

Letter from the Chairman

Dear Shareholders

Looking at our business in 2016, I am pleased to report that despite the difficult market environment, we laid a strong foundation to build the future of the company around our well-performing surface solutions business. While underperforming key markets such as China and parts of Europe as well as unexpected geopolitical and macroeconomic events like the UK's vote to leave the European Union or the US presidential elections created uncertainties that impacted the global economy, financial markets and our end markets, we were able to win important new projects and customers in all Segments. We could even improve our market-leading positions in some fields and took key steps to diversify our business into growth markets. We also made good progress with the repositioning and restructuring of our drive systems business and managed the Manmade Fibers Segment well during the significant market down cycle.

In March 2016, Dr. Roland Fischer, an experienced industry leader with broad expertise in the energy, aviation and aerospace sectors, was appointed CEO. Once on board, Roland undertook a series of initiatives to create a more customer- and market-oriented company, as well as measures to facilitate efficiency improvements. Specifically, the Group headquarters and Surface Solutions Segment's functions were merged. Recognizing the importance of motivated employees and highly-qualified specialists and teams, the HR department has been strengthened and realigned in order to win and retain the best professionals for Oerlikon. Anna Ryzhova was appointed Chief Human Resources Officer and a member of the Executive Committee. She is creating a more knowledge-based culture in which new and entrepreneurial ideas can be born and decisions can be taken quickly.

Intelligently engineering and processing surfaces and materials

With our strategy focusing on advanced materials and surface solutions, we address major societal and industrial trends. We are building Oerlikon's future on our ability to create value for customers by combining advanced materials science with functional surface technologies, built upon our comprehensive competence in the engineering and processing of materials and surfaces.

The acquisition of Metco in 2014 was a perfect match, making us a leader in technologies used to improve surface properties. A key step for us was the creation of the foundation to focus the company around our unique technological competencies. The joint power of Oerlikon Balzers, with its leading thin-film coating expertise, and Oerlikon Metco, with its extensive know-how in materials, thermal spray and other technologies, puts us in a distinct position of strength.

Today, we are able to offer an exceptionally broad and versatile portfolio of coating technologies, materials, equipment and services with a global footprint of more than 145 service and production centers. With Oerlikon Balzers, we hold a market-leading position in coating services and equipment and served in



2016 more than 30 000 customers from the automotive and general industrial markets. Oerlikon Metco is one of the largest players in thermal spray equipment and materials and has a firmly anchored position in the aerospace and industrial gas turbine markets, offering coating materials, services and components. Our strength lies in our deep understanding of our technologies, customer needs and markets and in creating solutions that support customers in the development of more effective and sustainable components and products. Surface solutions and advanced materials remain the key enablers for productivity gains, energy efficiency and lightweight solutions in many industries and for a broad range of applications.

Promising perspectives

The Segment's good results in 2016 confirm the value of the business and that we are moving in the right direction. In fact, in certain areas such as tooling, we are outperforming our peers and gaining market share. Today, many companies are not yet using our technologies. We see opportunities to expand our coating services for precision components used in all industries and for specialized applications in aerospace, turbines and medical fields.

We have, over the years, built up strong relationships with many key manufacturers in the aerospace, energy, automotive and tooling industries. By intensifying our relationships with customers, also in the R&D area, we see potential for developing coating technologies for applications that have not been coated so far, or that offer new functionalities. We also see attractive opportunities where we can easily transfer our expertise and technologies into other sectors and fields.

A promising new business area worth highlighting is additive manufacturing. Today, additive manufacturing technology is at a major inflection point in industrialization. The market is growing rapidly with an expected compound annual growth rate of approximately 40 % over the next five years. Additive manufacturing allows industrial components to be developed in new forms, new materials and with less material. It can also alter the economics of production, resulting in companies saving significantly on the cost of the part and retooling, and in short-

er production lead times, thereby increasing competitiveness. This is particularly interesting for companies in the tooling, aerospace, automotive or medical sectors, as it opens up new perspectives to improve productivity. We are building our business model in additive manufacturing as a service to all industrial companies.

