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# Interactional metadiscourse in English and Danish corporate annual reports

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Summary in Danish:

## Interaktionel metadiskurs i engelske og danske virksomheders årsrapporter

Jeg vil i afhandlingen undersøge kontekstuelle og lingvistiske forskelle mellem det indledende brev i danske og engelske årsrapporter samt bestyrelsens beretning og ledelsesberetningen i henholdsvis engelske og danske årsrapporter udarbejdet af børsnoterede aktieselskaber. Flere forskningskilder påpeger, at årsrapporten ikke udelukkende bør ses som en genre, der kun tjener det formål at offentliggøre regnskabsmæssige resultater og objektive oplysninger om virksomhedens drift. Endvidere indikerer nogle af disse kilder, at de(t) indledende brev(e) fra formanden og/eller den administrerende direktør bidrager forholdsvis meget til årsrapportens pr-værdi; de bidrager med andre ord til at overbevise aktionærer og potentielle investorer om, at det er en god idé at have aktier i virksomheden.

Dette betyder, at teksterne tjener sociale formål, og den forskningsretning, der undersøger hvordan forskellige tekster kan bruges til sociale formål betegnes genreanalyse. Genreanalytikere identificerer således de *diskursfællesskaber*, der gør brug af genrerne og forsøger at identificere de lingvistiske og retoriske strategier, disse personer benytter sig af for at opnå deres mål.

En af disse strategier kaldes metadiskurs. Metadiskurs er en samlet betegnelse for de lingvistiske ressourcer en tekstaftsender kan gøre brug af for at interagere med læseren. Teorien omfatter to dimensioner af metadiskurs: den interaktive og den interaktionelle. I den interaktive dimension guider afsenderen den intenderede målgruppe gennem teksten, så denne forstår afsenderens pointer på den måde, som afsenderen gerne vil have. I den interaktionelle dimension henvender afsenderen sig mere eller mindre direkte til modtageren ved hjælp af ressourcer, der kan inddeles i fem forskellige kategorier. Det er de interaktionelle ressourcer, der analyseres i dette speciale, og disse har en overbevisende funktion idet de kan bidrage med appelformerne etos og patos i de genrer, de benyttes. Etos er den appelform, der gør at modtageren opfatter afsenderen som en sympatisk person, og patos er den appelform hvorigennem man når ind til modtagerens følelser.

Analysen af årsrapportens kontekst viser at de virksomhedsledere, der er afsenderne af de engelske og danske årsrapporter indgår i forskellige slags ledelsesmodeller. De engelske ledere er altid organiseret i et organ, nemlig en bestyrelse, hvori der dog også sidder direktører. Danske virksomheder har derimod valgt mellem to ledelsesmodeller, hvoraf den ene minder meget om den engelske, idet virksomheden ledes af en bestyrelse, hvis bestyrelsesmedlemmer også gerne må være direktører i virksomheden, når blot flertallet af bestyrelsesmedlemmerne ikke er direktører. Den anden danske ledelsesmodel er tostrengt idet

virksomheden ledes af en direktion, hvis medlemmer ansættes af et tilsynsråd. I denne model kan en leder ikke være medlem af både tilsynsrådet og direktionen.

Informanter i form af kommunikationseksperter afslører dog i interviews, at selvom de omtalte ledere formelt er årsrapportens afsendere, så får de hjælp af kommunikationseksperter til at udarbejde rapporten. Disse informanter påpeger, at sprogstilen varierer i årsrapportens forskellige afsnit, fordi det er vigtigt, at de medlemmer af målgruppen, som ikke er eksperter i regnskabsterminologi, også har en realistisk chance for at forstå nogle af årsrapportens afsnit. Det er vigtigt, at årsrapporten fanger modtagernes interesse, da mange af dem faktisk ikke behøver at læse den, medmindre de gerne vil.

Analysen af interaktionel metadiskurs i de engelske og danske breve og ledelsesberetninger viser, at der bruges mest interaktionel metadiskurs i brevene sammenlignet med rapporterne, og den viser også, at der bruges mere interaktionel metadiskurs i de engelske rapporter end i de danske.

Undersøgelsen bekræfter dermed en tidligere undersøgelse af metadiskurs i årsrapporter affattet på engelsk i, at årsrapportens indledende brev har en mere overbevisende funktion end ledelsesberetningen set under ét.

En vigtig konklusion, man kan drage, når man kombinerer den viden, der udsprang af undersøgelsen af årsrapportens formål/kontekst og den funktion, interaktionel metadiskurs kan bidrage med, er at interaktionel metadiskurs spiller en vigtig rolle, eftersom tekstafsenderen kan bruge disse ressourcer til at henvende sig til læseren og gøre teksten mere følelsesmæssigt interessant for ham eller hende.

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## 2. Introduction

The present study sets out to analyse the context of and linguistic features in the English and Danish corporate annual report. It will focus on the introductory letter to shareholders and directors' reports of English companies and the introductory letters to shareholders and managements' reviews (in Danish) of Danish companies.

There seems to be a wide consensus among scholars that the purpose of the corporate annual report is not only to comply with legislative requirements; it is also intended to serve as an investor relations tool and make the company's shares more attractive on the stock exchange (Ditlevsen, 2012; Hyland, 1998a; de Groot, 2008; David, 2001; Stittle 2003).

Previous research also indicates that both lexico-grammatical and other resources contribute to this persuasiveness of the annual report. Thus, pictures have been found to communicate "truth" (David, 2001), and a "corporate message" serving to project a company image which investors are likely to deem success-prone for that particular type of company may also be employed (Stittle, 2003).

In the present study, however, I will be focusing on various linguistic items which, depending on their contextual functions, contribute to the persuasiveness of the genres in which they are found. While these linguistic items, which are known as *metadiscourse*, can thus realise the three classical persuasive appeal forms of *ethos*, *logos* and *pathos* (Hyland, 2005 & 1998a), this study is limited to the *interactional* metadiscourse categories, which create *ethos* and *pathos*, i.e. credible and affective appeals. Previous studies have shown that the CEO's letter makes use of more metadiscourse than the directors' report (Hyland, 2005), which allegedly has to do with the CEO's letter being a more persuasive element of the annual report (Hyland, 2005; Bülow-Møller, 2003). Bülow-Møller thus states that its purpose is to share the management's perspective and create a persona which the audience can relate to, so that the cold, hard key figures can be addressed along with the rest of the large quantity of information found in the annual report (2003, p. 63). Hyland (2005, pp. 78-84) shows that interactional metadiscourse contributes to creating this persona and this study sets out to investigate whether Danish letters to shareholders and managements' reviews contain as much metadiscourse as its English counterparts.

Metadiscourse analyses are a functional in nature, and in order to determine whether many of the items that have the potential to function metadiscoursally actually do so, a certain amount of contextual knowledge is required. For this reason, I will be also be discussing the concept of genre and perform a genre analysis of the annual report with focus on the introductory letter to shareholders and the directors'

report/management's review. I will take the approach recommended by Bhatia (1993, pp. 22-36) to analysing unfamiliar genres and the analysis of interactional metadiscourse realises step 6 of this model.

Thus the problems to be solved by the present study were:

1 What are the contextual characteristics of the genres of the introductory letter to shareholders and the directors' report in the English annual report and the introductory letter to shareholders' and the management's review of Danish companies?

2 How frequently is the different types of interactional metadiscourse used in the annual report and how does this frequency relate to the communicative purpose of the introductory letter to shareholders, the directors' report and the management's review?

## 2. Theoretical and methodological framework

### 2.1 Genre analysis

#### **2.1.1 The concept of genre**

In this thesis, I will take the approach to genre analysis recommended by Bhatia (1993, pp. 13-41). His definition of genre is:

(...) it is a recognizable communicative event characterized by a set of communicative purpose(s) identified and mutually understood by the members of the professional or academic community in which it regularly occurs. Most often it is highly structured and conventionalized with constraints on allowable contributions in terms of their intent, positioning, form and functional value. These constraints, however, are often exploited by the expert members of the discourse community to achieve private intentions within the framework of socially recognized purpose(s) (1993, p. 13)

Bhatia credits Swales (1981, 1985, 1990) with this definition of genre, except for the last sentence, which pertains to the psychological aspect of genre analysis (1993, pp 15-16). He elaborates on the definition by stating that it is the communicative purpose(s) which first and foremost characterises a genre, and that "this shared set of communicative purpose(s) shapes the genre and gives it an internal structure" (1993, p. 13). This characteristic of genre is what makes genre analysis different from previous paradigms within discourse analysis: genre analysis reveals not only *how* a text is but also *why* it is the way it is (Bhatia, 1993, pp. 3-12). For this reason, genre analysis also focuses to a high degree on the senders and receivers of



texts, which manifests itself in the key concept of *the discourse community* (Bhatia, 1993, p. 13-14; Swales, 1990, pp. 21-32), which will be covered in section 2.1.2. In the following paragraphs I would like to discuss in greater detail how genre analysis is different from other types of discourse analysis.

Discourse analysis, including applied genre analysis, is and has been performed by researchers of different disciplinary backgrounds, and for this reason it is a characteristic of genre analysis that its theoretical foundation rests on different disciplines (Bhatia, 1993, pp. 16-17). Bhatia mentions linguistics, sociology and psychology as important fields to consider when deciding how to design one's specific genre study (1993, pp. 16-22) and since these disciplines are clearly reflected in the seven-step approach recommended by Bhatia (1993, pp. 22-36) - used in the present study - I find it appropriate that we consider how they relate to the analysis of a genre.

Beginning with linguistics, Bhatia notes that the previous paradigms within discourse analysis had a less than optimal way of categorising texts. In Bhatia's words:

Very few of them distinguished a variety (or register) from a genre. For many of them, a science research article, for example, is as legitimate an instance of scientific English as is an extract from a chemistry lab report. This creates two types of problem. Firstly, it potentially misrepresents not only the communicative purposes of the two genres, but also the relationship between the participants taking part in the linguistic activity, thus obscuring the very communicative nature as well as the distinct characteristics of the two genres. Secondly, by implication it gives a grossly misleading impression that a research article in science is likely to be very different from a research article in sociology, linguistics or psychology, for example (1993, p. 17).

He then points to Swales' (1981) genre study of research article introductions as evidence that the concept of genre can produce explanations as to the nature of texts better than the concept of variety or register (Bhatia, 1993, pp. 17-18). In his study, Swales thus shows that all research article introductions – regardless of the subject matter of the article – have a very similar structure (Bhatia, 1993, pp. 17-18).

The field of sociology has contributed with the important insight that a text should always be seen in its context; it is not "a complete object, possessing meaning on its own" (Bhatia, 1993, p. 18). Instead, the goals of the participants and the purpose of the social occasion of which the text is a part must be taken into account, since these circumstances determine how the text is constructed (Bhatia, 1993, pp. 18-19).

The psychological, or psycholinguistic, aspect has two parts to it: 1) "The cognitive structure, typical of particular areas of enquiry", and 2) a tactical aspect which focuses on the "individual strategic choices

made by the writer in order to execute his or her intention" (Bhatia, 1993, p. 19). I find this aspect of genre analysis particularly relevant for the present study, since the directors' report and the management's review are both meant to give a "fair review" of the business of the company. Bhatia goes on to note that another genre in which a high degree of objectivity is to be expected may actually be presented from an angle which serves the reporter's "private intentions", namely the newspaper report:

"...a good reporter is generally well aware of what is expected of his news reporting, and the readers also have a fairly good understanding of the social function of the genre, i.e., to inform the readers about the day-to-day happenings in the world around them without bringing in any subjective interpretation or unnecessary bias. However, there are several types of non-discriminative linguistic strategies that reporters legitimately use in order to accomplish their intention in a particular news report. First, reporters use typical linguistic strategies in order to create various perspectives on news reports, thus bringing in some degree of subjective interpretation or even bias in their reporting. These may range from a convenient selection of facts to a subtle use of vocabulary. A news report in the *Guardian*, for example, is not written the same way as one in any of the tabloids, for example the *Sun* " (1993, p. 20).

As mentioned in the introduction, the linguistic strategies analysed in this study are known as metadiscourse. This is a functional analysis based on the idea that readers can do certain things to interact with their readers, and in the next section we will take a closer look at discourse communities, the contexts in which such interaction takes place.

### **2.1.2 The concept of discourse community**

In order to be able to describe how the concept of discourse community relates to the people who write and read directors' reports and management's reviews later in this thesis, I find it appropriate to discuss in this section the criteria for what constitutes such a community.

Swales (1990, pp. 24-27) proposes six defining characteristics of a discourse community:

#### *1. A discourse community has a broadly agreed set of common public goals*

Swales explains that since both spies or ordinary people may join discourse communities, he considers them to be public and that goals may be "high level or abstract" such as when adversarial members of a Senate or Parliament can both be seen as striving for better government (1990, pp. 24-25).

#### *2. A discourse community has methods of intercommunication among its members*

This means that even when people are in the same line of work and interact with similar or even the same people by means of the same genres, they can still not be considered as members of the same discourse community if they do not communicate with each other (Swales, 1990, p. 25). Swales mentions café owners who are not members of “the Local Chamber of Commerce (...) lighthouse keepers on their lonely rocks, missionaries in their separate jungles, or consular officials in their rotting outposts” as examples of individuals who do not meet this requirement (1990, p. 25).

*3. A discourse community uses its participatory mechanisms primarily to provide information and feedback*

This characteristic states that even if the methods of intercommunication exist, those people who do not make use of them cannot be said to be members of the discourse community (Swales, 1990, p. 26)

*4. A discourse community utilizes and hence possesses one or more genres in the communicative furtherance of its aims*

We have already covered the characteristics of genre, but Swales notes that new groupings need to establish recurrently used genres before they can be considered discourse communities (1990, p. 26)

*5. In addition to owning genres, a discourse community has acquired some specific lexis*

Swales gives the example of “highly technical terminology as in medical communities” and explains that this specialised use of language exists among other things because it facilitates efficient communication required among the members of the community (p. 26).

*6. A discourse community has a threshold level of members with a suitable degree of relevant content and discursual expertise*

Members enter and leave discourse communities perpetually, but in order to persist there must some people who are experts in the discourse community (Swales, 1990, p. 27)

The question to be answered in the analysis part of this thesis will be to identify how well the composers and users of the directors’ report and the management’s review may be said to make up a discourse community in the meaning which Swales gives to the concept through these 6 defining characteristics. This is discussed in section 3.1.4.

### **2.1.3 Persuasion in genre: Appeal forms and metadiscourse**

Helder (2009, p. 39) notes that Aristotle’s three appeal forms will almost always be part of the tools the sender of a genre uses in order to persuade the audience to “accept the ideas etc. put forward”. These

appeal forms are called logos (the appeal to reason), pathos (the appeal to emotions) and ethos (the appeal of our personality or character) (Helder, 2009, p. 39).

Helder notes that a text in which logos is the predominant appeal form is written in a formal, objective and dispassionate manner and “often includes things that can be measured and controlled” (2009, p. 39). She goes on to mention the annual report among genres dominated by logos.

The appeal form of pathos targets the emotions of the audience, and writers often accomplish this by adopting a certain style of writing; Helder mentions the choice of words, rhetorical figures and tropes and exemplification as commonly used tools for this purpose (2009, p. 39).

Ethos also has to do with emotions, since negative feelings towards the sender will make it difficult for the audience to accept his or her message (Helder, 2009, p. 39).

Hyland (2005, 1998a) shows how language classified as metadiscourse can be used to build a relationship with readers (ethos and pathos) and guide readers to interpret one’s arguments the way they are intended (logos). In section 2.3 we will take a look at the theory of metadiscourse.

## **2.2 Presentation of Bhatia’s model for analysing unfamiliar genres**

Bhatia (1993, pp. 22-36) recommends a seven-step approach to genre analysis. The seven steps are: (1) Placing the given genre-text in a situational context, (2) surveying existing literature, (3) refining the situational/contextual analysis, (4) selecting corpus, (5) studying the institutional context, (6) levels of linguistic analysis, (7) specialist information in genre analysis. I will not be describing steps 1, 2, 6 and 7 in detail, since step one is performed “intuitively (...) by looking at one’s prior experience, the internal clues in the text and the encyclopaedic knowledge of the world that one already has” (Bhatia, 1993, p. 22); my findings in relation to step 2 can be seen by the references to the literature used throughout this thesis; the theory and methodology for step 6, i.e. the metadiscourse analysis, will be described in section 2.3; and, as concerns step 7, I have relied on de Groot (2008) who interviewed specialist informants in order to obtain background information about the preparation process of annual reports instead of conducting such interviews myself.

### **2.2.1 Step 3: Refining the situational/contextual analysis**

Step three consists of:

defining the speaker/writer of the text, the audience, their relationship and their goals;

defining the historical, socio-cultural, philosophic and/or occupational placement of the community in which the discourse takes place;

identifying the network of surrounding texts and linguistic traditions that form the background to this particular genre text;

identifying the topic/subject/extra-textual reality which the text is trying to represent, change or use and the relationship of the text to that reality (Bhatia, 1993, p. 23)

See section 3.1 for my findings.

#### **2.2.2 Step 4: Selecting corpus**

The actions that Bhatia (1993) find to be necessary “in order to select the right kind and size of corpus” are to:

define the genre/sub-genre that one is working with well enough so that it may be distinguishable from other genres either similar or closely related in some ways. The definition may be based on the communicative purposes, the situational context(s) in which it is generally used, and some distinctive textual characteristics of the genre- text or some combination of these;

make sure that one’s criteria for deciding whether a text belongs to a specific genre/variety are clearly stated;

decide on one’s criteria for an adequate selection of the corpus for one’s specific purpose(s) – a long single typical text for detailed analysis, a few randomly chosen texts for exploratory investigation, a large statistical sample to investigate a few specified features through easily identified indicators (Bhatia, 1993, pp. 23-24).

The description of I have done this can be found in section 3.2.

#### **2.2.3 Step 5: Studying the institutional context**

This step, like step 3, involves looking at the context in which the genre is used; the focus here is more on examining how the context influences the use of language, however (Bhatia, 1993, p. 24). The rules and conventions that govern the use of language is often “implicitly understood and unconsciously followed by the participants in that communicative situation in which the genre in question is used” (Bhatia, 1993, p. 24), but Bhatia goes on to say that guide books and other such literature may be of assistance to the genre

analyst (p. 24). He also points out that it can be necessary to look at the norms within a specific institution, if the purpose is to analyse a genre as it is used in that particular context, but I will not be looking at the specific traditions of any of the companies whose reports I analyse in this study – the focus will be on annual reports in general.

## **2.3 Metadiscourse**

### **2.3.1 Definition and principles**

Hyland (2005) gives the following definition of metadiscourse: “Metadiscourse is the cover term for the self-reflective expressions used to negotiate interactional meanings in a text, assisting the writer (or speaker) to express a viewpoint and engage with readers as members of a particular community” (p. 37).

In order to elaborate on this definition, Hyland proposes three principles of metadiscourse (2005, pp. 38-48). These principles are important to keep in mind when analysing metadiscourse and I therefore find it appropriate to go over each of them before presenting Hyland’s ten categories of metadiscourse.

Hyland’s **first principle of metadiscourse** is that it is “distinct from propositional discourse”. Propositional content concerns all the things and events that are found in the world as opposed to in the discourse of the text (Hyland, 2005, p. 38). The communication of propositional content has traditionally been seen as the most important and interesting function of language and interaction in writing was therefore neglected for a long time (Hyland, 2005, pp. 6-8). The notions of propositions and propositional content have been around for a very long time, but (as we will return to later) it has proved very difficult for scholars to agree on definitions of these concepts (Lyons, 1977, pp. 141-142; Schiffer, 2006, p. ) and Hyland notes that propositional content and metadiscourse cannot always be clearly distinguished: “Sometimes a statement can have a dual function; for example, the Socratic paradox ‘I am lying’ simultaneously expresses a proposition and a commentary on it” (2005, p. 19). He goes on to elaborate on the propositional vs. metadiscourse dilemma by offering two more examples that are difficult to classify as *either* metadiscourse *or* propositional:

The two statements in example (1) below, for instance, could both be seen as discussing something going on in the world (propositional matter) or reports on such matters in the discourse (non-propositional material):

- (1) A taxonomic scheme such as the one I present below is not just a neutral description of diversity but a theory in itself.

(science textbook)

'Political correctness' is a tired old expression, not used much nowadays by anybody but the *Daily Mail*, which employs it as a weapon with which to castigate the left.

(newspaper column)

The 'taxonomic scheme' in the first utterance might be *a specific example*, something referred to and discussed in the text itself, or a reference to *all* such schemes existing in the world beyond the text. Similarly, the newspaper columnist might be evaluating *the expression* 'political correctness' as part of the discourse or its actual manifestation of real-world behaviours. The fact that the first writer refers to the scheme as 'presented below' and that 'political correctness' is enclosed in quotes and anaphorically referred to as 'a tired old expression' suggest a discourse internal reading for both examples (Hyland, 2005, p. 38)

The fact that some text can be seen as both metadiscourse and propositional call for some intellectually challenging decisions to be made when excluding or including different parts of the analysed text as metadiscourse and Appendix I provides clues as to the functional criteria I have set for each potential metadiscourse item: (+) means that a function was seen as metadiscoursal while (-) indicates that a function was seen as propositional.

Hyland's **second principle of metadiscourse** is that it expresses writer-reader interactions. This principle leads him to reject earlier classifications of metadiscourse which describe much of it as "textual" such as in this model taken from Hyland (1998, p. 6):

Category	Function	Examples
<b>Textual metadiscourse</b>		
Logical connectives	Express semantic relation between main clauses	In addition / but / therefore
Sequencers	Denote sequence of text material	First / next / finally / then
Frame markers	Explicitly refer to discourse acts or text stages	Finally / to repeat / my goal is
Endophoric markers	Refer to information in other parts of the text	Noted above / see below
Code glosses	Help readers grasp meaning of ideational material	Namely / e.g. / in other words
<b>Interpersonal metadiscourse</b>		
Hedges	Withhold writer's full commitment to statements	Might / perhaps / it is possible
Emphatics	Emphasize force or writer's certainty in message	In fact / definitely / it is clear

Attributors	Indicate the source of quoted information	According to / X says
Attitude markers	Express writer's attitude to propositional content	surprisingly / hopefully
Relational markers	Explicitly refer to or build relationship with reader	between us / you can see/ I / we

Hyland (2005, p. 41) points out that this so-called textual metadiscourse is actually used by writers very much with the intended readers' "knowledge, textual experience and processing needs" in mind. It does so for the purpose of directing them to understand the information presented, i.e. the propositional content, and leading them to the writer's preferred interpretation of the argument (p. 45). It is therefore slightly misleading calling it "textual" since it is also closely related to the audience and functions to facilitate interactions between writers and readers. For this reason, Hyland (2005, pp. 43-45) distinguishes between overt and discreet functions of metadiscourse referring to the discreet function as *interactive* and the overt function as *interactional*. These two types of metadiscourse are reflected in his 2005 model (below), which shows that there are five interactive sub-categories and five interactional subcategories.

Category	Function	Examples
<b>Interactive</b>	<b>Help to guide the reader through the text</b>	<b>Resources</b>
Transitions	express relations between main clauses	in addition; but; thus; and
Frame markers	refer to discourse acts, sequences or stages	finally; to conclude; my purpose is
Endophoric markers	refer to information in other parts of the text	noted above; see Fig; in section 2
Evidentials	refer to information from other texts	according to X; Z states
Code glosses	elaborate propositional meanings	namely; e.g; such as; in other words
<b>Interactional</b>	<b>Involve the reader in the text</b>	<b>Resources</b>
Hedges	withhold commitment and open dialogue	might; perhaps; possible; about



Boosters	emphasize certainty or close dialogue	in fact; definitely; it is clear that
Attitude markers	express writer's attitude to proposition	unfortunately; I agree; surprisingly
Self mentions	explicit reference to author(s)	I; we; me; our
Engagement markers	explicitly build relationship with reader	consider; note; you can see that

The writer makes use of interactive metadiscourse to make the text meet the needs and interests of the audience better and sets out “arguments so that they will recover the writer’s preferred interpretations and goals” (Hyland, 2005, p. 49). Interactional metadiscourse, on the other hand, functions to facilitate the writer’s intrusion into his or her text, to make his views known and constructing a community-recognised personality (Hyland, 2005, p. 49). In Hyland’s words, it

includes the ways he or she conveys judgments and overtly aligns him- or herself with readers. Metadiscourse here is essentially evaluative and engaging, expressing solidarity, anticipating objections and responding to an imagined dialogue with others. It reveals the extent to which the writer works to jointly construct the text with readers (2005, pp. 49-50).

By comparing the two models, we can see that the *interactive* category in the new model comprises most of what was formerly referred to as textual, except the former subcategory of “sequencers” is now included in the subcategory of “frame markers” while “attributors”, as the only subcategory previously categorised under “interpersonal metadiscourse”, is now included as interactive metadiscourse; it has changed its name to “evidentials”, however, and is no longer limited to “quoted information” but now includes “information from other texts” in general.

Whereas, to qualify as metadiscourse, certain interactive metadiscourse markers, e.g. *then*, must function to link arguments (or stages) in the discourse as opposed to real-world events in time, interactional metadiscourse markers communicate writers’ subjective stance, whether epistemic (hedges and boosters) or affective (attitude markers), it engages the reader (engagement markers) or it refers to the writer(s) (self mention).

As implied in the previous paragraph, Hyland’s **third principle of metadiscourse** states that “metadiscourse distinguishes external and internal relations” (2005, pp. 45-48). In describing this principle, Hyland gives examples showing how metadiscourse items belonging to the categories of transition marker, frame marker and hedge can also be used propositionally.

In relation to hedges, this means that the opinion of the writer must be central, not “the ability or volition of the subject of the sentence” (Hyland, 2005, p. 47). Hyland goes on to say that hedges such as “*might* and *possible* can be regarded as interpersonal features where they express writers’ inferences about the likelihood of something and as propositional where they are referring to real-world enabling conditions which can affect outcomes” (2005, pp. 47-48).

Hyland (2005, p. 48) illustrates the internal-external distinction for hedges and boosters with the following sentences:

- (9) The poor market performance could be due to customers switching to alternative on-line sources for their groceries. (business report)
- It is possible that Strauss will also pull out of the tour to Zimbabwe this winter (newspaper)
- (10) (...) A Travelcard makes it possible to visit all these sites in one day. (London guide)

In (9) the uses of *could* and *possible* are metadiscoursal, since they are used as expressions of the writer’s subjective opinions concerning likelihoods of the cause, whereas in (10), the use of *possible* is propositional, because it has to do with an enabling condition, i.e. whether one has a travelcard or not (p. 48). Other examples of subjectivity vs. real-world enabling conditions include:

- (a) It’s *possible* he just forgot to collect it.
- (b) It’s *possible* to see the peaks of Snowdonia on a clear day.

(a) is metadiscoursal because it is not an objective and true statement but the writer’s estimate whereas in (b) the proposition is an objective description of the weather’s influence on visibility (Hyland 2005, p. 25).

### 2.3.2 Metadiscourse and genre

As mentioned above, Hyland’s approach to metadiscourse is that it fulfils social, or interpersonal, functions and he points out that is necessary to know how to use metadiscourse to be seen as a competent “community insider” (2005, p. 60). This social view is in keeping with e.g. Bhatia (1993) and Swales (1990) who, as we have seen, see discourse community as a key concept in genre analysis. Hyland (2005, p. 88) indeed points out that both the rhetorical structure of genre, i.e. their moves, and “clusters of specific rhetorical features” may be the focus of genre studies, stating that “metadiscourse is one such feature”. In my view, metadiscourse analyses fit in nicely in Bhatia’s (1993) approach to analysing unfamiliar genres – specifically level 1 and 2 of step 6 of model (see p. of this thesis) – although the metadiscoursal as opposed to the propositional *function* of the lexico-grammatical features must be taken into account, which perhaps makes it a little less straightforward than most other types of lexico-grammatical analyses.

### 2.3.3 Metadiscourse and the rhetorical appeal forms

Hyland (2005) shows that metadiscourse may help to structure arguments persuasively, give readers the impression of a likeable, competent writer and that it may be used to appeal to the emotions of readers; in other words, it may be used to create logos, ethos and pathos in writing (pp. 63-85)

Logos is achieved through the nature of the propositional content of texts, but also through interactive metadiscourse, which connects the propositional content: “The logical connections used to elaborate an argument by adding, comparing, sequencing or explaining its elements are critical to a text’s overall persuasive force”. The only interactive category which does not create logos is evidentials, which help to create ethos, but this category is “not widely found” in company annual reports (Hyland, 2005, p. 78). As mentioned, interactive metadiscourse is not the object of investigation in the present study, and in the following paragraphs we will therefore focus on the categories of interactional metadiscourse, which are helpful in order to create ethos and pathos in corporate annual reports (Hyland, 2005, pp. 78-84).

To a greater degree than through evidentials, Hyland states that ethos is frequently accomplished by using hedges, boosters and self mentions. Boosters can help to create an image of a “confident, decisive and commanding” CEO and instils “certainty, assurance and conviction in the views presented” (Hyland, 2005, p. 78-79). Sometimes boosters are accompanied by self mentions, which increases the presence of the writer in the text and makes it clear that e.g. the CEO is responsible for making the statement (p.79). Hyland goes on to say that such “overt acceptance of personal responsibility” makes the CEO appear competent and authoritative. Hyland provides these examples from his corpus:

I know from my year as chairman of the Administration Board that budgeting has been a very delicate operation over the last two years. (Hong Kong and Shanghai Bank, 1994)

I am sure that our company will continue to grow in 1993. (Crocodile, 1993)

I believe strongly that our people should share in the success of Cable and Wireless and be well rewarded for exceptional personal performance. (C&W, 1994)

Particularly in less successful times, CEOs also need to come across as trustworthy, modest and cautious, however, and hedges represent one way in which this can be accomplished (Hyland, 2005, p. 79). Hyland (p. 80) asserts that such an image makes it more likely that investors will trust him or her to provide “honest assessments of future possibilities” and take “few risks with investors capital” and he again goes on to give examples:

At this juncture, however, it would appear that local infrastructure projects... should take up most of any slack caused by slower growth rates in the PRC. (Dao Heng Bank, 1993)

...it is possible to envisage a future when many banking services will be delivered direct to the home or business place via television screens. (Barcalys, 1993)

Each of the above projects has resulted in significant increase of rent and there is good reason to believe that future endeavours will produce similar results. (Amoy Properties, 1994)

Further, Hyland states that the use of boosters and hedges must be a balanced enough that the CEO comes across as sincere while still maintaining authority (2005, p. 80.)

Moving on to pathos, Hyland (2005, p. 81) notes that this emotional appeal form coincides with the metadiscoursal resources which involve readers and makes the material appear more relevant to them. Pathos is therefore built metadiscoursally by means of attitude markers, engagement markers, hedges and self mentions (p. 81-84). While attitude markers communicate the feelings of the writer, they also implicitly appeal to the readers to share these attitudes “and so they create and emphasize a set of shared, taken-for-granted purposes and understandings (Hyland, 2005, p.82):

Fortunately, in the past few years we have taken full advantage of the rising markets. (Amoy Properties, 1994)

Hopefully, these new ventures in a market with tremendous potential will bring more profits to the group. (Ming Pao Daily, 1993)

The reason for this level of performance and, more importantly, the 120... (Swire, 1993)

The appeal to the readers’ shared understandings and desires is also performed by engagement markers of which Hyland specifically mentions and gives examples of obligation modals (2005, p. 82):

Customers must be offered a speedy response, flexibility, innovation, value for money, and, above all, improved quality of service. (Barclays, 1993)

At the same time, it is essential that we should make a great effort to appreciate what is going on in China and respond accordingly. (Ming Pao Newspapers, 1994)

In addition, questions contribute to creating a dialogue with the reader (2005, p. 82):

(...) Have we made progress? Yes. Can we do more? Definitely. And we intend to. (Chase Manhattan, 1993 in Hyland, 2005, p. 82)

... while asides, of which Hyland gives the following example, “address the audience directly about the discourse itself” (2005. p. 82):

...but successful Asian economies – and there are a growing number of them – display certain shared characteristics. (Hong Kong Bank, 1993)

Hyland goes on to say that these resources can help the writer to present herself or himself “as a person with similar views, interests and objectives as the reader” (p. 83).

