantom stock options*

With regard to phantom stock option plans, as envisaged by IFRS 2, in the section regarding “Cash-settled share-based payment transactions”, the fair value of the plan at the date of the financial statements is remeasured, with any changes in fair value recognised in the Income Statement with a corresponding entry to a provision.

#### *Stock-based incentive plans*

With regard to “Stock-based incentive plans” (Stock options and Stock grants), as envisaged by IFRS 2, the Group calculates the fair value of the option at the granting date, booking it to the Income Statement as a cost over the vesting period of the benefit. The *ad hoc* equity reserve in the Consolidated Statement of Financial Position has been increased. This imputed cost is measured by specialists with the help of suitable economic and actuarial models.

### **Deferred taxation**

Deferred taxes are calculated on the taxable/deductible temporary differences between the book value of assets and liabilities and their tax bases, and classified under non-current assets and liabilities.

Deferred tax assets are accounted for only to the extent that it is probable that sufficient taxable profits will be available in the future against which they can be utilised.

The carrying amount of the deferred tax assets shown in the financial statements is subject to an annual review.

Deferred tax assets and liabilities are calculated at the tax rates expected to apply in the period when the differences reverse under the law of the countries in which the Group operates, considering current rates and those enacted or substantially enacted at the end of the reporting period.

Deferred tax liabilities are calculated on taxable temporary differences relating to equity investments in subsidiaries, associates and joint ventures, except where the Company can control the reversal of such temporary differences and it is probable that they will not reverse in the foreseeable future.

Current and deferred taxes are recognised in the income statement, except for those relating to items directly charged or credited to Other comprehensive income or other

equity items, in which case tax effect is recognised directly under Other comprehensive income or equity.

### **Participation in CIR's group tax filing system (applicable to Italian companies)**

In the fiscal year 2016, the Parent Company Sogefi S.p.A. and its subsidiary Sogefi Italy S.p.A. confirmed their participation in the CIR group tax filing system for the three-year period 2016-2018.

Each company joining to the group Italian tax filing system transfers its tax profit or loss to the parent company. The parent company recognises a credit corresponding to the IRES (Italian tax on company income) that companies have to pay (debit for the transferor company). On the contrary, for companies that booked tax losses, the parent company recognises a debt corresponding to the IRES for the part of loss actually offset at group level (credit for the transferee company).

In connection with the Group tax filing system, those companies that record non-deductible net financial expenses may use the excess tax benefits available for offset of other Group companies (thus making such expenses deductible) for a consideration. Such consideration, in an amount proportionate to the resulting tax benefit and applicable to excess tax benefits arising in Italy only, has been paid to the parent company CIR and is treated as expense for those companies that obtain the excess tax benefit and as revenue for those that transfer it.

### **Treasury shares**

Treasury shares are deducted from equity. The original cost of treasury shares and the profit/loss resulting from their subsequent sales are recognised as changes in equity.

### **Revenues recognition**

Revenues from the sale of products are recognised at the time ownership passes (time of risks and benefits transfer), which is generally upon shipment to the customer. They are shown net of returns, discounts and allowance.

The proceeds from the sale of *tooling* to customers can be recognised as follows:

- a) the full amount is recognised at the time risks and benefits of the *tooling* are transferred (if said transfer is deferred, margin is booked to "Other current liabilities");
- b) the amount is recognised by means of an increase of the sales price of the products manufactured using the relevant tooling, throughout a variable time frame depending on the number of products sold (in this case the unrealised sales price for the tooling is booked to "Inventory – Contract work in progress and advances").

Revenues from services rendered are recognised at the time the services are provided.

### **Income Statement Overview**

#### *Variable cost of sales*

This represents the cost of goods sold. It includes the cost of raw and ancillary materials and goods for resale, as well as variable manufacturing and distribution costs, including the direct labour cost of production.

#### *Manufacturing and R&D overheads*

This category includes manufacturing overheads such as indirect labour cost of production, maintenance costs, consumable materials, building rents, and industrial equipment involved in production.

Also included are all R&D overheads, net of any development costs that are capitalised because of their future benefits and excluding amortisation which is booked to a separate item in the Consolidated Income Statement.

