KENDRION

WE MAGNETISE THE WORLD

ANNUAL REPORT 2012

LINNIG

BINDER

100 YEARS OF ELECTROMAGNETISM

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A digital version of this report
is available on the website
(www.kendrion.com) along with
other publications such as press
releases, presentations as well as
the Annual Magazine 2012.

Contents

Profile

KENDRION N.V., a solution provider, develops, manufactures and markets innovative high-quality electromagnetic systems and components for customers all over the world. Kendrion's operations are carried out by four business units focused on specific market segments, namely *Industrial Magnetic Systems, Industrial Drive Systems, Passenger Car Systems* and *Commercial Vehicle Systems*.

KENDRION has leading positions in a number of business-to-business niche markets. Germany is Kendrion's main market, although other countries are becoming increasingly important.

Kendrion's activities

KENDRION develops advanced electromagnetic solutions for industrial applications. These are used by customers all over the world in systems such as lifts, door-locking systems, industrial robots, medical equipment, electrical switchbox systems, diesel and gasoline engines, air-conditioning installations, motor cooling systems and beverage dispensers. Kendrion's key customers include a.o. Bosch, Continental, Daimler, Delphi, Eaton, Evobus, Hyundai, Siemens and Yutong.

Kendrion's shares are listed on NYSE Euronext's Amsterdam market.

Organisation

WE MAGNETISE THE WORLD

Development, manufacturing and marketing of high-quality electromagnetic systems and components ■ Listed company on NYSE Euronext's Amsterdam Market

Revenue: approximately EUR 300 million ■ 1,600 employees (including 100 temps) in 12 countries

Industrial Magnetic Systems
Electromagnetic components tailored to the individual needs of advanced industries.

BINDER

Industrial Drive Systems
Electromagnetic brakes and clutches for the industrial drive technology.

BINDER

Passenger Car Systems
Project solutions for specific customer applications in the automotive and special vehicle industries.

BINDER

Commercial Vehicle Systems
Individual energy-saving systems for commercial vehicles and off-highway applications.

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Preface *To all our shareholders and other stakeholders,*

2012 was, once again, a special year for Kendrion. Forecasters had for several years predicted that the euro crisis would be detrimental to the European economy. Nonetheless, 2010 and 2011 were excellent years for Kendrion. It took until 2012 before Kendrion observed that the developments in a number of industrial submarkets were beginning to waver. After the summer this was followed by a decline in sales from our automotive activities. Nevertheless, Germany – still Kendrion's most important market – continued to exhibit a better performance than many other European countries. This is, for example, demonstrated by the activities of our Industrial Drive Systems business unit, which remained at a high level in 2012. All-in-all, Kendrion recorded a slight growth in revenue in 2012, largely due to the contribution made by the US Kendrion (Shelby) Inc. company (which is the former FAS Controls, Inc. company which Kendrion took over at the end of 2011). However, following a number of years of vigorous growth organic revenue fell by 4% in 2012. Fortunately, Kendrion was then able to benefit in full from the flexibility policy that the company has conducted during the past years, which enabled us to make adequate adjustments to the total cost level.

In 2012, Kendrion devoted a great deal of attention to the company's internal organisation within the context of its 'Entering another league' programme. Kendrion's intention to continue to work on the further enhancement of its market position in the European, American and Asian markets in the coming years gives cause for the need for a further expansion of the company's engineering capacity. During the course of 2012, the company took many steps towards the achievement of this objective – and with success: the number of engineers increased by 6%. Kendrion also continually reviews whether the staffing of the most important management positions is adequate or is in need of enhancement. This is also the reason why Kendrion initiated a special high potentials training programme in 2012 to provide for the future. The investments we made in 2012 also focused strongly on the future. In addition to our investments in new projects, we made further investments in the introduction of the new ERP system and in the improvement of a number of logistics processes. Our total investments reached a record level in 2012.

The developments in our US operations in 2012 were of importance to our endeavours to achieve geographic growth in revenue. The economic prospects in the USA improved in the first half of the year. The third quarter was weaker and the fourth quarter showed a slight improvement. During the course of 2012, substantial investments were made in Kendrion (Shelby) Inc. These relate to an incremental programme which will prepare the operating company for the forecast increase in revenue during the coming years. On balance, Kendrion (Shelby) Inc. made a good contribution to Kendrion's further development. As Kendrion (Mishawaka) LLC also forecasts further growth in the coming years we are, on balance, optimistic about Kendrion's future growth in the USA.

In the Asian region our Indian operations, which began in 2011, recorded a dip during the summer but subsequently achieved good growth. We expect that these operations will also generate many new projects in the coming years. We also succeeded in generating new projects for the future in our other important country, China. However, we are repeatedly confronted with the difficulties of achieving further growth in China by means of takeovers or joint ventures; many current activities are simply not at a European level. In addition, Kendrion's operations in China are not as yet of the scale required to make major investments in new high-grade (Chinese) staff.

Our innovation policy was once again placed high on the agenda in 2012. We completed many innovations, in part due to the contributions made by all business units. Within this context, in 2012 we decided to form the Kendrion Academy, an academy that will focus on fundamental technological developments in our field and on the further intensification of our contacts with specialised universities, universities of applied sciences and centres of expertise.

At the beginning of 2012, we decided to lodge an appeal against the ruling of the General Court of the European Union on our appeal against the fine imposed on us in 2005 by the European Commission for an infringement by our former subsidiary Fardem Packaging B.V. An appeal hearing was held in Luxembourg on 5 February 2013. It is not clear when a final ruling on this appeal is to be expected. Kendrion had already made a full provision in 2011 on the basis of the most unfavourable ruling.

Kendrion is placing an increasingly greater emphasis on sustainability and corporate social responsibility, as is demonstrated by our first CSR Report published in 2012. This trend will continue in 2013. Kendrion will also intensify its marketing efforts for 'green' products even further, as many of its products are designed to save energy and reduce emissions.

Although the developments in Kendrion's revenue and results were somewhat disappointing in 2012, and although we decided to make a provision for the European fine in 2011, our company has retained its powerful financial position. This is in part due to the favourable development in our cash flow during the year under review. The financial agreements we have reached with the banks also offer us sufficient scope for future acquisitions.

Kendrion organised the second Dr. Wilhelm Binder Day in Villingen, Germany, in November 2012. We organise this event to enable our customers and other stakeholders to find out more about the innovative products and markets on which Kendrion focuses and the prospects these offer for the future. An excellent number of more than 300 guests attended the Dr. Wilhelm Binder Day, which was once again a great success.

During the coming years Kendrion shall continue to manifest itself as a powerful and innovative niche player. Our interim report for 2012 announced that we also expect to achieve vigorous growth in the coming years. Our automotive activities in Europe and the USA are expected to make the greatest contribution to our forecast organic growth in revenue. Kendrion attaches great importance to an appropriate balance and spread of risks between the company's automotive and industrial activities and, consequently, focuses on acquisitions of industrial activities and acquisitions in the USA and Asia. However, and self-evidently, opportunities to acquire companies in Germany which further enhance our company's technology and market position will also receive a favourable assessment.

The steps we have taken in the past years give us confidence in the future. However, the greatest uncertainty confronting us is the rate of the recovery of the economy in our most important domestic markets. Our success in acquiring new projects in many of our key markets is a favourable development which creates the conditions required for healthy growth in the coming years.

For this reason we welcome this opportunity to express our gratitude to our employees, our management and our other stakeholders for their hard work, their support and their commitment.

We wish to express our particular gratitude to Mr Ris for the great contribution he has made as CFO of our company.

We are an ambitious company and can achieve our goals only when we continue to combine all our forces in the future.

Piet Veenema, CEO

Kendrion at a glance

Key figures

EUR million, unless otherwise stated

Share information

Normalised net profit per share (EUR) [3]

2011	1.79	
2012	1.16	↓ (35%)

Operations

Revenue

2011	267.9	
2012	284.9	↑ 6%

Operating result before amortisation (EBITA) [2, 3]

2011	30.7	
2012	22.3	↓ (27%)

Operating result before depreciation and amortisation (EBITDA) [3]

2011	40.0	
2012	32.7	↓ (18%)

Normalised net profit [3]

2011	20.5	
2012	13.6	↓ (34%)

EBITA [2, 3]/invested capital [5, 6] (ROI)

2011	22.2%	
2012	12.4%	↓ (44%)

Net investments

2011	13.5	
2012	18.7	↑ 38%

Depreciation and amortisation

2011	10.8	
2012	12.7	↑ 18%

Solvency (total equity/ balance sheet total)

2011	39.2%	
2012	44.8%	↑ 12%

Working capital in % of revenue [4]

2011	11.8%	
2012	11.9%	↑ 1%

EUR million, unless otherwise stated	2012	2011
Net profit	18.0	(20.1)
Organic growth [1]	(4.1%)	20.7%
Net interest-bearing debt	21.3	25.9
Net interest-bearing debt / equity (gearing)	0.21	0.28
Net interest-bearing debt [5] / operating result before depreciation and amortisation (EBITDA) [3]	0.65	(0.07)
Operating result before amortisation (EBITA) [2, 3, 8] / net finance costs	6.6	15.3
Outstanding shares at year-end (x 1,000)	11,655	11,493

Realisation of targets

Organic growth [1]	
Target	> 10% per year
Actual	(4.1%)

Return on Sales [2, 3] (ROS)	
Target	> 10.0%
Actual	7.8%

Return on invested capital [2, 3, 5, 6]	
Target	> 17.5%
Actual	12.4%

Solvency	
Target	not below 35%
Actual	45%

Ratio of interest-bearing debt and EBITDA [3]	
Target	< 3.00
Actual	0.65

Free cash flow [3, 7]	
Target	healthy free cash flow in relation to organic growth in % of net profit
Actual	71%

Dividend distribution	
Target	between 35-50% of net profit
Actual	50% of normalised net profit

1 *Organic growth is excluding revenue Kendrion (Shelby) Inc. (formerly named FAS Controls, Inc.) in 2012.*
2 *EBITA excluding amortisation related to acquisitions (part of other intangible assets).*
3 *Excluding EC fine and a.o. acquisition expenses in 2011 and excluding release earn-out Kendrion (Shelby) Inc. in 2012.*
4 *Working capital and revenue are excluding Kendrion (Shelby) Inc. in 2011.*
5 *Net interest-bearing debt and invested capital is excluding Kendrion (Shelby) Inc. in 2011.*
6 *Total invested capital is property, plant and equipment, intangible assets and current assets less the current tax liabilities, trade payables and other payables.*
7 *Before cash flow relating to aquisitions.*
8 *Financing costs excluding accrued interest EC fine.*

Mission, strategy and financial objectives

Mission

Kendrion is committed to being a leading international company that uses its existing know-how, innovative capabilities and commercial strengths to provide solutions to the company's industrial and automotive customers. In doing so Kendrion intends to be a transparent, flexible and reliable company where entrepreneurial zeal is combined with clear profit targets. Kendrion seeks to further strengthen its position as a fast-growing high-tech company.

Strategy

Kendrion's policy is focused on the creation of sustainable added value and the achievement of appealing return on investment for the company as a whole. This is based on a powerful focus on a number of selected operations and on profitable growth achieved both organically and via acquisitions. Kendrion's objective is to evolve from a European player into even more of a global player. Within this context, the USA, China and India are important countries for further growth. Kendrion intends to achieve this objective by building up and expanding its leading market positions in selected niche markets in terms of both revenue and added value.

Kendrion utilises its existing know-how, innovative capacity and commercial strengths to offer solutions to a wide range of customers, whereby the company shall focus on the further expansion in the fields of applications for electromagnetic systems and components.

Kendrion, characterised by its transparency, flexibility and local entrepreneurship, is driven by challenging but realistic targets. In addition, Kendrion intends to be and remain a company that appeals to its employees, customers and shareholders. Kendrion is aware of the importance of sustainability and of Kendrion's social responsibility, and for this reason the social and environmental standards governing all processes are continually being made more stringent.

Kendrion's spearheads are:
- Niche market leadership in selected business-to-business markets;
- Organic growth in the current operations;
- Utilisation of synergy in and between the business units (locally but also internationally);
- Balanced spread of the operations;
- Targeted add-on acquisitions;
- Enhancement of the innovative capacity;
- Corporate Social Responsibility and sustainability.

Niche market leadership in selected business-to-business markets

Kendrion endeavours to achieve niche market leadership in selected business-to-business markets. Niche markets are small markets, where 'small' refers not so much to revenue or volume as to a limited number of suppliers in the sense of quality (technology and innovation). Kendrion intends to acquire a leading position in the niche markets that offer appealing margins and which are governed by relatively high barriers to entry (know-how, investments). Kendrion's products and related services have the following features:
- The products and services are of an innovative and technical nature;
- Products and services are mostly customised;
- The contribution to costs may be 'minor', but is essential to the customer's finished products;
- The number of customers (and suppliers) is limited but there are long-term relationships;
- The market for a specific product or service offers the company an opportunity to hold a leading position in that market.

Organic growth in the current operations
Kendrion endeavours to achieve organic growth in its operations in terms of revenue, volume and result. This can be achieved by having powerful market positions, further expansion of the company's high-grade engineering and test facilities, offering customised solutions to customers and the provision of excellent logistics concepts. Top priority is assigned to the provision of first-rate service and knowing the market segments and customers demands.

Utilisation of synergy in and between the business units
Kendrion's four market-focused business units operate in different markets. Kendrion endeavours to achieve optimum synergy in and between the business units by measures including joining forces in marketing and sales and exchanges of engineering know-how, purchasing and support services such as HR, Finance, and IT.

Balanced spread of the operations
Kendrion attaches great importance to a balanced spread between its automotive and industrial operations as these activities are beneficial to each other and jointly increase Kendrion's level of expertise. For this reason Kendrion intends to improve this spread and, following an assessment, has expanded its strategic objectives as follows:

- Vigorous growth in revenue in the company's core activities (in part by means of acquisitions);
- Primary focus on value-added acquisitions preferably in industrial operations;
- Great efforts to achieve continued growth in the USA and China;
- Acquisitions in Europe, provided that they strengthen Kendrion's technological and market position.

Kendrion intends to safeguard stable results by avoiding a dependency on one geographical market. Kendrion endeavours to achieve a balanced geographical spread of its operations over the world, with Europe, the Americas and Asia as the most important geographic markets. In Europe, the importance of countries in Eastern Europe needs to increase. Eastern Europe offers opportunities in terms of production locations and markets, as is illustrated by the operating company in the Czech Republic. The Americas and Asia are also becoming more important. Kendrion is increasing its focus on these areas to achieve further growth, whereby the company is striving to create centres of excellence in each continent, each offering solutions as locally required.

Kendrion strives to achieve a balanced customer base in which, in principle, no customer generates more than 5% of the company's total revenue.

Targeted add-on acquisitions
Kendrion endeavours to acquire companies that enhance the company's leading position in its markets and the geographical spread of its operations. Kendrion is focused on strengthening the company's position in the markets outside Europe, more specifically in the markets of the American and Asian continents. An example is the acquisition of FAS Controls, Inc., North Carolina, USA, now operating under the name of Kendrion (Shelby) Inc. However, Kendrion still perceives interesting opportunities in Europe, in particular in Germany. Kendrion intends to achieve further growth, in particular by acquisitions in the industrial segments. Acquisition targets need to offer good returns in terms of their EBIT and ROI, preferably at levels similar to Kendrion's returns, but at least leading to improvement of the earnings per share.

Enhancement of the innovative capacity
Globalisation and technological developments are increasing the competitive pressure. Kendrion is aware that the company will be unable to achieve and retain its planned growth and attractive market positions without a strong innovative behaviour, strong engineering capacity, its knowledge of markets and customers and permanent improvements to its operations. This will in turn require Unique Selling Points and innovation.

Kendrion uses a multi-year Innovation Calendar that states fixed times at which the business units are encouraged to introduce innovations. This leads to annual presentations of Kendrion's most important innovations to its stakeholders, such as the second Dr. Wilhelm Binder Day, which Kendrion organised in Villingen (Germany) in November 2012. Kendrion also makes use of the services of an external Innovation Board for the provision of the necessary advice and support to the company. Kendrion recently also developed an Intellectual Property strategy and devotes continually increasing efforts to the development of knowledge management.

Corporate Social Responsibility (CSR) and sustainability
Pursuant to Kendrion's mission CSR and sustainability are intrinsic, integral elements of the company's operations. This form of entrepreneurship pivots on the creation of multiple values (People, Planet and Profit). Sustainability is already at the core of many of the company's products and innovations. Kendrion intends to secure a sustainable and 'green' environment for the generations to come for so far as this is within the company's control. Kendrion intends to enhance its sustainability strategy and bring the strategy further into line with the company's overall strategy, for example in terms of the use of materials and the product portfolio. Some of relevant

global trends such as climate change, scarcity of resources, sustainable energy and population growth offer also opportunities that Kendrion intends to explore further. In the longer term these can make an essential contribution to the creation of value for all Kendrion's stakeholders and the attraction of motivated employees.

Strategic objectives update

Some time ago, Kendrion stated its target of increasing revenue to EUR 350 million in 2012/2013. Since the company acquired the North Carolina-based (USA) manufacturing company FAS Controls, Inc. in December 2011, revenue has increased to roughly EUR 300 million, around EUR 200 million of which is generated by automotive operations (i.e. cars, buses and trucks). The combined revenue of the industrial business units totals approximately EUR 100 million. Further organic growth is expected for the coming years, where Kendrion's automotive activities, in particular, will be the driving force in both Europe and the United States.

Financial objectives

- Annual organic growth in revenue of at least 10%;
- Growth of the company, including acquisitions, to annual revenues of about EUR 450-500 million in 2015;
- Return on Sales (EBITA margin) in excess of 10%;
- Return on investment (ROI), inclusive of goodwill, in excess of 17.5%;
- A healthy free cash flow given the organic growth achieved;
- Solvency ratio not below 35%;
- Interest-bearing debt/EBITDA of lower than 3.0;
- Dividend distribution between 35% and 50% of the net profit.

Important events (summary of press releases)

16 January 2012

Kendrion lodges an appeal regarding the EC fine

On 16 November 2011, the General Court of the European Union in Luxembourg delivered its judgement in the case brought by Kendrion N.V. against the fine imposed on 30 November 2005 by the European Commission in the amount of EUR 34 million (excluding interest) for infringement of Article 81(1) of the EC Treaty by its former subsidiary Fardem Packaging B.V., established in Edam, the Netherlands (case number T-54/06). The General Court ruled that the fine is to be upheld in full. The judgement of the General Court has hardly any impact on the operational activities of Kendrion and does not influence its ability to meet its financial covenants and obligations.

Kendrion N.V. has decided to lodge an appeal with the Court of Justice of the European Union.

Besides the existing provision of EUR 2.2 million, Kendrion N.V. has decided to create an additional provision in 2011 amounting to EUR 39 million in view of the judgement of the General Court.

Kendrion N.V. has issued a bank guarantee to the European Commission. This bank guarantee will remain valid during the appeal with the Court of Justice.

18 January 2012

Kendrion expands credit facility for acquisitions

Kendrion has reached agreement with its bank consortium, comprising Rabobank, ING Bank and Deutsche Bank, on a supplementary credit facility of EUR 60 million to be used for acquisitions.

The supplementary credit facility is subject to virtually the same terms as the credit agreement entered into in January 2011 that will expire at the start of 2016.

The total credit facility now amounts to EUR 183.5 million, of which EUR 35 million for working capital and general use and EUR 100 million for acquisitions, from which the acquisition of FAS Controls, Inc. has already been financed. EUR 48.5 million is a bank guarantee for the European Commission in respect of the ongoing proceedings on the fine relating to Fardem Packaging B.V.

8 August 2012

Kendrion sees pressure on profit in 2012

Kendrion stated at the time of the publication of the first quarter 2012 figures that it expects growth in revenue and profit for the full year 2012 in comparison to 2011.

Revenue in the Industrial Magnetic Systems business unit in the second quarter of 2012 did, however, decrease by 15% in comparison to the same quarter of 2011. This decrease is connected with the continuing economic uncertainty in primarily Europe, which is causing new projects to be delayed and customers to purchase less.
With respect to the Commercial Vehicle Systems business unit, the results in the bus market are being realised according to plan, but Kendrion is encountering disappointing results in the truck market, with amongst others much lower-than-expected volumes in India.
Order entry and revenue performance within the Industrial Drive Systems and Passenger Car Systems business units are developing satisfactorily to date, albeit at a somewhat lower level than envisaged.

Based on the above developments, Kendrion is revising the outlook downward for the full year 2012. Kendrion expects annual profit in 2012 to be 15 to 20% lower than the normalised net profit (EUR 20.5 million) for the full year 2011.

Kendrion continues to look to the (medium) long term with confidence, particularly due to new projects in both the automotive and the industrial market that will lead to growth in revenue in the course of 2013.

23 August 2012

Strategic objectives update

Kendrion published its strategic objectives update as described on page 11 hereof.

16 November 2012

Eiko Ris resigns as CFO of Kendrion N.V.

The Kendrion Supervisory Board reports that Mr Ris, the CFO of Kendrion N.V., has announced his decision to continue his career elsewhere. Mr Ris will join Hertel Holding B.V. as CFO by 1 March 2013 at the latest.

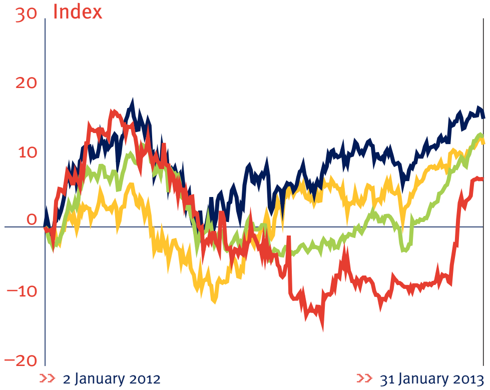
Information on Kendrion N.V. shares

Share capital

The authorised share capital amounts to EUR 80,000,000 and is comprised of 40,000,000 ordinary shares with a nominal value of EUR 2.00. On 31 December 2012, 11,655,214 shares had been issued. On the balance sheet date the company owned 15,839 shares that are required to cover the current share plans.

Kendrion's shares are listed on NYSE Euronext's Amsterdam market.

Movements in the share price from 2 January 2012 to 31 January 2013



Movements in the number of outstanding shares

	Ordinary shares entitled to dividend	Repurchased shares	Total number of issued shares
At 1 January 2012	11,445,133	47,392	11,492,525
Issued shares (share dividend)	155,675	–	155,675
Issued registered shares (share plan)	7,014	–	7,014
Delivered repurchased shares	31,553	(31,553)	–
At 31 December 2012	11,639,375	15,839	11,655,214

Other information

In EUR, unless otherwise stated	2012	2011	2010
Number of shares x 1,000 at 31 December	11,655	11,492	11,316
Market capitalisation at 31 December, EUR million	186.5	189.6	164.1
Enterprise value (EV) EUR million	207.9	215.5	169.3
Highest share price in the financial year	20.50	18.99	15.10
Lowest share price in the financial year	14.80	13.25	8.82
Share price on 31 December	16.00	16.50	14.50
Average daily ordinary share volume	11,199	17,489	13,642
EBITDA multiple (over EV)	6.35	5.39	5.10
Result per share	1.55	(1.79)	1.47
Normalised result per share	1.16	1.79	1.30
Share price earnings ratio	13.79	9.27	9.93

Major shareholders

Pursuant to the Netherlands Financial Supervision Act, Kendrion is aware, on the basis of the information in the registers of the Netherlands Authority for the Financial Markets (AFM), that the following shareholders possessed an interest of more than 5% on 31 December 2012:

Shareholder		Date of report
Parcom Capital (ING)	15.07%	1-10-2010
Delta Lloyd N.V.	9.49%	6-5-2011
Menor Investments B.V.	7.92%	9-1-2009
Janivo Beleggingen B.V.	5.88%	4-10-2011
Delta Lloyd Deelnemingen Fonds N.V.	5.10%	8-2-2012
Darlin N.V.	5.09%	1-11-2006
Jan Plas S.A.	5.02%	2-4-2009
J.N.A. van Caldenborgh	5.00%	4-3-2010
Total	58.57%	

Other movements in the size of the interests of Kendrion's major shareholders also took place during the course of 2012. These changes fall within the disclosure thresholds as stipulated in the Financial Supervision Act and, consequently, do not need to be disclosed by the major shareholders.

New legislation (the Corporate Governance Act, implementing the recommendations of the Corporate Monitoring Committee (the Frijns Committee)) will enter into force on 1 July 2013. This Act will introduce the obligation on shareholders to disclose a substantial holding of 3% or more, as well as the obligation to disclose gross short positions. A regulation will be introduced on the same date enabling the identification of shareholders holding 0.5% or more of the issued share capital in certain circumstances. Kendrion will give consideration to the approach it intends to adopt, within the stipulated statutory framework, to the options, rights and obligations relating to the identification of shareholders.

Transactions between the company and legal persons holding at least 10% of the shares in the company as specified in best practice provision III.6.4 of the Netherlands Corporate Governance Code have not taken place.

Dividend

Kendrion's dividend policy takes account of both the interests of the shareholders and the expected further development of the company.

Kendrion carried out an evaluation of its dividend policy during the course of 2011. The results from this evaluation were discussed during the General Meeting of Shareholders on 16 April 2012.

Kendrion endeavours to realise an attractive return for shareholders, supported by a suitable dividend policy. However, to provide the necessary assurances for its continuity the company needs to retain a healthy financial position. When the dividend to be distributed to shareholders is determined consideration also needs to be given to the amount of profit to be retained to support the medium and long-term strategic plans of the company and to maintain a minimum solvency ratio of 35%. Kendrion strives to distribute an annual dividend of between 35% and 50% of the net profit. In principle, Kendrion offers shareholders an opportunity to opt for dividend in cash and/or in the form of ordinary shares in Kendrion N.V.'s capital.

The Executive Board shall, in line with the dividend policy and with the approval of the Supervisory Board, submit a proposal to the shareholders for the payment of a dividend of 50% of the normalised net profit of 2012. The dividend is equivalent to an amount of EUR 6.75 million. The number of outstanding shares entitled to dividend at 31 December 2012 was 11,639,375 and, consequently, the dividend amounts to EUR 0.58 per ordinary share with a nominal value of EUR 2.00 each.

A proposal will be submitted to the shareholders during the General Meeting of Shareholders on 15 April 2013 for the payment of the dividend, at the shareholder's discretion, in cash and/or in ordinary shares, charged to the share premium reserve. The share dividend will be set on 7 May 2013 (before start of trading), on the basis of the volume-weighted average price of all ordinary shares in Kendrion traded on 29 and 30 April and 2, 3 and 6 May 2013, at a level whereby the value of the dividend in shares is virtually equal to the cash dividend. The dividend will be made available on 9 May 2013.

Financial calendar

Wednesday 27 February 2013	Publication of the 2012 full-year figures
Monday 18 March 2013	Record date General Meeting of Shareholders
Monday 15 April 2013	General Meeting of Shareholders
Wednesday 17 April 2013	Ex-dividend date
Friday 19 April 2013	Dividend record date
Monday 22 April – Monday 6 May 2013, 3 pm	Dividend election period (stock and/or cash)
Tuesday 7 May 2013	Determination stock dividend exchange ratio
Wednesday 8 May 2013	Publication of the results for the first quarter of 2013
Thursday 9 May 2013	Cash dividend made payable and delivery stock dividend
Wednesday 21 August 2013	Publication of the results for the first six months of 2013
Wednesday 6 November 2013	Publication of the results for the third quarter of 2013
Thursday 27 February 2014	Publication of the 2013 full-year figures
Monday 14 April 2014	General Meeting of Shareholders

Voting by proxy

Shareholders can be represented by proxy at meetings of shareholders. At request a proxy can be granted to an independent third party. Shareholders who are unable to attend the General Meeting of Shareholders can request proxy forms from the company. These are issued free of charge and are also available on Kendrion's website. Shareholders may also grant a proxy electronically through e-voting (www.abnamro.com/evoting).

Participation

A share plan for the top management of Kendrion was introduced in 2005. This plan provides for the issue of shares in Kendrion as payment in kind. After the General Meeting of Shareholders each year the number of shares to be awarded to the top management of Kendrion in that year is determined by the Supervisory Board on the basis of the Executive Board's recommendations. The plan does not extend to the Executive Board. In addition, the Vice-President Automotive, the Business Unit Managers and a number of other officers are offered an opportunity to apply for the conversion of a maximum of half of their annual net cash bonus into shares. Kendrion doubles the number of shares after three years when officers are still employed by Kendrion and still possess the shares. Pursuant to these share plans a total of 7,014 shares were awarded in 2012. For central administration and handling purposes it has been decided to issue new – registered – shares and to terminate the delivery of repurchased shares for the share plans reviewed in this section as from 2012.

A bonus scheme in shares was granted to the members of the Executive Board for 2012. More information about the shares granted to the members of the Executive Board is enclosed on pages 125, 126, 135 and 136. A comprehensive description of the bonus scheme for 2012 and onwards is included in the remuneration policy section on pages 60-62.

Regulations to prevent insider trading

Kendrion has implemented internal regulations to prevent insider trading. These regulations govern the Supervisory Board, Executive Board, Innovation Board, the Vice-President Automotive, the Business Unit Managers and their Controllers, and a number of other employees. In addition, the Executive Board and the Supervisory Board are governed by restrictions on trading in other listed companies. Kendrion has also designated a number of consultants affiliated with the company as insiders. Kendrion's Compliance Officer is entrusted with the supervision of compliance with the regulations.

Investor relations

Kendrion attaches great importance to appropriate communications with financial stakeholders and other interested parties such as investors, capital providers and analysts to provide them with a good insight into the developments at Kendrion. Price-sensitive information is disclosed in public announcements. Transparency should lead to healthy pricing, and must support sufficient liquidity.

Liquidity providing

In 2012, SNS Securities N.V. has acted as a liquidity provider for Kendrion N.V. As such, SNS Securities acts as counterparty for buy or sell orders of which the bid and ask prices are set within a range around the last executed price. This way, relatively smaller (retail) buy and sell orders can be executed through the liquidity provider which results in a more fair and orderly market.

Analysts

The following stock exchange analysts actively monitor the Kendrion share:

■ ABN AMRO Bank N.V.	Roderick van Esch
■ Rabo Securities N.V.	Frank Claassen
■ SNS Securities N.V.	Gert Steens
■ Theodoor Gilissen Bankiers N.V.	Tom Muller
■ The Idea Driven Equities Analyses company	Maarten Verbeek

More information about the Kendrion share is available from Kendrion's website, www.kendrion.com.

Members of the Supervisory Board

S.J. van Kesteren (71)
Mr Van Kesteren is the Chairman of the Supervisory Board. In 2005 the General Meeting of Shareholders appointed Mr Van Kesteren for a four-year term until 2009. In 2009 the General Meeting of Shareholders reappointed Mr Van Kesteren for a four-year term until 2013. At the General Meeting of Shareholders to be held on 15 April 2013 it will be proposed to reappoint him for a period of one last year. He is member of the Remuneration Committee of Kendrion. Mr Van Kesteren is Chairman of the Supervisory Board of Koninklijke Nedschroef Holding B.V. Formerly he was Chairman of the Board of Draka Holding N.V. and member of the Advisory Board of ABN AMRO Group N.V. Mr Van Kesteren is a Dutch national. He does not possess any shares in Kendrion.

R.L. de Bakker (62)
Mr De Bakker was appointed a member of the Supervisory Board during the Extraordinary General Meeting of Shareholders held in June 2005 for a two-year term until 2007. In 2007 Mr De Bakker was reappointed for a four-year term until 2011 and in the General Meeting of Shareholders of 2011 for a further period until 2015. He is Vice-Chairman of the Supervisory Board and Chairman of the Audit Committee of Kendrion. Mr De Bakker is Chairman of the Supervisory Board of SPIE Nederland B.V. and Chairman of the Supervisory Board of WCC B.V. He is also a member of the Board of a number of investment companies based in the Netherlands and a member of the Board of the Tom-Tom Continuity Foundation, Chairman of the Supervisory Board of the Florence Zorg Foundation and Chairman of the Supervisory Board of the Raamwerk Foundation. He was formerly Chief Financial Officer and member of the Executive Board of ASM International N.V. Mr De Bakker is a Dutch national. He does not possess any shares in Kendrion.

M.E.P. Sanders (59)
Ms Sanders was appointed a member of the Supervisory Board during the General Meeting of Shareholders held in April 2005 for a three-year term until 2008. In 2008 the General Meeting of Shareholders reappointed Ms Sanders for a four-year term until 2012. In 2012 the General Meeting of Shareholders reappointed Ms Sanders for a four-year term until 2016. She is Chair of the Remuneration Committee of Kendrion. Ms Sanders is Chair of the Supervisory Board of Hoens Broadcast Facilities B.V. and Chair of the Advisory Board of Difrax Beheer B.V. and Kalff de Jager B.V. Ms Sanders is member of the Supervisory Board of Stern Groep N.V. She is also member of the Advisory Board of De Hoge Dennen B.V. Ms Sanders is a Dutch national. She does not possess any shares in Kendrion.

H.J. Kayser (52)
Dr Kayser was appointed to the Supervisory Board during the Extraordinary General Meeting of Shareholders held in July 2009 for a four-year term scheduled to expire in 2013. At the General Meeting of Shareholders to be held on 15 April 2013 it will be proposed to reappoint Dr Kayser for a period of four years. He is a member of Kendrion's Audit Committee. Dr Kayser is CEO of 3W Power Holdings SA and AEG Power Solutions BV. He was formerly the CEO of Kuka AG. He held several (international) management positions with Siemens AG and McKinsey & Company during the period from 1989 to 2008. Dr Kayser is a German national. He does not possess any shares in Kendrion.

From left to right:
H.J. Kayser, member
S.J. van Kesteren, Chairman
R.L. de Bakker, Vice-Chairman
M.E.P. Sanders, member

Report of the Supervisory Board

Annual Report

We hereby present you the Annual Report for 2012 prepared by the Executive Board. The Annual Report includes the financial statements audited by KPMG Accountants N.V. The unqualified independent auditor's report is enclosed on pages 137 and 138 of this Report.

The Supervisory Board and the Executive Board held extensive discussions on the Annual Report for 2012 and the preparation of the Report, partly during a meeting attended by the auditor. These discussions have convinced us that the Annual Report complies with the transparency requirements, and we are of the opinion that it constitutes a good basis for the accountability of the Supervisory Board for its supervision and advice during the year under review.

The Supervisory Board recommends that the General Meeting of Shareholders to be held on 15 April 2013 adopts these financial statements and discharges the Executive Board and Supervisory Board of responsibility in respect of their respective management and supervision.

Composition of the Supervisory Board and Executive Board

Supervisory Board

The Supervisory Board is comprised of four members. The membership of the Supervisory Board remained unchanged during the year under review. In accordance with the rotation schedule, and after due consideration, a proposal to reappoint Mr Van Kesteren and Dr Kayser as a member of the Supervisory Board for a further one-year term and a four-year term respectively shall be submitted to the General Meeting of Shareholders to be held on 15 April 2013. The reason for the proposed one-year term for the reappointment of Mr Van Kesteren is twofold. Firstly, Mr Van Kesteren has announced that this will be his last year as Member of the Supervisory Board. Kendrion will begin the search for a new Member and Chair in 2013. Secondly, in this way an improved rotation schedule is introduced that will enable the Supervisory Board to reach an annual decision on the appointment or reappointment of one member of the Board.