Readers may also be mentioned directly in the text by means of second-person pronouns (Hyland, 2005, p. 83). Hyland (2005, p. 83) gives these examples (although the first pronoun in the last example is an inclusive first-person plural pronoun of course):

Of all the headlines of the past year our favourites, and perhaps yours, were the ones reporting that Union Carbide was the year’s best performing stock... (Union Carbide, 1992)

The board has good reasons to be optimistic about the future of the group; and so should you, too. (Elec and Eltek International Holdings, 1994)

As we enter the third era, your company can be counted upon to play an important part in the smooth transfer... (China Light and Power, 1993)

Sometimes the attitude markers appear in combination with self mentions which connect the attitudes more clearly to the sender of the text (Hyland, 2005, p. 83). Hyland’s (2005, p. 83) corpus offers the following examples:

We cannot, of course, achieve our international aims without strengthening our home base, and I am glad to say that financially we are finally in good shape. (HKIE, 1994)

It is my hope that it will further enhance the good image of the Group both in the eyes of our international investors and the public at large. (Amoy Properties, 1994)

Hyland also gives examples the reader-inclusive uses of first-person pronouns in plural (2005, p.83):

Let us hope that Government sees no reason to increase betting duty further for many years to come. (Hong Kong Jockey Club, 1994)

The directors are confident that our company can maintain a solid growth momentum in 1994. (Li and Fung, 1993)

Finally, Hyland explains that hedges may also be used to create an emotional appeal when they are used in a courteous manner to demonstrate “a reluctance to express views categorically” (2005, p. 84). This is a different function than when they are used to express doubt about truth-value, which, as we have seen, helps to build ethos.

### 2.3.4 Propositional attitude vs. evaluative lexis

We have seen that metadiscourse is distinct from propositional content, but in attempting to separate propositional content from metadiscourse I found myself faced with a dilemma concerning where exactly to draw a line. In Hyland's words:

At the most delicate level a writer's viewpoint can be conveyed through lexical choice alone, as the selection of an adjective can convey subtle shades of affect (the use of frugal vs stingy, forthright vs blunt or single versus spinster, for example). But to include such items as metadiscourse undermines the concept by widening it beyond any useful descriptive role. Metadiscourse studies therefore tend to distinguish between evaluative lexis, used to qualify individual items, and stance markers, which provide an attitudinal or evaluative frame for an entire proposition. Features which modify individual lexical words are therefore excluded as metadiscourse because they do not function in relation to an entire proposition (2005, p. 31)

This obviously means that in order to include only items which frame entire propositions, one needs to know how such a proposition can be realised linguistically, since Hyland seems to be indicating that individual lexical words should not be considered as such.

According to the Internet Encyclopedia of Philosophy, an Aristotelian proposition is either true or false and it "ideally consists of at least three words: a *subject* (a word naming a substance), a *predicate* (a word naming a property), and a connecting verb, what logicians call a *copula* (Latin, for "bond" or "connection")". An example of such a proposition would be "Socrates is wise", where "Socrates" is the substance, "wise" is the predicate and "is" is the copula (Groarke, 2011). A proposition can also be expressed by symbols, and the proposition "Socrates is wise" can thus be expressed S is P; here S stands for the subject and P stands for the proposition. Such a proposition may also be found in "spiders have eight legs", which would also be expressed "All S is P," where S, the subject, is "spiders"; P, the predicate, is "the state of being eight-legged," and the verb "is" functions as the *copula*" (Groarke, 2011). According to Aristotle, all propositions, even those which are linguistically complex, can be rewritten symbolically so that they display this structure (Groarke, 2011).

Although the term "proposition" has been a source of considerable disagreement among modern day philosophers (Lyons, 1977, 142), their take on the linguistic realisation is similar to that of Aristotle's since "some writers identify propositions with (declarative) sentences, others identify them with statements and others with the meanings of (declarative) sentences; and there is little consistency in the way in which statement is defined" (Lyons, 1977, p. 141). Halliday (1994, p. 70) states that "when language is used to exchange information, the clause takes on the form of a PROPOSITION. It becomes something that can be argued about – something that can be affirmed or denied and also doubted, contradicted, insisted on,

accepted with reservation, qualified, tempered, regretted and so on". The type of clause that is not a proposition, he holds to be those which represent "the exchange of goods-&-services, the entire range of offers and commands" (p. 70). Hunston (2000, p.179), however, also speaks of non-clausal propositions as in "George I regarded (Gibraltar) as an expensive symbol", where "Gibraltar is an expensive symbol" is the "implied proposition"; apparently, she takes a position which corresponds with Aristotle's view that linguistically complex propositions can still be rewritten symbolically and thus form a proposition.

The complexity of and controversy surrounding propositions and propositional content is clearly indicated by the conclusion of the contributor to the Oxford Handbook of a Philosophy of Language on propositional content:

On balance, my unprejudiced bet is on the theory I advanced in *The Things We Mean*, which holds that propositional contents are what I called pleonastic propositions. I suspect, however, that others might have a different opinion. I know that we have not reached the end of the discussion on the problem of propositional content (Schiffer, 2006)

Analyses of metadiscourse in which only stances towards propositions are seen as legitimate, exclude items functioning to modify words that are part of a clause expressing a proposition. Crismore et al. (1993, p. 41) thus not only exclude certain adjectives but also adverbs: "...the adverbial *really* in the sentence "It is really terrible" emphasizes the adjective *terrible* and is part of the propositional content whereas in the sentence "Really, it was terrible", it is a sentence adverbial and thus metadiscourse". Hyland (1998b) makes certain exceptions from this "clause requirement", however, since he sees the function of some adjectives which do not modify propositions as epistemic (epistemic markers comprise hedges and boosters):

However, the existence of such a possible mechanism of translation regulation in plant cells was not investigated (...)

...the possible involvement of photochrome C, D or E in an interactive or synergistic manner with photochrome A cannot presently be ruled out (p. 133)

Hyland goes on to say that "the use of *possible* in these contexts is epistemic as, like other uses, it does not refer to physical objects in the real world, but to what Lyons (1977: 442ff) calls second or third order entities, i.e. states of affairs or abstract propositions which may or may not exist" (1998b, p. 133). To elaborate on what Hyland is saying here, Lyons (1977) distinguishes between three different entities semantically: First-order entities are persons, animals and physical objects in the real world which are "located, at any point in time, in what is, psychologically at least, a three-dimensional space" (p. 443); second-order entities Lyons hold to be "events, processes, states-of-affairs, etc., which are located in time and which, in English, are said to occur or take place, rather than to exist" (p. 443); and third-order entities are "such abstract entities as propositions, which are outside space and time (p.443). I find it noteworthy

that nouns which refer to second-order and third-order entities are formed by nominalising verbs (Lyons, 1977, p. 445) and the heads of the noun phrases modified by *possible* in these examples may therefore be rewritten as clauses; it is difficult to derive a verb from *mechanism*, of course, but *possible* might have been placed as a pre-modifier to *existence* instead and it would then have been possible to rewrite (perhaps less elegantly) the examples by substituting the noun phrases with clauses:

It is possible that a mechanism of translation regulation in plant cells exists; this was not investigated, however (Invented)

It is possible and cannot presently be ruled out that photochrome C, D or E is involved in an interactive or synergistic manner with photochrome A (Invented)

By de-nominalising the two nouns modified by possible in the original sentences, the grammatical realisation of these entities thus changes into declarative clauses (that-clauses/complement clauses in these two examples) which is, as we have seen, the generally accepted linguistic form of propositions. Verbalising the noun phrases modified by adjectives in Appendix I was therefore a way for me to recognise instances of epistemic, and therefore metadiscoursal, stance when searching for hedges and boosters in the corpus.

Similarly, I also see Hyland's decision to include adverbs such as *approximately*, *about* and *around* when they function to hedge numerical data (1998b, pp. 139-140) as a divergence from the "propositional stance" approach. What is more, Blagojevic (2009) adopts by quotation Crismore et al.'s (1993) definition of an "attitude marker" but goes on to suggest a more comprehensive view regarding the form such markers may take:

1. Adverbs and adverbial phrases functioning as sentence adverbials - disjuncts
2. Verb-modifying adverbs functioning as subjuncts - intensifiers
3. Adjectives functioning as subjective complement in sentences with expletive 'it'
4. Adjectives functioning as prenominal modifiers
5. Modal verbs expressing obligation
6. Nouns of specific semantic content

The categories in Blagojevic's classification of attitude markers is thus different from that of Crismore et al. (1993) who excluded Blagojevic's category 4.

Perhaps this difference is related to the genres investigated in the two studies; Crismore et al searched for metadiscourse in "persuasive/argumentative position papers" written by American students and "opinion papers/essays" Finnish students as part of an exercise (1993, pp. 44-45). The American audience were the members of a political student organisation and the Finnish audience were a speaker and the leaders of the



local Greens party (pp. 44-45); the Finnish students wrote about pollution and CSR while the American students wrote about smoking in public places (pp.44-45). In order to select these topics, the students had been asked to rate their knowledge and interests in seven different controversial topics (p. 43). Blagojevic (2009), on the other hand, studied research articles written by English and Serbian authors. I do not know for certain whether Crismore et al.'s decision to exclude adjectives functioning as pronominal modifiers have something to do with the student's papers containing more literary style adjectives, e.g. "*frugal vs stingy*" (p. 48), which they saw as "more subtle uses of metadiscourse that are just as interesting and useful as the more explicit uses" although they limited their study to the latter (p. 48). However, since annual reports are usually written in a clear and formal style – UK companies are explicitly recommended to write the Operating and Financial Review in a "clear and readily understandable style" (ASB, 2006, p. 12) – the annual report as a genre is not likely to contain many adjectives which only *subtly* indicate the writer's attitude. In addition, the present study only included the items found in Appendix I, and these adjectives all convey clear and unambiguous, rather than subtle, attitudes. For these reasons, I have chosen to adopt Blagojevic's (2009) classification of metadiscourse – including category 4 – in the present study; I do not find that the concept of metadiscourse is widened "beyond any useful descriptive role" by doing so.

My decision to include adjectives which only modify a single noun or which functions as a predicate to a noun phrase was also motivated by the fact that attitudes to propositions (taken to be clauses only) make up a quite small percentage of the attitudes expressed and that, in my view, clear examples would have been left out of my analysis had been limited to propositional attitude. Take for instance this example:

The challenge of refocusing the UK business to ensure it sustains healthy market leadership is important enough to make it worth giving up some profit in the short term to safeguard the business in the long term (BAE Systems Chairman's statement)

Here, the adjective phrase headed by *important* modifies the noun phrase in which "challenge" is the head. Although the attitude marker *important* is part of a proposition (made up by the entire sentence) and modifies only a noun phrase, I believe that the analysis would have been less comprehensive if such examples had not been included as metadiscourse.

While Hunston and Thompson note that "opinions of likelihood, unlike those of goodness seem, generally, if not always, to be restricted to propositions and do not apply to entities" (2000, p. 4), the present analysis therefore accepted attitudinal stance (i.e. opinions of affect/goodness) towards first-order, second-order and third-order entities and epistemic stance (i.e. opinions of likelihood or commitment to truth-value) to second-order or third-order entities as metadiscourse.

### 2.3.5 Subjectivity

Hyland (1998a) notes that “language use is invariably “fuzzy”, which means that meta- and propositional use cannot always be distinguished, and that types of metadiscourse do not perform either textual or interpersonal functions” (p. 8-9) and that “writers frequently seek to accomplish several objectives simultaneously and we must be aware of this multi-dimensional aspect of language” (p. 9).

While carrying out my analysis, I also experienced that this fuzziness sometimes made it difficult to determine whether to analyse items’ functions as metadiscoursal or propositional or to determine to which category of metadiscourse the function belonged. For instance, the item *believe* is included in Hyland’s (2005) Appendix as a booster, but I found that in some instances the function could be interpreted as being more on the affective side, for instance when the committee believes that directors “should be rewarded based on such and such circumstances”. Do(es) the writer(s) say that they think that this constitutes a well-deserved reward – pointing to an affective function – or that they think that the directors should be rewarded because in their epistemic estimation this would increase their dedication and work-effort and thereby the chances of greater profit for the company and its shareholders? As it were, I decided to follow Hyland in his view that *believe* is primarily an indicator of epistemic stance and therefore a booster, but I did decide to analyse belief *in* something as attitude markers. The difficulty in clearly distinguishing the functions of some items means that my cognitive and subjective opinion was often the deciding factor in determining the functions of the metadiscourse candidates. In order to introduce some measure of consistency – and accountability – I therefore decided to write down in cue form the criteria employed for including or excluding items as instances of (each category of) metadiscourse. These cues are included in Appendix I, but it must be stressed that they are not an exhaustive explanation of universal criteria; they are merely the guidelines I used to carry out this particular analysis and items that did not appear in the corpus at all therefore have no explanatory cues attached to them. In the following sections, I will describe in greater detail some of my considerations concerning what functions the various items in the different categories needed to perform in order to qualify as metadiscourse. As we will see, the drawing the line between metadiscourse and propositional content was not always entirely straightforward.

### 2.3.6 Hedges

Crompton (1997) notes that hedging is an expression borrowed from the metaphor “ARGUMENT IS WAR” where it “evokes of guerrilla-style tactics: no fixed defensive position, concealment, camouflage, retaining the option of withdrawal” (p. 272). Less dramatically, Hyland characterises hedges in this way:

Hedges emphasize the subjectivity of a position by allowing information to be presented as an opinion rather than a fact and therefore open that position to negotiation. Writers must calculate what weight to give to an assertion, considering the degree of precision or reliability that they want it to carry and perhaps claiming protection in the event of its eventual overthrow. Hedges therefore imply that a statement is based on the writer’s reasoning rather than certain knowledge, indicating the degree of confidence it is prudent to attribute to it (2005, p. 52).

Researchers have voiced differing opinions on how to analyse these features and while Crompton (1997) proposes a definition and a taxonomy for which types of grammatical and semantic features should be accepted as hedges, other researchers (e.g. Salager-Meyer 1998 & 2000; Markkanen & Schröder, 1997) maintain that some level of subjectivity is necessary when analysing the phenomenon. Salager-Meyer thus refers to Kant, who stated that “clear definitions are untenable except in the realm of mathematics” (in Salager-Meyer, 2000, p. 178) and argues that hedging is a subjective phenomenon, “the product of a mental attitude” that can best be studied by “introspection and contextual analysis” (p. 180) which make it possible to discern a writer’s intention.

My own experience as I was carrying out the present analysis was that even with a taxonomy in place it was still necessary to use “introspection and contextual analysis” in order to identify hedges. Both Hyland’s (1998b, pp. 105-119) and Crompton’s (1997, p. 284) taxonomies, for instance, includes epistemic use of modal verbs, and I found that contextual analysis and introspection was still necessary in order to tell epistemic use of modals from non-epistemic use. Consider:

Like any industrial concern, BAE Systems does not just produce products or provide services for its customers; in the process, intellectual property may be created which often has a value to the Group far greater than is reflected in the value of the particular contract or programme of work under which it was created. It takes many forms, including products, processes and knowhow. (BAE Systems, 2012)

In this example, *may* can be seen as the writer’s subjective estimation about how the in the future BAE Systems may be fortunate enough to benefit from the creation of intellectual property. On the other hand, the example might also be seen as an objective textbook-like description which points out that sometimes, given the right enabling conditions, intellectual value can be created as industrial concerns do business. In such cases of doubt, I usually included the modal as a hedge, but I refer to the appendices for a complete view of my analysis. In this particular case, my considerations concerning the purpose of the annual report

led me to include *may* as a hedge. This is because the annual report is, among other things, meant to provide forecasts of varying degrees of certainty as to the future developments of the company's business; it is not primarily meant as an educational resource on the workings of running a business.

In 3.2.4, we also learned that metadiscourse is internal to the discourse as opposed to external, i.e. dependant on circumstances in the outside world. In relation to hedges, this means that the opinion, or epistemic stance, of the writer must be central, not "the ability or volition of the subject of the sentence" ([Palmer, 1990, p. 36] in Hyland, 2005, p. 47). Hyland goes on to say that hedges such as "*might* and *possible* can be regarded as interpersonal features where they express writers' inferences about the likelihood of something and as propositional where they are referring to real-world enabling conditions which can affect outcomes" (2005, pp. 47-48).

### 2.3.7 Boosters

Boosters are similar to hedges in that they mark the level of truth-value a reader should attribute to propositional content; boosters and hedges are just found at opposite ends of the 'epistemic' spectrum (Crismore et al., 1993, p. 47; Hyland pp. 52-53). Boosters thus indicate that other viewpoints are valid but that the writer is confident enough to take a stance. In Hyland's words: "By closing down possible alternatives, boosters emphasize certainty and construct rapport by marking involvement with the topic and solidarity with an audience, taking a joint position against other voices" (Hyland, 2005, p. 53). Many of the booster-items in the corpus which I analysed as metadiscourse modified second-order entities such as the ones modified by *possible* in the examples taken from Hyland (1998b) mentioned in section 2.3.4 on propositional attitude vs. evaluative lexis.

The item *demonstrates*, for instance, modifies the second-order entity commitment in the following example and was counted as metadiscourse:

The Remuneration Committee believes that a significant shareholding by Executive Directors aligns their interests with shareholders and **demonstrates (booster)** their ongoing commitment to the business.

One of my arguments for including *demonstrates* as metadiscourse here is that *commitment* is a nominalisation of the verb *committed* and the noun phrase could therefore also have been written as a clause without any change in meaning taking place:

(...) a significant shareholding by Executive Directors (...) **demonstrates (booster)** that they are committed to the business on an ongoing basis (or: that they have an ongoing commitment to the business) (invented)

I was careful only to analyse items as hedges or booster when they indicated the writers' epistemic stance. This meant that items such as "clear" were excluded from this category in examples such as

BAE Systems has continued to deliver on a clear (AM) strategy during 2012.

Let us consider what “clear” means in this example. Does it mean that the strategy is easy to understand and execute? Or does it mean that the strategy definitely exists as opposed to a lack of certainty of its existence? My interpretation of its meaning is that of “easy to understand and execute”. So far so good, but is this clarity an inherent and objectively identifiable trait of the strategy or is it the writer’s subjective opinion about the strategy? I would say that for someone inexperienced and inept in the workings of corporate strategies, the strategy might not seem clear and I would therefore analyse the clarity as the writers’ subjective opinion about the strategy. This subjective element, or stance-taking, leads me to conclude that “clear” has a metadiscoursal function, but the question is whether to categorise it as a booster or to place it under a different metadiscourse category. I would argue that it is not the strategy’s truth value that is being strengthened here; it is clear that the company has a strategy and it is even presented elsewhere in the annual report. Therefore, I have chosen to analyse “clear” as an attitude marker here although Hyland’s Appendix (2005, p. 221) includes it as a possible booster and does not include in his list of potential attitude marker candidates (pp. 220-221); the list of attitude markers does include at least one item with a similar meaning, however, i.e. “understandable” and in his characterisation of this category he also gives as an example the item “logical” (p. 53).

### 2.3.8 Attitude markers

Attitude markers communicate writers’ affective stance towards propositions and, as we have seen, other entities. One recurring cue in Appendix I is that of “unspecific reference”. It was a requirement for inclusion that the attitude markers showed the writers’/writer’s stance to something specific and not unspecific. Consider the following examples:

(16) ...en liste over de omkring 15 vigtigste risici. Disse rapporteres derefter til direktionen, og passende foranstaltninger for at mindske disse risici vedtages og implementeres. (Novozymes 2012 Annual Report)

My translation: ...a list of approximately 15 of the most important risks. These are then reported to the executive directors, and appropriate measures to reduce these risks are agreed and implemented.

(17) ”Vi har nu et tættere samarbejde med vores vigtigste kunder...” (PANDORA 2012 Annual Report)

My translation: ”We now have closer cooperation with our most important retailers...”

(18) ”Vi opfatter os selv som en produktvirksomhed – for os er produktet det vigtigste. (Novozymes 2012 Annual Report)

My translation: ”We consider ourselves a product company – for us, the product is the most important thing”

(19) For Maersk Oil er det vigtigste mål at opnå de planlagte fremskridt for centrale projekter som El Merk i Algeriet, Chissonga i Angola og Johan Sverdrup i den norske del af Nordsøen.

My translation: "To Maersk Oil, the most important goal is to achieve the planned progress for central projects such as El Merk in Algeria, Chissonga in Angola and Johan Sverdrup in the Norwegian part of the North Sea."

In examples (18) and (19), the writers are taking risks by stating that something is important, since by implication the reader can then conclude that other things are less important to the writer. Such statements say something about the values of the writer, which is also reflected in Englebretson's "five key conceptual principles of stance", which I found helpful in order to distinguish cases of actual stancetaking from reference to unspecified entities:

(1) Stancetaking occurs on three (often overlapping) levels – stance is physical action, stance is social attitude/belief/evaluation and stance is social morality; (2) stance is public, and is perceivable, interpretable, and available for inspection by others (...); (3) stance is interactional in nature – it is collaboratively constructed among participants, and with respect to other stances (...); (4) stance is indexical (...), evoking aspects of the broader sociocultural framework or physical context in which it occurs; (5) stance is consequential – i.e. taking a stance leads to real consequences for the persons or institutions involved (Englebretson, 2007, pp 6-7).

I find Englebretson's fifth principle particularly interesting, since most of the metadiscourse categories searched for in this study are used to convey ethos (Hyland, 2005, pp. ); in my view, being prepared to reveal one's personal and subjective opinion about things – knowing that it will have consequences – is something that will give the reader a clearer idea about who the writer is and will also make him or her more believable; in other words it will evoke ethos.

In (16), however, I do not find that the writers' stance to the "measures" is actually communicated because, at the time of writing, the measures are unknown; the writers' stance relative to the measures to be implemented is therefore not "perceivable, interpretable, and available for inspection by others", it is not interactional in nature, and consequential, because, in my view, there is not really any opportunity for the writer to disagree – it would be hard to find anyone who would think that the measures taken to reduce risks should not be appropriate and I find the thought of a company director proposing risk-mitigating measures that he or she does not find appropriate rather absurd. On the other hand, if the writers mentioned a specific risk and a specific measure to counteract a specific risk, then there would be plenty of opportunity for the reader to consider and debate with her or himself the appropriateness of the proposed measure and maybe the reader would come to the subjective conclusion that he or she actually thinks that the company shows bad (or good) judgement by considering that particular measure appropriate. In Hyland's words (2005, p. 37), the reader would be invited to share the writers' viewpoint and the two parties would thus interact with each other.

### 2.3.9 Engagement markers

Hyland (2005) notes that “because affective devices can also have relational implications attitude and engagement markers are often difficult to distinguish in practice”, but engagement markers are devices which address the reader, such as imperatives, second person pronouns and inclusive first person pronouns in plural. I have taken the use of e.g. *we* and *our* to be inclusive, and consequently analysed them as engagement markers, when reference was to ownership, since the shareholders are naturally among the owners of the company.

The verbs in Appendix I only qualified in the imperative except for obligation modal verbs. In relation to the latter, distinguishing between a writer’s subjective opinion about necessity and cases of objective necessity may of course be a subject of many philosophical ponderings, but I chose to analyse obligation under laws and rules as propositional – even though some people would probably point out that you do not *have to* follow the law – and all other cases as metadiscourse.

### 2.3.10 Self mentions

Since one of the genres analysed is known as “letter to *shareholders*” and since the primary members of the target audience are the shareholders, cf. section 3.1.2, I have taken the use of *we* and *our* to be inclusive, and consequently analysed them as engagement markers, when reference was to ownership, since the shareholders are naturally among the owners of the company. When reference was to strategy, however, the uses of *we* and *our* were analysed as instances of self mention. Sometimes the distinction was not easy to make, something which can be illustrated e.g. by my decision to regard “our” buildings and factories etc as having to do with ownership and “our” resources and products as being primarily related to the management of the business.

### 2.3.11 Potential metadiscourse items

Another issue was whether or not Hyland’s list of possible metadiscourse items was suitable for this study or whether some items should be removed or added. Particularly concerning the category of attitude markers. In my view, it is quite striking that items which communicate feelings of happiness or regret are not included in Hyland’s (2005) Appendix (p. 218-224). It seems to me that perhaps the Appendix was made with studies of academic language in mind, since it does not include some attitude markers which are quite likely to appear in e.g. annual report narratives, such as *delighted*, *encouraging*, *happy* and *unhappy*. It does include items which express similar feelings only in a more moderate or downplayed way, e.g. *disappointed*, *fortunate* and *unfortunate*. I feel tempted to speculate that the reason for this may have

something to do with the fact that the study Hyland uses “to illustrate the model and show how these resources are used to facilitate effective, community-specific interactions” is an academic study from 2004; just one year before the book that contains the Appendix was published. Further, his 1998 study of metadiscourse in CEOs’ letters and directors’ reports, he includes “pleasure” as a potential attitude marker (1998, p. 20), which is not part of the Appendix to his 2005 book. He also provides an example from a CEO’s letter in which the attitude marker “glad” is used (1998, p. 21). For these reasons, I have added a number of items (the ones in italics in Appendix I to this thesis) to Hyland’s (2005) list of attitude markers and I have also added items in the other categories. The items I have added appear in italics in the English list. I have gone for a semantically exhaustive collection of items in each language and the number of items in each language therefore varies.

These items were entered into the search function of Microsoft Word. This way, each item could be identified in the corpus texts and, by looking at the item in its co-text, I was able to determine whether its function was metadiscoursal.

### **2.3.12 Preparation of the corpus**

The text analysed for metadiscourse was what might be described as “running text”. Thus, all graphs, headers, footers, page numbers and pieces of text describing images were deleted from the corpus texts before the analysis was carried out. In addition, many other types of figures and tables were also deleted. Much of the text in a 2012 annual report of a multinational corporation quoted on the LSE’s FTSE 100 or NASDAQ OMX Nordic Copenhagen C20 indices is not organised into simple sentences, paragraphs and chapters like, for instance, a novel. Instead, much of the information appears in bullet point lists or in tables showing how the individual pieces of information interrelate. This means that decisions concerning which tables to exclude and which to include in this study was not as straightforward as it might be in connection with analyses of other genres. In general, however, bullet point lists and tables consisting of running text were included in the study, while tables consisting of figures or very few words, e.g. names or concepts, were excluded. In addition to the financial tables, schematics illustrating corporate strategies and approaches to risk management were therefore consistently excluded as were the boards’ activities during the year and financial calendars. The running text describing how the companies approach risks is often laid out in a table-like fashion, but this text is included in the analysis, however.

Tables found at the beginning of the chapters in some of the reports (BAE Systems and Whitbread) showing the chapters’ contents were also excluded. Including them would not have provided a fair basis for comparison with the “letter to shareholders” genre-texts, since these letters do not include such tables.



The appendices to BAE System's (pp. 101-103 and 107-113), Tesco's (pp. 74-75 and 80-86) and Whitbread's (p. 43 after the date and signature of the chairman of the remuneration committee and p. 44) remuneration reports consisted primarily of tables and were therefore excluded in their entirety.

The exclusion of the elements mentioned above of course influenced the word count of the texts analysed. Word count is important in this context, because the amount of metadiscourse is usually indicated in this study as the number of items per 100 words. Thus, the deletion of graphs etc. makes the word count lower, which makes the instances of metadiscourse more frequent, because the deleted elements contain little if any metadiscourse.

### 3 Analysis of the Management's Review and the Directors' Report

#### **3.1 Step three: Refining the situational/contextual analysis**

In this section I will describe my considerations concerning Bhatia's recommendations for carrying out this step as described in section 2.2.1. I have chosen to deal with English and Danish letters, directors' reports and management's reviews in the same sections, since there is a great deal of overlap as to the target audiences of all these texts and I will also discuss the contextual differences I have been able to identify in the same sections too. Thus, section 3.1.1 to 3.1.3 define "the speaker/writer of the text, the audience, their relationship and their goals"; section 3.1.4 defines "the historical, socio-cultural, philosophic and/or occupational placement of the community in which the discourse takes place"; section 3.1.5 identifies "the network of surrounding texts and linguistic traditions that form the background to this particular genre text"; and section 3.1.6 identifies "the topic/subject/extra-textual reality which the text is trying to represent, change or use and the relationship of the text to that reality" (Bhatia, 1993, p. 23)

##### **3.1.1. The speaker/writer of the text**

Pursuant to section 8 (1) of the Danish Financial Statements Act, it is *ledelsen*, i.e. the management of the company, which must prepare the annual report. This means that the management, at least formally, is the "speaker/writer of the text" since the management's review is part of the annual report. Section 8 (1) instructs its reader to see "bilag 1 A, nr. 5," which gives the definition of a Danish management:

Medlemmerne af de ansvarlige ledelsesorganer, som varetager henholdsvis den øverste ledelse og den daglige ledelse efter de love, vedtægter, aftaler eller sædvaner, der gælder for virksomheden. I virksomheder, der har et tilsynsorgan eller et tilsynsråd, er tilsynsorganet eller tilsynsrådet omfattet af de bestemmelser, som gælder for det øverste ledelsesorgan. Er der ikke et særskilt ledelsesorgan i virksomheden anses de personligt ansvarlige ejere i fællesskab for at udgøre det ansvarlige ledelsesorgan. (KPMG, 2011, p. 698)

My translation: The members of the responsible bodies of governance which are responsible for the top-level governance and day-to-day management, respectively, in accordance with those laws, by-laws, agreements or traditions which apply to the company.

Under section 111 (1) of *Selskabsloven*, i.e. The Danish Companies Act, the management of a public limited company, a Danish “*kapitalselskab*”, must choose one of two models of management. Table 3.1 describes the two models of management according to that act.

Table 3.1: The two management models of a Danish public limited company under the Danish Companies Act section 111 (1)	
Option 1	Option 2
<p>If a company chooses the first option, the management must consist of a non-executive board (<i>bestyrelse</i>), who are responsible for the senior and strategic management. The non-executive board must appoint an executive board which is responsible for the day-to-day management of the company and which may either consist of members of the non-executive board or of other persons. The majority of the members of the non-executive board must be persons who are not also be members of the executive board. The managing director must not also be the chairperson or vice-chairperson of the non-executive board.</p> <p>According to a statement from (the former) Erhvervs- og Selskabsstyrelsen (2011), the management is not allowed to make decisions of an unusual nature and must follow the directions of the non-executive board. The same source goes on to say that this model is known as the one-tiered model, since it makes it possible for members of the non-executive board to also be on the executive board.</p>	<p>The second option states that the company is managed by the executive board, which must be appointed by a supervisory board. Members of the executive board may not be part of the supervisory board.</p>

In contrast to this, English companies are managed by a single (one-tier) board – the Corporate Governance Code only mentions “the board” – and while section 154 (1) of the Companies Act 2006 states that public companies must have at least two directors and that at least one of them must be a natural person (section 155 (1)), UK Companies are only bound by the “comply or explain principle” and “not a rigid set of rules” as regards the structure and division of responsibilities among their directors (Financial Reporting Council, 2012, p. 4). According to provision A.2.1 of the Code, “the roles of chairman and chief executive should not be exercised by the same individual” and according to A.3.1 he should also be independent and therefore, among other principles, not be a former chief executive or employee at the company or have had a “material business relationship” with the company either directly or indirectly cf. B.1.1 of the Code. The Code goes on to say that a board should be “an appropriate combination of executive and non-executive directors (and, in particular, independent non-executive directors) such that no individual or small group of individuals can dominate the board’s decision taking” and the annual report should identify the independent non-executive directors (p. 11). The non-executive directors’ duties are to decide the executive directors’ remuneration and “scrutinise” their performance to determine whether or not it is satisfactory (p. 10), which is similar to the role of non-executive directors of Danish companies.

specialist informants interviewed by de Groot (2008) reveal, however, that in reality the drafting of an UK annual report is usually assigned to a staff and a “project manager or coordinator-writer” who “orchestrates all activities” (p. 81) and is usually employed at the communications or investor relations department” (p. 82). The activities involve “collecting information, drafting texts, selecting visual materials and cooperating with external agencies” (p. 82). The chairman usually delivers “the introductory statement of the annual report” and plays a role in the collection of information along with divisional directors, members of the communication department and the chief financial officer (p. 82). The executive directors must approve the reports’ multimodal design and may ask for some changes to be made before they approve its final version.