#### *Distribution and sales fixed expenses*

These are costs that are essentially insensitive to changes in sales volumes, relating to personnel, promotion and advertising, external warehousing, rentals and other sales and distribution activities. This category, therefore, includes all fixed costs identified as being incurred after finished products have been stocked in the warehouse and directly related to their sale and distribution.

#### *Administrative and general expenses*

This category includes fixed labour costs, telephone expenses, legal and tax consulting fees, rents and rentals, cleaning, security and other general expenses.

#### *Restructuring costs and other non-operating expenses/income*

These are figures that do not relate to the Group's normal business activities or refer to non-ordinary activities and are expressly disclosed in the notes if they are of a significant amount.

### **Operating grants**

These are credited to the Consolidated Income Statement when there is a reasonable certainty that the company will meet the conditions for obtaining the grant and that the grants will therefore be received.

### **Dividends**

Dividend income is recorded when the right to receive it arises. This is normally at the time of the shareholders' resolution that approves distribution of the dividends.

Dividends to be distributed are recognised as a payable to shareholders immediately after they have been approved.

### **Current taxes**

Current taxes are booked on the basis of a realistic estimate of taxable income calculated according to current tax legislation in the country concerned, taking account of any exemptions and tax credits that may be due.

## **Earnings per share (EPS)**

*Basic EPS* is calculated by dividing net result for the period attributable to the ordinary shareholders of the Parent Company by the weighted average number of ordinary shares outstanding during the period, net of treasury shares.

*Diluted EPS* is obtained by adjusting the weighted average number of shares outstanding to take account of all potential ordinary shares that could have a dilutive effect.

## **Translation of foreign currency items**

### *Functional currency*

Group companies prepare their financial statements in the local currency of the country concerned.

The functional currency of the Parent Company is the Euro and this is the presentation currency in which the consolidated financial statements are prepared and published.

### *Accounting for foreign currency transactions*

Foreign currency transactions are initially translated at the exchange rate ruling on the transaction date.

At the end of the reporting period, monetary assets and liabilities expressed in foreign currency are retranslated at the period-end exchange rate.

Non-monetary foreign currency items valued at historical cost are translated at the exchange rate ruling on the transaction date.

Non-monetary items carried at fair value are translated at the exchange rate ruling on the date this value was determined.

## **Critical estimates and assumptions**

Various estimates and assumptions regarding the future have to be made when preparing financial statements. They are the best estimates possible at the end of the reporting period. Given their nature, they could lead to a material difference in statement of financial position items in future years. The main items affected by these estimates are as follows:

- goodwill (Euro 126.6 million) – impairment test: for the purpose of determining the value in use of the Cash Generating Units, the Group took into account the trends expected for 2017 as determined based on the budget (approved by the Board of Directors on 23 January 2017) and the forecasts included in the 2018-2020 three-year plan for the following years (adjusted to eliminate any estimated benefits from future projects and reorganisations) approved by the Board of Directors on 13 June 2016 and on 27 February 2017. The impairment test, based on such forecasts, does not indicate a need for devaluation;
- tangible and intangible fixed assets of the subsidiary Sogefi Filtration do Brasil Ltda (Euro 12.7 million) - impairment test: at the end the fiscal year 2016, tangible and intangible fixed assets of the subsidiary were tested for impairment due to its negative economic and financial results and the sluggish performance of the Brazilian car market. To this end, the expected cash flows for 2017 as determined based on the budget and for the following 6 years (i.e. the estimated remaining

useful life of the assets) approved by the Advisory Board of the subsidiary on 24 February 2017 were taken into account. The impairment test, based on such forecasts, lead to a writedown of Euro 3,034 thousand;

