# 1. Trends in Schneider Electric's core markets

## 1.1 Industries and machine manufacturers

Market has rebounded during the last quarter of 2016 following a stabilization in Q3 after eight straight quarters of decline.

This improvement has been mainly driven by continuing recovery in China's capex and a rebound in raw material prices (Oil & metals).

Improvement in prices has led to:

- increasing income in Oil & mining-producing countries (supportive for all of our end-markets);
- increasing spending in opex, maintenance and sometimes brownfield capex in O&G upstream and Mining sector.

This backdrop has produced positive spillovers: sectors which export to China and supply equipment to O&G and Mining have revised upwards their own opex & capex plans.

China's recovery has supported the growth of trading partners (as East Asia), and the OEM (Original Equipment Manufacture) global market.

## 1.2 Non residential and residential buildings

### Non residential buildings

Non residential market was mixed in 2016 with China being the bright spot.

In the US, market slowed-down in 2016. Manufacturing buildings declined as the chemical and transportation equipment sectors contracted after several years of very strong growth. Conversely, construction in commercial, retail and educational segments accelerated.

In Western Europe, non residential construction improved slightly from a low base. Manufacturing and office buildings continued to recover in 2016, whereas commercial segment recorded a positive growth, thereby ending the continuous decline since 2008. Institutional building segments expanded marginally, hampered by a decline in the healthcare segment. In 2016, non residential construction turned positive in Germany and France.

In China, non residential construction grew strongly, mainly thanks to public buildings. This segment was helped by greater government pressure to support growth and improved funding conditions at the local government level. Office and commercial buildings were flat, hampered by over-supply and the rapid development of e-commerce.

In India, the market continued to grow, helped by accommodative government policies and positive business climate.

In Brazil, 2016 was another year of contraction.

In the Middle-East, the market declined. In Saudi Arabia, lower revenues from the oil industry led to a drop in Government spending and liquidity shortage, with Public companies delaying payments to contractors.

### Residential

Residential market growth accelerated in 2016, with varied positions among major regional blocks.

In the US, growth decelerated due to slowing demand in the single-family segment.

In Western Europe, growth gained momentum in 2016, driven by low interest rates that led to higher demand. France turned positive after three years of decline. Strong growth in Germany was driven by high job growth and ever lower unemployment rates. Growth accelerated slightly in Spain but slowed-down in the UK.

In China, residential construction recovered from beginning of 2016 after 2 consecutive years of decline. The recovery in property sector has been triggered by an accommodative monetary environment. Excess liquidity and easy credit led to a surge in residential sales. It has materially reduced inventory levels across most regions, except the North, which has pushed developers to increase housing starts.

## 1.3 Utilities and Infrastructures

### Electrical Utilities

In Western Europe, utilities' capex growth was driven by renewable equipment.

In the US, utilities' capex growth slowed-down in Distribution as well as in Transmission.

In Emerging countries, volatility in economic conditions and commodity and energy prices led to delay some investment decisions. However, the situation has improved at year-end.

The global utility market is continuously foreseen to grow over the years, but considerable changes are already appearing as a consequence of COP21 and COP22, in the "3D" context of Decarbonization, Decentralization, and Digitization, with an ever increasing adoption of Renewable Energy. The majority of power generation investment has been redirected to renewable energy, involving traditional utility investors as well as private investors (IPP), and more recently Oil&Gas companies, and even down to community or consumer level through a prosumer household, smart district & building development. Energy Efficiency is also driving substantial investment, and having a negative impact of the power consumption growth trends.

In this context of energy transition, grid operator's mission is to ensure that the appropriate network reliability, stability & power quality is evolving towards new missions and the implementation of new technologies. Regulatory practices are being redefined to allow more software-based smart grid investment as opposed to conventional hardware investment.

### Oil & Gas

The oil barrel price bottomed below 30 US dollars (Brent) in January 2016, but had almost doubled by early 2017.

Hopes for an OPEC production curtailment agreement have generated several increases over the year, each time challenged by high levels of stocks, non-conventional oil production in the US, increasing production & exports by Iraq and Iran, etc.

Recent OPEC decisions are now impacting the barrel price step by step, but implementation details are still to be settled. Non-conventional oil production is becoming more and more cost effective with break-even costs almost half of the pre-crisis levels. The ability to rapidly switch on and off production will keep the oil price low – as soon as the price goes up, more production will be added.