Based on the responses of the specialist informants, de Groot also notes that the annual report production process in English and Dutch corporations follows a very similar procedure in which the

In conclusion, this section has shown that, officially, the senders of directors’ reports and management’s reviews are the different types of boards that govern the companies. In Denmark, the people among these boards are required to spread responsibility and authority/decision-making by having two separate boards, although one option allows for some board members to be on both boards. In the UK, the Corporate Governance Code only recommends that responsibility and decision-making be divided among board members, but if it is not, the company must explain the reasons for this in its annual report. Unofficially, UK

directors (and Dutch) receive some help from communication experts when preparing the annual report and it is possible that the same is the case for many of the members of Danish boards too although I have not been able to find any sources to back up this conjecture.

### 3.1.2 The audience

Mourier (2009) notes that the UK annual report “formally (...) is for shareholders only” and section 423 of the Companies Act 2006 also ensures this group a prominent position among the possible readers of annual reports, since it states that directors must send copies of the report to the company’s shareholders.

In section 12 (2) of the Danish Financial Statements Act (ÅRL), the parties whom the Danish annual report is required to assist in their decision-making are laid down, and this section also reveals part of the communicative purpose of the annual report:

Årsrapporten skal udarbejdes således, at den støtter regnskabsbrugerne i deres økonomiske beslutninger. De omhandlede regnskabsbrugere er personer, virksomheder, organisationer og offentlige myndigheder m.v., hvis økonomiske beslutninger normalt må forventes at blive påvirket af en årsrapport, herunder nuværende og mulige virksomhedsdeltagere, kreditorer, medarbejdere, kunder, alliancepartnere, lokalsamfundet samt tilskudsgivende og fiskale myndigheder.

My translation:

The annual report shall be prepared so that it assists the financial statement users in making financial decisions. The mentioned financial statement users shall be understood to be the persons, companies, organisations, public authorities and others whose financial decisions can be expected to be influenced by an annual report including current and potential shareholders, creditors, employees, clients, alliance partners, municipalities and fiscal authorities.

Although the term “financial statement user” might give the impression that it refers only to those who use the financial statements, Nielsen et al., 2004 states that it is often taken as meaning “the stakeholders of the company in the widest sense” (my translation) (Nielsen et al., 2004, p. 303). This obviously indicates that the intended audience of the annual report is often quite heterogeneous. PwC & CBS (2011, p. 14) corroborates this view and also shows that Danish companies favour certain stakeholders over others when preparing their reports. In the PwC & CBS study, the annual reports’ target audience was divided into 11 different groups, and the 87 listed companies which participated in the study were then asked to rate each group according to how important they thought each group was on a scale from one to five. The top scorers turned out to be professional investors (3.95), share analysts (3.83) and private investors (3.64):

Table 3.2 Danish companies’ perceived target audience	
Target audience	Average score

Professional investors	3.95
Analysts	3.83
Private investors	3.64
Banks and credit institutions	3.50
Employees	3.14
Customers	3.14
Journalists	3.11
Suppliers	2.73
Public authorities	2.67
Interest groups (NGOs)	2.43
Trade unions	1.78

De Groot's (2008) interviews with Dutch and English specialist informants "yielded seven recurrent sub-groups", which are very similar to the ones PwC & CBS (2011) suggest for the Danish report:

- (prospective) institutional and private investors;
- financial analysts and stock brokers;
- (financial) media;
- (prospective) clients and suppliers;
- social interest groups/non-governmental organisations (NGOs);
- (regulatory) authorities;
- (prospective) employees and managers" (p. 69).

Both English and Danish annual reports thus have a heterogeneous readership although the shareholders are formally the intended audience in the case of the English report.

### **3.1.3 The relationship and goals of sender and audience**

The same informants also revealed that they were aware of the different communicative needs of these financial and non-financial readers and therefore used different communication strategies to make the annual reports relevant to all of them (p. 69). This related to themes, amount of information provided, vocabulary, tone of voice and text structure" (p. 69); information on shares were included for the sake of (potential) investors and sustainability for the sake of NGOs.

From an investor relations point of view, Stittle makes the observation that many of the intended readers of the annual report are actually not required to read the annual report and that much of its content will be quite difficult to understand for most laypersons. This leads him to state that companies should make an effort to make the annual report as interesting and manageable a read as possible and try to “foster a relationship between company and reader”.

From a more formal perspective, the requirements laid down in section 12 (2) of the Danish Financial Statements Act mentions that, like its audience, the decisions which the annual report must assist its users in making are also of a heterogeneous nature:

De omhandlede beslutninger vedrører

- 1) placering af regnskabsbrugerens egne ressourcer,
- 2) ledelsens forvaltning af virksomhedens ressourcer og
- 3) fordeling af virksomhedens ressourcer.

My translation:

The decisions in question relate to

- 1) investment of the financial statement user's own resources
- 2) the management's administration of the company's resources
- 3) allocation of the company's resources

So while the formal goals have little to do with entertainment – the above-mentioned decisions are definitely serious business – Stittle (2003) points out that an important goal of the writers' is to make the annual report an interesting read and a public relations document (p. 5) – presumably so that as many as possible of “the financial statement users' own resources” may be invested in the company.

### **3.1.4 The historical, socio-cultural, philosophic and/or occupational placement of the community in which the discourse takes place**

This part of the analysis has to do with the concept of the discourse community, which I mentioned in section 3.1.2. I will argue that the discourse community that makes use of the introductory letter to shareholders and the management's review consists of the company and its stakeholders. In the following paragraphs I will present my argument for this conclusion.

The annual reports analysed in this study are prepared by public limited companies and Valdez and Molineux (2010, p. 185) note that “the first modern shareholding enterprise” was a group of explorers who invested £25 each and set out to find a trade route to China and the Orient in 1553. This led to trade between England and Russia and since the shares were held jointly, they were ‘joint stock companies’ (Valdez and Molineux, 2010, p. 185).

Molineux and Valdez (2010) do not describe how communications between these shareholders took place in the very early days, but one of the genres they make use of today is obviously the annual report. The discourse community of company stakeholders thus meets number four of Swales’ six characteristics as presented in section 3.1.2. To meet Swales’ criterion number two that the would-be discourse community has methods of intercommunication and are not to be categorised as similar to “lighthouse keepers on their lonely rocks”, I believe that the Annual General Meeting is one of the things that makes the plc qualify in this respect. In addition, one would be hard-pressed to find a public limited company which does not have its own internet home page, and quoted companies obviously have the stock exchange to help them communicate and trade with investors too. This discourse community also makes use of specialised vocabulary (characteristic number five), since e.g. accounting terminology is arguably quite different from everyday language, and its foremost public goal (number one) is to do business and prosper financially. Swales’ characteristic number six stated that there is a “threshold level of members with a suitable degree of relevant content and discursal expertise”. I believe that a community of stakeholders actually have different types members which are experts in their own area. The accountants/auditors, for instance, are experts in accounting, the directors are experts in management, and at least some the company’s investors are probably quite expert in the area of investing while others are probably not.

### **3.1.5 The network of surrounding texts and linguistic traditions that form the background to the annual report**

Mourier (2009) notes that economic and financial texts are produced in various styles of language, and she points out that while many genres are written in formal and conventional language, others are written in economic or financial jargon “such as share analyses that are written by and for specialists using insider language (p. 7). She also notes that “e.g. texts from Børsen, the Economist, the Financial Times the Wall St Journal etc” are written in economic or financial journalese.

Other genres which relate to the annual reports of quoted companies are stock exchange announcements. The Danish Securities Trading Act section 27 thus states that all issuers of securities which are sold on a stock exchange in Denmark or other EU countries must disclose “internal knowledge” as quickly as possible

if it is likely that it will have any influence on the price of the company's securities. This means that much of the information contained in the annual report will be made public before the annual report itself; Stittle (2003) for example notes that "companies listed on the London Stock Exchange will have normally already released their profit figures to the stock exchange many months earlier in the form of a "preliminary announcement"" (p. 4). He goes on to point out, however, that the annual report does include a lot of information that preliminary announcements do not supply (p. 4).

The types of announcement a quoted company is required to make depends on which market its shares are sold (londonstockexchange.com). Thus, companies quoted on the London Stock Exchange's Main Market are required to make announcements concerning events that companies quoted on the Alternative Investment Market are not required to announce.

### **3.1.6 The topic/subject/extra-textual reality which the text is trying to represent, change or use and the relationship of the text to that reality**

The topic of the letter, directors' report and management's review which are analysed in this study is primarily the past and future development of the company's business and its financial position (European Council, 1978, article 46). The corporate governance section also provides information which enables the readers to determine whether the company is run in a competent manner (Financial Reporting Council, 2012).

As mentioned, the above-mentioned texts are both informative and persuasive in that they must comply with legislation and is also used as an investor relations tool.

## **3.2 Step 4: Selecting corpus**

The appendix includes corpus texts from four annual reports prepared by Danish companies and four prepared by English companies. In the following paragraphs, I will describe how these texts were selected, using Bhatia's recommendations (described in section 2.2.2) as the basis for my considerations.

define the genre/sub-genre that one is working with well enough so that it may be distinguishable from other genres either similar or closely related in some ways. The definition may be based on the communicative purposes, the situational context(s) in which it is generally used, and some distinctive textual characteristics of the genre- text or some combination of these;

make sure that one's criteria for deciding whether a text belongs to a specific genre/variety are clearly stated;

### **The annual report**



The annual reports of quoted Danish and English companies are quite well-defined genres, which share the communicative purpose of financial reporting. They are also used in similar discourse communities, i.e. that of a public limited company and, first and foremost, its shareholders, but, as we saw in section 3.1.2, other stakeholders and potential investors could also be seen as part of the discourse community.

The Danish annual reports were selected randomly by numbering all the companies on the Nasdaq OMX Nordic C20 index and using the random number generator on random.org to select four companies. Similarly, the English annual reports were also selected randomly by numbering all the English-based companies on the London Stock Exchange's FTSE 100 index and using the same number generator to select four companies. The annual reports published by these eight companies in 2012 constitute the corpus for this study. Annual reports prepared by financial services companies were ineligible, since this type of company does not report financially under the Danish Financial Statements Act (ÅRL) section 1 (3) and the Danish Financial Business Act (FIL) section 5 (1). In addition, only English-based companies on the FTSE 100 index were eligible. The Danish corpus texts were the ones prepared by Mærsk, Chr. Hansen, Pandora and Novozymes while the English corpus texts were the annual reports of Vedanta Resources, BAE Systems, Whitbread and Tesco.

### **Introductory letter to shareholders**

Garzone (2004) shows that some differences exist between the shareholders letters which exhibit at least one of three features, i.e. "the letter denomination, the presence of the salutation or the direct address, the close" (p. 181), the close meaning ""Sincerely", "best regards", etc. preceding the signature" (p. 182) and those letters which do not include any of these features. Based on two sub-corpora of 68 letters that included at least one feature (A) and 32 letters which included none of them (B – she also refers to these as CEOs' Messages), she notes that the two types of letter are similar in that

all of them are imbedded in the Annual Company Report and play the same, openly declared role: synthesizing its contents, highlighting the salient developments and providing some general indications to help readers identify the main trends in the company's performance (p. 183).

She then sets out to discuss the results of her analyses of the two corpora in order to determine whether or not it is legitimate to refer to letters without any of the three features as "Letters" (p. 182). Her findings showed that the frequency for first-person singular pronouns was about the same for A and B but that *you* (0.11 % vs. 0.04 %) and *your/yours* (0.08 % vs. 0.04 %) were more frequently used in A. Overall the results showed significantly greater discrepancy when comparing the letter corpus (A and B) with complete annual reports and combined with the findings of her analyses of elements relating to narration, evaluation and

authorial stance, she concludes that “the relation between author and recipient, either implicit or made explicit by means of specific linguistic features, is absolutely central in CEO’s messages, thus confirming their belonging to the Letter genre” (p. 193).

I will follow Garzone in this view and I have therefore included texts without any of the three features in my introductory letter to shareholders corpus. Garzone (2004) includes texts in her “CEOs letter corpus” when the sender is not the CEO but the chairman (p. 182), and I have not differentiated between letters from CEOs and chairpersons either.

I did, however, exclude a letter by Ane Mærsk Mc-Kinney Uggla in the Maersk report, although it was found in the beginning of the annual report and although Ane Mærsk Mc-Kinney Uggla is a board member at A.P. Møller-Mærsk A/S. I did not find that it was representative of introductory letters since it was not written by a chairman or CEO and since it was a description of the professional life of the late Mærsk Mc-Kinney Møller and not of matters related to the company’s performance, which – as the quote from Garzone above points out – is usually the case for shareholders letters.

The corporate governance sections of the English reports also contained letters by the chairmen of the boards and committees, but I included these in the directors’ report corpus, since they were not introductions to the entire report and since they did not play the same role as that mentioned by Garzone (2005) above, i.e. synthesizing the report’s contents and so on.

### **The directors report and the management’s review**

Since I wanted to compare the introductory letter to shareholders to the (rest of) the directors’ report or management’s review, I find it important address an important difference between the directors’ report and the management’s review with regard to their contents, namely the part where the management/the directors assume responsibility for the annual report.

Under EU directive 2004/109/EC article 4 (2)c, the annual reports of all companies listed in EU countries must contain a statement that the management / the directors assume responsibility as to the “true and fair view” provided by the financial statements and the fairness of the accompanying review. In Denmark, listed companies must therefore include a *ledelsespåtegning* (a statement by the management on the annual report) and English companies must include a statement of directors’ responsibilities. While the Danish Financial Statements Act (sections 9, 78 (1), 102 (1)) clearly separates this from the management’s review, the Companies Act 2006 (section 418) and the Disclosure and Transparency Rules 4.1.12 (FCA, 2013) treat the statement of the directors’ responsibilities as part of the directors’ report. For the sake of

comparability and since these texts seem to have a quite similar and standard wording leaving little room for writer creativity, I have chosen to exclude all statements by the managements on the annual reports and statements of directors' responsibilities in the corpus.

decide on one's criteria for an adequate selection of the corpus for one's specific purpose(s) – a long single typical text for detailed analysis, a few randomly chosen texts for exploratory investigation, a large statistical sample to investigate a few specified features through easily identified indicators (Bhatia, 1993, pp. 23-24).

I have chosen to analyse text from four Danish reports and four British reports. I found this sample to be adequate given the fact that this is a MA thesis. I also found it desirable to be able to include the analysed texts in Appendix II, and, in my opinion, the appendix would have become too large if a larger corpus had been selected. In addition, Hyland (1998a) has already provided a larger sample of English CEOs letters and directors' reports with which I can compare the findings of the present study.

### **3.3 Step 5: Studying the institutional context**

While, as Bhatia (1993) notes, it is often the case that the writers of many genres follow the rules and norms for composing texts unconsciously (p. 24), we have already seen in section 3.1.1 that at least the English directors receive help from communication specialists who are quite conscious about how to compose an annual report so that both informative and persuasive goals are met.

Concerning language use it is to be expected that the style of language is also quite formal, since the aims of the annual report are first to comply with legal requirements and, second, to woo investors into buying more shares.

Since the annual report is required by law and must live up to formal requirements, it is a reasonable assumption that the style of language is quite formal too. According to de Groot's specialist informants, however, the level of formality often varies in the English annual report: "While the non-financial texts are usually written in informal 'tabloid' English, the financial and technical texts are generally drawn up in fairly formal 'Queen's' English" (2008, p. 78), and de Groot specifically mentions the annual review as an example of one of the informal texts (p. 78). The informants explained that this variation in style was one reason and justification for only publishing annual reports in English; foreign readers were expected to be able to understand at least the informal texts (p. 77-78).

Stittle (2003) provides an interesting view as to how the nature of the company might influence the language in its annual report. His advice for companies is that they project a particular type of image of themselves throughout the report, a suitable "corporate message":

You may wish to give the impression that you are a fresh, innovative and leading company in your sphere of operations. (...) Alternatively, you may be an investment or asset management company or perhaps a banking company, and choose to portray a totally different image. You may wish to appear extremely safe, sound, reliable and, perhaps, slightly risk-adverse. Your aim might be based on projecting a message of integrity, safety and absolute customer confidence. In this case, you will not necessarily wish to use an avant-garde presentation with a “non-conventional” or “over-artistic” user of colour and presentation. In contrast an advertising agency might choose to highlight originality, wittiness, new ideas and an ultra-modern approach. A food manufacturing company might wish to emphasize its key products and concentrate on highlighting quality, innovation and high levels of customer satisfaction. A service or computing software company might wish to place emphasis on service standards or the continuous development and application of software packages. A healthcare company might want to stress a caring and concerned image in its presentation and content (2003. pp. 8-9).

### **3.4 Step 6: Analysis of interactional metadiscourse in the annual reports**

The findings of my analysis of the interactional metadiscourse in the different sections of the English reports can be seen in table 3.3, and the interactional metadiscourse found in the Danish reports can be seen in table 3.4 The figures indicate the number of interactional metadiscourse markers found per 100 words in the corpus.

Table 3.3: Interactional metadiscourse in English annual reports per 100 words				
	Introductory letter to shareholders (13022 words)	% of total	Directors' reports (147800 words)	% of total
Hedges	(55/13022x100=) <b>0.42236</b>	6.532	(320/147800x100=) <b>0.21651</b>	8.813
Boosters	(34/13022x100=) <b>0.26110</b>	4.038	(565/147800x100=) <b>0.38227</b>	15.560
Attitude markers	(157/13022x100=) <b>1.20565</b>	18.646	(123/147800x100=) <b>0.08322</b>	3.388
Engagement markers	(57/13022x100=) <b>0.43772</b>	6.770	(629/147800x100=) <b>0.42558</b>	17.323
Self mentions	(539/13022x100=) <b>4.13915</b>	64.014	(1994/147800x100=) <b>1.34912</b>	54.916
Total	(842/13022x100=) <b>6.46598</b>	100.000	(3631/147800x100=) <b>2.4567</b>	100.000
Total excluding self mentions	(303/13022x100=) <b>2.32683</b>	35.986	(1637/147800x100=) <b>1.10758</b>	45.084

Table 3.4: Interactional metadiscourse in Danish annual reports per 100 words				
	Introductory letter to shareholders (4605 words)	% of total	Management's review (57000 words)	% of total
Hedges	(20/4605x100=) <b>0.43431</b>	8.439	(311/57000x100=) <b>0.54561</b>	27.138
Boosters	(11/4605x100=) <b>0.23887</b>	4.641	(31/57000x100=) <b>0.05439</b>	2.271
Attitude markers	(23/4605x100=) <b>0.49946</b>	9.705	(105/57000x100=) <b>0.18421</b>	9.162
Engagement markers	(12/4605x100=) <b>0.26059</b>	5.063	(47/57000x100=) <b>0.08246</b>	4.101
Self mentions	(171/4605x100=) <b>3.71336</b>	72.722	(652/57000x100=) <b>1.14386</b>	56.894
Total	(237/4605x100=) <b>5.14658</b>	100.000	(1146/57000x100=) <b>2.01053</b>	100.000
Total excluding self mentions	(66/4605x100=) <b>1.43322</b>	27.848	(494/57000x100=) <b>0.86667</b>	43.106

As table the two tables show, there is significantly more interactive metadiscourse in the letters than in the directors' reports and managements' reviews. There is also more interactional metadiscourse in the English texts than in the Danish.

The differences in the frequency of interactional metadiscourse for the English and Danish texts could be due to the English companies generally being more resourceful financially and therefore communicatively. Or perhaps it has to do with differences in national culture, which Sørensen (2007) suggests is the case for Danish and American CEOs' letters.

One of the more surprising findings is that there was a higher frequency of boosters in the directors' reports than in the English shareholders letters. One explanation for this could be that the companies have not delivered the results they had hoped and that, as Hyland (2005, p. 79) suggests, the chairmen and CEOs of these companies do not wish to take an overly positive and optimistic tone in years of bad performance, cf. section 2.3.3. Tesco's chairman does put a lot of emphasis on the fact that it has been a year of

transition and states that “The challenge of refocusing the UK business to ensure it sustains healthy market leadership is important enough to make it worth giving up some profit in the short term to safeguard the business in the long term” before going on to describing profit growth as “modest” which is echoed by the CEO. The other three companies reported good results, so there could be other reasons for the relatively low frequency of boosters in the letters. One of these reasons could be the space allotted to the very large number of attitude markers found in the English letters, which was 14.5 times as high as for the directors’ reports.

For the Danish reports, a slight surprise was the higher frequency of hedges in the managements’ reviews compared to the letters. The difference was not great however, since there were only 1.26 as many hedges per 100 words in the reviews. By comparison there was still 2.5 times as much interactional metadiscourse in the Danish letters than in the reviews, or 1.64 times as much if one does not include self mentions.

The findings of my analysis corresponds well with the findings of Hyland (1998a), which also indicated a higher frequency of interactional metadiscourse in CEOs letters than in directors’ reports – to be sure back then he called it interpersonal metadiscourse, but 4 out of 5 categories remain effectively the same. My analysis does show a considerably higher frequency of interactional metadiscourse than Hyland (1998a), however, and this can at least partially be explained by my decision to include attitude markers which did not modify entire propositions. Thus, Hyland (1998a) counted 0.10 attitude markers in his CEOs letters and only 0.01 per 100 words in his corpus of directors’ reports while I found 1.20565 in the letters and 0.08322 in the directors’ reports. Another explanation might be that my corpus included the letters of FTSE 100 companies, which presumably have access to top-level resources and experts who can assist them in composing persuasive texts. By comparison, Hyland’s corpus included reports published in 1992-1994 by companies of different sizes of which “almost all” were quoted on the Hong Kong Stock Exchange (p.4). Table 3.5 shows Hyland’s (1998a) findings. His study used a previous metadiscourse model shown in section 2.3.1 and I have included the corresponding names of Hyland’s 2005 model in parentheses when these are different, except for “attributors”, which is not interactional metadiscourse in Hyland’s newer model. Another difference is that the older model does not include self mentions.

Table 3.5: Hyland’s (1998a) findings		
	CEOs’ letters per 100 words	Directors’ reports per 100 words
Hedges	0.46	0.11
Emphatics (=boosters)	0.13	0.00

Attitude markers	0.10	0.01
Relational markers (=engagement markers)	0.09	0.00
Attributors (not counted in my analysis)	0.01	0.00
Interpersonal metadiscourse	0.77	0.13

## 4 Conclusion

This study has investigated the context of and the interactional metadiscourse in the English and Danish annual report with special focus on the shareholders letter, the directors' report and the management's review. The analysis has shown that there are minor differences in context, i.e. the senders of the report are business leaders who organise themselves slightly different, since there is only one board in English companies while Danish companies can choose a two-tier model. The Danish company may however also choose a one-tier model which can make for a management which is quite similar to an English board of directors if all the executive directors are on the non-executive board of the Danish company as well.

The contextual part of the genre analysis further revealed that the at least the English executive and non-executive directors receive help from communication specialists in the preparation of the annual report. While the business leaders must approve the report, the project manager/communications expert is responsible for early decisions regarding its contents and layout.

The readership of the annual report is heterogeneous and communication experts are well-aware that the sections of the annual report which allows for non-specialised language need to be written with less expert readers in mind. The level of interest the annual report incites in readers – who are under no obligation to read it – is important to consider when preparing the annual report. This part of the analysis also revealed a difference regarding the formal requirements, since these take the intended readers of the English report to be shareholders, while the Danish financial Statements Act states that the intended audience also includes various other stakeholders.

The analysis of interactional metadiscourse in the corpus texts indicated that the shareholders letter of both the English and the Danish annual report is indeed a more persuasive element than the directors' report and the management's review since it conveys more ethos and pathos. When combined with the findings in the other steps of the genre model, it is clear that interactional metadiscourse is an important element in the sections of the annual report which allow for its presence. Interactional metadiscourse has the ability to engage the reader on a personal level and to appeal to his or her emotions. It must therefore be considered a critical element in the annual report meeting the persuasive aspect of its communicative purpose.



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## Appendix I: Metadiscourse items (source: Hyland, 2005)

### Interactional metadiscourse

#### Danish attitude markers

! 0 (-part of booklet's title)	ganske vist 0	enig 0
enige 0	forbløffet 0	forbløffede 0
forbløffende 0	<b>passende:</b> letters 0, <b>reviews 2</b> (-unspecific reference)	<b>hensigtsmæssig:</b> letters 0, <b>reviews 1</b> (+all)
velvalgt 0	forbavset 0	forbavsede 0
forbavsende 0	retmæssigt 0	besynderlig 0
besynderligt 0	ønskværdig 0	<b>ønskværdigt:</b> letters 0, <b>reviews 1</b> (+all)
skuffet 0	<b>skuffede:</b> letters 0, <b>reviews 1</b> (+all)	skuffende 0
uenig 0	uenige 0	utilfredsstillende 0
utilfreds 0	utilfredse 0	begejstret 0
dramatisk 0	dramatiske 0	essentiel 0
<b>essentielle:</b> letters 0, <b>reviews 1</b> (+all)	essentielt 0	selv x 0 (-interactive metadiscourse i.e. "although"=transition marker, – "themselves")
<b>forventet:</b> letters 1, <b>reviews 2</b> (+ past reference, -future reference)	<b>forventede:</b> letters 0, <b>reviews 2</b> (+past reference, - future reference)	heldig 0
<b>heldigvis:</b> letters 1, reviews 0 (+all)	forhåbentlig 0	håbefuld 0
håbefulde 0	<b>vigtig:</b> letters 4, <b>reviews 5</b> (+all)	<b>vigtigt:</b> letters 4, <b>reviews 17</b> (+all)
upassende 0	<b>interessant</b> letters: 0, <b>reviews: 1</b> (+all)	foretrække 0
foretrak 0	foretrækker 0	foretrukket 0 (-others preferring something)
bemærkelsesværdig 0	bemærkelsesværdigt 0	chokeret 0
chokerende 0	chokerede 0	slående 0
iøjnefaldende 0	overrasket 0	overraskede 0
overraskende 0	utrolig 0	utroligt 0
forståelig 0	forståeligt 0	forståelige 0
<b>uventet</b> letters 0, <b>reviews 1</b> (+all)	uventede 0 (-hypothetical unexpected things)	uheldig 0
uheldige 0	usædvanlig 0	usædvanlige 0
usædvanligt 0	sædvanlig 0	<b>sædvanlige:</b> letters 0, <b>reviews 1</b> (+all)
<i>anerkende 0</i>	<i>anerkendelse 0</i>	<b>anerkender:</b> letters 0, <b>reviews</b>

		<b>1 (+all)</b>
<b>tilfredsstillende: letters 1, reviews 6</b>	<i>vigtigst 0</i>	<b>vigtigste: letters 2, reviews 7</b> (-unspecific reference)
<b>vigtigere: letters 1, reviews 0</b> (+all)	<i>glade 0</i>	<i>glad 0</i>
<b>ønsker: letters 0, reviews 15</b> (+company wishes, -others' wishes)	<b>ønske: letters 0, reviews 1</b> (+company wishes, -others' wishes)	<i>glæde 0</i>
<i>glæder 0</i>	<i>stolt 0</i>	<i>stolte 0</i>
<i>stolthed 0</i>	<i>indrømme 0</i>	<i>dejlig 0</i>
<i>ydmyg 0</i>	<b>klart: letters 0, reviews 4</b> (+easily seen or understood (as opposed to epistemic function))	<b>klar: letters 2, reviews 4</b> (-boosters)
<b>klarere: letters 1, reviews 3</b> (+all)	<b>anser: letters 1, reviews 2</b> (-boosters, -adjective counted as the attitude marker)	<b>anse: letters 1, reviews 0</b> (+all)
<b>prioriterer: letters 0, reviews 1</b>	<i>fremragende 0</i>	<b>god: letters 0, reviews 8</b>
<b>tragisk: letters 0, reviews 2</b>	<b>tragiske: letters 0, reviews 1</b>	<b>værdifuld: letters 0, reviews 1</b>
<b>værdifulde: letters 0, reviews 2</b>	<i>værdifuldt 0</i> (-unspecific reference)	<i>sorg 0</i>
<i>ærgre 0</i>	<i>tilfreds 0</i>	<i>tilfredse 0</i> (-goal to have satisfied employees)
<i>ængerligt 0</i>	<i>kritik 0</i>	<i>kritisere 0</i>
<i>ærgrer 0</i>	<i>dejligt 0</i>	<i>lykkelig 0</i>
<i>lykkelige 0</i>	<i>henrykt 0</i>	<i>henrykte 0</i>
<i>glæde 0</i>	<i>glædelig 0</i>	<i>glædeligt 0</i>
<i>dejlig 0</i>	<i>fantastisk 0</i>	<i>fornøjelse 0</i>
<i>fornøjelsen 0</i>	<i>tak 0</i>	<b>takke: letters 1, reviews 0</b> (+all)
<i>takker 0</i>	<i>taknemmelig 0</i>	<i>taknemmelige 0</i>
<i>taknemmelighed 0</i>	<i>imponerende 0</i>	<i>imponeret 0</i>
<i>imponere 0</i>	<i>imponerede 0</i>	<i>opløftende 0</i>
<i>opmuntre 0</i>	<i>opmuntrer 0</i>	<i>opmuntrende 0</i>
<b>spændende: letters 0, reviews 1</b>	<i>spændt 0</i>	<i>spændte 0</i>
<i>optimistisk 0</i>	<i>optimistiske 0</i>	<i>fair 0</i> (-unspecific reference)
<i>unfair 0</i>	<b>besluttet: letters 0, reviews 1</b> (-participles, +adjectives)	<i>besluttede 0</i> (-past tense verb form)
<i>beslutsomhed 0</i>	<i>tro på 0</i>	<b>tror på: letters 1, reviews 0</b> (+all)
<i>velkommen 0</i>	<i>velkomne 0</i>	<b>rimelig: letters 0, reviews 1</b> (-epistemic, + level of satisfaction or fairness, -unspecific reference)

rimeligt 0	urimelig 0	urimeligt 0
<b>rimelige</b> : letters 0, <b>reviews 1</b> (+all)	urimelige 0 (-unspecific reference)	lettet 0
lettede 0	acceptabel 0	acceptabelt 0
acceptable 0	<b>uacceptabelt</b> : letters 0, <b>reviews 1</b> (+all)	uacceptabel 0
uacceptable 0	ros 0	rose 0
<b>lægger vægt på</b> : letters 0, <b>reviews 1</b> (+all)	<b>lægger stor vægt på</b> : letters 0, <b>reviews 3</b> (+all)	<b>desværre</b> : letters 0, <b>reviews 1</b> (+all)
indrømmer 0	fortryder 0	fortrydelse 0
fortryde 0	ulykkelig 0	ulykkeligt 0
ulykkeligvis 0	slående 0	glimrende 0
erkende 0	<b>erkender</b> : letters 0, <b>reviews 2</b> (+all: in the sense of "accepting sth without being too happy about it")	<b>opfattelse</b> : letters 0, <b>reviews 1</b> (-epistemic reference/hedging)
(at kunne) lide 0		