- pension plans (Euro 53.2 million): actuaries who offer their consulting services to the Group use different statistic assumptions in order to anticipate future events for the purpose of estimating pension plan expenses, liabilities and assets. Such assumptions concern discount rate, future wage inflation rates, mortality and turnover rates;
- recoverability of deferred tax assets on tax losses (Euro 17.2 million decreased of Euro 5.4 million in comparison with the previous reporting period): as at 31 December 2016, deferred tax assets on tax losses incurred during previous years were accounted for to the extent that it is probable that taxable income will be available in the future against which they can be utilised. Such probability is also determined based on the fact that such losses have originated mainly under extraordinary circumstances that are unlikely to occur again in the future and that the same could be recovered throughout an unlimited or long-term time frame;
- derivatives (Euro 16 million in assets and Euro 7,9 million in liabilities): the estimate of the fair value of derivatives (relating to interest and exchange rates) and the effectiveness test on derivatives held for hedge accounting were performed with the aid of external consultants based on valuation models commonly used in the industry, in line with the requirements of IFRS 13 (calculation of DVA - debit valuation adjustment);
- provision for product warranties (Euro 16.3 million)/Other non-current receivables (Euro 10 million).

- 1) With regard to provision for product warranties, there are claims in progress by two customers relating to a defective component supplied starting from 2010 by the subsidiary Sogefi Air & Refroidissement France S.A.S. (formerly named Systèmes Moteurs S.A.S., "SM") before and after it was purchased by Dayco Europe S.r.l. (during 2011). The Company believes that the defect was caused by a thermostat manufactured by a supplier of SM and in 2012 filed a law suit against that supplier at the French courts seeking indemnity for any damages it might have to pay to its customers.

In the course of the proceedings, the court appointed a technical expert to write an expert witness report, initially for the purpose of determining the causes of product defect. Subsequently, the subsuppliers and the customers, and lastly Dayco took part in the investigation process.

To date, the court's expert is tasked with determining the nature of the defect, the liability of the different parties involved and the amount of damages.

To date, the expert established that the defect was caused by the thermostat manufactured by the supplier of SM.

With regard to the liability of the parties involved, the expert is analysing the different phases of the product approval procedure to allocate liability among

the different parties involved (thermostat supplier, its sub-suppliers, SM as first-tier supplier, and the customers).

With regard to the determination of damages, the expert was asked to evaluate whether the damages claimed by the customers are appropriate for the purpose of allocating final damages among the parties involved.

- 2) As regards the amount of damages, the customers claimed Euro 188.5 million in damages, Euro 122.6 million of which mainly relate to past and future campaigns and Euro 65.9 million for damage to reputation and loss of future income. Based on existing proceedings, the Company and its legal counsel deem that there is only a remote possibility that a liability will arise from the latter claim in the amount of Euro 65.9 million.
- 3) With regard to the claim worth Euro 122.6 million (Euro 122.8 million as at 31 December 2015), the Company investigated such claim thoroughly to identify the concerned production periods and – prior to the allocation of liability, if any – according to its estimates Euro 60.2 million (Euro 60.4 million as at 31 December 2015) relate to products manufactured before the SM acquisition, and Euro 62.4 million to post-acquisition periods.

In this regard, in May 2016, the Company obtained an arbitration award in the international arbitration proceedings initiated against Dayco to recover the costs incurred by SM after the acquisition.

In short, the award confirmed that Sogefi has a general right to indemnification for the claims relating to products manufactured before Sogefi purchased SM, and ordered Dayco to pay Euro 9.4 million to Sogefi for the claims already paid (including the amounts paid in connection with the above mentioned defective component). The award amount had been paid at the end of the year 2016.

If appropriate, the Company will claim such general right to indemnification against Dayco in connection with amounts paid to customers for production lots of the defective components before Sogefi purchased SM.

The award stated that Sogefi is responsible for any claims relating to production lots manufactured after the acquisition.

- 4) The Company estimates the claims relating to production lots manufactured after the acquisition in total Euro 62.4 million before this liability is allocated among the different parties involved (thermostat supplier, its sub-suppliers, SM, and the customers).  
The Company and its legal counsel believe that the Court's expert may not allow a portion of such amounts.
- 5) SM paid Euro 21 million on a provisional basis for claims received by customers. These amounts were paid under standstill agreements, without any admission of liability. Such amounts will be adjusted or partly refunded as required when the Court decides on the merits of the case or under subsequent settlement agreements.