All four members of the Supervisory Board comply with best practice provision III.3.4 of the Netherlands Corporate Governance Code (stipulating the maximum number of Supervisory Boards of Dutch listed companies of which an individual may be a member). The Bill on management and supervision, which entered into force on 1 January 2013, introduced further restrictions on the number of supervisory positions that may be held by members of the Supervisory Board and Executive Board. Potential candidates for the positions of CEO or CFO may not hold more than two supervisory positions at other entities that are governed by the same restrictions or hold the position of Chairman of the Supervisory Board or one-tier Board at those entities. Mr Sonnemans, Kendrion's proposed new CFO, complies with this new regulation. Persons may be (re)appointed as members of the Supervisory Board only when they are members of no more than four Supervisory Boards at other entities that are governed by the same restrictions. Within this context the position of Chairman is regarded as equivalent to two positions. Positions currently held by members of the Supervisory Board are however not affected. Mr De Bakker is currently a member of more Supervisory Boards than permitted under the provisions of the new Act. However, the provisions of the Act become only applicable in the event of a (re)appointment. Mr Van Kesteren and Dr Kayser, proposed for reappointment, comply with the new regulation.

The Supervisory Board is of the opinion that it complies with the independence requirements stipulated by the Netherlands Corporate Governance Code.

The prevailing regulations and addendum governing the ownership of and transactions in the company's securities and the securities of other designated companies offer sufficient assurances.

The profile of the Supervisory Board includes a statement (in part in view of the diversity provisions of best practice provision III.3.1 of the Netherlands Corporate Governance Code) that endeavours shall be made to achieve a mixed composition in terms of age and experience and that preferably at least one woman shall be a member of the Supervisory Board. These endeavours have been achieved. The profile of the Supervisory Board is available on the company's website.

New legislation has entered into force to provide for the balanced participation of men and women in the management and supervision of 'large' public and private limited liability companies. Balanced participation is deemed to exist when at least 30% of the seats are held by men and at least 30% by women. Kendrion's Executive Board and Supervisory Board do not achieve this gender balance.

The imbalance in the Executive Board is in part due to the limited number of members. The selection process for a new CFO did not identify any women who fitted the profile drawn up by the Supervisory Board.
25% of the seats on the Supervisory Board are held by women (1 out of 4), a proportion in accordance with the existing profile.
A proposal will be submitted to the General Meeting of Shareholders on 15 April 2013 for the reappointment of Mr Van Kesteren and Dr Kayser. Although Kendrion attaches great importance to diversity and intends to increase the percentage of women in the company's senior management, Kendrion is of the opinion that continuity in and the relevant experience of the members of the existing Supervisory Board is currently of greater importance than taking the opportunity offered by the two (re)appointments to increase the number of women.

Both the Supervisory Board and the Executive Board comply with the conflicts of interest rules laid down in the Netherlands Corporate Governance Code.
No transactions took place in the year under review in which conflicts of interest on the part of the members of the Executive Board or the Supervisory Board played a role.
The Supervisory Board has taken notice of the new conflict of interest regulations prescribed by the Bill on management and supervision and shall act accordingly.

Executive Board
The membership of the Executive Board remained unchanged in 2012. On 16 November 2012 it was announced that the CFO, Mr Eiko Ris, had decided to continue his career elsewhere. Mr Ris will remain in his position at Kendrion until 28 February 2013. The Supervisory Board wishes to express its gratitude to Mr Ris for his great contribution to Kendrion's performance and growth in recent years and wishes him every success in his future career. The Supervisory Board began to search for a new CFO immediately after Mr Ris' announcement and called on an experienced and reputable international executive search consultancy firm for assistance. This search was based on an explicit profile which took account of the future responsibilities of the new CFO and the officer's ability, in cooperation with the CEO, Executive Committee and other staff, to implement Kendrion's Mid-term Plan. We are gratified that we have been able to find a suitable candidate in such a short time and are pleased to submit a proposal to the shareholders for Mr Sonnemans' appointment to the position of CFO for a four-year period.

Evaluations

In several meetings of the Supervisory Board, not attended by the Executive Board, the performance of the Supervisory Board, its Committees and its members, the performance of the Executive Board and its members and an evaluation of the remuneration policy governing the Executive Board were discussed. These meetings also reviewed the requirements for the profile, composition and competence of the Supervisory Board.
The Supervisory Board has worked with a self-assessment questionnaire, to be filled out by each of its members. The performance of this form of evaluation was discussed in a meeting of the Supervisory Board.
This revealed a number of issues for attention points that will be addressed further in 2013, to be monitored by the Chairman of the Supervisory Board. These issues include the further development of CSR, the continuation of technical workshops to receive information about developments, new visits to sites and meetings with management. Last year, the issues requiring attention were the further optimisation of the preparations of meetings and the intention to have an even stronger focus on CSR. The first of these issues was addressed by measures including the introduction of a pre-meeting attended solely by the members of the Supervisory Board prior to the formal Supervisory Board meetings attended by the Executive Board. The second issue was also addressed. The Supervisory Board reviewed the achievements in 2012 and the proposals for the even more ambitious CSR strategy and targets for 2013 prior to

their formal adoption. In conclusion, some members of the Supervisory Board attended a technical workshop in Villingen, Germany, to increase their knowledge of the products and their applications.

The Supervisory Board also held consultations with the external auditor, in part attended by the Executive Board. In addition to these formal meetings, the Chairman of the Supervisory Board held regular informal discussions with the CEO, and the Chairman of the Audit Committee had informal discussions with the CFO.

The Audit Committee once again reviewed the need for an internal auditor. The Supervisory Board recommends that the Executive Board, in line with the Audit Committee's proposal, maintains the current situation. The Supervisory Board is of the opinion that the internal control procedures described in more detail on pages 33 and following of this Annual Report are adequate for Kendrion's needs.

KPMG Accountants N.V. ('KPMG') were appointed Kendrion's auditor in 2005 and reappointed by the General Meeting of Shareholders in 2009. In 2012, KPMG was reappointed for a further period of two years from 2012 (for the 2012 and 2013 financial years). Pursuant to KPMG's rotation schedule, the Engagement Partner was exchanged in 2012, in close consultation with Kendrion. Pursuant to new legislation the auditor's audit services must be segregated from the auditor's consulting services. Kendrion will comply with this regulation. In view of agreements concluded before the new regulation entered into force KPMG may still be engaged in internal control, compliance and due diligence services in 2013.

Meetings

The Supervisory Board met with the Board on ten occasions. These meetings reviewed a number of permanent items on the agenda which included the company's strategy, the results of and developments within the market-focused business units and Kendrion as a whole, flexibility, innovation, corporate governance, CSR, the independence of the auditor, the auditor's findings and recommendations, the business units' policy and business plans, the financing, fiscal position, risk management, PR/IR, the ERP project HORIZON, as well as management development. One meeting was convened specifically for a detailed discussion of the strategy, including the mid-term growth and acquisition policy. With the exception of two meetings, all meetings were attended by all members of the Supervisory Board.

The Supervisory Board paid a working visit to the Kendrion (Mishawaka) LLC and Kendrion (Shelby) Inc. plants in the USA. The Supervisory Board was also pleased to attend the second Dr. Wilhelm Binder Day in Villingen, Germany, held on 22 November 2012 and welcomed the opportunity this offered for informal contacts with shareholders, customers, employees and other stakeholders.

Committees

The Supervisory Board instituted two specific committees, an Audit Committee and a Remuneration Committee. Both Committees have been assigned the duty of making the preparations for the decision-making by the full Supervisory Board. The roles and responsibilities of the Committees are in accordance with the relevant provisions of the Netherlands Corporate Governance Code (best practice provisions III.5.4 and III.5.10).

The regulations of both Committees have been published on Kendrion's website.

Audit Committee

In 2012 the Audit Committee was comprised of Mr De Bakker (Chairman and financial expert within the meaning of the Netherlands Corporate Governance Code) and Dr Kayser.

The Audit Committee held four meetings with the CFO and his staff during the year under review which discussed issues including the development in the results, tax position, risk management, claims, treasury activities, the potential consequences of the new Accountancy Profession Act, and insurances. The external auditors joined the meetings in which the yearly figures of 2011 and the half year figures of 2012 were discussed. The members of the Committee attended all meetings, sometimes by telephone.

Remuneration Committee

In 2012 the Remuneration Committee was comprised of Ms Sanders (Chair) and Mr Van Kesteren.

The Remuneration Committee held four meetings in 2012. The meetings were attended by members of the Executive Board. During the meetings the bonus systems were discussed, as well as the expected outcome of the variable remuneration for 2012. The Committee also reviewed, together with a reputable international HR consultant, the latest developments in and standards for variable remunerations within stock listed companies of the nature of Kendrion. The discussions also extended to the general management organisation. In conclusion, the Committee discussed the consequences of the termination of Mr Ris' contract of employment as Kendrion's CFO and prepared a remuneration package for the new CFO. Both members of the Committee attended the meetings.

Highlights supervision

The discussions between the Executive Board and the Supervisory Board are always open. Proposals are discussed in a critical but constructive manner, and based on the transparent provision on information. The financial results as well as working capital and other developments (including the associated press releases) were discussed in detail during the meetings held prior to the publication of the quarterly, half-year and annual figures. The company's external auditor attended the meeting in which the annual figures were discussed.

One meeting was devoted especially to evaluating and discussing the company's strategy on the mid-term, including the acquisition strategy. During this meeting the Supervisory Board also scrutinised the business unit's principles, risks and opportunities in greater detail. Intensive discussions were held on the markets, acquisition targets and the geographical focus.

The Audit Committee and the Supervisory Board devoted comprehensive attention to the organisation's internal risk management and control systems, including the degree of flexibility. More information is enclosed in the risk management section on pages 33 and following of this Annual Report. In one meeting, the overview of internal control issues from the auditor was discussed as well as the results, progress and further improvements of the internal tests of the financial reporting systems. The Supervisory Board expressed its satisfaction with the fact that the management letter revealed only a very limited number of relatively minor issues and that almost all issues reported in the previous management letter had been addressed.

The Executive Board and the Supervisory Board also reviewed the financing package, including the financial covenants and other relevant terms and conditions.
The Supervisory Board is of the opinion that the financing package creates the right level of flexibility required for Kendrion to execute its mid-term strategy.

The Supervisory Board kept close track of developments relating to the fine imposed by the European Commission for the alleged infringement of Article 81, paragraph 1, of the EC Treaty by a former Kendrion subsidiary. The Supervisory Board was extremely disappointed about the unfavourable verdict of 16 November 2011 and, following a review and discussion of a further legal analysis, fully endorsed the decision to lodge an appeal with the Court of Justice of the European Union early in 2012. An oral hearing by the Court of Justice was held on 5 February 2013.

The Supervisory Board was updated from time to time on the progress of the ERP Project HORIZON. In one meeting, the responsible Program Director was present to provide a status update.
The Supervisory Board is satisfied that the implementation to date complies with the overall time plan and that the associated costs are within the specified budget.

The Supervisory Board held extensive discussions on the design of the organisational and management structure, in part in view of Mr Miersch's appointment as Business Unit Manager of Commercial Vehicle Systems as from 1 January 2013 and the appointment of Dr Bernd Gundelsweiler as Vice-President Automotive. The Supervisory Board requested continual attention to the management positions and any vacancies that arise.

The Supervisory Board and the Executive Board discussed the dividend policy and dividend proposal that will be put on the agenda of the General Meeting of Shareholders (see page 20).

The Supervisory Board recognises the importance of Kendrion's corporate social responsibility and advocates a strong focus on the company's social and environmental standards governing its processes, and the relationship between the overall strategy and sustainability. The Supervisory Board reviewed the achievements of 2012 and endorsed the CSR Board's plans for 2013. More information about Kendrion's CSR activities is enclosed on pages 28 and 29 and will be provided in the CSR Report to be published around the end of March 2013.

The Supervisory Board is periodically updated on the latest developments in the relevant legislation and corporate governance regulations, for example the Bill on management and supervision.

Remuneration policy

The remuneration policy is designed to offer remuneration that attracts managers qualified to manage an international company of the nature and character of Kendrion. The policy is also sufficiently challenging to motivate managers and, with good performance, retain them for the longer term. The composition of the remuneration package supports Kendrion's short and long-term objectives.

The package is of a performance-oriented design, whereby the results are used to determine a variable income, which is of a challenging level but not excessive.

The Supervisory Board adopted the remuneration package after taking account of the movement in results, movement in the share price and non-financial indicators also relevant to the long-term creation of company value. Consideration was also given to the influence of the total remuneration of the Executive Board on the overall remuneration rates within the company. The Supervisory Board has analysed the possible outcomes of the proposed variable remuneration components of the policy.

The Supervisory Board periodically benchmarks the remuneration package against information supplied by external experts to verify that it is in line with the company's objectives and the market. Based on the latest benchmark, the Supervisory Board will propose some changes to the variable remuneration policy to the General Meeting of Shareholders to be held on 15 April 2013. These proposals are further explained on pages 61 and 62.

A further explanation of the remuneration policy and a specification of actual remuneration, including the consequences of the termination of Mr Ris' contract of employment and the framework for the remuneration package for the new CFO, is provided on pages 61 and 62, and can also be reviewed in the remuneration report of the Supervisory Board as published on Kendrion's website.

Remuneration Executive Board

The Supervisory Board determined the remuneration for the individual members of the Executive Board in accordance with the remuneration policy approved by the General Meeting of Shareholders.

The departure of Mr Ris has given cause to the Supervisory Board's decision to award his variable remuneration for 2012 in cash rather than in shares. It has also been decided that the conditional award of shares over preceding years to him shall be converted into an unconditional award. Any holding periods of such shares, where relevant, shall lapse.
The fixed remuneration stated in the management contract concluded with Mr Sonnemans, the proposed new CFO, amounts to EUR 300,000 gross per annum. The criteria governing the variable remuneration are in accordance with the provisions on pages 61 and 62. The specific personal non-financial targets have yet to be determined. The compensation on the termination of the contract by Kendrion other than in the case of what is referred to as a 'bad leaver' amounts to the gross fixed remuneration for a period of at least six months and at most one year, in part based on the number of years the position is held. The contract is for a fixed term of four years, although it can be extended if the General Meeting of Shareholders decides to reappoint the CFO. Kendrion's contribution for pension and disability risk insurance amounts to a maximum of 25% of the pension base.

A specification of the remuneration for the Executive Board and the Supervisory Board is enclosed in the notes to the financial statements (page 135).

The Supervisory Board has received confirmation from the auditor that the figures on which the 2012 bonus for the Executive Board is based are derived from the audited financial statements, and that the calculation of the bonus has been checked.

Share plans

A share plan for the top management of Kendrion was introduced in 2005. This plan provides for the allocation of shares in Kendrion as payment in kind. After the General Meeting of Shareholders in each year the number of shares awarded to the senior management of Kendrion in that year is determined by the Supervisory Board on the basis of the Executive Board's recommendations. The plan does not extend to the Executive Board. In addition, the Vice-President Automotive, the Business Unit Managers and a number of other officers are offered an opportunity to apply for the conversion of a maximum of half of their annual net cash bonus into shares. Kendrion doubles the number of shares after three years when officers are still employed by Kendrion and still possess the shares. Pursuant to these share plans a total of 7,014 shares were issued in 2012.

Profit appropriation

Kendrion recorded a net profit of EUR 18.0 million over 2012; excluding the release of the earn-out provision relating to the acquisition of FAS Controls, Inc., normalised net profit amounted to EUR 13.6 million.

The Executive Board shall, in line with the dividend policy and with the approval of the Supervisory Board, submit a proposal to the shareholders for the payment of a dividend of 50% of the normalised net profit of 2012. The dividend is equivalent to an amount of EUR 0.58 per share entitled to dividend. A proposal will be submitted to the shareholders during the General Meeting of Shareholders on 15 April 2013 for the payment of the dividend, at the shareholder's discretion, in cash and/or in ordinary shares charged to the share premium reserve.

The members of the Supervisory Board have signed the financial statements to comply with their statutory obligation pursuant to Article 2:101, paragraph 2, of the Netherlands Civil Code.

The Supervisory Board thanks the Executive Board and all Kendrion employees for their contribution and efforts in the year 2012.

Supervisory Board
S.J. van Kesteren, Chairman
R.L. de Bakker, Vice-Chairman
M.E.P. Sanders
H.J. Kayser

Zeist, 26 February 2013

Members of the Board

P. Veenema (57)
Position: Chief Executive Officer
Nationality: Dutch
Joined Kendrion: 1993
Appointment to current position: 2003
Additional positions: member of the Supervisory Board of Helvoet Holding B.V. and member of the Supervisory Board of N.V. Holding Westland Infra

E. Ris* (54)
Position: Chief Financial Officer (until 28 February 2013)
Nationality: Dutch
Joined Kendrion: 2001
Appointment to current position: 2004
Additional positions: member of the Board of Supervision of Zaans Medisch Centrum, Chairman of the Audit Committee of Zaans Medisch Centrum and member of the Supervisory Board of Dekker Holding Krabbendam B.V.

F. Sonnemans (51)
Position: Chief Financial Officer (as of 18 February 2013)
Nationality: Dutch
Appointment to current position: it will be proposed to the General Meeting of Shareholders to be held on 15 April 2013 to appoint Mr Sonnemans for a period of 4 years, until 2017
Mr Sonnemans has no additional positions

From left to right: **P. Veenema, E. Ris**

* *On 16 November 2012, it was announced that Mr Eiko Ris had decided to leave the company and continue his career at Hertel Holding B.V., where he will take up the position of CFO.*

Highlights

- Further expansion of a focused company with a clear profile;
- A somewhat disappointing net profit – although satisfactory in view of the market conditions – of EUR 18 million (normalised EUR 13.6 million);
- Decline in organic revenue due to the poor economic conditions in a number of Kendrion's key markets;
- Decline in organic revenue recorded by two business units, resulting in a lower EBITA of 9.4% (normalised 7.8%);
- Kendrion benefited in 2012 from past measures implemented for the company's flexibility policy, which enabled Kendrion to adjust the cost base;
- Strong financial position, with a solvency of 44.8% (total equity EUR 103.1 million) and low bank debts (net EUR 21.3 million) at the end of 2012;
- Satisfactory free cash flow of nearly EUR 10 million, especially when the high investment level in 2012 is taken into account;
- Further steps taken in the implementation of the company's strategy (the 'Entering another league' Mid-term Plan) for the achievement of leading global positions in Kendrion's most important niche markets;
- Acquisition of the remaining 49% of the shares in Kendrion (Linz) GmbH, Austria, at the end of 2012;
- Full focus on enhancing the company's engineering capabilities;
- Focus on the successful development of new innovations, foundation of the Kendrion Academy to support innovation in the future;
- Second Dr. Wilhelm Binder Day in Germany in November 2012, with more than 300 visitors;
- Publication of the first official CSR Report in April 2012, and roll-out of the CSR programme;
- Continued success with implementation of IFS' ERP software in Germany on 1 October 2012 (Industrial Drive Systems) and in Austria on 1 January 2013 (Passenger Car Systems).

Organisational structure

Kendrion is a strongly focused company with one main objective: the development, manufacture and sales of innovative high-quality electromagnetic components and systems. The operations are organised into four market-focused business units:

- *Industrial Magnetic Systems:* electromagnetic components tailored to the individual needs of advanced industries;
- *Industrial Drive Systems:* electromagnetic brakes and clutches for the industrial drive technology;
- *Passenger Car Systems:* project solutions for specific customer applications in the automotive and special vehicle industries;
- *Commercial Vehicle Systems:* individual energy-saving systems for commercial vehicles and off-highway applications.

Each business unit has a number of operating companies in various geographical locations. The organisation has implemented a decentralised structure to promote the company's decisiveness.

The individual business units have a shared strategy and the Vice-President Automotive, the Business Unit Managers and the Managing Directors of the individual operating companies collaborate in a wide range of fields, such as engineering, project management, purchasing, production strategy, marketing and sales.
The Executive Board, supported by the Vice-President Automotive, the Business Unit Managers and the Chief Technology Officer – together the Executive Committee – takes all significant decisions concerning the strategy and direction of the electromagnetic operations as a whole including the allocation of resources to the individual operating companies. The Executive Committee, that meets regularly, reviews the financial and operational performance of the individual companies on the basis of the internal management information and identifies the prevalent best practices to be shared and implemented within Kendrion.

Kendrion strongly encourages motivated local entrepreneurship. Short lines of communication enable managers to respond rapidly and adequately to new developments at their customers or in local markets. Kendrion's Executive Board performs a coordinating role in the development of the strategy, and is responsible for the acquisition policy.

A number of responsibilities are entrusted to Kendrion Group Services, such as financing and cash management, reporting and controlling, taxation, risk management, corporate communications and investor relations, facility management, insurance, IT, human resources management, Corporate Social Responsibility, legal affairs and corporate governance.

More information about the business units is enclosed on pages 50 and following of this Annual Report.

Targets and objectives

Continued focus on key issues

2012 was, to a greater or lesser extent, a transitional year for Kendrion. After strong organic growth in revenue of 43% in 2010, and 21% in 2011, revenue increased by 6.3% in 2012, with a decrease of 4.1% in organic revenue. Nevertheless, the objectives formulated in 2009 once again demonstrated their value in 2012.
These objectives are:

- Actively respond to developments in all key markets;
- Increase flexibility of staffing and costs;
- Further globalisation;
- Enhance capacity for innovation;
- Improve sustainability;
- Further improve working capital management;
- Continue to strengthen risk management.

Kendrion can conclude that the specific steps taken to attain these objectives once again achieved the desired results in 2012.

Actively respond to developments in all key markets

Kendrion was successful in strengthening the engineering staff in its business units to enable the company to accommodate developments in its key markets and to respond satisfactorily to Kendrion customer problems – and in the year under review Kendrion was actually more successful than in previous years. In 2012, Kendrion also devoted considerable attention to market segmentation. The sales and engineering teams in each of Kendrion's business units are increasingly focusing on the development of specific market segments, such as the machine equipment market or the medical market, and are increasing their market intelligence. In 2012, Kendrion introduced its new 'treasure mapping' tool for assessments of potential new projects prior to their acceptance. This new tool is used for annual critical evaluations of the existing portfolio of potential projects: it enables the company to set aside projects that are not assigned top priority and focus on the really promising prospects and projects.

Increase flexibility of staffing and costs

The major lesson learned since the economic crisis in 2008/2009 is that flexibility in all areas and at all levels is essential to Kendrion's development and growth. Kendrion strongly believes that those companies which best adapt to rapidly changing circumstances will be the ones which win out in the future. For this reason, since 2008/2009, Kendrion has devoted a great deal of effort to the incorporation of flexibility in the company's total cost structure (staffing costs and other operating expenses) and continually assesses every opportunity and option available for achieving this flexibility. In 2012, Kendrion benefited from this strategy, as some business units were able to reduce costs fairly rapidly in the second half of the year. Kendrion is now continuously reviewing new flexibility instruments as the rates for temporary employees in Germany have been increasing since November 2012, following the introduction of new legislation. In addition, Kendrion's suppliers need to be managed in such a way as to enable them to respond rapidly to developments in the company's market segments. Kendrion therefore is making considerable efforts to select appropriate strategic suppliers for the longer term, as a means of increasing flexibility in the future. The company monitors the flexibility of each business unit once a quarter.

Further globalisation
The world is Kendrion's marketplace. In the Americas, future growth is supported by the expected vigorous growth of Kendrion's existing operating companies, including the latest acquisition of Kendrion (Shelby), Inc. In 2012, this company implemented many of the measures required to fully integrate in Kendrion's operational procedures. This new company enhances the activities of the Passenger Car Systems business unit.

Kendrion will further strengthen its position, not only by monitoring business opportunities in existing markets but also by focusing even more closely on emerging markets. 2012 was the first full operational year of Kendrion's greenfield operation in Pune, India. Although the market slowed during the summer, the company's activities look promising for the coming years. Kendrion also succeeded in the further expansion of its Eastern European activities and demonstrated further organic growth in China. Nevertheless, Kendrion believes it still needs to make major advances in the future in this country. In this particular market, the company believes that the need for qualified suppliers with strong engineering expertise like Kendrion will grow in the coming years. To make the most of these opportunities, Kendrion undoubtedly needs to have more Chinese management skills on board, a need that is not easy to fulfil for the longer term. Nevertheless, contacts with several further important market players were established and extended during 2012. These also resulted in new projects.

Enhance capacity for innovation
Innovation involves more than simply requesting everyone to be innovative; innovation can be achieved by creating the appropriate conditions and scope for innovation, starting with paying it the attention it deserves. Kendrion has implemented an organisational structure designed to ensure continued innovation within the company. The Innovation Board, Innovation Calendar, Dr. Wilhelm Binder Day, Dr. Wilhelm Binder Symposium and the appointment of dedicated Innovation Managers at the Kendrion business units have encouraged the adoption of an innovative attitude, which also resulted in several new innovations in each business unit in 2012. During the second Dr. Wilhelm Binder Day, organised in November 2012, new innovations were presented to more than 300 customers and other stakeholders.

The whole range of initiatives taken by Kendrion enhanced its reputation as an innovative company. In September 2012, the Kendrion (Mishawaka) LLC operating company was presented the Company Award for the most innovative business unit in recognition of its development of a new (consumer market-oriented) technology that will be launched on the market in 2013.

Kendrion is seeing increasing evidence that the company is recognised by its customers as an innovative partner. For this reason Kendrion will continue to seek new ways to increase its potential for innovation in the coming years.

Improve sustainability
Sustainability is at the core of many of the company's products and innovations. Kendrion and its highly motivated staff exploit the specific expertise and experience available within the company as a means of increasing safety and substantially reducing emissions and fuel consumption. Kendrion is inspired by the desire to secure a sustainable and 'green' environment for generations to come, fully appreciating and assuming its responsibility for achieving this objective. Kendrion installed an internal CSR Board, which coordinates action plans to further improve the sustainability of the company, its internal processes and supply chain in 2013 and the coming years. These improvements will also extend to a more strategic level (see also pages 28 and 29 of this report for more information on Kendrion's CSR efforts).

Further improve working capital management
Revenue of some business units came under pressure during 2012, although stock levels did not decline at the same pace. The company's considerable efforts paid off in the fourth quarter, and resulted in a significant reduction in stock levels. The company's additional focus on collecting receivables was rewarded at year-end: all-in-all, Kendrion's net working capital was reduced by 5% as compared to a 4.1% decline in organic revenue.

Continue to strengthen risk management
Kendrion's risk management programme once again received full attention in 2012, both in terms of strategic risks and financial reporting, the extension of the audit programme to encompass smaller entities and the initiation of the tax compliance programme in the second half of 2012.

>> Financial
Kendrion's financial targets will remain unchanged during the coming years. The primary target stipulates the achievement of organic growth of at least 10%. In 2013, new revenue will be generated by projects that will be implemented by all business units. Passenger Car Systems will account for the strongest growth, due to its new projects in the USA, together with Germany, with projects scheduled for the second half of 2013. However, it is not as yet clear whether

this new revenue will supplement the revenue level achieved in 2012 or whether it will need to compensate for declines in existing revenue due to the pressure imposed by continuing economic uncertainties in the manner experienced by some business units in 2012.

Mid-term Plan

Kendrion has always paid considerable attention to Mid-term Plans. The new Mid-term Plan 2013-2015, which continues as 'Entering another league', focuses in particular on strengthening Kendrion's internal organisation to improve its leading position as component supplier in clearly defined niche markets in the years ahead. For this reason, the internal focus will – as discussed above – be placed on issues including flexibility, innovation and sales/ marketing. Furthermore, Kendrion will strive to strengthen its engineering capacity through local empowerment of its plants, by adding local engineers, and through further plans to improve the company's manufacturing facilities. The Mid-term Plan also defines areas for growth, as viewed from both an activity and a geographical perspective.

As is standard practice, the Plan is based on targets for the coming years, which are specified in consultation with the Executive Committee. The operating companies employ these targets to prepare their individual Mid-term Plans. The Business Unit Managers then use these individual plans to prepare an overall plan for their business unit. The Executive Board processes the results to draw up Kendrion's Mid-term Plan and tests it against the targets specified by Kendrion's Executive Board. The Mid-term Plan serves as a benchmark for the strategy pursued by management at local and business unit level, as well as for their responsibilities. Kendrion can then determine, at an early stage, whether it is meeting – and, even more importantly, will continue to meet – the company's targets. As a result, Kendrion is able to respond promptly to major changes in market conditions (as has been demonstrated in the past) and has an actual blueprint of the approach to adopt in order to secure further growth.

Corporate Social Responsibility

Corporate Social Responsibility (CSR)

CSR is high on Kendrion's agenda. CSR and sustainability are intrinsic, integral elements of Kendrion's local operations. For Kendrion, CSR means conducting business with consideration for climate effects and energy sources, with a feeling for people and the environment, and on the basis of a responsibility for the chain in which the company operates. This form of entrepreneurship pivots on the creation of multiple value – and consequently not just Profit, but also People and Planet. Kendrion intends to give shape to CSR in a practical and relevant manner.

Transparency and chain responsibility are important issues for Kendrion. Kendrion attaches great importance to good relationships with the group's customers, employees, suppliers, other business partners and the communities where Kendrion is active. Cooperation and consultations are essential if Kendrion is to fulfil its ambitions.

CSR also offers all Kendrion's business units opportunities to develop innovative products for new markets. Kendrion develops many specific electromagnets that are necessary for the appropriate performance of products that take account of climate effects, sources of energy, safety and the environment.

Environment and quality

Kendrion endeavours to reduce waste and make efficient use of energy, and encourages the company's employees to make continual organisational and technical improvements to environmental procedures. During the design phase and technical planning Kendrion takes due account of the consequences for the environment. This relates not only to the reduction of harmful emissions and the achievement of a lower environmental impact, but also to the retention of the company's good reputation. As a company Kendrion bears a social responsibility that necessitates attention to environmental issues when assessing processes. Involvement, both now and in the future, is of great importance to the individual Kendrion companies and the enterprise as a whole. The quality, environmental management and safety systems are usually combined in one system that forms the basis for the implementation of many projects. Virtually all Kendrion's operating companies comply with the most stringent quality and safety requirements. Kendrion's environmental management systems comply with the ISO 14001 standard.

UN Global Compact

Kendrion joined the UN Global Compact in September 2009. The UN Global Compact is the world's largest network initiative that unites companies, UN organisations and civil society in support of ten principles encompassing human rights, labour, the environment and sound business practices. Kendrion endorses these principles.

CSR Board

In 2011, the Executive Committee decided to give further shape to Kendrion's CSR activities by measures including the appointment of a CSR Board. The CFO chaired the Board in 2012. The Board is comprised of representatives from the business units and a number of corporate departments. The Board formulated a CSR ambition statement (published on Kendrion's website) and specified the key issues, targets and key performance indicators (KPIs) for 2012. The key issues include working conditions standards (including, but not limited to, health and staff satisfaction), community investment, chain responsibility and energy reduction, business ethics, knowledge-sharing and communication. Kendrion achieved almost all of its targets for 2012. Kendrion's performance in 2012 will be explained and described in more detail in the next CSR Report, which will be published (also on Kendrion's website) at about the end of the first quarter of 2013. Kendrion has specified a new set of targets for 2013, most of which focus on the key issues addressed in 2012. Kendrion also intends to increasingly align its overall strategy to sustainability and CSR issues and targets, and will initiate some studies to examine this approach.

CSR Report

Kendrion published its first Corporate Social Responsibility Report, based on the General Reporting Initiative (GRI) guidelines level C, in early April 2012. The report, which reviewed the key issues, targets and KPIs in more detail, has been published on Kendrion's website. Hardcopies of the report are available for interested parties.

Code of Conduct

Kendrion has implemented a Code of Conduct in its organisation that applies to all Kendrion staff. The principles and best practices established in this Code reflect the main values that need to guide Kendrion's staff in the performance of their duties, and the actions they need to take in a variety of circumstances and situations. The core themes include market position, authorities, corporate social responsibility, accountability in general, and the obligation for due care regarding safety and health, the environment, and social interests. Kendrion promotes compliance with the Code of Conduct by continually bringing the Code to the attention of (new) managers and staff. A similar Code of Conduct was introduced for Kendrion's suppliers in the course of 2012.

Whistleblower's Charter

The Whistleblower's Charter offers the Kendrion employees an opportunity to report irregularities or suspicions of irregularities to the management without jeopardising their (legal) position.
No irregularities were reported in 2012.

Human Resources

Personnel

Kendrion is a decentralised organisation comprised of four market-focused business units. Responsibilities are assigned as low as possible within the organisation, and local entrepreneurship is encouraged. This ensures that Kendrion can respond rapidly to the continually changing market and special customer requirements. Moreover, this enables Kendrion to promote creativity, innovation and offer all business units an opportunity to develop their full potential.

In 2012, Kendrion once again demonstrated that the company's entire organisation can deal with challenges by adopting a results-oriented and efficient approach. The flexibility provided by the use of temporary employees has enabled the company to adopt an appropriate response to economic fluctuations. In view of the uncertainties about the future economic circumstances, maintaining the flexibility of costs – including personnel costs – will continue to be of great importance in the coming years. Kendrion expects more pronounced fluctuations in the global economy in the future.

Kendrion's Human Resources (HR) policy is decentralised, and local management bears the responsibility for the local HR policy within the specified guidelines. A number of duties are coordinated at a central level by the HR department in Villingen, Germany. These duties primarily relate to the (senior) management, a group of about 40 managers, and to the improvement of opportunities for recruitment. The HR department also focused on closer cooperation between the operating companies to improve exchanges and enable colleagues to benefit from each other. One important event was the international HR meeting held in October 2012, which was attended by HR colleagues from all locations and offered them the first opportunity to meet each other in person. Issues discussed at this meeting included diversity and staff satisfaction.

Kendrion, like many other companies, was affected by a shortage of skilled engineers. However, the company took innovative countermeasures to resolve this problem. In 2012, Kendrion began to reach appropriate candidates via new recruitment channels such as social networks. Kendrion was also active in cross-border recruitment and successfully cooperated in an initiative with the Federal State of Baden-Wurttemberg (Germany), the location of the heart of several of Kendrion's engineering centres. Issues on the agenda included the reconciliation of private and working life; the cooperation resulted in a further improvement.

In 2012, Kendrion's operating companies further extended their regional activities intended to enhance their appeal as local employers. The companies' presence at schools and universities and their PR activities were intensified.

Bond with the employees

Kendrion's Executive Board and the Business Unit Managers devote a great deal of attention to the communication of the strategy, the plans of action resulting from the strategy, and the details and progress of the plans. This ensures that the employees are provided with a clear insight into what is expected of them, and consequently are able to make an active contribution to the achievement of growth. Many operating companies have implemented career development and training programmes designed to improve their staff's knowledge and skills. Employees receive guidance in forms such as annual performance appraisal interviews. Kendrion's corporate magazine 'Magnetised', for all staff, is published three times a year.

In general, Kendrion has – although on occasion difficult issues need to be discussed – a good relationship with the works councils and the unions.

Number of employees

Kendrion has approximately 1,600 employees (including 100 temps) in twelve countries.

Compensation

Kendrion offers its employees attractive compensation terms that are in line with the local market and based on job-specific requirements. A bonus scheme has been implemented for the management that is based on the company's performance (operating result and free cash flow) and on individual performance targets. Kendrion has implemented a share scheme for senior management.

