The Eurowings group is managed largely independently of the network airlines as an integral part of the Lufthansa Group, so as not to dilute the structural cost advantages of the point-to-point model. At the same time, it benefits from belonging to the world's largest aviation group, with its wide range of aviation services.

Leading position in aviation services to be secured and profitable growth generated
With the aviation services companies, the Lufthansa Group has several global leaders in their respective markets. These companies can exploit further growth opportunities – organic, via partnerships or through acquisitions – in a targeted way in order to secure the Lufthansa Group's leading position in these aviation services markets. The diversification of its investment portfolio of airlines and aviation services creates synergies and constitutes a key strength of the Lufthansa Group.

Clear customer focus and quality are also the key elements for the aviation services. Customers of Lufthansa Cargo, for example, benefit from innovative logistics services in an expanded route network. Lufthansa Technik is extending its offer by refining its products and services and expanding its global presence. In a highly competitive market, the customers of the LSG group benefit from flexible and individual catering offers that provide effective support for their own services and brands.

To continue delivering profitable growth, the Aviation Services in the Lufthansa Group continuously adapt their business models to changes in value chains and competitive conditions. Continuous cost-cutting and extensive individual efficiency programmes also ensure commercial success.

FINANCIAL STRATEGY AND VALUE-BASED MANAGEMENT

Financial strategy aims to increase Company value
The Lufthansa Group revised its financial strategy in 2017 with the aim of increasing its Company value sustainably. It will concentrate on three dimensions: increasing profitability, focusing the use of capital and safeguarding financial stability.

Increasing profitability

Management system drives value creation in the Company
The Lufthansa Group applies a value-based system of management. At its centre is the profitability of the Company. In addition to the continuous improvement of revenue quality, this particularly calls for further efforts in cost management. Greater cost discipline, the increased flexibility of cost structures and improved productivity are intended to strengthen structural profitability over the entire airline industry cycle. Unit costs at the passenger airlines, adjusted for fuel costs and exchange rates, are to be reduced by 1 per cent to 2 per cent per year. In order to embed these objectives in all decision-making processes, performance-related pay for managers is tied to the financial performance of the Company.

The Company's profitability is measured by Adjusted EBIT. It is derived from EBIT (earnings before interest and tax), which is then adjusted exclusively for non-recurring effects from the valuation and disposal of assets as well as the valuation of pension provisions.

C07 FINANCIAL STRATEGY

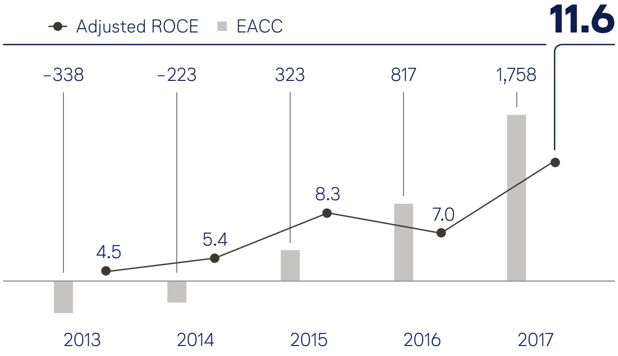
	Sustainable increase of Company value		
	Improve profitability	**Focus capital allocation**	**Maintain financial stability**
Focus	– Sustainable value generation – Intense cost management	– Continuous shareholder participation – Balanced investment level – Working capital management	– Stabilise investment grade rating – Hedging of financial risks – Access to different forms of funding and maintaining appropriate liquidity
Target	– Adjusted ROCE and EACC – Adjusted EBIT margin	– Capital expenditure – Dividend	– Adjusted net debt/Adjusted EBITDA

The return on capital employed (Adjusted ROCE) is measured for the Lufthansa Group and the individual companies. If Adjusted ROCE exceeds the weighted average cost of capital (WACC), the Company is creating value.

In addition to the return on capital employed, the absolute amount of value added is measured by earnings after costs of capital (EACC). EBIT is the starting point for calculating EACC. It must be sufficient to cover the taxes due on earnings and the return expected by investors and lenders.

In 2017, the Lufthansa Group had an Adjusted ROCE of 11.6 per cent. This was 4.6 percentage points up on the previous year. EACC came to EUR 1.8bn in 2017 (previous year: EUR 817m).

