Business performance

World economy

Overview:
moderate growth while general conditions remain difficult
In 2012, the global economy[1] showed only moderate growth. Gross domestic product grew by about 2 percent around the world. Mature markets exceeded the prior year's level only slightly, by around 1 percent, while emerging markets achieved an increase of approximately 4 percent. This trend continues to be driven by the financial crisis in Europe, with a particularly negative general economic environment in Southern European countries, the debt crisis in the USA and the weakening of growth in Asian emerging markets.

Developments in 2012:
stronger first half of the year
Over the course of the year under review, global economic growth slowed. Economic output declined, particularly in the second half of the year, in the face of the continuing financial and debt crises in Europe and the USA, and the slowdown in growth momentum in Asia.

Industry and consumption:
industry shows moderate growth
With an increase of around 3 percent, industrial production expanded only slightly more than private consumption, which rose by approximately 2.5 percent. While the export-dependent industries in particular posted moderate increases, growth in consumer-related sectors was significantly subdued.

Regions:
mature markets moderate, emerging markets robust
Over the year as a whole, both the North American and Japanese economies posted moderate growth of around 2 percent. In Western Europe, economic growth declined slightly due to recessionary trends seen particularly in some Southern European countries, whereas Germany's economy managed to grow by around 1 percent, driven by exports and low unemployment. The emerging regions of Asia (excluding Japan), Latin America and Africa/Middle East registered comparatively robust economic growth. Asia (excluding Japan) boosted its economic output by around 5 percent, as before driven mainly by China and India. Latin America registered growth of around 3 percent, and Africa/Middle East of around 4 percent. By contrast, economic growth slowed to approximately 2 percent in Eastern Europe, primarily as a result of declining demand from Western Europe.

Raw material prices:
moderate increase year on year
Raw material prices increased moderately in 2012 on a year-on-year basis. In the first six months they were influenced by strong fluctuations in input material prices, which stabilized at a high level in the second half of the year. The situation differed both by region and type of input material. Prices for palm kernel oil and butadiene dropped, for example, whereas ethylene prices rose in Europe and Asia, and prices for caustic soda rose around the world. The average price of crude oil was on a par with the prior year.

Currencies:
euro in the throes of the European debt crisis
The euro devalued substantially versus the US dollar on average during the year. However, the development was volatile throughout the year: at the beginning of the year the euro rose steadily, occasionally reaching 1.35 US dollars in the first quarter. Around the middle of the year, the euro drifted steadily lower to 1.20 US dollars before climbing back to 1.32 US dollars toward the end of the year. This development was mainly driven by the debt crisis in Europe.

Changes in the exchange rates of other currencies important to Henkel are indicated in the following table:

Average rates of exchange versus the euro

	2011	2012
Chinese yuan	8.99	**8.10**
Mexican peso	17.31	**16.90**
Russian ruble	40.91	**39.93**
Turkish lira	2.34	**2.31**
US dollar	1.39	**1.28**

[1] Source of global economic data: Feri EuroRating Services, January 2013.

Inflation:
moderate rise in global price levels

Global inflation was around 3 percent. While the overall rate of inflation decreased in both mature markets and emerging markets, the changes differed by region and country. Inflation declined in North America and Western Europe – including Germany. Inflation also declined in Eastern Europe and Asia – and especially in China. By contrast, inflation rose substantially in Latin America and Africa/Middle East.

Unemployment:
unchanged year on year around the world

Global unemployment was on a par with the prior year at 7.5 percent. The unemployment rate in mature markets remained unchanged year on year at around 8 percent, and was also stable, at approximately 7 percent, in emerging markets. The development however differed considerably between regions. Unemployment in North America dropped from around 9 to 8 percent, whereas it increased noticeably in Western Europe in the wake of the debt crisis. Germany's unemployment rate declined slightly to 6.5 percent. Unemployment fell in Eastern Europe, was slightly above the prior year in Asia, and remained stable year on year in Latin America.