Over 800 of the contracts of employment in Germany and Austria are governed by or follow the collective bargaining agreements for the metal industry in the respective countries.

Awards

Kendrion also promotes innovation and improvement, and encourages the management and employees.

In September 2012, Company Awards were presented to the most innovative Kendrion company and the best performing business unit. The Innovation Award was awarded to Kendrion (Mishawaka) LLC, Indiana, USA, business unit Industrial Magnetic Systems. The business unit Passenger Car Systems won the Simply the Best Award.

Management development

Good management, expertise and motivation are of essential importance to the future, and for this reason Kendrion assigns high priority to management development. The corporate management development programme is supported by the Kendrion Executive Programme, a customised, international modular teaching programme in which the company collaborates with the Rotterdam School of Management. Two three-day modules are organised each year. The subjects covered by the programme are communication and leadership, sales and marketing, strategy, production and logistics, HR and project management. The programme also constitutes an important platform for exchanges of experience between the (senior) management, and for the further expansion of collaboration between the various operating companies.

Kendrion implemented a new 'Kendrion High Potential Programme' in 2012. This three-year programme is divided into several learning modules. Kendrion selected twelve high-potential employees from all over the world with the objective of training tomorrow's generation of managers. The first learning module began in January 2013. New candidates will join the programme each year.

Almost every year a group of non-financial managers follows a course in finance. This course, which is also customised, covers issues of importance to Kendrion, such as risk management, sales, investment decisions and planning and control. In addition, the various business units have implemented training programmes at all levels in the organisation. Kendrion's management development endeavours to find an appropriate equilibrium between the transfer of internal knowledge and the recruitment of external knowledge.

The development of the managers is followed by means such as annual performance appraisal interviews where the managers' targets and duties are reviewed and the managers receive feedback on their performance. In addition, managers participate in an individual development assessment.

Dr. Wilhelm Binder Day 2012

The extreme mountaineer, Mr Reinhold Messner, who more than 40 years ago had set forth to conquer the highest summits of the world, offered insights into his expeditions during his presentation as a special guest at the Dr. Wilhelm Binder Day in Villingen, Germany, held on 22 November 2012.

During the day Kendrion presented itself as a global company: the Industrial Magnetic Systems, Industrial Drive Systems, Passenger Car Systems and Commercial Vehicle Systems business units also gave vivid presentations of their operations. In the appropriate settings of a simulated flight, more than 300 customers, shareholders, business partners, professors and students embarked on a trip into the world of modern technology.

During the Dr. Wilhelm Binder Day Kendrion announced that the company intends to strike out in new innovation directions. The measures implemented to promote innovation include the foundation of the Kendrion Academy. This academy aims to further enhance the company's innovative capacity, spread technical knowledge among the employees and strengthen the ties with universities.

Social policy

Kendrion is and wishes to remain a conscientious and reputable company. Kendrion intends to be a versatile and flexible company for its employees, a company where pleasure in entrepreneurship is combined with clear result targets.

The need to say farewell to temporary or permanent employees, for example due to the current economic situation, can have a great impact for the people involved. Kendrion acts in accordance with the prevailing local conditions and circumstances and with respect for the individual concerned.

Kendrion's HR policy endeavours to ensure that the composition of the company's personnel, including the lower and middle management, reflects the geographical spread of Kendrion's operations. Kendrion attaches importance to the creation of diversity in nationalities, cultures and gender. This diversity also promotes intercultural experience, which is highly compatible with the current internationalisation trend. It is important that Kendrion is a versatile company which reflects society. For this reason any form of preference or discrimination must be taboo.

The importance Kendrion attaches to a good social policy is also demonstrated by the company's accession to the UN Global Compact that includes labour principles relating to the working conditions of employees. Labour standards, including health & safety promotion, education, absenteeism and staff satisfaction, are also one of the key elements defined by the CSR Board. Kendrion's CSR Board also includes a delegate from the HR department. Reference is also made to the CSR Report as published on the website of Kendrion. CSR activities also contribute to making Kendrion an attractive employer for (potential) employees.

Personnel: key figures	2012	2011
Total number of employees at 31 December	1,630	1,629
Number of women in permanent employment	559	571
Number of men in permanent employment	838	801
Number of employees with a fixed-term contract	233	257
Number of temporary employees (FTE)	90	162
Number of permanent and temporary employees at 31 December (FTE)	1,632	1,695
Number of direct employees (FTE)	790	809
Number of indirect employees (FTE)	752	725
Average age of women	42.8	41.0
Average age of men	40.5	40.0
Average age of all employees	41.5	40.4
Average number of years' service	10.3	9.4
Average rate of absenteeism per employee (%)	2.6	2.9
Influx percentage (%)	16	28
Departure percentage (%)	16	18
Wage costs per FTE (EUR)	46,584	48,035
Training costs (as a % of wage costs)	0.9	0.7

Risks and risk management

Background

Kendrion promotes local entrepreneurship at its companies and, consequently, offers scope to the managements to exercise the associated discretionary powers. Kendrion actively conveys the essential need to maintain a healthy equilibrium between entrepreneurial spirit and the extent to which risks are accepted. Adequate risk management is an integral element of good business practice. When risks are made visible Kendrion's managers can implement adequate measures in their everyday management that offer them optimum control of the risks. Kendrion's risk management is not intended to eliminate all risks entirely: seeking business opportunities is not without risks.
Kendrion's objective is to adopt an approach to business risks that minimises surprises and the impact of any surprises that nevertheless occur, while always taking account of the necessary balance between risk exposure and costs. Kendrion's risk-reward appetite is periodically evaluated by the Executive Board and shared with and discussed by the Executive Committee. The Executive Board balances business opportunities with the expectations of shareholders, employees, regulators and other stakeholders. The risk-reward appetite can be specified in the following terms:

Risk category	Strategic objectives	Kendrion's risk-reward appetite
Strategic risks	Profitable growth and satisfactory free cash flow	**Moderate:** strike appropriate balance between risk and reward
	Customer intimacy	
	Balanced spread of activities, both geographically and between markets	
	Solid financial position	
Operational risks		**Moderate:** align targets and the related costs, focus on sustainable profit maximisation
Financial reporting risks		**Low:** full compliance with financial reporting rules and regulations, transparency
Compliance risks		**Low:** full compliance with the relevant legislation, regulations and political environments

Kendrion has a responsibility to put internal controls and procedures into place and test them to verify their adequate performance. The local management is expected to be fully aware of the operating risks and the necessity for internal control procedures. Kendrion has devoted structural attention to the optimisation of the risk management and control system as part of the everyday decision-making. All companies are logically confronted with business risks during the pursuit of their operations.
The Executive Board wishes to emphasise that risk management and control systems – no matter how professional they may be – can neither offer absolute guarantees that the company's objectives shall be achieved nor entirely prevent material errors, loss, fraud, or violations of laws or regulations.

Kendrion's approach to the company's risk management is laid down in the Enterprise Risk Management Framework as shown in the following illustration:

Kendrion Risk Management 2012

Enterprise Risk Management

Strategic & Business Risk Management
- Risk workshop
- Quarterly evaluation per business unit

Operational Risk Management
- Quality systems
- Safety & health; environment
- Hedging against commodity price risk
- Monitoring & hedging financial risk
- Insurance
- IT governance
- Quarterly evaluation per business unit

Financial Reporting Risk Management
- Group Reporting Manual
- Monthly closing procedures
- Internal control procedures
- Audits (external & internal)
- Monthly review cycle with business unit management

Compliance & Regulatory
- Reporting & disclosures
- Legal counseling
- Internal audits
- Anti-Bribery & Corruption
- Training

Planning & Control Cycle

Kendrion's Code of Conduct & Whistleblower's Charter

Kendrion's Control Framework (COSO)

Kendrion employs a structured risk management framework that reveals the various elements of risk management and the relationship between the elements. Kendrion's objective is to avoid duplication within separate systems whenever possible. Links are made, when this is worthwhile, between systems where they interact. The factors that underpin the quality of the management framework are integrity, business ethics and the staff's expertise, the management style and the manner in which authorities and responsibilities are delegated and monitored by the management, but also the deployment and development of the staff, and the manner in which the aforementioned factors are directed.
The risk management process is based on the generally accepted COSO Enterprise Risk Management framework.

Control environment and financial reporting risk management in the year under review

Control environment

The Executive Board is responsible for the control environment including internal risk management and control systems, and for the optimum management of the strategic, operational, financial and reporting risks confronting Kendrion. The internal risk management and control systems extend to issues including policy-making, processes, duties, influencing conduct and other aspects of the organisation that jointly provide for the achievement of targets and the prevention or timely identification of potentially material errors, loss, fraud, or infringement of legislation and regulations.

During the year under review the major elements and foundations of Kendrion's internal risk management and control systems were as follows:

Code of Conduct

Kendrion has implemented a Code of Conduct in its organisation that applies to all Kendrion staff. The principles and best practices established in this Code reflect the main values that need to guide Kendrion's staff in the performance of their duties, and the actions they need to take in a variety of circumstances and situations. The core themes include market position, authorities, corporate social responsibility, accountability in general, and the obligation for due care regarding safety and health, the environment, and social interests. Kendrion promotes compliance with the Code of Conduct by continually bringing the Code to the attention of (new) managers and staff.

Whistleblower's Charter

The Whistleblower's Charter offers the Kendrion employees an opportunity to report irregularities or suspicions of irregularities to the management without jeopardising their (legal) position. In 2012, no irregularities have been reported.

Regulations to prevent insider trading

Kendrion has implemented regulations to prevent insider trading which are designed to make a contribution to the prevention of employee infringement of the prevailing insider trading and market abuse regulations. These regulations include a prohibition on dealing in Kendrion's shares in the period prior to the publication of the quarterly, half-yearly and annual figures.

Rules and Regulations and Letters of Representation

Kendrion employs Rules and Regulations and Letters of Representation. The Rules and Regulations constitute rules of behaviour governing all Kendrion Managing Directors. The Letters of Representation are submitted once a quarter, in a bottom-up procedure, to the Managing Directors of the operating companies and Controllers, and to the Business Unit Managers and their Controllers. Each officer is required to sign the letter to confirm to their managers that the information and financial information they have reported is correct and complete.

Group Reporting Manual including Standard Chart of Accounts

Kendrion has implemented a Group Reporting Manual governing all operating companies to provide for correct financial reporting. The Manual is continually updated. To this end the company has implemented measures including the formation of the Kendrion Group Reporting Committee, with representatives from the operating companies. Reporting sets are standardised.

The ERP HORIZON project includes the implementation of a global Standard Chart of Accounts, whereby all operating companies are required to make use of one detailed accounting structure. This Standard was developed during the course of 2011.

Planning and control cycle
Insight into Kendrion's performance is obtained from the monthly reports of the current figures submitted by all the operating companies, weekly cash forecasts and daily consolidated turnover reports. In the summer of each year Kendrion prepares a Mid-term Plan with a three-year planning horizon. This plan provides insight into the strategic course of the companies and business units. The Mid-term Plan is accompanied by a more detailed annual budget to provide a precise management tool. The budget is also used to reach short-term agreements with managers. A complete forecast prepared each quarter offers insight into financial expectations until the end of the year, and updates the budget. The Executive Board and the Executive Board's control and audit team devote a great deal of attention to the assessment and follow up of all report cycles. When necessary, special audits are conducted to review specific issues in more depth. Consultations on the progress, development of key performance indicators and variations from long-term targets are held at various levels in the organisation. Kendrion has implemented a capital expenditure procedure which makes use of standard investment request forms. Executive Board approval is required for new projects with planned annual revenue in excess of EUR 1 million to test return on investment, payback period and cash flows. Executive Board approval is also required for actual capital expenditure in excess of EUR 50,000.

Quarterly and monthly reports and meetings
Regular discussions in the monthly meetings between the Executive Board and the Vice-President Automotive, the Business Unit Managers and similar reviews within the business units address the internal risk management system. Each business unit submits a comprehensive written report at least once a quarter which provides details about the financial and operational situation and the status of any current claims and proceedings, where relevant. These reports include an estimate of the possible financial consequences of each of the claims.

Strategic and business risk management
In 2012, the Executive Board conducted a risk survey with the Senior Management (about 40 Officers) which reviewed 40 potential risks that could confront Kendrion in relation to the company's strategic objectives. The results from this survey were discussed by each business unit to determine the top 10 risks confronting the relevant business unit (in terms of the greatest impact, likelihood and vulnerability). Each business unit will evaluate its top 10 risks once every six months. Quarterly meetings are held with the business units' managements to review their top 10 risks. More information is enclosed in the following section on strategic and business risks.

Operational risk management
Kendrion's companies make active use of quality systems designed to improve the processes. Virtually all companies have been awarded ISO certification, and possess the relevant safety certificates.

Financial reporting risk management
The Controllers' regular duties include the structured management of financial reporting risks. Pursuant to this duty the Controllers periodically monitor the organisation's implementation of and compliance with control measures, i.e. monitor the use of control measures as an integral element of the Group's operations. Kendrion has also implemented corporate guidelines that specify the monthly close procedures and the minimum controls to be performed. Kendrion has developed an internal audit programme (KiC: Kendrion-in-Control) for an assessment of the effectiveness of the companies' control framework. Kendrion has expanded the scope of the internal audit programme. Following this expansion the smaller operating companies will also be subjected to periodic audits as from 2012. Operating companies with an annual revenue of › EUR 15 million are audited at least once a year and operating companies with an annual revenue of ‹ EUR 15 million at least once every three years. The audits encompass the revenue and accounts receivable, the purchases and accounts payable, inventories, fixed assets, human resources and tax compliance reporting cycles. These audits are conducted by Kendrion N.V. Controllers with the assistance of staff from external audit firms, depending on the available capacity. This organisation guarantees the internal auditors' independence.

Compliance & regulation
Kendrion must comply with the local legislation and regulations in all countries in which the company is active. The responsibility for compliance rests with the local management. Transactions and affairs that could be of influence on the legal structure of the Kendrion Group companies and material claims should be addressed at corporate level. Kendrion obtains advice from external legal experts to acquire timely information about the latest developments in the legislation and regulations, including the applicable stock exchange regulations. Kendrion has also arranged for liability insurance at corporate level to protect the companies and their Managing Directors from possible claims. Internal audits conducted from time to time at the operating companies investigate issues including compliance with local legislation

and regulations.

Kendrion has also adopted an Anti-Bribery and Corruption (AB&C) policy which has resulted in the implementation of adequate procedures for the mitigation of the relevant risks. This policy encompasses issues including the periodic performance of risk assessments, due diligence, communication and training.

Strategic and business risks

Kendrion's strategic and business risks identified are reviewed below. The most important risks selected are:

- Excessive focus on short-term rather than on long-term objectives;
- Volatile economic conditions, including the insolvency of customers and suppliers;
- Technological substitution;
- Shifts in customer preferences;
- Dependency on A-customers;
- Attraction and retention of qualified staff;
- Non-performing Information Systems.

These risks are associated with Kendrion's strategic objectives and could impact these objectives as follows:

	Profitable growth	Customer intimacy	Balanced spread	Solid financial position
Short-term focus	•	•	•	
Volatile economy, adaptation	•	•	•	•
Technological substitution	•	•		
Shift in customer preferences	•	•		
Customer dependency	•		•	
Attraction and retention of qualified staff	•	•	•	
Information Systems	•	•		

Short-term focus

The company could focus excessively on short-term results rather than aiming for long-term profitable growth. Measures implemented to achieve a rapid improvement in results could jeopardise Kendrion's strategic and market position. An economic downturn could lead to a reduction in the number of qualified staff, limit capital and innovation expenditure and, in the longer term, result in slower growth, lower profitability and a reduced free cash flow, a weaker position relative to customers and an inability to act at a global level. The impact could be high: the likelihood and vulnerability are moderate. For this reason the company holds regular reviews of the balance between long and short term effects. The frequency of these reviews is increased in times of difficult economic conditions. Kendrion has a solid financial position and has sufficient financial resources to continue its investments in growth, both in terms of competent staff and appropriate production equipment.

Volatile economy, adaptation

A lack of adaptation to deteriorating economic conditions could be detrimental to Kendrion's financial results and the company's ability to achieve its strategic goals. The likelihood is high and the vulnerability is moderate.
Kendrion both expects and experiences greater volatility in future economic development. In addition, the situation in the eurozone remains unstable at present.

Kendrion has prioritised the maintenance of a flexible organisation to enable the company to 'breathe' with the economic tides. Flexibility not only relates to working with temporary personnel or with personnel with contracts of employment for a definite period and a focus on the reduction of variable operating expenses. It also includes the ability to communicate up-to-date finance information efficiently to decision-makers throughout the organisation, the development of plans to enable personnel to switch between business units, make justifiable insourcing and outsourcing decisions, adjust supplier contracts, implement performance-dependent employee benefits, work with flexible hour contracts and make use of opportunities for the reduction of working hours in specific countries.

Kendrion carried out a sensitivity analysis to review the relationship between the decrease in revenue and the operating result.

Kendrion strives to keep pace with the volatility of market demand and ultimately to mitigate a further 20% decline in revenue before incurring an operating loss and without redundancy expenses. However, as this is not feasible for a longer period, structurally lower revenues result in the need for fundamental changes to the organisation. Any such decision to implement cost-reduction measures is taken only once the decline has been assessed as structural. Moreover, the results can decline incrementally and in specific business areas, when adaptation such as redundancy expenses will be required.

In addition to the increased focus on flexibility, Kendrion's medium to longer-term objective is to decrease the company's dependency on the European and, more specifically, German market. Kendrion is of the opinion that a broader geographical spread in combination with a spread between customers and markets will reduce the company's vulnerability to regional economic or market downturns. Within this context it should be noted that Germany discourages the hiring of temporary staff by the imposition of penalty rates when temporary employees are hired for longer than three months. Production will also need to be phased out and transferred to more flexible Eastern European countries.

All accounts receivable departments and purchasing departments devote specific attention to the financial position of the company's customers and suppliers. Kendrion has a good track record to date.

Technological substitution/ shift in customer preferences

Kendrion could be unable to offer its markets or customers the solution they need, either due to technological substitutes available from other suppliers or the company's inability to meet the customer's needs. This is a particularly important issue for Automotive (Passenger Car Systems and Commercial Vehicle Systems). The impact on profitable growth and customer intimacy could be high: the likelihood and vulnerability are moderate. In view of the pressure imposed on prices in this competitive market special, high technological solutions are essential to appropriate opportunities for profitability.

Kendrion is an innovative player in the field of electromagnetic systems and products. The company carries out innovative projects in close consultation with its customers, an approach which Kendrion also perceives as contributing to the company's provision of added value. However, new technologies and innovations in the market environment could result in the imposition of changed requirements on Kendrion's products and operations. Although this would offer the company opportunities it could also result in the risk of being unable to meet the requirements or lagging in developing new solutions. Kendrion has put the enhancement of the company's innovative capacity high on the agenda. Kendrion uses a number of tools to strengthen innovative development in the business units. These include:

- An Innovation Board comprised of German and Dutch professors in various fields of expertise;
- Innovation Managers at each business unit;
- Innovation Calendar, requiring the business units to develop new ideas at fixed times during the year;
- An annual Innovation Award;
- Treasure Mapping (prioritisation of the most promising projects);
- Innovation Cells (multi-disciplinary 'pressure cooker' groups) for the development of new solutions in a relative short period of time;
- The launch of the Kendrion Academy to enhance cooperation with knowledge institutes and universities, develop focused engineers and form partnerships for the development of new technological solutions.

Customer dependency

Kendrion has a wide range of customers in various markets and, consequently, the company's dependency on a small number of customers is low. Passenger Car Systems has about 40 customers, of which the top 10 generate 65% of the revenue of some operating companies. Losing one of these customers would have a high impact and, in the absence of compensatory measures, would be detrimental to Passenger Car Systems' growth objective and profitability. The likelihood is low to moderate as Kendrion is a technologically advanced player which offers customer solutions: the vulnerability is high, since virtually no counter measures are available. Kendrion endeavours to ensure that individual customers do not generate more than 5% of Kendrion's total revenue. The Continental Group generates about 10% of Kendrion's total revenue (common real diesel valves). Kendrion is actively pursuing the reduction of single customer dependency by the award of projects from other customers.

Attraction and retention of qualified staff

People are Kendrion's most important asset. A lack of skilled staff could have a high impact on most of the strategic objectives. The likelihood and vulnerability are moderate to high and, consequently, this is an important area for attention. Electromagnetic know-how is highly specific and requires on-the-job-training.
Kendrion is making great efforts to mitigate this risk by taking actions including the following:

- The Kendrion Executive Programme for Senior Management at the Rotterdam School of Management, which provides high-quality management training;
- The recently commenced HIPO programme for high potentials (see page 61);

- The management development programme;
- Apprentice programmes at several companies;
- Maintenance of good contacts with education institutes;
- Further increase of Kendrion's appeal on the creation of the Kendrion Academy.

Non-performing Information Systems (IS)
Inadequate IS (including the infrastructure) and/or implementation of new systems could have a big impact on the company's business processes and, consequently, the results. The likelihood and vulnerability are low to moderate as an adequate range of mitigating actions have been taken.

This risk has received significant management attention during the year under review due to the preparations for a replacement of the existing ERP applications within the next two years.

The major IS risks include the risk of operation faults, interruptions, loss of data and unauthorised system access. IS is of importance to Kendrion, both in terms of the risks and business support. Kendrion's Executive Board and, in particular, the CFO bears the overall IS responsibility. Kendrion has implemented a corporate IS policy and strategy which extends to issues including:

- The arrangements for IS decision-making and the decisions that can be made at each level (central or local);
- IT governance for system and data responsibility;
- The regulations governing the implementation of IS systems;
- The arrangements for sourcing IS products and services for the business units and their operating companies;
- The requirements to be met by the IS organisation in serving the users as internal customers;
- The measures that need to be implemented to mitigate risks, such as access security (programmes, equipment backup and recovery, change management procedures, etc.);
- The development of solutions for customer requirements (such as EDI) and the integration of suppliers in the supply chain for Kendrion's processes.

The implementation of new software, servers and network systems can pose interruption risks that can in turn pose major consequential risks (loss of orders, customers, or the company's reputation etc.). These implementations must be based on best practice guidelines and common procedures that include the following:

- An adequate governance structure throughout the entire projects;
- Thorough preparations;
- Balanced selection of suppliers;
- Milestone planning and reviews;
- Audits for important go/no-go decisions;
- Business cases;
- End user acceptance and training.

Infrastructure – Most operating companies and Kendrion Group Services are supported by the IS department in Villingen, Germany. This department coordinates the service level agreements with suppliers such as network providers, security providers, maintenance companies and suppliers of hardware. Kendrion works with highly skilled IS staff and reputable external IS suppliers. The servers are well protected against outsiders, fire and unauthorised access. Appropriate procedures have also been implemented for regular backups of the data. The infrastructure operates at a high level of availability. The availability of the services is monitored and the support team is active on a 24/7 basis. During 2012, the Commercial Vehicle Systems operating companies in Germany and the USA were migrated to the IS department at Villingen, Germany. Kendrion (Shelby) Inc. (acquired at the end of 2011), was also migrated to Villingen. All the large operating companies are now serviced by the IS department at Villingen.

Software application portfolio – Most operating companies use a standardised ERP system (operational since 2000), Microsoft Operating Systems (OS) and applications and software for specific applications such as project management. The software is stable and Kendrion has the knowledge required for user support. In 2010, Kendrion's Executive Committee decided to invest in a new ERP software application. The planned total investment amounts to EUR 5.5 million over a three-year period (2011-2013). Following the migration of Passenger Car Systems Germany in the fourth quarter of 2011, Commercial Vehicle Systems USA, Industrial Drive Systems Germany and Passenger Car Systems Austria were successfully migrated to the new ERP platform in 2012. Industrial Magnetic Systems Germany will follow in the first half of 2013, and Commercial Vehicle Systems in Germany and Kendrion (Shelby) Inc. in the second half of 2013, after which all the larger operating companies will have transferred to the new ERP software platform by the end of 2013. The implementation schedule has since been extended to 2014 due to the acquisition of FAS Controls, Inc. (now operating under Kendrion (Shelby) Inc.) at the end of 2011.

ERP implementations are accompanied by high risks of business interruption and substantial budget overrides. Kendrion has implemented measures to minimise these risks by strict and high-level governance that also extends to adequate project management. Measures implemented in 2010, such as the recruitment of a dedicated Program Director and the appointment of Information Managers for each business unit, paid off. Milestones and deliverables that have also been agreed and laid down in the contract with IFS (the ERP software supplier) will reduce the risk of cost overruns. Kendrion has remained well within budget to date (31 December 2012).

Other important risks

Strategic	Operational	Financial
Project management	Commodity markets	Treasury
Intellectual property	Product liability	Tax
	Environmental liabilities	

Strategic risks

Project management

Adequate project management is essential if new products are to enter the production phase with success, and the risks associated with inadequate project management can exert a significant effect on the results. Kendrion imposes stringent requirements on the finished product. Customers request the company to develop products complying with specific functional requirements that can, on occasion, come close to the limits of the technologically achievable. Project teams and the requisite disciplines assess the feasibility, since an incorrect estimation of the technical feasibility can result in the (potential) customer's loss of confidence. Moreover, the available capacities are scarce and the successful completion of projects is of great importance. For this reason the company is also confronted with the risk that Kendrion's engineers succeed in developing a technologically acceptable solution, but that the customer nevertheless decides not to proceed with Kendrion. In order to avoid such circumstances, Kendrion is continually aiming for sole suppliership. In general, the majority of the development costs are borne by the customer, either in instalments during the development phase or as part of the selling price per unit. However, in spite of the compensation for the costs incurred, there is a risk that engineering hours allocated to a customer do not generate new revenue when the customer ultimately decides not to select Kendrion's product.

Project management is also applicable to greenfield operations and acquisitions. The progress in the organisation at new locations and acquisitions is reported at a number of management levels, thereby ensuring continual attention and, where relevant, implementation of the necessary measures.

Intellectual Property (IP)

The high-grade technological know-how Kendrion has accrued regularly results in inventions that can be utilised to improve existing products or develop new high-quality products which in turn enable the company to obtain an edge on the competition. There is a risk of this know-how leaking out or coming into the hands of the competition, which could ultimately put Kendrion's leading position in jeopardy.

Kendrion restricts this risk by the further development of the company's IP policy. Pursuant to one important element of this policy Kendrion applies for a patent for each of the company's most important technological innovations. Applications for patents of this nature may be submitted in the geographical areas in which the most important direct and indirect customers – and competitors – are located and in which the applicable regulations and administration of justice offer an effective means of contesting patent infringements.

In other instances the know-how acquired from projects for specific customers can be protected by concluding confidentiality agreements with the relevant customers. For this reason confidentiality agreements may also be concluded with Kendrion developers.

The development of new products or submission of applications for patents is accompanied by the risk of the infringement of third-party IP rights. Any such infringement can result in the relevant third party claiming damages and filing a petition for an injunction prohibiting the use of the technology in question. Kendrion protects itself from this risk by cooperating with a specialised patent agency. This agency carries out studies of potential infringements of Kendrion's rights by third parties and vice versa.

Operational risks

Commodity markets

Kendrion's results could suffer from the reduced availability of raw materials and fluctuations in the price of raw materials. Steel and copper are Kendrion's most important raw materials, followed by permanent magnets. Raw materials are purchased from reputable suppliers.

Steel is Kendrion's number-one raw material, although a large proportion is contained in purchased components such as turning parts. Kendrion concludes fixed price arrangements with steel suppliers for periods up to twelve months. These prices also govern a large number of Kendrion's component suppliers. When the copper price risk is not passed on to the customer then Kendrion usually fixes the purchase price for the next four quarters on a rolling basis. During 2011, prices for permanent magnets increased eight-fold due to China's strategy of controlling the scarcity of rare earth materials. Kendrion reached agreement with the large majority of customers receiving applications that contain permanent magnets on automatic price adjustments based on the movements in permanent magnet prices. During the course of 2012 prices declined to a level of about 200% of the price prior to mid-2011.

The raw materials are purchased separately by each business unit on the basis of their individual requirements, but in accordance with a group policy which is reviewed once a quarter by Kendrion's Commodity Board. Self-evidently, Kendrion endeavours to minimise the effects of price fluctuations on the group's results. The feasibility of this objective depends on contractual clauses and the market. In addition, a time lag is usual.

Product liability

Claims under product liability can be detrimental to Kendrion's operations and operating results due to the resultant damage to the company's reputation. Kendrion has taken out liability insurance at group level for its operating companies to reduce the financial risks arising from possible claims under product liability. The amount and scope of the cover are comparable to those of other companies in Kendrion's sectors: the cover is benchmarked once every few years. Kendrion also aims to limit the group's liability exposure by employing up-to-date general terms and conditions and arranging for reviews of material or long-term contracts by legal advisors.

Environmental liabilities

The nature of Kendrion's operations and business are such that they give cause to limited environmental risks. Most Kendrion companies have been awarded ISO 14001 certification. This certification also includes international environmental standards.

Financial risks

Treasury

Please refer to pages 111 and following of the financial statements for an outline of Kendrion's financial market risks and the policy to mitigate these risks or their impact.

Tax

Kendrion's operating companies have been granted a high degree of autonomy. In most countries the responsibility for accurate tax returns has been assigned to the local management, who receive assistance from reputable local tax consultants. Kendrion carries out an annual inventory at corporate level, in close collaboration with renowned international tax consultants, to assess whether fiscal developments could have an effect on the company's subsidiaries. Corporate reviews of the tax expenses and tax positions of the company's subsidiaries are carried out once a quarter. During 2012, Kendrion developed and implemented a tax compliance audit programme. This programme serves as the basis for reviews and assessments of our operating companies' compliance with the regulations governing a variety of taxes. The tax compliance audit programme has been incorporated in the internal audit programme.

Results from and shortcomings revealed by the internal audit programme

In 2012, the internal audits encompassed more than 80% of the value of the relevant reporting cycles. The overall results from the audits conducted in 2012 were satisfactory, as was revealed by Kendrion N.V.'s internal audits and the further decline in the number – that was already low – of the external local auditors' audit findings communicated in the management letters and identified during the final audits. In general, the internal control systems of the smaller companies audited during 2012 were also satisfactory, although there is room for improvement in formalisation of procedures.

In view of the above, the Executive Board is of the opinion that the design of the internal risk management and control systems provide a reasonable assurance that the financial reporting does not contain any errors of material importance and that, with due regard for the aforementioned shortcomings, the risk management and control systems performed adequately in the year under review.

Financial review

Changes in the group

On 31 December 2012, Kendrion acquired the remaining 49% of the shares in Kendrion (Linz) GmbH. These shares were purchased as the minority shareholder was in his seventies and wished to prepare for his retirement. The total purchase price for the 49% of the shares was EUR 0.7 million. As Kendrion had and retains control over the acquired company no changes in the carrying amounts of assets (including goodwill) or liabilities have been recognised as a result of this transaction.

Financial results

Normalised net profit

EUR million	2012	2011
Net result	18.0	(20.1)
Provision for EC fine, including legal expenses	–	39.4
Net acquisition costs and other expenses	–	1.2
Release earn-out Kendrion (Shelby) Inc.	(4.4)	–
Normalised net profit	13.6	20.5

EUR million	2012	2011
Revenue	284.9	267.9
Normalised net profit	13.6	20.5
Return as %	4.8	7.7
Return on Investment	12.4%	22.2%*

* *Invested capital before acquisition of FAS Controls, Inc. (currently named Kendrion (Shelby) Inc.).*

In the year under review, net profit – as compared on a normalised basis – was EUR 6.9 million lower than in the previous year.

EUR million	2012
Added value	(11.5)
Lower staff and operating expenses	1.4
Kendrion (Shelby) Inc. operating result (EBITA)	3.2
Preparation costs for new automotive projects USA	(1.0)
Amortisation Kendrion (Shelby) Inc.	(0.9)
Higher depreciation	(0.4)
Interest charges funding acquisition Kendrion (Shelby) Inc.	(0.8)
Accrued interest EC fine	(1.4)
Higher net finance charges	(0.6)
Lower tax charge	5.1
	(6.9)

A substantial proportion of the decline in added value was due to a EUR 11 million organic revenue decrease. We refer to the Added value paragraph on page 45.

Kendrion responded to the decline in revenue by reducing costs by EUR 2.5 million. However, at the same time the company recruited more staff, like engineers in anticipation of medium to longer-term growth. As a result, on balance costs were reduced by approximately EUR 1.4 million.

Revenue
In 2012, revenue increased by 6.3% from EUR 267.9 million to EUR 284.9 million. As Kendrion acquired FAS Controls, Inc. (currently named Kendrion (Shelby) Inc.) in the USA at the end of 2011, 2012 was the first full year in which Kendrion (Shelby) Inc.'s revenue contributed to Kendrion's consolidated revenue. Kendrion (Shelby) Inc. generated revenue of EUR 27.8 million in 2012. Consequently, organic revenue fell by 4.1%.

The developments in organic revenue in the quarters of the year (compared to last year) were as follows:
1st quarter: 6%
2nd quarter: – 3%
3rd quarter: – 10%
4th quarter: – 9%

December was a particularly weak month, with many fewer working days caused by major customers closing down their production for more than two weeks. Organic volume fell by – 4.2% for the year: revenue benefited from 0.8% price increases for customers and the higher prices for permanent magnets (0.4%). Conversely price reductions for customers reduced revenue by 1.7%. Currency fluctuations had a 0.6% influence on revenue.

Kendrion's geographical spread improved on the acquisition of Kendrion (Shelby) Inc. at the end of 2011: the Americas now accounts for 17% of total revenue, whilst Europe's contribution has decreased by 9% (from 79% to 70%). Kendrion also intends to increase the Asian share of revenue.

Revenue by customer location

EUR million	2012	Share	2011	Share	Growth
Germany	138.9	49%	148.0	55%	– 6%
Other European countries	60.6	21%	64.9	24%	– 7%
Asia	32.9	12%	32.4	12%	2%
the Americas	49.8	17%	19.9	8%	150%
Other countries	2.7	1%	2.7	1%	– 2%
Total	284.9		267.9		6%

Developments in each business unit

Industrial Magnetic Systems was confronted with a weaker market by the end of the first quarter, due to greatly reduced demand in the German textile machine sector and the US beverage industry. The demand from all German and Swiss customers fell in the second quarter. This reduced demand subsequently remained stable at a lower level until the end of the year: revenue was approximately 15% lower from the second quarter as compared to the corresponding quarters of the previous year. Kendrion responded by dismissing temporary workers, reducing working hours in Germany and terminating a number of employment contracts. The full effect of these measures was not immediately apparent in 2012: for example, some employment contracts could be terminated only at the end of the year.

Industrial Magnetic Systems has a broad customer portfolio. The top 10 customers generate 27% of the total revenue. The 2012 revenue generated by the largest customer amounted to EUR 2.2 million, equivalent to 4% of the business unit's revenue and less than 1% of Kendrion's total revenue.

In 2012, interesting projects were acquired in the USA (consumer market and energy systems) as well as in Germany (power plants, ski lift industry and textile machines) that would result in the generation of additional revenue in 2013.

Industrial Drive Systems achieved organic growth of 5% in 2012, and benefited from the continuing vigorous German servo-motor market. Nevertheless, growth in the second half of 2012 flattened out as compared to the second half of 2011. The top 10 customers generate 63% of the business unit's revenue: the remaining 37% is spread fairly evenly over a wide range of customers. The revenue generated by the largest customer was EUR 12.6 million, equivalent to 25% of the business unit's revenue and 4% of Kendrion's total revenue.