C08 DEVELOPMENT OF ADJUSTED ROCE in % **AND EACC** in €m



T009 CALCULATION OF ADJUSTED ROCE, EACC AND COST OF CAPITAL

in €m	2017	2016	Change in %
Revenue	35,579	31,660	12.4
Other operating income	2,382	2,279	4.5
Operating income	**37,961**	**33,939**	**11.9**
Operating expenses	34,808	31,749	9.6
Result from equity investments	157	85	84.7
EBIT	**3,310**	**2,275**	**45.5**
Adjusted EBIT	**2,973**	**1,752**	**69.7**
Interest on liquidity	178	64	178.1
Taxes (assumption 25% of EBIT + Interest on liquidity)	-872	-585	49.1
Cost of capital [1]	-858	-937	-8.5
EACC	**1,758**	**817**	**115.1**
ROCE[2] in %	**12.8**	**9.0**	**3.8 pts**
Adjusted ROCE[3] in %	**11.6**	**7.0**	**4.6 pts**
Balance sheet total	36,267	34,697	4.5
Non-interest bearing liabilities			
of which liabilities from unused flight documents	3,773	3,040	24.1
of which trade payables, other financial liabilities, other provisions	5,989	5,464	9.6
of which advance payments, deferred income, other non-financial liabilities	2,281	2,121	7.5
of which others	3,603	3,811	-5.5
Capital employed	20,621	20,261	1.8
Average capital employed	**20,441**	**19,533**	**4.6**
WACC in %	4.2	4.8	-0.6 pts

[1] WACC x Average capital employed.
[2] (EBIT + Interest on liquidity – 25% taxes based on EBIT + Interest on liquidity)/ Average capital employed.
[3] (Adjusted EBIT + Interest on liquidity – 25% taxes based on Adjusted EBIT + Interest on liquidity)/Average capital employed.

T010 ADJUSTED ROCE AND EACC PER BUSINESS SEGMENT

	Adjusted ROCE		EACC	
	2017 in %	2016 in %	**2017** in €m	2016 in €m
Group	11.6	7.0	1,758	817
Network Airlines	17.1	11.1	1,622	1,089
Point-to-Point Airlines	4.2	-8.0	-63	-124
Logistics	15.5	-3.4	128	-105
MRO	7.7	8.6	147	142
Catering	3.9	6.0	-17	-15

Tighter cost management remains in focus

In addition to generating revenue potential, the Lufthansa Group aims to increase its profitability by continuously and sustainably reducing its costs. Cost-cutting measures are devised and implemented in all operating segments. The segments will focus on different areas in the financial year 2018.

After the successful conclusion of wage negotiations with the pilots at Lufthansa German Airlines and the initial agreement on cost reductions with Fraport, the network airlines are now concentrating above all on the integration of their commercial functions. Fleet renewal is progressing at all airlines, the network portfolio is being optimised and measures to cut fuel costs are being implemented.

Supply contracts in the Point-to-Point Airlines segment are monitored continuously to identify further potential for reducing costs. Existing capacities within the Lufthansa Group are also to be used to reduce MRO costs. Current processes are reviewed and streamlined on an ongoing basis.

The Logistics segment benefits from leaner sales structures. Making key processes more efficient and achieving cost advantages by means of savings also creates flexibility when overcapacities arise in the market. Further potential for savings lies in the analysis of the freighter fleet and handling processes.

In the MRO segment, the existing sites and the related conditions are continuously examined in order to withstand permanent pricing pressure from the market. The focus lies on the parameters of the working-time corridor and the flexible use of capacities, process efficiency and the reduction of production complexity. Agreements have already been reached and further negotiations are ongoing with the works council.

The Catering segment has already implemented wide-ranging programmes to efficiently shape its processes and structures and continues to apply them. Its focus is on transforming its business model in Europe; centralised production and the related logistics are intended to increase flexibility and improve the cost structure. In addition, the company continues to focus on merging its administrative and indirect workflows.

Focused use of capital

Dividend policy aims for continuous distributions

Shareholders should participate in the Company's success. The long-term dividend policy plans for a regular dividend payout ratio of 10 to 25 per cent of consolidated EBIT. One condition is that a distribution of this amount is permitted by the net profit for the year as shown in the individual financial statements of Deutsche Lufthansa AG that are drawn up under German commercial law and that there are no other opposing considerations. In addition to the regular dividend payment, the dividend policy also allows for shareholders to participate in a particularly positive performance by the Company by means of a special dividend or share buy-back.

In line with the dividend policy, the Executive Board and Supervisory Board will table a proposal at the Annual General Meeting on 8 May 2018 to distribute a dividend of EUR 0.80 per share to shareholders for the financial year 2017. This represents a total dividend payout of EUR 377m or 11.4 per cent of EBIT for 2017.