Development by sector:
subdued increase in global consumption

Growth in private consumer spending remained moderate at approximately 2.5 percent. Consumer spending in mature markets actually only increased by around 1 percent year on year in the year under review. Consumers in North America increased their spending by around 2 percent. The debt crisis pushed consumer spending down slightly in Western Europe, while Germany experienced an increase of around 1 percent. The emerging markets exhibited a higher propensity to consume with an increase of around 5 percent.

Industry:
moderate growth

Industrial production expanded at a moderate rate of around 3 percent in 2012, which was again slightly faster than the economy as a whole. Growth continued to be driven by export-dependent sectors, especially the transport sector. Other export-dependent sectors, such as electronics and metal processing, showed moderate increases in production.

The change in industrial production differed from one region to the next. The manufacturing sector in North America repeated its prior year's expansion of around 4 percent, while all other regions posted growth rates that fell considerably below the prior year. The debt crisis even caused negative industrial growth in Western Europe. Industrial production declined in Latin America, and particularly in Brazil.

Our important customer sectors, the transport and electronics industries, saw production expand by around 6 percent and 3 percent, respectively. Within the electronics industry, the growth relevant to us in basic products such as electrical systems and semiconductor units was slightly higher than the prior year. The metal industry underwent significantly less growth compared to 2011, expanding by around 3 percent. Expansion in consumer-related sectors, such as the global packaging industry, was extremely sluggish. These sectors had only marginal growth along with food products, beverages, paper and printing. Production in the construction industry increased moderately, by around 2 percent in 2012. Construction activity was extremely brisk in North America and the emerging regions, except for Eastern Europe, but declined in Western and Eastern Europe by around 6 and 2 percent, respectively.

Review of overall business performance

The year 2012 was a very successful year for Henkel. Despite a challenging market environment, we were able to fully meet all of the financial targets that we had set in 2008 for 2012. All three business sectors contributed to this important success.

Henkel's business performance was impacted by the general conditions prevailing in the global economy, as described above. The debt crises in Europe and the USA and the weakening of growth in Asia (excluding Japan) played a particularly influential role. Despite these challenging conditions, Henkel was able to generate organic sales growth of 3.8 percent. Performance was again given a particular boost by the emerging regions of Eastern Europe, Africa/Middle East, Latin America and Asia (excluding Japan). For the first time, emerging markets accounted for 43 percent of Group sales (2011: 42 percent).

Sales

in million euros

Over the course of the year, prices for our direct materials (raw materials, packaging, purchased goods and services) stabilized at a high level in procurement markets. They registered year-on-year increases in the lower single-digit percentage range. By increasing our selling prices, enforcing strict cost discipline, and improving production and supply chain efficiency, we were able to increase our adjusted gross margin by 1.3 percentage points to 47.1 percent in 2012.

Moreover, continuously adjusting our structures to our markets and customers, and further reducing our overheads by expanding our shared services and optimizing our production network enabled us to further improve our profitability in 2012 compared to the prior year. Our adjusted [1] return on sales reached 14.1 percent for the first time ever, meaning that we even slightly surpassed the 2012 target of 14 percent set in the fall of 2008.

Our highly successful business performance is also reflected in a further improvement in our net working capital to sales ratio, our very strong free cash flow, and our improved key financial ratios: over the course of year, we were able to reduce our net debt to 85 million euros (previous year: 1,392 million euros). We increased our operating debt coverage ratio from 92 to 496 percent. This gratifying performance strengthens our target rating of "A flat" (Standard & Poor's) as well as "A2" (Moody's), which were awarded again in 2011.

Our solid financial structure and large liquidity reserve allowed us to take advantage of opportunities for external growth during the course of the year. We acquired the high-performance pressure sensitive adhesives business of Cytec Industries Inc. in the USA on August 1, 2012. We also acquired the laundry detergent business of Colgate-Palmolive in the Dominican Republic in the third quarter of 2012.

Based on our business performance in 2012, we were able to announce new and challenging financial targets for 2016 in November of last year.