### Danish boosters

<b>faktisk</b> : letters 0, <b>reviews 1</b> (+all)	<b>altid</b> : letters 2, <b>reviews 11</b> (+all)	tror 0 (- attitude markers "tror på")
troede 0	troet 0	uden tvivl 0
bestemt 0 (-"nærmere bestemt"/"more precisely")	ingen tvivl 0	klar 0 (-attitude markers)
klart 0 (-attitude markers)	endeligt 0	afgjort 0
definitiv 0	definitivt 0	<b>viser</b> : letters 2, <b>reviews 2</b> (-"show interest")
<b>viste</b> : letters 0, <b>reviews 2</b> (-fluctuations and figures which can be seen physically on a graph or table, +company's interpretation)	<b>vist</b> : letters 1, reviews 0 (+ "show progress"-show up, -shown in diagram)	utvivlsom 0
fastslå 0 (-"determine whether")	fastslog 0	tydelig 0 (-objectives)
<b>tydeligt</b> : letters 2, reviews 0 (+all)	<i>tydeligvis</i> 0	<b>konstatere</b> : letters 0, <b>reviews 1</b> (+all)
konstaterer 0	konstateret 0	konstaterede 0
uomtvistelig 0	uomtvisteligt 0	uigendrivelig 0
uigendriveligt 0	sandelig 0	indiskutabel 0
indiskutabelt 0	<b>ved</b> : letters 2, <b>reviews 1</b> (+only verbs: present tense of "at vide")	<b>klar over</b> : letters 0, <b>reviews 1</b> (+all)
må ( <i>possibility</i> ) 0 (-necessity, -	<b>aldrig</b> : letters 1, <b>reviews 1</b>	de facto 0

permission)	(+all)	
selvfølgelig 0	selvfølgelige 0	selvsagt 0
bevise 0	bevist 0	beviser 0 (-noun not followed by complement clause)
opdage 0 (-unspecific reference)	opdaget 0	opdagede 0
virkelig 0	lover 0	love 0 (-"laws")
<b>sikker: letters 1</b> , reviews 0 (+certain, -safe, -reliable)	sikkert 0 (-safe)	erkende 0
erkender 0 (-attitude markers)	må 0 (-permission, -obligation)	i sandhed 0
sand 0	unægtelig 0	unægtelig 0
uden diskussion 0	utvivlsomt 0	<b>overbevisning: letters 0, reviews 1</b> (+all)
endelig 0 (-interactive metadiscourse: frame markers)	<b>overbevist om: letters 1, reviews 2</b> (+all)	<b>overbeviste om: letters 0, reviews 2</b> (+all)
anse 0 (-attitude markers)	<b>anser: letters 1, reviews 3</b> (-attitude markers)	<b>sikrede: letters 0, reviews 1</b> (+all)
sikret 0 (-secured loan, -"tries to ensure")	naturligvis 0 (-transition marker, i.e. interactive function, used to counter an argument: "Increased demands may of course...")	<b>sikrer: letters 0, reviews 8</b> (-"sikrer sig" i.e. to buy sth)

### Danish self mention

<b>jeg: letters 2</b> reviews 0 (+all)	<b>vi: letters 78, reviews 212</b> (-inclusive, i.e. things related to financial success)	mig 0	<b>vores: letters 71, reviews 246</b> (-ownership of buildings etc, +"our strategy" and things related to the management of the business)	min 0	<b>os: letters 7, reviews 19</b> (+all, since no inklusive occurrences were found)
<b>ledelsen: letters 0, reviews 9</b> (-management as action,	<b>bestyrelsen: letters 8, reviews 78</b> (-"bestyrelsen og direktionen"	<b>direktionen: letters 0, reviews 22</b> (-"bestyrelsen og	<b>ledelsens: letters 0, reviews 2</b> (-management as action,	<b>bestyrelsens: letters 1, reviews 33</b>	<b>direktionens: letters 0, reviews 9</b>

+management as people)	and "direktionen og bestyrelsen")	direktionen" and "direktionen og bestyrelsen")	+manageme nt as people)		
<b>topledelsen:</b> <b>letters 1,</b> <b>reviews 2</b>	<b>topledelsens:</b> letters 0, <b>reviews 1</b>	<b>bestyrelsen og</b> <b>direktionen:</b> letters 0, <b>reviews 10</b>	<b>bestyrelse</b> <b>og direktion:</b> letters 0, <b>reviews 5</b> (- reference to a section called "bestyrelse og direktion")	<b>direktionen</b> <b>og</b> <b>bestyrelsen:</b> <b>letters 2,</b> <b>reviews 4</b>	<b>mine: letters</b> <b>1,</b> reviews 0 (+all)
mit 0	direktionens og bestyrelsens 0	bestyrelsens og direktionens 0			

### Danish engagement markers

( 0	? : <b>letters 2,</b> reviews 0 (+all)	læseren 0
tilføj 0	tillad 0	analysér 0
benyt 0	arrangér 0	vurdér 0
gå ud fra 0	for resten 0	udregn 0
vælg 0	inddel 0	sammenlign 0
forbind 0	betragt 0	definér 0
demonstrér 0	bestem 0	lad være med at 0
udvikl 0	anvend 0	sørg for 0
bedøm 0	evaluér 0	find 0
følg 0	<b>gå:</b> letters 0, <b>reviews 1</b> (+all imperatives)	er nødt til 0
forestil 0	apropos 0	forøg 0
indlæs 0	indsæt 0	integrer 0
indtast 0	lad $x = y$ 0	lad os 0
<b>hav:</b> letters 0, <b>reviews 1</b> (+all imperatives)	kig på 0	markér 0
mål 0	stig op 0	<b>må:</b> letters 0, <b>reviews 4</b> (- permission, -epistemic function,+obligation)
brug for 0	notér 0	læg mærke til 0
observér 0	ens ( <i>genitive</i> ) 0	opstil 0
<b>bør:</b> letters 0, <b>reviews 1</b> (+obligation, -epistemic function)	<b>vores (inclusive):</b> letters 4, <b>reviews 10</b>	vær 0



dan 0	forbered 0	husk 0
gendan 0	konsulter 0	<b>se:</b> letters 0, <b>reviews 1</b> (+all imperatives)
<b>man:</b> letters 0, <b>reviews 3</b> (+all)	genkald 0	flyt 0
gennemgå 0	iagttag 0	udvælg 0
indstil 0	burde 0	udvis 0
antag 0	angiv 0	tag 0
<b>tænk:</b> letters 0, <b>reviews 1</b> (+gentænk)	vend 0	os ( <i>inclusive</i> ) 0
brug 0	<b>vi (<i>inclusive</i>):</b> letters 6, <b>reviews 5</b>	<b>du:</b> letters 0, <b>reviews 3</b> (+all)
din 0	De 0	Deres 0
antag 0	<b>læs:</b> letters 0, <b>reviews 9</b> (+references to other sections etc)	<b>formentlig:</b> letters 1, reviews 0

### Danish hedges

<b>omkring:</b> letters 1, <b>reviews 18</b> (+in the meaning of a bit more or less than the stated figure, number etc, -physical location, -before and after sth: "omkring årsskiftet")	<b>næsten:</b> letters 0, <b>reviews 8</b> (+all)	øjensynligt 0
tilsyneladende 0	<b>synes:</b> letters 0, <b>reviews 1</b> (+all)	syntes 0
almindeligvis 0	<b>ca.:</b> letters 7, <b>reviews 74</b> (+all)	argumentere for 0
argumenterede for 0	argumenteres for 0	<b>omtrent:</b> letters 0, <b>reviews 2</b> (+all)
<b>forudsat:</b> letters 0, <b>reviews 1</b> (-past conditions "som forudsat")	<b>forudsætter:</b> letters 0, <b>reviews 2</b> (+all)	i store træk 0
vis mængde 0	vis udstrækning 0	vist niveau 0
hævder 0	hævede 0	hævedes 0
kunne 0 (-ability)	næppe 0	tvivl 0
tvivlsomt 0	i bund og grund 0	anslår 0
<b>anslået:</b> letters 0, <b>reviews 3</b> (+all)	anslås 0	ret 0 (-legal right etc)
føler 0 (-feelings of employees, -fig. description of innovation process: "Vi føler os stadig frem")	følte 0	føltes 0
<b>ofte:</b> letters 0, <b>reviews 7</b> (+all)	mit synspunkt 0	vores synspunkt 0
generel 0 (-fixed expressions:	<b>generelt:</b> letters 0, <b>reviews 9</b>	gå(r) ud fra 0

"generel ledelse og økonomistyring", "generel overkapacitet", "generel ratestigning")	(+indicating exceptions to the stated proposition, -GAAP, -meaning "all" or "everybody", -meaning: in a number of ways that are not mentioned specifically)	
<b>indikerer:</b> letters 0, <b>reviews 2</b> (+all)	indikerede: letters 0, <b>reviews 1</b> (+all)	indikeret 0
formodentlig 0	<b>i de fleste tilfælde:</b> letters 0, <b>reviews 1</b> (+all)	<b>oftest:</b> letters 0, <b>reviews 1</b> (+all)
fra dette synspunkt 0	<b>opfattelse:</b> letters 2, <b>reviews 10</b> (-opinions of others)	fra dette perspektiv 0
(min/vores) mening 0	fra vores perspektiv 0	<b>stort set:</b> letter 1, <b>reviews 3</b> (+all)
sandsynligt 0	sandsynlig 0	hovedsageligt
måske	muligvis 0	for det meste 0
eventuel: 0 (-part of GC recommendation)	i det store hele 0	<b>bør:</b> letters 0, <b>reviews 1</b> (+epistemic function, -obligation)
<b>eventuelt:</b> letters 0, <b>reviews 1</b> (+all)	plausibel 0	plausibelt 0
<b>mulig:</b> letters 0, <b>reviews 1</b> (+not certain, -ability or real-world enabling conditions: "størst mulig"/"highest/biggest possible")	muligt 0 (-real-world enabling conditions or abilities)	postulere 0
postulerede 0	<i>sædvanligvis 0</i>	antageligvis 0
<b>kan:</b> letters 2, <b>reviews 30</b> (-ability or real-world enabling conditions, +writer's estimation of likelihood)	<b>sandsynligvis:</b> letters 0, <b>reviews 2</b> (+all)	burde 0 (-rebuttal with past reference)
<b>relativt:</b> letters 0, <b>reviews 3</b> (+all)	<b>tæt på:</b> letters 0, <b>reviews 1</b> (-geographically close, +modifying a figure)	lader til 0
skulle 0 (-pluperfect, -legal requirement)	nogle gange: 0	<b>i nogen grad:</b> letters 0, <b>reviews 1</b> (+all)
<i>mere eller mindre 0</i>	<i>i grove træk 0</i>	antyder 0
antydede 0	antydte 0	antager 0
antaget 0	antog 0	mistænker 0
<b>tendens til:</b> letters 0, <b>reviews 1</b> (+ "historical tendency to increase")	tilbøjelighed 0	tilbøjelig 0
så vidt jeg ved 0	<b>typisk:</b> letters 0, <b>reviews 5</b> (+all)	usikker 0

usikkert 0	uklar 0	uklart 0
usandsynlig 0	usandsynligt 0	<b>som regel:</b> letters 0, <b>reviews 1</b> (+all)
tit 0	rimelig 0 (-hedge counted under "sikkerhed")	<b>formoder:</b> letters 0, <b>reviews 1</b> (+all)
<i>formode 0</i>	<i>mene 0</i>	mener 0
<b>antagelse:</b> letters 0, <b>reviews 1</b> (+all)	<b>antagelser:</b> letters 0, <b>reviews 1</b> (+all)	regner med 0
<i>opfatte 0</i>	opfatter 0	antagelse 0
generelle 0 (-"generelle opfattelse" which is counted as one hedge under <i>opfattelse</i> )	<b>sikkerhed:</b> letters 1, <b>reviews 3</b> (+statements that DO NOT promise anything with absolute certainty, -employee work safety, -product safety)	<b>ville:</b> letters 0, <b>reports 6</b> (-used in main clause the propositional content of which is subject to a hypothetical condition expressed in a (hvis/)if-clause)
<b>forventer:</b> letters 5, <b>reviews 28</b> (-customers' expectations, +expectations to the future)	<b>forventet:</b> letters 0, <b>reviews 6</b> (future expectations, -past expectations, -expected by others, e.g. "expected reliability")	<b>forventes:</b> letters 0, <b>reviews 76</b> (+expectations to the future, -others' expectations)
rimeligt 0		

### English hedges

<b>about:</b> letters 0, <b>reports 9</b> (-"regarding", + "cirka")	<b>almost:</b> letters 3, <b>reports 7</b> (+ all)	<b>apparent:</b> letters 0, <b>reports 1</b> (-"easily noticed")
apparently 0	appear 0	appeared 0
appears 0 (- Endophoric/reader directions, - hypothetical: "if it appears to the Board")	<b>approximately:</b> letters 10, <b>reports 17</b> (+ all)	argue 0
argued 0	argues 0	<b>around:</b> letters 4, <b>reports 29</b> (+ approximately, - physical, - fig)
assume 0 (-"assume responsibility")	<b>assumed:</b> letters 0, <b>reports 2</b> (- assume new role)	<b>broadly:</b> letters 0, <b>reports 10</b> (- encompassing many things)
certain amount 0	certain extent 0	certain level 0
claim 0 (-legal, -money)	claimed 0	claims 0 (-legal, -money)
<b>could:</b> letters 1, <b>reports 50</b> (+future, - ability, -permission, -past reference)	couldn't 0	doubt 0
doubtful 0	<b>essentially:</b> letters 0, <b>reports 3</b> (+all)	<b>estimate:</b> letters 0, <b>reports 4</b> (+used to determine fig., % etc. mentioned in the report, -earlier estimates, - no estimate being made)
<b>estimated:</b> letters 1, <b>reports 15</b> (+used to determine fig. or % etc mentioned in the report, -earlier estimates)	fairly 0 (-fair treatment, -box in questionnaire)	feel 0 (-"look and feel" in a store, - customers' feelings)
feels 0	<b>felt:</b> letters 0, <b>reports 5</b> (-felt pressure, -hypothesizing "if this is	frequently 0 (- comparative, -)

	felt”, -asking staff about their feelings)	
from my perspective 0	from our perspective 0	from this perspective 0
<b>generally:</b> letters 0, <b>reports 3</b> (-GAAP, + there may be exceptions, -thankfulness for support and “more generally,” for developing the group; and “we want women to succeed more generally” etc.)	guess 0	<b>indicate:</b> letters 0, <b>reports 1</b> (+statement about the future)
<b>indicated:</b> letters 0, <b>reports 3</b> (-communicated)	<b>indicates:</b> letters 0, <b>reports 3</b> (-communicates)	<b>in general:</b> letters 0, <b>reports 2</b> (-none specific mentioned e.g. “the mining industry in general” and “in general merchandise”, +may be exceptions)
in most cases 0	in most instances 0	in my opinion 0
in my view 0	in this view 0	in our opinion 0
in our view 0	<b>largely:</b> letters 0, <b>reports 7</b> (+all)	<b>likely:</b> letters 2, <b>reports 19</b> (+future, -not writer’s estimation)
<b>mainly:</b> letters 0, <b>reports 30</b> (+all)	<b>may:</b> letters 0, <b>reports 64</b> (-permission, -real-world enabling conditions, +statements about the future)	maybe 0
might 0	mostly 0	<b>often:</b> letters 0, <b>reports 4</b> (+all)
<b>on the whole:</b> letters 0, <b>reports 1</b>	ought 0	<b>perhaps:</b> letters 1, reports 0 (+all)
plausible 0	plausibly 0	possible 0 (-“best possible”, -past reference)
possibly 0	postulate 0	postulated 0
postulates 0	presumable 0	presumably 0
probable 0	probably 0	quite 0
rather x 0 (-rather than)	<b>relatively:</b> letters 0, <b>reports 1</b> (+all)	<b>roughly:</b> letters 1, reports 0 (+all)
seems 0	<b>should:</b> letters , <b>reports 6</b> (-affective -> counted as engagement markers, -hypothetical uses which could be substituted by “if” or “in case that” without changing the meaning)	sometimes 0
somewhat 0	suggest 0	suggested 0
suggests 0	suppose 0	supposed 0
supposes 0	suspect 0	suspects 0
<b>tend to:</b> letters 0, <b>reports 1</b> (+all)	tended to 0	tends to 0
to my knowledge 0	typical 0	<b>typically:</b> letters 1, <b>reports 5</b> (+all)
uncertain 0	uncertainly 0	unclear 0
unclearly 0	unlikely 0	<b>usually:</b> letters 0, <b>reports 1</b> (+all)
<b>would:</b> letters 2, <b>reports 47</b> (+hypothesising, -volition, -past reference/the pluperfect, -“assess whether X would be desirable”)	wouldn’t 0	<b>anticipate:</b> letters 2, <b>reports 5</b> (+all)

<b>anticipated:</b> letters 2, reports 12 (-quotes)	arguably 0	<b>expect:</b> letters 8, reports 16 (+future, -requirements to business partners, -customers' expectations)
<b>expected:</b> letters 12, reports 77 (+future reference, -past reference, -quote, -expectations to employees' behaviour, -theoretical "expected value" in terms of remuneration) fortsæt fra s 217	<b>expects:</b> letters 1, reports 4 (-CSR-standards expected of suppliers etc)	<b>intend:</b> letters 2, reports 7 (+all)
<b>intended:</b> letters 0, reports 8 (-past reference, -unspecified objects' intended use)	<b>intends:</b> letters 0, reports 7 (+all)	<b>not aware:</b> letters 0, reports 3 (+all)
<b>predict:</b> letters 0, reports 2 (+all)	<b>forecast:</b> letters 0, reports 10 (-past reference: "as forecast")	<b>reasonable:</b> letters 0, reports 11 (-attitude, -others' opinions)
<b>reasonably:</b> letters 0, reports 1 (-"may reasonably" where "may" has already been counted as a hedge)	<b>expectation:</b> letters 0, reports 2 (-past reference, -other parties' expectations)	<b>satisfied:</b> letters 0, reports 3 (+epistemic meaning, -affect)
<b>consider:</b> letters 0, reports 2 (as/to be etc.) (-attitude markers, -"consider... at monthly meetings")	<b>considers (as/to be etc.):</b> letters 0, reports 5 (-attitude markers, -a review that "considers many options")	presume 0
presumed 0	presumably 0	

### English boosters

<b>actually:</b> letters 0, reports 1 (+all)	<b>always:</b> letters 2, reports 14 (-"don't always")	<b>believe:</b> letters 7, reports 23 (-beliefs of others, -belief in sth as a philosophy/moral value (counted as attitude markers), +epistemic function)
<b>believed:</b> letters 0, reports 1 (-beliefs of others)	<b>believes:</b> letters 0, reports 26 (-unspecific/ hypothetical reference "if it believes that...", +beliefs of committees, +epistemic function)	beyond doubt 0
certain 0 (-in the meaning "some (of)")	certainly 0	<b>clear:</b> letters 1, reports 2 (-easy for people to see/understand, +certainty that sth is true or exists)
<b>clearly:</b> letters 1, reports 1 (-easy for people to see/realise/understand, +reinforce writers' commitment to truth value)	conclusively 0	decidedly 0
definite 0	definitely 0	<b>demonstrate:</b> letters 1, reports 4 (-future objectives to demonstrate sth, -demonstrate technology, -"demonstrate how", +demonstrate that sth exists/is true e.g "its

		commitment to the continuous professional and personal development of its workforce")
<b>demonstrated: letters 1, reports 4</b> (+demonstrate that sth exists e.g. a company's ability to do sth well)	<b>demonstrates: letters 0, reports 3</b> (+demonstrate that sth exists/is true e.g. "their ongoing commitment to the business", -hypothetical e.g part of complement clause introduced by "if")	doubtless 0
<b>establish: letters 0, reports 3</b> (+establish sth as a known fact, -all other uses e.g. safety standards, policies, arrangements, an objective)	established 0 (-procedures, policies groups and other things not related to certainty of knowledge)	<b>evident: letters 1, reports 2</b> (+all: "our strength/success is evident")
evidently 0	<b>find: letters 0, reports 1</b> (-opinions of customers etc, -"you will find", +writer's opinion)	finds 0
found 0 (-hypothetical reference, -discovered/seen, -directions to other pages or web sites etc.)	in fact 0	incontestable 0
incontestably 0	incontrovertible 0	incontrovertibly 0
<b>indeed: letters 1, reports 1</b> (+all)	indisputable 0	indisputably 0
<b>know: letters 3, reports 1</b> (-familiarity of a person, -knowledge of others, e.g the reader and customers )	known: 0 (-negated: "not presently known", -unspecified "known issues", -"known as")	must ( <i>possibility</i> ) 0 (-according to law, rules etc., -as a requirement for success)
<b>never: letters 2, reports 0</b> (-"propulsion system, which never needs refuelling")	no doubt 0	obvious 0
<b>obviously: letters 0, reports 1</b> (+all)	<b>of course: letters 1, reports 2</b> (+all)	<b>prove: letters 0, reports 1</b> (-"may (=hedge) prove sufficient", + "...our range of products continues to prove popular...")
<b>proved: letters 0, reports 1</b> (+all)	proves 0	realise 0 (-"realise growth/market prices")
realised 0	realises 0 (-hypothetical reference)	<b>really: letters 1, reports 1</b> (+modifying finite verb, - "...incentive (...) to really care...", +slogan: "really caring about customers")
<b>show: letters 1, reports 1</b> (-show physically e.g. graphs and show of hands, +figuratively e.g. "results show that we are making progress")	<b>showed: letters 1, reports 3</b> (+all)	<b>shown: letters 2, reports 2</b> (+figurative use e.g. "shown a trend", -directions to other parts of the text i.e. interactive metadiscourse/endophoric markers)
<b>shows: letters 0, reports 3</b> (-endophoric, -"show how",	<b>sure: letters 3, reports 1</b> (+make sure, -certainty subject to a	surely 0

+“show that”, +second order entities: “show commitment/progress”)	condition)	
<b>think:</b> letters 0, <b>reports 1</b> (-hypothetical reference, +“I think that...”)	<i>thinks</i> 0	<i>thought</i> 0 (noun: “independent thought”)
<b>truly:</b> <b>letters 3</b> , reports 0 (+all)	<b>true:</b> <b>letters 1, reports 1</b> (+all)	undeniable 0
undeniably 0	undisputedly 0	undoubtedly 0
without doubt 0	<b>ensure:</b> letters 0, <b>reports 6</b> (+so as to ensure, +simple present: “we ensure” and “working groups that ensure a consistent approach”, -“(in order) to ensure”, -objective to ensure sth etc.)	<b>ensured:</b> <b>letters 1</b> , reports 0 (+all)
<b>ensures 13</b> (+all)		

### English attitude markers

! 0	admittedly 0	agree 0 (-duties/goals to agree sth)
agrees 0 (-decide/accept course of action etc, +share opinion)	agreed 0 (-say yes, -decide/accept course of action etc., +share opinion)	amazed 0
amazing 0	amazingly 0	<b>appropriate:</b> letters 0, <b>reports 28</b> (-unspecific reference e.g. “where appropriate”)
<b>appropriately:</b> letters 0, <b>reports 6</b> (-unspecific reference)	astonished 0	astonishing 0
astonishingly 0	correctly 0	curious 0
curiously 0	desirable 0 (-unspecific reference: “whether an earlier date for such a re-tender would be desirable)	desirably 0
disappointed 0	disappointingly 0	disagree 0
disagreed 0	disagrees 0	dramatic 0
dramatically 0	<b>essential:</b> <b>letters 4, reports 13</b> (+all)	essentially 0 (-hedging)
<b>even:</b> <b>letters 3, reports 5</b> (-“break even”, -“even out”, -smooth/flat, -“even if/though/as”(=transition marker), +sth unexpected, -part of quote)	<b>expected:</b> <b>letters 2, reports 14</b> (+past reference, - future reference, +expectations to employee behaviour etc.)	expectedly 0
<b>fortunate:</b> <b>letters 1</b> , reports 0 (+all)	fortunately 0	<b>hopeful 1</b> (+all)
hopefully 0	<b>important:</b> <b>letters 12, reports 52</b> (-unspecified reference, -opinions of others)	<b>importantly:</b> letters 0, <b>reports 1</b> (+all)
inappropriate 0 (-unspecified or	inappropriately 0	interesting 0

hypothetical reference)		
interestingly 0	<b>prefer:</b> letters 1, reports 0 (+all)	preferable 0
preferred 0 (-the preferences of others)	remarkable 0	remarkably 0
shocked 0	shocking 0	shockingly 0
striking 0	strikingly 0	surprised 0
surprising 0	surprisingly 0	unbelievable 0
unbelievably 0	understandable 0 (-unspecified reference, -official requirement of the annual report)	understandably 0
unexpected 0 (-unspecific and future reference, e.g. “any further unexpected changes”)	unexpectedly 0	unfortunate 0
unfortunately 0	<b>unusual:</b> letters 1, reports 0	unusually 0
usual 0 (-unspecified reference)	<i>acknowledge 0</i>	<i>acknowledged 0</i>
<i>acknowledges 0</i>	<b>recognise:</b> letters 1, reports 6 (-part of hedge: “intended to recognise”, +expressions of awareness and prioritization, humility or respect)	<i>recognised 0</i>
recognises 0	<b>passionate:</b> letters 2, reports 0 (-reference to specific branch only)	<b>like:</b> letters 0, reports 1 (+verbs only, - “would like to thank/pay tribute” where <i>thank</i> or <i>pay tribute</i> counts as the AM)
<b>delighted:</b> letters 2, reports 0 (-“delighted customers”)	<i>dissatisfied 0</i>	<i>displeased 0</i>
<i>dissatisfying 0</i>	<i>glad 0</i>	<i>happy 0</i>
<b>good:</b> letters 24, reports 32 (-Whitbread’s CSR programme “Good Together”, -opinions of others, -hopes to deliver “good” results etc, -“a good deal of”)	<b>satisfied:</b> letters 0, reports 4 (+affect, -epistemic)	<b>poor:</b> letters 0, reports 1 (-unspecific reference)
<i>bad 0</i> (-“bad debts”)	<i>happily 0</i>	<b>acceptable 1</b> (-unspecific reference)
<b>grateful:</b> letters 3, reports 0 (+all)	<i>pleasure 0</i>	<i>dissatisfaction 0</i>
<i>gratefulness 0</i>	<b>impressive:</b> letters 1, reports 2 (+all)	<i>impressively 0</i>
<b>consider (as/to be etc.):</b> letters 0, reports 1 (-considering corp. gov. as an agenda at board meetings, -opinions of others, -epistemic reference, i.e. hedging, +judgements based on personal values)	<b>considers (as/to be etc.):</b> letters 0, reports 4 (-sentences in which the adjectives count as metadiscourse, -epistemic reference, i.e. hedging, -a review that “considers many options”)	<i>praise 0</i>
<i>satisfying 0</i>	<b>satisfactory 2</b> (-“subject to satisfactory X” etc.)	<i>thankful 0</i>
<i>unhappy 0</i>	<i>thankfulness 0</i>	<i>unhappily</i>
<b>unacceptable 1</b> (-unspecific reference)	<i>uplifting 0</i>	<i>relief 0</i> (-“tax relief”, -“relief bags”)



<i>relieved</i> 0	<b>pride</b> 3 (+“pride ourselves”, -pride of others, e.g. staff)	<b>proud:</b> letters 2, reports 4 (+all)
<b>thank:</b> letters 6, reports 1 (-part of quote)	<b>pleasing:</b> letters 1, reports 3 (+all)	<b>successful:</b> letters 5, reports 16 (-future/unspecific reference)
<b>encouraging:</b> letters 5, reports 2 (-sender encouraging others, +sender encouraged by sth)	<b>exciting:</b> letters 1, reports 3 (+all)	<i>excited</i> 0
<b>committed:</b> letters 8, reports 28 (+membership of organisation/club which is committed to sth, -credit/loans/assets, -future reference/requirement)	<b>fair:</b> letters 0, reports 4 (+stance as to specific things/events/concepts that actually exist/take place etc., -“fair (market) value”, -an objective in relation to remuneration strategy, -“Office of Fair Trading”)	<b>determined:</b> letters 0, reports 1 (-make decision/judgement, -determine the number of sth etc., + strong desire and intention to do/achieve sth)
<b>acceptable:</b> letters 2, reports 4 (-unspecific reference)	<b>outstanding:</b> letters 4, reports 3 (-meaning “not yet paid” etc., -unspecific reference, e.g. the goal of “outstanding performance”)	<b>excellent:</b> letters 6, reports 8 (-unspecific reference, -answer in a survey)
<i>admit</i> 0	<b>disappointing:</b> letters 2, reports 3 (+all)	<b>confident:</b> letters 3, reports 1 (-part of slogan/strategy)
<b>welcome:</b> letters 0, reports 2 (-welcomed by others, -welcome signage in stores, -pleased/fortunate to welcome sby when the adjective counts as the AM)	<b>welcomed:</b> letters 0, reports 2 (+all)	<b>welcomes:</b> letters 0, reports 2 (+all)
<b>reasonable:</b> letters 0, reports 2 (-hedges, -others’ opinions, -unspecific reference)	<b>believe:</b> letters 1, reports 4 (-beliefs of others, +belief in sth as a philosophy/moral value, -epistemic reference (counted as boosters))	<i>believes</i> 0 (-epistemic reference (counted as boosters))
<i>believed</i> 0 (-beliefs of others, -epistemic attitude (counted as booster))	<b>regret:</b> letters 1, reports 1 (+all)	<b>recognise:</b> letters 1, reports 6 (+only when combined with self mention)
<i>optimistic</i> 0	<i>optimism</i> 0	<b>well:</b> letters 10, reports 44 (-“as well as”, -expressions with a hyphen, -
<b>regrettably:</b> letters 0, reports 2	<b>regrettable:</b> letters 1, reports 0 (+all)	

### English engagement markers

( 0	? : letters 0, reports 25 (+all)	(the) reader’s 0
add 0 (-all forms but the imperative)	allow 0 (-non-imperatives)	analyse 0 (-non-imperatives)
apply 0	arrange 0	assess 0
assume 0	by the way 0	calculate 0

choose 0	classify 0	compare 0
connect 0	consider 0	consult 0
contrast 0	define 0	demonstrate 0
determine 0	do not 0	develop 0
employ 0	ensure 0	estimate 0
evaluate 0	find 0	follow 0
<b>go:</b> letters 0, <b>reports 1</b> (+direction to web page)	<b>have to:</b> letters 1, <b>reports 4</b> (-related to the requirements to financial reporting)	imagine 0
incidentally 0	increase 0	input 0
insert 0	integrate 0	key 0
let $x = y$ 0	let us 0	let's 0
look at 0	mark 0	measure 0
mount 0	must: letters 0, <b>reports 8</b> (-by ordinary or special resolution i.e. decided by the shareholders themselves, -under statutory or regulatory information)	<b>need to:</b> letters 1, <b>reports 21</b> (-hypothetic reference: "if there are issues that need to be addressed", -unspecific reference: "We are clear on what we need to do")
note 0	observe 0	one's 0
order 0	<b>ought to:</b> letters 0, <b>reports 2</b> (+all, since no epistemic uses were found)	<b>our (inclusive):</b> letters 15, <b>reports 52</b>
pay 0	picture 0	prepare 0
recall 0	recover 0	<b>refer:</b> letters 0, <b>reports 1</b>
regard 0	remember 0	remove 0
review 0	<b>see:</b> letters 15, <b>reports 92</b> (directions to other parts of the reports or web sites were also included although they could have been seen as interactive metadiscourse and therefore excluded)	select 0
set 0	<b>should:</b> letters, <b>reports 42</b> (-epistemic possibility (=hedging), -unspecific reference, e.g. "how sth should", -obligation imposed by legislation etc., +opinions, company policies and decisions that sth should X)	show 0
suppose 0	state 0	take (a look/as example)
think about 0	think of 0	turn 0
us ( <i>inclusive</i> ) 0	use 0	<b>we (inclusive):</b> letters 1, <b>reports 22</b>
<b>you:</b> letters 2, <b>reports 22</b> (+all)	<b>your:</b> letters 0, <b>reports 3</b> (-employee survey called Your Say)	<b>shareholder:</b> letters 9, <b>reports 74</b> (-specific shareholders)
<b>shareholders:</b> letters 23, <b>reports 198</b> (+all)	<b>stakeholder:</b> letters 0, <b>reports 16</b>	<b>stakeholders:</b> letters 2, <b>reports 32</b> (+all)
reader 0	<b>readers:</b> letters 0, <b>reports 1</b> (+all)	<b>be assured:</b> letters 0, <b>reports 1</b>

		(+all)
<b>please:</b> letters 0, <b>reports 1</b> (-used with imperatives already counted, +“please visit”)		

### English self mention

<b>I:</b> letters 42, <b>reports 19</b>	<b>we:</b> letters 216, <b>reports 740</b> (-reader inclusive)	<b>me 3</b>	<b>our:</b> letters 233, <b>reports 1122</b> (-reader inclusive, -“our board” which was included under <i>board</i> )	mine 0	<b>us:</b> letters 18, <b>reports 57</b> (+all)
myself 0	<b>ourselves:</b> letters 2, <b>reports 7</b> (+all)	<b>board of directors:</b> letters 0, <b>reports 11</b> (-boards of other companies)	<b>board:</b> letters 27, <b>reports</b> (boards of other companies, -boards of subsidiaries)	<i>board of directors’</i> 0	<b>board’s:</b> letters 3, <b>reports 25</b> (-not the company’s board specifically: “a board’s”)

### Appendix II: Corpus of English and Danish letters

#### Chairman’s letter

##### **Committed (AM)** to enhancing **shareholder (EM)** value

BAE Systems has delivered a robust performance in a challenging environment. The combination of rapid changes in defence priorities around the world, together with the economic pressures that constrain government customers, has hindered growth but **I (SM) believe (booster)** 2012 stands out as a year of validation of the direction and stature of the Group.

