

# Risk Report

Continental's overall risk situation is analyzed and managed corporation-wide using the risk management system.

The management of the Continental Corporation is geared towards creating added value. For us, this means sustainably increasing the value of each individual business unit and the corporation as a whole. This is achieved if Continental generates a long-term return on capital that exceeds our weighted-average costs of capital. In the context of our global activities, we evaluate the risks and opportunities that arise responsibly and on an ongoing basis in order to achieve our goal of adding value.

We understand risk as the possible occurrence of internal or external events that can have a negative influence on the attainment of our strategic and operational targets. As a global corporation, Continental is exposed to a number of different risks that could impair business and, in extreme cases, endanger the company's existence. We accept manageable risks if the resulting opportunities lead us to expect to achieve a sustainable growth in value.

## **Risk management and internal control system**

Pursuant to sections 289 (5) and 315 (2) of the German Commercial Code (*Handelsgesetzbuch – HGB*), the main characteristics of the internal control and risk management system in respect of the accounting process must be described. All parts of the risk management system and internal control system which could have a material effect on the annual and consolidated financial statements must be included in the reporting.

To ensure that risks are detected in time, their causes analyzed, and that the risks are assessed and avoided or at least minimized, there is a uniform corporation-wide risk management system, which also comprises the early detection system for risks to the company as a going concern in accordance with Section 91 (2) of the German Stock Corporation Act (*Aktiengesetz – AktG*). The risk management system regulates the identification, recording, assessment, documentation and reporting of risks and is integrated into the com-

pany's strategy, planning, and budgeting processes. By including risk management in the management and reporting systems, Continental ensures that risk management is an integral component of business processes in the corporation.

In order to operate successfully as a company in our complex business sector and to ensure the effectiveness, efficiency and propriety of accounting and compliance with the relevant legal and sublegislative regulations, Continental AG has created an effective, integrated internal control system that encompasses all relevant business processes. The internal control system forms an integral part of the risk management system. A summary is therefore given below. The risk management system also includes the compliance management system which is described in detail in the Corporate Governance Declaration (pages 42 et seq.).

The Executive Board is responsible for the risk management system and the internal control system. The Supervisory Board and the Audit Committee monitor and review its effectiveness. For this purpose, the internal control system includes regulations on reporting to the Supervisory Board, the Audit Committee, the Executive Board and the Compliance & Risk Management Committee.

The risk management system and the internal control system include all subsidiaries significant to the consolidated financial statements with their relevant accounting processes. Key elements of the corporation-wide control systems are the clear allocation of responsibilities and controls inherent in the system when preparing the financial statements. The dual control principle and separation of functions are fundamental principles of this organization. In addition, Continental's management ensures accounting that complies with the requirements of law via guidelines on the preparation of financial statements and on accounting, access authorizations for IT systems and regulations on the involvement of internal and external specialists.

## Risk reporting



The effectiveness of the accounting-related internal control system is evaluated in major areas through effectiveness testing of the reporting units. The results of the effectiveness tests must be recorded in the Continental Corporation's reporting systems on a quarterly basis and are then evaluated by the corporation management. If any weaknesses are identified, the corporation's management initiates the necessary measures.

### Identifying and assessing risk

Responsibility for identifying and assessing key risks is distributed among various levels and organizational units within Continental AG.

For purposes of risk identification, assessment and reporting, the management of each unit of the corporation analyzes the material risks relating to that unit. Local management can utilize instruments for this, such as local operations management handbooks, centrally-developed function-specific questionnaires and the process and control descriptions of Internal-Controls@Continental system, which were developed for all major companies for implementing the requirements of the revised version of the 8<sup>th</sup> EU Directive. In line with this, the key controls in business processes

(e.g. purchase to pay, order to cash, asset management, HR, IT authorizations and the financial statement process) are controlled on a quarterly basis and reviewed with respect to their effectiveness.

Corporate functions such as Compliance, HR, Quality, Law, Purchasing, Insurance and Systems & Standards, Finance, Interest and Currency Management also conduct additional audits with respect to the implementation of the respective corporate guidelines relevant to each area and analyze the processes concerned in terms of efficiency and potential weak points. The aim is to monitor compliance with the guidelines, identify potential risks in processes and to support the standardization of the operating processes.

In addition to the risk analyses carried out by the local management and the corporate functions, the internal audit department also performs audits.

Continental AG has set up a Compliance & Anti-Corruption Hotline to give the employees and third parties outside the corporation the opportunity to report violations of legal regulations, its fundamental values and ethical standards. Information on any kind

of potential violations, such as bribery or antitrust behavior, but also accounting manipulation, can be reported anonymously via the hotline where permissible by law. Tips received by the hotline are examined and pursued by Corporate Audit and the Compliance department.

The risks identified within the framework described above are categorized and evaluated according to specified criteria. Risks are normally assessed according to their negative impact on the unit's operating result.

The evaluation of risks and their impact on accounting takes into account their probability and their impact on sales, results or total assets.

#### **Risk reporting**

As with risk assessment, the reporting of the identified, analyzed and assessed risks is also allocated to various organizational levels.

Using an extensive risk inventory, the units regularly report any changes to previously reported risks plus any new developments that could turn into material risks as part of their reporting. Any new material risks arising between regular reporting dates have to be reported immediately. This also includes risks identified in the audits of the corporate functions. Furthermore, the central controlling function analyzes the key figures provided as part of this reporting at corporation and

division level so that the causes of potential risks can be identified early on.

The Compliance & Risk Management Committee informs the Executive Board of Continental on a regular basis of existing risks, their assessment and the measures taken. In addition, there is reporting to the management levels below the Executive Board according to their area of responsibility. The Supervisory Board and the Audit Committee are also informed regularly of the major risks, any weaknesses in the control system and measures taken. Furthermore, the auditors are to report to the Audit Committee of the Supervisory Board regarding any weaknesses in the accounting-related internal control system which the auditors identified as part of their audit activities.

#### **Risk management**

The responsible management initiates suitable countermeasures that are also documented in the reporting systems for each risk identified and assessed as material. The Compliance & Risk Management Committee monitors and consolidates the identified risks at the corporation level. It regularly reports to the Executive Board and recommends further measures if needed. The Executive Board discusses and resolves these measures, and reports to the Supervisory Board's Audit Committee. The responsible bodies continually monitor the development of all identified risks and the progress of actions initiated. Regular audits of the risk management process by the internal auditors guarantee its efficiency and further development.