Please note also that at the end of the year 2015, the Company's provision for product warranties – less the total amount already paid of Euro 21 million – amounted to Euro 16.3 million. This amount was reviewed in the light of the developments of the dispute at the end of the year 2016, and the Company and its legal counsel confirmed that the allocation corresponds to a prudential estimate.

- 6) With regard to the indemnities owed by the seller of SM shares, it is worthwhile pointing out that the Sogefi Group entered an indemnification asset totalling Euro 23.4 million in the Consolidated Financial Statements in 2011, because the seller Dayco had provided contractual guarantees relating to defect liability claims existing at the time of the acquisition, including those noted above.

Based on the outcome of the arbitration proceedings, the Company reduced the amount expected to be recovered from Dayco by Euro 4 million and consequently wrote down the indemnification asset as at 31 December 2016 by the same amount.

The written down indemnification asset less collected awarded amounts totalled Euro 10 million at the end of the year 2016.

Please note that both Sogefi and Dayco appealed parts of the award before the Court of Appeals in Milan. Sogefi appealed the part of the award ordering it to pay the claims concerning the products manufactured after the acquisition; Dayco appealed the part of the award confirming the validity of the indemnities in favour of Sogefi provided for by the acquisition contract. It should be noted that the validity of such indemnities was confirmed by both the award and a preliminary ruling of the Court of Appeals in Milan, that rejected Dayco's petition to stay enforcement of the award and confirmed that the award is enforceable.

It should be noted that these are complex proceedings that involve judgements on technical, juridical and commercial matters, and present uncertainties connected with the outcome of the proceedings before the French courts and the arbitration award. Estimates concerning risks provision and the recovery of booked assets are based on the best information available at the time of preparing the financial statements. They are subject to change as events evolve.

## 2.4 Adoption of new accounting standards

### IFRS ACCOUNTING STANDARDS, AMENDMENTS AND INTERPRETATIONS APPLICABLE SINCE 1 JANUARY 2016

The following IFRS accounting standards, amendments and interpretations were first adopted by the Group as from 1 January 2016:

- Amendments to IAS 19 “*Defined Benefit Plans: Employee Contributions*” (issued on 21 November 2013) concerning the recognition of contributions from employees or third parties to defined benefit plans. The adoption of these amendments had no impact on the consolidated financial statements of the Group.
- Amendments to IFRS 11 “*Accounting for acquisitions of interests in joint operations*” (issued on 6 May 2014) concerning the accounting for acquisitions of interests in a joint operation when the operation constitutes a business. The adoption of these amendments had no impact on the consolidated financial statements of the Group.
- Amendments to IAS 16 and IAS 38 “*Clarification of acceptable methods of depreciation and amortisation*” (issued on 12 May 2014) establishing that a depreciation or amortisation method that is based on revenue is not appropriate, because the revenue arising from the operation of a business of which the asset under depreciation or amortisation is part reflects a different pattern from the mere use of the economic benefits arising from the asset, which is a pre-requisite for depreciation or amortisation. The adoption of these amendments had no impact on the consolidated financial statements of the Group.
- Amendments to IAS 1 “*Disclosure Initiative*” (issued on 18 December 2014): the goal of the amendments is to provide some clarifications on disclosures and other elements that may be perceived as hindrance to a clear and intelligible presentation of financial statements. The adoption of these amendments had no impact on the consolidated financial statements of the Group.

As part of its annual improvement process, on 12 December 2013, the IASB published documents “*Annual Improvements to IFRSs: 2010-2012 Cycle*” (including IFRS 2 *Share Based Payments – Definition of vesting condition*, IFRS 3 *Business Combination – Accounting for contingent consideration*, IFRS 8 *Operating segments – Aggregation of operating segments* and *Reconciliation of total of the reportable segments’ assets to the entity’s assets*, IFRS 13 *Fair Value Measurement – Short-term receivables and payables*) and – on 25 September 2014 – document “*Annual Improvements to IFRSs: 2012-2014 Cycle*” (including: IFRS 5 – *Non-current Assets Held for Sale and Discontinued Operations*, IFRS 7 – *Financial Instruments: Disclosure* and IAS 19 – *Employee Benefits*) partly amending existing standards. The adoption of these amendments had no impact on the consolidated financial statements of the Group.