Improvement in oil price has led to a recovery in spending in opex, maintenance and sometimes brownfield capex during the last quarter of 2016. Capex in large projects has continued to decline over the year.

## 1.4 Data centers and Networks

The global IT market experienced nearly flat growth in 2016 due to political uncertainty in global markets, as well as international trade, energy and foreign exchange volatility, which has fostered a wait-and-see approach causing some enterprises to delay IT investments.

In 2016, a number of major technology trends converged including cloud computing, mobile edge analytics, digital business and artificial intelligence. In response, Large Enterprises continued to deploy IT in a hybrid environment of on-premise, colocation, hosting and cloud.

In particular, aggressive build-out of cloud computing platforms by internet giants was a key driver of significant growth at both hyperscale sites and regional data centers. Schneider Electric is leveraging its global presence and comprehensive data center solutions to accommodate our customer needs wherever they decide to locate their IT infrastructure.

As internet use is trending towards bandwidth-intensive content such as augmented reality, video on demand, and social media, and with the increasing adoption of the Internet of Things, computing power and storage is increasingly placed at the edge of the network closer to end users. The IT division is well positioned to drive faster growth by targeting various edge computing applications such as micro data center and modular data center offers, which provide our customers with fast deployment, flexibility and higher efficiency.

The data center three phase power and cooling infrastructure market continued to experience a shift from internal enterprise data centers to colocation & cloud. In this environment, overall growth was flat, with faster growth in megawatt applications, where Schneider is well positioned as a technology leader.

Industrial power and infrastructure customers streamlined their capital expenditure budgets, particularly in emerging markets, in line with the collapse of oil and commodity prices earlier in the year, which affected economies in Brazil, Russia, and the Middle East. However, with the stabilization of commodity prices, along with the continued moderate outlook for infrastructure investments in power generation, chemical production and semiconductors in North America and Europe, the outlook for 2017 is positive.

The worldwide IT services market showed strong growth, a trend which is expected to continue in 2017. Buyer investments in legacy IT equipment, and new digital software services, including intelligent automation, predictive analytics, and services optimization and innovation continue to reflect high demand. In this environment, we launched new digital platforms such as StruxureOn™, enabling protection of our customers' most critical equipment through smart alarming, remote troubleshooting and data-driven insights, delivered by experts monitoring connected data center assets 24/7 – providing visibility and live data directly to your smartphone.

# 2. Review of the consolidated financial statements

## 2.1 Review of business and consolidated statement of income

### Changes in the scope of consolidation

In 2016, the Group reconsidered the prevailing elements in the analysis of control over Delixi performed in 2014 following the transition to IFRS 10. Following this analysis, Delixi has been consolidated by the equity method as of January 1st, 2016 without restatement of comparative information in respect of the impacts considered nonmaterial.

### Acquisitions & divestments occurred during the year

On March 31, 2016, the disposal of the Transportation business (announced in 2015) was finalized with a final sale price established at EUR31 million.

No significant acquisitions occurred during 2016.

### Acquisitions & divestments occurred in 2015

On December 11, 2015, Schneider Electric announced that it had obtained all required regulatory approvals and subsequently finalized the sale of Juno Lighting, LLC ("Juno") to Acuity Brands, Inc. for a consideration of approximately USD385 million (EUR343 million). The transaction generated a capital loss of EUR163 million recorded as Other operating expense.

No significant acquisition occurred during 2015.

### Changes in foreign exchange rates

Changes in foreign exchange rates relative to the euro had a negative impact over the year. This effect amounts to negative EUR679 million on consolidated revenue and to negative EUR199 million Adjusted EBITA(1).

### Revenue

On December 31, 2016, the consolidated revenue of Schneider Electric totaled EUR24,693 million, a decrease of 7.3% at current scope and exchange rates compared to EUR26,640 million on December 31, 2015.

This variance breaks down into an organic decrease of -0.9%, an effect linked to the disposals of -3.9% and a negative exchange rate effect of -2.5%, primarily due to the appreciation of the British pound and the Chinese yuan against the euro.

Solutions represent 44% of the total revenue in 2016, versus 43% in 2015.

