

MANAGEMENT OF THE MAIN BUSINESS RISKS

In line with international best practice, the Group has initiated a structured, formal “ERM - Enterprise Risk Management” process that involves the joint efforts of management across all operations worldwide under the coordination of the Group's Chief Risk Officer.

Management at worldwide operations will identify and assess both potential and residual risks based on a specific risk model associated with the Group's strategic goals as well as define risk mitigation strategies.

More specifically, the Chief Risk Officer is to first prioritise risk areas within the risk model based on the Group's strategic goals and guidelines (key value drivers) (such as raw materials/commodities, economic situation, exchange rates, technology innovation, customer portfolio balancing, competitor monitoring, etc.), and define reference economic-financial parameters to measure risks and their impact (impact on revenues, EBIT, etc.) where applicable. Managers at a business unit and local level are then required to validate/supplement exposure findings in the identified priority risk areas and submit risk mitigation plans to help complete the overall Sogefi Group ERM Report. This method ensures that the following elements are in place and kept constantly up to date:

- target levels of exposure to priority risks;
- risk management strategies in line with existing risk attitude (transfer, reduce, eliminate, mitigate risk);
- action plans and management approaches to keep exposure levels within target limits.

The findings of the Sogefi Group ERM Report are also used to define the Internal Audit Action Plan adopting a risk-based approach, in line with international best practice. In detail, the Internal Audit Action Plan is defined yearly based directly on the findings of the assessments made as part of the Enterprise Risk Management process, and focusing on highest-risk areas identified by the ERM assessments.

For more details of the risk assessment method and the tasks and functions of the corporate Control and Risk System please read the “Code of Conduct of Sogefi S.p.A.” attached to the “Annual Report on Corporate Governance” for the year 2016 available at www.sogefigroup.com.

The following section looks at the main risks and uncertainties that the Group is potentially exposed to in the achievement of its business objectives/operations, together with a description of the ways in which said risks are managed.

To facilitate comprehension, risk factors have been grouped on the basis of their origin into homogeneous risk categories, with distinction between those that arise outside the Group (**external risks**) and those associated with the characteristics and structure of the organisation itself (**internal risks**).

In terms of **external risks**, first of all, the Group adopts a centralised management approach (at Group level or at business unit level) to **financial risk** (which includes

risks of changes in interest rates and exchange rates, risks of changes in raw materials prices, credit risk and liquidity risk), described in further detail in the *Explanatory and Supplementary Notes to the Consolidated Financial Statements* which should be referred to¹.

With regard to **risks relating to competitors**, the Group is one of the leading players in the suspension components, filtration and Air&Cooling sectors at a worldwide level, and benefits from a progressive consolidation of the market and the resulting gradual reduction in the number of competitors.

With regard to the Suspensions sector, the Group benefits from objective barriers to the entry of new competitors, as this sector is structurally capital intensive and a wide technological and qualitative gap puts manufacturers in low-cost countries at a disadvantage. Similarly, the technological and qualitative gap represents a barrier to the entry of new competitors in the original equipment air intake and cooling sectors as well, while in the spare part sector, important barriers to entry are represented by the Group's exhaustive product range and by the lack of notoriety of the brands of manufacturers in *low-cost* countries.

As regards the **risks associated with customer management**, as well as the management of **credit risk** already mentioned within **financial risk**, the Group manages the **risk of the concentration of demand** by appropriately diversifying its customer portfolio, both from a geographic perspective and in terms of distribution channel (the major world manufacturers of cars and industrial vehicles in the original equipment market and leading international customers in the spare parts market).

Over the last few years, the Group has significantly reduced **credit risk** in the independent *aftermarket* (IAM), whereas the credit risk in original equipment (OEM) and original equipment spares (OES) markets is limited because these customers are world-leading auto makers and industrial vehicle manufacturers.

As regards the **risks associated with supplier management**, increased focus on multi-sourcing, especially from non-European suppliers and the ongoing search for alternate suppliers, helps to reduce the **risk of being excessively dependent on key suppliers/single suppliers**.

It should be noted that this multi-sourcing approach, i.e. sourcing each raw material from multiple suppliers based in different world countries helps to reduce the **risk of changes in raw materials prices** mentioned earlier when discussing the management of **financial risk**.

The Group places particular attention on the management of **country risk**, given the considerable geographic diversification of its business activities at world level.

In terms of the **risks associated with technological innovation**, the Group constantly seeks to innovate products and production processes.