This business unit dominates the European market for permanent magnet brake solutions. In 2011, Industrial Drive Systems began to focus on the market for spring applied brake solutions. These brakes are the dominating solutions in Asia and USA and also have a reasonable share of the European market. The business unit developed a new spring applied brake, which will be launched in 2013. New projects were also acquired in China, which would usually result in the generation of additional revenue in 2013.

Passenger Car Systems' revenue for 2012 includes the revenue of EUR 28 million generated by Kendrion (Shelby) Inc. Organic revenue declined by 6% as compared to 2011. This 6% decline was not uniform over the quarters of 2012: revenue was strong in the first quarter, fell by 5% in the second quarter and then fell by no less than 15% in the third and fourth quarters as compared to the corresponding quarters in the previous year.
This was particularly manifest at the Austrian plant, because an important first tier customer lost sales to a competitor. The Austrian plant was also confronted with lower volumes for the French car market. The plants in Germany, the Czech Republic and China also experienced lower demand in the second half of 2012, although the decline was much less pronounced than in Austria.
The newly acquired Kendrion (Shelby) Inc. had a very strong first half year, followed by a weak third quarter, due to the decline in revenue generated by sales to truck manufacturers and for special vehicle lighting activities, and a somewhat better fourth quarter, although revenue did not return to the level of the first half of 2012.

Revenue fell, as expected, in December when the customers closed down their production for more than two weeks.

The business unit generated virtually no new revenue in 2012. This was, firstly, due to the low number of interesting projects in the crisis year of 2009, the effects of which – in view of the two to three years' project lead time – only became apparent in 2012. Secondly, the normal price reductions for customers had been specified in advance for 2012. This resulted in a EUR 2 million lower added value and consequently to a decline in the operating result in 2012.

In 2012, Passenger Car Systems focused on the enhancement of its engineering and testing capacity in both Germany and the USA. Nine new engineers were hired in 2012.

At the beginning of 2012, Kendrion reported new projects amounting to EUR 295 million which had been acquired in 2011, equivalent to an average additional revenue of EUR 30 – 40 million per annum. In 2012, the business unit acquired new revenue of EUR 250 million, equivalent to an average additional revenue of EUR 25 – 35 million per annum. The coming five years approximately 100 – 150 million revenue will be phased out.

In 2012, work was carried out on the US projects for gasoline engines and park brake systems market that were acquired in 2011. This work is on schedule. The first revenue is expected in the second half of 2013. Further new revenue will be generated by other projects in 2013, in particular in Germany and the Czech Republic.

Commercial Vehicle Systems achieved growth of 2% in 2012. Following the growth of 6% in the first quarter growth was modest in the later quarters of the year. Much of this growth was recorded in India – EUR 2.6 million – where the production costs were too high due to a delay in the local sourcing of components. In 2012, the cost price has been reduced by local sourcing that is expected to yield a more acceptable result in 2013. In 2012, the for Kendrion relevant Brazilian market was weak and the European market was somewhat weaker. The after sales in the US truck market increased greatly.

The business unit has a strong position in the global market by virtue of its product range of clutches for applications amongst others engine cooling systems. It has an extensive network of agents and is market leader in the luxury touring cars segment, with a broad customer portfolio. The truck market is increasingly coming into focus, in analogy with the existing US and Indian markets. Commercial Vehicle Systems intends to achieve further growth in this segment and has expanded its engineering strength further in 2012.

The top 10 customers account for 59% of the business unit's revenue. The largest customer generates 19% of the business unit's revenue, equivalent to 3% of Kendrion's total revenue.

In 2013, additional growth is forecast in India, Brazil and the USA. The European market is uncertain. In China, revenue is expected to be weak at the beginning of the year, due the delay in new projects for our main customer.

Added value
In 2012, added value amounted to EUR 136.4 million, excluding the release of the EUR 4.4 million earn-out provision. Kendrion (Shelby) Inc. contributed EUR 13.9 million: on a comparable basis added value decreased from EUR 134.0 million (49.8%) to EUR 122.5 million (47.7%), a decline of EUR 11.5 million.

In 2012, raw material costs were influenced by the higher prices of permanent magnets (0.9%) and currency effects (0.5%). Price reductions were achieved with suppliers (– 0.6%). The lower added value, including the effects on revenue, was the result of:

- lower revenue of EUR 5 million;
- effect of reduced stock of finished goods (absent contribution to margin), EUR 2 million;
- price effects, in particular Passenger Car Systems' substantial price reductions, EUR 1.5 million (net after purchase price reductions);
- revenue providing low added value (India and tools), effect EUR 2.5 million.

Pre-agreed annual discounts, customary for automotive projects, are usually compensated by purchase discounts and by the new projects that are ramping up. As the average development time for new projects is two to three years, the virtual inability to acquire new projects in the crisis year of 2009 has now had a detrimental effect on the added value generated in 2012.

Kendrion's activities in India still had a high material share as most components were still purchased in Germany. However, by the end of 2012 most components were purchased locally: this will improve the added value in 2013.

The added value as expressed in % of revenue decreased by 2.1%, due to the reduction of the stock of finished goods, net price reductions, the revenue from India and tools with a low added value.
The prices in 2012 agreed for steel and copper – the main raw materials – in 2012 were stable as compared to 2011. Although the prices for permanent magnets have been declining incrementally, this has had virtually no effect on added value as material clauses in the contracts with most companies have corrected for price variations since mid-2011.

Staff costs and other operating expenses
Staff costs, including costs for temporary employees, amounted to EUR 79.8 million. This amount includes EUR 7.7 million staff costs for Kendrion (Shelby) Inc. Consequently, staff costs decreased organically by EUR 0.7 million from EUR 72.8 million in 2011. The most important effects related to annual salary increases and increased staffing levels in Industrial Drive Systems and Passenger Car Systems, where the full effect of the increased staffing levels in 2011 became apparent in 2012. This resulted in a EUR 2.4 million increase in costs. The reductions in staffing levels at Industrial Magnetic Systems in Germany and Passenger Car Systems in Austria implemented following the sharp decline in revenue reduced costs by EUR 1.3 million. Staff costs were negatively influenced by severance payments and the 100 year bonus in 2011 (EUR 1.5 million).

Staff costs in relation to revenue and added value have evolved as follows:

Staff costs	2012	2011
In relation to revenue	28.0%	27.2%
In relation to added value[1]	58.5%	54.3%

[1] *Added value excluding release earn-out Kendrion (Shelby) Inc.*

The increase in indirect staff is required to accommodate future anticipated growth, in particular in Industrial Drive Systems and Passenger Car Systems. The reduction in temporary staff is due both to the decline in Industrial Magnetic Systems' revenue and to anticipation of a weak December month. The increase in staff costs as compared to added value was, in particular, due to:

- The increased staffing level of Industrial Drive Systems, with limited growth in revenue, and Passenger Car Systems, with stable revenue;
- Staff reduction measures at Industrial Magnetic Systems, which had not yet their full effect on staff expenses in 2012;
- Indian revenue had hardly any added value;
- Stock reduction (finished goods).

Other operating expenses for 2012, excluding Kendrion (Shelby) Inc., amounted to EUR 20.5 million, EUR 0.7 million below the level in 2011. Although some business units reported higher operating expenses, Passenger Car Systems reduced its costs by EUR 1.2 million, in particular in Austria, in response to the pressure on revenue. Commercial Vehicle Systems incurred quality costs of EUR 0.6 million in 2012. Furthermore 2011 was influenced by non-recurring items concerning the 100 year celebration.

FTE (year-end)	2012	2011*	% growth
Direct staff	790	809	–2.4%
Indirect staff	752	725	7.1%
Temporary employees	90	162	– 44.1%

* *2011 is including Kendrion (Shelby) Inc.*

Net financing costs

Net financing costs amounted to EUR 4.9 million, including unfavourable currency exchange differences of EUR 0.3 million (2011: EUR 0.2 million). Finance charges, excluding the currency results, were EUR 2.8 million higher than in 2011. In 2012, the EUR 1.5 million accrued interest on the provision for the EC fine had a major impact (2011: EUR 0.1 million). The expenses incurred for unused credit lines and amortised transaction costs had a EUR 0.6 million impact on finance charges. The interest charges were EUR 0.8 million higher due to the acquisition of Kendrion (Shelby) Inc. Average (gross) bank debt levels, excluding (unpooled) cash and deposit positions amounted to EUR 40 million in 2012. The average interest charge was 3%.

Income tax

The effective income tax rate for 2012 is 7.7%. The tax charge is favourably influenced by the following:

- Further measures to improve the tax position in the Netherlands, resulting in an EUR 1.3 million increase in deferred tax assets in the fourth quarter;
- Increase in the deferred tax asset for Kendrion (Shelby) Inc. by EUR 0.5 million in the second quarter due to the capitalisation of differences between commercial and tax accounting that was provided for at the end of 2011 due to the low historical taxable results.
- The EUR 4.4 million release of the earn-out provision for Kendrion (Shelby) Inc. is also a non-tax item.

The tax charge was unfavourably influenced by a EUR 0.5 million tax charge in Germany following a tax audit conducted by the German Tax Authorities for the 2006 – 2009 period.

When the above items are not taken into account the effective tax rate would have been 18.5% (2011: 24.6%, normalised).

More information about the effective tax rate is enclosed on page 124 of the financial statements.

Tax paid in 2012 amounted to EUR 4.1 million, EUR 2.6 million higher than the tax charge in the profit and loss account.
This can be explained as follows:

- The aforementioned favourable effects on the deferred tax asset, EUR 1.8 million has to be eliminated;
- In several jurisdictions, prepaid tax was based on earlier forecasts: at year-end the accrued tax liability was lower than prepaid (in countries including Austria and the Czech Republic).

Net income attributable to equity holders of the company has been adjusted for the release of the earn-out provision relating to Kendrion (Shelby) Inc. and has subsequently been applied to determine the dividend proposal. Kendrion proposes an optional dividend of 50% of the normalised net result, equivalent to EUR 0.58 per share entitled to dividend.

Net income, earnings per share and dividend

EUR million	2012	2011
Net income attributable to equity holders of the company	17.9	(20.2)
Provision for EC fine, including legal expenses	–	40.6
Release earn-out Kendrion (Shelby) Inc.	(4.4)	–
Adjusted net income attributable to equity holders of the company	13.5	20.4
Amortisation acquisition-related intangible assets	2.3	1.5
Tax effect on amortisation intangible assets	(0.8)	(0.4)
Adjusted net income attributable to equity holders of the company before amortisation	15.0	21.5
Normalised earnings per share (EPS)	1.16	1.79
Adjusted normalised EPS (before amortisation)	1.30	1.87

Statement of financial position totals, working capital and financial position

Condensed statement of financial position

Assets

EUR million	31 December 2012	31 December 2011*
Property plant & equipment	61.8	55.2
Intangible assets		
■ Goodwill	57.5	57.8
■ Acquisition related	13.1	15.6
■ Software	3.9	2.6
Deferred income tax	10.5	9.7
Other	0.7	0.5
Non-current assets	**147.5**	**141.4**
Inventories	35.2	38.5
Trade and other receivables	34.5	39.6
Income tax	3.0	1.0
Cash	9.9	9.2
Current assets	**82.6**	**88.3**
Balance sheet total	**230.1**	**229.7**

* *Restated for comparison reasons.*

The balance sheet total remained almost unchanged from the total at the end of 2011. However, the composition exhibits a material change: non-current assets increased by EUR 6.4 million, whilst current assets were reduced by almost the same amount. Kendrion's capital expenditure was high in 2012, at EUR 18.7 million: in addition to the replacements of equipment, additional clean room facilities were built for Passenger Car Systems in Germany and the USA and new assembly lines were also built for the common rail diesel projects in Germany and the gasoline project in the USA. Additional equipment was purchased for Industrial Drive Systems in excess of the normal capex levels. In Villingen, Germany, the main building's façade was renovated and new expensive heating equipment was installed that will ultimately reduce energy consumption. The ongoing investments in the ERP HORIZON implementation also had an influence on the high level of capital expenditure.

Goodwill payments were made for the Linnig Group in 2007 (now Commercial Vehicle Systems), Tri-Tech in 2008 (now Kendrion (Mishawaka) LLC), Magneta in 2010 (now Kendrion (Aerzen) GmbH), and FAS Controls, Inc. (now Kendrion (Shelby) Inc.) at the end of 2011.

Intangible assets relating to the four acquisitions consist largely of the calculated fair value of customer relations and technology. The annual amortisation charge of these intangibles (without taking foreign currency translation differences into account) will amount to EUR 2.0 million in 2013, and will decrease to EUR 1.3 million in 2017 and EUR 0.5 million in 2018 (up to 2026). More information is enclosed on pages 94 and following.

Deferred income tax

EUR million	2012	2011
Valued tax losses carried forward		
Germany income tax (15.8%)	34.3	38.6
Germany trade tax (12.2%)	3.7	9.0
The Netherlands income tax (25.0%)	8.6	3.6
Other	2.2	–
Total	48.8	51.2
Temporary differences	5.0	5.8
Deferred tax assets	53.8	57.0
Deferred income tax	10.5	9.7

More detailed information is enclosed on pages 97, 98 and 99 of the financial statements.

Net working capital 31 December

EUR million	2012	2011*
Inventories	35.2	34.7
Trade and other receivables, tax receivable	37.5	36.6
Trade and other payables, tax payable	38.8	39.8
Net working capital	33.9	31.5
As % of revenue	11.9%	11.8%

* *Before acquisition of FAS Controls, Inc. (currently named Kendrion (Shelby) Inc.).*

Net working capital as a % of revenue was stable as compared to the end of last year. At the end of the year under review the current tax assets were approximately EUR 2 million above the customary level due to developments in several tax jurisdictions, including a delayed withholding tax collection as well as unadjusted tax prepayments. When these effects are not taken into account the net working capital as a % of revenue would have been 11.2%.

The Days Inventory Outstanding as based on the fourth quarter revenues remained stable at 49 days: stock levels have been adjusted to the lower revenue. The Days Sales Outstanding improved from 44 to 43 days and Days Payable Outstanding increased by 1 day. The trade receivables portfolio is of good quality. The year-end provision amounted to EUR 0.2 million. Amounts ›30 days overdue was EUR 0.7 million, equivalent to 2% of the net book value.

At year-end the solvency ratio improved to 44.8% (year-end 2011: 39.2%).

Net debt

EUR million	2012	2011
Non-current borrowings	25.8	34.8
Current borrowings	5.4	0.3
Cash and cash equivalents	9.9	9.2
Net bank debt as per 31 December	21.3	25.9
12 months EBITDA[1]	32.7	44.7
Debt cover[1]	0.65	0.58
Debt cover (net bank debt including EC fine)	1.97	1.51

[1] *Excluding EC fine and a.o. acquisition expenses and including Kendrion (Shelby) Inc. in 2011 and excluding release earn-out Kendrion (Shelby) Inc. in 2012.*

Credit facility in place

EUR million	Actual
■ For working capital	35.0
■ For acquisitions	100.0
■ For EC fine	48.5

Amendment credit facility

Kendrion was recently able to amend its credit facility agreement with its lenders, with a particular focus on the acquisition lines. As from 17 January 2013, these lines were to be reduced by EUR 8 million bi-annually. The amended agreement cancelled the reduction scheduled for 17 January 2013. As from 17 July 2013, the acquisition credit line will only be reduced bi-annually by EUR 8 million if the debt cover is below a predetermined threshold.

More information is enclosed on pages 104 and 105 of the financial statements.

Free cash flow

In 2012, the free cash flow generated before acquisitions was satisfactory at EUR 9.7 million, as compared to EUR 13.6 million (normalised net profit). The main reasons for ending under net profit were the capital expenditure that exceeded depreciation by EUR 8.3 million, whereby an active reduction of the net working capital compensated for the high capital expenditure to an amount of EUR 3.1 million. All business units made a good contribution to the overall free cash flow. The cash-out for acquisitions, amounting to EUR 0.7 million, relates to the purchase price of 49% of the shares of Kendrion (Linz) GmbH in Austria and a working capital settlement for Kendrion (Shelby) Inc. at the beginning of 2012.

Contingent liabilities

The EC fine, as referred to in the company's Annual Reports since 2005, is provided for in full since 2011 and is no longer contingent. Information about other contingent liabilities is enclosed on pages 119 and 120 of the notes to the financial statements.

Credit facility compliance

EUR million		Actual
Debt cover (Net bank debt/12 months EBITDA[1])	‹ 2.5	0.65
Interest cover (12 months EBITDA[1]/Net finance charges[2])	› 4.0	17.72

[1] *EBITDA excluding release earn-out Kendrion (Shelby) Inc. and impairment of property, plant and equipment.*

[2] *The net finance charges exclude foreign exchange differences, the commitment fees for unused facilities and the amortisation of upfront and legal fees, but include the fee for the EC fine bank guarantee.*

Invested capital 31 December

EUR million	2012	2011
Balance sheet total	230.1	229.7
Less: non-interest bearing debt	38.8	43.3
Less: other investments, including derivatives	0.7	0.5
Less: deferred income tax receivable	10.5	9.7
Invested capital	180.1	176.2

The growth in invested capital in 2012 was due to following:

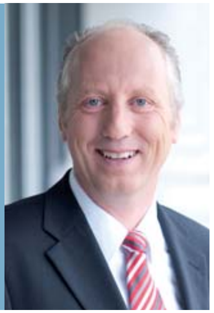
EUR million	
Lower net working capital	(1.9)
Higher property, plant and equipment plus software	7.9
Lower goodwill and acquisition related intangible assets	(2.8)
Other impacts	(2.8)

Directors' declaration

The Executive Board is responsible for the preparation of the financial statements and the annual report in accordance with Dutch law and International Financing Reporting Standards (IFRS). As prescribed in Article 5-25 C of paragraph 2 of the Financial Supervision Act, and with due regard for the above, the Executive Board declares, that to its knowledge (i) the financial statements give a true and fair view of the assets, liabilities, financial position and profit of Kendrion N.V. and the companies jointly included in the consolidation; (ii) the report of the Executive Board gives a true and fair view of the situation at balance sheet date, the situation during the financial year at Kendrion N.V. and the companies affiliated with Kendrion, whose figures are incorporated in the financial statements, and (iii) that the report of the Executive Board describes the significant risks which Kendrion faces.

The members of the Executive Board have signed the financial statements to comply with their statutory obligation pursuant to Article 2:101, paragraph 2 of the Netherlands Civil Code and Article 5-25 C, paragraph 2, under C, of the Financial Supervision Act.

Developments in each business unit



Norman Graf
Business Unit Manager
Industrial Magnetic Systems

Industrial Magnetic Systems

Profile

The Industrial Magnetic Systems business unit develops and manufactures electromagnetic systems for industrial applications including mechanical engineering, energy distribution, process automation, doors and safety technology, medical equipment and the beverages industry. Both the group of customers and range of applications are extremely diverse. The business unit's products make use of the most advanced technology and comply with the most stringent reliability and precision requirements. The activities of Industrial Magnetic Systems are subdivided into two core competences:

- projects with customised products in large volumes;
- modified products and services.

The business unit's head office is located in Donaueschingen (Germany) and the business unit has production facilities in Germany, the USA and China. In addition, the business unit has sales organisations in the UK, Austria, Switzerland and Italy. The other major European markets are covered by sales partners and distributors.

The business unit has a customer portfolio of approximately 2,000 customers who generate revenue ranging from about EUR 1,000 a year to, for a number of customers, EUR 1 – 2.5 million. Major customers include Euchner, Fresenius, Schindler, Siemens and Stoll.

Objectives and strategy

Industrial Magnetic Systems continues to expand its position from a player on the European market to a global player in specific submarkets, whereby the business unit's objectives are to achieve powerful organic growth and excellent returns.

Industrial Magnetic Systems develops new project activities in its markets by means of relationships with customers operating on a global scale or possessing powerful positions in local submarkets. In addition, Industrial Magnetic Systems' project activities have enabled the business unit to expand its operations to the provision of modified products and services. These operations offer less risky opportunities to generate revenue, certainly in more difficult economic times. During the coming years the business unit will focus on selected key markets where the most important developments are foreseen in the global industry.

Developments 2012

2012 was characterised by the general uncertainty in Europe and the USA. Parts of the economy which were heavily involved in exports and primarily in emerging markets made a stable contribution to the generation of revenues and profits. For some larger customers, 2012 brought a noticeable drop in sales due to the overall economic situation. Taking the year as a whole, this has led to a decline in revenues and profits in both Europe and the USA.

Due to this reluctance in the market, customers have also delayed the launch of some new projects which will now be implemented in 2013. The organisations in Germany, Switzerland, the USA and China are preparing for these product launches. Despite the tense overall situation, the Development and Sales sections have speeded up activities and are pushing ahead determinedly.
At factory level, some strategic product transfers have been made within the business unit so that the unit now has clearly structured and separate manufacturing areas for the large series, the small and medium series and the Kendrion technology lines. In future these measures will lead to greater efficiency and optimised logistics.

Market and market position

Industrial Magnetic Systems' main market continues to be Germany with its advanced market-leading mechanical engineering and automation industries. The USA, China, France and Italy are the other most important countries for the business unit. Special attention was devoted in the year under review to market development in the USA and technology transfer from Europe to the USA.

The business unit focuses on niche markets that feature excellent growth figures and that are gaining importance for the future. These markets include the energy, medical & pharma, transportation and safety industries.

Industrial Magnetic Systems' Chinese operation focuses on customer and product applications that require a high level of technical know-how, product quality and reliability. In principle, the business unit focuses less on the low-cost segment of the market. However, attention is also being devoted to the simpler applications required by the Chinese market so that the business unit can expand its operations in this region and acquire strong market positions.

The beverage industry is the most important market segment for the business unit's US operating company, which is the clear market leader in this segment. Expansion into other niche markets, such as the power plant sector is in progress.

Outlook for 2013

Several new product launches are planned in Germany and the USA in 2013. Industrial Magnetic Systems will additionally expand its portfolio and steer its sales and development activities towards a new niche. The preparatory work is already underway.

Following separation of the manufacturing areas in 2012, the focus will now be on developing the production share in a low-cost country. As a consequence of this measure, there will be even greater concentration on the core competence in Germany.

Overall, Industrial Magnetic Systems is expecting a slight rise in revenues in what is still a volatile environment as well as a significant improvement in the operating profit as a result of the measures introduced in 2012.

Developments in each business unit

Industrial Drive Systems

Michael Bernhard
Business Unit Manager
Industrial Drive Systems

Profile

The Industrial Drive Systems business unit develops and manufactures electromagnetic brakes and clutches for drive systems that accelerate, retard, position, hold and secure movable drive components and loads. The primary applications for the business unit's products are robotics and process-automation technology, machine construction and lift technology. The business unit's head office and production location are located at Villingen (Germany) and it also has a sales and service organisation in Bradford (UK) as well as a production location in Aerzen (Germany). The other major European markets are covered by sales partners and distributors. In 2012, Industrial Drive Systems expanded the facility in Suzhou (China). This facility, formerly solely a sales office, is now also a production plant for the manufacture of a number of products for the Asian market and the global market.

The business unit has a customer portfolio of more than 800 customers. Some major customers generate revenue of up to EUR 12 million per annum.
Major customers include Bosch, Lenze, Schottel, Siemens and Valeo.

Objectives and strategy

Industrial Drive Systems has further enhanced its position as a European market leader in permanent magnet brake technology. The business unit's objectives are to achieve powerful organic growth and excellent returns. Industrial Drive Systems develops new project activities in its markets by means of relationships with customers operating on a global scale or possessing powerful positions in local submarkets. In addition, the business unit is also expanding its operations in the field of services on the basis of project activities.

During the coming years the business unit will focus on two key markets, namely industrial automation and the production of high-efficient products such as clutches and brakes, the markets where the most important developments are foreseen in the global industry.

Developments in 2012

Industrial Drive Systems redefined the role of industrial engineering and then formed and integrated a global process development group to assure state-of-the art production processes at the operating companies that achieve high quality standards.

Special attention has been devoted to the formation of a FIT (Flexible, Innovative and Transparent) Team to assure the continuing process and cost-effective optimisation of the Villingen production plant. Programmes including the TPS (Toyota Production System) and LEAN production as well as the retrofitting and renewal of the whole permanent magnet brake production line have been set up for the coming two to three years. Lastly, Industrial Drive Systems has begun the planning for the integration of a high-end MES System with the new IFS ERP System (the implementation of which was successfully completed by 1 October 2012) for the achievement of highly efficient production scheduling with a minimum of machine set-up time.

The business unit developed a series of high-end double-disk brakes of a world-class technological design and quality for one of its major customers, a global player in the elevator business. Outstanding engineering and sales customer relationships are key guarantees for high turnover in the Asian market in the coming years.

Industrial Drive Systems implemented a marketing strategy for compliance with the future green technology requirements for the reduction of CO_2 emissions. This will make Kendrion's products even more appealing to the worldwide markets.

Market and market position

Germany, with its advanced market-leading mechanical engineering and automation industries, remains Industrial Drive Systems' major market. The business unit is the wordwide market leader in permanent magnet brakes.

Additional attention has been devoted to the enhancement of spring-applied brake operations, whereby Kendrion intends to play the role of problem-solver for specific customer needs and questions and, in so doing, distinguish the company from the market for standard products.

Industrial Drive Systems is still a small niche player in the USA and China. Nevertheless, the business unit has succeeded in achieving remarkable growth figures in Asia during the last years.

The increasing use of technology for the generation of sustainable energy, a global trend, has opened an attractive new segment of the market to the business unit. Industrial Drive Systems possesses the technology required for this segment. A number of new projects have been initiated and Kendrion benefited from the results of these developments in 2012.

Outlook for 2013

Kendrion Industrial Drive Systems expects the market to exhibit a flatter trend as compared to 2011 and 2012, although the business unit does not forecast a decrease in turnover. The business unit also expects to welcome the first customers for its new spring-applied brakes, which will serve as pilots. Industrial Drive Systems will assign priority to finishing the design process of this new spring-applied brake, setting up the state-of-the-art production line and launching the product officially on the worldwide market at the Nuremberg SPS/IPC/Drives Fair in November 2013.

The business unit will also be confronted with the great challenge of starting up the production line for the double-disc brakes at Suzhou, China. This will be Industrial Drive Systems' launching project for the manufacture of its brakes in China for the Asian market. The business unit will also increase its efforts to expand trade in permanent magnet brakes outside Europe.

Industrial Drive Systems will reap the first results from the increased efficiency of its plant at Villingen and will continue with the FIT Programme and some cost-effective product redesigns.

The business unit will begin a number of product innovation projects focused on increasing torque by means of air gaps and power reduction with spring-applied brakes. Industrial Drive Systems will also begin a development process for a new electronic module that will achieve further power reduction. In addition, the business unit has already begun work on an electronic concept phase that will help customers in eliminating brake power cables by offering them an electronic adapter module that can be integrated in the motor housing.

Industrial Drive Systems has begun the concept phases for a low-cost servo brake that could enable the business unit to offer the market for spring-applied brakes used in servo motors an appealing price package. The business unit is also working on a low-noise permanent magnet brake solution specifically for the medical market.

Industrial Drive Systems offers a wide range of innovative product ideas that will offer Kendrion even greater opportunities for growth in the next two to three years.

Developments in the business units

Automotive – Passenger Car Systems and Commercial Vehicle Systems

Bernd Gundelsweiler*
Vice-President
Automotive

*In 2012, Bernd Gundelsweiler was appointed Vice-President Automotive (Passenger Car Systems and Commercial Vehicle Systems business units). On 1 January 2013, Erik Miersch was appointed Commercial Vehicle Systems Business Unit Manager.

No other industry is experiencing changes as rapidly as the automotive industry. Developments in technology, the growing demand for environmentally-friendly vehicles and stringent emissions requirements pose challenges which Kendrion, as a supplier to the automotive industry, has tackled with success.

The business units Passenger Car Systems and Commercial Vehicle Systems passionately identifies with its customers' products. The business units' ability to identify with customer requirements and preferences, the result of its strong customer focus and competences, differentiates Kendrion from its competitors.

>> Passenger Car Systems

Profile

The Passenger Car Systems business unit develops and manufactures electromagnetic components for applications in the automotive industry. The business unit is globally renowned as a competent development and engineering partner with a worldwide network and has production facilities in Germany, Austria, the Czech Republic, the USA and China. All products are developed and designed in accordance with the customer's specific needs, whereby great emphasis is placed on performance and reliability. Kendrion has been awarded ISO/TS 16949 certification, and supports environmentally-conscious working methods in accordance with ISO 14001.

Objectives and strategy

Passenger Car Systems is continually expanding its market position by obtaining new customer orders that relate to new projects or to further applications that expand the current portfolio. The business unit's objectives are to achieve acceptable organic growth with satisfactory returns and cash flow. The business unit's operations are conducted on the basis of an explicit strategy which addresses niche markets by offering them innovative technological solutions in the fields of switching solenoids (on/off or proportional), braking or clutch systems and advanced valve technology (common rail/gasoline valves). In addition, the business unit also develops and manufactures electromagnetic components for hydraulic systems. The highly reliable production processes are in part carried out in clean-room conditions, and are virtually entirely or partly automated, depending on the annual production volume. Passenger Car Systems complies with stringent quality standards through the use of end-of-line control units for complete systems or individual functions.

Developments in 2012

In 2012, Passenger Car Systems' operations were boosted by its entry into the US market. Following the successful acquisition of FAS Controls, Inc. (now Kendrion (Shelby) Inc.) the plant was integrated in the business unit and prepared for the launch of the new fuel systems products. These products focus on fuel efficiency and environmental protection. All the products in this range meet the most stringent Euro Norms. The business unit's product portfolio is an exact match with current market trends.

Alongside the business unit's activities in the passenger car market the business unit also generated and launched new business in the medium and heavy-duty areas and adopted its technology for the highly demanding requirements in the truck sector. The new developments in projects for specific customers have enlarged the business unit's market position.

Passenger Car Systems' international position was strengthened by beginning the manufacture of stroke solenoids at its Chinese plant and acquiring further new business for its US activities. A number of strategic product transfers within the business unit increased efficiency and optimised the logistics. All departments are fully staffed and ready to tackle new challenges.

Market and market position

The international automotive market can be divided into three regions, Europe, the USA and Asia. The business unit's largest market is Europe and, within that market, Germany. From a global perspective the business unit's major customers are Daimler, Continental, Delphi Europe, INA, Automotive Lighting and ZF Lemförder. Customers can rely on Passenger Car Systems as a development partner, with active project teams, in-depth technical knowledge and access to development, test and production facilities.
Further growth in the worldwide electromagnetic component market is expected due to new applications in environmental protection, aggregates that can be switched on/off and common rail/gasoline technology that minimises emissions. New hybrid and electric cars create new market segments that are favourable to Passenger Car Systems.

Outlook for 2013

Passenger Car Systems will expand its electromagnetic portfolio with a further new niche product. The production and new development of units/applications will serve the global market. The business unit's flexibility will enable it to adapt immediately to market demands and provide optimum service to customers all over the world.

Passenger Car Systems, as a customer-orientated organisation with strong focus on corporate social responsibility, is committed to achieving market and innovation leadership in electromagnetic niche technologies.

Commercial Vehicle Systems

Profile

Commercial Vehicle Systems develops and manufactures components and complete cooling systems for buses, trucks and special vehicles. The main products include fan clutches for engine cooling, compressor clutches for vehicle air-conditioning and air pressure, vibration dampers for crankshaft applications, fan clutches with angle gear for cooling, pneumatic and hydraulic clutches, brakes and belt tensioners.

The business unit's customers include all major OEMs in the global bus market and all first-line suppliers of air-conditioning systems, as well as manufacturers of refuse collection vehicles, agricultural vehicles, railway vehicles, and specialised vehicles such as piste bullies for the preparation of ski pistes.

Commercial Vehicle Systems has its head office (including production, R&D, sales and accounting) in Markdorf (Germany), and has additional production, R&D and sales departments in Atlanta (USA), Mexico City (Mexico), São Paulo (Brazil), Pune (India) and Nanjing (China). Commercial Vehicle Systems has a global network of partners for distribution and service. In 2013, the operations at the plant in Atlanta, USA, will be integrated in the Kendrion (Shelby) Inc. plant for efficiency reasons.

The business unit's products help to reduce the fuel consumption of commercial vehicles and consequently contribute to lower vehicle emissions. Thanks to this contribution, the business unit has seen steady operational growth in recent years. The goal of the business unit's corporate philosophy is to provide answers for customers' technical issues by helping them to reduce fuel consumption using solutions mainly based on electromagnetic components.

Objectives and strategy

Commercial Vehicle Systems' steady growth over the past ten years has been built on the business unit's objectives of supplying customers all over the world and doing business with every OEM in Asia, North and South America and Europe.

The business unit's objective is to evolve from a local niche player into a global company and to play a critical role in the fulfilment of Kendrion's ambition, to set the standards for quality and speed in R&D. The targets specify excellent organic growth and returns.

Developments in 2012

In 2012 the business unit once again achieved stable production with high sales in the bus and truck market due, in particular, to the operations of the plants in China and Germany.

Following the successful customer release of the plant in India, Commercial Vehicle Systems began production of fan clutches for truck applications. The development of additional customer applications is ongoing. The implementation and introduction of a local supply base, achieved by localisation in India was completed.

Another interesting Retrofit Programme was launched in Korea, with a 3-speed fan clutch for offering substantial fuel benefits for Seoul's city buses. This Programme offers a potential for a rollout in other cities.

Market and market position

There are three regions in the international market for components for engine-cooling systems and air-conditioning: Europe, the Americas and Asia. Kendrion Linnig is the European market leader in compressor and fan clutches. The company faces technical competition in the engine-cooling segment from companies offering solutions not based on electromagnetic components. But as the requirements on engine cooling and emission reductions become increasingly stringent, Kendrion is increasingly convinced that the company is in the right position to expand its share of the market.

Although Commercial Vehicle Systems is still a niche player in the USA and South America, the business unit has implemented ambitious objectives that will enable it to achieve steady growth. The situation in Asia is also conducive to growth, and Kendrion is working on new projects with a large number of new customers in that region.

Outlook for 2013

The market developments in 2013 are expected to bring further growth for the Commercial Vehicle Systems business unit. These additional sales will be feasible as a result of the series production of a larger number of fan clutches/compressor clutches for bus and truck applications.

Commercial Vehicle Systems is seeking new customers and applications in the BRIC countries. The business unit will continue with the products it has introduced in China and India. Europe's Euro 6 Norm will boost increased cooling capacity and additional projects.

The business unit is also working on the development of a new next generation fan clutch solution for trucks and buses.
The high production volumes resulted in the decision to implement a project business organisation for the operations in the truck business.

Commercial Vehicle Systems is scheduled to participate in trade shows in China, the USA and Europe.

Corporate governance

Every year Kendrion states the outlines of the company's corporate governance structure in the Annual Report, and submits all substantial changes to the structure to the General Meeting of Shareholders for discussion. Information about corporate governance and the rules and regulations is available at Kendrion's website (www.kendrion.com), under 'Corporate Governance'. This section and the 'Information on Kendrion N.V. shares' section incorporate the information referred to in Article 1 of the Decree of 5 April 2006 for the implementation of Article 10 of the EU Takeover Directive. In addition, the information contained in this section in combination with the information about the management and control systems for the financial reporting contained in the risk management section can be regarded as the Corporate Governance Statement prescribed by the Decree establishing further instructions concerning the content of the Annual Report (*'Besluit tot vaststelling van nadere voorschriften omtrent de inhoud van het jaarverslag'*) as amended in December 2009. This Corporate Governance Statement has also been published on the company's website.