## 2.2 Changes in revenue by operating segment

**The Building business** generated revenues of EUR10,700 million, or 43% of the consolidated total. This represents a decrease of -9.8% on a reported basis, mainly due to the deconsolidation of Delixi (-5.5 pts), and an increase of **+0.3%** on a like-for-like basis, with growth in Wiring Devices & Final Distribution activities. North America was up. The US benefitted from successful new offer launches in a favorable construction market while the commercial & industrial buildings market was tepid. Mexico posted continued growth throughout the year. Western Europe was about flat, with mixed results. Spain and Italy grew on successful commercial initiatives while Germany declined. France was down despite growth in improving residential markets. The Nordics grew thanks to new product launches, while the UK was flat. Asia Pacific grew slightly, driven by strong growth in India, while Australia suffered from a high base of comparison. China posted slight growth thanks to successful commercial initiatives and improvement in Tier 1 and Tier 2 construction markets. Rest of the World declined, dragged down by the economic situation in the Middle East, while CIS and Africa posted growth. South America was about stable, as the decline in Brazil was offset by growth in the rest of the region.

*(1) Adjusted EBITA (Earnings Before Interest, Taxes, Amortization of Purchase Accounting Intangibles) is earnings EBITA before amortization and impairment of intangible assets from acquisitions, impairment of goodwill, other operating income and expenses and restructuring costs..*

**The Industry business** generated revenues of EUR5,485 million, or 22% of the consolidated total. This represents a decrease of -3.7% on a reported basis and a decrease of **-1.2%** on a like-for-like basis. Organic growth continued to be impacted by lower Oil & Gas prices. Western Europe was flat, with growth in Italy and Spain offsetting declines in France and the UK. North America continued to be weighed down by lower industrial investments and a strong US dollar, while the priority remains enhancing cross-selling through channel initiatives. Asia Pacific declined, suffering from weak industrial investment in China, despite good growth in India and Korea. Rest of the World was up, with mixed results, with Africa and CIS posting growth, offsetting declines in the Middle East and South America. Services were up for the year.

**The Infrastructure business** generated revenues of EUR4,919 million, or 20% of the consolidated total. This represents a decrease of -9.4% on a reported basis and a decrease of **-3.4%** on a like-for-like basis, driven by greater project selectivity. Excluding the impact of selectivity initiatives, the business was slightly up for the year. Western Europe grew, driven by growth in the UK, France, and Germany. North America was down, as lower O&G prices and a stronger dollar weighed on industrial investments in the US, and Canada continued to suffer from less resource-linked investment. Asia-Pacific declined. In China, growth from emerging market segments could not offset the weakness seen in traditional segments, while Australia suffered from lower investment in resources. Rest of the World was down due to weakness in the Middle-East, where persistently low O&G prices led to lower investment. Services continued to grow.

**The IT business** generated revenues of EUR3,589 million, or 15% of the consolidated total. This represents a decrease of -1.9% in a reported basis and a decrease of **-0.8%** on a like-for-like basis. Overall, the environment was mixed, with growing investment in some data center segments such as co-location, but lower IT spending in some regions. The US grew, driven by reinvigorated IT channels and strong services growth. Western Europe declined, due to Germany and the UK, in soft IT markets. Asia Pacific grew, driven by strong growth in India and East Asia, while Japan declined. Rest of the World was penalized by weakness in the Middle East and Africa. Services posted solid growth.

## 2.3 Gross profit

Gross profit decreased from EUR9,845 million for the year ended December 31, 2015 to EUR9,390 million for the year ended December 31, 2016, or -4.6%, mainly due to the perimeter impacts.

As a percentage of revenues, the gross margin increased to 38.0% in 2016 (*versus* 37.0% in 2015), thanks to productivity improvements and the selectivity of the projects.

## 2.4 Support Function Costs: research and development and selling, general and administrative expenses

Research and development expenses, excluding capitalized development costs and development costs reported as cost of sales, decreased by 5.3% from EUR565 million for the year ended December 31, 2015 to EUR535 million for the year ended December 31, 2016. As a percentage of revenues, the net cost of research and development remained stable at 2.2% of revenues for the year ended December 31, 2016 (2.1% for the year ended December 31, 2015).