It is this consistently robust performance which enabled the Group to explore the possibility of a merger opportunity with EADS. The merger held the prospect of creating a combined business that would have been a global technology leader across both the commercial aerospace and defence sectors and which, **we (SM) believe (booster)**, would have delivered significantly enhanced value for **shareholders (EM)**. Behind that consistent operational performance lies a soundly-based strategy that has been forged over the past decade and which has enabled the Group to develop as one of the global leaders in defence, aerospace and security.

BAE Systems today operates with a broad base of business across multiple international markets. The Group has a large order backlog of platform programmes addressing all three defence domains of air, sea and land. In addition, the Group has expanded to provide a range of services-based capabilities, complementing and, to a large extent derived from, its products-based positions. More recently, BAE Systems has expanded its services offering into the provision of capabilities for government intelligence communities as well as commercial customers seeking cybersecurity solutions.

The **Board (SM)** reviews this strategy regularly and refreshes those actions that are required to deliver the strategy. That review considers many options, including the prospects for transformational transactions. It was against this backdrop that the option regarding a possible merger with EADS emerged.

The merger discussions were at no time seen as a replacement for the Group’s established strategy. BAE Systems remains focused on its strategy and prospects for the business remain **good (AM)**. In particular, the outlook in international markets remains buoyant as evidenced by a two-fold increase in international order intake outside the US and UK markets in 2012. Further opportunities to mitigate or offset **likely (hedge)** pressures on sales growth in US and UK markets remain.

BAE Systems is **committed (AM)** to enhancing **shareholder (EM)** value by maximising earnings performance. Efficiency measures continue to be implemented, aimed at delivering affordable solutions for customers and attractive returns for **shareholders (EM)**.

The combination of the Group’s focus on cash generation and its capital allocation policy provides opportunities for further enhanced **shareholder (EM)** returns and, in February 2013, the Group announced a three-year share repurchase programme of up to £1bn. In addition to this accelerated return to **shareholders (EM)**, the Group’s capital allocation policy will continue to reflect pension obligations, business development needs for the longer term and dividends.

<p>Dividend (pence)</p> <p>The <b>Board (SM)</b> has recommended a final dividend of 11.7p per share making a total of 19.5p per share for the year, an increase of 4% over 2011.</p>
<p>Governance</p> <p>“Transparency is a critical element of good governance and in the Governance section of this report on pages 76 to 117, <b>I (SM)</b> and other directors report on how <b>we (SM)</b> have discharged the <b>important (AM)</b> responsibilities the <b>Board (SM)</b> has for the stewardship of the Company.”</p> <p><b>See (EM)</b> page 80 for the Chairman’s corporate governance letter</p>

BAE Systems places great importance on the way it conducts its business. Alongside strategic and operational progress, the Group has also made huge strides over recent years in establishing high standards of governance.

The path to establishing high standards of governance has followed a complex and at times arduous journey. Rather than addressing the cosmetics of issues as they have arisen, **we (SM)** have sought to drive fundamental culture change throughout the organisation. The process can **never (booster)** be considered to be complete and best practice in governance will **always (booster)** remain an objective, but **I (SM) believe (booster)** BAE Systems is justified in now being regarded as a leader in this area.

Consistent with the drive for continuous improvement, the Group’s core governance procedures and policies were again reviewed and updated during the year.

The Group continues to pursue an integrated approach to performance in all aspects of its business life. This Total Performance approach includes the setting of financial and non-financial objectives for management. Further details of this Total Performance approach, and the way it embraces all employees, can be found on page 17 of this report.

BAE Systems recognises the benefits derived from drawing on the talents of a diverse workforce. One **important (AM)** element of this is the Group’s drive, through a structured programme of initiatives, to attract more women into the workplace. Although there is still much to do in this regard, across industry as a whole, the early stages of progress are now apparent within BAE Systems and are **expected (hedge)** to provide the foundations for a better gender balance in future years. In addition to this progress, and consistent with **our (SM)** commitment to improve diversity, the Group again met its aspirational goal set pursuant to the Davies Report, with women representing more than 25% of the composition of the Group’s **Board (SM)**.

#### Directors

In May, Michael Hartnall, a non-executive director, stood down from the **Board (SM)** having served nearly nine years in that capacity.

As previously announced, Sir Peter Mason stepped down as the **Board’s (SM)** Senior Independent Director in January 2013. Nick Rose, a non-executive director, succeeds Sir Peter as the **Board’s (SM)** Senior Independent Director. Sir Peter will step down from the **Board (SM)** at the Annual General Meeting in May 2013. Sir Peter has been a great asset to the **Board (SM)**, over many years, sharing his wise counsel and extensive industrial experience. The **Board (SM)** is **grateful (AM)** to him for his support and, more generally, his contribution to the development of the Group.

As **I (SM)** near the start of my tenth year as Chairman, one of Nick Rose’s tasks as the **Board’s (SM)** new Senior Independent Director is to manage the succession for my own role. It is **important (AM)** that this process is driven by the objective of finding the right person, not just by the timetable. Notwithstanding the undoubted challenges the future holds, **I (SM) believe (booster) I (SM)** will be handing over the tiller of a **well-managed (AM)**, **strong (AM)** and **successful (AM)** company, that is operating to high standards of governance.

#### Dividend

The **Board (SM)** has recommended a final dividend of 11.7p per share making a total of 19.5p per share for the year, an increase of 4% over 2011. At this level, the annual dividend is covered 2.0 times by underlying earnings (2011 2.1 times excluding the UK tax agreement benefit). Subject to **shareholder (EM)** approval at the 2013 Annual General Meeting, the dividend will be paid on 3 June 2013 to holders of ordinary shares registered on 19 April 2013.

Dick Oliver  
Chairman

#### Chief executive’s review

##### Delivering on a **clear (AM)** strategy

BAE Systems has continued to deliver on a **clear (AM)** strategy during 2012. The Group’s geographic breadth of business has provided, and is **expected (hedge)** to continue to provide, resilience at a time when some of its markets are constrained by economic pressures.

Following a period of growth, defence budgets in the US have flattened and are **expected (hedge)** to remain constrained in response to reducing overseas operations and measures to address federal deficits. In the UK, the defence market has stabilised following changes to programme priorities outlined in 2010 through the UK government’s Strategic Defence and Security Review.

Growth opportunities in some segments of the US and UK markets are identified, but the overall outlook in both countries is **expected (hedge)** to continue to be constrained.

In wider international markets, the Group is seeing **good (AM)** growth in order intake leading to **anticipated (hedge)** growth in international sales. In 2012, order intake outside of the US and UK was £11.2bn, compared with £4.8bn in 2011.

BAE Systems has a **clear (AM)** strategy, focused on enhancing its position as a premier global defence, aerospace and security company. Consistent with that strategy, discussions between BAE Systems and EADS were held between June and October of 2012. The discussions involved extensive engagement with many of the Group’s government **stakeholders (EM)**, including in the UK, US and Saudi Arabia, and **we (SM)** were **grateful (AM)** for the positive support received. The merger would have been an **exciting (AM)** development, but no agreement **acceptable (AM)** to all parties could be reached.

Focus on the underlying business performance was sustained as a priority while the merger discussions were underway. The Group's continued strategic aim is to drive **shareholder (EM)** value through a combination of meeting **our (SM)** customers' requirements, further improvements in financial performance and enhanced competitive positions across the business. The focus of the Group's Strategic Actions in pursuit of these goals includes: growth in its cyber, intelligence and security businesses; addressing growth opportunities in electronic systems; driving further value from the Group's broad base of platforms and services positions; and increased business in international markets outside of the UK and US.

The evolution of BAE Systems has seen the Group's business develop from an equipment supply-centred model to one that now embraces a services culture. In 2012, 50% of the Group's sales were generated in services across a wide range of activities and geographies.

Services activities include in-service support in the UK for the Royal Air Force's trainer aircraft and fast jet fleets, and the Royal Navy's surface fleet. In Australia and Saudi Arabia, the Group provides a broadly-based range of support services to the armed forces.

BAE Systems provides extensive support to US armed forces through provision of land vehicle reset and upgrade programmes, rotary wing and other aircraft support, and naval ship repair services. The Group also manages complex facilities including ammunition production in the US and the UK.

BAE Systems' services activities also include the provision of extensive cyber and intelligence capabilities. The Group's strategy includes growing its positions in the cyber and intelligence services markets for governments, and pursuing organic growth opportunities in commercial cyber and security applications and systems.

Affordability is a key consideration for all the Group's customers and BAE Systems has been **successful (AM)** in reducing costs over a sustained period. Whilst necessary to address lower demand in some business areas, cost reduction has also been targeted to achieve competitive advantage. A **regrettable (AM)** but unavoidable element of these cost reduction measures is the impact on employment. Excluding M&A activity, net employee headcount (including contractors) reduced by **approximately (hedge)** 3,600 during the year, bringing the total net reduction across the past four years to **approximately (hedge)** 26,000. In addition, site rationalisation has continued. These efficiency improvements lead to benefits for customers as well as underpinning the Group's value proposition for **shareholders (EM)**.

US

BAE Systems' business in the US contributed **approximately (hedge)** 40% of Group sales in 2012. The US business has felt the dual pressure of reduced activity in support of deployed operations in Iraq and Afghanistan, and measures to reduce US federal budget deficits. In particular, the US land vehicles business has, as forecast, seen significant year-on-year reductions from the peak of activity in 2008. The US elections have introduced some additional defence procurement uncertainty with the administration entering a six-month period of Continuing Resolution from the end of September 2012.

Overhanging the US defence sector into 2013 is the potential impact of a sequestration or other budget reductions that **could (hedge)** result in indiscriminate funding cuts. The Group bases its plans on conservative assumptions and continues to address its cost base accordingly.

UK

Defence budgets in the UK are **expected (hedge)** to remain flat, but the recent stabilising of equipment and services requirements and the budget outlook has established a more predictable planning environment.

The Group's UK maritime business is experiencing a high level of activity. Growth is **anticipated (hedge)** in the submarines business on the back of the multi-year Astute Class submarine programme and the build-up in engineering workload for the Successor programme. BAE Systems received further Successor funding during the year, with **approximately (hedge)** 1,000 people now working on the programme.

Also in the UK maritime business, the last ship of the six-ship Type 45 destroyer programme completed sea trials. **Good (AM)** progress continues to be made on the Queen Elizabeth Class Carrier programme with delivery of major blocks underway for the assembly of the first of these two ships. Work continues on the design of the Type 26 ships to replace the UK's Type 23 frigates from early in the next decade. Type 26 production is **expected (hedge)** to utilise a lower level of UK ship build capacity following the currently high levels on the Carrier programme. Discussions continue with the UK government to determine how best to sustain the capability to deliver complex warships in the UK in the future.

In the military air sector, European Tranche 2 Typhoon deliveries have continued and international prospects for Typhoon remain **good (AM)** with the potential to extend production into the next decade. The Group continues to deliver assemblies for the US-led F-35 Lightning II programme under Low-Rate Initial Production contracts.

International

#### Total Performance

BAE Systems' Mission is to deliver sustainable growth in **shareholder (EM)** value through its commitment to Total Performance.

Total Performance encompasses:

- Customer Focus;
- Programme Execution;
- Financial Performance; and
- Responsible Behaviour.

Total Performance is explored in more detail throughout the Directors' Report.

**See (EM)** page 16 for the Group Strategic Framework for 2013

In addition to its US and UK operations, BAE Systems continues to build on its positions in international markets. As well as established operations in Saudi Arabia, Australia and more recently India, the Group is pursuing multiple new business opportunities worldwide. Defence remains a high priority in the Kingdom of Saudi Arabia. BAE Systems has a large involvement in the support of established Royal Saudi Air Force (RSAF) and Royal Saudi Navy programmes in the Kingdom.

Deliveries of RSAF Typhoon aircraft are contracted to recommence in 2013, following a contract amendment to enable UK final assembly of the balance of 48 aircraft under the original contract for 72.

Discussions to formalise Typhoon price escalation under the Salam programme remain ongoing.

Discussions have commenced on the next phase of support, following on from the three-year agreement that formed part of the arrangements for initial entry into service of the Typhoon aircraft.

Under the Saudi British Defence Co-operation Programme, orders totalling £3.4bn were awarded for support through to 2016, including the provision of manpower, logistics and training to the RSAF. In addition, a £1.6bn contract was awarded in May to support the RSAF's future aircrew training requirements involving the supply of, and initial support for, Hawk Advanced Jet Trainer and Pilatus training aircraft.

BAE Systems is the leading provider of equipment and support to the Australian armed forces. The Group's largest programme in Australia is the Canberra Class programme to build two 27,000 tonne Landing Helicopter Dock vessels for the Royal Australian Navy. BAE Systems continues to develop its business in India. The Indian government has recently confirmed its intention to buy the M777 artillery system and negotiations for a third batch of 20 locally assembled Hawk aircraft are **expected (hedge)** to commence in 2013.

In Oman, a £2.5bn contract for 12 Typhoon and eight Hawk aircraft and associated training and support has been awarded, and **we (SM)** are progressing opportunities for Typhoon in Malaysia and the United Arab Emirates.

In June, the business was awarded a \$750m (£462m) CV90 combat vehicle contract in Norway.

Balance sheet and capital allocation

The Group recognises the importance to **investors (EM)** of a clear capital allocation policy, consistent with sustaining a strong investment grade credit rating, as part of its value proposition.

In addition to meeting its pension funding obligations, the Group **expects (hedge)** to continue organic investment in its businesses to sustain and grow, plans to continue to pay dividends in line with its policy of a long-term sustainable cover of **around (hedge)** two times underlying earnings and to make accelerated returns of capital to **shareholders (EM)** when the balance sheet allows. Consistent with this approach, in February 2013, the Group initiated a three-year share repurchase programme of up to £1bn. Full implementation of this programme is subject to satisfactory resolution of Salam Typhoon price escalation negotiations. Discussions with the Group's UK pension scheme trustees have commenced to address any implications for deficit funding plans. Investment in value-enhancing acquisitions will continue to be considered where market conditions are right, where they deliver on the Group's strategy and where they offer greater value than repurchasing the Group's own shares.

M&A activity

The Group's business portfolio is reviewed regularly to determine whether greater value can be created from the sale of a business rather than its retention, and three small business disposals were made during the year for a combined consideration of **approximately (hedge)** £111m.

In March, the Group completed the sale of BAE Systems Safety Products Inc. and Schroth Safety Products GmbH (Safety Products). In July, the Safariland, LLC (Safariland) business and the assets comprising BAE Systems Tensylon High Performance Materials Inc. (Tensylon) were sold. BAE Systems continues to seek bolt-on acquisitions that enhance routes to market or which provide rapid access to relevant technologies and capabilities.

In November, the Group agreed the acquisition of Marine Hydraulics International, Inc., a US marine repair, overhaul and conversion company, for cash consideration of **approximately (hedge)** \$69m (£42m). The acquisition is **expected (hedge)** to complete in the first quarter of 2013.

Pension funding

Triennial funding valuations of the Group's two largest UK pension schemes, the BAE Systems Pension Scheme and the BAE Systems 2000 Pension Plan, were completed as at 31 March 2011. In 2012, agreement on revised deficit funding plans was reached with the trustees of those schemes and the next valuation will commence in April 2014.

Total Performance

The Group continues to build on the **good (AM)** progress in recent years to establish a Total Performance culture across its business operations. For BAE Systems, Total Performance is not just about what the Group does, but how it is done. Total Performance places emphasis on delivering **shareholder (EM)** value, meeting the needs of customers and, at all times, acting responsibly. In addition to delivering against its Financial Performance objectives, the Group sets targets for the achievement of non-financial performance measures, including Customer Focus, Programme Execution and Responsible Behaviour.

BAE Systems is **committed (AM)** to achieving and sustaining high standards of business conduct and continues to reinforce a culture of responsible behaviour. Mandated policies and processes within the Group's Operational Framework are updated routinely to ensure they reflect the Group's Responsible Trading Principles. All employees receive training to help them apply the Group's global Code of Conduct, with mandatory refresher programmes undertaken during the year.

The Group's people strategy of through-career capability development and emphasis on promoting high levels of employee engagement seeks to maximise the contribution that its workforce makes to a culture of Total Performance. It enables every member of the team to fulfil their personal potential. The success of this strategy is measured ultimately in the success of the business as a whole.

BAE Systems has talented people who are **committed (AM)** to excellence, doing work that is **truly (booster)** inspired.

The safety of **our (SM)** employees and those using **our (SM)** products is critical to **our (SM)** business and a fundamental responsibility.

**I (SM)** am deeply **saddened (AM)** to report the death of one of **our (SM)** employees whilst at work in Saudi Arabia in a road traffic

accident.

Safety continues to be a priority for the Group, with businesses continuing to drive consistently high standards of safety. Performance in safety was underpinned this year by the Group achieving a 30% reduction in the Recordable Accident Rate.

#### Management

In June, Tom Arseneault was appointed Executive Vice President of the Product Sector businesses headquartered in the US and Chief Technology Officer for BAE Systems, Inc. Also in June, Lynn Minella was appointed Group Human Resources Director following the retirement of Alastair Imrie. On their appointment, both Tom and Lynn joined the Group's Executive Committee.

With effect from 30 March 2013, Larry Prior, Executive Vice President of the Service Sector businesses headquartered in the US and Chief Operating Officer for BAE Systems, Inc., and member of the Group's Executive Committee, will leave the Group to pursue other opportunities. In February 2013, David Herr was appointed Executive Vice President of the Service Sector businesses and joined the Group's Executive Committee.

#### Summary

BAE Systems is a resilient business with talented people and the resources to continue to develop within a clear strategic framework. The strategy has seen the Group focus on defence, aerospace and security markets across a broad geographic base. BAE Systems aims to deliver attractive returns to its **shareholders (EM)** through its positions on priority programmes and in services with high relevance to its customers.

Ian King

Chief Executive

#### Chairman's statement

**I (SM)** am **pleased (AM)** to report another **good (AM)** set of results for Whitbread, with double-digit revenue and profit growth, as well as 15% growth in both EPS and dividends during the year. **We (SM)** are focused on putting the customer at the heart of everything **we (SM)** do. **We (SM)** continually develop **our (SM)** products and services while investing in **our (SM)** brands to build ever stronger consumer propositions, all the time keeping a tight control on costs. This has enabled **us (SM)** to perform **well (AM)** in tough market conditions giving **us (SM)** the confidence to expand in line with **our (SM)** ambitious growth plans.

In a challenging hotel market, the increasing strength of the Premier Inn brand and **our (SM)** dynamic pricing system have **ensured (booster) we (SM)** continue to outperform competitors.

The sharper focus in **our (SM)** restaurants business delivered a turnaround in performance in the second half of the year. Costa remains one of the success stories of the UK high street with like for like sales growth of 5.5%, while some 22% of total system sales now come from its international businesses.

It has been a record year for expansion in **our (SM)** main growth engines of Premier Inn and Costa. **We (SM)** opened 4,430 new rooms (31 hotels), 12 restaurants, over 330 Costa stores around the world and now have 1,192 Costa Express machines. This puts **us (SM)** **well (AM)** on track to achieve the 2016 milestones **we (SM)** laid out last April. Overseas, Costa continues to build presence in some 25 countries and in the year **we (SM)** celebrated **our (EM)** 100th store in China.

Premier Inn is developing a 'capital right' strategy to expand in the emerging budget hotel markets of the Middle East, India and Asia Pacific.

As **we (SM)** invest in growing **our (SM)** brands the focus is very much on delivering good returns that create substantial **shareholder (EM)** value. To further this end, **we (SM)** are proposing to introduce a ROCE measure to **our (SM)** senior management long-term incentive plan for 2012/13.

#### Dividend

As **we (SM)** said at this time last year, **we (SM)** have re-balanced the interim and final dividend payments to reflect the earnings profile during the year more closely. The **Board (SM)** recommends a final dividend of 33.75p per share, making a total dividend for the year of 51.25p per share, up by 15.2%.

The final dividend will be paid on 13 July 2012 to **shareholders (EM)** on the register at the close of business on 18 May 2012. Once again, a scrip dividend alternative will be offered and further information on how **shareholders (EM)** can elect to participate in the scrip dividend scheme is available from the registrars or on the Company's website.

#### Board (SM)

During the year, **we (SM)** appointed two new non-executive directors, Susan Hooper and Susan Taylor Martin. They are both highly talented multi-lingual executives with international experience. Each of them brings a different range of skills to the Whitbread **Board (SM)** as **we (SM)** continue to grow **our (SM)** market-leading businesses both in the UK and selectively around the world.

Susan Hooper is an experienced international leisure sector executive holding the position of Chief Executive at Acromas Travel where she has been responsible for the Saga, AA and Titan Hi Tours holiday and travel businesses since 2009. Her other leisure and consumer experience includes Senior VP, EMEA at Royal Caribbean Cruises International, where she also represented them on the board of First Choice Holidays PLC, and senior roles at Avis Europe. Her appointment was effective from 1 September 2011.

Susan Taylor Martin has held executive roles in rapidly changing markets. She was appointed President, Media at Thomson Reuters in July 2011 and has held a number of other roles at Thomson Reuters during a period of extensive technological innovation and corporate change. These roles included, President, Global Investment Focus Accounts and Managing Director, UK and Ireland within Thomson Reuters Markets. Prior to that she was Global Head, Corporate

Strategy for Reuters, which she joined in 1993. Her appointment was effective from 1 January 2012.

Earlier this month **we (SM)** announced a change of responsibilities for Christopher Rogers, who will become Managing Director of Costa with effect from 1 August 2012 when John Derkach leaves **us (SM)** to become Chief Executive of Tragus. Christopher joined Whitbread as Finance Director in 2005 and has played a key role in the Company's transformation over the last seven years. Prior to joining Whitbread, he had developed a wealth of experience in consumer-facing businesses such as Kingfisher, where he held product marketing, commercial and finance roles. Christopher has served on the Costa Management Board since it was formed in 2008 and has played an active role in Costa's development. **We (SM)** have started the search process for a new Finance Director.

#### Governance

As Chairman of the Company, **I (SM)** believe **(AM)** that corporate governance is not simply something for the **Board (SM)** to consider as an agenda item at **our (SM)** monthly meetings. Corporate governance affects all aspects of **our (SM)** operations and **I (SM)** am pleased **(AM)** with the high standards **we (SM)** maintain in this regard. On pages 28 to 34, there is a comprehensive report which sets out **our (SM)** approach to governance.

#### People

The dedication and energy of **our (SM)** employees is a key part of **our (SM)** 'customer heartbeat' strategy, which is described in more detail later in this report. **I (SM)** would like to pay tribute **(AM)** to the tremendous **(AM)** contribution of **our (SM)** people and the high quality service they provide to **our (SM)** customers every single day of the year. On behalf of the **Board (SM)** and the executive team, **I (SM)** wish to express **our (SM)** thanks **(AM)** to each of them for their hard work this year and the contribution they have made to **our (SM)** overall performance.

Anthony Habgood

Chairman

25 April 2012

#### Chief executive's review

Whitbread delivered a **good (AM)** performance in 2011/12, in a challenging economic environment. Strong organic expansion, combined with like for like sales growth, increased Group total sales by 11.2% to £1,778.0 million. Premier Inn sales grew by 8.3% to £755.9 million, Restaurants by 1.8% to £483.4 million and Costa by 27.5% to £541.9 million. Group underlying profit before tax increased by 11.3% to £320.1 million (2010/11: £287.5 million), with underlying diluted EPS increasing by 15.2% to 134.1p. Group return on capital grew to 13.6% from 12.9%.

**Our (SM)** continuing focus on improving customer propositions drove Group like for like sales up by 2.6%. Premier Inn's like for like sales growth of 3.2% was impacted by a slowdown in the total hotel market in the second half of the year, particularly in the regions. Restaurants full year like for like sales fell by 0.2%, with an improvement in performance in the second half of the year, as management actions drove like for like sales growth. Costa continues its success story and delivered another strong performance with like for like sales up 5.5%.

Central to creating **shareholder (EM)** value is combining growth with a strong focus on improving return on capital.

**Our (SM)** openings in Hotels & Restaurants over the last three years have **shown (booster) good (AM)** returns as the new sites mature and the return on capital for the division increased slightly to 12.4%. Return on capital in Costa grew to 32.4%, up from 28.3%.

**Our (SM)** strong cashflow from operations of £478.3 million funded increased capital investment of £307.9 million, as well as the proposed growth in the dividend. **We (SM)** maintain **our (SM)** strong balance sheet. Year end debt increased by £16.4 million to £504.3 million.

The **Board (SM)** recommends a final dividend payment of 33.75p per share, making a total dividend for the year of 51.25p per share, an increase of 15.2%. The final dividend will be paid on 13 July 2012 to **shareholders (EM)** on the register at the close of business on 18 May 2012. A scrip dividend alternative will be offered again.

**Our (SM)** success depends on the hard work and professionalism of **our (SM)** 40,000 team members and **I (SM)** would like to **thank (AM)** them for their **enormous (AM)** contribution.

#### Strong brands getting stronger

As the UK's largest hotel and restaurant group, with over 2,000 outlets, Whitbread's brands are visited by some 19 million customers a month. The Premier Inn management and team members are focused on delivering a consistently high quality, great value, customer experience, in **well (AM)** designed hotels to ensure **we (SM)** are the number one choice in every local market. **We (SM)** continue to outperform **our (SM)** competitive set and were named 'Best Value Hotel Chain' by YouGov and awarded 'Most Improved Brand of the Year 2012' by BDRC. **We (SM)** are **passionate (AM)** about improving customer experience. Premier Inn has one of the UK's largest customer satisfaction surveys with over 814,000 responses in 2011/12. Of these, 66% scored their stay nine or ten out of ten and a further 23% scored it seven or eight out of ten.

Costa delivered another **excellent (AM)** performance and, demonstrating its growing reputation, was voted 'Best Brand' by Marketing Week and 'Best Branded Coffee Shop Chain—Europe' by Allegra Strategies. Costa has also increased its lead over Starbucks in YouGov's 'Brand Preference' measure.

Whitbread Hotels & Restaurants

Premier Inn



Premier Inn continued to outperform its competitive set and delivered a resilient performance in the midscale and economy hotel sector, which became more challenging as the year progressed. Premier Inn like for like revpar grew by 1.8% in the year, with an increase of 0.8% in the regions and 7.3% in London.

**Our (SM)** outperformance is a result of the quality and consistency of **our (SM)** product and service, the breadth of **our (SM)** network, **our (SM)** continued investment in the Premier Inn brand and the evolution of **our (SM)** dynamic pricing model. **Our (SM)** online channel, PremierInn.com, has also made **good (AM)** progress with visitor numbers increasing by 26.9% to 44 million in the year. 77% of bookings are now made through automated channels. In the year ahead, Premier Inn will maintain its advertising expenditure both on TV and online. **We (SM)** will also continue to invest in **our (EM)** estate and are spending **around (hedge)** £70 million refurbishing some 13,000 rooms over the two financial years to February 2013.

Dynamic pricing continues to evolve and enables **us (SM)** to optimise room rate whilst working towards **our (SM)** occupancy target of 80%. During the year **we (SM)** trialled a new dual pricing structure with 'Premier Saver' rates (which are non-refundable and payable on booking) and 'Premier Flexible' rates (which are fully refundable and payable either on check-in or at booking). The dual pricing structure will be rolled out across the remaining estate in 2012/13.

**We (SM)** delivered **our (SM)** highest organic room growth to date in 2011/12, opening 4,055 new rooms and 29 new hotels. This takes **our (EM)** total number of hotels in the UK & Ireland to 620 with 47,429 rooms. **We (SM)** plan to open 4,200 new rooms during 2012/13. Together with the remainder of **our (SM)** committed pipeline of 6,300 rooms, this will take **us (SM)** to nearly 58,000 rooms putting **us (SM)** on track to achieve **our (SM)** milestone of 65,000 rooms by 2015/16.

London is an **important (AM)** focus of **our (SM)** expansion and from **our (SM)** committed pipeline **we (SM)** expect **(hedge)** to increase **our (SM)** presence from 7,225 rooms to over 10,500 rooms. **Our (SM)** pipeline for London is predominantly leasehold which offers attractive returns with the EBITDA of a leasehold room significantly higher than that of a comparable room in the regions.

In the year, **we (SM)** implemented a new organisation structure within Hotels & Restaurants under WHR Managing Director, Patrick Dempsey. This created more focused management teams in Premier Inn and Restaurants whilst maintaining **our (SM)** joint site benefits. As part of this change **we (SM)** introduced cluster management to the Premier Inn estate which is now divided into 112 clusters. This structure provides greater focus at site level, delivering a better customer experience and sharing of best practice. Last year, **we (SM)** announced a 'capital right' approach for **our (SM)** international expansion. **We (SM)** appointed a new Managing Director, Paul Macpherson, who has **valuable (AM)** experience in this field. **We (EM)** now have six hotels internationally, four in the Middle East and two in India, which performed **well (AM)** in 2011/12 with increasing revpar and occupancy. The hotel market remains fragmented within these markets and with no dominant international players. Combined with strong economic growth and changing demographics this underpins the opportunity for expansion. **We (SM)** will broaden **our (SM)** presence with **our (SM)** pipeline of five hotels and then pursue a 'capital light' strategy. During 2011/12, **we (SM)** invested £4.4 million in Premier Inn International and expect **(hedge)** to invest a further £10-15 million in 2012/13.

#### Restaurants

Restaurants made steady progress with an increase in like for like sales of 1.2% and covers up 4.8% in the second half of the year, after a **disappointing (AM)** first half. **We (SM)** are focused on improving operational performance by strengthening **our (SM)** brands and customer propositions. To achieve this **we (SM)** have appointed a dedicated management team, both centrally and at site level, which has helped drive sales, operational excellence and cost efficiencies.

**Our (SM)** Restaurants management has pursued a number of activities aimed at increasing sales and attracting more customers. These included the continued roll out of the Buffet Place concept within the Brewers Fayre estate. A total of 71 sites were converted in the year taking the total to 95 and these achieved an average sales uplift of 6% on conversion. In addition **we (SM)** made **our (SM)** Premier Inn breakfast fully available to the public and installed Costa 'bean to cup' coffee machines across the estate. To improve operational performance **we (SM)** launched three Skills Academies, which were set up to improve the training for managers and team members in food quality and service. Already 1,700 delegates have passed through these Academies and there are plans for 9,000 team members to attend in 2012/13.