Kendrion is characterised by a transparent and efficient corporate governance structure that lays down the relationship between the shareholders, Supervisory Board and Executive Board. Kendrion monitors corporate governance developments closely to ensure that any necessary changes to the structure can be implemented in good time.

>> Corporate governance structure

Kendrion N.V. is a public limited liability company under Netherlands law, with its registered offices in Zeist, the Netherlands. The company's authorised share capital is divided into 40,000,000 ordinary shares with a nominal value of EUR 2.00. At year-end 2012 11.655,214 ordinary shares had been issued, of which 7,014 are registered shares, and of which 15,839 shares are held by the company. These own shares were purchased for the variable remuneration package for the members of the Executive Board and, in the past, for the senior management's share plan. Kendrion's shares are listed on NYSE Euronext's Amsterdam market. Kendrion N.V. does not have a Works Council.

Articles of Association

A resolution to amend the Articles of Association can be passed by the General Meeting of Shareholders solely on the proposal of the Executive Board as approved by the Supervisory Board. Resolutions of this nature can be passed by an absolute majority of the votes cast at the General Meeting of Shareholders. Amendments to the Articles of Association are also governed by a number of procedural regulations specified in more detail in the company's Articles of Association.

The Articles of Association have been published on Kendrion's website.

General Meeting of Shareholders

A notice convening a General Meeting of Shareholders shall be issued on behalf of the Executive Board or the Supervisory Board by no later than the 42nd day prior to the day of the meeting. Parties who have the right to vote and attend the meeting and who are registered as such in a designated (sub)register on the 28th day prior to the day of the meeting ('registratiedatum') will be entitled to attend the meeting and vote, irrespective of the identity of the entitled party with respect to those shares at the time of the meeting.

Votes representing shares can be cast at the General Meeting of Shareholders either personally or by proxy. No restrictions are imposed on these proxies, which can be granted electronically or in writing to the company, or to independent third parties. Pursuant to the Articles of Association the Executive Board will be entitled to determine that shareholders may also vote by letter prior to the meeting. Each share grants an entitlement to one vote. All resolutions adopted by the General Meeting of Shareholders are passed by an absolute majority of the votes cast, unless the law or the Articles of Association prescribe a larger majority. The shareholders possess the rights conferred by Kendrion's Articles of Association and by law.

Shareholders individually or jointly representing at least 1% of the issued share capital (or individually or jointly representing at least EUR 50 million of the issued share capital) are entitled to submit a request to the Executive Board or Supervisory Board for the inclusion of items on the agenda of the General Meeting of Shareholders. Should new legislation increase this percentage then the new percentage will apply. However, during the General Meeting of Shareholders held on 18 April 2011 it was agreed that the Executive Board will continue to apply the 1% level until this item has been discussed again by the General Meeting of Shareholders. New legislation, which enters into force on 1 July 2013, prescribes a percentage of 3%. This issue will be placed on the agenda for the General Meeting of Shareholders to be held in 2014. A request to include items on the agenda shall be granted provided that the motivated request is submitted in writing to the CEO or the Chairman of the Supervisory Board at least 60 days before the date of the General Meeting of Shareholders. Resolutions relating to items placed on the agenda at the request of shareholders can be passed by an absolute majority of the votes cast that represents at least one third of the issued share capital. In the event that an absolute majority supports the resolution but this majority does not represent one third of the issued share capital then in a new meeting to be convened the resolution can be passed by an absolute majority of the votes independent of the represented issued share capital (unless the law prescribes a larger majority or a quorum).
Unless indicated otherwise, there are no restrictions on the transfer of shares, the exercising of voting rights or the term for exercising those rights, and there are no special controlling rights attached to shares.

New legislation (the Corporate Governance Act, implementing the recommendations of the Corporate Monitoring Committee (the Frijns Committee)) will enter into force on 1 July 2013. This Act will introduce the obligation on shareholders to disclose a substantial holding of 3% or more, as well as the obligation to disclose gross short positions. A regulation will be introduced on the same date enabling the identification of shareholders holding 0.5% or more of the issued share capital. Kendrion will give consideration to the approach it intends to adopt, within the stipulated statutory framework, to the options, rights and obligations relating to the identification of shareholders.

Shareholders representing 60.4% of the total issued share capital attended or were represented at the General Meeting of Shareholders held in the year under review on 16 April 2012.

Executive Board

In 2012, Kendrion was managed by an Executive Board with two members (the CEO and CFO) and was supervised by the Supervisory Board. Mr Ris will step down as CFO on 28 February 2013. A proposal will be put on the agenda for the General Meeting of Shareholders on 15 April 2013 for the appointment of Mr Sonnemans as the new CFO for a period of four years, in accordance with the Corporate Governance Code. The Executive Board possesses the powers which the relevant legislation and Articles of Association have not assigned to the Supervisory Board or the General Meeting of Shareholders.

The Executive Board has adopted regulations governing the Executive Board's procedures and decision-making.
These regulations have been approved by the Supervisory Board. The members of the Executive Board are appointed by the General Meeting of Shareholders on the recommendation of the Supervisory Board. Each member of the Executive Board can be dismissed by the General Meeting of Shareholders at any time. The General Meeting of Shareholders can pass a resolution for dismissal on the proposal of the Supervisory Board by an absolute majority of the votes cast. The General Meeting of Shareholders can pass a resolution for dismissal other than on the proposal of the Supervisory Board solely by an absolute majority of the votes cast that represents at least one third of the issued share capital.

The Executive Board is supplemented by an Executive Committee, which is not mandated under the Articles of Association, comprised of the Executive Board, the Vice-President Automotive, the Business Unit Managers and the Chief Technology Officer. The Executive Committee is a consultative body and the Executive Board always has the deciding vote.

Important resolutions of the Executive Board require the approval of the Supervisory Board. The resolutions governed by this stipulation are specified in Kendrion's Articles of Association.

The Executive Board has the authority, with the approval of the Supervisory Board, to decide to issue shares and to limit or exclude pre-emptive rights of existing shareholders in the period until 16 October 2013. This authority relates to a maximum of 10% of the issued share capital at the time of issue.

In addition, the Executive Board has the authority to arrange for the company to acquire shares in its capital. This authority relates to a maximum of 10% of the issued share capital, and runs until 16 October 2013. Each year, the Executive Board places a request to be granted the authority for the issue and purchase of shares referred to above on the agenda of the General Meeting of Shareholders.

Supervisory Board

The Supervisory Board's duty is to supervise the management of the Executive Board and the general developments within the company and its affiliated companies, and to advise the Executive Board. Meetings of the Supervisory Board are usually attended by the Executive Board.

The Supervisory Board currently has four members. The members of the Supervisory Board are appointed by the General Meeting of Shareholders on the recommendation of the Supervisory Board. The Supervisory Board has adopted regulations and a profile of the Supervisory Board. The Supervisory Board elects a Chairman from amongst its members.
The members of the Supervisory Board step down by rotation pursuant to a schedule adopted by the Supervisory Board. Members of the Supervisory Board who step down can be reappointed. These reappointments take account of the manner in which the candidate performed his or her duties as a member of the Supervisory Board.
Each member of the Supervisory Board can be dismissed by the General Meeting of Shareholders at any time in a resolution passed by an absolute majority of the votes cast. Resolutions for dismissal not on the proposal of the Supervisory Board are passed solely by an absolute majority of the votes cast that represents at least one third of the issued share capital.

The Supervisory Board has established two Committees, an Audit Committee and a Remuneration Committee. The Committees are responsible for the preparations for the decision-making by the Supervisory Board. Their roles and responsibilities are in accordance with the relevant provisions of the Netherlands Corporate Governance Code. The regulations for both Committees have been adopted by the Supervisory Board. The regulations have been published on Kendrion's website.

New legislation has entered into force to provide for the balanced participation of men and women in the management and supervision of 'large' public and private limited liability companies. Balanced participation is deemed to exist when at least 30% of the seats are held by men and at least 30% by women. Kendrion's Executive Board and Supervisory Board do not achieve this gender balance.
The imbalance in the Executive Board is in part due to the limited number of members. The selection process for a new CFO did not identify any women who fitted the profile drawn up by the Supervisory Board. 25% of the seats on the Supervisory Board are held by women (1 out of 4), a proportion in accordance with the existing profile.
A proposal will be submitted to the General Meeting of Shareholders on 15 April 2013 for the reappointment of Mr van Kesteren and Dr Kayser. Although Kendrion attaches great importance to diversity and intends to increase the percentage of women in the company's senior management, Kendrion is of the opinion that continuity in and the relevant experience of the members of the existing Supervisory Board is currently of greater importance than taking the opportunity offered by the two (re)appointments to increase the number of women.

Corporate governance structure in light of the Netherlands Corporate Governance Code

The provisions of the Netherlands Corporate Governance Code as amended on 10 December 2008 are applicable to Kendrion. The Netherlands Corporate Governance Code is available at www.commissiecorporategovernance.nl. Kendrion has applied virtually all the principles and best practice provisions – to the extent that they are applicable – laid down in the Code.

The company reserves, however, the right, both now and in the future, not to apply the occasional best practice provision, whereby the company shall always comply with the principle formulated in the Netherlands Corporate Governance Code that the company shall explain why it has not applied the best practice provision in question. For example, the company will not be able to breach existing agreements at will. It should be noted that the Netherlands Corporate Governance Code also states that agreements of this nature should be respected. The provisions of the Netherlands Corporate Governance Code that have not been applied are listed below.

II.1.1 *A Management Board member is appointed for a maximum period of four years.*
This provision is not in line with the contractual situation of the current CEO. Kendrion respects this contractual situation.

II.2. *Remuneration of the Executive Board.*
Kendrion has applied or will apply virtually all best practice provisions. The precise criteria for the variable remuneration are not disclosed, since the company is of the opinion that the disclosure of the (relevant) performance criteria is undesirable from the perspective of the competitive and market positioning of the company. In addition, the publication of the performance criteria is at variance with the management of external expectations, such with the knowledge that there is a simultaneous internal need for incentives for the members of the Executive Board in the form of challenging targets.

II.2.8 *The maximum remuneration in the event of dismissal is one year's salary.*
This provision is not in line with the contractual situation of the current CEO (currently over two years of total remuneration based on the years of service). Kendrion respects this contractual situation.

IV.3.1 *All investor relations meetings shall be announced in advance, and provisions shall be made for all shareholders to follow these meetings in real time.*
Kendrion announces all press meetings and analyst meetings in advance. Kendrion is of the opinion that webcasting these meetings is not necessary. Unannounced meetings with individual analysts are also held.
No price-sensitive information is disclosed during these meetings.

Agreements in the meaning of Article 1.j. of the Decree of 5 April 2006 for the implementation of Article 10 of the EU Takeover Directive (change of control)
The credit facility of Kendrion N.V. incorporates what is referred to as a 'change of control' provision. Once a party acquires more than half the company's issued share capital or voting rights then the company is governed by a repayment commitment.

Code of Conduct and the Whistleblower's Charter

The Code of Conduct and the Whistleblower's Charter are available for inspection on the website.
The Whistleblower's Charter offers the Kendrion employees an opportunity to report irregularities or suspicions of irregularities to the management without jeopardising their legal position.

Remuneration policy

General
Kendrion's current remuneration policy was discussed by and adopted at the General Meeting of Shareholders in 2010.
The remuneration report, which is published on the company's website, explains the policy for the remuneration of the Executive Board and the Supervisory Board.
The remuneration report also provides information about the remuneration that was actually paid over 2012. Information about the remuneration received by the individual members of the Executive Board and the Supervisory Board is also enclosed in the financial statements (page 135).

The policy for the remuneration of the members of the Executive Board is based on the allocation of remuneration of an amount and structure such that qualified and expert executives can be recruited. The policy is also challenging to such an extent that it motivates the members of the Executive Board and, when they exhibit an appropriate performance, ensures they can be retained in the longer term. The composition of the remuneration package promotes the achievement of Kendrion's short and long-term objectives. Pursuant to the Netherlands Corporate Governance Code, the Supervisory Board possesses discretionary powers for the downward or upward adjustment of the total remuneration should the variable remuneration system result in unreasonable and inequitable remuneration. In addition, when so requested by the Supervisory Board, the variable component of the remuneration adopted in the past two years must be repaid in part or in full should it transpire that this was unjustifiably awarded on the basis of incorrect financial information. The Supervisory Board periodically tests the package to verify that it is in line with the company's objectives and the market on the basis of information supplied by external experts.

The current remuneration policy provides for a fixed component and a variable component, as well as a pension scheme and a number of fringe benefits.

Fixed remuneration
The fixed remuneration is in line with the aforementioned policy. During the year under review the fixed component was adjusted solely pursuant to the indexation provision of the remuneration policy.

Variable remuneration
The variable remuneration is intended to promote the Executive Board members' attention to the development of the company and the value of the share. The variable remuneration is appropriate in relation to the fixed remuneration.

The Supervisory Board determines the variable remuneration for the individual members of the Executive Board on the basis of their performance and results as compared to the agreed performance criteria.

The General Meeting of Shareholders held in April 2010 decided that a variable bonus for the Executive Board members shall be awarded in 2010 and the following years that promotes the achievement of Kendrion's short and long-term objectives. The annual variable remuneration for an at-target performance will amount to 40% of the gross fixed remuneration of the CEO and 35% of the gross fixed remuneration of the CFO, with a maximum of 50% of the gross fixed remuneration. 70% of the bonus will be comprised of financial performance criteria (net profit, ROI, free cash flow and relative Total Shareholders Return (the movement in Kendrion's TSR compared to the AScX) and 30% will be comprised of individual (non-financial) performance criteria. The four financial performance criteria are weighted approximately equally. The component of the bonus relating to the relative TSR is set to zero when the relative TSR is less than zero.

One third of the amount to be determined by the Supervisory Board shall be paid in cash. Two thirds of the bonus shall be comprised of a conditional award of shares (the vesting scheme). The award of the shares becomes unconditional after three years (including the relevant year in which the performance is assessed) if the CEO and CFO are still in office and the Supervisory Board is of the opinion that there are no exceptional circumstances that would render the unconditional award unreasonable. The award of the shares is definitively withdrawn in the event that the relevant member of the Executive Board leaves Kendrion as a 'bad leaver' during the three-year vesting period. The Supervisory Board possesses discretionary powers to refrain from the full issue of the shares in the event that the relevant member of the Executive Board leaves the company as a 'good leaver' in the vesting period (for example, on retirement or in the event of an occupational disability) when the full issue of the shares would be unreasonable under the circumstances.

Once the award of the shares has become unconditional after the expiry of the vesting period they must be retained for a minimum of two years (the holding period) unless the relevant member of the Executive Board terminates his/her term of office or the term of office is terminated during this period.

Element	**Fixed**	**Variable**	
	Base salary	Annual incentive	
Way of payment	Cash	Performance related restricted shares ($^1/_3$ cash)	
Performance measure	Not applicable	■ Net profit ■ ROI ■ Free cash flow ■ Relative total Shareholder Return[1]	Total 70%[2]
		■ Non-financial individual performance criteria, including sustainability	Total 30%[2]
Pay-out at minimum performance	100%	0%	
Target pay-out as % of gross fixed remuneration	100%	CEO: 40% CFO: 35%	
Maximum pay-out as % of gross fixed remuneration	100%	CEO: 50% CFO: 50%	

1 *The TSR as one of the financial performance criteria for the annual incentive will be cancelled.*

2 *50% as of 2013 if approved by the General Meeting of Shareholders of 15 April 2013. Also a three-year term incentive as of 2013 will be proposed.*

The aforementioned financial and individual performance criteria are determined for each full year prior to the beginning of the relevant financial year. The precise criteria are not disclosed, since the company is of the opinion that the disclosure of the (relevant) performance criteria is undesirable from the perspective of the competitive and market positioning of the company. In addition, the publication of the performance criteria is at variance with the management of external expectations, such with the knowledge that there is a simultaneous internal need for incentives for the members of the Executive Board in the form of challenging targets.

The following amendments to the variable remuneration policy will be proposed to the General Meeting of Shareholders to be held on 15 April 2013. These amendments shall, in particular, enhance the long-term nature of the variable remuneration policy for the Executive Board.

The existing variable remuneration policy shall be supplemented with a share match. At present, 2/3 of the annual variable remuneration is invested in shares. Kendrion will, depending on the long-term performance criteria, increase the number of shares awarded pursuant to the above by 50% net (a matching ratio of 1:2). The performance criteria are the relative Total Shareholders Return (TSR) and a group of sustainability criteria, both of which will be assigned a weighting of 50%. The performance period shall be of a term of three years, which begins at the time of the award of the annual variable remuneration. This performance period is in line with the provisions of the Netherlands Corporate Governance Code. Consequently the award, where relevant, is made after a period of three years.

The shares awarded pursuant to the annual variable remuneration are governed by a vesting period of three years (including the year in which the performance is measured) and a holding period of two years. The shares awarded pursuant to the share match are governed by a holding period of two years, which begins at the time of the award.

The relative TSR performance criterion for the share match is achieved when Kendrion's TSR score is higher than the average of the AScX and the German Small Cap Index, the SDAX. The sustainability criteria are (i) energy/CO_2 reduction, (ii) waste & recycling, (iii) employee satisfaction and (iv) management development / succession planning. Each of these sustainability criteria is assigned an equal weighting of 25%. The precise sustainability criteria shall be specified each year.

As from 2013, the four financial and non-financial performance criteria governing the annual variable remuneration shall each be assigned a weighting of 50% rather than the former 70% and 30% respectively. The relative TSR was one of the four financial performance criteria. This will no longer be taken into account in the assessment of the annual variable remuneration.
The sustainability target components of the non-financial performance criteria will be assigned a relatively high weighting.

The Supervisory Board has drawn up the scenario analyses prescribed by the Netherlands Corporate Governance Code.

Pensions and risk premium
Pursuant to the policy, the company bears the cost of the contributions for the old-age pension and risk premiums for partner pension and disability of the members of the Executive Board to a maximum of 25% of the pension base. The pension base takes account for a maximum salary of EUR 300,000. The pensionable age is currently 65. No schemes have been agreed for the (voluntary) early retirement of the members of the Executive Board. Above mentioned elements have not been changed in 2012.

Sundry
The company does not grant loans, advances or guarantees to the members of the Executive Board.
No exceptional remuneration was paid to the members or former members of the Executive Board in the year under review.

Severance pay
The contract of employment with the current CEO grants the officer entitlement to severance pay equal to the compensation for involuntary dismissal in the event that the contract of employment is terminated after a change of control. The provisions of the new CFO's contract entitle the Officer to severance pay of a maximum of one year's fixed gross salary should, following a change of control, the CFO terminates his contract because he is of the opinion that he cannot reasonably be expected to remain in his position and the Supervisory Board agrees to that.

Remuneration of the Supervisory Board
The remuneration received by the members of the Supervisory Board is comprised of a fixed remuneration that is independent of the results, whereby a distinction is made between the remuneration received by the Chairman and the other members of the Supervisory Board. Pursuant to this distinction the remuneration received by the Chairman is about one third higher than the remuneration received by the other members. The General Meeting of Shareholders held on 16 April 2012 resolved that the fixed remuneration of the Chairman of the Supervisory Board will amount to EUR 40,000 and each of the other members EUR 30,000, besides the remuneration of EUR 5,000 for the membership of one of the Committees of the Supervisory Board, as determined in 2009. In addition to this fixed remuneration the members also receive a contribution towards their expenses.

Prospects

In the latter part of 2012, Kendrion noticed the first effects of the worldwide economic crisis: turnover came under pressure, which impacted the company's net profit. Nevertheless, Kendrion continued to strengthen the company's internal organisation by increasing the group's engineering capacity. Pursuant to the company's Mid-term Plan 2012-2014, 'Entering another league', Kendrion worked on continual improvements to the organisation's market intelligence and management capacity, and also continued to streamline the company's procedures and its market presence. When viewed from this perspective it is gratifying to note that all business units acquired interesting projects in 2012, which should lead to further growth in revenue during the coming years. Kendrion also devoted a great deal of effort to new innovations on the basis of the company's Innovation Calendar and its use of tools including 'Innovation Cells' and 'Treasure mapping'. The foundation of the Kendrion Academy was a logical next step in this focus on innovation. The progress that has been made to date resulted in Kendrion's decision to set the priorities in the company's new Mid-term Plan 2013-2015, also known as 'Entering another league'.

At the beginning of 2013, the future development of the global economy is still very uncertain. The prospects for most of the company's home markets for the first half of 2013 are somewhat pessimistic. It is impossible to predict the developments in the world's economy during the second half of the year. Within this context Kendrion would still appear to have an advantage due to the generation of a substantial proportion of the company's revenue in Germany, the country which is still the driving force behind the European economy. Unfortunately, the forecasts indicate only very moderate growth in the German market during the year. The Automotive industry plays a key role in Germany: however, the prospects for this market are not very clear at present. Two unfavourable developments are the decreasing flexibility of the German labour market following to the introduction of new labour regulations and the lack of qualified engineers. There is also uncertainty about the developments in the company's other important home markets, the USA and China. Although the situation in the USA is now beginning to look a little more optimistic, the developments in China are less uniform, with Kendrion seeing a sluggish market for Commercial Vehicle Systems, for instance.

The information currently available is insufficient for the issue of a specific forecast for 2013: the uncertainty is too great. However, as things now stand the company will at least benefit from the initiation of several new projects in the second half of 2013. All business units expect that important new projects the company had acquired earlier will enable them to increase their volumes. This is applicable to Industrial Magnetic Systems in Germany and the USA, to Industrial Drive Systems, in particular in China, to Passenger Car Systems in the USA, Germany and the Czech Republic, and to Commercial Vehicle Systems in countries including Brazil and India. It should be noted, in particular, that the company maintains its 2013 forecast for vigorous growth at Kendrion (Shelby) Inc., (USA), the company Kendrion acquired more than one year ago.

On the basis of the price agreements with suppliers, Kendrion expects raw material costs to remain fairly stable in 2013.

At the beginning of 2013, the order book is no longer continuing to decline (as it did in the second half of 2012) and is actually improving gradually.

Investments in 2013 are expected to be considerably above the level of depreciation, largely due to investments in new projects (in particular, at Industrial Drive Systems and Passenger Car Systems) and in the current ERP HORIZON project.

Kendrion will continue to strive to strengthen its market position by acquisitions preferably in the Industrial markets. The focus will remain on acquiring strong niche players in the USA to strengthen the company's position in these markets. However, the company is also interested in opportunities for further growth in Germany that offer Kendrion new technical and market opportunities. Although China remains an important target market, the country's market structure currently appears to be a major obstacle to substantial acquisitions.

Although Kendrion looks to the future with great confidence, in the current conditions Kendrion is unable to issue a specific forecast for the development of the company's revenue and profit in the coming period.

Financial statements
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Consolidated statement of financial position at 31 December

Note	EUR million	2012	2011* Restated	1 Jan. 2011* Restated
	Assets			
	Non-current assets			
1	Property, plant and equipment	61.8	55.2	46.5
2	Intangible assets	74.5	76.0	50.1
3	Other investments, including derivatives	0.7	0.5	0.0
4	Deferred tax assets	10.5	9.7	12.9
	Total non-current assets	**147.5**	**141.4**	**109.5**
	Current assets			
5	Inventories	35.2	38.5	28.2
	Current tax assets	3.0	1.0	0.3
6	Trade and other receivables	34.5	39.6	30.2
7	Cash and cash equivalents	9.9	9.2	9.0
	Total current assets	**82.6**	**88.3**	**67.7**
	Total assets	**230.1**	**229.7**	**177.2**

Note	EUR million	2012	2011* Restated	1 Jan. 2011* Restated
	Equity and liabilities			
8, 9	**Equity**			
	Share capital	23.2	22.9	22.6
	Share premium	59.9	64.6	68.4
	Reserves	2.1	22.7	6.6
	Retained earnings	17.9	(20.2)	16.5
	Total equity attributable to equity holders of the company	103.1	90.0	114.1
	Minority interest	–	0.3	0.2
	Total equity	**103.1**	**90.3**	**114.3**
	Liabilities			
10	Loans and borrowings	25.8	34.8	2.5
11	Employee benefits	7.1	8.3	7.3
	Government grants received in advance	0.1	0.1	0.3
13	Provisions	43.6	46.4	2.7
4	Deferred tax liabilities	6.2	6.2	3.4
	Total non-current liabilities	**82.8**	**95.8**	**16.2**
7	Bank overdraft	5.4	0.3	1.7
10	Loans and borrowings	–	–	10.0
	Current tax liabilities	0.7	1.2	2.0
14	Trade and other payables	38.1	42.1	33.0
	Total current liabilities	**44.2**	**43.6**	**46.7**
	Total liabilities	**127.0**	**139.4**	**62.9**
	Total equity and liabilities	**230.1**	**229.7**	**177.2**

* *Restated for comparison reasons (IAS 8 restatement applied regarding early adoption of IAS 19A).*

Consolidated statement of comprehensive income

Note	EUR million	2012	2011* Restated
19	Revenue	284.9	267.9
21	Other operating income	5.1	1.0
	Total revenue and other operating income	**290.0**	**268.9**
	Changes in inventories of finished goods and work in progress	1.0	(4.2)
	Raw materials and subcontracted work	148.2	139.1
22	Staff costs	79.8	72.8
	Depreciation and amortisation	12.7	10.8
16, 23	Other operating expenses	23.9	61.9
	Results before net finance costs	**24.4**	**(11.5)**
	Finance income	0.1	0.1
	Finance expense	(5.0)	(2.1)
24	**Net finance costs**	**(4.9)**	**(2.0)**
	Profit before income tax	**19.5**	**(13.5)**
25, 26	Income tax expense	(1.5)	(6.6)
	Profit for the period	**18.0**	**(20.1)**
	Attributable to:		
	Equity holders of the company	17.9	(20.2)
	Minority interest	0.1	0.1
	Profit for the period	**18.0**	**(20.1)**

Note	EUR million	2012	2011* Restated
	Other comprehensive income		
	Remeasurements of defined benefit plans	0.6	(1.5)
	Foreign currency translation differences for foreign operations	(0.8)	0.7
	Net change in fair value of cash flow hedges, net of tax	0.1	(0.2)
	Tax on other comprehensive income	(0.1)	0.3
	Other comprehensive income for the period, net of income tax	(0.2)	(0.7)
	Total comprehensive income for the period	**17.8**	**(20.8)**
	Total comprehensive income attributable to:		
	Equity holders of the Company	17.7	(20.9)
	Minority interest	0.1	0.1
	Total comprehensive income for the period	**17.8**	**(20.8)**
9	Basic earnings per share (EUR), based on weighted average	1.55	(1.79)
9	Diluted earnings per share (EUR)	1.55	(1.79)

* *Restated for comparison reasons (IAS 8 restatement applied regarding early adoption of IAS 19A).*

Consolidated statement of changes in equity

EUR million	Share capital	Share premium	Translation reserve	Hedge reserve	Reserve for own shares	Other reserves	Retained earnings	Total	Minority interest	Total equity
Balance at 1 January 2011	22.6	68.4	1.6	0.0	(0.5)	5.5	16.5	114.1	0.2	114.3
Total comprehensive income for the period										
Profit or loss	–	–	–	–	–	–	(20.2)	(20.2)	0.1	(20.1)
Other comprehensive income										
Remeasurements of defined benefit plans	–	–	–	–	–	(1.2)	–	(1.2)	–	(1.2)
Foreign currency translation differences for foreign operations	–	–	0.7	–	–	–	–	0.7	–	0.7
Net change in fair value of cash flow hedges, net of income tax	–	–	–	(0.2)	–	–	–	(0.2)	–	(0.2)
Total other comprehensive income for the period	–	–	0.7	(0.2)	–	(1.2)	–	(0.7)	–	(0.7)
Total comprehensive income for the period	–	–	0.7	(0.2)	–	(1.2)	(20.2)	(20.9)	0.1	(20.8)
Transactions with owners, recorded directly in equity										
Contributions by and distributions to owners										
Issue of ordinary shares	0.3	2.9	–	–	–	–	–	3.2	–	3.2
Own shares sold	–	–	–	–	0.2	–	–	0.2	–	0.2
Share-based payment transactions	–	–	–	–	–	0.1	–	0.1	–	0.1
Dividends to equity holders	–	(6.7)	–	–	–	–	–	(6.7)	–	(6.7)
Total contributions by and distributions to owners	–	–	–	–	–	16.5	(16.5)	–	(0.0)	(0.0)
Balance at 31 December 2011	22.9	64.6	2.3	(0.2)	(0.3)	20.9	(20.2)	90.0	0.3	90.3

Consolidated statement of changes in equity (continued)

EUR million	Share capital	Share premium	Translation reserve	Hedge reserve	Reserve for own shares	Other reserves	Retained earnings	Total	Minority interest	Total equity
Balance at 1 January 2012	22.9	64.6	2.3	(0.2)	(0.3)	20.9	(20.2)	90.0	0.3	90.3
Total comprehensive income for the period										
Profit or loss	–	–	–	–	–	–	17.9	17.9	0.1	18.0
Other comprehensive income										
Remeasurements of defined benefit plans	–	–	–	–	–	0.5	–	0.5	–	0.5
Foreign currency translation differences for foreign operations	–	–	(0.8)	–	–	–	–	(0.8)	–	(0.8)
Net change in fair value of cash flow hedges, net of income tax	–	–	–	0.1	–	–	–	0.1	–	0.1
Total other comprehensive income for the period	–	–	(0.8)	0.1	–	0.5	–	(0.2)	–	(0.2)
Total comprehensive income for the period	–	–	(0.8)	0.1	–	0.5	17.9	17.7	0.1	17.8
Transactions with owners, recorded directly in equity										
Contributions by and distributions to owners										
Issue of ordinary shares	0.3	2.4	–	–	–	–	–	2.7	–	2.7
Own shares sold	–	–	–	–	0.1	–	–	0.1	–	0.1
Share-based payment transactions	–	–	–	–	–	0.1	–	0.1	–	0.1
Dividends to equity holders	–	(7.1)	–	–	–	–	–	(7.1)	–	(7.1)
Total contributions by and distributions to owners	–	–	–	–	–	(20.2)	20.2	–	(0.3)	(0.3)
Acquisition of minority interest subsidiary	–	–	–	–	–	(0.4)	–	(0.4)	(0.1)	(0.5)
Balance at 31 December 2012	23.2	59.9	1.5	(0.1)	(0.2)	0.9	17.9	103.1	–	103.1

Consolidated statement of cash flows

Note	EUR million	2012	2011
	Cash flows from operating activities		
	Profit for the period	18.0	(20.1)
	Adjustments for:		
	Net finance costs	4.9	2.0
	Income tax expense	1.5	6.6
	Depreciation of property, plant and equipment	9.7	9.0
	Amortisation of intangible assets	3.0	1.8
	Impairment of property, plant	0.3	–
		37.4	(0.7)
	Change in trade and other receivables	4.2	(4.8)
	Change in inventories	3.2	(6.4)
	Change in trade and other payables	(3.9)	7.5
	Change in provisions	(4.7)	38.6
		36.2	34.2
	Interest paid	(3.8)	(2.6)
	Interest received	0.1	0.1
	Tax paid	(4.1)	(4.1)
	Net cash flows from operating activities	**28.4**	**27.6**
	Cash flows from investing activities		
20	Acquisitions of subsidiaries, net of cash received	(0.7)	(31.3)
	Investments in property, plant and equipment	(17.0)	(11.3)
	Disinvestments of property, plant and equipment	0.3	0.2
	Investments in intangible fixed assets	(2.0)	(2.4)
	Disinvestments of intangible fixed assets	0.0	0.0
	(Dis)investments of other investments	0.0	0.0
	Net cash from investing activities	**(19.4)**	**(44.8)**
	Free cash flow	**9.0**	**(17.2)**

Note	EUR million	2012	2011
	Cash flows from financing activities		
	Proceeds from borrowings (non current)	–	32.3
	Repayment of borrowings (non current)	(9.0)	–
	Repayment of borrowings (current)	–	(10.0)
	Dividends paid	(4.4)	(3.5)
	Change in shares held in own Company	0.1	–
	Net cash from financing activities	**(13.3)**	**18.8**
	Change in cash and cash equivalents	(4.3)	1.6
	Cash and cash equivalents at 1 January	8.9	7.3
	Effect of exchange rate fluctuations on cash held	(0.1)	(0.0)
7	Cash and cash equivalents at 31 December	4.5	8.9

Notes to the consolidated financial statements

Reporting entity

Kendrion N.V. (the 'Company') is domiciled in the Netherlands. The Company's registered office is at Utrechtseweg 33, 3704 HA Zeist.
The consolidated financial statements of the Company as at and for the year ended 31 December 2012 comprise the Company and its subsidiaries (together also referred to as the 'Group'). The Group is involved in the design, manufacture and sale of high-quality electromagnetic systems and components.

Basis of preparation

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations of the standards adopted by the International Accounting Standards Board (IASB) and endorsed by the European Union (hereinafter referred to as EU-IFRS) per 31 December 2012.

The Company financial statements are part of the 2012 financial statements of Kendrion N.V. With regard to the Company income statement of Kendrion N.V., the Company has made use of the option provided by Section 402 of Book 2 of the Netherlands Civil Code.

The consolidated financial statements were authorised for issue by the Executive Board on 26 February 2013.

(b) Basis of measurement

The financial statements are presented in millions of euros, the euro also being the Group's functional currency.

The financial statements have been prepared on a historical cost basis except that:

- derivative financial instruments are stated at fair value;
- liabilities arising from cash-settled share-based payments arrangements are stated at fair value;
- the defined benefit liability is recognised as the net total of the plan assets and the present value of the defined benefit obligation;
- the contingent consideration is stated at fair value.

The methods used to measure the fair values are discussed further in note q.

The preparation of the financial statements in conformity with EU-IFRS requires the Executive Board to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

The estimates and associated assumptions are based on historical experience and various other factors that are considered reasonable in the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. Changes in estimation methods and the impact thereof are outlined in the notes to the relevant item.

Judgements made by the Executive Board in the application of EU-IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are included in the following notes:

- note 2 – measurement of the recoverable amount of cash-generating units containing goodwill
- note 4 – utilisation of tax losses
- note 11 – measurement of defined benefit obligations
- note 13 – provisions
- note 15 – valuation of financial instruments
- note 18 – contingent liabilities
- note 20 – business combinations and acquisitions of non-controlling interests

(c) Change in accounting policy

(i) Defined benefit plans

The Group early adopted IAS 19 'Employee Benefits' (2011) with a date of initial application of 1 January 2012.The adoption has been applied retrospectively in conformity with the requirements of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'.

The amendment abolishes the 'corridor' method of recognising actuarial gains and losses, which must now be recognised immediately in other comprehensive income (OCI), and also requires immediate recognition in profit or loss of past service cost. Under the amended IAS 19 the interest income on plan assets recognised in profit or loss is calculated by applying the rate used to discount the plan's liabilities, rather than their long-term expected rate of return, which changes the amount of the total return on plan assets recognised in OCI.