## Material risks

### Financial risks

#### **Continental is exposed to a number of risks associated with its syndicated loan.**

To finance the takeover of Siemens VDO Automotive AG (“Siemens VDO”) in 2007, Continental and a banking syndicate entered into a syndicated credit facilities agreement for €13.5 billion, which was amended and restated most recently late in March 2011 (“syndicated loan”). Loans and credit lines provided as part of this agreement totaled €5.375 billion as of December 31, 2011. Among other obligations, the syndicated loan agreement requires Continental to meet specific financial covenants, in particular a maximum leverage ratio (calculated as the ratio of Continental’s consolidated net financial indebtedness to consolidated adjusted EBITDA) and a minimum interest cover ratio (calculated as the ratio of Continental’s adjusted consolidated EBITDA to consolidated net interest). The maximum leverage ratio is now 3.00. The interest cover ratio cannot fall below 2.50.

Owing to the market and operational risks presented below, under certain circumstances it may not be possible for Continental to comply with the ratios described above. If Continental fails in one of these obligations, the creditors are entitled to declare their facilities immediately due and payable. In this case, the facilities granted under the syndicated loan will become due for payment immediately and/or all credit lines will be canceled. As of December 31, 2011, the leverage ratio was 1.48 and the interest cover ratio was 6.33.

By way of an early repayment of €484.9 million in April 2011, Continental reduced the committed amount of the loan to €6 billion. A further early repayment of the tranche of €625 million originally due in August 2012 was made at the end of December 2011. The remaining €5.375 billion breaks down into a fixed loan of €2.875 billion and a revolving credit line of €2.5 billion. Both tranches are due in April 2014. If Continental still has a non-investment grade rating when this loan matures in 2014, in the event of a renewed significant disruption of the global or European finance markets, it cannot be ruled out that the refinancing of the total

amount then due would fail on the bond or bank market, with the result that Continental would be unable to repay it. In addition, any refinancing of these liabilities through further bank financing or on the capital markets (if possible at all) could lead to a material increase of Continental’s net interest expense.

Furthermore, under the terms of the loan agreements, a prepayment event also occurs in the event of a change-of-control at Continental AG. Under the loan agreements, a change-of-control occurs when one person or several persons acting in concert (pursuant to Section 2 (5) *Wertpapiererwerbs- und Übernahmegesetz – WpÜG*) acquire more than 50% of the voting rights in the company or gain control of the company by means of a domination agreement (*Beherrschungsvertrag*) pursuant to Section 291 of the German Stock Corporation Act (*Aktiengesetz – AktG*). Upon occurrence of such change-of-control event, each lender may demand repayment of its share in all outstanding loans, plus interest, and all other amounts accrued under the loan agreements. A change-of-control could occur, in particular, if the shareholding of Schaeffler Group, Herzogenaurach, in the company’s voting capital stock exceeds 50% due to Schaeffler acquiring further shares in the company or as a result of Schaeffler being regarded as acting in concert with other shareholders in the company, or if a domination agreement pursuant to Section 291 *AktG* is concluded between Schaeffler and the company. The loans described here could also become immediately due and payable if grounds for termination arise under other financing agreements for debt of a total amount of more than €75.0 million.

#### **Continental faces liquidity risks due to its relatively high debt level and the turbulence on the financial markets.**

Continental faces liquidity risks arising from tense credit markets and its existing financial liabilities. As Continental still has above-average high levels of debt by industry standards (net indebtedness amounting to €6,772.1 million as of December 31, 2011), the situation on the credit markets (including the market for high-yield bonds) could make it difficult for the company to obtain financing at commercially reasonable terms. In addition, owing to Continental’s non-investment grade rating, the company may be unable to continue its factoring programs under which it has

factored invoices to banks and other institutions in the past or to continue to issue high-yield bonds. Continental's cash from operating activities, current cash resources and available sources of external financing could be insufficient to meet Continental's future capital requirements.

Furthermore, disruptions on the financial markets, including the insolvency or restructuring of a number of financial institutions, and the generally restricted availability of liquidity could adversely affect the availability and cost of additional financing for Continental and also the availability of financing already arranged or committed. Continental's liquidity could also suffer if its suppliers introduce more stringent terms of payment or if its customers were to extend their normal payment terms.

**Continental's credit rating has been downgraded several times in the past and could be downgraded again in spite of the recent improvement.**

Continental's net indebtedness increased significantly as a result of the acquisition of Siemens VDO in 2007. As a result, its net equity-to-debt ratio also deteriorated substantially. In the course of 2008 and 2009, Continental's equity ratio decreased due to the effects of the financial crisis and the resulting economic downturn on Continental's business and earnings situation as well as due to extraordinary goodwill impairment in the Powertrain, Interior and Chassis & Safety divisions. These developments, as well as the uncertainty regarding the effects of the stake held by Schaeffler in Continental's capital on its strategy and credit quality, have caused the rating agencies covering Continental to downgrade its credit rating from BBB+ (Standard & Poor's) and Baa1 (Moody's), both with stable outlook, in June 2007, to "B+ Creditwatch Negative" (Standard & Poor's) and "B1 Negative Outlook" (Moody's) in August 2009. In May 2010, Standard & Poor's reduced Continental's rating further from B+ to "B Stable Outlook", in particular due to the influence of major shareholder Schaeffler on Continental's credit standing and Continental's forthcoming refinancing requirements for 2012. After Continental successfully placed the first high-yield bond, Moody's changed its forecast in July 2010 from "negative" to "stable". In 2011, Moody's and Standard & Poor's improved Continental's rating. Moody's has rated Continental as Ba3 since April 2011 while Standard &

Poor's improved its rating to B+ in July 2011. However, Continental's current credit rating is still in the non-investment grade range. Continental will therefore have more difficulty in refinancing at economically reasonable conditions. For example, as a consequence of its rating, Continental may be unable to continue the factoring programs under which it has factored trade receivables to banks and other institutions in the past. This could also increase Continental's difficulty in issuing high-yield debt or even render this impossible.

It is uncertain whether the current global economic performance and production level in the automotive sector are sustainable. If the present situation proves not to be lasting, this could have negative effects on Continental's liquidity and lead to a further deterioration of its credit rating. Any such downgrade could have adverse effects on Continental's options for obtaining funding as well as its financing costs and interest expenses. A further downgrade of Continental's credit rating could also impact Continental's liquidity position if its suppliers change the terms of payment offered to Continental for this reason, for example by requesting payment in advance. These negative consequences could be exacerbated if credit insurers were to further restrict coverage for Continental's accounts payable. In addition, a further downgrade of Continental's credit rating could cause Continental's customers to extend their normal payment terms or even to terminate their business relationships with Continental and to engage other suppliers.