In 2016, we made our first organic and inorganic investments in this field. There will be costs incurred initially with investments, but these investments are essential for the start-up phase and for building up the new business in order to benefit from returns in the medium term. In the metal-based additive manufacturing market, estimated to reach almost CHF 2 billion by 2021, the Group plans to invest a total of around CHF 300 million to develop this business and targets to achieve around CHF 300 million in sales per year within the five-year period.

Sustaining market leadership despite down cycle

We also hold unique technology expertise and strong market positions in the processing of polymer materials. Our Manmade Fibers Segment is a world market leader for systems used in processing filaments, bulked continuous filaments (BCF – carpet yarn), staple fibers and polymer materials. We are the only company with the know-how to offer a complete manmade fiber spinning system from a single source – from melt to yarn, fibers and nonwovens. Our equipment enables customers to benefit from low operating costs and a reduced energy-consumption and equipment footprint.

Despite the fact that the filaments equipment market has been undergoing a sharp cyclical downturn, the Segment has strong structural fundamentals and attractive prospects. Our market-leading technologies form the basis for almost all manmade fibers textiles made and used in growth markets such as apparel, energy, food, functional wear, infrastructure and transportation. The yarns and fibers produced by our systems are applied broadly – in filters, automobile tires, safety belts, airbags, roofing membranes, safety equipment, protective clothing and conveyor belts, as well as in geotextiles, medical textiles and much more.

In the years 2012 to 2014, boosted by significant investments in manmade fibers equipment in China, the Segment achieved peaks in sales of over a billion Swiss francs and strong profitability that contributed substantially to the Group's performance. The overinvestments in the market led to overcapacities, which triggered the start of a down cycle in 2015 that was made even more serious and noticeable due to China's economic slowdown. This resulted in the Segment's sales falling by almost 40% in 2016. The decisive measures taken by the Segment to reduce its breakeven point and protect profitability have resulted in the EBITDA margin remaining positive in 2016. This is especially notable when viewed against the near 40% reduction in sales and a noteworthy achievement of the management. At the same time, the Segment has invested in maintaining its innovation and capabilities, and is well positioned to benefit when the market recovers.

Challenging environment as innovation driver

Looking ahead, China will remain the Manmade Fibers Segment's key market since most of our key customers for filaments

equipment are located in this country. Toward the end of 2016, we noted that shelved projects are starting to be revived, indicating that the bottom of the cycle was reached in 2016. A second important market for manmade fibers is India. In 2016, the Indian textile market appeared to be ramping up on higher-quality equipment in its move to gain a share of the export market. We saw a first round of investments there in 2016 and were able to secure approximately 80% of all orders for filament spinning lines. We expect to see an improvement in 2017 for our filaments equipment business, in terms of both sales and operating profitability. However, at the moment, the overall market for filaments equipment remains challenging with limited projects, and is highly price-competitive. This will impact the profitability of the Segment in 2017, and margins are only expected to see an improvement over the medium term.

We will use the gradual market recovery in Asia to further build our market share, increase our installed customer base to favorably position ourselves for potential follow-up projects, and increase the share of recurring service business generated from the installed systems. In parallel, we have accelerated our diversification and are building up businesses outside the China-led filaments equipment market. We also see additional opportunities in special industrial applications such as fibers for reinforcing concrete, cement and plastics that can be used in the automotive, aerospace, construction and marine sectors.

Good progress in reshaping drive systems business

The Drive Systems Segment continued to face challenging market conditions in most of its end markets. Equipment investments were sluggish in the agriculture, construction, transportation and oil & gas sectors, although there were initial indications that the trough in the oil & gas sector is reached and that the start of a slow recovery could be expected. In spite of the tough market climate, the Segment won new projects and customers, and made good progress in repositioning and restructuring.