To improve operational performance **we (SM)** launched three Skills Academies, which were set up to improve the training for managers and team members in food quality and service. Already 1,700 delegates have passed through these Academies and there are plans for 9,000 team members to attend in 2012/13.

To mitigate food, labour and utilities inflation **we (SM)** plan to improve cost efficiency through better procurement, menu management and labour scheduling. **We (SM)** continue to expand **our (EM)** restaurant estate and opened 12 new sites in the year, taking **our (EM)** total to 387. **We (SM)** plan to open a further six new sites in 2012/13.

#### Costa

Costa produced another **excellent (AM)** performance during the year with underlying profits up 38.0% to £69.7 million, worldwide system sales up 24.3% to £819.3 million and like for like sales in UK equity stores up 5.5%.

In early 2012 **we (SM)** organised Costa into four divisions: Costa UK Retail; Costa Enterprises (which includes wholesale, corporate franchise and Costa Express); Costa EMEI (which covers operations in Europe, Middle East and India); and Costa Asia. This reflects the increasing breadth and globalisation of the brand and supports **our (SM)** growth strategy for the future.

Costa UK Retail has delivered consistently **good (AM)** like for like sales growth across all channels and regions. Key drivers of success include the Ice Cold Costa Summer campaign which saw category sales rise by 44%, further investment in the estate with some 128 refurbishments and the rollout of new store designs including four Metro stores. **We (SM)** also strengthened **our (SM)** distribution through new channels such as Drive Thru, of which there are now five across the country, with an opportunity for a further 70 locations.

Costa Express had a **good (AM)** year with growth ahead of **our (SM)** original expectations. **Typically (hedge)**, the number of cups sold per machine increases by **around (hedge)** 20% once it is rebranded to Costa Express from Coffee Nation. There are now 1,192 Costa Express machines in the UK which includes 622 conversions. **We (SM)** plan to roll out more than 1,000 Costa Express machines in 2012/13 supported by a new contract with Shell for over 500 machines.

Costa's EMEI region is growing in significance with a total of 647 stores including 95 in India and 93 in Poland. In the year 88 net new stores were opened.

Costa Asia has seen strong growth in China with 69 net stores opened in 2011/12 taking the total to 164, with plans to open a further 100 stores in the year ahead. **We (SM) expect (hedge)** Costa's Chinese business to break even in the second half of 2012/13.

In 2011/12 **we (SM)** opened 332 net new stores; 175 in the UK and 157 overseas taking **our (EM)** total number of stores to 2,203.

**We (SM)** plan to open 350 stores in 2012/13 putting **us (SM) well (AM)** on track to achieve **our (SM)** growth milestones of £1.3 billion system sales, 3,500 stores worldwide and **around (hedge)** 3,000 Costa Express machines by 2015/16.

#### Good Together

**We (SM)** are **delighted (AM)** to have been awarded Platinum status in the 2012 BITC Corporate Responsibility index, which recognises the results **we (SM)** are achieving through **our (SM)** Good Together programme. The programme is focused on three main pillars which are Team and Community, Customer Well-being and Environment.

Within the area of Team and Community, **our (SM)** focus is on providing industry leading apprenticeship schemes and training for **our (SM)** 40,000 team members and supporting community programmes around the world. **We (SM)** created 2,500 new UK jobs in 2011/12 (a significant percentage of which went to the long-term unemployed) and 3,600 nationally recognised qualifications, including apprenticeships, have been awarded to **our (SM)** team members.

**Our (SM)** teams have raised over £1 million for WaterAid and helped build 24 new Costa Foundation schools providing an education to over 14,500 children in coffee-growing communities.

As part of **our (SM)** Customer Well-being strategy **we (SM)** aim to provide trusted products that are sustainably sourced as well as ensuring **our (SM)** customers are given an informed choice. As signatories to the Government's Responsibility Deal **we (SM)** are working closely with the Department of Health to support efforts to reduce salt and artificial additives and make customers more aware of the nutritional content of food and drink. Under the Environment workstream **we (SM)** aim to have the best in sector energy, waste and water initiatives. To date, **we (SM)** have achieved an 11% reduction in energy consumption (relative to sales) and the diversion of 83% of all **our (SM)** waste from **our (EM)** hotels and restaurants from landfill. **We (SM)** have set targets for zero waste to landfill, 15% reduction in water usage and 25% carbon reduction by 2016/17.

#### Management team

Earlier this month **we (SM)** announced that John Derkach will leave **us (SM)** to become Chief Executive of Tragus on 1 August 2012. John has done an **outstanding (AM)** job in leading Costa's **successful (AM)** growth over the last six years.

**We (SM)** wish **(AM)** him every success in his new role.

Following John's departure, Christopher Rogers will take over as Managing Director of Costa and **we (SM)** have already started the search for a new Finance Director.

#### Current trading and outlook

In 2012/13 **we (SM)** shall continue with **our (SM)** progress towards **our (SM)** 2016 growth milestones together with a strong focus on return on capital. This year **we (SM)** plan to open 4,200 new Premier Inn UK rooms, six new restaurants and 350 new Costa stores worldwide.

In the new financial year both Premier Inn and Restaurants have **shown (booster)** positive like for like sales growth and Costa has continued its **good (AM)** momentum, both in the UK and internationally. Trading in 2011/12 was variable month-by-month and **we (SM) expect (hedge)** this to continue with short term comparatives affected by the phasing of bank holidays and the Olympics.

Andy Harrison

Chief Executive

25 April 2012

**Our (SM)** values

Genuine	Confident (AM)	Committed (AM)
<b>Really (booster)</b> caring about customers	Striving to be the best at what <b>we (SM)</b> do	Working hard for each other

#### Chairman's statement

Nearly six months after taking over from Sir David Reid, it is **good (AM)** to have this opportunity to share my perspective on recent developments which **I (SM)** will do under three headings: context; transition; and governance.

## Context

There are many things that strike a newcomer to Tesco. This is a business with an **unusual (AM)** range and depth of core competencies; it has **outstanding (AM)** operational effectiveness; it understands deeply what it means to orientate a business around the customer; it is **passionate (AM)**, and **successful (AM)**, about developing talent from within; and it manages a complex operating environment with great team work.

It is also a business that is not afraid to learn and change, capacities **perhaps (hedge)** more than any others which are **essential (AM)** to long-term growth. In this respect there are three areas in particular worth identifying.

**First (FM)**, Tesco is a business with significant strategic optionality. It has expertise and capital, human and financial, that can be leveraged in different geographies, in different sectors of retailing and through new and different channels, notably **of course (booster)** the internet. The development of these opportunities can make Tesco a stronger company and benefit the UK as a whole. And with such opportunity also comes responsibility – to ensure that the trade-offs between different investments are reached in a disciplined way; and that the optimum balance is struck overall between current returns and future growth.

**Second (FM)**, as the business grows internationally, it is **important (AM)** not only that **we (SM)** explain **ourselves (SM)** to the world but also that **we (SM)** listen and see **ourselves (SM)** as others do. Since arriving at Tesco last year **I (SM)** have visited many different parts of the business around the world, met many of **our (SM)** staff, talked to **shareholders (EM)**, suppliers, commentators, community leaders and to customers. This is the broader context of **our (SM)** business to which **we (SM)** need continuously to relate, openly, honestly and constructively for the long-term benefit of **our (SM)** business. **Third (FM)**, **I (SM)** have been **impressed (AM)** by the skills, commitment and values held by the people who work at Tesco and all of whom not only contribute to its success but make the company what it is. They are a **great (AM)** team and all those with a stake in Tesco have reason to **admire (AM)** and be **grateful (AM)** for their efforts. **I (SM)** would like to **thank (AM)** them, on behalf of the whole **Board (SM)**, for all that they do.

## Transition

This has been a year of transition.

Philip Clarke took over as Chief Executive at the beginning of the year and he has been shaping both the organisation of the business and the management team which inevitably, after a long period of stability, are entering a period of change and development. This work takes time but is **essential (AM)** to **our (SM)** future as a strong and profitable company.

All successful companies go through periods of transition. **Indeed (booster)**, the capacity to change and develop over time is fundamental to **truly (booster)** world-class companies. The critical issue for those responsible is to fully acknowledge the need for and to manage change in a measured and timely fashion when it is called for.

**We (SM)** have moved to address performance issues in the UK. The challenge of refocusing the UK business to ensure it sustains healthy market leadership is **important (AM)** enough to make it worth giving up some profit in the short term to safeguard the business in the long term. **We (SM)** laid out in April how **we (SM)** **intend (hedge)** to do this.

**Elsewhere (FM)**, **we (SM)** have continued the substantial re-orientation of the US business to give it the best possible opportunity to secure its future with all the potential for longer-term growth that **would (hedge)** bring. **We (SM)** have announced **our (SM)** intention to exit from Japan. **We (SM)** are **willing (AM)** to invest for the long term but where **we (SM)** cannot see a profitable, scalable business earning good returns within an **acceptable (AM)** timescale, **we (SM)** **prefer (AM)** to pursue better opportunities. And **we (SM)** have slowed down the development of Tesco Bank to increase its focus on quality, service and risk management. These are substantial changes, in management, organisation and business and they **have to (EM)** be seen as part of a continuing process of moving the company forward, making changes where necessary to ensure long-term stability and sustainable profitability.

## Governance

Governance is the framework that articulates a company's values and supports its behaviours. During the year, **we (SM)** updated **our (SM)** governance framework and processes as described in more detail on page 50. An **important (AM)** aspect of these changes was the creation of the Board Corporate Responsibility Committee to ensure that the **Board (SM)** maintains a strategic focus on corporate responsibility in its widest sense, reflecting the importance to the Group of how it engages externally. When a company has significant economic and social scale it is **essential (AM)** that it reflects on the full nature of its accountability for its activities, and how it should discharge that responsibility to the communities in which it operates. This will be an **important (AM)** focus for the new Committee.

There have been a number of changes to the **Board (SM)**. In addition to Sir David Reid, David Potts retired during the year, Richard Brasher stepped down from the **Board (SM)** in March, and Andrew Higginson will retire in September. **We (SM)** **thank (AM)** them all for their contribution to the business over the years. **We (SM)** are also **pleased (AM)** to welcome Deanna Oppenheimer to the **Board (SM)** as a Non-executive Director. Deanna brings valuable international, retail, banking and digital experience to **our Board (SM)**.

## Financial results

In the year, **we (SM)** delivered sales growth of 7.4%. Profit growth was modest, with a strong international performance **hedge (hedge)** offset by a reduction in UK profits. Trading profit grew by 1.3%, and profit before tax grew by 5.3%. Return on capital

employed improved from 12.9% last year to 13.3%, and **we (SM)** continued **our (SM)** long record of dividend growth for **shareholders (EM)**, with the full year dividend up 2.1% to 14.76p.

The fact that in a year when economic headwinds have been **evident (booster)** in practically every part of the globe **our (SM)** business increased sales, profits, return on capital and dividends speaks for its overall resilience.

Looking ahead

Last year was a **challenging (AM)** one for the business and **we (SM)** are acutely **aware (AM)** that this was reflected for **our (SM) shareholders (EM)** in the share price. **We (SM)** will continue in 2012/13 to address long-standing business issues in the UK and elsewhere in order to secure future prosperity as well as ensuring that **our (SM)** financial and human resources are developed and deployed where they are able most effectively to generate future growth and returns.

If **I (SM)** have one overriding impression of Tesco after six months, it is that here is a **truly (booster)** international business, deploying its expertise across the world to drive opportunity, growth and returns, all of which ultimately benefit the UK. **I (SM) look forward (AM)** to being part of it.

**Sir Richard Broadbent**

Chairman

Chief Executive's review

Building for the future

"My first year as Chief Executive has been a year where **we (SM)** have implemented **important (AM)** changes at Tesco, a year when **we (SM)** have built strength for the future."

It has been a year of significant change and one in which **we (SM)** took decisive action on some very **important (AM)** issues for Tesco: **our (SM)** reset of expectations for the UK for the forthcoming year, the announcement of **our (SM)** intention to dispose of **our (SM)** business in Japan, the focus on moving Fresh & Easy closer to profitability and the renewed focus on delivering a reliable Tesco Bank. As a part of this **we (SM)** made several key management changes during the year which have allowed some significant new appointments as **we (SM)** renew and reinvigorate the Tesco team.

This has very much laid the ground for the future; a future where **we (SM)** will make **sure (booster)** that **our (SM)** capital and **our (SM)** talent are put to work where it benefits most **our (SM)** customers and hence **our (SM) shareholders (EM)**. The future Tesco will **demonstrate (booster)** greater innovation and creativity as **we (SM)** address the needs of consumers around **our (EM)** world – both in store and online.

**We (SM)** regularly deliver over 75 million shopping trips a week and as a retailer are only as **good (AM)** as the last trips. Ensuring that Tesco is highly valued by customers on each and every one of those shopping trips will be what makes Tesco achieve sustainable success. That is what **we (SM)** set out to do every day.

**I (SM) believe (booster)** that **we (SM)** have faced into challenges with real determination and taken decisions for the future. **I (SM) know (booster)** that it has been a tough year to be a Tesco shareholder. **I (SM) know (booster)** too that my whole team and **I (SM)** are **confident (AM)** that the changes **we (SM)** are making are the **right (AM)** things to do – for customers, staff, the business and its **shareholders (EM)** – and that the long-term opportunities for Tesco remain **undiminished (AM)**.

Performance in 2011/12

**We (SM)** delivered modest profit growth in a challenging economic environment, with a strong international performance **hedge (hedge)** offset by a reduction in UK profits. Whilst the year gave **us (SM)** many things to be **proud (AM)** of, overall it was not the most **pleasing (AM)** performance. My team and **I (SM)** are **resolved (AM)** to get Tesco back to winning, particularly at home.

Group sales increased by 7.4% to £72 billion, while Group trading profit was up 1.3% on last year and underlying profit before tax rose to £3.9 billion, an increase of 1.6%. Group capital expenditure in the year was £3.8 billion. Group return on capital employed ('ROCE') increased – to 13.3% (last year 12.9%).

The **Board (SM)** has proposed a final dividend of 10.13p per share, taking the full year dividend to 14.76p, which is an increase of 2.1% on last year.

The decisions **we (SM)** have taken during the year have had an impact on **our (SM)** financial performance. **We (SM)** decided to forego some short-term profit to re-invest in the long-term health of the business, with a clear focus on improving the shopping trip for customers.

The UK business **clearly (booster)** did not meet **our (SM)** own expectations in the year and, partly as a result of this, **we (SM)** decided to accelerate **our (SM)** plan to make improvements which has meant a necessary reset to expectations for **our (SM)** growth in 2012/13 as well. This acceleration and reset were announced with **our (SM)** Christmas trading update in January. Despite this significant re-investment programme, **we (SM)** remain **committed (AM)** to driving higher returns for **shareholders (EM)**. Although **our (SM)** investment plans in the UK make achieving **our (SM)** ROCE target more challenging in the short term, **we (SM)** still **expect (hedge)** to deliver a ROCE of 14.6% by 2014/15, with broadly based growth from around the Group.

Strategic update

In last year's Annual Report, I (SM) set out an evolution of our (SM) strategy into seven parts:

- To grow the UK core;
- To be an outstanding international retailer in stores and online;
- To be as strong in everything we (SM) sell as we (SM) are in food;
- To grow retail services in all our (SM) markets;
- To put our (SM) responsibilities to the communities we (SM) serve at the heart of what we (SM) do;
- To be a creator of highly valued brands; and
- To build our (SM) team so that we (SM) create more value.

This strategy remains as relevant (AM) now as it did a year ago and I'm (SM) pleased (AM) to be able to update you (EM) on the progress we (SM) have made on each of these strategic objectives. I (SM) also set out immediate management priorities for the business last year – keeping the UK strong (AM) and growing (AM); becoming outstanding (AM) internationally, not just successful (AM); becoming a multi-channel retailer wherever we (SM) trade; delivering on the potential of retail services; applying Group skill and scale; and delivering higher returns. You (EM) will see how these priorities have shaped our (SM) actions through the year.

To grow the UK core

In the UK, high petrol prices and falling real incomes affected customers' discretionary spending in the year. The combination of disappointing (AM) sales in the second half of the year and our (SM) decision to increase investment into the shopping trip meant that our (SM) UK performance was weaker than planned. Sales grew by 6.2%, supported by excellent (AM) new store performance, but trading profit declined by (1.0)%.

The issue we (SM) are addressing is that the shopping trip just hasn't been improving fast enough and our (SM) standards haven't been as consistent as our (SM) customers have come to expect. As a result, we (SM) are taking action to improve each aspect of the customer offer. This will involve significant revenue and capital investment in a comprehensive plan encompassing six key areas.

The UK Plan – Building a Better Tesco

Our (SM) Plan for the UK business has six elements:

Service & Staff: helping our (SM) people deliver great service by investment in recruitment, training and equipment, dedicated to particular departments such as produce so that our (SM) customers notice the change.

Stores & Formats: making our (EM) stores better places in which to shop and work, with the pace of new store development moderating, and the pace of refreshing our (EM) existing stores stepping up.

Price & Value: delivering great value for money through the right blend of price, promotions, couponing and loyalty.

Range & Quality: building the right ranges of quality products, reviewing and refreshing our (SM) entire range of Tesco brand products, making our (SM) ranging more store and format-specific, and bringing dunnhumby, our (SM) marketing insight business, back into the heart of Tesco.

Brand & Marketing: making sure (booster) that we (SM) get back to having the right conversation with our (SM) customers about Tesco.

Clicks & Bricks: making this a potent combination for our (SM) customers, with the roll-out of Click & Collect and the transformation of our (SM) range and online presence.

We (SM) are clear (booster) on what we (SM) need to do, we (SM) have trialled substantial elements of the changes and we (SM) know (booster) they work. Our (SM) investment programme has already started and we (SM) expect (hedge) this to deliver stronger results. The Big Price Drop in September 2011 was the first step, but the changes we (SM) are making are about much more than price. They are a combination of price, quality, range and service, including a significant investment to create an additional 20,000 jobs over the next two years. These changes will reinvigorate the shopping trip for customers, and consequently deliver improved performance for shareholders (EM).

To be an outstanding international retailer in stores and online

Our (SM) international businesses performed strongly, with trading profits up 18%, or by 22% before the impact of a crisis tax levied in Hungary. We (SM) have seen progress in our (SM) established businesses, such as in Central Europe, South Korea and Thailand, and from our (SM) newer, rapidly growing businesses, such as Fresh & Easy in the United States and Tesco Malaysia. It is encouraging (AM) that we (SM) are winning market share in almost (hedge) all of our (SM) markets and, in some countries, at a faster rate than for many years.

Asia: another strong performance

I (SM) am pleased (AM) with the performance of our (SM) businesses in Asia. Sales and profit grew well (AM) – sales by over 10%, and trading profit by over 20%. We (SM) delivered solid (AM) like-for-like sales growth and an excellent (AM) contribution from new stores.

Our (SM) business in Thailand had an extraordinary year. The worst flooding for 70 years caused us (SM) to close over 150 stores temporarily and all four of our (SM) distribution depots. The superb (AM) dedication of our (SM) team enabled us (SM) to keep supply lines open for customers and to support staff affected by the flooding, and we (SM) have come out of the crisis stronger. We (SM) grew like-for-like sales and profits in the year. South Korea had another good (AM) year, although I (SM) anticipate (hedge) a modest reduction in like-for-like sales next year as restrictions on trading hours for large retailers are implemented across the country.

In China, we (SM) have continued to focus on building scale in three regions of the country. With the economic environment currently proving challenging for mainstream retailers, we (SM) have decided to take a more cautious stance on the market, at

least for now. **We (SM)** have decided not to commit substantial new capital to freehold shopping centres, and **we (SM)** have also elected to hold back on the pace of new hypermarket development this year. **We (SM)** will only open 16 stores, instead of stepping up as **we (SM)** had planned. **We (SM)** still **believe (booster)** that China can be an engine of growth and **we (SM)** can speed up again when the outlook improves.

**We (SM)** took an **important (AM)** step this year in deciding to exit Japan. It is right to focus on **our (SM)** larger, profitable and growing businesses in the Asia region. It is **never (booster) easy (AM)** to make decisions of this kind and **I (SM)** would like to **thank (AM) our (SM)** staff in Japan for their continued **hard (AM)** work and **professionalism (AM)** through this time.

Europe: growth in a difficult environment

Following a strong performance in Europe in the first half of the year, the performance in the second half was weaker than **expected (AM)**. Sales for the year grew by 8% and trading profit increased marginally, by 0.4%. Trading profit growth **would (hedge)** have been in line with sales had it not been for the impact of the crisis tax imposed in Hungary, which cost £38 million in the year.

The economic background was particularly **difficult (AM)** in Hungary and in the Republic of Ireland this year. Given the current conditions, **we (SM)** are focusing on growth primarily through **our (EM)** existing stores in these markets, rather than investing substantial new capital. In addition to these headwinds in two of **our (SM)** largest markets, profits were held back by disruption connected to the opening of **our (SM)** new distribution centre in Poland, but this is behind **us (SM)** now.

**We (SM)** have made **good (AM)** progress with the closer integration of **our (SM)** European businesses this year, from sharing infrastructure to buying as a single region. This means that **we (SM)** can leverage the skill and scale of the Tesco Group to deliver a better shopping trip for customers and higher returns for **shareholders (EM)**. One example of this is **our (SM)** recent launch of grocery dotcom in Prague, with initial sales **well (AM)** ahead of plan, and **our (SM)** dotcom business in Warsaw will be launched soon.

United States: on the path to profitability

It has been a year of **encouraging (AM)** progress in Fresh & Easy. Sales grew by 27%, with **almost (hedge)** 12 percentage points coming from like-for-like stores. **We (SM)** have also delivered reduced trading losses for the first time, with an 18% improvement on last year. After four years of rising losses, this is a decisive change of trend, driven by further improvements to **our (SM)** customer offer. Features such as in-store bakeries, more loose produce, additional ranges and new Fresh & Easy products have been very popular with customers and **we (SM)** have seen an acceleration in **our (SM)** already strong growth in customer numbers. The progress **we (SM)** have made gives **us (SM)** more confidence that **we (SM)** will deliver a further significant reduction in losses in the coming year. The timing of break-even will be later than **we (SM)** had previously **expected (AM)**, as **we (SM)** will focus on getting more of **our (EM)** existing stores to reach profitability before **we (SM)** step up the rate of new store openings. **We (SM)** can then reach sufficient scale to cover **our (SM)** substantial central overhead costs and **we (SM)** **anticipate (hedge)** that **we (SM)** will reach the break-even point during 2013/14.

To be as strong in everything **we (SM)** sell as **we (SM)** are in food

It has been tough to achieve growth in sales of discretionary items – not least in the UK, where **we (SM)** have seen a number of specialist general merchandise retailers go into administration – and **our (SM)** UK like-for-like growth in general merchandise, clothing and electricals has remained negative. To adjust to this, **we (SM)** have been allocating more space to the most popular products and improving merchandising. **We (SM)** are committing less capital to new space for non-food and instead focusing more resource on continuing to develop **our (SM)** online capability.

Europe and Asia delivered stronger performances in general merchandise, clothing and electricals, despite subdued consumer confidence **even (AM)** in the better performing economies. **I (SM)** was **pleased (AM)** with the performance of clothing in Central Europe, with sales growing by 12% at constant exchange rates. This is testament to the strength of the F&F brand and also to the performance of **our (EM)** new Extra format stores. **We (SM)** ended the year with 44 of the new Extras in Europe and three in Asia. These stores are introducing **our (SM)** customers to a different way of shopping, with stronger ranging and new services, with extremely **encouraging (AM)** results. Different categories of food and general merchandise have their own distinctive look and feel within the Extra store, known as 'Worlds', such as Baby World and Sports World. **We (SM)** are making similar changes to the look and feel within **our (EM)** large UK stores, partly as a result of the **encouraging (AM)** performances in Europe.

To grow retail services in all **our (SM)** markets

Tesco Bank is a key part of the potential **we (SM)** see in retail services. Since **we (SM)** took full control of the Bank in 2008, **our (SM)** focus has been on developing **our (SM)** own systems and infrastructure and recruiting and developing a new team to run the operation. **I'm (SM) delighted (AM)** to say that this period of migration from The Royal Bank of Scotland ('RBS') to **our (SM)** own platforms is now nearing an end. Building a bank is a **complex (AM)** task and **I (SM)** took the decision during the year to slow down the migration, so as to minimise the customer impact. This final stage of migration will be completed imminently, at which point the business can put more emphasis on growth and on developing the potential **we (SM)** see in financial services.

**We (SM)** have delivered **good (AM)** business growth in the year with revenue up 14%, driven by a **good (AM)** performance in the insurance business. The Bank's profit figure includes several accounting adjustments, so **we (SM)** measure business performance using baseline profitability, which increased by a very **encouraging (AM)** 29%. The Bank's capital position has also remained strong through the year, supported by a 7% growth in savings balances.

With the migration **almost (hedge)** completed, the Bank is **well (AM)** positioned for future growth. **We (SM)** are also on track to launch new products, starting with mortgages, to broaden into a full-service retail bank.

To put **our (SM)** responsibilities to the communities **we (SM)** serve at the heart of what **we (SM)** do **We (SM)** have reinforced **our (SM)** commitment to be a good corporate citizen this year: as a retailer, an employer and a neighbour. **We (SM)** employ over half a million people worldwide, which allows **us (SM)** to make a real difference in the communities where **we (SM)** operate. **Our (SM)** core business involves two vital roles in the heart of the community: providing customers with safe, **good (AM)** quality, affordable, nutritious food and creating **good (AM)** jobs and careers. Beyond this, **we (SM)** have **demonstrated (booster)** that **we (SM)** put **our (SM)** responsibilities to communities at the heart of what **we (SM)** do in a huge variety of ways: **I (SM)** want to **pay tribute (AM)** to just some of the **great (AM)** achievements of the last year. **Even (AM)** when their own homes were in danger or flooded, **our (SM)** people in Thailand went to extraordinary lengths for customers. Some **even (AM)** gave up their days off and travelled for hours by boat to continue to get **essential (AM)** supplies to **our (SM)** customers. There is no better example of **our (SM)** colleagues living **true (booster)** to the Tesco Values: 'No one tries harder for customers' and 'Treat people how **we (SM)** like to be treated'. **Our (SM)** responsibility to **our (SM)** people is to provide them with good jobs and careers. In the last year, **we (SM)** have created thousands of jobs across **our (SM)** businesses, invested in a state-of-the-art, zero-carbon training academy in South Korea and have continued **our (SM)** work in the employment of young people, university graduates and the long-term unemployed. **Our (SM)** customer offering is based on strong relationships with **our (SM)** suppliers. For example, **we (SM)** now have supplier academies in all of **our (SM)** Central European markets for suppliers to present their products to **our (SM)** buyers. This enables **us (SM)** to support the growth of **our (SM)** suppliers whilst sourcing the best local and regional products for **our (SM)** customers. Any business on the scale of Tesco has the opportunity to make a significant difference in tackling climate change. **We (SM)** were **proud (AM)** to be recognised by the Carbon Disclosure Project again this year, with Tesco named the top retailer in the world. **We (SM)** will continue **our (SM)** work as **we (SM)** progress towards **our (SM)** ambitious target of being a zero-carbon business by 2050.

To be a creator of highly valued brands

Across **our (SM)** markets **our (SM)** own-label programme encompasses a broad spectrum of ranges to appeal to diverse customer needs, giving customers the quality products they are looking for at competitive prices. In the last year **we (SM)** have expanded **our (SM)** offering, launching new ranges such as Venture Brands in the UK and Europe – including Chokablok chocolate and ice cream and Carousel children's toys – which offer customers premium quality at great prices. **We (SM)** have started to differentiate **our (SM)** ranges more clearly, such as **our (SM)** sub-brands Gourmet and Eat Well in Fresh & Easy and Goodness, which is a range of healthy and nutritious children's products now also available in the UK. **We (SM)** recently relaunched **our (SM)** UK Tesco Value range as Everyday Value, with quality improvements to hundreds of products and new, brighter packaging. This is the first stage in a refresh of **our (SM)** entire range of over 8,000 Tesco brand products in the UK in the next two years, including a comprehensive update to **our (SM)** Tesco Standard range. This is an area of substantial and growing strategic importance for **us (SM)**, as **we (SM)** **recognise (AM)** the role that **our (SM)** brands play in attracting customers and as **we (SM)** start to leverage **our (SM)** expertise in brand management across **our (SM)** markets.

To build **our (SM)** team so that **we (SM)** create more value

Strengthening **our (SM)** management

This time last year **we (SM)** were in the early days of some of **our (SM)** new management structures. **I (SM)** had just introduced a matrix structure throughout Tesco with CEOs for each of **our (SM)** key business areas – the UK, Asia, Europe, and the US – supported by integrating functions, such as Property, Human Resources and Marketing. **I (SM)** am very **pleased (AM)** with how this structure has bedded in and **expect (hedge)** to see even greater value creation as a result.

The introduction of a dedicated UK Operating **Board (SM)** has enabled greater focus at home and given the importance of the changes **we (SM)** are currently making for customers, **I (SM)** have recently decided to assume direct responsibility for the UK business during the process of its renewal.

**I (SM)** have continued to strengthen both the Executive Committee and **our (SM)** senior management teams through the last year, drawing on **our (SM)** **deep (AM)** pool of internal talent.

**We (SM)** have also been **fortunate (AM)** to welcome **our (SM)** new Chairman, Sir Richard Broadbent, following Sir David Reid's decision to retire. **I (SM)** want to **thank (AM)** David for his lasting contribution to Tesco over 26 years on **our (SM)** **Board (SM)** and, on a personal level, for all the help he has given **me (SM)** in settling into my role as CEO.

Building the Tesco team

Tesco's most **important (AM)** asset will **always (booster)** be its people, who live by **our (SM)** Values to do their very best for customers. Many of **our (SM)** plans for the coming year are built on investment in **our (SM)** people. **We (SM)** employ more than half a million people across the globe and this will continue to increase, with plans to create an additional 20,000 jobs in the UK alone in the coming two years and to continue to grow **our (SM)** teams around the world. It is the quality, commitment and dedication of **our (SM)** people that gives **me (SM)** so much confidence that **we (SM)** can and will achieve **our (SM)** plans for the years ahead.

Delivering higher returns

In April last year **we (SM)** set out a target to increase **our (SM)** already **good (AM)** level of ROCE to 14.6% by 2014/15. **We (SM)** improved ROCE from 12.9% to 13.3% in 2011/12. Although it is **likely (hedge)** that **we (SM)** will see a small reduction in 2012/13

as a result of **our (SM)** UK investment plans, **we (SM)** continue to see a number of opportunities to drive returns and **we (SM)** still **expect (hedge)** to deliver **our (SM)** targeted increase to 14.6% by 2014/15.

Doing the right thing

**I (SM)** am **confident (AM)** that **we (SM)** are **ready (AM)** to tackle whatever challenges lie ahead. The decisive action that **we (SM)** have taken in the past year and the management changes which have reinvigorated the Tesco team have laid the ground for the future; a future where **we (SM)** will make **sure (booster)** that **our (SM)** capital and **our (SM)** talent are put to work where it benefits most **our (SM)** customers and hence **our (SM)** shareholders (EM). **We (SM)** have and will continue to focus on doing the right thing for customers, for communities, for staff, for the business and for **our (SM)** shareholders (EM).

**Philip Clarke**

Chief Executive

Chairman's Statement

Anil Agarwal

A Transformational Year

Overview

Vedanta has made **significant (SM)** progress in the execution of its strategy this year, delivering production growth and increasing Reserves and Resources across the portfolio, completing two acquisitions, and announcing a consolidation and simplification of the Group. Over the years, Vedanta has become a world-class, diversified resources company, and this year **we (SM)** added oil & gas to **our (SM)** portfolio.

Robust Financial Results

Despite volatile economic conditions across the world, Vedanta increased volumes across most of its commodities and successfully integrated recent acquisitions, which contributed to **our (SM)** strong EBITDA growth, up 13% to US\$4.0 billion.