**Continental's other financing agreements contain, and future debt obligations are also likely to contain, restrictive covenants and change-of-control provisions.**

In addition to the risks related to the syndicated loan, Continental also faces risks in connection with its other financing agreements, especially a loan from the European Investment Bank ("EIB"), which amounted to €300.0 million as of the end of 2011, the bond of €750.0 million (due for repayment in 2015) that Continental issued in July 2010, the bond of €1,000.0 million that Continental issued in September 2010 (due in 2017) and the two bonds issued in October 2010 of €625.0 million each (due in 2016 and 2018 respectively). These other financing agreements also contain numerous covenants that limit Continental's operations and require Continental to maintain specific

financial ratios, as well as change-of-control provisions. Under the covenants of the loan agreement with the EIB, an example of a change-of-control is when one person or several persons acting in concert (pursuant to Section 2 (5) *WpÜG*) acquire more than 50% of the voting rights in the company or gain control of the company by means of a domination agreement pursuant to Section 291 *AktG*. In this case, the EIB may request information on the change-of-control from the company. If the EIB sees its interests affected by the change-of-control, it may demand repayment of the outstanding amount under the EIB loan plus interest within 30 days.

Any future credit financing is likely to contain similar restrictive covenants and change-of-control provisions. If Continental fails to comply with any of these covenants or if a change-of-control occurs and Continental is unable to obtain a waiver from the respective lenders, this could provide grounds for the termination of the relevant debt instrument, which would then become immediately due and payable. In addition, the EIB can declare its loan immediately due and payable if there are grounds for the termination of other financing agreements exceeding €40.0 million.

**Continental is exposed to risks in connection with interest rate changes and hedging.**

Continental is exposed to risks associated with changes in variable interest rates, as a number of Continental's credit facilities (in particular the facilities granted under the syndicated loan) bear interest at a floating rate. Therefore, an increase or decrease in interest rates would affect Continental's current interest expenses and its future refinancing costs. These risks are monitored and evaluated as part of our interest rate management activities and managed by means of derivative interest rate hedging instruments. In 2008, Continental hedged a portion of the syndicated loan in an amount of €3,125.0 million in order to mitigate Continental's exposure to fluctuating interest rates. The average fixed interest rate to be paid resulting from the hedges with a term until August 2012 is 4.19% p.a. plus margin. However, the future use of derivative interest rate hedging instruments is generally dependent on the availability of adequate credit lines. Currently, the availability of additional credit lines is being negatively affected by the disruptions in the financial markets, Continental's high level of financial

indebtedness and its credit rating. As a result, Continental could be unable to use derivative financial instruments in the future and Continental's hedging strategy could therefore ultimately be negatively impacted. Moreover, any hedging transactions executed in the form of derivative financial instruments could result in losses.

**Risks related to the markets in which Continental operates**

**Continental could be exposed to significant risks in connection with a global financial and economic crisis.**

Continental generates a large percentage (approximately 72%) of its sales from automotive manufacturers (OEMs). The remainder of Continental's sales is generated from the replacement or industrial markets, mainly in the replacement markets for passenger, van and truck tires, and to a lesser extent in the non-automotive end-markets of the other divisions.

During the most recent global economic crisis, automotive sales and production deteriorated substantially, resulting in a sharp decline in demand for Continental's products among its OEM customers. At present it is not known if the current economic situation will persist. If this is not the case, automobile production could fall again and remain at a low level for an extended period of time, especially in Europe and the NAFTA region, where Continental generated approximately 78% of its sales in 2011. A prolonged weakness in or deterioration of the global automotive markets or consumer credit markets is likely to adversely affect Continental's sales and results of operations. Tax increases that reduce consumers' disposable income could be another factor to weaken global demand on the vehicle markets. Especially in the member countries of the European Union, tax increases are a likely reaction to the increase in public debt due to the various aid programs for banks and the EU's aid measures for its member states. Furthermore, Continental's five largest OEM customers (BMW, Ford, Daimler, VW and General Motors) generated approximately 41% of the Continental Corporation's sales in 2011. In 2009, a combination of significantly lower global production levels, a shortage of liquidity and increased costs of capital

caused severe financial distress among a number of OEMs and forced these companies to implement restructuring measures extending to reorganization under bankruptcy laws. There can be no assurance that any of these restructuring measures will be successful in the long term. If one or more of Continental's OEM customers is lost or terminates a supply contract prematurely, the original investments made by Continental to provide such products or outstanding claims against such customers could be wholly or partially lost. In many markets important to Continental, governments introduced scrapping programs in 2009, such as the Car Allowance Rebate System (CARS) in the United States and the Car Scrapping Bonus (*Umweltprämie*) in Germany, intended to provide economic incentives to car owners to trade in older vehicles and purchase new vehicles. Most of these programs, which were designed to stimulate the economy by boosting vehicle sales, have since expired. As these scrapping programs may have led to increased sales by bringing forward potential demand from later years rather than increasing demand incrementally in the relevant markets, vehicle sales may decline in the short term with likely negative consequences for production volumes on which Continental depends.

**Continental operates in a cyclical industry.**

Global production of vehicles and, as a result, sales to OEM customers (from whom Continental currently generates approximately 72% of its sales) are cyclical. They depend, among other things, on general economic conditions and consumer spending and preferences, which can be affected by a number of factors, including fuel costs and the availability of consumer financing. As the volume of automotive production fluctuates, the demand for Continental's products also fluctuates, as OEMs generally do not commit to purchasing minimum quantities from their suppliers, or to fixed prices. It is difficult to predict future developments in the markets Continental serves, which creates problems in estimating the requirements for production capacity. Since its business is characterized by high fixed costs, Continental risks underutilization of its facilities (particularly in the Automotive Group) or having insufficient capacity to meet customer demand if the markets in which Continental is active either grow or decline faster than Continental has

anticipated. Underutilization of Continental's facilities could result in idle capacity costs, write-offs of inventories and losses on products due to falling average sale prices. Furthermore, falling production volumes can produce declines in sales and margins, as well as earnings.