Balanced investment rate to modernise the fleet and maintain flexibility

Going forward, the Lufthansa Group will continue to invest steadily in the renewal of its fleet, in-flight and ground products and infrastructure. Long-term investment obligations will increasingly be made more flexible, however. As a result, the aircraft ordered for the period until 2025 serve mainly to replace older aircraft. Market opportunities arising in the short and medium term can nonetheless be exploited by activating reserve aircraft or procuring used aircraft. This makes the investment profile more balanced and increases focus on the deployment of capital. It also increasingly creates greater room for manoeuvre regarding any further consolidation activity. Regular capital expenditure is financed from the Company's own cash flow. The aim is also to generate a free cash flow that is significantly positive. ↗ C14 **Primary, secondary and financial investments, p. 37.**

Gross capital expenditure rose by 34.4 per cent to EUR 3.0bn in 2017. This was largely due to the acquisition of parts of the Air Berlin group and, more generally, to the significant growth of the Lufthansa Group and a corresponding increase in investment requirements.

Safeguarding of financial stability

Investment grade ratings secure financial room for manoeuvre

Investment grade ratings for the Company's debt secure its financial flexibility. Deutsche Lufthansa AG has an investment grade rating of BBB– at Standard and Poor's, and the outlook was once again lifted from "negative" to "stable" in April 2017 due to an expected stabilisation of the financial profile within the investment grade category. In August 2017, Moody's upgraded its rating from the non-investment grade Ba1 to the investment grade Baa3, with a "stable" outlook. Moody's based its upgraded rating on factors such as positive operating performance in 2017, the cost reductions achieved and the strengthening of the Group's financial profile. Since November 2016, Deutsche Lufthansa AG has also had a third investment grade rating of BBB– from the agency Scope Ratings, which raised its outlook from "stable" to "positive" in December 2017 as a result of the improved financial profile.

T011 DEVELOPMENT OF RATINGS

Rating/outlook	**2017**	2016	2015	2014	2013
Standard & Poor's	BBB–/ stable	BBB–/ negative	BBB–/ stable	BBB–/ stable	BBB–/ stable
Moody's	Baa3/ stable	Ba1/ stable	Ba1/ positive	Ba1/ positive	Ba1/ stable
Scope Ratings	BBB–/ positive	BBB–/ stable			

T012 LUFTHANSA'S CREDIT RATINGS

Standard & Poor's (April 2017)[1] Long-term: BBB– Short-term: A-3 Outlook: Stable	Moody's Investors Service (August 2017)[1] Long-term: Baa3 Short-term: Prime-3 Outlook: Stable	Scope Ratings (December 2017)[1] Long-term: BBB– Short-term: S-2 Outlook: Positive
Strengths	**Strengths**	**Strengths**
⊕ One of the leading global network carriers with an excellent competitive position and one of the largest route network world-wide; strong market position at hubs in Frankfurt, Munich, Zurich and Vienna	⊕ One of the largest airlines in the world and a leading position in the European airline sector with a strong diversified route network; Eurowings strategy of point-to-point traffic addresses cost competitiveness	⊕ Global network coverage, diversified route network, member of the global airline alliance Star Alliance and a high share of business travellers with a strong market position at hubs in Frankfurt, Munich, Zurich and Vienna
⊕ Balanced exposure to high-yielding, premium long-haul traffic across its route portfolio; leading domestic market position in Germany; regional brands are well established	⊕ Robust business profile with diversified business segments reduces its exposure to volatility in passenger and cargo business	⊕ Balanced exposure to high-yielding, premium long-haul traffic across its route portfolio; leading domestic market position in Germany
⊕ Well diversified business profile with leading market positions in maintenance, repair and overhaul (MRO) services as well as airline catering adds stability to Lufthansa Group's earnings	⊕ Diversity of business segments; maintenance, repair and overhaul (MRO) and airline catering business segments deliver stable profit contribution	⊕ Diversified operations (maintenance, repair and overhaul (MRO) and airline catering) with strong market positions mitigating cyclicality risks in passenger and cargo traffic
⊕ Strong liquidity position	⊕ Solid liquidity position	⊕ Solid liquidity position
Weaknesses	**Weaknesses**	**Weaknesses**
⊖ Cost position as a competitive disadvantage	⊖ Profitability of the Passenger Airline Group depends on external factors including uncertain fuel prices and economic development in Europe	⊖ Cyclicality of the airline industry; Lufthansa Group's profitability below its peers'
⊖ Significant and volatile pension obligations due to a fluctuating discount rate	⊖ Market position is challenged by Middle-Eastern airlines in the long-haul segment and low-cost carriers in the short-haul segment	⊖ Cost advantages could erode by competitive pressure

[1] Latest report.

Adjusted net debt/Adjusted EBITDA as an indicator of the Company's ability to service its debts

The ratio of Adjusted net debt/Adjusted EBITDA will be used in future to measure the Group's ability to service its debts. It replaces the debt repayment ratio used previously. By using adjusted net debt, the new ratio also includes pension provisions as well as classic net indebtedness.