Specifically, the Group's pipeline includes certain product/process innovations that are

¹ For a detailed description of the centralised management of financial risk adopted by the Group, please see the "Explanatory and Supplementary Notes to the Consolidated Financial Statements", Chap. E, Note no. 39.

not available to key competitors, such as new elastic suspension components made from composite materials, a new oil cooling technology that uses aluminium foam and an innovative particulate emission control system.

With regard to the **risks related to health, safety and the environment**, each subsidiary has its own internal function that manages HSE in accordance with local laws and in accordance with Sogefi Group's guidelines. More specifically, the Parent Company Sogefi S.p.A. has approved an Environmental Policy for Health and Safety, which sets out the principles that all operations of subsidiaries should observe for the organisation of the HSE management system. Special emphasis is placed on monitoring the risk of accidents, which is a pillar of the plant operating approach "Kaizen Way" adopted at all production sites across the world and coordinated by a dedicated central management team at Group level.

In correlation with the environmental policy, 18 plants in the Suspensions business unit, 12 in the Filtration business unit and 8 in the Air&Cooling business unit are currently certified as complying with the international standard ISO 14001. With regard to OHSAS 18001, 2 plants in the Filtration business unit, 2 in the Air&Cooling business unit and 1 in the Suspensions business unit have had their health and safety systems certified to this standard.

The Company also took additional environmental mitigation measures in order to reduce energy consumption especially in production processes and at the same increase the use of renewable energy. In addition, the Company launched a programme to reduce the release of gas emissions into the environment, increase material recycling and reuse so as to dramatically reduce waste production (especially in those countries where the Group expect volumes to grow significantly) and – last but not least – to improve deputation plants so as to better treat liquid waste before releasing them into the environment and the sewage system.

Noteworthy are also the Group's measures aimed at enhancing logistics efficiency and significantly reducing environmental impact (for instance, less special transport operations, increased use of returnable containers, standardised pallet sizes, use of warehouses closer to production plants of customers, etc.).

The activities carried out in the plants are monitored by both experienced internal auditors and external auditors. Particular attention is paid to personnel training in order to consolidate and disseminate a safety culture.

As regards **internal risks**, namely risks mostly connected with internal activities and with the characteristics of the organisation itself, one of the major risks identified, monitored and actively managed by the Group is the **risk of product quality/complaints due to non conformity**: in this regard, it is worth drawing attention to the fact that the Sogefi Group considers ongoing quality improvement as a fundamental objective to meet customers' needs. The same focus on quality is placed on the supplier selection and approval process, as well as in the on-going quality control of supplies used in the manufacturing process (raw materials, semi-finished products, etc.), in order to prevent non-conformities in Group products partly or totally due to defective supplies. In correlation with the Group's quality policy, 20 plants in the Suspensions business unit, 15 in the Filtration business unit and 9 in the Air&Cooling business unit are currently certified as complying with the international standard ISO TS 16949. Some plants' systems are certified according to business specifications. Unforeseeable risk is

adequately covered by insurance, as regards both third party product liability and the potential launch of product recall campaigns.

With regard to the **risks associated with adequacy of managerial support (e.g. the effectiveness/efficiency of Group monitoring and reporting, of internal information flows etc.)**, information can be found in the “Annual Report on Corporate Governance”.

In terms of the set of **risks associated with human resource management**, the Group acknowledges the key role played by its human resources and the importance of maintaining clear relationships based on mutual loyalty and trust, as well as on the observance of conduct dictated by its Code of Ethics.

Working relationships are managed and coordinated in full respect of workers’ right and in full acknowledgement of their contribution, with a view to encouraging development and professional growth. Established selection processes, career paths, and incentive schemes are the tools used to make the most of human resources. The Group also uses a system of annual performance appraisals based on a clear definition of shared objectives, which can be measured in numerical, economic, financial, qualitative and individual terms. A variable bonus is paid depending on the degree to which said objectives are achieved. As regards medium-long term incentive schemes, again in 2016 a stock grant plan has been allocated to top management positions.

Lastly, with regard to the risks associated to the management of Information Systems, the Group manages the risks linked to the potential incompleteness/inadequacy of IT infrastructure and the risks related to the physical and logical safety of systems in terms of the protection of confidential data and information by means of specific units at group level. However, the Group places special emphasis on cyber risks, such as online fraud attempts e theft of sensitive data and/or information protected under privacy law. In order to minimise these risks, suitable technical and operational measures are being implemented and/or upgraded to prevent unauthorised fraudulent access to the different information systems of the Group by third parties, preventing financial losses and loss of sensitive data.