**The automotive supply industry is characterized by intense competition, which could reduce Continental's sales or put continued pressure on its sales prices.**

The automotive supply industry is highly competitive and has been characterized by rapid technological change, high capital expenditures, intense pricing pressure from major customers, periods of oversupply and continuous advancements in process technologies and manufacturing facilities. As OEMs are increasingly affected by innovation and cost-cutting pressures from competitors, they seek price reductions in both the initial bidding process and during the term of the contract with their suppliers. In particular, vehicle manufacturers expect lower prices from suppliers for the same, and in some cases even enhanced functionality, as well as a consistently high product quality. Should Continental be unable to offset continued price reductions through improved operating efficiencies and reduced expenditures, price reductions could impact profit margins. In addition, Continental's existing competitors, in particular its competitors from Asia, may pursue an aggressive pricing policy and offer conditions to customers that are more favorable than Continental's. Aside from this, the markets in which Continental is active are characterized by a trend towards consolidation. Increased consolidation among Continental's competitors or between Continental's competitors and any of its OEM customers could allow competitors to further benefit from economies of scale, offer more comprehensive product portfolios and increase the size of their serviceable markets. This could require Continental to accept considerable reductions in its profit margins and the loss of market share due to price pressure. Furthermore, competitors may gain control over or influence suppliers or customers of Continental by shareholdings in such companies, which could adversely affect Continental's supplier relationships.

**Continental is exposed to fluctuations in prices of raw materials, electronic components and energy.**

For the divisions of the Automotive Group, cost increases could result, in particular, from rising rare earth, steel and electronic components prices, while the divisions of the Rubber Group are mainly affected by the development of prices of natural and synthetic rubber as well as oil. In the recent past, prices for rare earths, steel and electronic components, oil, natural and synthetic rubber have been subject to at times substantial fluctuations around the world. Continental does not actively hedge against the risk of rising prices of electronic components or raw materials by using derivative financial instruments. Therefore, if Continental is unable to compensate for or pass on its increased costs to customers, such price increases could have a significant adverse impact on Continental's results of operations.

While the lower prices for natural and synthetic rubber had a positive effect on Continental's earnings in 2009, price increases in 2010 resulted in additional costs of €483 million. In 2011 these additional costs even exceeded €950 million. As long as Continental is able to pass on these additional costs by increasing its selling prices, it is possible that the positive effects of the price increases will not end until after the period in which the additional costs are incurred. In this case, the additional costs may not be compensated for at the time they arise. As a manufacturer dependent on large quantities of energy for production purposes, Continental is also affected by changes in energy prices. If Continental is unable to compensate for or pass on its increased costs resulting from rising energy prices to customers, such price increases could have a material adverse impact on Continental's earnings situation.

**Continental generates by far the greatest share of its total sales in Europe and, in particular, in Germany.**

In 2011, Continental generated 59% of its total sales in Europe, of which 26% were generated in Germany. By comparison, 19% of Continental's total sales in 2011 were generated in NAFTA, 17% in Asia, and 5% in other countries. Therefore, in the event of an economic downturn in Europe or in Germany in particular, Continental's business and earnings situation could be affected more extensively than its competitors'. Fur-

thermore, the automotive and tire markets in Europe and NAFTA are largely saturated. Continental is therefore seeking to generate more sales in emerging markets, particularly Asia, to mitigate the risks resulting from Continental's strong focus on Europe and Germany. In the current global economic situation, adverse changes in the geographical distribution of automotive demand could also cause Continental to suffer. The current level of automotive production is driven mainly by solid demand from the Asian and North American markets, while demand in Europe is relatively low. It is not known if the demand from Asia and North America will prove sustainable. If demand falls there and is not compensated for by an increase on another regional market, this could adversely affect demand for Continental products.

**Continental is exposed to risks associated with the market trends and developments that could affect the vehicle mix sold by OEMs.**

Continental currently generates approximately 72% of its sales from OEMs, mainly in its Automotive Group. Global production of vehicles and, as a result, sales to OEM customers are currently subject to a number of market trends and technical developments that may affect the vehicle mix sold by OEMs.

- ▶ Due to increasingly stringent consumption and emission standards throughout the industrial world, including the EU, the U.S.A. and Japan, as well as oil price fluctuations and the resulting significant increase in fuel costs, car manufacturers are increasingly being forced to develop environmentally-friendly technologies aimed at lower fuel consumption and a reduction of CO<sub>2</sub> emissions. These developments have caused a trend towards lower-consumption vehicles. The emerging markets are focusing strongly on the small car segment as their introduction to mobility.
- ▶ In recent years, the market segment of "affordable" cars (those costing less than \$10,000/€7,000) has grown steadily, particularly in emerging markets such as China, India, Brazil and Eastern Europe.
- ▶ Over the past decade, hybrid electric vehicles, which combine a conventional internal combustion engine drive system with an electric drive system, have become increasingly popular. Their market share will

increase further in the coming years. Furthermore, the first purely electric vehicles that use (just) one or more electric motors for propulsion have already been launched. If the industry is able to develop functional electric vehicles in line with consumers' expectations, these could gain a considerable market share in the medium to long term.

As a result of the market trends described above and technical developments, the vehicle mix sold by Continental's customers has shifted significantly over the past two years and can also change further in future.

**Continental is exposed to risks associated with changes in currency exchange rates and hedging.**

Continental operates worldwide and is therefore exposed to financial risks that arise from changes in exchange rates. This could result in losses if assets denominated in currencies with a falling exchange rate lose value, while at the same time liabilities denominated in currencies with a rising exchange rate appreciate. In addition, fluctuations in foreign exchange rates could enhance or minimize fluctuations in the prices of raw materials, as Continental sources a considerable portion of its raw materials in foreign currency. As a result of these factors, fluctuations in exchange rates could influence Continental's earnings situation. External and internal transactions involving the delivery of products and services to third parties and companies of the Continental Corporation result in cash inflows and outflows which are denominated in currencies other than the functional currency of the respective member of the Continental Corporation ("transaction risk"). In particular, Continental is exposed to fluctuations in the U.S. dollar, Mexican peso, Czech koruna, Chinese renminbi, Romanian leu, Japanese yen and Hungarian forint. To the extent that cash outflows of the respective member of the Continental Corporation in any one foreign currency are not offset by cash flows resulting from operational business in the same currency, the remaining net foreign currency exposure is hedged against on a case-by-case-basis using the appropriate derivative financial instruments, particularly currency forwards, currency swaps and currency options with a term of up to twelve months. Moreover, Continental is exposed to foreign exchange risks arising from external and internal loan agreements, which result from cash inflows and outflows in currencies which are denominated in currencies other

than the functional currency of the respective member of the Continental Corporation. These foreign exchange risks are in general hedged against by using appropriate derivative financial instruments, particularly currency forwards/swaps and cross-currency interest-rate swaps.

Continental's hedging strategy could ultimately be unsuccessful. Moreover, any hedging transactions executed in the form of derivative financial instruments can result in losses. Continental's net foreign investments are generally not hedged against exchange rate fluctuations. In addition, a number of Continental's consolidated companies report their results in currencies other than the euro, which requires Continental to convert the relevant items into euro when preparing Continental's consolidated financial statements ("translation risk"). Translation risks are not hedged.