*IFRS AND IFRIC ACCOUNTING STANDARDS, AMENDMENTS AND INTERPRETATIONS APPROVED BY THE EUROPEAN UNION BUT NOT YET MANDATORY APPLICABLE AND NOT EARLY ADOPTED BY THE GROUP AS AT 31 DECEMBER 2016*

The Group has not adopted the following new and amended standards, that have been issued but are not mandatory applicable.

- IFRS 15 – *Revenue from Contracts with Customers* (issued on 28 May 2014 and supplemented with additional clarifications on 12 April 2016) bound to replace IAS 18 – *Revenue* and IAS 11 – *Construction Contracts*, as well as the interpretations IFRIC 13 – *Customer Loyalty Programmes*, IFRIC 15 – *Agreements for the Construction of Real Estate*, IFRIC 18 – *Transfers of Assets from Customers* and SIC 31 – *Revenues-Barter Transactions Involving Advertising Services*. The standard provides for a new revenue recognition model, which will be applicable to all agreements made with customers, with the exception of those falling under the scope of application of other IFRSs, such as leases, insurance contracts and financial instruments. The main steps for revenue recognition according to the new model are:
  - identifying the agreement in place with the customer;
  - identifying the performance obligations under the agreement;
  - defining the transaction price;
  - price allocation to the performance obligations under the agreement;
  - revenue recognition criteria when the entity satisfies each performance obligation.

This standard is applicable as from 1 January 2018, though early adoption is allowed. The amendments to IFRS 15, *Clarifications to IFRS 15 – Revenue from Contracts with Customers*, published by IASB on 12 April 2016, have not yet been endorsed by the European Union. Directors expect that the adoption of IFRS 15 will have an impact on the revenue recognition and the relevant disclosure included in the Group’s Consolidated Financial Statements. Still, it will be impossible to provide a reasonable estimate as to the effects until the Group completes a detailed analysis of the agreements in place with the customers.

- Final version of IFRS 9 – *Financial instruments* (issued on 24 July 2014). The standard includes the results of IASB project pending the replacement of IAS 39:
  - it introduces new criteria to classify and measure financial assets and liabilities;
  - with reference to the impairment model, the new standard requires the losses on receivables to be estimated based on the expected losses model (instead of the incurred losses model of IAS 39) using information that can be evidenced, available free of charge or without unreasonable effort and including historic, current and forecast data;
  - a new hedge accounting model is introduced (additional types of transactions can be designated for hedge accounting, different accounting method for forward contracts and options when they are included in a hedge accounting transaction, changes to effectiveness test).

The new standard must be applied to reporting period beginning on 1 January 2018 and thereafter.

Directors expect IFRS 9 to have an impact on the balances and the relevant disclosures in the Consolidated Financial Statements of the Group. Still, it will be impossible to provide a reasonable estimate as to the effects until the Group completes a detailed analysis.

*IFRS ACCOUNTING STANDARDS, AMENDMENTS AND INTERPRETATIONS NOT YET ENDORSED BY THE EUROPEAN UNION*

The European Union has not yet completed its endorsement process for the standards and amendments below reported at the date of these Financial Statements.

- IFRS 16 – *Leases* (issued on 13 January 2016) is to replace IAS 17 – *Leases*, as well as IFRIC 4 *Determining whether an Arrangement contains a Lease*, SIC-15 *Operating Leases—Incentives* and SIC-27 *Evaluating the Substance of Transactions Involving the Legal Form of a Lease*.

The new standard provides a new definition of lease and introduces a criterion based on the control (right of use) of an asset to differentiate between lease and service agreements according to: asset identification, right to replacement of the asset, right to obtain all economic benefits arising out of use of the asset and right to control the use of the asset underlying the agreement.

The standard introduces a single lessee accounting model for recognising and measuring lease agreements, which provides for the underlying asset – including assets underlying operating leases – to be recognised in the statement of financial position as assets and lease financial liability. Lessees may elect to not recognise agreements for low-value assets or with a term of up to 12 within the scope of this standard. No significant changes are introduced for lessor accounting.