Alongside reducing costs, we invested in productivity-enhancing initiatives such as implementing the harmonized quality systems, standardizing key procedures and improving technology competences. The progress is clearly visible, and our initiatives to strengthen and realign our capabilities and resources with market opportunities will continue in 2017 and help to drive profitability and further improve the business outlook. We will therefore continue our efforts and invest to establish a robust business foundation for the Drive Systems Segment in order to reposition it for future opportunities.

With the measures already taken, the prospects for the Drive Systems Segment are improving. Going forward, we are using our market leadership position and our core competence to successfully expand into adjacent industries such as commercial trucks and high-volume automotive applications, and have already achieved major new business wins in these areas in 2016.

Our unique understanding of and manufacturing capabilities for performance gears and bevel gear sets for power transfer units

(PTUs) and differentials have allowed us to successfully extend our product applications into commercial and especially into electric vehicles. Recent technology innovations include planetary drives with integrated electric and hydraulic motors as well as dynamic brakes. These integrated systems provide a more compact and lower-weight package while delivering enhanced performance, functionality and safety. The latest development, an integrated compact electric drive solution for compact construction machines, features an integrated new electric motor design that is up to 70% smaller and lighter yet 20% more efficient than traditional solutions.

In the area of hybrids and e-drives, the Drive Systems Segment has steadily established itself as an innovator. For hybrid applications, we have developed a concept both for performance cars and compact, front-wheel drive, high-volume production cars, combining the efficiency and low cost of automated manual transmissions with the smooth driving experience of an automatic while reducing fuel consumption by up to 20%. In addition, we have established partnerships in 2016 with electric motor manufacturers to provide electric drive solutions for on- and off-highway applications.

A cautiously optimistic outlook

Since political and economic uncertainties, compressing market cycles and market volatility are likely to remain, the ability to adapt and change will be a constant theme in the coming years. At the same time, change will also be driven by the expanding demand for energy, mobility and infrastructure, fueling the need for industrial manufacturers to become more energy efficient, minimize the use of scarce resources and improve environmental sustainability.

Technological change driven by digitalization is recognized as the accelerator of long-term growth. Accordingly, the successful digitalization of our business is a key prerequisite for staying competitive. The respective transformation of the company has already started. It represents the biggest challenge we are facing in the years to come as innovative production and service solutions and improved productivity is unthinkable without the benefit offered by digitally designed, developed, managed and controlled processes. With a digital initiative involving additional investments and resources, we will ensure that Oerlikon stays at the forefront as one of the technologically-leading global companies, also during times of fundamental industrial changes.

In this context, we will be cultivating a stronger innovation culture that encourages the development of new ideas and successful product launches. We have a robust set-up and a strong balance sheet that allows us to invest in the transformation, both organically and inorganically. The upside potential as we execute our strategy will become more visible with each step we take, and bring us closer to become a powerhouse in surface solutions and advanced materials. The result will be a profitable, attractive and sustainable company with a competitive business model and clear differentiation.

In 2016, our share price developed positively, outperforming Swiss and industrial indices. Our objective with our new strategy

is to create long-term value for our shareholders and a sustainable dividend policy. Reflecting the strength of our balance sheet and development of the company, the Board of Directors will be proposing at the upcoming Annual General Meeting of Shareholders (AGM) a dividend payout of CHF 0.30 per share, that is maintaining the same payout as in the previous year.

Progress is only possible through hard-working and dedicated people. I would like to take this opportunity to thank all employees at Oerlikon, the management team and my colleagues on the Board for their valuable support, hard work and commitment. I would also like to thank Hans Ziegler, who resigned in 2016 as a Board member, for his contributions over the past years. At the same time, I would like to express my gratitude to all of our customers, who continued to invest and have confidence in our technologies.

Last but not least, I would like to thank you, our shareholders and investors, for the trust that you place in Oerlikon, in our strategy and in supporting us as we execute the strategy and work to ensure that Oerlikon reaches its fullest potential.

February 28, 2017

Best regards



Prof. Dr. Michael Süss
Chairman of the Board of Directors