**Risks related to Continental's business operations**

**The Powertrain division is exposed to particular operational risks.**

Continental has identified a number of problem areas within the Powertrain division (consisting mainly of Siemens VDO businesses acquired in 2007), including a number of unprofitable long-term supply contracts, technical and quality problems involving product design, materials and mechanical parts, organizational problems and a high fixed cost base. The company has initiated a turnaround program and several restructuring measures, involving among other things several changes at the division's management level and a reduction of the organizational structure. Continental has not yet succeeded in remedying all of the problems identified within the Powertrain division by implementing these measures. In particular, the technical and quality issues encountered by the Powertrain division have led in the past, and continue to lead, to cost-intensive application engineering. Moreover, the problems encountered by the Powertrain division were intensified due to the 2009 global recession and its consequences, since the Powertrain division's high fixed cost base prevented a quick adjustment of the cost structure to lower production volumes caused by the sharp decline in demand.

After the Powertrain division's reported EBIT passed the break-even point in 2011, the medium-term objective is still to generate a reported EBIT margin of 8% in this division by 2015. However, the problems described could make achieving this goal more difficult. The technical quality issues encountered by the Powertrain division with respect to product design, materials and mechanical parts could cause warranty or product liability claims which exceed customary standards by far and which may not be covered by Continental's insurance policies. Moreover, defective products could result in a loss of sales, contracts, customers or market acceptance. Furthermore, Continental could still be forced to dedicate a considerable amount of additional management capacity to solve these problems. Any failure or delay in solving the operational issues at the Powertrain division could affect Continental's competitive position in a number of important and rapidly growing market segments, such as the market for efficient engine management systems for gasoline and diesel engines and the hybrid electric or the electric vehicle market. As a consequence, the goodwill recognized for the Powertrain division could be subject to further impairment in future.

**Continental is exposed to risks in connection with the sale and transfer of shares in ContiTech AG to Continental Pension Trust e.V.**

On August 19, 2009, Continental AG, ContiTech Universe Verwaltungs-GmbH (a wholly owned subsidiary of the company; "ContiTech Universe"), ContiTech AG and Continental Pension Trust e.V. (the trustee of the contractual trust arrangements (CTAs) for Continental AG, Continental Reifen Deutschland GmbH and Continental Teves AG & Co. oHG) entered into an agreement concerning the sale and transfer of 22,148,273 shares (representing 24.9% of the capital stock of ContiTech AG) by ContiTech Universe to Continental Pension Trust against payment of a purchase price of €475.6 million. Among other stipulations, the purchase agreement contains a number of regulations on the sale and transfer of the shares to ContiTech AG. Under certain conditions, these authorize the Continental Pension Trust (i) to obligate ContiTech Universe to repurchase the ContiTech shares at a purchase price of at least €475.6 million, (ii) to sell its ContiTech shares to a third party, (iii) to sell its ContiTech shares to a third party which acquires the Conti-

Tech shares held by ContiTech Universe, or (iv) to obligate ContiTech Universe to sell its ContiTech shares to a third party which acquires the ContiTech shares held by Continental Pension Trust.

**Continental depends on its ability to develop and launch innovative products in a timely manner, which includes securing sufficient funds for this purpose.**

The future success of Continental depends on the company's ability to develop and launch new and improved products in a timely manner. The automotive market in particular is characterized by a trend towards higher performance and simultaneously more fuel-efficient, less polluting and quieter engines, growing demands by customers and stricter regulations with respect to engine efficiency and by the trend towards affordable cars and hybrid and electric vehicles. These new developments could entail technical challenges, the mastering of which could be very time-consuming for Continental. Consequently, Continental may be unable to develop innovative products and adapt them to market conditions quickly enough. Furthermore, developing new and improved products is very costly and therefore requires a substantial amount of funding. The general lack of liquidity caused by the disruptions in the financial markets, combined with the company's debt and non-investment grade rating, is adversely impacting the availability and cost of additional financing and could also limit the availability of credit already arranged or committed. If Continental is unable to secure sufficient funding to finance its development activities, it could lose its competitive position in a number of important and rapidly growing sub-markets. Furthermore, Continental devotes significant resources to research and development, especially in the divisions of its Automotive Group, but also in the Rubber Group. In recent years, Continental's R&D expenses in relation to total sales accounted for more than 5%. If Continental devotes resources to the pursuit of new technologies and products that fail to be accepted in the marketplace or that fail to be commercially viable, all or part of these significant R&D expenses may be lost and Continental's business may suffer.

**Continental depends on a limited number of key suppliers for certain products.**

Continental is subject to the risk of unavailability of certain raw materials and production materials. Although Continental's general policy is to source input products from a number of different suppliers, a single sourcing cannot always be avoided and, consequently, Continental is dependent on certain suppliers in the Rubber Group as well as with respect to certain products manufactured in the Automotive Group. Since Continental's procurement logistics are mostly organized on a just-in-time or just-in-sequence basis, supply delays, cancellations, strikes, insufficient quantities or inadequate quality can lead to interruptions in production and, therefore, have a negative impact on Continental's business operations in these areas. Continental tries to limit these risks by endeavoring to select suppliers carefully and monitoring them regularly. However, if one of Continental's suppliers is unable to meet its delivery obligations for any reason (for example, insolvency, destruction of production plants or refusal to perform following a change in control), Continental may be unable to source input products from other suppliers upon short notice at the required volume. The economic crisis in 2009, in addition to the natural disasters in Japan and Thailand, have shown how quickly the financing strength and ability of some automotive suppliers to deliver can be impaired, even resulting in insolvency. This mainly affected Tier 2 and 3 suppliers (suppliers who sell their products to Tier 1 or 2 suppliers respectively), while Tier 1 suppliers (suppliers who sell their products to OEMs directly) were not affected to the same degree. Such developments and events can cause delays in the delivery or completion of Continental products or projects and could result in Continental having to purchase products or services from third parties at higher costs or even to financially support its own suppliers. Furthermore, in many cases OEM customers have approval rights with respect to the suppliers used by Continental, making it impossible for Continental to source input products from other suppliers upon short notice if the relevant OEM customer has not already approved other suppliers at an earlier point in time. All of this could lead to order cancellations or even claims for damages. Furthermore, Continental's reputation amongst OEM customers could suffer, with the possible consequence that they select a different supplier.