Sales and profits

In a challenging economic environment, Henkel Group sales grew to 16,510 million euros in fiscal year 2012, an increase of 5.8 percent versus the prior year. After adjusting for foreign exchange, sales increased by 3.1 percent. Organic sales growth (i.e. after adjusting for foreign exchange and acquisitions/divestments) amounted to 3.8 percent, driven by both price and volume.

[1] Adjusted for one-time charges/gains and restructuring charges.

The rate of organic sales growth declined somewhat during the course of the financial year due to a slowdown in world economic expansion. While organic growth in the first half of the year came in at 4.3 percent, it eased to 3.2 percent in the second half.

Sales development[1]

in percent	2012
Change versus previous year	5.8
Foreign exchange	2.7
Adjusted for foreign exchange	3.1
Acquisitions/divestments	– 0.7
Organic	3.8
of which price[2]	3.1
of which volume	0.7

[1] Calculated on the basis of units of 1,000 euros.
[2] In determining the price effect, we account for the positive structural effect arising from the launch of new products.

We achieved organic sales growth in each of our business sectors, further expanding our share of relevant markets. Laundry & Home Care sales grew organically by 4.7 percent. Adhesive Technologies was able to increase organic sales by 3.6 percent to 8,256 million euros. Beauty Care reported organic sales growth of 3.1 percent.

Price and volume effects

in percent	Organic sales growth	of which price	of which volume
Laundry & Home Care	4.7	3.4[1]	1.3
Beauty Care	3.1	1.8[1]	1.3
Adhesive Technologies	3.6	3.5	0.1
Henkel Group	3.8	3.1[1]	0.7

[1] In determining the price effect, we account for the positive structural effect arising from the launch of new products.

We were able to further improve revenues in almost all regions:

In Western Europe we were able to virtually match the prior year, generating sales of 5,610 million euros in a highly competitive market environment. Organic sales growth was negative, at –0.5 percent. The positive trend in Germany and Northern Europe was overshadowed by the recessionary trend in Southern Europe. The share of sales from the region decreased from 36 to 34 percent.

Sales in Eastern Europe increased by a nominal 6.2 percent to 2,986 million euros. The organic sales growth of 6.0 percent was supported primarily by our businesses in Turkey and Russia. The share of sales from the region remained constant at 18 percent.

In the Africa/Middle East region, we were able to grow sales by a nominal 15.3 percent to 1,077 million euros. Organic sales growth was 12.6 percent, driven by double-digit growth rates in, among others, the United Arab Emirates, Algeria and Egypt. The share of sales from the region increased from 6 to 7 percent.

Sales in the North America region registered a nominal increase of 11.3 percent to 3,023 million euros. Despite a reluctant consumer climate in the USA, organic sales growth for the region came in at 4.8 percent. The share of sales from the region increased from 17 to 18 percent.

Sales in Latin America declined slightly by a nominal –0.4 percent to 1,062 million euros. Organically, we were able to achieve sales growth of 3.1 percent, mainly thanks to our business performance in Mexico, whereas Brazil experienced declining sales. The share of sales from the region decreased from 7 to 6 percent.

In the Asia-Pacific region, we were able to grow sales by a nominal 13.1 percent to 2,597 million euros. With organic growth of 7.4 percent, the region continued to show very strong performance, driven in particular by double-digit growth rates in China and India. The share of sales attributable to the Asia-Pacific region increased to 16 from 15 percent in the prior year.

Sales by business sector*

in million euros

* Excluding Corporate.

Sales by region[1]/EBIT by region[1]

in million euros

Region	Year	Sales	EBIT
Western Europe	2011	5,624	675[2]
	2012	5,610	811
Eastern Europe	2011	2,813	384
	2012	2,986	425
Africa/Middle East	2011	934	79
	2012	1,077	103
North America	2011	2,716	289
	2012	3,023	456
Latin America	2011	1,065	105
	2012	1,062	83
Asia-Pacific	2011	2,296	360
	2012	2,597	417

[1] Excluding Corporate.
[2] Application of IAS 8 "Accounting policies, changes in accounting estimates and errors" (see notes on pages 116 and 117).