Total research and development expenses, including capitalized development costs and development costs reported as cost of sales (see note 4 to the Consolidated Financial Statements) decreased by 2.8% from EUR1,272 million for the year ended December 31, 2015 to EUR1,236 million for the year ended December 31, 2016. As a percentage of revenues, total research and development expenses increased slightly at 5.0% for the year ended December 31, 2016 from 4.8% for the year ended December 31, 2015.

In 2016, the net effect of capitalized development costs and amortization of capitalized development costs amounted to EUR107 million on operating income *versus* EUR145 million in 2015.

Selling, general and administrative expenses decreased by 4.4% from EUR5,639 million for the year ended December 31, 2015 to EUR5,375 million for the year ended December 31, 2015. As a percentage of revenues, selling, general and administrative expenses increased from 21.2% in 2015 to 21.8% in 2016.

Combined total support function costs, that is, research and development expenses together with selling, general and administrative costs, totaled EUR5,910 million for the year ended December 31, 2016 compared to EUR6,204 million for the year ended December 31, 2015, a decrease of 4.7%. The support function costs to sales ratio increased from 23.3% for the year ended December 31, 2015 to 23.9% for the year ended December 31, 2016.

## 2.5 Other operating income and expenses

For the year ended December 31, 2016, other operating income and expenses amounted to a net loss of EUR63 million, mainly due the impairment of intangible assets (EUR87 million), costs linked to acquisitions from previous years and disposals in the period (EUR36 million), a EUR31 million gain on the curtailment of employee benefit plans in the US and in Switzerland, and provisions release following a transactional agreement.

For the year ended December 31, 2015, other operating income and expenses amounted to a net loss of EUR522 million, mainly due to net losses on sale of business (EUR223 million), notably on Juno divestment, and impairment of assets (EUR246 million), notably on Transportation business related to the expected divestment described above. Other main items included costs linked to acquisitions for EUR118 million (notably Invensys integration costs), and a EUR53 million gain on the curtailment of employee benefit plans in the UK and in France.

## 2.6 Restructuring costs

For the year ended December 31, 2016, restructuring costs amounted to EUR313 million compared to EUR318 million for the year ended December 31, 2015. This amount in restructuring costs is linked to the *Simplify* initiatives that were announced in early 2015 as part of the "Schneider is On" program.

## 2.7 EBITA and Adjusted EBITA

We define EBITA as earnings before interest, taxes and amortization of purchase accounting intangibles. EBITA comprises operating profit before amortization and impairment of purchase accounting intangible assets and before goodwill impairment.

We define adjusted EBITA as EBITA before restructuring costs and before other operating income and expenses, which includes acquisition, integration and separation costs.

Adjusted EBITA amounted to EUR3,480 million for the year ended December 31, 2016, compared to EUR3,641 million for the year ended December 31, 2015, representing a decrease of 4.4%, mainly due to the perimeter effects. As a percentage of revenue, adjusted EBITA increased from 13.7% for the year ended December 31, 2015 to 14.1% for the year ended December 31, 2016.

EBITA increased by 10.8% from EUR2,801 million for the year ended December 31, 2015 to EUR3,104 million for the year ended December 31, 2016, mainly linked to net losses on sales of business, impairment of assets and higher restructuring expenses in 2015. As a percentage of revenue, EBITA increased to 12.6% in 2016 compared with 10.5% in 2015.

## 2.8 EBITA and Adjusted EBITA by business segment

The following table sets out EBITA and adjusted EBITA by business segment:

**Full year 2016**

| *(in millions of euros)* | ***Buildings*** | ***Industry*** | ***Infrastructure*** | ***IT*** | **Corporate costs** | **Total** |
|---|---|---|---|---|---|---|
| Revenue | 10,700 | 5,485 | 4,919 | 3,589 | - | 24,693 |
| Adjusted EBITA* | 2,099 | 918 | 477 | 604 | (618) | 3,480 |
| Adjusted EBITA% | 19.6% | 16.7% | 9.7% | 16.8% | - | 14.1% |

* *Adjusted EBITA: EBITA before restructuring costs and before other operating income and expenses (including acquisition, integration and separation costs).*

**Full year 2015**

| *(in millions of euros)* | ***Buildings*** | ***Industry*** | ***Infrastructure*** | ***IT*** | **Corporate costs** | **Total** |
|---|---|---|---|---|---|---|
| Revenue | 11,859 | 5,696 | 5,428 | 3,657 | - | 26,640 |
| Adjusted EBITA* | 2,132 | 975 | 495 | 644 | (605) | 3,641 |
| Adjusted EBITA% | 18.0% | 17.1% | 9.1% | 17.6% | - | 13.7% |

* *Adjusted EBITA: EBITA before restructuring costs and before other operating income and expenses (including acquisition, integration and separation costs).*

**Buildings business** recorded an adjusted EBITA margin of 19.6% for the year ended December 31, 2016, up 1.6 pts compared to 18.0% for the year ended December 31, 2015, thanks to better support function cost control, and sales organic growth.