**Continental is exposed to warranty and product liability claims.**

Continental is constantly subject to product liability lawsuits and other proceedings alleging violations of due care, violation of warranty obligations or material defects, and claims arising from breaches of contract, recall campaigns or fines imposed by governments. Any such lawsuits, proceedings and other claims could result in increased costs for Continental. Moreover, defective products could result in loss of sales and of customer and market acceptance. Such risks are insured up to levels considered economically reasonable by Continental, but its insurance coverage could prove insufficient in individual cases. Additionally, any defect in one of Continental's products (in particular tires and safety-related products) could also have a considerable adverse effect on the company's reputation and market perception. This could in turn have a significant negative impact on Continental's sales and income. Moreover, vehicle manufacturers are increasingly requiring a contribution from their suppliers for potential product liability, warranty and recall claims. In addition, Continental has long been subject to continuing efforts by its customers to change contract terms and conditions concerning warranty and recall participation. Furthermore, Continental manufactures many products pursuant to OEM customer specifications and quality requirements. If the products manufactured and delivered by Continental do not meet the requirements stipulated by its OEM customers at the agreed date of delivery, production of the relevant products is generally discontinued until the cause of the product defect has been identified and remedied. Furthermore, Continental's OEM customers could potentially claim damages, even if the cause of the defect is remedied at a later point in time. Besides this, failure to fulfill quality requirements could have an adverse effect on the market acceptance of Continental's other products and its market reputation in various market segments.

**Continental's operations depend on qualified executives and key employees.**

Continental's success depends on its Executive Board members, other qualified executives, and employees in key functions. The loss of executives or key employees could have a material adverse effect on the market position and prospects of Continental. Considerable expertise could be lost or access thereto gained by

competitors. Due to the intense competition in the automotive industry, there is a risk of losing qualified employees to competitors or being unable to find a sufficient number of appropriate new employees. There is no guarantee that Continental will be successful in retaining these executives and the employees in key positions or in attracting new employees with corresponding qualifications. Continental tries to retain the commitment of its qualified executives and key employees through performance-based remuneration systems.

**Continental is exposed to risks in connection with its pension commitments.**

Continental provides defined benefit pension plans in Germany, the U.S.A., the U.K. and certain other countries. As of December 31, 2011, the pension obligations amounted to €3,342.8 million. These existing obligations are financed predominantly through externally invested pension plan assets. In 2006, Continental established legally independent trust funds under contractual trust arrangements for the funding of pension obligations of certain subsidiaries in Germany. In 2007, Continental assumed additional pension trust arrangements in connection with the acquisition of Siemens VDO. As of December 31, 2011, Continental's net pension obligations (pension obligations less pension plan assets) amounted to €1,563.0 million.

Continental's externally invested pension plan assets are funded through externally managed funds and insurance companies. While Continental generally prescribes the investment strategies applied by these funds, it does not determine their individual investment alternatives. The assets are invested in different asset classes including equity, fixed-income securities, real estate and other investment vehicles. The values attributable to the externally invested pension plan assets are subject to fluctuations in the capital markets that are beyond Continental's influence. Unfavorable developments in the capital markets could result in a substantial coverage shortfall for these pension obligations, resulting in a significant increase in Continental's net pension obligations.

Any such increase in Continental's net pension obligations could adversely affect Continental's financial condition due to an increased additional outflow of funds to finance the pension obligations. Also, Conti-

ental is exposed to risks associated with longevity and interest rate changes in connection with its pension commitments, as an interest rate decrease could have an adverse effect on Continental's liabilities under these pension plans. Furthermore, certain U.S.-based subsidiaries of Continental have entered into obligations to make contributions to healthcare costs of former employees and retirees. Accordingly, Continental is exposed to the risk that these costs will increase in the future.

**Continental is exposed to risks in connection with its interest in MC Projects B.V. and its interests in other companies.**

Continental and Compagnie Financière Michelin, Granges-Paccot, Switzerland ("Michelin"), each hold a 50% stake in MC Projects B.V., Amsterdam, Netherlands, a company to which Michelin contributed the rights to the Uniroyal brand for Europe as well as for certain countries outside Europe. In turn, MC Projects B.V. licensed to Continental certain rights to use the Uniroyal brand on or in connection with tires in Europe and elsewhere. Under the terms of the agreement concluded in this connection, both the agreement and the Uniroyal license can be terminated if a major competitor in the tire business acquires more than 50% of the voting rights of Continental AG or of its tire business. Furthermore, in this case Michelin also has the right to acquire a majority in MC Projects B.V. and to have MC Projects B.V. increase its minority stake in the manufacturing company Barum Continental spol. s. r. o., Otrokovice, Czech Republic – Continental's largest tire plant in Europe – to 51%. These events could have an adverse effect on the business, financial and earnings position of Continental's Tire division.

Furthermore, Continental conducts its business in part via other companies carried at equity in which Continental holds an interest. Continental's ability to fully exploit the strategic potential in markets in which it operates through associated companies would be impaired if it were unable to agree with its partners or other interest groups on a strategy and the implementation thereof. Moreover, Continental could be subjected to fiduciary obligations to its partners or other shareholders, which could prevent or impede its ability to unilaterally expand in a business area in which the company in question operates. Additionally, there is a risk that the transfer of know-how and/or trade secrets

to partners in the context of such collaborations could result in a drain of expertise from Continental. In particular, after a potential separation from a collaboration partner, there is no guarantee that the know-how and/or trade secrets transferred to such partner will not be used or disclosed to third parties, thereby adversely affecting Continental's competitive position.

**Continental's operations rely on complex IT systems and networks.**

Continental relies heavily on centralized, standardized information technology systems and networks to support business processes, as well as internal and external communications. These systems and networks are potentially vulnerable to damage or interruption from a variety of sources. Although Continental has taken precautions to manage its risks related to system and network disruptions, an extended outage in a data center or telecommunications network or a similar event could lead to an extended unanticipated interruption of Continental's systems or networks. Furthermore, Continental has outsourced all its SAP operations and certain other business-critical systems to a third-party service provider, making it and thus Continental vulnerable to damage and loss caused by fire, natural hazards, terrorism, power failures, or other disturbances at such third party's facilities and networks.

**Continental could be adversely affected by property loss and business interruption.**

Fire, natural hazards, terrorism, power failures, or other disturbances at Continental's production facilities or within Continental's supply chain – with customers and with suppliers – can result in severe damage and loss. Such far-reaching negative consequences can also arise from political unrest or instability, especially in emerging economies. The risks arising from business interruption and loss of production are insured up to levels considered economically reasonable by Continental, but its insurance coverage could prove insufficient in individual cases. Furthermore, such events could injure or damage individuals, third party property or the environment, which could, among other things, lead to considerable financial costs for Continental.