This was partially offset by higher operating costs and increased export duty rates on iron ore.

Net debt rose to US\$10.1 billion, (31 March 2011: US\$1.97 billion) and gearing increased to 35% reflecting the investment of US\$8.67 billion in Cairn India Limited (Cairn India), but **we (SM)** continued to maintain a strong and liquid balance sheet and robust credit metrics. Free cash flow remained robust at US\$2.5 billion, ahead of last year's US\$2.4 billion even though this only included **approximately (hedge)** four months of cash flow from Cairn India.

Strong Operational Performance

Record production of refined zinc, lead including silver, power, aluminium, alumina and increased contributions from **our (SM)** recent acquisitions of Zinc-International and Cairn India assets were the key drivers of **our (SM)** strong operational performance as **our (SM)** growth projects started to yield results. The ramp up of the silver-rich Sindesar Khurd mine and the new silver refinery delivered an **impressive (AM)** 35% increase in silver production for the year, with production reaching a new high of 7.8moz and a US\$210 million contribution to EBITDA.

The commissioning of the 2,400MW Jharsuguda power plant and lead smelter at Dariba significantly boosted **our (SM)** power generation and lead production, respectively.

**Our (EM)** newly acquired assets performed well, with Cairn India driving production forward by 21% to an average of 172,887boepd gross with current capacity now at 175,000boepd following the ramp up of the Mangala and Bhagyam fields in Rajasthan and Zinc-International's output was **well (AM)** ahead of the last year at 444kt.

This performance is the result of the hard work and commitment of **our (SM)** 32,000 employees across the organisation and on behalf of the **Board (SM)**, **I (SM)** would like to **thank (AM)** them for their contribution to this **excellent (AM)** performance.

Market Conditions

Despite volatile global market conditions, demand for commodities remained strong throughout the year, driven by economic growth and urbanisation in emerging economies, which account for **approximately (hedge)** 80% of **our (SM)** revenues. Commodity prices were strong in the first half of FY 2012, but corrected in the second half of the year, with the end result that prices for silver moved up substantially, iron ore **showed (booster)** a healthy increase, zinc prices fell and copper, aluminium and lead were marginally ahead of the previous year. Oil prices increased over the year.

Growth rates in India, **our (SM)** home market, moderated to 6.9% due to higher inflation. Demand for natural resources however continued its upward trend, particularly for aluminium with India projected to become the second largest consumer of aluminium in Asia during CY 2012. Over the long term, **we (SM)** **believe (booster)** that the increasing size of the domestic market in India and favourable demographics will continue to drive robust economic growth.

Vedanta is a significant contributor to the Indian economy and government exchequer. **We (SM)** meet 82% of India's zinc consumption and **approximately (hedge)** 40% of its aluminium, copper and lead requirements.

The Group contributes 20% of India's crude oil production, reducing the requirement for imports and foreign currency expenditure. In this financial year, **we (SM)** contributed US\$4.4 billion, including US\$2.4 billion of Cairn for the full year, to the Indian exchequer towards direct and indirect taxes, royalty, cess on oil etc.

Key Strategic Developments

Growth



**We (SM)** continued to focus on extending **our (SM)** existing resources and growing **our (SM)** assets organically, investing in projects that expand **our (SM)** high quality asset base and increase **our (SM)** production volumes. During the year, **we (SM)** invested US\$2.4 billion in **our (SM)** organic growth programme, increasing production of zinc-lead, silver, copper, aluminium, power and oil & gas.

**We (SM)** have successfully completed the integration of the assets acquired from Anglo American last year, now **our (SM)** Zinc-International segment. The assets **we (SM)** acquired also included the Gamsberg deposit in South Africa, which is one of the largest undeveloped zinc deposits in the world. With a resource base of 186mt deposit, Gamsberg has the potential to deliver over 400ktpa over a mine life of more than 20 years and a feasibility study is under way to scope the project.

**We (SM)** extended **our (SM)** resources portfolio into oil & gas with the acquisition of the controlling stake in Cairn India for US\$8.67 billion, financed equally from **our (SM)** own resources and acquisition debt. Cairn India is the largest private crude producer in India. Its world class assets in Rajasthan currently contribute more than 20% of India's production. These assets carry gross recoverable oil Reserves and Resources of **approximately (hedge)** one billion barrels and have a potential to produce **roughly (hedge)** 40% of India's oil production. The acquisition of a controlling stake in Cairn India has added an additional high quality asset in an attractive natural resources segment and will contribute to the earnings profile of the Group.

During the year, **we (SM)** acquired iron ore deposits in Liberia in Western Africa, with Reserves and Resources **estimated (hedge)** at over 1 billion tonnes. **We (SM) intend (hedge)** to bring these assets, which comprise brown field as well as green field sites, into production over the next two to three years. With this acquisition, Vedanta will become a significant player in the upcoming West African iron ore hub catering to the seaborne iron ore trade. This acquisition is a logical and strategic fit with Sesa Goa's existing iron ore business and is **expected (hedge)** to create significant long-term value for **shareholders (EM)**.

#### Long-term Value

**We (SM)** have maintained **our (SM)** position as a low cost producer through **our (SM)** culture of continuous improvement. As well as major investment projects, a myriad of small projects have been implemented across all **our (SM)** businesses to reduce energy consumption, improve productivity, debottleneck processes and increase efficiency.

To ensure the long-term future of the Group, **we (SM)** aim to grow **our (SM)** Reserves and Resources ('R&R') at a faster rate than **we (SM)** deplete them, through exploration and acquisitions. Exploration focus yielded **excellent (AM)** results during the year particularly for zinc, oil & gas and iron ore.

In line with **our (SM)** strategy to simplify **our (SM)** corporate structure, towards the end of the year **we (SM)** announced a merger of Sesa Goa Ltd and Sterlite Industries (India) Ltd to create Sesa Sterlite Ltd, and a consolidation of the Vedanta Group. As part of the Group consolidation, Vedanta's stake in Cairn India and Vedanta Aluminium will move under Sesa Sterlite. Sesa Sterlite Ltd is **expected (hedge)** to be one of the world's largest global diversified natural resources majors, ranked by EBITDA.

The simplification of the Group structure is **expected (hedge)** to yield significant benefits through a more efficient capital structure, increased flexibility to allocate capital, broader access to capital markets and enhanced visibility of earnings and cash flow. The merger will also generate significant synergies for the **shareholders (EM)** of Sesa Goa, Sterlite and Vedanta.

#### Sustainability

**We (SM)** have continued to focus on aligning **our (SM)** policies and management systems to the sustainability standards recognised internationally by the IFC, ICMM and UNGC. This year **we (SM)** have completed the development of a comprehensive Sustainability Framework that is now being rolled out across **our (SM)** operations and **I (SM)** am **pleased (AM)** to say that **we (SM)** have signed the UN Global Compact.

**We (SM)** want to go even further and embed sustainable development into every aspect of what **we (SM)** do which is one of the five priorities that **I (SM)** have set. The others are to:

- Improve **our (SM)** health and safety performance for a safer, more secure and healthier environment for every employee and contractor
  - **We (SM)** work in an inherently risky industry and it is with great **regret (AM)** that **I (SM)** **have to (EM)** report 22 fatalities this year. **Our (SM)** efforts to eliminate unsafe conditions and unsafe behaviour are starting to yield results. **Our (SM)** quarterly figures **show (booster) good (AM)** progress and **our (SM)** lost time injury rate continues to fall, reducing by 10% year on year.
- Contribute further and in a more targeted way to local communities
  - **We (SM)** are passionately **committed (AM)** to making a difference to **our (SM)** local communities, contributing US\$38 million this year to community development projects, benefiting over 3 million people.
- Continue to manage and minimise **our (SM)** impact on air, water and land
  - **Our (SM)** environmental focus on reducing specific consumption of energy and water is making sound progress with most of **our (SM)** operations yielding significant positive results.
- Maintain a dialogue with **Stakeholders (EM)** to help **us (SM)** understand and respond to their material issues
  - So far over 1,000 people have received training in the new Sustainability Framework and implementation is continuing.

Achieving **our (SM)** goals will take a great deal of hard work, but **we (SM)** are **committed (AM)** to **our (SM)** journey of continuous improvement.

#### Dividends

In line with **our (SM)** policy to progressively increase **our (SM)** dividend payments to **shareholders (EM)**, the **Board (SM)** has recommended a final dividend of 35 US cents per share, an increase of 8% that will be paid on 5 September 2012 to **shareholders (EM)** on the register on 17 August 2012. This takes the total dividend for the year to 55 US cents per share, 5% above last year.

Looking Forward

**We (SM)** start the new financial year with a world-class asset portfolio, a low cost structure and a strong near-term growth profile. The outlook for natural resources remains robust: industrialisation and urbanisation in China and India and other emerging economies continues to drive demand and Vedanta is well-positioned to serve these markets. **Our (SM)** significant capital investment programme, which has **hedge (hedge)** been invested, will deliver near-term production growth across **our (SM)** portfolio, in turn driving strong cash flow growth. Looking further forward, Cairn India, Liberia and Gamsberg offer **outstanding (AM)** opportunities to grow **our (SM)** production **well (AM)** into the future.

Anil Agarwal

Chairman

16 May 2012

## ET ÅR MED FREMGANG

2012 har for PANDORA været et år præget af forandringer og forbedring af **vores (EM)** forretning. **Vi (SM)** startede året med en **klar (AM)** strategi om at gennemføre to centrale tiltag:

- Tilpasning af **vores (SM)** produkt- og prisstrategi (det rigtige produktsortiment)
- Forbedring af kvaliteten af forhandlernes lagerbeholdninger (ombytning af udgåede produkter med hurtigt sælgende produkter)

**Vi (SM)** mener, at de tiltag **vi (SM)** satte i værk i 2012, er blevet gennemført med succes. **Vi (SM)** ombyttede produkter i forhandlerledet til en værdi af DKK 609 millioner og erstattede dem med Best Sellers. Dermed fjernede **vi (SM)** flaskehalsen af langsomt sælgende produkter på forhandlernes lagre, hvilket gav forhandlerne mulighed for at købe nye produkter for den frigjorte likviditet.

Strategien har skabt øget goodwill hos forhandlerne, der har værdsat de tiltag, PANDORA har gennemført for at afhjælpe lagerproblemerne.

**Vi (SM)** lancerede nye, innovative produkter, til kommercielt rigtige priser, og alle årets kollektioner solgte godt ind i butikkerne (en gros) og – endnu **vigtigere (AM)** – også ud af butikkerne (detail). For at sikre **vores (SM)** forhandlere større udskiftning og mere fornyelse i produktsortimentet vil **vi (SM)** fremadrettet lancere syv kollektioner om året med færre nye designs pr. leverance fordelt på flere leverancer. Hyppigere og mindre leverancer vil minimere risikoen for opbygning af for store lagre hos forhandlerne. Alle **vores (SM)** 2012-produktlanceringer klarede sig godt, både hvad angår salget ind til butikkerne og salget ud af butikkerne, og **vi (SM)** bruger de gode erfaringer til at skabe **vores (SM)** kommende kollektioner. I 2012 har **vi (SM)** forbedret **vores (SM)** dataindsamling, så **vi (SM)** nu er i stand til at følge det daglige salg ud af butik på produktniveau fra de fleste af **vores (EM)** konceptbutikker. Denne viden er af afgørende betydning for at måle **vores (SM)** kommercielle performance og samtidig sikre den rette balance i salget ind til og ud af butikkerne.

Herudover har **vi (SM)** arbejdet hårdt på at forbedre mange andre områder af forretningen. **Vi (SM)** har især fokuseret på **vores (EM)** konceptbutikker og på at gøre det lettere for kunderne at handle. **Vi (SM)** har arbejdet med zoning ved at præsentere produkterne i kategorier frem for i kollektioner, og ved at udstille produkterne i displays på gulvet, så kunderne har mulighed for at både se og røre dem. Endelig har **vi (SM)** gjort priserne mere synlige og har udviklet den måde, hvorpå **vi (SM)** visuelt præsenterer produkterne, for at gøre butikkerne friskere og mere kundenvenlige.

Resultatet af disse tiltag var en stigning i det direkte sammenlignelige salg ud af konceptbutikkerne på **vores (SM)** fire største markeder i fjerde kvartal 2012 (en stigning i USA på 7%, i Australien på 10%, i Storbritannien på 12% og i Tyskland på 5%).

**Vi (SM)** fastholdt **vores (SM)** fokus på brandede butikker i 2012 og åbnede 223 konceptbutikker og 83 shop-in-shops. **Vi (SM)** tror **(AM)** på branded salg og vil fortsat åbne konceptbutikker og shop-in-shops. **Vi (SM)** har nu et tættere samarbejde med **vores (SM)** vigtigste kunder og hjælper dem med at forbedre uddannelse af deres medarbejdere og måden, hvorpå de visuelt præsenterer produkterne, og **vi (SM)** tilbyder koordinerede markedsføringskampagner og kundespecifikke produkter.

PANDORA er på mange måder stadig et ungt selskab, der inden for relativ kort tid er fusioneret med en række eksterne distributører og er blevet en global virksomhed. Som en konsekvens af denne overgang har **vi (SM)** strømlinet mange dele af **vores (SM)** forretning. **Vi (SM)** har centraliseret varelagre, forbedret **vores (SM)** globale it-systemer og implementeret bedre processer for, hvordan **vi (SM)** arbejder som en samlet, effektiv virksomhed. Disse tiltag er nødvendige, men kræver også tid og tilføjelse af omkostninger, før **vi (EM)** kan drage fordel af dem. Det er **vores (SM)** opfattelse (**hedge**), at relevante potentielle forbedringsprojekter nu er identificeret og igangsat, og **vi (SM)** forventer (**hedge**) at afslutte størstedelen i løbet af 2013.

**Vores (SM)** strategi forbliver uændret. 2013 vil være et år, hvor **vi (SM)** planlægger at skabe kontrolleret vækst ved fortsat at forbedre det direkte sammenlignelige salg ud af butikkerne, især i de brandede butikker, og ved at etablere distribution af høj kvalitet på såvel nye som eksisterende markeder.

**Vi (SM)** vil fortsat fokusere på at udvikle **vores (SM)** væsentligste markeder og samtidig åbne nye butikker på **vores (SM)** såkaldt nye markeder – Asien, Italien, Frankrig, og Rusland. Det er **vigtigt (AM)** at fokusere på kvalitet frem for kvantitet. **Vi (SM)** vil være mere selektive i **vores (SM)** butiksåbninger og fokusere på kvaliteten af den enkelte butik frem for på mængden af butiksåbninger. Det er **vores (SM)** plan at åbne **ca. (hedge)** 150 nye konceptbutikker i 2013.

**Vi (SM)** vil fortsat arbejde ihærdigt med at forbedre **vores (SM)** produkter. **Vores (SM)** primære fokus vil være på **vores (SM)** hovedkategorier, charms og charms-armbånd, men **vi (SM)** anser **(booster)** også ringe for at have et væsentligt fremtidigt vækstpotentiale. Endelig vil **vi (SM)** fortsat udvikle **vores (SM)** øvrige kategorier, øreringe, halskæder og ure, der bidrager til at skabe et komplet produktsortiment.

**Vores (SM)** 2013-kollektioner vil være baseret på de succeser, **vi (SM)** har opnået i salget ud af butikkerne, og vil indeholde flere produkter til kommercielt rigtige priser, der sælger godt hos forhandlerne. **Vi (SM)** arbejder på nye, innovative koncepter inden for kategorierne charms og charms-armbånd og planlægger at lancere et nyt koncept i forbindelse med julen 2013.

**Vi (SM)** opfatter **os (SM)** selv som en produktvirksomhed – for **os (SM)** er produktet det **vigtigste (AM)**. Samtidig **ved (booster) vi (SM)**, hvor **vigtig (AM)** markedsføring er for **vores (EM)** succes. I løbet af meget kort tid er PANDORA blevet et globalt brand med høj kendskabsgrad og et positivt image rundt om i verden. **Vi (SM)** vil fortsætte væsentlige investeringer i markedsføring. Det er **vores (SM)** opfattelse **(hedge)**, at **vi (EM)** kan få mere ud af det eksisterende investeringsniveau ved at flytte ressourcer fra reklameproduktion til medier, mere fokuseret på de digitale medier og tv og mindre på trykte medier. PANDORA bliver fulgt af mange på de sociale og digitale medier; 1,6 millioner "likes" på Facebook samt 2,9 millioner medlemmer af PANDORA Club er et **tydeligt (booster)** bevis herpå.

**Vi (SM)** mener, at **vores (SM)** produkter egner sig godt til onlinesalg. Tilgængelige priser, ideelle som gaver, lave fragtomkostninger og at de fleste fås kun i én størrelse, bortset fra ringe og kæder, betyder, at få produkter bliver returneret. Sidst i november 2012 lancerede **vi (SM)** et pilotprojekt – en PANDORA Estore – i Storbritannien, som udbyder hele **vores (SM)** produktsortiment. Resultatet er meget lovende, og **vi (SM)** vil nu udvide denne i Storbritannien og samtidig arbejde på at udvikle **vores (SM)** online-distribution på alle væsentlige markeder. Det er **vores (SM)** mål at åbne PANDORA Estore på flere europæiske markeder i løbet af 2013.

**Bestyrelsen (SM)** har i 2012 gennemgået **vores (SM)** kapitalstruktur. Resultatet af gennemgangen er, at **vi (SM)** ændrer **vores (SM)** udbyttepolitik. Tidligere sigtede PANDORA mod en udbytteprocent på **omkring (hedge)** 35% af årets resultat, men har nu valgt med udgangspunkt i udbyttet for 2011 på DKK 5,50 pr. aktie at opretholde et stabilt og herefter stigende nominelt udbytte pr. aktie. Ud over det, og for at nå **vores (SM)** mål om en netto rentebærende gæld i forhold til EBITDA på 0-1x målt på 12-måneders løbende basis, har **bestyrelsen (SM)** endvidere besluttet at iværksætte et aktietilbagekøbsprogram på op til DKK 700 millioner for 2013. Disse initiativer sender et stærkt signal om **vores (SM)** tiltro til **vores (SM)** yderst effektive og likviditetsskabende forretningsmodel, der sætter **os (SM)** i stand til at tilbagebetale overskydende likviditet til **vores (SM)** aktionærer.

2012 var et hårdt år. **Vores (SM)** medarbejdere arbejdede hårdt og fokuseret på at implementere de tiltag, **vi (SM)** introducerede i 2011, og i tredje og fjerde kvartal 2012 begyndte **vi (SM)** at se tydelige resultater. Det direkte sammenlignelige salg ud af konceptbutikkerne steg, **vores (SM)** nye produkter solgte godt ind til og ud af butikkerne, **vores (SM)** lagerbeholdninger blev reduceret og forhandlernes varelager blev ligeledes forbedret, både i kvalitet og værdi. **Vi (SM)** **ved (booster)**, at **vi (SM)** fortsat skal arbejde hårdt, og at der er områder, **vi (SM)** skal forbedre, men **vi (SM)** er **overbevist om (booster)**, at **vi (SM)** er på vej i den rigtige retning.

Allan Leighton

Bjørn Gulden

Chairman Chief

Executive Officer

## BREV TIL VORES (SM) AKTIONÆRER

### VÆKSTFAKTORER

Omsætningen steg med 10% til EUR 699 mio. og den organiske vækst med 8% (11% justeret for højere salgspriser, der afspejler ændrede råvarepriser på karmin). Alle tre divisioner bidrog til væksten.

Cultures & Enzymes Division opnåede en solid organisk vækst på 10%. Mejerikulturer til fremstilling af ost og fermenteret mælk oplevede høj vækst, mens usikkerheden om anvendelse af sundhedsanprisninger af fødevarer i EU fortsat påvirkede salget af probiotiske kulturer negativt.

Health & Nutrition Division leverede stærk organisk vækst på 13%, drevet af både human og animal health-produkter.

Den organiske vækst i Natural Colors Division lå på 2%, men 12% justeret for ændringer i salgspriserne der afspejlede de lavere råvarepriser på karmin i 2011/12. Væksten var drevet af en fortsat konvertering fra syntetiske farver til naturlige farver.

#### RENTABILITET

EBIT steg med 16% til EUR 185 mio., mens EBIT-marginen steg fra 25,0% i 2010/11 til 26,5% i år. Fremgangen skyldtes især effekten af lavere råvarepriser på karmin og stordriftsfordele i Health & Nutrition Division og Natural Colors Division, mens EBITmarginen i Cultures & Enzymes Division faldt, primært på grund af nedskrivning af aktiverede omkostninger til kliniske studier.

#### INVESTERING I FREMTIDEN

Hos Chr. Hansen fortsætter **vi (SM)** med at investere i fremtiden. Forsknings- & Udviklingsomkostningerne for 2011/12 udgjorde 7% af omsætningen og ventes at forblive på dette niveau i den nærmeste fremtid. I 2011/12 er der foretaget betydelige investeringer i fortsat at øge **vores (SM)** viden om og dokumentation for de sundhedsmæssige fordele ved probiotiske kulturer på baggrund af omfattende kliniske studier. Et studie af probiotiske kulturers effekt på det menneskelige immunsystem blev afsluttet i september 2012. Studiet er baseret på mange års forskning i probiotiske kulturer og er en **vigtig (AM)** del af **vores (SM)** strategi om at differentiere **os (SM)** gennem dokumentation. Selv om studiet har øget **vores (SM)** viden om effekten af probiotiske kulturer, vurderer vi, at de foreliggende data er utilstrækkelige til at opnå godkendelse af sundhedsanprisning i EU i henhold til artikel 13, stk. 5, og der er derfor foretaget en nedskrivning af aktiverede udviklingsomkostninger på EUR 4 mio. Der er behov for yderligere bearbejdning og analyse af den viden, der er indhentet i dette og tidligere studier, før en ansøgning kan indgives.

**Vi (SM)** investerer desuden fortsat i procesoptimering samt nye innovative produkter. En række produkter blev lanceret på tværs af organisationen i løbet af året. Produkter, der er udviklet inden for de seneste tre år, tegnede sig for 14% af omsætningen i 2011/12.

**Vi (SM)** fortsatte investeringerne i produktionsanlæg i 2011/12. Ny frysetørningskapacitet til **vores (SM)** Health & Nutrition Division er under opførelse, og fermenteringsanlægget i København er blevet suppleret med en fuldautomatisk pakkelinje til frosne kulturer. Planlægningen af kapacitetsudvidelse i København blev ligeledes påbegyndt i 2011/12 med henblik på etablering i løbet af de næste to år. Natural Colors Division oplevede fortsat høj volumenvækst, og **vi (SM)** har investeret i ny produktionskapacitet til nye Ultra Stable Red™-anthocyaninfarver, som blev lanceret i september 2012.

Fortsat investering i **vores (SM)** medarbejdere er stadig **vigtig (AM)** for at sikre succes for Chr. Hansen. I 2011/12 steg det samlede antal kursusdage pr. medarbejder pr. år med 21% til 3,1. Uddannelsesforløbene har omfattet intensive lederudviklingsprogrammer og uddannelse i konkurrenceret samt bekæmpelse af korruption.

Medarbejdertilfredshedsundersøgelsen blev gennemført i 2011/12 med et resultat, der var et godt stykke over benchmark i branchen, men dog marginalt lavere end resultatet af den forrige undersøgelse fra 2009/10.

#### RESSOURCEEFFEKTIVITET

At skabe værdi for virksomheden og samtidig minimere den miljømæssige påvirkning fra forretningsaktiviteterne er afgørende, ikke kun for Chr. Hansen, men også for **vores (SM)** kunder. I 2011/12 blev der lanceret adskillige produkter, der potentielt **kan (hedge)** hjælpe kunderne med at reducere miljøpåvirkningen fra deres virksomhed, herunder produkter, der kan reducere affaldsgenereringen som følge af fordærv af fødevarer hos detailhandlere eller reducere ressourceforbruget hos kunderne.

#### AKTIONÆROPLYSNINGER

I januar 2012 indgik den tidligere hovedaktionær Financière Star 1, Luxembourg en aftale om at sælge deres aktiepost på 25,7% i Chr. Hansen Holding A/S til NOVO A/S, Danmark. Ved udgangen af 2011/12 ejede internationale institutionelle investorer **ca. (hedge)** 55% af aktiekapitalen, mens de resterende 45% af aktiekapitalen var ejet af danske investorer, herunder Novo A/S' andel og private investorers andel på 7-8%.

#### KAPITALSTRUKTUR OG UDBYTTE

I april 2012 indledte **bestyrelsen (SM)** et aktietilbagekøbsprogram med det formålet at tilpasse kapitalstrukturen via udlodning af overskydende kapital til aktionærerne. **Bestyrelsen (SM)** vil søge at fastholde en gearing, der er i overensstemmelse med en solid

”investment-grade” kreditvurdering mens overskydende kapital returneres til aktionærene, enten gennem ordinære og ekstraordinære udbyttebetalinger eller gennem aktietilbagekøbsprogrammer.

Selskabets udbyttepolitik er at udbetale et udbytte på 30-50% af årets resultat. Der foreslås et udbytte på EUR 0,39 (DKK 2,90) pr. aktie for regnskabsåret 2011/12, svarende til EUR 52 mio. Udbyttet svarer til 40% af årets resultat. Forslag til udbytte sker på baggrund af **bestyrelsens (SM)** vurdering af forretningsudvikling, vækststrategi samt finansieringsbehov. Der er ingen **sikkerhed (hedge)** for, at der vil blive foreslået eller udloddet udbytte i et givet år.

#### FREMTIDEN

Chr. Hansen er godt rustet til fremtiden. Der er planlagt investeringer i medarbejdere og kapacitet, og **vi (SM)** ser stadig attraktive vækstmuligheder i **vores (SM)** kerneforretning, men også i beslægtede brancher, hvor **vi (SM)** kan udnytte **vores (SM)** kernekompetencer inden for fermentering af kulturer og fremstilling af naturlige farver. **Vi (SM)** vil også fokusere på fortsat at øge forståelsen af sundhedseffekterne af probiotiske kulturer gennem øget dokumentation, selv om dette **formentlig (hedge)** vil tage længere tid end oprindeligt **forventet (AM)**.

Ole Andersen

Lars Frederiksen

Bestyrelsesformand

Adm. direktør

#### Meddelelse fra Gruppens administrerende direktør

Gruppen leverede et **tilfredsstillende (AM)** resultat i 2012 og fortsatte sin strategi, der inkluderer et væsentligt investeringsprogram, der fokuserer på at bygge og udvide fire forretninger i verdensklasse over de næste fem år. resultatet og afkastet af den investerede kapital lå over 2011, men under målet om 10% vækst for hele perioden, hovedsagelig som følge af ugunstige shippingmarkeder, der påvirkede indtjeningen i henholdsvis container- og tankskibsforretningen. Ikke-shipping relaterede aktiviteter leverede fortsat gode resultater. **Vores (SM)** forretningsenheder er konkurrencedygtige og får særdeles positive vurderinger af kunder og partnere for kvalitet og pålidelighed. Maersk Line formåede desuden at reducere omkostninger og forbedre rater efter en vanskelig start på året som følge af lave containerfragtrater.

#### FREMME VÆKST

Med en vækst på 2,5% i 2012 er den globale vækst stadig afdæmpet, og da **vi (SM) forventer (hedge)** et lignende niveau i 2013, regner **vi (SM)** med, at de vigtigste shippingkorridorer fortsat vil være svage på kort sigt. Ved at koncentrere vore transport- og infrastrukturinvesteringer omkring vækstmarkederne kan Gruppen medvirke til at realisere det økonomiske potentiale i lande, hvor flaskehalse i logistikken bremser vækst.

Containerskibene til Maersk Lines afrikanske og sydamerikanske rutenet, købet af Global Ports i Rusland og etableringen af en større containerterminal i Mexico er eksempler på sådanne investeringer og partnerskaber med regeringer. Gruppen vil fortsat udnytte sin globale tilstedeværelse til at realisere flere muligheder på vækstmarkeder med det formål at opnå en sund geografisk spredning på langt sigt.

Derudover optimerer Gruppen løbende sin forretningsportefølje for at sikre, at positionerne styrkes i de mest lovende segmenter inden for de industrier, hvor forretningsenhederne opererer.

#### VORE AMBITIONER

Gruppen afholdt sin første kapitalmarkedsdag i oktober 2012. I en omskiftelig verden revideres strategier og mål jævnligt, men ved at lægge vore ambitioner åbent frem, sigter **vi (SM)** mod at forbedre vore resultater og motivere hele organisationen til at arbejde sammen og opbygge en endnu stærkere virksomhed til gavn for vore aktionærer og partnere på tværs af forretninger og landegrænser over hele kloden. Maersk Line, Maersk Oil, APM Terminals og Maersk Drilling har hver især **vist (booster)** gode fremskridt mod deres mål om at blive Gruppens stærke hjørnestene, hver med et overskud på over USD 1,0 mia. og operationelle resultater i verdensklasse.

Gruppen havde tillige succes med at afslutte aktiviteter, der ikke længere var at **anse (AM)** for kerneforretninger, eksempelvis Maersk LNG og den store FPSO Maersk Peregrino, hvilket frigav kapital på op imod USD 3,4 mia. til investeringer i de fortsættende forretninger.

På sikkerhedsområdet har Gruppen også gjort fremskridt og fortsatte dermed sidste års positive udvikling. Antallet af dødsfald er dog fortsat for højt. I 2012 mistede 17 kolleger livet, mens de var på arbejde. **Vi (SM) anser (AM)** ét dødsfald for at være ét for meget, og **vi (SM)** har en **klar (AM)** målsætning om at undgå dødsulykker ved systematiske sikkerhedsforbedringer.

#### OPFYLDE PRIORITETER

Med forventningen om en fortsat afdæmpet vækst i 2013 er det **vigtigt (AM)** for Gruppen at have fokus på vore forretningsenheders drift og resultater, så Gruppen kan levere et godt resultat og leve op til vore partners og kunders forventninger.

Det vil bl.a. bestå i at sikre, at der sker fremskridt inden for en række meget betydningsfulde projekter på tværs af gruppens strategiske kerneforretninger: For Maersk Oil er det **vigtigste (AM)** mål at opnå de planlagte fremskridt for centrale projekter som El Merk i Algeriet, Chissonga i Angola og Johan Sverdrup i den norske del af Nordsøen.

I Maersk Drilling udvides flåden med tre nye borerigge i slutningen af 2013 og starten af 2014. Målet er at få dem leveret og taget i drift uden forsinkelser eller ekstra omkostninger. Maersk Line vil fortsætte sin effektive kapacitetsstyring i forbindelse med leveringen af de første nye Triple-E skibe, som vil tilgå flåden i år.

APM Terminals' topprioritet er en effektiv gennemførelse af Santos terminalprojektet i Brasilien (åbner i starten af 2013) og Maasvlakte II projektet i Holland. En anden prioritet er optimering af Gruppens balance med henblik på yderligere vækst. Det fremgår af Gruppens betydelige vækstplaner, som i 2013 medfører investeringer for **ca. (hedge) USD 9 mia.** Ud over de allerede indgåede forpligtelser **forventer (hedge) Gruppen**, at der vil opstå attraktive muligheder i de kommende år. Alle forretningsenheder vil derfor iværksætte en gennemgang af deres balancer med henblik på at identificere aktiver med lavt afkast og afvikle marginale ikke-kerneaktiviteter for at frigøre kapital til de mest lønsomme investeringer. Andre initiativer til kapitaleffektivisering vil blive iværksat for at gøre det muligt for Gruppen at realisere attraktive vækstmuligheder. Gruppen har fastholdt sin finansielle fleksibilitet og er godt forberedt på at eksekvere sine investeringsplaner. Gruppen har en stærk likviditetsbuffer og har ikke behov for refinansiering på mellemkort sigt.

Alt i alt var 2012 et godt år for A.P. Møller - Mærsk Gruppen, og **jeg (SM)** vil gerne **takke (AM) vores (SM)** medarbejdere og ledere for de gode resultater og deres engagement.