**Industry business** recorded an adjusted EBITA margin of 16.7% for the year ended December 31, 2016, down 0.4 pts compared to 17.1% for the year ended December 31, 2015, penalized by the decline in the investments and Oil & Gas low price.

**Infrastructure business** recorded an adjusted EBITA margin of 9.7% for the year ended December 31, 2016, up 0.6 pts compared to 9.1% for the year ended December 31, 2015, benefiting from the selectivity of projects.

**IT business** reported an adjusted EBITA margin of 16.8% for the year ended December 31, 2016, down 0.8 pts compared with 17.6% margin for the year ended December 31, 2015, penalized by a negative mix and sales decrease.

Corporate costs amounted to EUR618 million for the year ended December 31, 2016 or 2.5% of Group revenues, a slight increase compared to the year ended December 31, 2015 (2.3% of Group revenues or EUR605 million).

## 2.9 Operating income (EBIT)

Operating income (EBIT) increased from EUR2,229 million for the year ended December 31, 2015 to 2,951 million for the year ended December 31, 2016. This 32.4% increase is explained by both the EBITA improvement and by an impairment of Pelco trademark amounting to EUR295 million in "Amortization and impairment of purchase accounting intangibles", booked in 2015.

## 2.10 Net financial income/loss

Net financial loss amounted to EUR462 million for the year ended December 31, 2016, compared to EUR446 million for the year ended December 31, 2015. The increase in the net financial loss is mainly explained by the losses generated by the foreign exchange increasing by EUR35 million, not compensated by a decrease in the cost of net financial debt from EUR295 million for year ended December 31, 2015 to EUR272 million for the year ended December 31, 2016.

## 2.11 Tax

The effective tax rate was 28.6% for the year ended December 31, 2016, an increase compared to 21.8% for the year ended December 31, 2015. The corresponding tax expense increased from EUR389 million for the year ended December 31, 2015 to EUR712 million for the year ended December 31, 2016. The tax expense included in 2015 a EUR115 million deferred tax income related to the impairment of Pelco trademark.

Furthermore, the planned reduction in the corporate income tax rate in France from 34.43% to 28.92% following the passing of the Finance Bill 2017 (“Loi de finances 2017”) led to a negative adjustment in the P&L at the end of 2016 for EUR(119) million. This is to account for the adjustment downward of the net deferred tax assets corresponding mainly to past tax losses in France.

## 2.12 Share of profit/(losses) of associates

The share of profit of associates decreased from EUR109 million for the year ended December 31, 2015 to EUR34 million for the year ended December 31, 2016 mainly due to a non recurrent gain realized on the sale of assets reported by CST in 2015.

## 2.13 Non-controlling interests

Non-controlling interests in net income for the year ended December 31, 2016 totaled EUR61 million, compared to EUR96 million for the year ended December 31, 2015. This represented the share in net income attributable, in large part, to the non-controlling interests of certain Chinese companies. The decrease is mainly linked to the decision to consolidate Delixi by the equity method as described in note 2.1.

## 2.14 Profit for the period

Profit for the period attributable to the equity holders of the parent company amounted to EUR1,750 million for the year ended December 31, 2016, that is, a 24.4% increase over the EUR1,407 million profit for the year ended December 31, 2015, mainly due to the improvement in EBITA described in note 2.9.

## 2.15 Earnings per share

Earnings per share increased from EUR2.47 for the year ended December 31, 2015 to EUR3.12 for the year ended December 31, 2016.

## 2.16 Consolidated cash-flow

### Operating Activities

Net cash provided by operating activities before changes in operating assets and liabilities amounted to EUR2,942 million for the year ended December 31, 2016, up 8.4% compared to EUR2,715 million for the year ended December 31, 2015, and represented 11.9% of revenue in 2016 compared with 10.2% in 2015.