**Continental is exposed to risks from performance bonds that were granted to customers of its divested Public Transport Solutions business.**

In the past, Continental has regularly granted performance bonds in connection with orders received from customers in its Public Transport Solutions business. On August 31, 2009, four subsidiaries of Continental AG, as sellers, entered into a framework agreement, which was closed on November 2, 2009, concerning the sale of the Public Transport Solutions business to subsidiaries of Trapeze Software Inc., Ontario, Canada ("Trapeze"). Under this framework agreement, Trapeze did not assume liability under any performance bonds issued by Continental to secure obligations under the contracts entered into with customers of the Public Transport Solutions business before or after the sale of the business.

Trapeze is obliged to indemnify Continental, should Continental make a payment in response to a performance bond. However, Continental's recourse is limited, unless the claim of the customer under the performance bond was made due to Trapeze's willful deceit or other intentional breach of the relevant customer contract. As a consequence, Continental may still be held liable under the performance bonds and has only limited recourse vis-à-vis Trapeze, although Continental can no longer influence the way in which the obligations towards the customer are fulfilled.

## Legal, environmental and taxation risks

### **Continental could be held liable for soil, water or groundwater contamination or for risks related to hazardous materials.**

Many of the sites at which Continental operates have been used for industrial purposes for many years, leading to risks of contamination and the resulting site restoration obligations. Moreover, Continental could be responsible for the remediation of areas adjacent to its sites if these areas were contaminated due to Continental's activities, that is, if Continental were to be found the polluter of these areas. Furthermore, soil, water and/or groundwater contamination has been discovered at a number of sites operated by Continental in the past, including Mayfield, Kentucky, U.S.A.; Adelheidsdorf, Germany; Culpeper, Virginia, U.S.A.; Gifhorn, Germany; Mechelen, Belgium; and Várzea Paulista, Brazil. The responsible authorities could assert claims against Continental, as the owner and/or tenant of the affected plots, for the examination or remediation of such soil and/or groundwater contamination, or order Continental to dispose of or treat contaminated soil excavated in the course of construction. Continental could also be sued for damages by the owner of plots leased by Continental or of other properties, if the authorities were to pursue claims against the relevant owner of the property and if Continental had caused the contamination.

On several of the sites where contamination has been discovered, remediation activities have already taken place upon order by or agreement with the competent authorities. Costs typically incurred in connection with such claims are generally difficult to predict. Moreover, if any contamination were to become a subject of public discussion, there is a risk that Continental's general reputation or its relations with its customers could be harmed.

Furthermore, at some of the sites at which Continental operates, hazardous materials were used in the past, such as asbestos-containing building materials used for heat insulation. The health and safety of third parties (for example former employees) may have been affected due to the use of such hazardous materials and Continental could therefore be exposed to related damage claims in the future.

Continental faces similar risks with respect to former sites which it has since sold. Even if Continental has contractually excluded or limited its liability vis-à-vis a purchaser, it could be held responsible for currently unknown contamination on properties which it previously owned or used. Likewise, there can be no assurance that environmentally hazardous substances will not pollute the environment or that Continental will not be called upon to remove such contamination.

### **Continental could become subject to additional burdensome environmental or safety regulations and additional regulations could adversely affect demand for Continental's products and services.**

Continental, as a worldwide operating corporation, must observe a large number of different regulatory systems across the world that change frequently and are continuously evolving and becoming more stringent, particularly with respect to the environment, chemicals and hazardous materials, as well as health regulations. This also applies to air, water and soil pollution regulations and to waste legislation, all of which have recently become more stringent through new laws, particularly in the EU and the U.S.A. Moreover, Continental's sites and operations necessitate various permits and Continental has to comply with the requirements specified therein. In the past, adjusting to new requirements has necessitated significant investments and Continental assumes that further significant investments in this regard will be required in the future.

Furthermore, any additional regulations restricting or limiting car traffic with the aim of managing global warming (climate change) could lead to a material decrease in car sales and consequently adversely affect demand for Continental's products and services.

### **Continental could be unsuccessful in adequately protecting its intellectual property and technical expertise.**

Continental's products and services are highly dependent upon its technological know-how and the scope and limitations of its proprietary rights therein. Continental has obtained or applied for a large number of patents and other industrial property rights that are of considerable importance to its business. The process of obtaining patent protection can be lengthy and

expensive. Furthermore, patents may not be granted on currently pending or future applications or may not be of sufficient scope or strength to provide Continental with meaningful protection or commercial advantage. In addition, although there is a presumption that patents are valid, this does not necessarily mean that the patent concerned is effective or that possible patent claims can be enforced to the degree necessary or desired.

A major part of Continental's know-how and trade secrets is not patented or cannot be protected through industrial property rights. Consequently, there is a risk that certain parts of Continental's know-how and trade secrets could be transferred to collaboration partners, customers and suppliers, including Continental's machinery suppliers or plant vendors. This poses a risk that competitors will copy Continental's know-how without incurring any expenses of their own.

Furthermore, prior to the acquisition of Siemens VDO by Continental, Siemens AG (i) contributed to Siemens VDO industrial property rights, know-how and software that were exclusively attributed to the "Siemens VDO Automotive" business unit, (ii) granted to Siemens VDO non-exclusive rights to use industrial property rights, know-how and software that were not exclusively attributed to the "Siemens VDO Automotive" business unit as of the contribution date, including certain industrial property rights of Siemens AG related to electric motors and voice recognition systems, and (iii) granted to Siemens VDO exclusive rights to use certain industrial property rights of Siemens AG related to the piezo fuel injection system. At the same time, Siemens AG retained non-exclusive, irrevocable, unrestricted, transferable and royalty-free rights to use such contributed industrial property rights, inventions on which such rights are based, know-how and software. As a consequence, Siemens AG may still use the industrial property rights, inventions on which such rights are based, know-how and software which were contributed to Siemens VDO, or for which non-exclusive rights of use were granted to Siemens VDO, to compete with Continental on the market or could license such industrial property to third parties, thereby materially adversely affecting Continental's competitive position.

Moreover, Continental has concluded a number of license, cross-license, collaboration and development agreements with its customers, competitors and other third parties under which Continental is granted rights to industrial property and/or know-how of such third parties. It is possible that license agreements could be terminated, under certain circumstances, in the event of the licensing partner's insolvency or bankruptcy and/or in the event of a change-of-control in either party, leaving Continental with reduced access to intellectual property rights to commercialize its own technologies.