43 %
of our sales generated in emerging markets.

Sales generated by our emerging regions of Eastern Europe, Africa/Middle East, Latin America and Asia (excluding Japan) increased nominally by 9.3 percent to 7,115 million euros. Organic sales growth was 7.8 percent, with all our business sectors contributing. The share of sales from emerging markets increased from 42 to 43 percent.

In order to continuously adapt our structures to our markets and customers, we spent 124 million euros for restructuring (previous year: 227 million euros). We further expanded our shared services and continued to optimize the production networks in our Adhesive Technologies and Laundry & Home Care business sectors.

The following explanations relate to the results achieved by the business sectors adjusted for one-time charges/gains, and restructuring charges, in order to provide a more transparent presentation of operational performance:

Adjusted operating profit (EBIT)

in million euros	2011 restated[1]	2012	%
EBIT (as reported)	1,765	2,199	24.6
One-time gains	– 57	–	
One-time charges	94	12	
Restructuring charges	227	124	
Adjusted EBIT	2,029	2,335	15.1

[1] Application of IAS 8 "Accounting policies, changes in accounting estimates and errors" (see notes on pages 116 and 117).

We were able to increase adjusted operating profit (adjusted EBIT) to 2,335 million euros, an increase of 15.1 percent over the figure of 2,029 million euros in the prior year. All three business sectors contributed to this positive development. Despite having to pay higher prices in procurement markets, we were able to improve the adjusted return on sales (adjusted EBIT margin) for the Group by 1.1 percentage points to 14.1 percent, thereby achieving one of our key financial targets for 2012.

Adhesive Technologies produced the most significant margin improvement with an increase from 13.9 to 15.1 percent, due in part to the introduction of innovative product solutions and efficiency improvements. Laundry & Home Care was also able to significantly improve its profitability to 14.5 percent (previous year: 13.2 percent) thanks to strong sales growth and strict cost management. Beauty Care improved its adjusted return on sales by 0.3 percentage points to 14.5 percent (previous year: 14.2 percent). This was again due to gratifying sales growth and thorough cost management. Further explanations relating to our business performance can be found in the discussion of the business sectors starting on page 80.

Comparison between actual business performance and guidance

In our 2012 reports, we expected organic sales growth of between 3 and 5 percent for the Henkel Group in fiscal year 2012. Compared to the figures for 2011, we expected adjusted return on sales (EBIT) to increase to 14 percent, and adjusted earnings per preferred share to rise by around 15 percent.

We fully realized this sales and earnings guidance. Our organic growth rate of 3.8 percent was within the guidance corridor. All three business sectors contributed significantly to this growth. At Group level, we achieved a significant increase in adjusted return on sales from 13.0 to 14.1 percent, and a 17.8 percent improvement in adjusted earnings per preferred share, increasing it to 3.70 euros (2011: 3.14 euros).

Additionally, prices for direct materials (raw materials, packaging, purchased goods and services) increased by low single-digit percentages, as predicted in our reports for 2012. Our restructuring expenses totaled 124 million euros, as expected. We invested 393 million euros in property, plant and equipment, which was in line with our forecasts in our reports.

Guidance versus performance 2012

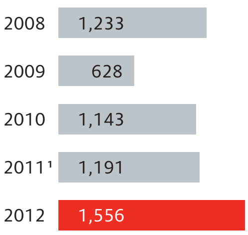
	Guidance for 2012	Performance in 2012
Organic sales growth	Henkel Group: 3–5 percent	Henkel Group: 3.8 percent
	Laundry & Home Care: in the low single-digit percentage range	Laundry & Home Care: 4.7 percent
	Beauty Care: in the low single-digit percentage range	Beauty Care: 3.1 percent
	Adhesive Technologies: in the mid single-digit percentage range	Adhesive Technologies: 3.6 percent
Adjusted return on sales	Increase to 14 percent	Increase to 14.1 percent
Adjusted earnings per preferred share	Increase of around 15 percent	Increase of 17.8 percent