The change in working capital generated EUR28 million in cash in the year ended December 31, 2016, compared to EUR117 million generated in the year ended December 31, 2015.

In all, net cash provided by operating activities increased by 4.9% from EUR2,832 million in the year ended December 31, 2015 to EUR2,970 million in the year ended December 31, 2016.

### Investing Activities

Net capital expenditure, which included capitalized development projects, decreased by 2.9% to EUR764 million for the year ended December 31, 2016, compared to EUR787 million for the year ended December 31, 2015, and represented 3.1% of revenues in 2016 (3.1% in 2015).

Free cash-flow (cash provided by operating activities net of net capital expenditure) amounted to EUR2,206 million in 2016 *versus* EUR2,045 million in 2015.

Cash conversion rate (free cash-flow over net income attributable to the equity holders of the parent company on continuing operations, adjusted for the impact of business disposals, Pelco trademark impairment in 2015 and the tax adjustments described in note 2.11 was 118% in 2016 versus 113% in 2015.

The effect of acquisitions and divestments during the year was a net cash outflow amounting to EUR20 million in 2016. Our acquisitions represented a cash inflow, net of cash acquired, of EUR296 million for the year ended December 31, 2015, corresponding mainly to the disposals described in note 2.1.

### Financing Activities

In 2016, the Group reimbursed bonds for EUR672 million and issued a bond in euros for EUR800 million.

The net decrease in other financial debts amounted to EUR794 million during the year ended December 31, 2016, compared to a net decrease in other financial debts amounting to EUR1,262 million during the year ended December 31, 2015. The dividend paid by Schneider Electric was EUR1,127 million in the year ended December 31, 2016, compared with EUR1,108 million in the year ended December 31, 2015.

# 3. Review of the parent company financial statements

Schneider Electric SE posted an operating loss of EUR16 million in 2016 compared with EUR1 million the previous year.

Interest expense net of interest income amounted to EUR128 million *versus* EUR126 million the previous year.

Current loss amounted to EUR162 million in 2016 compared to a current loss of EUR141 million in 2015.

The net loss stood at EUR100 million in 2016 compared with a net loss of EUR53 million in 2015.

Equity before appropriation of net profit amounted to EUR8,745 million at December 31, 2016 *versus* EUR9,808 million at the previous year-end, after taking into account 2016 loss, dividend payments of EUR1,127 million and share issues in an amount of EUR163 million.

# 4. Review of subsidiaries

## Schneider Electric Industries SAS

Revenue totalled EUR3.2 billion in 2016 (EUR3.3 billion in 2015).

The subsidiary posted an operating gain of EUR115 million in 2016 compared with an operating loss of EUR38 million in 2015.

Net profit amounted to EUR264 million in 2016 compared with EUR238 million of net profit in 2015.

# 5. Outlook

In 2017 the Group expects more positive momentum in its major end-markets. In North America, modest growth is anticipated with improvement in industrial activity and continued growth in residential markets. Western Europe is expected to grow moderately, benefiting from an environment with a lower Euro and still relatively low oil price, while some Brexit-related risks remain. China is expected to improve in Industry and Infrastructure markets while the construction market should grow at a slower pace due to policy tightening. The Group will still face headwinds from O&G and continued weakness in some resource driven economies, although these may ease towards the end of the year.

Additionally, in 2017 the Group will face a strong increase in raw material costs estimated at c.EUR(200) million at current prices. In this environment, the Group's priority is to grow its partner network through the launch of many new integrated offers, accelerate services and software, working on margin improvement through continued selectivity on projects and keep a strong attention on cost control. In addition, the Group should benefit from the recent deployment of its EcoStruxure architectures in several domains to create further opportunities for growth.

Therefore, in line with the objectives announced at the 2016 Investor day, the Group targets for 2017:

- Organic revenue growth between +1% and +3% for the Group outside Infrastructure. For Infrastructure the priority remains margin improvement and the organic growth target for the division is to be about flat underlying, before an expected -4% to -5% impact from project selectivity for the division in 2017.
- +20bps to +50bps organic improvement on adjusted EBITA margin. The FX impact at current rates is expected to be about neutral on margin.