Business strategy risks

Business strategy risks can arise from the expectations we set for internal projects, acquisitions and strategic alliances failing to materialize in part or in full. This may, in turn, mean that we are unable to recoup the associated capital expenditures. Individual projects could also be delayed or even stopped by unforeseen risks. We endeavor to identify these business strategy risks as early as possible through regular and intensive analysis of the market and our competition, and to take suitable countermeasures to mitigate or minimize them.

Our strategy of standardizing our processes on a global scale and concentrating our production facilities may give rise, for example, to strained relationships with employees and vendors. We limit exposure through early risk analyses performed by experienced specialist departments, supported by external consultants where appropriate.

Overall risk – Management Board appraisal

At the time this report was prepared, there were no identifiable risks related to future developments that could endanger the existence either of Henkel AG & Co. KGaA or of the Group as a going concern. As we have no special-purpose entities or investment vehicles, there is no risk that might originate from such a source. Aggregation of the most significant individual risks is not appropriate due to the improbability that such risks would occur simultaneously. Our risk analysis indicates that our exposure to risk does not represent any lasting danger to the net assets, financial position and results of operations either of Henkel AG & Co. KGaA or the Group. Although our assessment of the probability of occurrence and/or potential financial impact of individual risk categories has changed compared to the previous year, the overall risk situation has not changed to any significant degree. The system of risk categorization adopted by Henkel continues to indicate that the most significant exposure currently relates to the impact of macroeconomic and sector uncertainty and financial risk, to which we are responding with the countermeasures described above.

Forecast

Macroeconomic development

Overview: moderate gross domestic product growth of less than 3 percent

We expect global economic growth to remain moderate in 2013. Based on figures published by Feri EuroRating Services, we expect gross domestic product to increase by less than 3 percent.

We expect the mature markets to grow by just over 1 percent. The North American economy is likely to grow by around 2 percent, with Japan's expanding by less than 1 percent. In Western Europe, we expect a slight recovery, with growth of less than 1 percent following slightly declining growth in 2012.

The emerging markets will once again achieve comparatively strong economic growth of approximately 5 percent in 2013. In the case of Asia (excluding Japan), we expect economic output to increase by around 6 percent, with Latin America likely posting a plus of approximately 4 percent. Eastern Europe should grow by around 3 percent. For the Africa/Middle East region, we expect economic growth of approximately 4 percent.

Raw material prices: moderate rise in price level

We anticipate moderate price rises in all business sectors in 2013. In light of the geopolitical and global economic situation, we expect the procurement markets to remain highly volatile. Limited capacities in some supply areas may lead to shortages.

Currencies: no major changes

We do not expect any material change in the euro exchange rate versus the US dollar, and anticipate an annual average for 2013 of around 1.25 US dollars per euro. This forecast assumes no intensification of the debt crisis in Europe. Moreover, we expect that currencies of importance for Henkel from the emerging markets, such as the Russian ruble, Chinese yuan, Mexican peso and Turkish lira, will not change to any major extent in this environment. We have used the following exchange rates in our forecast:

Average exchange rates versus the euro

	2012	2013[1]
Chinese yuan	8.10	8.00
Mexican peso	16.90	16.90
Russian ruble	39.93	40.30
Turkish lira	2.31	2.30
US dollar	1.28	1.25

[1] Forecast.

Inflation: moderate rise in global price levels

According to data provided by Feri EuroRating Services, global inflation is predicted to be around 4 percent. While we can continue to expect a high degree of price stability for the mature markets, with a rise of around 2 percent, the inflation rate in the emerging regions is likely to average around 6 percent.

Sector development

Consumption and the retail sector: growth of less than 3 percent

Based on data provided by Feri EuroRating Services, we anticipate that worldwide private consumption – and, linked to this, retail sales – will rise by less than 3 percent in 2013. In the mature markets, consumers are likely to spend around 1 percent more than in the previous year. The emerging markets should again show an increase in consumption of around 5 percent in 2013.

Industry: growth of more than 3 percent

According to figures provided by Feri EuroRating Services, industry will grow globally by just over 3 percent compared to the previous year and, as such, faster than the overall economy.

We expect the transport industry to record an increase of around 4 percent. Production in the electronics industry, an important customer sector for Henkel, is likely to increase by around 6 percent, the same level witnessed in 2011. Within the electronics industry, the growth of basic products relevant for Henkel, such as electrical systems and semiconductor units, should be considerably higher than the previous year. Production in the metal industry is likely to expand by around 4 percent. Development in consumer-related sectors, such as the global packaging industry, is likely to be stronger than the previous year, with growth according to our estimates in the low single-digits percentage range. We expect global construction to expand by around 3 percent.