(ii) **Impact of change in accounting policy**

The following table summarises the adjustments made to the statement of financial position on implementation of the change in accounting policy:

EUR million	Deferred tax assets	Employee benefits	Reserves
Balances at 1 January 2011, as previously reported	12.8	7.0	6.8
Impact of the change in accounting policy	0.1	0.3	(0.2)
Restated balances at 1 January 2011	12.9	7.3	6.6
Balances at 31 December 2011, as previously reported	9.3	6.5	24.1
Impact of the change in accounting policy at 1 January 2011	0.1	0.3	(0.2)
Impact of the change in accounting policy during 2011	0.3	1.5	(1.2)
Restated balances at 31 December 2011	9.7	8.3	22.7

The change in accounting policy had an immaterial impact (less than EUR 0.1 million) on the defined benefit expense recognised in profit or loss, income taxes and earnings per share for the current and comparative period.

More details are enclosed in Note 11.

Significant accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and by the Group entities, except for the change in accounting policy as explained in note c.

(a) >> Basis of consolidation

(i) **Business combinations**

Business combinations are accounted for using the acquisition method at the acquisition date, which is the date on which control is transferred to the Group. Control refers to the authority to govern the financial and operating policies of an entity to obtain benefits from its activities. When assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

The Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interests in the acquiree; plus
- when the business combination is achieved in stages, the fair value of the pre-existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

The consideration transferred does not include amounts relating to the settlement of pre-existing relationships. Such amounts generally are recognised in profit or loss.

Transactions costs, other than those associated with the issue of debt or equity securities, which the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is measured at fair value at the acquisition date. If the contingent consideration is classified as equity, then it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes in the fair value of the contingent consideration are recognised in profit or loss.

When share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree's employees (acquiree's awards) and relate to past services, then all or part of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market-based value of the replacement awards as compared to the market-based value of the acquiree's awards and the extent to which the replacement awards relate to past and/or future service.

(ii) Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights, that are currently exercisable or convertible, are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The shares of third parties in shareholders' equity and results are stated separately. The accounting policies of subsidiaries have been changed, where necessary, to align them with the policies adopted by the Company.

(iii) Composition of the Group

2012

The Company reached an agreement with the owner of the minority interest of Kendrion (Linz) GmbH on the acquisition of remaining 49% interest in the company as from 31 December 2012.

2011

The Company reached an agreement with the owners of FAS Controls, Inc. on the acquisition of the company as from 27 December 2011.

(iv) **Transactions eliminated on consolidation**

Intragroup balances and transactions, as well as any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements.

(b) Foreign currency

(i) **Foreign currency transactions**

Transactions expressed in non-euro zone currencies are translated into euros at exchange rates at the date of the transaction. Monetary assets and liabilities denominated in non-euro zone currencies at the reporting date are translated into euros at the exchange rate at that date. Non-monetary assets and liabilities denominated in non-euro zone currencies that are measured at historical cost are translated at the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in the non-euro zone currencies that are measured at fair value and are translated in euros against the exchange rates which were valid at the dates that the fair values were set. Currency differences on foreign currrency transactions are recognised in profit or loss, except loans considered to be part of the net investment, or qualifying cash flow hedges which are recognised directly in other comprehensive income.

(ii) **Foreign operation**

The assets and liabilities of non-euro zone operations, including goodwill and fair value adjustments arising on the moment of acquisition, are translated into euros at exchange rates at the reporting date. The income and expenses of non-euro zone operations are translated into euros at rates approximating the exchange rates at the date of the transaction. Foreign currency differences are recognised directly in the translation reserve in equity.

On the partial or complete sale of a foreign operation the related amount is transferred from the translation reserve to the profit or loss.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a non-euro zone operation, of which the settlement is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a non-euro zone operation and are recognised directly in equity in the translation reserve.

(c) Property, plant and equipment

(i) **Owned assets**

Items of property, plant and equipment are measured at cost or assumed cost less accumulated depreciation and accumulated impairment losses (see accounting policy g). The cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and reinstating the site on which they are located, a reasonable proportion of production overheads, and capitalised borrowing costs.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) **Leased assets**

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Owner-occupied property acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (see below) and impairment losses (see accounting policy g).

(iii) **Subsequent costs**

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised as a charge in the statement of comprehensive income as incurred.

(iv) **Depreciation**

Depreciation is charged to the profit or loss on a straight-line basis over the estimated useful life of each component of property, plant and equipment. Land is not depreciated.

Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that the Group will obtain ownership by the end of the lease term.

Depreciation methods, useful lives and residual values are reviewed annually.

(v) **Recognition of transaction results**

Gains and losses on the disposal of property, plant and equipment are accounted for in other operating income/other expenses in the statement of comprehensive income.

(d) Intangible assets

(i) **Goodwill**

Goodwill that arises upon acquisition of subsidiaries is included in intangible assets. For the measurement of goodwill at initial recognition see note a.

Goodwill is carried at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but is tested annually for impairment (see note g).

Negative goodwill arising on an acquisition is recognised directly in profit or loss.

(ii) **Research and development**

Expenditure on research activities undertaken with the prospect of gaining new scientific or technical knowledge and understanding is recognised in profit or loss as incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalised includes the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use, and capitalised borrowing costs. Other development expenditure is recognised in profit or loss as incurred.

Capitalised development expenditure is measured at cost less accumulated amortisation and accumulated impairment losses.

(iii) **Other intangible assets**

Other intangible assets, that are acquired by the Group and have finite useful lives, are stated at cost less accumulated amortisation (see below) and accumulated impairment losses (see note g). Based on the purchase price allocation of acquisitions, intangible assets are recognised which are part of the other intangible assets and relate to, amongst others, valued customer relations, trade names and technologies.

(iv) **Subsequent expenditure**

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits, embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(v) **Amortisation**

Amortisation is recognised in profit or loss on a straight-line basis over the estimated useful lives of the intangible assets unless such lives are indefinite. Goodwill and other intangible assets with an indefinite useful life are systematically tested for impairment at each reporting date. Other intangible assets are amortised from the date they are available for use. Amortisation methods, useful lives and residual values are reviewed at each reporting date and adjusted if appropriate.

(e) >> Financial instruments and other investments

(i) **Financial instruments**

Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, recognised interest bearing loans and borrowings, trade and other payables, cash and cash equivalents, and other non-derivative financial instruments, recognised on the date they are originated.

Non-derivative financial instruments are recognised initially at fair value, less any directly attributable transaction costs. The Group derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in such transferred financial assets that is created or retained by the Group is recognised as a separate asset or liability. Financial assets and liabilities are offset and the net amount presented in the statement of financial position when, and only when, the Group has a legal right to offset the amounts and intends either to settle them on a net basis or to realise the asset and settle the liability simultaneously. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Trade and other receivables
Trade and other receivables are carried at amortised cost, less impairment losses (see note g).

Recognised interest-bearing loans and borrowings
After initial recognition, interest-bearing loans and borrowings are carried at amortised cost with any difference between the initial carrying amount and the redemption amount, based on the effective interest method taken to the profit or loss over the term of the loans.

Trade and other payables
Trade and other payables are carried at amortised cost.

Cash and cash equivalents
Cash and cash equivalents comprise cash and bank balances and other call deposits payable on demand. Bank overdrafts that are repayable on demand, and form an integral part of the Group's cash management, are included as a component of cash and cash equivalents in the statement of cash flows and are measured at face value.

Other non-derivative financial instruments
Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses.

Derivative financial instruments, including hedge accounting

The Group holds derivative financial instruments to hedge its foreign currency and interest rate exposures.

Derivatives are initially measured at fair value, with attributable transaction costs recognised in the statement of comprehensive income when incurred. Subsequent to initial recognition, derivatives are carried at fair value. Any changes are taken to the profit or loss, unless the instruments are designated as cash flow hedges.

Embedded derivatives are separated from the host contract and accounted for separately. If the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative, would meet the definition of a derivative, and the combined instrument is not measured at fair value in profit or loss. Changes in the fair value of separated embedded derivatives are recognised immediately in profit or loss. At 31 December 2012 no embedded derivatives existed.

Changes in the fair value of a derivative hedging instrument, designated as a cash flow hedge, are recognised in other comprehensive income and presented in the hedging reserve in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes are recognised immediately in profit or loss.

On initial designation of the derivative as the hedging instrument designated as a cash flow hedge, the Group formally documents the relationship between the hedging instrument, the hedged item and the hedged risk, including the risk management objective and strategy in undertaking the hedge transaction, together with the methods that are used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in achieving offsetting of the changes in the cash flows for the respective hedged items attributable to the hedged risk, and whether the actual results of each hedge are with a range of 80–125%. For a cash flow hedge of a forecasted transaction, the Group establishes that the hedged transactions are highly probable to occur and present an exposure to variations in cash flows that could ultimately affect profit or loss.

If the hedging instrument no longer meets the criteria for a cash flow hedge, expires or is sold, then hedge accounting is discontinued prospectively. The cumulative result previously included in equity is recognised in the profit or loss unless it is expected that the original hedged transaction will still take place.

(f) Inventories

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs to sell.

The cost of inventories of the Group is based on the weighted average cost, and includes expenditure incurred in acquiring the inventories, production or conversion costs and other costs incurred in bringing them to their current location and condition. The cost of inventories includes an appropriate share of overheads based on normal operating capacity.

(g) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss, in respect of a financial asset measured at amortised cost, is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised as a charge in profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost, the reversal is recognised in profit or loss.

(ii) **Non-financial assets**

The carrying amounts of the Group's non-financial assets, other than inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, the recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the 'cash-generating unit'). For the purpose of impairment testing, the goodwill acquired in a business combination is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

(iii) **Reversal of impairment losses**

An impairment in respect of a receivable carried at amortised cost is reversed, if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. Impairment losses in respect of goodwill are not reversed. Impairment losses in respect of other assets are reversed if there has been a change in the estimates used to determine the recoverable amount.
An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. Reversals of impairment losses are recognised in profit or loss.

(iv) **Calculation of recoverable amount**

The recoverable amount of the Group's receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed on initial recognition of these financial assets). Receivables with a short remaining term are not discounted. The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(h) Share capital

(i) Ordinary shares

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity, net of any tax effect.

(ii) Repurchase, disposal and reissue of share capital (treasury shares)

When own shares recognised as equity are repurchased, the amount of the consideration paid, including directly attributable costs and net of any tax effects, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to or from other reserves.

(iii) Dividends

The holders of ordinary shares are entitled to receive dividends as determined from time to time by the General Meeting of Shareholders. The Executive Board has the authority to decide, with the approval of the Supervisory Board, what portion of the profit will be allocated to the reserves. If applicable the declared but not yet paid dividends are recognised as a liability.

(i) Employee benefits

(i) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in profit or loss when they are due. Prepaid contributions are recognised as an asset to the extent that cash refund or a reduction in future payments will occur.

(ii) Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group’s net obligation in respect of defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. The fair value of any plan assets is deducted.
The Group determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability (asset).
The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of the Group’s obligations and that are denominated in the same currency in which the benefits are expected to be paid.

The calculation is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Group, the recognised asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. In order to calculate the present value of economic benefits, consideration is given to any minimum funding requirements that apply to any plan in the Group. An economic benefit is available to the Group if it is realisable during the life of the plan, or on settlement of the plan liabilities.

Remeasurements arising from defined benefit plans comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest). The Group recognises them immediately in other comprehensive income and all other expenses related to defined benefit plans in employee benefit expenses in profit or loss.

When the benefits of a plan are changed, or when a plan is curtailed, the portion of the changed benefit related to past service by employees, or the gain or loss on curtailment, is recognised immediately in profit or loss when the plan amendment or curtailment occurs.

The Group recognises gains and losses on the settlement of a defined benefit plan when the settlement occurs. The gain or loss on a settlement is the difference between the present value of the defined benefit obligation being settled as determined on the date of settlement and the settlement price, including any plan assets transferred and any payments made directly by the Group in connection with the settlement.

(iii) **Other long-term service benefits**

The Group's net obligation in respect of long-term service benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using the projected unit credit method, discounted to its present value and net of the fair value of any related assets. The discount rate is the yield at the financial position date on AA-credit rated bonds that have maturity dates approximating the terms of the Group's obligations. Any actuarial gains and losses are recognised in profit or loss in the period in which they arise.

(iv) **Share-based payment transactions**

The grant-date fair value of share-based payment awards granted to employees and the Executive Board, is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

(j) Provisions

A provision is recognised in the statement of financial position when the Group has a present legal or constructive obligation as a result of a past event, that can be measured reliably and it is probable that settlement of the obligation will involve an outflow of funds.

If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

The unwinding of the discount is recognised as finance cost.

(k) Revenue

(i) Goods sold and services rendered

Revenue from the sale of goods is recognised in profit or loss when the significant risks and rewards of ownership have been transferred to the customer. No revenues are recognised if there are significant uncertainties about the collectability of the consideration due, the associated costs on the possible return of goods and also when there is no continuing management involvement with the goods, and the amount of revenue cannot be measured reliably. The transfer of risks and rewards varies depending on the terms of the individual sales contract.

(ii) Government grants

Unconditional government grants are recognised in profit or loss as operating income when they become receivable.

Other government grants are recognised in the statement of financial position initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as other income in profit or loss in the same periods in which the expenses are incurred. Grants for the cost of an asset that compensate the Group are recognised in profit or loss as other operating income over the useful life of the asset.

(l) Expenses

(i) Operating lease payments

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease.

(ii) Financial lease payments

Minimum lease payments are apportioned between the finance expense and the reduction in the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(iii) Net finance costs

Finance income comprises interest income on funds invested, and financial assets held to maturity. Interest income is recognised as it accrues in profit or loss, using the effective interest method.

Finance expenses comprise interest expense on borrowings, commitment fees, accrued interest on provisions, interest on pension liabilities, impairment losses recognised on financial assets and losses on interest rate hedge instruments to the extend they are recognised in profit or loss. All borrowing costs are recognised in profit or loss using the effective interest method.

Realised and unrealised foreign currency gains and losses on monetary assets and liabilities, including changes in fair value of currency hedge instruments that are not qualified as cash flow hedges are reported on a net basis.

(m) Income tax

Income tax for the year comprises current and deferred tax. Income tax is recognised in profit or loss unless it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax, payable or receivable, on the taxable income for the year, using applicable tax rates enacted or substantially enacted at the financial position date, and any adjustment to tax calculated in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences:

- the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit;
- relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future;
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantially enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the asset can be applied. Deferred tax assets are reduced where it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend is recognised.

(n) Earnings per share

The Company presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the reporting period. Diluted earnings per share is determined by adjusting profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilutive potential ordinary shares.

(o) Segment reporting

The Group continues to determine and present operating segments based on the information that is provided internally to the Executive Board, the Group's chief operating decision-maker. This is in conformity with IFRS 8-Operating segments.

Based on the criteria of IFRS 8, in essence the individual operating companies of Kendrion are the operating segments of the Group. An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. The operating segment's operating results are reviewed regularly by the Executive Board to make decisions about resources to be allocated to the segment and assess its performance, and for which separate financial information is available.

Based on the aggregation criteria of IFRS 8, however, these operating segments have been aggregated into one single reportable operating segment on the consolidated level of Kendrion as a Group. In accordance with IFRS 8, the Company discloses general and entity-wide disclosures, including information about geographical areas and major customers of the Group as a whole.

(p) New standards and interpretations

A number of new standards, amendments to standards and interpretations are effective for the year ended 31 December 2012, and, where relevant, have been applied in the preparation of these consolidated financial statements.

The standards or interpretations published by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC), which are in effect for the year ended 31 December 2012, and may be relevant and may have an impact on the financial statements, are as follows:

- **IAS 19:** Employee benefits. The Group early adopted IAS 19 Employee Benefits (2011) with a date of initial application of 1 January 2012 and changed its basis for determining the income or expense related to defined benefit plans. More details are enclosed in the 'Basis for preparation' section and Note 11.

- **IAS 12:** Income taxes. The amendment clarifies the determination of deferred tax on investment property measured at fair value. The financial statements were not impacted by this amendment, as Kendrion does not have any investment property measured at fair value.

The standards or interpretations published by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) which are not yet in effect at 31 December 2012 and may be relevant, are as follows:

- **IAS 1:** Presentation of Financial statements. The amendments to IAS 1 require companies to group together items within Other Comprehensive Income (OCI) that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in OCI and profit or loss should be presented as either a single statement or two consecutive statements. These amendments are not expected to have influence on the Group's financial statements.

- **IFRS 9:** Financial instruments. This new standard introduces new requirements for the classification and measurement of financial assets. Under IFRS 9 financial assets are classified and measured based on the business model in which they are held and the characteristics of their contractual cash flows. IFRS 9 is effective for annual periods beginning on or after 1 January 2015 with early adoption permitted. The adoption of IFRS 9 is expected to have an negligible impact on the Group's financial assets and liabilities.

- **IFRS 10:** Consolidated Financial Statements. This new standard establishes principles for the preparation and presentation of consolidated financial statements when a reporting entity controls one or more investees. IFRS 10 builds on the concepts in IAS 27 and SIC-12 and combines them into a single consolidation model, based on the principle of control. This standard will become effective from 1 January 2013. This new standard is not expected to have influence on the Group's financial statements.

- **IFRS 11:** Joint Arrangements. IFRS 11 establishes principles for the financial reporting by parties to a joint arrangement. IFRS 11 supersedes IAS 31 Interests in Joint Ventures and SIC-13—Jointly Controlled Entities–Non-Monetary Contributions by Ventures. This standard will become effective from 1 January 2013. This new standard is not expected to have influence on the Group's financial statements.

- **IFRS 12:** Disclosure of Interests in Other Entities. This is a new and comprehensive standard on disclosure requirements for all forms of interests in other entities, including subsidiaries, joint arrangements, associates and unconsolidated structured entities. This standard will become effective from 1 January 2013. The Group does not expect a material impact on the disclosures as a result of this new standard.

- **IFRS 13:** Fair value measurement. This new standard defines fair value and sets out a single framework for measuring fair value and required disclosures about fair value measurements. This standard will become effective from 1 January 2013. This new standard is not expected to have influence on the Group's financial statements.

(q) ## Fair values

(i) **Measurement of fair value**

Several of the Group's accounting policies, as well as the information supply by the Group, require the fair value of both financial and non-financial assets and liabilities to be determined. For valuation and information supply, the fair value is measured using the following methods. Where applicable, more detailed information on the basis of the fair value measurement is disclosed in the specific notes on the asset or liability in question. The principal methods and assumptions used in estimating the fair value of financial instruments included in the summary are given below.

(ii) **Property, plant and equipment**

The fair value of property, plant and equipment recognised as a result of a business combination, is based on market value in use. The market value of property is the estimated amount for which the property in question could be exchanged on the valuation date between a buyer and seller in an arm's length transaction, in which both parties have acted knowledgeably, prudently and without compulsion. The market value of other items of property, plant and equipment is based on the quoted market prices of comparable assets and goods.

(iii) **Intangible assets**

The fair value of patents and trademarks acquired as part of a business combination is measured on the basis of the discounted estimated royalties, which have been avoided through ownership of the patent or trademark. The fair value of customer relationships acquired in a business combination is based on the excess earnings method over multiple periods, valuating the asset in question by deducting a real return on all other assets which in total create the related cash flows. The fair value of other intangible assets is based on the expected discounted value of the cash flows from the use and ultimate sale of the assets.

(iv) **Financial lease liabilities**

The fair value is estimated on the basis of the present value of future cash flows, discounted at the interest rate for lease contracts of a similar kind. The estimated fair value reflects movements in interest rates.

(v) **Inventories**

The fair value of inventories acquired as part of a business combination is determined on the basis of the estimated selling price as part of the normal business operations, less the estimated costs of completion and the selling costs, plus a reasonable profit margin which reflects the completion and sales effort.

(vi) **Trade and other receivables/trade and other payables**

The face value of receivables and liabilities falling due within one year is regarded as a reflection of their fair value. The fair value of all other receivables and liabilities is measured on the basis of present value. The discount factor is based on the risk free interest rate of the same duration of the receivable and/or payable, plus a credit mark up reflecting the credit worthiness of the Group.

(vii) **Interest-bearing loans**

The fair value is calculated on the basis of the present value of future repayments of principal and interest at the prevailing market rate of interest, augmented by a credit mark-up reflecting the credit worthiness of the Group.

(viii) **Derivatives**

The fair value of forward exchange contracts is based on the present value of the contractual cash flows for the remaining term based on a risk-free interest rate.

(ix) **Non-derivative financial liabilities**

The fair value of non-derivative financial liabilities is determined for information supply and is based on the present value of future repayments of principal and interest, discounted at a risk-free rate and a margin based on the credit worthiness of the Group on the reporting date.

(x) **Contingent consideration**

The fair value of contingent considerations arising in a business combination is calculated using the income approach based on the expected payment amounts and their associated probabilities. When appropriate it is discounted to present value.

(r) Financial risk management

The Group has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk.

This section provides general information about the Group's exposure to each of the above risks in the course of its normal business operations, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are concluded in the financial instrument section in these consolidated financial statements.

The Executive Board bears the ultimate responsibility for the organisation and control of the Group's risk management framework. The Group's risk policy is designed to identify and analyse the risks confronting the Group, implement appropriate risk limits and control measures, and monitor the risks and compliance with the limits. The risk management policy and systems are evaluated at regular intervals and, when necessary, adapted to accommodate changes in market conditions and the Group's operations.

The Company's Supervisory Board supervises compliance with the Group's risk management policy and procedures.

For a more detailed description of risk management and the position of financial risk management in the Group's framework, we refer to the Annual Report.

(i) **Credit risk**

Credit risk is the risk of financial loss to the Group in the event that a client or counterparty to a financial instrument fails to meet its contractual obligations. Credit risks arise primarily from accounts receivable, derivative transactions concluded with banks and cash positions and deposits held with banks. The Group continually monitors the credit risk within the Group. The Group does normally not require collateral for trade and other receivables and financial assets.

The credit policy includes an assessment of the creditworthiness of every new major client before offering payment and delivery terms. This assessment includes external credit ratings or reports if they are available. The creditworthiness of major clients is actively monitored on an ongoing basis.

The Group recognises impairment provisions of an amount equal to the estimated losses on trade and other receivables and other investments. The main component of this provision comprises specific provisions for losses on individual accounts of material significance.

(ii) **Credit risk concentration**

The Group's most significant customer, a German automotive group, accounted for 11% of the trade and other receivables at 31 December 2012. In 2011 the largest customer accounted for 8% of total receivables. No other customers accounted for more than 5% of the trade and other receivables at 31 December 2012. The geographical credit risk from the Group's direct customers is largely concentrated in Germany. However, as the Group's most important customers in the various segments of the German market are multinational or global players this reduces the Group's dependency on the German market.

(iii) **Investments and financial instruments**

The Group currently does not invest in debt securities. Cash positions and exposure to the financial instruments of financial counterparties are monitored actively. The Group's main financial counterparties are well-established banks with good creditworthiness. The cash in bank accounts at other than the core relationship banks is maintained at the minimum level required for the operations of the Group's companies.

(iv) **Liquidity risk**

The liquidity risk is the risk that the Group is unable to meet its financial obligations at the required time. Liquidity risk management is based on the maintenance of sufficient liquidity in the form of unused (committed) credit facilities or cash to meet present and future financial obligations in normal and adverse circumstances.

A summary of the credit lines available to the Group is enclosed in note 10 of these consolidated financial statements. Almost 100% of the available facilities are provided by a syndicate of lenders existing of Rabobank, ING Bank and Deutsche Bank on an equal basis. The Group had approximately EUR 100 million available within its existing credit facility on the financial position date.

(v) **Market risk**

The market risk is the risk of the deterioration of the Group's income due to movements in market prices, such as exchange rates and interest rates. The management of market risk exposure is intended to keep the market risk position within acceptable limits.

Derivatives are used to manage specific market risks. These transactions are carried out within the treasury framework adopted by the Executive Board. Where necessary, the Group uses hedge accounting to manage volatility in the statement of comprehensive income.

(vi) **Interest rate risk**

Pursuant to the Group's policy, between 50-85% of the exposure to changes in interest rates on borrowings is maintained on a fixed rate basis, taking into account any assets with exposure to changes in interest rates and expected short term free cash flow. The policy is implemented by making use of derivative financial instruments such as interest rate swaps and interest rate options.

The Group has entered into two interest rate swap contracts of EUR 10 million each, to reduce interest rate risk exposure to increasing market rates, thereby fixing the interest rate of EUR 20 million in interest bearing debt for periods of one respectively two years.

(vii) **Currency risk**

The Group is exposed to exchange rate risks on sales, purchases, equity positions and loans expressed in currencies other than the euro. The Group companies are primarily financed in their own currency. The majority of the revenues and costs of the Group companies are realised in the eurozone, alltough exposure to foreign currencies is increasing due to increased activities, in particular in the USA and Asia. Approximately 80% of the cost base and over 75% of the revenue is realised in euros. Sales outside the eurozone are partly produced locally and partly exported from the eurozone. Most of these exports are realised in euros.

The Group's activities in the Czech Republic result in the most significant currency exposure, since the majority of revenue is generated in euros and part of the costs are realised in Czech krones. Pursuant to the Group's policy this currency exposure is hedged to a level of at least 70% for the next four quarters and at least 30% for the next four quarters thereafter. Exchange rate risks are hedged with derivatives.

The Group also actively hedges intercompany loans in foreign currency with forward, swaps or back-to-back external or internal loans in the same foreign currency.

Pursuant to the Group's policy for other monetary assets and liabilities denominated in foreign currency, net exposure is maintained at an acceptable level by buying or selling foreign currencies at spot rates as required to correct short-term imbalances.

The Group's policy stipulates that, in principle, equity investments and other translation exposures are not hedged.

(viii) **Other price risks**

Steel, copper and rare earth metals used in permanent magnets are the most important commodities that confront Kendrion with potential price risks.

Copper constitutes the Group's main direct exposure to raw material price risks, since copper wire is an important component of electromagnets. Pursuant to the Group's policy, the sensitivity to copper prices is actively reduced both by concluding fixed-price purchase contracts in the normal course of business with copper wire suppliers and by including raw material clauses in sales contracts. As the occasion arises the Group can also conclude derivative financial instrument contracts with financial counterparties to hedge the copper risk. No financial derivative contracts for raw materials were outstanding at the balance sheet date.

The Group is also exposed to rare earth metals such as neodymium, used in permanent magnets which are used in some of the Group's products. Prices of these commodities have shown significant volatility since 2011. After an 800% price increase during 2011, prices have gradually decreased back to a level of approximately 200% of the levels before 2011. The Group closely monitors development in this market and has increased stock levels and the number of supply sources for these permanent magnets. Furthermore agreements have been made with customers representing the majority of the sales volume in this respect, to link sales prices to developments of permanent magnet prices.

The Group is mainly exposed to raw material price risks relating to oil and steel, primarily as part of the purchase prices of machined components. This exposure is monitored and, when feasible, reduced by means of raw material clauses with customers and by concluding fixed-price agreements with suppliers for periods between 6 and 12 months. The Kendrion steel contracts also, in part, govern the purchasing from component suppliers.

The Group has formed a Commodity Board with representatives from all Business Units, which meets on a quarterly basis and has the objective of further increasing and sharing knowledge on commodities and commodity markets reducing risks and / or prices and setting purchasing policies.

(ix) **Capital management**

The Executive Board's policy is designed to maintain a strong capital gearing to retain the confidence of investors, creditors and the markets and to safeguard the future development of the business activities. The Executive Board monitors the return on equity, which the Group defines as the net operating result divided by shareholders' equity, excluding minority interests. The Executive Board also monitors the level of dividend distributed to ordinary shareholders.

The Executive Board seeks to strike a balance between a higher return that would be achievable with a higher level of borrowed capital and the benefits and security of sound capital gearing.

Kendrion carried out an evaluation of its dividend policy during the course of 2011. The results of this evaluation were discussed during the General Meeting of Shareholders on 16 April 2012. Kendrion strives to distribute an annual dividend between 35% and 50% of the net profit taking consideration to the amount of net profit to be retained to support the medium and long term strategic plans of the company and to maintain a minimum solvency of 35%.

Neither the Company nor its subsidiaries are subject to any externally imposed capital requirements beyond those stipulated by law.

1 ## Property, plant and equipment

EUR million	Land and buildings	Plant and equipment	Other fixed assets	Under construction	Total
Cost					
Balance at 1 January 2011	31.7	57.6	26.1	3.0	118.4
Acquired through business combinations	2.1	4.4	0.0	–	6.5
Acquired, other	1.0	4.6	3.6	5.3	14.5
Disposals	(0.6)	(0.6)	(1.3)	(3.2)	(5.7)
Currency translation differences	(0.0)	0.0	0.1	(0.0)	0.1
Balance at 31 December 2011	34.2	66.0	28.5	5.1	133.8
Balance at 1 January 2012	34.2	66.0	28.5	5.1	133.8
Acquired, other	2.0	4.9	3.6	10.7	21.2
Disposals	(0.3)	(2.7)	(0.7)	(4.3)	(7.0)
Currency translation differences	(0.0)	(0.0)	(0.1)	(0.0)	(0.1)
Balance at 31 December 2012	35.9	68.2	31.3	11.5	147.9
Depreciation and impairment losses					
Balance at 1 January 2011	16.5	35.8	19.6	–	71.9
Depreciation for the year	1.0	5.6	2.4	0.0	9.0
Disposals	(0.6)	(0.5)	(1.2)	–	(2.3)
Balance at 31 December 2011	16.9	40.9	20.8	0.0	78.6
Balance at 1 January 2012	16.9	40.9	20.8	0.0	78.6
Depreciation for the year	1.2	5.7	2.8	0.0	9.7
Impairment	–	0.2	0.1	–	0.3
Disposals	(0.3)	(2.5)	(0.7)	–	(2.5)
Balance at 31 December 2012	17.8	44.3	23.0	0.0	86.1
Carrying amounts					
At 1 January 2011	15.2	21.8	6.5	3.0	46.5
At 31 December 2011	17.3	25.1	7.7	5.1	55.2
At 1 January 2012	17.3	25.1	7.7	5.1	55.2
At 31 December 2012	18.1	23.9	8.3	11.5	61.8

Translation differences are calculated on the carrying amount and reflected in the related item in the cost.

The estimated useful life is as follows:

Buildings	10 – 30 years
Plant and equipment	5 – 10 years
Other fixed assets	3 – 7 years

2 Intangible assets

EUR million	Goodwill	Software	Other	Total
Cost				
Balance at 1 January 2011	41.3	2.1	11.9	55.3
Acquired through business combinations	17.2	0.0	8.9	26.1
Acquired, other	–	2.4	–	2.4
Disposals	–	(0.1)	–	(0.1)
Other movements	(0.9)	–	–	(0.9)
Currency translation differences	0.2	0.0	(0.1)	0.1
Balance at 31 December 2011	57.8	4.4	20.7	82.9
Balance at 1 January 2012	57.8	4.4	20.7	82.9
Acquired, other	–	2.0	–	2.0
Disposals	–	0.0	–	0.0
Currency translation differences	(0.3)	0.0	(0.2)	(0.5)
Balance at 31 December 2012	57.5	6.4	20.5	84.4
Amortisation and impairment losses				
Balance at 1 January 2011	–	1.6	3.6	5.2
Amortisation for the year	–	0.3	1.5	1.8
Disposals	–	(0.1)	–	(0.1)
Balance at 31 December 2011	–	1.8	5.1	6.9
Balance at 1 January 2012	–	1.8	5.1	6.9
Amortisation for the year	–	0.7	2.3	3.0
Disposals	–	(0.0)	–	(0.0)
Balance at 31 December 2012	–	2.5	7.4	9.9

EUR million	Goodwill	Software	Other	Total
Carrying amounts				
At 1 January 2011	41.3	0.5	8.2	50.1
At 31 December 2011	57.8	2.6	15.6	76.0
At 1 January 2012	57.8	2.6	15.6	76.0
At 31 December 2012	57.5	3.9	13.1	74.5

Depreciation, amortisation and impairment loss

Depreciation, amortisation and impairment losses are recognised in the following items in the statement of comprehensive income:

EUR million	2012	2011
Depreciation and amortisation of intangible assets and property, plant and equipment	12.7	10.8

The estimated useful life of software is between three and eight years. The estimated life of other intangible assets is approximately between eight and fifteen years. Goodwill has an indefinite estimated useful life. The investments in software during 2012 (EUR 2.0 million) mainly relate to the introduction of a new ERP system. The depreciation period for the ERP system is eight years based on the expected useful life.

Impairment testing for cash-generating units containing goodwill

EUR million	2012	2011
Kendrion Linnig Group	27.6	27.6
Kendrion (Mishawaka) LLC (formerly named Kendrion Tri-Tech LLC)	5.8	5.9
Kendrion (Aerzen) GmbH (formerly named Kendrion Magneta GmbH)	7.1	7.1
Kendrion (Shelby) Inc. (formerly named FAS Controls, Inc.)	17.0	17.2
	57.5	57.8

Key assumptions and method of quantification

The Group recognises its intangible assets in accordance with IAS 38 and IFRS 3. In accordance with IAS 36, the Group has performed an impairment test on the capitalised goodwill in Germany and the USA. The test was carried out by discounting future cash flows to be generated from the continuing use of the cash-generating unit to which the goodwill applies and on the assumption of an indefinite life.

The cash flows for the next three years were based on the relevant Mid-term Plans and budgets drawn up by the local management. For the subsequent years the residual value was calculated on the basis of the results in the last year of relevant forecasts and whereby a moderate growth rate of 2% was taken into account to reflect inflation. The forecasts took no account of tax considerations, i.e. were based on pre-tax cash flow. The discount rate (WACC) was also pre-tax. In accordance with IAS 36.44, expansion investments were excluded from the calculations.

The expected growth in cash flows as a result of these expansion investments was also excluded.

The Group has not processed any impairment of goodwill in this accounting period.

Key assumptions used in the calculation of recoverable amounts are discount rates, terminal value growth rates and EBIT growth. Assumptions are based on past experience and external sources.

These assumptions are as follows:

Discounted cash flow projections

	Discount rate		Terminal value growth rate		Assumed EBIT growth	
	2012	2011	2012	2011	2012	2011
Kendrion Linnig Group	10.8%	8.3%	2.0%	2.0%	20.0%	13.5%
Kendrion (Mishawaka) LLC (formerly named Kendrion Tri-Tech LLC)	11.3%	9.7%	2.0%	2.0%	74.2%	8.9%
Kendrion (Aerzen) GmbH (formerly named Kendrion Magneta GmbH)	11.9%	8.4%	2.0%	2.0%	9.7%	19.2%
Kendrion (Shelby) Inc. (formerly named FAS Controls, Inc.)	10.6%	9.3%	2.0%	2.0%	33.0%	18.8%

Discount rate

In determining the pre tax discount rate, first the post tax average costs of capital were calculated for all cash generating units containing goodwill. The post tax rate is based on a debt leveraging compared to the market value of equity of 10%. The debt leveraging was derived from a peer group benchmark analysis. The cost of equity is based on a market risk premium of 6.5% for all cash generating units, a risk-free interest rate of approximately 2%, and a beta factor (sensitivity to the overall stock market) of 1.00. The cost of debt is based on a risk-free rate of 2%, a credit margin of 2% and the local corporate income tax rates. All the post tax average cost of capital rates of the cash generating units containing goodwill approximated 8.2% to 8.5%, which rates were used for calculating the after tax cash flows. Based on an iterative process the pre tax discount rates mentioned in the table above were derived for discounting the post tax cash flows.