From 2019 onwards, when the new accounting standard for leases is introduced (IFRS 16), it will also include financial obligations from the Group's leases (also for property and aircraft).

At the end of 2017, the ratio was 1.7. This is an improvement of 46.9 per cent on the previous year. This is partly due to the strong earnings improvement and partly due to significant savings in pension provisions. The positive performance of this indicator shows the progress that has been made to further strengthen the financial profile of the Lufthansa Group.

Structured risk management minimises finance risks

Integrated risk management, particularly of hedges for fuel, exchange rate and interest rate risks, minimises the short-term financial risks for the Lufthansa Group. The hedges smooth price fluctuations by means of rule-based processes.

T013 ADJUSTED NET DEBT/ADJUSTED EBITDA

	2017 in €m	2016 in €m	Change in %
Net indeptedness[1]	2,637	2,454	7.5
Pension provisions	5,116	8,364	–38.8
Adjusted net debt	**7,753**	**10,818**	**–28.3**
Adjusted EBIT	2,973	1,752	69.7
Amortisation	1,719	1,586	8.4
Adjusted EBITDA	**4,692**	**3,338**	**40.6**
Adjusted net debt/ Adjusted EBITDA	**1.7**	**3.2**	**–46.9**

[1] In order to calculate net indebtedness, here 50% of the hybrid bond issued in 2015 (EUR 247m) has been discounted. Calculation of net indebtedness ↗ **p. 40.**

Diverse forms of funding ensure liquidity

Optimising the funding mix reduces financing costs, maintains a balanced maturity profile and diversifies the Lufthansa Group's portfolio of creditors. The majority of the aircraft fleet should remain unencumbered and wholly owned by the Lufthansa Group in order to maintain its great financial and operational flexibility.

The main financing instruments are aircraft financing and unsecured financing arrangements such as borrower's note loans and publicly traded bonds. Furthermore, the Lufthansa Group has bilateral credit lines with a large number of banks, which serve as an additional liquidity reserve. As of 31 December 2017, these credit lines came to EUR 855m (previous year: EUR 869m) and had not been used.

The Group aims to maintain liquidity of at least EUR 2.3bn at all times, in order to manage liquidity and refinancing risks for the Lufthansa Group, especially at times of volatile demand and financial markets.

A total of six Japanese operating lease (JOLCO) transactions were concluded in 2017. This enabled funds totalling EUR 372m to be raised on favourable terms. These JOLCO deals are repaid continuously over the approximately eleven-year term of the respective contracts.

In December 2016, Deutsche Lufthansa AG issued borrower's note loans for a total of EUR 1.2bn to investors. A liquidity inflow from this transaction of EUR 659m was paid out to Deutsche Lufthansa AG in January 2017. The borrower's note loans have different maturities, as well as fixed and floating-rate tranches. Furthermore, a loan with a volume of EUR 49m and a maturity of seven years was arranged with a Japanese lender.

In September 2017, Deutsche Lufthansa AG relaunched its Euro Medium Term Note (EMTN) programme, a form of debt issuance programme. The programme enables the Group to issue bonds on the capital market at very short notice. It is listed on the Luxembourg stock exchange. No bonds were issued in 2017, however.

There were no significant off-balance sheet financing activities last year. However, various Lufthansa Group companies did enter into rental and/or operating lease contracts. These mainly relate to leases for aircraft and property. ↗ **Notes to the consolidated financial statements, Note 20, p. 132f.**

Fleet and route network

Fleet was significantly expanded in 2017. | Fleet size can be adapted flexibly to fluctuations in demand. | Existing aircraft orders for delivery by 2025 optimise the fleet structure. | Extensive route network optimised continuously.

FLEET

Fleet structure is optimised continuously
At year-end 2017, the Lufthansa Group fleet consisted of 728 aircraft with an average age of 11.4 years. This is 111 aircraft more than in the previous year. This growth is exclusively due to the consolidation of Brussels Airlines and the acquisition of aircraft from the Air Berlin group.

Aircraft from Airbus and Boeing make up the majority of the fleet. Aircraft from Bombardier and Embraer are also deployed on short- and medium-haul routes. Aircraft from the manufacturers Fokker or BAE Systems are no longer in service at the Lufthansa Group as of year-end 2017. In recent years, the number of aircraft types in operation has been continuously reduced through a corresponding fleet strategy and will continue to go down further in the years ahead.

A total of 29 new aircraft, including seven long-haul aircraft, were delivered to the Lufthansa Group in the financial year 2017. The latter consisted of five Airbus A350-900s for Lufthansa German Airlines and two Boeing 777-300ERs for SWISS. Deutsche Lufthansa AG also took out an operating lease on another A330-200 aircraft currently flying for the Eurowings group.