The standard applies for reporting period beginning on or after 1 January 2019. Early application is only allowed for early adopters of IFRS 15 – *Revenue from Contracts with Customers*. Directors expect that the adoption of IFRS 16 will have a significant impact on lease accounting and the relevant disclosures included in the Group’s Consolidated Financial Statements. Still, it will be impossible to provide a reasonable estimate as to the effects until the Group completes a detailed analysis of the relevant agreements.

- Amendment to IAS 12 “*Recognition of Deferred Tax Assets for Unrealised Losses*” (published on 19 January 2016). This document provides clarifications on the recognition of deferred tax assets for unrealised losses under certain circumstances and on the estimation of taxable income for future periods. The amendments apply as from 1 January 2017, though early adoption is allowed. The Directors are evaluating the possible effects of applying these amendments to the Group’s Consolidated Financial Statements.
- Amendments to IAS 7 “*Disclosure Initiative*” issued on 29 January 2016. The document provides some clarifications to improve information on financial liabilities. Specifically, the amendments require such disclosures as to allow the recipients of the financial statements to understand changes in liabilities generated by financing operations. The amendments apply as from 1 January 2017, though early adoption is allowed. They do not require a presentation of comparative information relating to previous years. The Directors are evaluating the possible effects of applying these amendments to the Group’s Consolidated Financial Statements.

- Amendments to IFRS 2 “*Classification and measurement of share-based payment transactions*” (issued on 20 June 2016). This document provides clarifications on how to account for the effects of vesting conditions in cash-settled share-based payments, how to classify share-based payments that include net settlement features and how to account for changes to the terms and conditions of a share-based payment that turn cash-settled share-based payment to equity-settled share-based payment. The amendments apply as from 1 January 2018, though early adoption is allowed. The Directors are evaluating the possible effects of applying these amendments to the Group’s Consolidated Financial Statements.
- Document “*Annual Improvements to IFRSs: 2014-2016 Cycle*”, issued on 8 December 2016 (including IFRS 1 *First-Time Adoption of International Financial Reporting Standards - Deletion of short-term exemptions for first-time adopters*, IAS 28 *Investments in Associates and Joint Ventures – Measuring investees at fair value through profit or loss: an investment-by-investment choice or a consistent policy choice*, IFRS 12 *Disclosure of Interests in Other Entities – Clarification of the scope of the Standard*) partially supplements existing standards. Directors do not expect any significant effect on the consolidated financial statements of the Group when these amendments are adopted.
- IFRIC 22 “*Foreign Currency Transactions and Advance Consideration*” (issued on 8 December 2016). This interpretation provides guidelines on foreign currency transactions when non-monetary advance consideration paid or received is recognised before recognition of the relating asset, expense or income. This document clarifies how an entity has to determine the date of the transaction and consequently the spot exchange rate to be used for foreign currency transactions whose consideration is paid or received in advance. IFRIC 22 applies as from 1 January 2018, though early adoption is allowed. Directors do not expect any significant effect on the consolidated financial statements of the Group when these amendments are adopted.
- Amendments to IAS 40 “*Transfers of Investment Property*” (issued on 8 December 2016). These amendments provide clarifications on the transfer of properties to, or from, investment properties. Specifically, an entity should only reclassify a property asset to or from investment property when there is evidence of a change in use of that asset. Such change in use must be supported by a specific event occurred in the past. A change in intention by the entity’s management alone is not sufficient. These amendments apply as from 1 January 2018, though early adoption is allowed. Directors do not expect any significant effect on the consolidated financial statements of the Group when these amendments are adopted.
- Amendments to IFRS 10 and IAS 28 “*Sales or Contribution of Assets between an Investor and its Associate or Joint Venture*” (issued on 11 September 2014). The purpose of these amendments was to resolve the conflict between IAS 28 and IFRS 10 concerning the measurement of profit or loss arising from transfers or assignments of a non-monetary asset to a joint venture or associate in return for its shares. The IASB has suspended the application of these amendments for the time being.