Reconciliation from sales to adjusted operating profit

in million euros	2011	%	2012	%	Change
Sales	15,605	100.0	**16,510**	**100.0**	5.8%
Cost of sales	–8,455	–54.2	**–8,738**	**–52.9**	3.3%
Gross profit	7,150	45.8	**7,772**	**47.1**	8.7%
Marketing, selling and distribution expenses	–4,081	–26.2	**–4,278**	**–25.9**	4.8%
Research and development expenses	–396	–2.5	**–406**	**–2.6**	2.5%
Administrative expenses	–706	–4.5	**–727**	**–4.4**	3.0%
Other operating income/charges	62	0.4	**–26**	**–0.1**	> 100%
Adjusted operating profit (EBIT)	2,029	13.0	**2,335**	**14.1**	15.1%

Net income

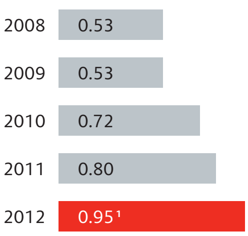
in million euros



[1] Application of IAS 8 "Accounting policies, changes in accounting estimates and errors" (see notes on pages 116 and 117).

Preferred share dividends

in euros



[1] Proposal to shareholders for the Annual General Meeting on April 15, 2013.

Expense items

The following explanations relate to our operating expenses adjusted for one-time charges/gains and restructuring charges. The reconciliation statement and the allocation of the restructuring charges between the various items of the statement of income can be found on page 106.

Due to a higher sales volume and raw material price increases, the cost of sales increased year on year by 3.3 percent to 8,738 million euros. Gross profit rose by 8.7 percent to 7,772 million euros. We were able to improve the gross margin by 1.3 percentage points to 47.1 percent, supported by higher selling prices, savings from cost reduction measures, and improvements in production and supply chain efficiency.

Marketing, selling and distribution expenses increased to 4,278 million euros (previous year: 4,081 million euros). We spent a total of 406 million euros on research and development, thus slightly increasing these expenses to 2.6 percent of sales. At 727 million euros, administrative expenses accounted for 4.4 percent of sales, slightly less than in the previous year.

Other operating income and charges

The balance of adjusted other operating income and charges was –26 million euros. The year-on-year decline (2011: 62 million euros) was primarily due to lesser amounts released from provisions.

Financial result

The financial result improved by 14 million euros to –141 million euros, mainly as a result of positive foreign exchange effects. The decrease in our net debt and lower interest rates also had a positive effect.

Net income

Income before tax increased by 448 million euros to 2,058 million euros. Taxes on income amounted to 502 million euros. The tax rate of 24.4 percent was slightly lower than the previous year (26.0 percent). The adjusted tax rate of 24.8 percent declined by 1.2 percentage points compared to the previous year. Net income increased by 30.6 percent, from 1,191 million euros to 1,556 million euros. After deducting 46 million euros attributable to non-controlling interests, net income totaled 1,510 million euros (+30.1 percent). Adjusted net income after deducting non-controlling interests was 1,603 million euros compared to 1,356 million euros in fiscal year 2011. A summary of the annual financial statements of the parent company of the Henkel Group – Henkel AG & Co. KGaA – can be found on page 164.

Dividends

In keeping with our financial strategy, the dividend payout of Henkel AG & Co. KGaA should be around 25 percent of net income after non-controlling interests, adjusted for exceptional items. As such, we intend to propose a higher dividend to the Annual General Meeting than was paid in the previous year: we are proposing 0.95 euros per preferred share and 0.93 euros per ordinary share. The payout ratio would therefore be 25.6 percent.

Earnings per share (EPS)

Basic earnings per preferred share increased from 2.69 euros to 3.49 euros. Earnings per ordinary share increased from 2.67 euros to 3.47 euros. Adjusted earnings per preferred share amounted to 3.70 euros (previous year: 3.14 euros).