Opportunities: expanding our market positions and strict focus on cost

We see clear opportunities to expand our market positions in all of our business sectors across Europe and North America, and to further exploit the potential in emerging markets. In the emerging markets, we see above-average growth opportunities that we want to exploit through our local business activities. The regions concerned include, in particular, Asia-Pacific, Eastern Europe and Africa/Middle East, with Latin America also part of the wider group.

We regard our research and development activities and the rigorous continuation of our innovation offensive as a great future source of opportunity. We are developing a steady stream of new and innovative products and problem solutions offering our customers added value. We have a well filled and balanced pipeline of medium and long-term innovations that we intend to launch on the market in all three of our business sectors, both this year and in years to come.

Additional opportunity lies in our strict focus on cost and our willingness to constantly examine and analyze the status quo. The results of this process lead to measures for cost reductions and capacity adjustments, or the elimination of non-core business activities and minor brands from our portfolio. We also expect the planned further expansion of our shared services to make a substantial contribution to cost reduction.

Opportunities also arise from the rigorous pursuit and implementation of our strategic priorities, which are explained in detail in the “Strategy and financial targets 2016” section on pages 48 to 53.

Outlook for the Henkel Group 2013

We expect the Henkel Group to generate organic sales growth of between 3 and 5 percent in fiscal year 2013. Our expectation is that each business sector generates organic sales growth within this range.

We base this prediction on our strong competitive position, which we have consolidated and further extended in recent years through our innovative strength, strong brands, leading market positions and quality of our portfolio.

In recent years we have introduced a number of measures that have had a positive effect on our cost structure. Also in this year, we intend to continue adapting our structures to constantly changing market conditions and to continue our strict cost discipline, especially in administration. By optimizing and standardizing our processes and continuing to expand our shared services, we can pool activities and thus further improve our own efficiency while at the same time enhancing the quality of our customer service. The optimization of our production and logistics networks will, moreover, help to improve our cost structures.

These factors, together with the expected increase in sales, will have a positive effect on our earnings performance. Compared to the figures for 2012, we expect our adjusted return on sales (EBIT) to increase to around 14.5 percent, and that all business sectors will contribute to this improvement. We expect adjusted earnings per preferred share to increase by around 10 percent.

We also expect the following developments in 2013:
- Moderate increase in the prices for raw materials, packaging and purchased goods and services,
- Restructuring charges of around 125 million euros.
- Investments in property, plant and equipment of around 500 million euros.

Dividends
Based on the anticipated increase in earnings, we expect a further increase in the dividend paid for fiscal year 2013.

Capital expenditures
We are planning to increase our investments in property, plant and equipment to around 500 million euros in fiscal year 2013. In keeping with our growth strategy, we will allocate the largest share of our budget for the first time to expanding our business in emerging markets.

Considerable investments are planned in our Laundry & Home Care and Beauty Care business sectors for optimizing and expanding production in the Africa/Middle East, Latin America, and Eastern Europe regions. In our Adhesive Technologies business sector, the focus in 2013 will be on further expanding our capacities for products for the construction industry in Eastern Europe to enable us to expand in new regional markets. Investment activity in the emerging markets of Asia-Pacific will focus on further consolidation of our production sites. In addition, investments in IT infrastructure will contribute substantially to optimizing our processes.

Net debt, financing and acquisitions

We plan to reduce our net debt to zero in fiscal year 2013 and to convert it into a net asset. In doing so, we will continue to support our financial flexibility by maintaining adequate holdings of cash and credit lines for securing our commercial paper program.

When assessing potential acquisitions, we will continue to endeavor not to jeopardize our target ratings of “A flat” (Standard & Poor’s) and “A2” (Moody’s) over the long term.

Post-2013 outlook

We announced our new strategy and financial targets for 2016 in November 2012. We are confident that, by rigorously implementing our strategic priorities, we will be able to continue our growth trend in sales and profits in 2014. We plan to advance cash flow from operating activities in line with sales. Capital expenditures are scheduled to remain high. Net debt development will be influenced by our acquisition activity. We will publish specific financial targets for 2014 in our 2013 annual report.

Subsequent events

Effective January 10, 2013, we sold Chemofast Anchoring GmbH, Willich, Germany. As at December 31, 2012, the assets and liabilities of the company were reported as “held for sale.”