**There is a risk that Continental could infringe on the industrial property rights of third parties.**

There is a risk that Continental could infringe on industrial property rights of third parties, since its competitors, suppliers and customers also submit a large number of inventions for industrial property protection. It is not always possible to determine with certainty whether there are effective and enforceable third-party industrial property rights to certain processes, methods or applications. Therefore, third parties could assert claims (including illegitimate ones) of alleged infringements of industrial property rights against Continental. As a result, Continental could be required to cease manufacturing, using or marketing the relevant technologies or products in certain countries or be forced to make changes to manufacturing processes and/or products. In addition, Continental could be liable to pay compensation for infringements or could be forced to purchase licenses to continue using technology from third parties.

**Continental could be threatened with fines and claims for damages for alleged or actual antitrust behavior.**

In 2007, the European Commission and the U.S. Department of Justice ("DoJ") initiated their investigations into antitrust behavior in the marine hose market. The European Commission found Continental AG, Conti-Tech AG and Dunlop Oil & Marine Limited ("DOM"), in addition to other companies, to be responsible for violations of antitrust law. The proceedings of the European Commission and the DoJ against the company were concluded in 2009. In addition to the European Commission and the DoJ, the authorities in other countries (Brazil, Japan, Australia, South Korea and

Canada) had initiated their own investigations of DOM for the infringement of national competition law. After DOM reached a settlement with the Brazilian antitrust authorities in December 2011, all proceedings have now been concluded or, as was the case in Canada, are not being pursued further. DOM is still facing claims for damages by third parties due to the infringement of antitrust law as a result of the marine hose cartel. Class actions in the U.S.A. were settled. A claim brought before the British High Court was also settled. However, further claims are still threatened in the U.K. and other countries (e.g. Japan, South Korea, Australia and Brazil).

In May 2005, the Brazilian competition authorities opened investigations against Continental's Brazilian subsidiary Continental Brasil Indústria Automotiva ("CBIA") following a complaint of anticompetitive behavior in the area of commercialization of tachographs. On August 18, 2010, the Brazilian competition authorities determined an "invitation to cartel" and imposed a fine of BRL 12 million (about €5.0 million) on CBIA. CBIA denies the accusation and has filed an appeal with the relevant court. However, third parties may also claim damages from CBIA resulting from the infringement of Brazilian antitrust law. On October 2, 2006, South African antitrust authorities received a complaint from a third party accusing several South African tire manufacturers of alleged antitrust behavior, including Continental Tyre South Africa (Pty.) Limited ("CTSA"), a company that is 74% owned by Continental. On August 31, 2010, the South African antitrust authorities came to the conclusion that CTSA had violated South African antitrust law and referred the matter to the responsible antitrust court for a decision. CTSA denies the allegation of infringements of South African antitrust law. However, the tribunal could impose a fine of up to 10% of CTSA's sales. In addition, third parties may also claim damages from CTSA resulting from the infringement of South African competition law.

On February 24, 2010, the European Commission conducted searches at several companies that manufacture wiring harnesses for automotive purposes, including S-Y Systems Technologies Europe GmbH ("S-Y"), Regensburg, Germany. S-Y is a company in which Continental and the Japanese company Yazaki,

a wiring harness manufacturer, each own 50%. The European Commission announced that it has indications that the companies in question have violated EU antitrust law. However, it is not clear whether the European Commission will impose fines against S-Y or Continental. Searches are a preliminary step in investigations into antitrust behavior and are not indicative of the outcome. If the European Commission determines that S-Y or Continental can be accused of antitrust behavior, it could impose a fine based on the severity and the duration of the violations not to exceed 10% of the previous year's sales of the participating company. Even if the European Commission determines that only S-Y exhibited antitrust behavior, it cannot be ruled out that the parent companies may be included in the fine due to joint and several liability. Continental has conducted internal audits in certain business units to check compliance with antitrust law. These audits revealed anticompetitive behavior with respect to one product group. Continental took measures to end this behavior. There is a risk that antitrust authorities may conduct investigations due to this behavior and impose fines and that third parties, especially customers, may file claims for damages. The amount of such fines and any subsequent claims is unknown from the current perspective, but could be significant. It also cannot be ruled out that future internal audits may reveal further actual or potential violations of antitrust law that in turn could result in fines and claims for damages. In addition, alleged or actual antitrust behavior could seriously disrupt the relationships with our business partners.

**Continental might be exposed to tax risks regarding the use of tax loss and interest carryforwards in connection with changes in the shareholder structure of the company.**

Section 8c of the German Corporate Income Tax Act (*Körperschaftsteuergesetz – KStG*) provides for the pro rata elimination of tax loss and interest carryforwards and current losses as a rule in cases where more than 25% and up to 50% of the shares in a company have been acquired within a five-year period by an individual purchaser. If more than 50% of the shares have been acquired by an individual shareholder, carryforwards and current losses are as a rule eliminated completely.

**Continental could be subject to tax risks attributable to previous tax assessment periods.**

Additional tax expenses could accrue at the level of the company or its subsidiaries in relation to previous tax assessment periods which have not been subject to a tax audit yet. The last completed tax audit for the company and its German subsidiaries related to the assessment periods up to and including 2003. A routine tax audit for the company and its German subsidiaries is currently being conducted by the German tax authorities for the assessment periods of 2004 to 2007. Tax audits are also pending in foreign jurisdictions for essentially the same assessment periods. As a result of the aforementioned tax audits, a material increase in the company's or its subsidiaries' tax burden is currently not expected. It cannot however be ruled out that tax audits may lead to an additional tax burden.

Furthermore, Continental is exposed to risks in connection with the takeover of Siemens VDO in 2007, since the tax indemnity provided by the seller of Siemens VDO does not cover the entire tax exposure potentially materializing for pre-acquisition periods.

**Continental is exposed to risks from legal disputes.**

Companies from the Continental Corporation are involved in a number of legal and arbitration proceedings and could become involved in other such proceedings in future. These proceedings could involve substantial claims for damages or payments, particularly in the U.S.A. Further information on legal disputes can be found in Note 34.

**Statement on overall risk situation**

In the opinion of the Executive Board, the risk situation of the Continental Corporation has not changed significantly in the past fiscal year. However, isolated risks have increased as against fiscal 2010:

- ▶ There are growing indications of a slowdown in economic growth around the world and particularly in the eurozone. Accordingly, market risks in conjunction with falling demand have risen in precisely the most important market of Europe – despite the good performance in the past fiscal year.
- ▶ The risks of price fluctuations in raw materials, electronic components and energy have risen. The costs of natural and synthetic rubber and rare earths especially increased significantly in fiscal 2011.
- ▶ However, despite the changes in individual risks, the analysis in the corporation-wide risk management system did not reveal any risks that, individually or collectively, pose a threat to the company or the corporation as going concerns. In the opinion of the Executive Board, there are also no discernible risks to the corporation as a going concern in the foreseeable future.