Compared to last year the discount rates have increased. The increase was caused by the increase in market risk premium rate from 4.9% at 31 December 2011 to 6.5% at 31 December 2012.

Terminal value growth rate

All cash-generating units with goodwill have five years of cash flows included in their discounted cash flow models. A conservative long-term growth rate into perpetuity has been determined on the basis of a target rate of 2% price inflation in Europe and the USA.

EBIT growth

Forecasted EBIT is expressed at the compound annual growth rates in the initial five years of the cash flow models employed for impairment testing and is based on the three-year Mid-term Plans, drawn up locally in a bottom-up forecasting process and the 2% growth rate mentioned above.

Sensitivity to changes in assumptions

The recoverable amounts of all cash-generating units with goodwill exceed the carrying amounts. Management has carried out an analysis of sensitivity to changes in assumptions. When other variables were kept unchanged, management established that a 20% reduction in the expected EBIT levels would not lead to impairment. The same analysis was carried out for the discount rate. A 2.5% point increase in the pre-tax average cost of capital as compared to the rates mentioned above would not lead to impairment in any of the cash-generating units with goodwill. Referring to note 0, in which the Group explains that the single reportable operating segments are aggregated into one single reportable operating segment of Kendrion as a Group, the Group chooses not to report on recoverable amounts on reporting entities.

3 >> Other investments, derivatives

Other investments in 2012 include recognised upfront and legal fees related to the facility agreement (see note 10) and the extension of the EC Fine guarantee. Kendrion amortises these costs over the remaining maturity of the facility and guarantee. As these costs relate to the facility agreement as a whole and not to individual loans, these costs are not part of the effective interest rate of outstanding loans.

4 >> Deferred tax assets and liabilities

The Group has recognised deferred tax assets for tax loss carry-forwards in Germany and the Netherlands in the financial position.

Germany

Tax assessments have been submitted for the German intermediate holding up to and including 2010, and for the German operating companies up to and including 2010. As from 2005, these years are still open for potential tax audits with the exception of Kendrion (Aerzen) GmbH (formerly named Kendrion Magneta GmbH) which has been audited up to and including 2008. The years up to 2009 are currently being audited by the German tax authorities. At 31 December 2012 the tax loss carry-forwards amounted to about EUR 4 million ('Gewerbesteuer') and EUR 34 million ('Körperschaftsteuer'). These are recognised in full, resulting in deferred tax assets of EUR 5.9 million.

The Netherlands

Tax assessments have been submitted up to and including 2010. The years 2005 up to 2010 are still open for potential tax audits. At 31 December 2012 the tax loss carry-forwards amounted to EUR 30 million. These are recognised in part, resulting in deferred tax assets of EUR 2.2 million.

The main element of the tax loss carry-forwards originates from 2007, after the final settlement of the Dutch tax return for 2007, in which a large tax loss incurred on the sale of Automotive Metals was recognised by the Dutch tax authorities.

Deferred tax assets and liabilities included in the financial position

The deferred tax assets and liabilities can be specified as follows:

EUR million	Assets		Liabilities		Net	
	2012	2011	2012	2011	2012	2011
Property, plant and equipment	0.2	0.2	1.8	1.8	(1.6)	(1.6)
Intangible assets	0.7	0.1	3.7	4.0	(3.0)	(3.9)
Inventories	0.1	–	0.2	0.2	(0.1)	(0.2)
Employee benefits	0.4	0.6	–	–	0.4	0.6
Provisions	0.1	0.2	0.3	0.1	(0.2)	0.1
Other items	0.1	0.5	0.2	0.1	(0.1)	0.4
Tax value of recognised loss carry-forwards	8.9	8.1	–	–	8.9	8.1
Deferred tax assets/liabilities	10.5	9.7	6.2	6.2	4.3	3.5

The deferred tax assets relate to a large extent to recognised tax loss carry-forwards.

The deferred tax liabilities relate almost entirely to temporary differences between the carrying amount and tax base of property, plant and equipment and intangible assets. These are of a relatively long term, mostly over five years.

Movements in temporary differences during the financial year

Net, EUR million	2012			
	At 1 January	Recognised in income	Recognised in other comprehensive income	At 31 December
Property, plant and equipment	(1.6)	0.0	–	(1.6)
Intangible assets	(3.9)	0.9	–	(3.0)
Inventories	(0.2)	0.1	–	(0.1)
Employee benefits	0.6	(0.1)	(0.1)	0.4
Provisions	0.1	(0.3)	–	(0.2)
Other items	0.4	(0.5)	–	(0.1)
Tax value of loss carry-forwards used	8.1	0.8	–	8.9
	3.5	0.9	(0.1)	4.3

Net, EUR million	2011					
	At 1 January	Effect acquisitions	EUR	Recognised in income	Recognised in other comprehensive income	At 31 December
Property, plant and equipment	(0.7)	(1.0)	(1.7)	0.1	–	(1.6)
Intangible assets	(2.2)	(2.4)	(4.6)	0.7	–	(3.9)
Inventories	(0.1)	0.0	(0.1)	(0.1)	–	(0.2)
Employee benefits	0.3	–	0.3	–	0.3	0.6
Provisions	0.1	0.0	0.1	0.0	–	0.1
Other items	0.5	0.0	0.5	(0.1)	–	0.4
Tax value of loss carry-forwards used	11.6	0.0	11.6	(3.5)	–	8.1
	9.5	(3.4)	6.1	(2.9)	0.3	3.5

In 2012, the net amount from the movement in deferred tax assets and liabilities, presented as tax in the profit or loss, is EUR 0.9 million (2011: EUR –2.9 million).

Unrecognised deferred tax assets

At 31 December 2012, the Group had not valued tax losses of approximately EUR 21 million (2011: EUR 27 million) primarily originating in the Netherlands. Tax losses in the Netherlands can be carried forward for a period of nine years. The majority of the current unrecognised losses will expire in 2016.

5 >> Inventories

EUR million	2012	2011	1 Jan. 2011
Raw materials, consumables, technical materials and packing materials	15.1	17.1	12.6
Work in progress	8.9	8.6	7.7
Finished goods	10.4	12.1	7.4
Goods for resale	0.8	0.7	0.5
	35.2	38.5	28.2

The inventories are presented after accounting for a provision for obsolescence amounting to EUR 3.8 million (2011: EUR 4.2 million).
In 2012 the amount of the write down to net realisable value of the inventories was EUR 0.5 million (2011: EUR 0.6 million).

6 ## Trade and other receivables

EUR million	2012	2011	1 Jan. 2011
Trade receivables	31.2	34.9	26.4
Other taxes and social security	0.6	1.3	1.1
Other receivables	1.6	1.9	1.0
Derivatives used for hedging	–	–	0.1
Prepayments	1.1	1.5	1.6
	34.5	39.6	30.2

The credit and currency risks associated with trade and other receivables are disclosed in note 15 and the financial risk management paragraph in note r.

7 ## Cash and cash equivalents

EUR million	2012	2011	1 Jan. 2011
Bank balances	9.9	9.2	9.0
Bank overdrafts	(5.4)	(0.3)	(1.7)
Cash and cash equivalents in the statement of cash flows	4.5	8.9	7.3

The bank balances are freely available. The interest-rate risk for the Group and a sensitivity analysis for financial assets and liabilities are disclosed in notes 15 and r.

8 ## Capital and reserves

Capital and share premium

	Shares entitled to dividend		Repurchased shares		Total number of issued shares	
	2012	2011	2012	2011	2012	2011
At 1 January	11,445,133	11,257,259	47,392	59,115	11,492,525	11,316,374
Issued shares (share dividend)	155,675	176,151	–	–	155,675	176,151
Issued registered shares (share plan)	7,014	–	–	–	7,014	–
Delivered repurchased shares	31,553	11,723	(31,553)	(11,723)	–	–
At 31 December	11,639,375	11,445,133	15,839	47,392	11,655,214	11,492,525

Issuance of ordinary shares

In 2012 155,675 new shares were issued as share dividend. During 2012, the Company delivered 38,567 shares to the Executive Board and senior management as part of its share plan and remuneration packages. The Company purchased none of the Company's shares in 2012 (2011: none).

Ordinary shares

The authorised share capital consists of:

EUR million	2012	2011
40,000,000 ordinary shares of EUR 2.00	80.0	80.0

Issued share capital

Balance at 1 January 2012: 11,492,525 ordinary shares (2011: 11,316,374)	22.9	22.6
Balance at 31 December 2012: 11,655,214 ordinary shares (2011: 11,492,525)	23.2	22.9

Share premium

EUR million	2012	2011
Balance at 1 January	64.6	68.4
Dividend payment	(7.1)	(6.7)
Share premium on issued shares	2.4	2.9
Balance at 31 December	59.9	64.6

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of associates in the non-euro zone. Gains and losses relating to the translation risk are recognised in equity. The build-up of the cumulative figure commenced on 1 January 2004.

Hedge reserve

The hedge reserve comprises the effective portion of the cumulative net movement in the fair value of cash flow hedging instruments relating to hedged transactions that have not yet occurred, net of tax.

The net movement was EUR 0.1 million (2011: EUR – 0.2 million). The realisation of hedged transactions amounted to EUR 0.3 million (2011: EUR 0.0 million). The hedge reserve decreased with EUR 0.2 million due to valuation (2011: EUR – 0.2 million). There was no hedge ineffectiveness in 2012 (2011: EUR 0.0 million).

Reserve for own shares (treasury shares)
The reserve for the Company's own shares comprises the cost of the Company shares held by the Company for the share plan and the remuneration packages for the Executive Board and senior management. At 31 December 2012, the Company held 15,839 of the Company's shares (2011: 47,392). See also note 27.

Other reserves
Other reserves are all the reserves other than those shown separately and comprise primarily of the accumulated, undistributed profits from previous financial years.

Retained earnings
In 2012, the result for 2011 was fully transferred in other reserves. Retained earnings in the 2012 financial statements consequently consist solely of the result for 2012.

Restrictions
Certain subsidiaries are restricted, either by law or by the provisions of their Articles of Association, in the extent to which they may distribute equity. These restrictions amounted to EUR 17.3 million at 31 December 2012 (2011: EUR 11.7 million).

Minority interests
Until 30 December 2012 the Company had one non 100%-subsidiary that was fully consolidated: Kendrion (Linz) GmbH (Austria). On 31 December 2012, the Company acquired the remaining 49% interest in Kendrion (Linz) GmbH, increasing its ownership from 51 to 100%.

9 >> Earnings per share

Basic earnings per share
The calculation of the basic earnings per share at 31 December 2012 is based on the profit of EUR 17.9 million (2011: loss EUR 20.2 million) attributable to the holders of ordinary shares and the weighted average number of shares outstanding during the year 2012: 11,571,000 (2011: 11,337,000).

EUR million	2012	2011
Net profit attributable to ordinary shareholders	17.9	(20.2)

Weighted average number of ordinary shares

In thousands of shares	2012	2011
Ordinary shares outstanding at 1 January	11,445	11,257
Effect of shares issued as share plan	7	–
Effect of own shares repurchased	31	11
Effect of shares issued as share dividend	156	176
Ordinary shares outstanding at 31 December	11,639	11,445
Weighted average number of ordinary shares	11,571	11,337
Basic earnings per share (EUR)	1.54	(1.77)
Basic earnings per share (EUR), based on weighted average	1.55	(1.79)

Diluted earnings per share

The calculation of the diluted earnings per share at 31 December 2012 is based on the profit of EUR 17.9 million (2011: loss EUR 20.2 million) attributable to the holders of ordinary shares and the weighted average number of shares in issue during the year: 11,571,000 (2011: 11,337,000).

EUR million	2012	2011
Net profit attributable to ordinary shareholders	17.9	(20.2)
Effect of dilution	–	–
Net profit attributable to ordinary shareholders (diluted)	17.9	(20.2)

Weighted average numbers of ordinary shares (diluted)

In thousands of shares	2012	2011
Weighted average numbers of ordinary shares at 31 December	11,571	11,337
Weighted average numbers of ordinary shares at 31 December (diluted)	11,577	11,337
Diluted earnings per share (EUR), based on weighted average	1.55	(1.79)

10 Loans and borrowings

These notes contain information on the contractual provisions of the Group's interest-bearing loans and borrowings, which are carried at amortised cost price. For further information on the interest rate, currency and liquidity risks borne by the Group, see notes 15 and r.

EUR million	2012	2011	1 Jan. 2011
Non-current liabilities			
Bank loans	25.0	33.4	0.0
Financial lease liabilities	0.0	0.1	0.1
Other loans	0.8	1.3	2.4
	25.8	34.8	2.5

EUR million	2012	2011	1 Jan. 2011
Current liabilities			
Interest-bearing debts to credit institutions	–	–	10.0
	–	–	10.0

Financing conditions

At 31 December 2012, the Group had the following credit lines available:

- A EUR 183.5 million facility agreement, with a syndicate of three banks consisting of Deutsche Bank, ING Bank and Rabobank. The facility agreement includes the following facilities:
  - EUR 35 million revolving working capital facility, with a commitment running until 17 January 2016;
  - EUR 40 million acquisition facility, with a commitment running until 17 January 2016;
  - EUR 60 million acquisition facility, with a commitment running until 17 January 2016;
  - EUR 48.5 million guarantees facility. This facility was provided In connection with the fine imposed by the European Commission;
- EUR 1.0 million other facilities, including a EUR 0.8 million loan in Austria.

At 31 December 2012, the total unutilised amount of the facilities was approximately EUR 100 million.

Kendrion was recently able to amend the Facility Agreement with a particular focus on the acquisition lines. The amendment consists of an easing of the EUR 8 million bi-annual reduction obligation, which will now commence on 17 July 2013, but only if the leverage ratio (net debt / EBITDA) exceeds a predetermined threshold.

Banking syndicate credit facility

Pursuant to the terms of the facility agreement with the banking syndicate, the Group has agreed to a number of financial covenants relating to interest-bearing debt / EBITDA (debt cover) and interest coverage (EBITDA / interest costs). The required covenants are tested each quarter on a 12-month rolling basis. All covenant ratios were satisfied with ample margin at year-end 2012.

Security provided

The Group has provided security for a subsidised ERP (European Restructuring Programme) loan in Austria with an outstanding amount of EUR 0.8 million, referred to above, in the form of a pledge on specific machinery in Austria for which the loan was received. No security is provided in relation to the facility agreement with the banking syndicate.

Interest-rate sensitivity

The interest payable on the Group's interest-bearing borrowings is mainly at rates fixed for three months or shorter periods. Reference is made to notes 15 and r for further details.

Financial lease liabilities

The financial lease liabilities are payable as follows:

EUR million			2012			2011
	Minimum lease	Interest	Principal	Minimum lease	Interest	Principal
‹ 1 year	0.0	0.0	0.0	0.0	0.0	0.0
1 – 5 years	0.0	–	0.0	0.1	–	0.1
› 5 years	–	–	–	–	–	–
	0.0	0.0	0.0	0.1	0.0	0.1

The financial lease liabilities relate to machinery. According to the provisions of the lease contracts, no conditional lease payments are due.

11 Employee benefits

EUR million	2012	2011	1 Jan. 2011
Present value of unfunded obligations	3.6	3.8	3.5
Present value of funded obligations	6.0	6.6	5.5
Fair value of plan assets	(4.4)	(3.8)	(3.6)
Recognised liability for defined-benefit obligations (see below)	5.2	6.6	5.4
Liability for long-service leave and anniversaries	1.9	1.7	1.9
Total employee benefits	7.1	8.3	7.3
Employee benefits classified as liabilities	(7.1)	(8.3)	(7.3)
Total employee benefits	(7.1)	(8.3)	(7.3)

Movements in net liability for defined benefit obligations recognised in the statement of financial position

EUR million	2012	2011
Recognised net liability for defined-benefit obligations at 1 January	6.6	5.4
Expense recognised in the income statement	0.5	0.3
Benefits paid by the plan	(0.4)	(0.4)
Other movements (including currency differences and employer contributions paid)	(0.9)	(0.2)
Actuarial (gains) losses	(0.6)	1.5
Acquired through business combinations	–	0.0
Recognised net liability for defined-benefit obligations at 31 December	5.2	6.6

Movement in plan assets

EUR million	2012	2011
Fair value of plan assets at 1 January	(3.8)	(3.6)
Contributions paid employer	(0.1)	–
Contributions paid participants	(0.1)	–
Payments made	0.0	0.1
Expected return on plan assets	(0.1)	(0.2)
Other movements	(0.3)	(0.1)
Fair value of plan assets at 31 December	(4.4)	(3.8)

Expense recognised in the consolidated statement of comprehensive income regarding defined benefit arrangements

EUR million	2012	2011
Current service costs	0.3	0.3
Interest on obligation	0.3	0.2
Expected return on plan assets	(0.1)	(0.2)
	0.5	0.3
Actual return on plan assets	(0.1)	0.1

The cost related to the defined benefit pension arrangements are processed in the following line items of the statement of comprehensive income:

EUR million	2012	2011
Interest expense	0.3	0.1
Staff costs	0.2	0.2
	0.5	0.3

Principal actuarial assumptions (expressed as weighted averages)

	2012	2011
Discount rate at 31 December	3.1%	3.0%
Future salary increases	0.9%	0.8%
Future pension increases	1.1%	1.0%

Historical information

EUR million	2012	2011	2010	2009	2008
Net liability for defined-benefit obligations	9.6	10.4	9.0	7.5	12.0
Fair value of plan assets	4.4	3.8	3.6	2.4	5.3
Deficit in plan	5.2	6.6	5.4	5.1	6.7

Actuarial calculations of employee benefits have not been materially influenced by amendments based on historical experience and by variable assumptions.

Composition plan assets

EUR million	2012	2011
Bonds	2.7	2.1
Equity	1.0	1.0
Real estate	0.4	0.4
Government loans	0.1	0.1
Other	0.2	0.2
Total	4.4	3.8

Sensitivity analysis

	Defined benefit obligation	
EUR million	1 percent increase	1 percent decrease
Discount rate	(1.1)	1.4
Future salary growth	0.1	(0.1)
Future pension	0.9	(0.7)

Liabilities arising from employee benefits

The pension plans consist of both defined contribution plans and defined benefit plans. In the case of defined contribution plans, the contribution is charged to the year to which it relates. With defined benefit plans, benefit obligations are calculated using the projected unit credit method. Calculations are made by qualified actuaries. The pension liability shown on the financial position is the present value of the defined benefit obligation at the financial position date minus the fair value of the plan assets at the financial position date. The discount rate used to calculate the defined benefit obligation is based on the yield on AA-rated corporate bonds in Europe.

The greater part of the defined benefit obligation at year-end 2012 relates to pension arrangements in Germany, Austria and Switzerland. The organisation administers the plan in-house and is fully liable for the benefit obligations. A portion is reinsured.

Liabilities arising from employee benefits also include liabilities relating to long-service leave, termination of employment and service anniversaries.

12 Share-based payments

At 31 December 2012, the Group had the following share-based payment arrangements.

Loyalty bonus (equity settled)

The Group introduced a share incentive programme in 2010, which entitles key management to purchase shares in the Company for an amount equal to a maximum 50% of their net cash bonus. Employees who retain these shares for three years and remain in service for three years become entitled to a number of shares equal to the number of shares purchased by the employee.

Terms & conditions share programme (loyalty bonus)

Grant date	Number of instruments	Vesting conditions
Shares granted to key management in 2010	2,064	3 years of service
Shares granted to key management in 2011	2,245	3 years of service
Shares granted to key management in 2012	3,201	3 years of service
Total shares	7,510	

Share plan for the Executive Board (equity settled)

Details of the remuneration of the Executive Board are provided in note 27.

Awarded shares

Every year, the Company awards a number of shares in the Company to certain key employees. There are no vesting conditions attached to these shares.

13 Provisions

EUR million	2012	2011	1 Jan. 2011
Balance at 1 January	46.4	2.7	2.6
Provisions made during the period	1.6	43.9	0.1
Provisions used during the period	(0.0)	(0.2)	–
Provisions released during the period	(4.4)	(0.0)	(0.0)
Balance at 31 December	43.6	46.4	2.7
Non-current part	43.6	46.4	2.7
	43.6	46.4	2.7

This item includes a provision of EUR 43.3 million relating to the fine imposed by the European Commission.

On 30 November 2005, the European Commission imposed a EUR 34 million fine on the Company for the infringement of competition law by the Company's former subsidiary, Fardem Packaging B.V. The facts and circumstances then known and the legal advice taken at the time resulted in the Company's decision to form a provision for this fine of an amount of EUR 2.3 million at 31 December 2005. The Company also issued a guarantee to Fardem's purchaser for an equal amount. The Company lodged an appeal against the fine in 2006. The amount payable relating to the fine and the provision accrue annually with an interest percentage of 3.56%. On 16 November 2011, the General Court of the European Union in Luxembourg ruled that the fine is to be upheld in full. The Company decided to increase the provision to the full amount of the fine (including accrued interest) following the General Court's ruling. The total amount has accrued to EUR 43.3 million at 31 December 2012 (2011: 41.8 million). After conducting thorough review of the complete ruling and seeking external legal opinion, in January 2012, the Company decided to lodge an appeal against the General Court's ruling of 16 November 2011 with the Court of Justice of the European Union. On 5 February 2013, an oral hearing was held before the Court of Justice in Luxembourg.

The provisions released during the period includes the release of the earn out provision of EUR 4.4 million relating to the acquisition of FAS Controls Inc. in 2011.

14 Trade and other payables

EUR million	2012	2011	1 Jan. 2011
Trade payables	23.5	26.2	18.9
Other taxes and social security contributions	2.1	1.5	1.2
Derivatives used for hedging	0.2	0.2	–
Non-trade payables and accrued expenses	12.3	14.2	12.9
	38.1	42.1	33.0

15 ## Financial instruments

Credit risk

The carrying amount of the financial assets represents the maximum credit risk. The maximum credit risk on the reporting date was as follows:

EUR million	Carrying amount	
	2012	2011
Cash and cash equivalents	9.9	9.2
Other long term investments	0.7	0.5
Current income tax	3.0	1.0
Trade and other receivables	34.5	39.6
Total	48.1	50.3

The Group's most significant customer, a German automotive group, accounted for 11% of the trade and other receivables at 31 December 2012. In 2011 the largest customer accounted for 8% of total receivables. The geographical credit risk from the Group's direct customers is largely concentrated in Germany. However, as the Group's most important customers in the various segments of the German market are multinational or global players this reduces the Group's dependency on the German market.

Impairment losses

Aged analysis of the trade and other receivables

EUR million	2012		2011	
	Gross	Provision	Gross	Provision
Within the term of payment	30.0	–	34.4	–
0 – 30 days due	3.8	–	4.2	–
31 – 60 days due	0.3	–	0.8	(0.1)
› 60 days due	0.6	(0.2)	0.5	(0.2)
Total trade and other receivables	34.7	(0.2)	39.9	(0.3)

The provision for trade receivables is used to absorb impairment losses, unless the Group is certain that collection of the amount owed is impossible, in which case the amount is treated as a bad debt and written off against the financial asset in question.

At 31 December 2012 the provision for impairment losses on trade and other receivables relates to several customer invoices that the Group believes to be non-collectible, in whole or in part. Based on historic payment behaviour and financial information currently known all receivables that are not impaired at 31 December 2012 are collectible. EUR 0.9 million of trade receivables are over 30 days overdue, of which EUR 0.2 million is provided. Individual invoices with a material amount are outstanding to well-known customers with a solid financial position, while invoices with immaterial amounts are spread over a large number of customers. The group has written off less than EUR 0.1 million receivables in 2012 (2011: EUR 0.1 million), which are recognised under other operating expenses in the comprehensive statement of income.

Liquidity risk

The contractual terms of the financial obligations, including the estimated interest payments and repayment obligations, are set out below.

31 December 2012 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Non-derivative financial liabilities							
Bank loans	25.0	(26.9)	(0.3)	(0.3)	(0.6)	(25.7)	–
Finance lease liabilities	0.0	(0.0)	(0.0)	(0.0)	(0.0)	–	–
Bank overdrafts	5.4	(5.4)	(5.4)	–	–	–	–
Other loans and borrowings	0.8	(0.9)	(0.3)	(0.3)	(0.3)	–	–
Trade and other payables	37.9	(37.9)	(37.9)	–	–	–	–
Tax liabilities	0.7	(0.7)	(0.7)	–	–	–	–
Derivative financial liabilities							
Interest rate swap contracts	0.1	(0.1)	(0.1)	(0.0)	–	–	–
Forward exchange contracts	0.1	(0.1)	(0.1)	–	–	–	–
Total	70.0	(72.0)	(44.8)	(0.6)	(0.9)	(25.7)	–

31 December 2011 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Non-derivative financial liabilities							
Bank loans	33.5	(37.3)	(0.5)	(0.5)	(0.9)	(35.4)	–
Finance lease liabilities	–	–	–	–	–	–	–
Bank overdrafts	0.3	(0.3)	(0.3)	–	–	–	–
Other loans and borrowings	1.3	(1.3)	(0.2)	(0.3)	(0.5)	(0.3)	–
Trade and other payables	41.8	(41.8)	(41.8)	–	–	–	–
Tax liabilities	1.2	(1.2)	(1.2)	–	–	–	–
Derivative financial liabilities							
Interest rate swap contracts	–	–	–	–	–	–	–
Forward exchange contracts	0.3	(0.3)	(0.2)	(0.1)	–	–	–
Total	78.4	(82.2)	(44.2)	(0.9)	(1.4)	(35.7)	–

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

Within the scope of the Group's risk management the Group has hedged the currency and interest risks with derivatives, whereby the hedges have been designated as cash flow hedges. The following table lists the value of these derivatives at financial position date, and when the derivatives will influence profit or loss and cash flows.

Cash flow hedges (in cash flows statement)

The following table indicates the periods in which the cash flows associated with derivatives that are cash flow hedges are expected to occur.

2012 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	(0.1)	(0.1)	(0.1)	–	–	–	–
Forward exchange contracts							
Assets	–	–	–	–	–	–	–
Liabilities	(0.1)	(0.1)	(0.1)	–	–	–	–
Total	(0.2)	(0.2)	(0.2)	(0.0)	–	–	–

2011 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	–	–	–	–	–	–	–
Forward exchange contracts							
Assets	–	–	–	–	–	–	–
Liabilities	(0.2)	(0.2)	(0.1)	(0.1)	–	–	–
Total	(0.2)	(0.2)	(0.1)	(0.1)	–	–	–

Cash flow hedges (in statement of comprehensive income)

The following table indicates the periods in which the cash flows associated with derivatives that are cash flow hedges are expected to impact profit or loss.

2012 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	(0.1)	(0.1)	(0.1)	–	–	–	–
Forward exchange contracts					–	–	–
Assets	–	–	–	–	–	–	–
Liabilities	(0.1)	(0.1)	(0.1)	–	–	–	–
Total	(0.2)	(0.2)	(0.2)	–	–	–	–

2011 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	–	–	–	–	–	–	–
Forward exchange contracts	–	–	–	–	–	–	–
Assets	–	–	–	–	–	–	–
Liabilities	(0.2)	(0.2)	(0.1)	–	(0.1)	–	–
Total	(0.2)	(0.2)	(0.1)	–	(0.1)	–	–

Interest-rate risk

Part of the Group's loans is governed by a floating interest rate (usually 3-month EURIBOR). In view of the Treasury Policy, the Group hedges at least 50% of the floating interest rate exposure. To this extent the Group has outstanding interest rate swaps with a notional amount of in total EUR 20 million. The aggregate fair value of the outstanding interest rate swaps at 31 December 2012 was negative EUR 0.1 million (2011: EUR 0.0 million).

The following table shows the interest rates prevailing at the financial position date for interest-bearing financial liabilities. 95% of all interest expenses relate to senior bank loans. The effective interest rate of these loans equalise the nominal interest rate. Loans were not provided at an up, – or discount and no incremental transaction costs were incurred when the loans were drawn.

				2012		2011	
	Currency	Nominal interest	Year of redemption	Fair value	Carrying amount	Fair value	Carrying amount
Senior bank loans	EUR	EURIBOR + 2.30%	2016	25.0	25.0	33.5	33.5
ERP Fund Loan	EUR	2.25%	2014	0.8	0.8	1.2	1.2
Bank overdrafts	Various	EURIBOR + 2.30%	2013	5.4	5.4	0.3	0.3
Finance lease liabilities	USD	6.50-8.00%	2013	0.0	0.0	0.1	0.1
Total interest-bearing debt				31.2	31.2	35.1	35.1

Sensitivity analysis interest

Financial assets and liabilities with a fixed interest rate are not recognised at fair value by processing the value changes in profit or loss. For this reason a movement in interest rates across the yield curve at 1 January 2013 would not have had a material influence on the 2012 result.

The Group has hedged a considerable part of the floating interest rate exposure by means of interest rate swaps. When taking into account these swaps, in total EUR 20.8 million of the EUR 25.8 million long and short term loans at financial year end have an interest rate which is fixed for one year or longer. Based on the interest bearing debt levels at year end and expected cash flow development, a 1% point increase in the interest rate across the yield curve as from 1 January 2013, will have an increasing effect on interest expenses in 2013 of maximum EUR 0.1 million.

Exchange rate risk

The aggregate fair value of the outstanding forward exchange rate contracts concluded to hedge anticipated transactions was negative EUR 0.1 million at 31 December 2012 (2011: EUR 0.3 million).

A 10% point appreciation of the currencies listed below against the euro would increase shareholders' equity at 31 December 2012 and the result for 2012 by the amounts shown in the following table. The same analysis was performed at 31 December 2011. A 10% point depreciation of the listed currencies against the euro would have had the opposite effect.

The same test was done for the profit or loss, where the sensitivities for a 10% appreciation or depreciation on 31 December 2012 would have had an impact as is shown below.

31 December 2012	Equity	Result
US dollar	3.3	0.1
Czech krone	0.6	(0.1)
Swiss franc	0.2	(0.1)
Chinese yuan	0.9	0.1
Indian rupee	0.0	0.1

31 December 2011	Equity	Result
US dollar	3.7	–
Czech krone	0.6	(0.3)
Swiss franc	0.3	(0.1)
Chinese yuan	0.7	–
Indian rupee	–	(0.2)

Principal exchange rates during the reporting period were as follows:

Applicable currency rates

Value of EUR	At 31 December 2012	At 31 December 2011	Average over 2012
Pound sterling	0.8161	0.8353	0.8133
Swiss franc	1.2072	1.2156	1.2052
Czech krone	25.1509	25.7872	25.1851
Chinese yuan	8.2207	8.1586	8.1420
US dollar	1.3194	1.2939	1.2923
Mexican peso	17.1845	18.0512	17.0268
Brazilian real	2.7036	2.4159	2.5145
Romanian ley	4.4445	4.3233	4.4457
Indian rupee	72.5584	68.7144	68.9465

Fair values of financial instruments

The following table shows the fair values and carrying amounts of the financial instruments.

EUR million	2012		2011	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets carried at amortised costs				
Loans and receivables (including current tax assets)	37.5	37.5	40.6	40.6
Cash and cash equivalents	9.9	9.9	9.2	9.2
Held to maturity investments	0.7	0.7	0.5	0.5
	48.1	48.1	50.3	50.3
Liabilities carried at amortised costs				
Secured bank loans	(25.0)	(25.0)	(33.5)	(33.5)
Other debts	(0.8)	(0.8)	(1.2)	(1.2)
Finance lease liabilities	(0.0)	(0.0)	(0.1)	(0.1)
Bank overdraft	(5.4)	(5.4)	(0.3)	(0.3)
Trade and other payables (including current tax liabilities)	(38.6)	(38.6)	(43.0)	(43.0)
	(69.8)	(69.8)	(78.1)	(78.1)
Liabilities carried at fair value				
Interest derivatives	(0.1)	(0.1)	–	–
Forward exchange contracts	(0.1)	(0.1)	(0.3)	(0.3)
	(0.2)	(0.2)	(0.3)	(0.3)

The Group has no available-for-sale financial assets and all liabilities at fair value were designated as such upon initial recognition. The loans and receivables consist of the trade and other receivables, including the current tax assets in the statement of financial position. The held-to-maturity investments and other long-term receivables are included in the other investments, including derivatives in the statement of financial position. The interest derivatives and forward exchange contracts are included in the trade and other payables in the statement of financial position.

Interest rate used in measuring fair value

The interest rate used for discounting estimated cash flows, where applicable, is based on the swap curve at 31 December 2012, augmented by the prevailing credit mark-up, and is as follows:

	2012	2011
Derivatives	0.2%-0.3%	0.6%-1.5%
Leases	2.50%	3.10%
Bank loans	2.50%	2.72%
Loans and receivables	2.50%	2.33%

Fair value hierarchy

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

level 1 quoted prices (unadjusted in active markets for identical assets or liabilities);

level 2 inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);

level 3 inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Level 3	Total
31 December 2012				
Forward exchange contracts used for hedging	–	(0.2)	–	(0.2)
Contingent considerations	–	–	–	–
Total	–	(0.2)	–	(0.2)
31 December 2011				
Forward exchange contracts used for hedging	–	(0.3)	–	(0.3)
Contingent considerations	–	–	(4.4)	(4.4)
Total	–	(0.3)	(4.4)	(4.7)

The following table shows a reconciliation from the beginning to the ending balances for fair value measurements in level 3 of the fair value hierarchy:

	Contingent consideration
Balance at 1 January 2012	4.4
Arising from business combinations	–
Change in fair value of contingent consideration	(4.4)
Balance at 31 December 2012	–

Level 3 fair value measurements are sensitive to professional judgments and assumptions. No sensitivity analysis is performed as the only level 3 fair value measurement relates to the contingent consideration (earn-out) arising from business combinations.

16 Operating lease agreements

Lease contracts in which the Group acts as lessee

The sums payable on non-redeemable operating lease and rental contracts are as follows:

EUR million	2012	2011
‹ 1 year	3.0	3.0
1 – 5 years	4.4	3.9
› 5 years	2.0	2.7
	9.4	9.6

In the 2012 financial year a charge of EUR 0.8 million was recognised in profit or loss in respect of operating leases (2011: EUR 0.8 million) based on continuing activities. The operating lease contracts are mostly related to buildings.

17 Capital commitments

During the year ended 31 December 2012, the Group signed purchase contracts for property, plant and equipment totalling EUR 3.7 million (2011: EUR 6.5 million).

18 Contingent liabilities

Kendrion (Villingen) GmbH (Germany) was summoned to appear before the court of Milan, Italy, by the Italian Binder Magnete s.r.l. company (not a member of the Kendrion Group), in connection with Kendrion (Villingen) GmbH's termination of the distribution contract between the parties. Binder Magnete s.r.l. claims compensation of EUR 1,250,000. Kendrion has filed a counterclaim. The facts and circumstances currently known and the legal advice that has been taken resulted in the decision to form a provision of EUR 90,000. The court's ruling is to be expected in 2013.

The former Managing Director of Linnig Brasil Acoplamentos Ltda. (currently named Kendrion (São Paulo) Sistemas Automotivos Ltda.) decided to leave the company in August 2011. The former director has unexpectedly filed a claim at the local court for a total amount of BRL 3,435,683 (equivalent to EUR 1,270,781) in connection with employment law issues. The local court rejected all his claims in first instance: however, he appealed against this verdict in 2012. The facts and circumstances currently known and the legal advice that has been taken resulted in the decision to form a provision of an amount of BRL 75,000 (EUR 27,741).

On 25 February 2013, Kendrion LINNIG GmbH, Markdorf, Germany, part of Kendrion's Commercial Vehicle Systems business unit, received two claims from related customers in South Korea. The two claims relate to warranty issues in 2012, and amount to a total of USD 1.3 million. The company will review the extent to which it bears the responsibility for the warranty issues and whether any elements of the claim should be rejected. For this reason further information and an estimate of any financial effects cannot be provided at present. Kendrion has adequate liability insurance to protect its group companies from claims. The level of insurance cover for the two claims received by the company will need to be examined in more detail.

The Group has divested a number of divisions and companies in the past. The customary representations and warranties for transactions of this nature are included in the relevant Share or Asset Purchase Agreements. The Group, as is customary for transactions of this nature, also issued representations and warrants for potential (tax) claims relating to periods prior to the various divestment dates.

19 >> Operating segments

The Group, in accordance with IFRS 8, has enclosed general and entity-wide disclosures in these consolidated financial statements.

Geographical segments based on physical location of the Group operating companies

The revenue and non-current assets per geographic area are specified below.

EUR million	The Americas		Germany		Asia	
	2012	2011*	2012	2011*	2012	2011*
Revenue from transactions with third parties	39.0	12.3	163.3	163.6	20.2	17.9
Non-current assets	24.2	23.6	100.3	95.7	1.1	1.4
Deferred tax assets	1.4	0.1	6.4	8.2	0.3	0.1
Pensions	0.0	0.0	3.8	4.5	0.0	0.0

EUR million	Other European countries		Consolidated	
	2012	2011*	2012	2011*
Revenue from transactions with third parties	62.4	74.1	284.9	267.9
Non-current assets	11.4	11.0	137.0	131.7
Deferred tax assets	2.4	1.3	10.5	9.7
Pensions	1.4	2.1	5.2	6.6

* *Restated for comparison reasons (IAS 8 restatement applied regarding early adoption of IAS 19A).*

Sales segmented by customer location

EUR million	2012	2011
Germany	138.9	148.0
Other European countries	60.6	64.9
Asia	32.9	32.4
The Americas	49.8	19.9
Other countries	2.7	2.7
Total	284.9	267.9

Major customers

One customer, supplied indirectly via several product categories and group companies, accounts for more than 5% of the company's total revenue. This customer accounts for 9% of total revenue.

20 >> Business combinations and acquisitions of non-controlling interests

2012

On 31 December 2012, the Group acquired the remaining 49% interest in Kendrion (Linz) GmbH for EUR 0.7 million, increasing its ownership from 51 to 100%. The Group recognised a decrease in non-controlling interests of EUR 0.1 million and a decrease in other reserves of EUR 0.4 million.

2011

On 27 December 2011, the Company reached an agreement with the owners of FAS Controls, Inc. (currently named Kendrion (Shelby) Inc.) located in Shelby, North Carolina (USA), on the acquisition of 100% of the interest in the company. Kendrion (Shelby) Inc. is active in the automotive and truck market and supplies high-quality electromagnetic valves, in addition to pressure switches and lighting modules. The company is a true niche player, technologically advanced and profitable.

During the five days prior to 31 December 2011, Kendrion (Shelby) Inc. did not contribute revenue or net profit to the Group's results due to the fact that the company was closed during the last week of December. The management estimates that if the acquisition had taken place on 1 January 2011, the consolidated revenue would have been EUR 293.4 million and the consolidated net loss for the year would have been EUR 19.4 million. When management determined these amounts it was assumed that the fair value adjustments, as determined provisionally, arising on the date of acquisition would have been identical to those on acquisition on 1 January 2011.

21 Other operating income

EUR million	2012	2011
Release of unused provisions and accrued expenses	4.5	0.6
Net gain on disposal of property, plant and equipment	0.2	0.0
Other	0.4	0.4
	5.1	1.0

The release of unused provisions and accrued expenses includes the release of the earn out provision of EUR 4.4 million relating to the acquisition of FAS Controls, Inc (currently named Kendrion (Shelby) Inc.) in 2011.

22 Staff costs

EUR million	2012	2011
Wages and salaries	64.3	57.8
Social security charge	9.4	7.5
Temporary personnel	4.0	5.5
Contributions to defined contribution plans	0.2	0.3
Expenses related to defined benefit plans	0.2	0.1
Increase in liability for long-service leave	0.1	(0.2)
Other costs of personnel	1.6	1.8
	79.8	72.8
Total number of employees and temporary workers at 31 December (FTE)	1,632	1,482

23 Other operating expenses

EUR million	2012	2011
Lease expenses	0.8	0.8
Increase in provision for doubtful debts	0.0	0.0
Premises costs	5.2	4.7
Maintenance expenses	2.6	3.0
Transport expenses	1.4	1.8
Consultancy expenses	4.1	4.1
Sales and promotion expenses	1.2	1.3
Car, travel and representation costs	3.1	2.7
Addition to provision EC fine	–	39.4
Other	5.5	4.1
	23.9	61.9

Research & Development expenses (including staff and other operating expenses) for 2012 totalled EUR 17.1 million (2011: EUR 12.2 million). Details of the provision relating to the fine imposed by the European Commission are provided in note 13.

24 Net finance costs

EUR million	2012	2011
Interest income	0.1	0.1
Net exchange gain	–	–
Finance income	0.1	0.1
Interest expenses	(4.4)	(1.8)
Interest expenses related to employee benefits	(0.3)	(0.1)
Net exchange loss	(0.3)	(0.2)
Finance expense	(5.0)	(2.1)
Net financing costs	(4.9)	(2.0)

The significant increase in interest expenses is mainly due to the accrued interest on the EC fine imposed on the group which was fully provided during 2012, the increase of the average interest bearing debt as a consequence of the FAS acquisition at the end of 2011, and higher transaction costs (commitment fee charges) related to the increased acquisition facility as from January 2012.

25 Income tax

Recognised in profit or loss

EUR million	2012	2011
Current tax charge on year under review	(1.5)	(6.6)
Total corporation tax expenses in profit or loss	(1.5)	(6.6)

26 Reconciliation with the effective tax rate

	Reconciliation with tax rate		Reconciliation with effective rate EUR million	
	2012	2011	2012	2011
Profit before income tax			19.5	(13.5)
Income tax expense at local corporation tax rate	25.0%	25.0%	4.9	(3.4)
Non-deductible expenses	3.6%	(78.2)%	0.7	10.6
Effect of tax rates in foreign jurisdictions	1.4%	(2.7)%	0.3	0.3
Tax holiday in foreign jurisdiction	–	2.9%	–	(0.4)
Tax exempt income	(9.3)%	–	(1.8)	–
Change in unrecognised temporary differences	(1.3)%	–	(0.3)	–
Recognition of previously unrecognised tax losses[1]	(11.9)%	4.4%	(2.3)	(0.6)
Other movements	0.2	(0.9)%	0.0	0.1
	7.7%	(48.6)%	1.5	6.6

[1] *Mainly due to recognition of carry forward tax losses in the Netherlands.*

27 Related parties

Identity of related parties

A related-party relationship exists between the Company and its subsidiaries, their managers and executives. The Company has a number of agreements with its subsidiaries relating to the charging of central costs to and from the business units, including management, development, information technology and marketing costs, as well as agreements in respect of Group financing. Internal supplies also take place within the business units. Intercompany transactions are effected at arm's length market prices. As all subsidiaries are fully consolidated and reflected in these financial statements, the amounts of these transaction are not further specified. For a list of the principal subsidiaries and associates please refer to page 139.

Transactions with managers in key positions

The remuneration of the Executive Board is as follows:

EUR thousand	2012	2011
Total remuneration	736.8	1,397.2
Pension and other expense	160.8	173.3

The total remuneration is included in staff costs (see note i).

The General Meeting of Shareholders held in April 2010 decided that a variable bonus for the members of the Executive Board shall be awarded in 2010 and the following years to promote the achievement of the Group's short and long-term objectives. The annual variable remuneration for an at-target performance will amount to 40% of the gross fixed remuneration of the CEO and 35% of the gross fixed remuneration of the CFO, with a maximum of 50% of the gross fixed remuneration in case of above at-target performance. 70% of the bonus will be comprised of financial performance criteria (net profit, ROI, free cash flow and relative Total Shareholders Return (the movement in the Group's TSR compared to the AScX)) and 30% will be comprised of individual (non-financial) performance criteria. The four financial performance criteria are weighted more or less equally. The part of the bonus that relates to the relative TSR will be zero in case the relative TSR is less than zero.

One third of the amount to be determined by the Supervisory Board shall be paid in cash. Two thirds of the bonus shall be comprised of a conditional award of shares (the vesting scheme). The award of the shares becomes unconditional after three years (including the relevant year in which the performance is assessed) when the CEO and CFO are still in office and the Supervisory Board is of the opinion that there are no exceptional circumstances that would render the unconditional award unreasonable. The award of the shares is definitively withdrawn in the event that the relevant member of the Executive Board leaves the Group as a 'bad leaver' during the three-year vesting period. The Supervisory Board possesses discretionary powers to refrain from the full issue of the shares in the event that the relevant member of the Executive Board leaves the Company as a 'good leaver' in the vesting period (for example, on retirement or in the event of an occupational disability) when the full issue of the shares would be unreasonable under the circumstances.

Once the award of the shares has become unconditional after the expiry of the vesting period they must be retained for a minimum of two years (the holding period) unless the relevant member of the Executive Board terminates his term of office or the term of office is terminated during this period.

The Supervisory Board has decided that, on the basis of the performance and relevant criteria in 2012, the CEO shall receive a bonus of 8% of his gross fixed remuneration and the CFO shall receive a bonus of 7% of his gross fixed remuneration. The CEO's bonus amounts to EUR 30,400 of which EUR 4,864 shall be paid in cash. EUR 9,728 is awarded conditionally in shares on the basis of the closing share price on 15 April 2013. The vesting period ends in 2015 and the holding period ends in 2017. The CFO's bonus amounts to EUR 21,350. The amount after income tax will be paid fully in cash, because of his resignation as per 28 February 2013.

The vesting and holding periods regarding bonuses awarded to the CEO and CFO in prior years at year-end can be specified as follows:

Description	Number of shares	Vesting period	Holding period
Shares granted to the CEO (bonus 2009)	2,750	N/A	April 2015
Shares granted to the CFO (bonus 2009)	1,800	N/A	April 2015*
Shares granted to the CEO (bonus 2010)	3,263	End of 2012	End of 2014
Shares granted to the CFO (bonus 2010)	2,459	End of 2012*	End of 2014*
Shares granted to the CEO (bonus 2011)	3,132	End of 2013	End of 2015
Shares granted to the CFO (bonus 2011)	2,323	End of 2013*	End of 2015*

* *In 2013 the Supervisory Board decided to unconditionally award the shares granted to the CFO because of the resignation of the CFO as per 28 February 2013.*

The General Meeting of Shareholders to be held at 15 April 2013 will be proposed to adopt some changes to the variable remuneration policy, which we further explained on page 62.

Pensions

The Executive Board participates in the defined contribution plan of the Company in 2012. The contribution was EUR 70,300 for the CEO and EUR 70,300 for the CFO.

Transactions with shareholders

There were no transactions with shareholders. One of the Company's shareholders Parcom Capital is part of ING Bank N.V., which is also one of the banks that arranged the existing facility agreement of the Group referred to in note 10.

28 Accounting estimates and judgements by management

The Executive Board discussed the selection and disclosure of the critical accounting policies for financial reporting and estimates as well as the application of these policies and estimates with the Supervisory Board.

In preparing the financial statements, the management is required under IFRS to make various judgements, estimates and assumptions which affect the implementation of policy and the amounts disclosed in relation to assets, liabilities, income and expenses. The estimates and assumptions are based on experience and factors deemed reasonable in the circumstances. Estimates and assumptions are constantly reappraised.
Changes in the accounting estimates used are reflected in the period in which the estimate is changed if the change affects only that period or in the period in which the estimate is changed and in future periods if the change affects both the reporting period and future periods.

Estimated impairment of goodwill

The Group tests annually whether the goodwill is subject to any impairment, in conformity with the accounting policy disclosed in note g.
The impairment model applied is the discounted cash flow method (value determination on the basis of the discounted value of the expected cash flows) applying a weighted average cost of capital (pre-tax WACC) of around 11%. The use of estimates is essential for making this calculation.
The explicit prognoses period contains five planning years. As of year six the residual value is calculated based on the last explicit prognoses year (year five). No further growth in earnings is considered, with the exception of an inflation adjustment. The first three years of the explicit prognoses period are based on cash flow projections derived from the bottom-up generated Mid-term Plan (available per company and approved by the Executive Board). The last two years are based on experience or target data for the Group under review. The pre-tax WACC is consistent with external sources of information, past experience and internal assessment of the used assumptions.

Pensions

Since the pension arrangements involve long-term obligations and uncertainties, it is necessary to make assumptions in order to estimate the amount that the Group needs to invest to fund its pension obligations. Actuaries calculate the obligation for defined benefit plans partly on the basis of information provided by the Executive Board, such as future pay rises, the return on plan assets, mortality tables and the probable extent to which pension scheme members will leave the scheme because they have reached retirement age, become incapacitated or left the Group.

29 Post-balance sheet events

There are no post-balance sheet events.

Company balance sheet at 31 December
(before profit appropriation)

Note	EUR million	2012	2011
	Non-current assets		
	Property, plant and equipment	0.1	0.1
	Intangible assets	–	–
	Other investments, including derivatives	0.4	0.3
1.3	Financial assets	173.7	155.7
	Total non-current assets	174.2	156.1
	Current assets		
1.4	Receivables	0.7	0.5
	Cash and cash equivalents	0.3	0.0
	Total current assets	1.0	0.5
	Total assets	175.2	156.6
1.5	**Equity**		
	Share capital	23.2	22.9
	Share premium	59.9	64.6
	Reserves	2.1	22.7
	Retained earnings	17.9	(20.2)
	Total equity	103.1	90.0
1.6	**Provisions**	43.5	41.8
1.7	**Loans and borrowings (current)**	28.6	24.8
	Total equity and liabilities	175.2	156.6

Company income statement

Note	EUR million	2012	2011
1.11	Share in results of Group companies after tax	17.8	22.8
	Other results after tax	0.1	(43.0)
	Net profit	17.9	(20.2)

Notes to the company financial statements

1 ## Notes to the company financial statements

1.1 **General**

The Company financial statements are part of the 2012 financial statements of Kendrion N.V. (the ‘Company’). With regard to the Company statement of comprehensive income of Kendrion N.V., the Company has made use of the option provided by Section 402 of Book 2 of the Netherlands Civil Code.

1.2 **Principles of valuation of assets and liabilities and determination of results**

In selecting the principles of valuation of assets and liabilities and determination of results employed in the company financial statements, Kendrion N.V. has made use of the option provided by Section 362, subsection 8, of Book 2 of the Netherlands Civil Code. Consequently, the principles of valuation of assets and liabilities and determination of results (the ‘accounting policies’) employed in the Company financial statements of Kendrion N.V. are identical to those employed in the consolidated EU-IFRS financial statements. Interests in entities in which Kendrion N.V. has significant influence are measured using the equity method. The consolidated EU-IFRS financial statements have been prepared in accordance with the standards adopted by the International Accounting Standards Board as endorsed for use in the European Union (hereinafter referred to as ‘EU-IFRS’). These policies are discussed in notes a – r.
The share in the results of Group companies relates to the Company’s share in the results of those companies. Results on transactions whereby assets and liabilities have been transferred between the Company and its subsidiaries and between subsidiaries have not been recognised to the extent they can be considered unrealised.

1.3 **Financial fixed assets**

EUR million	Interest in Group Companies	Loans to Group Companies	Deferred tax	Total 2012	Total 2011
Carrying amount at 1 January	153.2	1.6	0.9	155.7	138.3
Results of Group companies	17.8	–	–	17.8	22.8
Movements in loans and borrowings	–	0.0	–	0.0	(4.0)
Movements in deferred tax assets	–	–	1.3	1.3	(0.4)
Other movements	(1.1)	–	–	(1.1)	(1.0)
Carrying amount at 31 December	169.9	1.6	2.2	173.7	155.7

The main part of the loans to Group companies has a duration of over one year.

The investments in the principal subsidiaries and associates are disclosed on page 139 of the Annual Report.

1.4 Receivables

EUR million	2012	2011
Receivables from Group companies	0.5	0.2
Prepayments and accrued income	0.2	0.3
	0.7	0.5

All receivables are due within one year.

1.5 Equity

EUR million	Share capital	Share premium	Hedge reserve	Reserve for own shares	Statutory reserve for participations	Other reserves	Retained earnings	Total 2012	Total 2011
Balance at 1 January	22.9	64.6	–	(0.3)	11.7	11.3	(20.2)	90.0	114.1
Appropriation of retained earnings	–	–	–	–	–	(20.2)	20.2	–	–
Dividend payment	–	(7.1)	–	–	–	–	–	(7.1)	(6.7)
Own shares sold	–	–	–	0.1	–	–	–	0.1	0.2
Issue of ordinary shares	0.3	2.4	–	–	–	–	–	2.7	3.2
Share-based payment transaction	–	–	–	–	–	0.1	–	0.1	0.1
Other	–	–	–	–	5.6	(6.2)	–		(0.7)
Total recognised income and expenses	–	–	–	–	–	–	17.9	17.9	(20.2)
Balance at 31 December	23.2	59.9	–	(0.2)	17.3	(15.0)	17.9	103.1	90.0

1.5.1 Share capital

The authorised capital of the Company amounts to EUR 80 million, divided into 40 million ordinary shares of EUR 2.00, of which 11,655,214 ordinary shares have been issued.

1.5.2 Share premium

The share premium represents revenue from shares issued at more than their nominal value (issued above par). The issued and paid share capital, including share premium, is fiscally acknowledged capital.

1.5.3 Hedge reserve

The hedge reserve comprises the effective share of the cumulative net movement in the fair value of cash-flow hedging instruments relating to hedged transactions that have not yet been executed.

1.5.4 Reserve for own shares

The reserve for the Company's own shares comprises the cost of the Company shares which are held by the Company for the share plan and remuneration packages for the Executive Board and senior management. At 31 December 2012, the Company held 15,839 of its own shares (2011: 47,392).

1.5.5 Statutory reserve for participations

This reserve represents the undistributed profits of subsidiaries the free distribution of which the Company cannot procure. The statutory reserve for participations arises as a result of participations being valued by the equity method and is shown as the share in the undistributed results of the subsidiaries since they were first valued using the equity method. The amount of any dividend – from these subsidiaries – to which there is an entitlement on adoption of the financial statements is deducted from this reserve.

1.5.6 Other reserves

Other reserves are all the reserves other than those shown separately and comprise primarily the cumulative, undistributed profits from previous financial years.

1.5.7 Retained earnings

In 2012, the full result for 2011 was included in other reserves. Retained earnings consequently consist solely of the result for 2012.

1.6 Provisions

EUR million	2012	2011
Other provisions	43.5	41.8
	43.5	41.8

The provisions include a provision of EUR 43.3 million (2011: EUR 41.8 million) relating to the fine imposed by the European Commission.

1.7 **Loans and borrowings (current)**

EUR million	2012	2011
Debts to credit institutions	–	0.1
Debts to suppliers and trade payables	0.4	0.5
Debts to Group companies	27.4	22.4
Other debts	0.8	1.8
	28.6	24.8

1.8 **Financial instruments**

See note 15 to the consolidated financial statements for details on financial instruments.

1.9 **Staff costs**

EUR million	2012	2011
Wages and salaries	1.9	1.8
Social security charge	0.2	0.1
Pension costs	0.3	0.2
	2.4	2.1
Total number of employees and temporary workers at 31 December (FTE)	9	9

The Company has only defined contribution plans for its employees. The Company had 9 employees (FTE) at year-end 2012 (2011: 9).

1.10 **Commitments not appearing on the balance sheet**

1.10.1 Joint and several liability and guarantees

The Company and its Group Companies have issued guarantees mainly in the context of the financing by financial institutions. The Company has issued declarations of joint and several liability, as referred to in Section 403 of Book 2 of the Netherlands Civil Code, for:

- Combattant Holding B.V., Zeist
- Kendrion Finance B.V., Zeist

A EUR 48.5 million bank guarantee has been issued to the European Commission. This guarantee is valid until 14 March 2016. The guarantee relates to the fine of EUR 34 million (excluding accrued interest) imposed by the European Commission at the end of 2005 for infringement of Article 81(1) of the EC Treaty by the Company's former subsidiary Fardem Packaging B.V. and which was upheld in full by the General Court of the European Union in Luxembourg on 16 November 2011. On 5 February 2013, an oral hearing was held before the Court of Justice in Luxembourg. (See also section 13 of the notes to the consolidated financial statements.)

1.10.2 **Fiscal unity**

The Company and its Dutch subsidiaries form a fiscal unity for corporation tax purposes; according to the standard terms, each of the companies is jointly and severally liable for corporation tax payable by all the members of the fiscal unity.

1.11 **Share in results of Group Companies**

This relates to the Company's share in the results of its associates, of which EUR 17.8 million (2011: EUR 22.8 million) relates to Group Companies.

1.12 **Fees to the auditor**

With reference to Section 2:382a of the Netherlands Civil Code, the following fees have been charged by KPMG to the Company, its subsidiaries and other consolidated entities:

EUR thousand			2012			2011
	KPMG Accountants NV	Other KPMG member firms and affiliates	Total KPMG	KPMG Accountants NV	Other KPMG member firms and affiliates	Total KPMG
Audit of financial statements	88.0	186.0	274.0	86.0	181.0	267.0
Other assurance services	5.0	–	5.0	5.0	–	5.0
Tax advisory services	–	–	–	–	13.0	13.0
Other non-audit services	45.0	–	45.0	93.0	139.0	232.0
Total	138.0	186.0	324.0	184.0	333.0	517.0

The other fees in 2011 primarily relate to due diligence procedures, review of the FAS Controls purchase price allocation, assistance in the HORIZON ERP process and audit-related assignments.

1.13 Remuneration of and share ownership by the Executive Board and Supervisory Board

Remuneration of the Executive Board

The remuneration of current Executive Board members charged to the Company and Group companies, including pension expenses as referred to in Section 383, subsection 1, of Book 2 of the Netherlands Civil Code, amounted to EUR 897,600 (2011: EUR 1,123,800). This remuneration is specified as follows:

EUR thousand			2012			2011
	P. Veenema	E. Ris	Total	P. Veenema	E. Ris	Total
Fixed remuneration	380.0	305.0	685.0	370.0	280.0	650.0
Variable remuneration	30.4	21.4	51.8	185.0	137.2	322.2
Total remuneration	410.4	326.4	736.8	555.0	417.2	972.2
Pension and other expenses	81.3	79.5	160.8	80.9	70.7	151.6
	491.7	405.9	897.6	635.9	487.9	1,123.8

The 2012 variable remuneration will be granted directly after the General Meeting of Shareholders on 15 April 2013. For the CEO (P. Veenema) the amount after income tax will be paid in cash for 1/3 and will be covered conditionally for 2/3 in shares against the prevailing closing share price of 15 April 2013. For the CFO (E. Ris) the amount after income tax will be paid in cash, because of his resignation as per 28 February 2013.

Remuneration of the Supervisory Board

The total remuneration of current and former Supervisory Board members in 2012 amounts to EUR 150,000 (2011: EUR 130,000). This remuneration is specified as follows:

EUR thousand	2012	2011
Current Supervisory Board members:		
S.J. van Kesteren	45	40
R.L. de Bakker	35	30
M.E.P. Sanders	35	30
H.J. Kayser	35	30
	150	130

No loans, advances or related guarantees have been given to the Executive Board or Supervisory Board members.

Share ownership by the Executive Board and the Supervisory Board

		31 December 2012	31 December 2011
Executive Board	P. Veenema	32,918	15,649
	E. Ris	20,973	8,973
Supervisory Board		–	–

Zeist, 26 February 2013

Executive Board	*Supervisory Board*
P. Veenema	S.J. van Kesteren
E. Ris	R.L. de Bakker
	M.E.P. Sanders
	H.J. Kayser

Other information

To: The General Meeting of Shareholders of Kendrion N.V.

Independent auditor's report

Report on the financial statements

We have audited the accompanying financial statements 2012 of Kendrion N.V., Zeist. The financial statements include the consolidated financial statements and the company financial statements. The consolidated financial statements comprise the consolidated statement of financial position as at 31 December 2012, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of the significant accounting policies and other explanatory information. The company financial statements comprise the company balance sheet as at 31 December 2012, the company income statement for the year then ended and the notes, comprising a summary of the accounting policies and other explanatory information.

Management's responsibility

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code, and for the preparation of the Report of the Board in accordance with Part 9 of Book 2 of the Netherlands Civil Code. Furthermore, management is responsible for such internal control as it determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion with respect to the consolidated financial statements

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Kendrion N.V. as at 31 December 2012 and of its result and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code.

Opinion with respect to the company financial statements

In our opinion, the company financial statements give a true and fair view of the financial position of Kendrion N.V. as at 31 December 2012 and of its result for the year then ended in accordance with Part 9 of Book 2 of the Netherlands Civil Code.

Report on other legal and regulatory requirements

Pursuant to the legal requirements under Section 2:393 sub 5 at e and f of the Netherlands Civil Code, we have no deficiencies to report as a result of our examination whether the Report of the Board, to the extent we can assess, has been prepared in accordance with Part 9 of Book 2 of this Code, and whether the information as required under Section 2:392 sub 1 at b - h has been annexed. Further, we report that the Report of the Board, to the extent we can assess, is consistent with the financial statements as required by Section 2:391 sub 4 of the Netherlands Civil Code.

Arnhem, 26 February 2013

KPMG ACCOUNTANTS N.V.
M.J. de Vries RA

Provisions in the Articles of Association governing the appropriation of profit

Under article 35.1 and 35.2 of the Articles of Association of the Company, the Executive Board shall, with the approval of the Supervisory Board, determine which part of the profits is added to the reserves. The profit remaining after transfer to the reserves is available to the General Meeting of Shareholders. The Company can only make payments to the shareholders and other parties entitled to the distributable profit insofar as the shareholders' equity exceeds the paid-up and called-up part of the capital plus the statutory reserves and exceeds the amounts resulting from the distribution test, performed by the Executive Board at the date of each dividend payment.

Profit appropriation

Appropriation of net profit

EUR million	
Net profit	17.9

The Executive Board has decided, with the approval of the Supervisory Board, that the net profit of EUR 17.9 million will be added to the other reserves.

Post-balance sheet events

There are no post-balance sheet events.

Principal subsidiaries

At 31 December 2012

Industrial Magnetic Systems (Norman Graf)	
Kendrion (Donaueschingen/Engelswies) GmbH, Donaueschingen, Germany	Norman Graf
Kendrion (Donaueschingen/Engelswies) GmbH, Engelswies, Germany	Alfons Mattes
Kendrion (Suzhou) Co., Ltd., Suzhou, P.R. China	Jürgen Weisshaar
Kendrion (Mishawaka) LLC, Mishawaka, Indiana, USA	Brad Price
Kendrion (Switzerland) AG, Hausen am Albis, Switzerland	Edgar Bruhin
Kendrion (Linz) GmbH, Linz, Austria	Erich Holzinger

Industrial Drive Systems (Michael Bernhard)	
Kendrion (Villingen) GmbH, Villingen-Schwenningen, Germany	Michael Bernhard
Kendrion (UK) Ltd., Bradford, United Kingdom	Peter McShane
Kendrion (Suzhou) Co., Ltd., Suzhou, P.R. China	Jürgen Weisshaar
Kendrion (Mishawaka) LLC, Mishawaka, Indiana, USA	Brad Price
Kendrion (Aerzen) GmbH, Aerzen, Germany	Laurent Lebas

Passenger Car Systems (Bernd Gundelsweiler)	
Kendrion (Villingen) GmbH, Villingen-Schwenningen, Germany	Bernd Gundelsweiler
Kendrion (Eibiswald) GmbH, Eibiswald, Austria	Martin Kollmann
Kendrion (Prostějov) s.r.o, Prostějov, Czech Republic	Jiři Hýbl
Kendrion (Suzhou) Co., Ltd., Suzhou, P.R. China	Jürgen Weisshaar
Kendrion (Shelby) Inc., Shelby, North Carolina, USA	William Brown

Commercial Vehicle Systems (Bernd Gundelsweiler) (a.i.)[1]	
Kendrion LINNIG GmbH, Markdorf, Germany	Bernd Gundelsweiler (a.i.)[1]
Kendrion (São Paulo) Sistemas Automotivos Ltda., Louveira, Brazil	Timo Mader
Linnig Corporation, Tucker, Georgia, USA	Jürgen Häberle
Linnig de México, S.A. de C.V., Mexicaltzingo, Mexico	Alexander Glaser
Kendrion Drive Tech. (Nanjing) Co., Ltd., Nanjing, P.R. China	Liangchen Lu
Kendrion Linnig India pvt Ltd, Pune, India	Sameer Deshmukh

A complete list of all subsidiaries can be obtained from the Chamber of Commerce in Utrecht (number 30113646) and from the offices of the Company.

[1] *On 1 January 2013, Erik Miersch was appointed Business Unit Manager for Commercial Vehicle Systems and Managing Director for Kendrion LINNIG GmbH.*

Industrial Magnetic Systems
Industrial Drive Systems
Passenger Car Systems
Commercial Vehicle Systems
Kendrion N.V.

Subsidiaries
Partners

Europe

Rest of the world

Five-year summary

[1] *The reader should be aware that Kendrion went through a lot of changes since 2006; divestments took place including results on disposals, which does not give a clear insight in comparability between the years.*

[2] *Relates to inventories, receivables minus non interest bearing debts.*

[3] *2009 EBITA and EBITDA excluding effect restructuring provision and costs related to the disposal of the Vink Group. EBITA excluding amortisation related to acquisitions.*

[4] *2008 including Distribution Services and 2011 including FAS Controls, Inc.*

[5] *Pro forma. Unaudited.*

[6] *For 2008 including net interest bearing debt Vink in assets and liabilities as held for sale.*

[7] *Before cash flow acquisitions and disposals (2011 and excluding acquisition expenses).*

[8] *Total invested capital is property, plant and equipment, intangible assets and current assets less the current tax liabilities, trade payables and other payables.*

[9] *2011 EBITA and EBITDA are normalised (excluding EC fine and a.o. acquisition expenses).*

[10] *The results for 2011 have been negatively influenced by a non-recurring supplementary provision of over EUR 39 million as a result of the judgement regarding the EC fine.*

EUR million	2012	2011[10]	2010	2009	2008
Kendrion N.V. consolidated [1]					
Statement of comprehensive income conform financial statements					
Revenue	284.9	267.9	221.9	149.2	207.4
Organic growth	(4.1)%	20.7%	42.9%	(27.0)%	3.6%
Operating result (EBIT)	24.4	(11.5)	22.8	(5.0)	11.0
Operating result before amortisation (EBITA) [3]	26.7	(10.0)	24.2	(3.9)	14.3
Depreciation and amortisation	12.7	10.8	10.1	8.8	8.3
Operating result before depreciation and amortisation (EBITDA)	37.1	(0.7)	32.9	3.8	19.3
Profit for the period	18.0	(20.1)	16.6	4.0	12.9
Statement of financial position at 31 December conform financial statements					
Total assets	230.1	229.3	177.1	152.8	280.5
Total equity	103.1	91.7	114.5	96.1	93.5
Net interest-bearing debt	21.3	25.9	5.2	13.9	75.3
Working capital [2]	33.9	35.8	26.0	21.7	22.4
Invested capital [8]	180.1	176.7	129.3	113.1	177.4
Cash flow conform financial statements					
Net cash from operating activities	28.3	27.6	25.6	3.9	21.3
Net investments	18.7	13.5	8.9	5.9	13.5
Free cash flow [7]	9.7	14.6	17.4	(1.9)	3.7
Ratios – pro forma					
Solvency	44.8%	40.0%	64.7%	62.9%	33.3%
Net interest-bearing debt [6] / EBITDA [3, 4, 5, 9] (debt cover)	0.6	0.6	0.2	1.1	2.4
Net interest-bearing debt [6] / equity (gearing)	0.2	0.3	0.1	0.1	0.8
EBITA [3, 9] / net finance costs (interest cover) [4, 5]	5.5	12.1	8.1	1.6	3.2
Working capital [2, 4, 5] in % of revenue	11.9%	12.1%	11.7%	14.5%	11.6%
Market capitalisation (in millions) as at 31 December	186.5	189.6	164.1	105.8	74.1
Net interest-bearing debt as at 31 December [6]	21.3	25.9	5.2	13.9	75.3
Theoretic value of the organisation (Enterprise value) [5]	207.8	215.5	169.3	119.7	149.4
Number of employees at 31 December (fte) [4]	1,542	1,534	1,218	1,027	2,414

Glossary

Code of Conduct A set of behavioural rules and standards which broadly reflects the values that should guide all employees, for example in relation to doing business responsibly, safety, health and the environment.

Compliance Officer The Kendrion employee who is charged with supervising compliance with the regulations to prevent insider trading.

Corporate governance The management of the business, the supervision of that management, the rendering of account thereon and the way in which stakeholders can influence decisions.

COSO Enterprise Risk Management Framework Risk management framework based on the system proposed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (see www.coso.org).

Defined benefit plan A pension scheme where the employee is promised a pension the level of which depends on their age, salary and years of service.
The commitment carried in the financial position is the cash value of the projected pension benefits on the financial position date, less the fair market value of fund investments.

Defined contribution plan Pension scheme where the employer pays agreed contributions to a fund or insurance company and no obligation arises for the employer to pay supplementary contributions in the event of a shortfall in the fund or insurance company.

Derivatives Derivative financial products which do not represent a direct cash value; they include options, forward exchange contracts and swap contracts.

ERP system Enterprise Resource Planning: an ICT system which supports all the business processes within an organisation, such as purchasing, sales and accounting, with data being exchanged between departments.

Fair value The current value. For assets or liabilities for which there is an active market, this is generally the market value.

Hedging The covering of financial risks, usually relating to (undesirable) movements in market interest rates, exchange rates and raw material prices.

IFRS International Financial Reporting Standards, also referred to as IAS (International Accounting Standards). With effect from 2005, all listed companies in the European Union must comply with these accounting rules.

Interest rate swap Derivative financial product whereby an agreement is reached with a counterparty (bank) to exchange specific interest payments on a predetermined underlying amount during a predetermined period. A variable interest rate (e.g. three-month EURIBOR) is usually swapped for a fixed interest rate.

Mid-term Plan A plan for the medium term (three years) which is drawn up by the Group annually to facilitate the management and control of its organisation in the short to medium term.

Normalisation Figures from which exceptional effects have been eliminated in order to improve comparability and transparency.

Number of employees (FTEs) Number of employees stated in full-time equivalents.

Organic (sales) growth Growth in revenue after eliminating the effects of acquisitions and disposal of activities.

Return on investment (ROI) The result before amortisation of intangibles related to acquisitions, interest and tax as a percentage of the average invested capital.

Return on sales (ROS) The result before amortisation of intangibles related to acquisitions interest and tax as a percentage of revenue.

Solvency ratio The ratio of total equity to the financial position total.

Translation risk Translation risk: a change in the value of an asset or liability of a subsidiary as a result of movements in the (non-euro) exchange rate.

TSR Total shareholders return.

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