Nils Smedegaard Andersen

#### EN FREMTID I FÆLLESSKABETS TEGN

Novozymes' forretningsmodel stod sin prøve i 2012, da en række individuelle udfordringer blev overvundet af den diversificerede forretningsportefølje og den øgede driftseffektivitet. **Vi (SM)** lagde også grundstenene til nye og lovende partnerskaber, der **viser (AM)**, hvor vidtrækkende **vores (SM)** strategiske muligheder er i **vores (SM)** arbejde med at udvikle bæredygtige, biologiske løsninger til nogle af verdens mest presserende udfordringer.

Global befolkningstilvækst og økonomisk fremgang øger fortsat presset på den industrialiserede verden, der er funderet på begrænsede ressourcer. Selv om debatten om klimaforandringer og grøn teknologi er trådt i baggrunden som følge af bekymringer for økonomien og budgetbegrænsninger, er der stadig behov for at gentænke morgendagen.

#### SAMMEN ER **VI (EM)** STÆRKERE

Det forløbne år var et strategisk **vigtigt (AM)** år for Novozymes, idet virksomheden indgik historisk mange partnerskaber med førende globale virksomheder såsom Syngenta, Beta Renewables og BASF.

Partnerskaber er ikke nyt for Novozymes. **Vores (SM)** evne til at skabe og fremme tætte kunderelationer har længe været betragtet som en konkurrencefordel, som bidrager til at gøre forretningsforhold mindre komplekse, udveksle viden og afstemme interesser. I takt med at Novozymes' teknologiske kapacitet er vokset, er de samfundsmæssige og økonomiske fordele ved virksomhedens biologiske løsninger blevet tydeligere. Det har åbnet nye markeder for **os (SM)** og dermed skabt et voksende behov for nye partnerskaber.

Erstatninger for kemikalier, avancerede biobrændstoffer, biologiske pesticider m.m. giver **os (SM)** rige muligheder for at gentænke morgendagen. Ved at gå sammen med samarbejdspartnere i hele værdikæden, der alle arbejder hen imod et fælles mål, kan **vi (SM)** rykke grænserne yderligere på det enkelte marked og dermed potentielt tilbyde kunderne bedre biologiske løsninger hurtigere.

#### FÆLLES VÆKST

Novozymes går sammen med mange forskellige interessenter i det globale samfund om at skabe innovation og investere i

morgendagens biobaserede, vedvarende samfund. Jo mere **vi (SM)** lærer af hinanden, jo hurtigere når **vi (SM)** målet.

#### NYT LEDERSKAB

De interne partnerskaber er lige så vigtige som de eksterne, da de er afgørende for at skabe tillid og fremme samarbejde, innovation og lederskab. Partnerskabet mellem **topledelsen (SM)** – med den administrerende direktør i spidsen – og **bestyrelsen (SM)** er et internt partnerskab af altafgørende betydning. 2013 bliver et forandringsår for Novozymes, idet Steen Riisgaard, som har stået ved roret siden 2000, hvor Novozymes blev etableret som selvstændig virksomhed, fratræder sin stilling den 31. marts.

Steen har i de forløbne 12 år bidraget væsentligt til Novozymes' succes og efterlader sig en tung arv. Som virksomhedens frontfigur i tæt samarbejde med resten af organisationen har Steen med stor dygtighed fordoblet Novozymes' omsætning og antal medarbejdere, tredoblet indtjeningen og øget markedsværdien med en faktor fem. Tallene taler for sig selv, men de siger ikke alt. Under Steens ledelse har Novozymes' kultur blomstret, og lederskabet har været stærkt og stabilt. I dag står Novozymes så stærk som nogensinde og godt rustet til yderligere vækst.

Med udnævnelsen af Peder Holk Nielsen, tidligere koncerndirektør for Enzyme Business, som ny administrerende direktør mener **bestyrelsen (SM)**, at den har valgt den bedste kandidat til at stå i spidsen for Novozymes' fortsatte udvikling og styrkelsen af samarbejdet med **bestyrelsen (SM)**, som skal bringe virksomheden videre til næste stadie. Virksomhedens langsigtede vækstgrundlag er uændret, og den eksisterende strategiske platform vil gøre det muligt for Peder Holk Nielsen, **direktionen og bestyrelsen (SM)** fortsat at udforske og udnytte mulighederne for at skabe langsigtet værdi for virksomheden og dens interessenter.

#### OPDATERING AF LANGSIGTEDE MÅL

**Direktionen og bestyrelsen (SM)** har opdateret Novozymes' langsigtede mål for de næste fem år. **Vi (SM)** stiler fortsat mod kraftig organisk salgsvækst med høj rentabilitet og effektiv kapitaludnyttelse. Tiden er dog inde til en opdatering nu, hvor visibiliteten i dele af virksomheden er blevet **klarere (AM)**, især når det handler om bæredygtigt landbrug (BioAg), om biofarma og om enzymer til omdannelse af biomasse. Det er også tid til at hæve barren for overskudsgrad set i lyset af de gode fremtidsudsigter, og fordi virksomheden i de seneste par år har nået dette mål.

Novozyymes har sat sig som mål at opnå en gennemsnitlig årlig organisk salgsvækst på over 10% – et mål, **vi (SM) forventer (hedge)** at nå i 2015 og fremover. Dette mål **kan (hedge)** nås under forudsætning af, at verdensøkonomien stabiliserer sig, og potentialet i de ovennævnte forretninger bliver realiseret. **Vi (SM) forventer (hedge)** en overskudsgrad på over 24% og et afkast af investeret kapital (ROIC) på over 22%. Derudover har **vi (SM)** har opdateret **vores (SM)** mål for bæredygtighed, således at de afspejler **vores (SM)** ambitioner på bæredygtighedsområdet og **vores (SM)** aktiviteter i hele værdikæden med henblik på at sikre Novozymes' langsigtede udvikling som en international, rummelig og succesrig virksomhed.

#### 2013 OG DEREFTER

Med Peder Holk Nielsen ved roret og med udgangspunkt i de opdaterede langsigtede mål vil Novozymes i 2013 fokusere på at sikre en effektiv eksekvering af virksomhedens strategi i et omskifteligt makroøkonomisk klima, samtidig med at det langsigtede engagement i innovation, partnerskaber og bæredygtighed fastholdes.

Januar 2013

#### Bestyrelsen (SM)

Novozyymes A/S

BERETNING

NOVOZYMES' ÅRSRAPPORT 2012

#### NOVOZYMES – BLOT EN VIRKSOMHED SOM ALLE ANDRE? (EM)

**Vi (SM)** opfyldte ikke **vores (SM)** langsigtede mål for salgsvækst i 2012, men selv i en vanskelig global økonomisk situation var der mange positive takter: kraftig vækst i overskudsgraden, en række lovende partnerskaber og fortsat fokus på innovation.

2012 var et blandet år for Novozymes: udfordrende på nogle områder og lovende på andre. Ved at arbejde proaktivt med nye forretningsmodeller og udnytte kundernes skiftende behov lykkedes det **os (SM)** at lancere innovative løsninger på markedet og indgå stærke partnerskaber. **Vores (SM)** smidighed blev imidlertid sat på prøve: **Vi (SM)** leverede en solid indtjening og fortsatte

med at øge produktiviteten, men **vi (SM)** var ikke i stand til at realisere **vores (SM)** langsigtede mål for salgsvækst, idet **vi (SM)** kun nåede 4% i organisk vækst. Betyder det så, at Novozymes blot er "en virksomhed som alle andre"? (**EM**)

#### STÆRK IND TJENING I ET VANSKELIGT MARKED

Der var to primære grunde til, at **vi (SM)** havde det svært i 2012: dels afmatningen i den globale BNPvækst, dels uroen på det amerikanske bioenergi marked. Sammenlignet med 2011 faldt ethanolproduktionen i USA med **ca. (hedge)** 5%, blandt andet på grund af en tørke, der ramte hele industrien. Samtidig faldt enzyminholdet pr. liter i den ethanol, der blev fremstillet. Industrien var dog **heldigvis (AM)** i stand til at forsvare energiloven Renewable Fuel Standard, selv om der blev gjort forsøg på at tilsidesætte den.

På den anden side oplevede Novozymes en markant vækst i salget inden for vaskemidler og dyrefoder. Det **viser (AM)**, at **vi (SM)** er i stand til at vokse gennem innovation.

Alt i alt oplevede **vi (EM)** en vækst på 17% i resultat af primær drift og en overskudsgrad på over 24%, hvilket var højere end **vores (SM)** forventninger ved årets begyndelse, og kunderne sparede **ca. (hedge)** 48 mio. tons CO<sub>2</sub> ved at anvende **vores (SM)** produkter. Men den organiske salgsvækst lå på kun 4%, langt under **vores (SM)** mål på 10%. Det skal **vi (SM)** gøre bedre i 2013.

#### SUCCESS GENNEM SAMARBEJDE

Ligesom innovation, bæredygtighed og en diversificeret portefølje er centrale elementer i **vores (SM)** forretningsmodel, har partnerskaber **altid (booster)** spillet en **vigtig (AM)** rolle i forhold til fremtidig vækst. To gode eksempler i 2012 var vaskemidler og bæredygtigt landbrug (BioAg).

Salget til vaskemiddelindustrien gik fortsat særdeles godt, idet væksten lå på 14% i 2012. I de sidste fem år har Novozymes således oplevet en gennemsnitlig årlig vækst på over 10% i dette forretningsområde. Det skyldes i høj grad de stærke alliancer, **vi (SM)** har opbygget med førende aktører rundt om i verden.

Interessen for BioAg er stigende og har ført til en række markante opkøb på området inden for det sidste år. I august købte Bayer CropScience den amerikanske virksomhed AgraQuest for 425 mio. dollar, og i november blev Becker Underwood købt af BASF for **ca. (hedge)** 1 mia. dollar. Begge transaktioner understreger det betydelige potentiale i BioAg-industrien. **Vores (SM)** partnerskab med Syngenta om udvikling af JumpStart® og det biologiske svampemiddel Taegro® har givet **vores (SM)** BioAg-forretning betydelig tyngde, og området er nu det største i BioBusiness.

#### GLOBAL SAMHØRIGHED

Dialog er nøglen til håndtering af muligheder og risici og til at dække det biobaserede samfunds behov. Det hjælper også Novozymes og Novozymes' netværk af globale interessenter med at omsætte høje forventninger til levedygtige produkter.

#### FREMTIDIG VÆKST BASERET PÅ PARTNERSKABER

For en voksende global virksomhed er strategiske partnerskaber et **vigtigt (AM)** element i at nå ud til og betjene nye kunder. Et par gode eksempler er bioenergi- og biokemikalieindustrien, hvor **vi (SM)** har udnyttet **vores (SM)** fleksible forretningsmodeller til at skabe nye muligheder og etablere et solidt grundlag for vækst.

**Vores (SM)** partnerskab med Beta Renewables er et væsentligt skridt fremad, når det drejer sig om at kommercialisere avancerede biobrændstoffer. Ved at koble **vores (SM)** enzymer sammen med Beta Renewables' teknologi til bioenergiproduktion er **vi (SM)** i stand til at tilbyde kunderne en unik, nøglefærdig løsning, der på samme tid kan reducere de finansielle og teknologiske risici og øge **vores (SM)** årlige salg med op til 1 mia. kr. hen mod slutningen af dette årti.

I august indgik **vi (SM)** en aftale med BASF og Cargill om udvikling af en industriel bioteknologisk produktionsproces til fremstilling af akrylsyre på basis af fornybare råvarer. Akrylsyre indgår i en lang række produkter, herunder bleer, og målet er at kunne tilbyde forbrugere verden over et biobaseret alternativ til **stort set (hedge)** samme pris som en kemikaliebaseret løsning.

#### MÅLET ER 10% ORGANISK SALG SVÆKST

**Vi (SM)** opbyggede stærke partnerskaber i 2012, og **jeg (SM)** er **sikker (booster)** på, at Novozymes fra 2015 vil kunne levere to cifret vækst i samarbejde med nuværende og fremtidige strategiske partnere.

I **mine (SM)** 12 år som administrerende direktør har den gennemsnitlige organiske vækst ligget på **ca. (hedge)** 7-8%. Der har været op- og nedture, men **vi (EM)** bliver alligevel ved med at vokse, fordi **vi (SM)** er i stand til at omsætte **vores (SM)** viden og teknologi



til rentable produkter og løsninger, som udvider markedet. Det fremgår **tydeligt (booster)** af **vores (SM)** afkast af investeret kapital (ROIC), der er steget fra 10% i 2000 til 20% i 2012, og af **vores (SM)** overskudsgrad, som er steget fra 16% i 2000 til 24% i 2012.

Novozymes har **altid (booster)** været drevet af innovation – det ligger i **vores (SM)** DNA. Andre vil måske forsøge at følge i **vores (SM)** fodspor, men med over 6.000 medarbejdere på verdensplan, der alle bidrager til at skabe innovation, og med en portefølje af løsninger, der effektivt kan bidrage til at løse en række globale problemer, bliver **vi (EM)** **aldrig (booster)** en virksomhed som alle andre.

Steen Riisgaard

Administrerende direktør

### Appendix III: Directors' reports and managements' reviews

#### Executive Committee key objectives – 2013

The **Board (SM)** reviews and updates the Group Strategic Framework annually. The Group Strategic Framework integrates the Group's major goals and actions into a cohesive document defining the direction and shape of the Group over the long term. There are agreed annual objectives which focus on specific deliverables in support of both delivery of short-term results and the overall strategy. The Executive Committee has set the following objectives for 2013 and a review of performance against these objectives will be contained in the Annual Report 2013.

Target	Description
1. Financial Performance	Meet 2013 financial targets
2. Customer Focus and Programme Execution	Continued focus on improving customer satisfaction and programme execution
3. Responsible Behaviour	Progress towards recognised leading positions
4. Electronic Systems	Be agile, sustain revenues and deliver strong bottom line performance
5. Cyber, Intelligence and Security	Enhance and grow <b>our (SM)</b> positions in cyber, intelligence and security
6. Platforms & Services (US)	Drive value from <b>our (SM)</b> land portfolio and deliver sustainable, profitable growth in the services sector
7. Platforms & Services (UK)	Deliver sustainably profitable through-life businesses in the air, maritime and combat vehicles sectors
8. Platforms & Services (International)	Grow <b>our (SM)</b> Platforms & Services (International) business
9. Engagement	Inspire and engage <b>our (SM)</b> people to deliver success

See **(EM)** page 16 for the Group Strategic Framework for 2013

#### Executive Committee key objectives – 2012 performance

The Executive Committee set objectives for 2012 which focused on specific deliverables in support of both delivery of short-term results and the overall strategy. The specific in-year performance indicators used to measure performance against the Executive Committee's key objectives are discussed below.

Objective	2012 performance
Financial Performance	The target for underlying earnings <sup>1</sup> per share was not achieved as

<p>Meet 2012 financial targets</p> <p><b>See (EM)</b> page 30 for more information</p>	<p>formalisation of price escalation on the Salam Typhoon programme remains outstanding. The targets for average and year-end net cash/(debt)<sup>2</sup> were exceeded.</p>
<p>Customer Focus and Programme Execution</p> <p>Continued focus on improving customer satisfaction and programme execution</p> <p><b>See (EM)</b> page 18 for more information</p>	<p>The Group continued to deliver on its commitments to customers and delivered an overall improvement in outturn margin across its major programmes.</p>
<p>Responsible Behaviour</p> <p>Progress towards recognised leading positions</p> <p><b>See (EM)</b> page 39 for more information</p>	<p>The corporate responsibility agenda has been embedded further into the Group's operations in line with its commitment to Total Performance. Group targets in respect of business conduct, safety, diversity and inclusion, and environment have been achieved.</p>
<p>Electronic Systems</p> <p>Be agile, sustain revenues and deliver strong bottom line performance</p> <p><b>See (EM)</b> page 56 for more information</p>	<p>Whilst sales<sup>3</sup> have been impacted by the Continuing Resolution and lower operational tempo-driven activity, order backlog<sup>3</sup> has increased<sup>4</sup> and return on sales was 14.2%. Programmes are back on schedule after recovery efforts following severe flooding at Johnson City, New York, in 2011. The Commercial Aircraft electronics business has achieved <b>good (AM)</b> growth. The business has continued to focus on cost reduction and the evolving priorities of its customers.</p>
<p>Cyber, Intelligence and Security</p> <p>Establish a leading position in Cyber, Intelligence and Security</p> <p><b>See (EM)</b> page 60 for more information</p>	<p>The Intelligence &amp; Security business in the US remains stable despite delays in awards on a significant bid pipeline of contract re-competes and new opportunities. Growth in BAE Systems Detica has been impacted by routes-to-market issues in the Global Communications Solutions business. BAE Systems Detica's Security Operations Centre became fully operational, providing services to detect and remediate advanced cyber attacks.</p>
<p>Platforms &amp; Services (US)</p> <p>Drive value from <b>our (SM)</b> land portfolio and deliver sustainable, profitable growth in the services sector</p> <p><b>See (EM)</b> page 64 for more information</p>	<p>In Land &amp; Armaments, the cost base was reduced further to reflect the lower level of activity and business disposals were completed as portfolio streamlining continued. A \$750m (£462m) contract was awarded for CV90 armoured combat vehicles to Norway. In Support Solutions, order backlog<sup>3</sup> increased<sup>4</sup> as the munitions facilities management, and aircraft sustainment and modernisation businesses achieved key contract wins. The \$69m (£42m) acquisition of Marine Hydraulics International, Inc. is <b>expected (hedge)</b> to complete in the first quarter of 2013, complementing the ship repair business.</p>
<p>Platforms &amp; Services (UK)</p> <p>Deliver in the UK sustainably profitable through-life businesses in the air and maritime sectors</p> <p><b>See (EM)</b> page 68 for more information</p>	<p>Order intake<sup>3</sup> in Platforms &amp; Services (UK) was strong, including £2.5bn on Typhoon and Hawk aircraft for Oman and £1.6bn on Hawk aircraft for Saudi Arabia. Progress was made on Typhoon export campaigns to Malaysia and the United Arab Emirates, and rationalisation activity to address programme changes was implemented. In maritime, major UK programmes progressed in line with planned milestones and two of three Offshore Patrol Vessels were delivered to the Brazilian Navy.</p>
<p>Platforms &amp; Services (International)</p> <p>Increase <b>our (SM)</b> Platforms &amp; Services (International) business</p> <p><b>See (EM)</b> page 72 for more information</p>	<p>In Saudi Arabia, orders were received under the Saudi British Defence Co-operation Programme for support to the end of 2016. Salam Typhoon price escalation and future support negotiations remain ongoing. In Australia, <b>good (AM)</b> progress was made on the Landing Helicopter Dock (LHD) and Air Warfare Destroyer programmes, with the first LHD hull arriving in Australia for completion. In India, the government confirmed its intention to buy 145 M777 howitzers.</p>
<p>1 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (<b>see (EM)</b> note 8 to the Group accounts).</p> <p>2 <b>See (EM)</b> page 32 and note 10 to the Group accounts.</p> <p>3 Including share of equity accounted investments.</p> <p>4 Excluding the impact of exchange translation.</p>	<p><b>See (EM)</b> page 13 for the Group's Key Performance Indicators for 2012</p> <p><b>See (EM)</b> page 16 for the Group Strategic Framework for 2013</p>

## KEY PERFORMANCE INDICATORS (KPIs)

The Board uses a range of quantitative financial and non-financial performance indicators, reported on a periodic basis, to monitor the Group's performance against its Total Performance and Executive Committee key objectives. Executive directors' remuneration is linked to certain of these measures.

### Financial Performance

The Group sets itself challenging financial targets through the Integrated Business Planning process to improve financial performance and drive **shareholder (EM)** value.

p12 2012 Executive Committee key objectives p46 Principal risks p30 Financial Performance p84 Integrated Business Planning process

### Funded order intake<sup>1</sup> (£bn)

£22.2bn  
2011: £16.6bn

#### Definition

Funded order intake represents the value of funded orders received from customers in the year.

Funded order intake is a measure of in-year performance and supports future years' sales performance.

#### Comment

Funded order intake<sup>1</sup> increased by 34% on 2011 driven by a high level of awards in Saudi Arabia and a contract to supply Typhoon and Hawk aircraft to Oman. Non-US and UK funded order intake<sup>1</sup> increased to £11.2bn from £4.8bn in 2011.

### Sales<sup>1</sup> (£bn)

£17.8bn                      -7%  
2011: £19.2bn

#### Definition

Sales represents the amounts derived from the provision of goods and services, and includes the Group's share of sales of its equity accounted investments.

#### Comment

The 7% reduction in sales<sup>1</sup> this year **mainly (hedge)** reflects the **expected (AM)** lower volume in the Land & Armaments business and the transition to UK final assembly arrangements under the Salam Typhoon programme. The next deliveries are in 2013.

Sales<sup>1</sup> in 2012 have been impacted by the deferral of trading relating to the finalisation of price escalation on the Salam Typhoon programme.

p31 Sales<sup>1</sup> bridge chart

1 Including share of equity accounted investments.

### Underlying EBITA<sup>2</sup> (£m)

£1,895m                      -6%                      2011: £2,025m

#### Definition

Underlying EBITA excludes amortisation and impairment of intangible assets, finance costs and taxation expense, and non-recurring items (for 2011 and 2012, these are profit/loss on disposal of businesses and regulatory penalties).

Underlying EBITA is used by the Group for internal performance analysis as a measure of operating profitability that is comparable over time.

#### Comment

Underlying EBITA2 in 2012 has been impacted by the deferral of trading relating to the finalisation of price escalation on the Salam Typhoon programme.

Return on sales was sustained at 10.6%.

p31 Non-recurring items

Underlying earnings<sup>3</sup> per share (pence)

38.9p                      -2% \*Target<sup>5</sup> not achieved                      Part of the executive directors' 2012 annual incentive

2011: 45.6p (39.7p\*) -15%

#### Definition

Underlying earnings represent pro-t for the year attributable to equity **shareholders (EM)** excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (**see (EM)** note 8 to the Group accounts).

Underlying earnings per share provides a measure of **shareholder (EM)** return that is comparable over time.

#### Comment

Underlying earnings<sup>3</sup> per share in 2012 has been impacted by the deferral of trading relating to the finalisation of price escalation on the Salam Typhoon programme.

p32 Underlying earnings<sup>3</sup> per share bridge chart

p31 Non-recurring items

Operating business cash flow<sup>4</sup> (£m)

£2,692m                      Target<sup>5</sup> achieved                      Part of the executive directors' 2012 annual incentive

2011: £634m 3,000 2,692

#### Definition

Operating business cash flow represents net cash flow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

Operating business cash flow is the measure used to assess the operating cash generation of the Group.

#### Comment

The £2.1bn increase in operating business cash flow<sup>4</sup> primarily reflects down-payments received on new contracts to Saudi Arabia and Oman.

A significant cash receipt **expected (hedge)** on the Salam Typhoon programme has been deferred until ongoing negotiations regarding price escalation have been concluded.

p32 Reconciliation of cash inflow from operating activities to operating business cash flow<sup>4</sup>

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (**see (EM)** page 31).

3 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (**see (EM)** note 8 to the Group accounts).

4 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

5 The target is the Group's budget for the year, which represents the first year of the five-year Integrated Business Plan (**see (EM)** page 84).

#### Customer Focus<sup>6</sup>

The Group's priority is to understand its customers' evolving needs and expectations, and deliver on its commitments throughout the life of the products and services it delivers.

p12 2012 Executive Committee key objectives p46 Principal risks p84 Lifecycle Management (LCM)

#### Customer satisfaction

Performance	Definition	Comment
The Group targets an aggregated year-on-year improvement in customer satisfaction across its major contracts. Customer satisfaction metrics can only be fully interpreted and understood on a contract-by-contract basis and, therefore, aggregated data is not presented.	Customer satisfaction surveys are used to collect customer opinions on key customer-funded projects. This provides an opportunity for customers to share information on perceived performance levels and identify areas of strength and weakness.	The data for the customer satisfaction metric included 92 contracts reported in Contract Reviews prepared under LCM. The year's target was achieved.  Target achieved Part of the executive directors' 2012 annual incentive

#### Programme Execution

The Group's performance is dependent on the successful execution of its projects. It is **important (AM)** that the Group wins and contracts for high-quality new programmes, and delivers on those projects within tight tolerances of quality, time and cost performance.

p12 2012 Executive Committee key objectives p46 Principal risks

#### Programme margin variation

Performance	Definition	Comment
The Group targets an aggregated year-on-year improvement in programme margin across its major contracts. Programme margin variation metrics can only be fully interpreted and understood on a contract-by-contract basis and, therefore, aggregated data is not presented.	Programme margin variation measures outturn projections of, and movements in, margin of key customer-funded projects. It provides an indicator of the Group's ability to effectively manage major programmes.	The data for the programme margin variation metric included 100 contracts reported in Contract Reviews prepared under LCM, representing over 60% of the Group's funded order backlog. The year's target was achieved.  Target achieved Part of the executive directors' 2012 annual incentive

#### Responsible Behaviour

High standards of business conduct are **essential (AM)** to the Group's Mission to deliver sustainable growth in **shareholder (EM)** value.

p12 2012 Executive Committee key objectives p46 Principal risks p39 Corporate responsibility review p59 Performance by reporting segment

#### Safety<sup>7</sup>

Performance	Definition	Comment
In 2012, the Recordable Accident Rate reduced by 30% against 2011 performance.	The number of injuries per 100,000 employees is monitored, and actions taken to minimise the risk to the Group's employees and its operations, and drive continual performance improvement.	<p>The Recordable Accident Rate is the principal metric used by the Group's businesses to monitor performance in safety. The Group also uses a five-level Safety Maturity Matrix to help its businesses around the world work towards consistently high safety standards.</p> <p>Target achieved Part of the executive directors' 2012 annual incentive</p>

6 Prior to 2012, a schedule adherence metric, which measured the timing of achievement of key contract milestones, was a Customer Focus KPI. From 2012, this metric is no longer reviewed by the Executive Committee.

7 Prior to 2012, the safety KPI was the Lost Work Day Case Rate, calculated as the number of injuries resulting in days lost per 100,000 employees. From 2012, the KPI used to monitor safety performance is the Recordable Accident Rate, which focuses on the number of accidents rather than days lost, enabling inclusion of a wider scope of accidents within the Group's reviews, which is **expected (hedge)** to lead to improvements in accident prevention.

#### OUR (SM) STRATEGY

**Our (SM)** Strategy defines the direction and shape of the Group over the long term.

#### Our (SM) Vision

**Our (SM)** Vision provides a clear definition of the future that **we (SM)** wish to attain.

While **our (SM)** Vision defines **our (SM)** destination, commitment to Total Performance guides **our (SM)** actions for the benefit of all **stakeholders (EM)**. This is embedded in **our (SM)** Mission.

#### Our (SM) Mission

**Our (SM)** Mission describes **our (SM)** overall goal and the philosophy that underpins **our (SM)** activities. Meeting **our (SM)** Mission is key to achieving **our (SM)** Vision.

**Shareholder (EM)** value is defined as share price appreciation and dividend growth, driven by increased earnings per share and strong cash generation.

Total Performance is **demonstrated (booster)** in every aspect of the way **we (SM)** do business – Customer Focus, Programme Execution, Financial Performance and Responsible Behaviour.

**We (SM)** believe **(booster)** that by embodying the four elements of Total Performance wherever **we (SM)** operate, **we (SM)** will deliver growth in **shareholder (EM)** value and become the premier global defence, aerospace and security company.

#### Our (SM) Strategy

**Our (SM)** Strategy defines the direction and shape of the Group over the long term. This enables **us (SM)** to prioritise the deployment of **our (SM)** resources in a challenging environment. **We (SM)** are **committed (AM)** to implementing **our (SM)** Strategy in the most effective manner and will remain agile and adapt to the changing environment.

**We (SM)** **anticipate (hedge)** that defence budgets in certain of **our (SM)** major markets will experience reductions. **Our (SM)** Strategy focuses on the growing importance of winning international business, where growth markets remain.

The key elements of **our (SM)** Strategy are to:

Support **our (SM)** customers in safeguarding their vital interests

**We (SM)** operate in the defence, aerospace and security markets, which in turn have their own unique market drivers. **Our (SM)** Strategy is to understand and respond to the needs of **our (SM)** customers in each of these markets, and **anticipate (hedge)** that these needs **may (hedge)** be subject to rapid change. **We (SM) need to (EM)** be agile as an organisation, to enable **us (SM)** to identify and prioritise capabilities which support **our (SM)** customers' vital interests, creating demand for **our (SM)** products and services.

Inspire and develop **our (SM)** people to drive **our (SM)** success

**We (SM)** **recognise (AM)** that **we (SM)** can only deliver **our (SM)** Mission through the performance of **our (SM)** people. **We (SM)** **believe (booster)** that if **we (SM)** engage with **our (SM)** people **we (SM)** can inspire the will to succeed and develop skills to drive improvements in performance, enabling **us (SM)** to compete more effectively in an increasingly challenging environment. **See (EM)** page 26 for more information on this new element of **our (SM)** Strategy

Drive **shareholder (EM)** value by improving financial performance and competitive positions across the business

The current environment is increasingly competitive and, to deliver growth in **shareholder (EM)** value, **we (SM) need to (EM)** focus on generating strong cash flows and profits. Improving efficiency in **our (SM)** operations will also make **us (SM)** more competitive to win future business. All **our (SM)** operations in the defence, aerospace and security markets **must (EM)** strive to increase value and eliminate non-value-added activity whilst maintaining **our (SM)** commitment to Total Performance.

#### Strategic Actions

This Strategy translates into the five Strategic Actions. These directly flow from **our (SM)** Vision, Mission and Strategy, and are designed to shape **our (SM)** business portfolio and strengthen performance over the long term. These actions translate the Group's over-arching strategy into operational plans that are delivered through **our (SM)** lines of business.

#### Integrated Business Plans

The Integrated Business Planning process is an annual, two-stage process that culminates in a five-year strategic and financial plan, which is used to shape the Strategic Actions. **See (EM)** page 84 for more information on the Integrated Business Planning process

#### OUR (SM) BUSINESS MODEL

BAE Systems delivers a wide range of products and services for air, land and naval forces, as well as advanced electronics, security, information technology solutions and support services.

Delivering sustainable growth in **shareholder (EM)** value through Total Performance...

<b>1. Customer Focus</b> The Group's priority to all its customers is to understand their evolving needs and expectations, and deliver on its commitments throughout the life of the products and services it delivers. Customer satisfaction is a key indicator	<b>2. Programme Execution</b> The Group's performance is dependent on the successful execution of its projects. It is <b>important (AM)</b> that the Group wins and contracts for high-quality new programmes, and delivers on those projects within tight	<b>3. Financial Performance</b> The Group sets itself challenging financial targets through its Integrated Business Planning process. Financial Performance is measured through a range of key financial salients derived from the Group's	<b>4. Responsible Behaviour</b> Responsible Behaviour is embedded within the business. The Group's Code of Conduct is a summary of the principles and standards of business conduct <b>expected (AM)</b> of all employees. Together with the Group's
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of Customer Focus. <b>See (EM)</b> page 18 for more information	tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner. Key indicators of performance include outturn projections of, and movements in, margin of key customer-funded projects and customer satisfaction. <b>See (EM)</b> page 20 for more information	consolidated financial statements, including funded order intake <sup>1</sup> , sales <sup>1</sup> , underlying EBITA <sup>2</sup> , underlying earnings <sup>3</sup> per share and operating business cash flow <sup>4</sup> . <b>See (EM)</b> Financial Performance on page 30 for more information	Responsible Trading Principles, the Code of Conduct underpins its business activities. Metrics are used to measure safety, diversity and inclusion, and environmental impacts. <b>See (EM)</b> Corporate responsibility review on page 39 for more information
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...across multiple markets and opportunities...

BAE Systems benefits from a broad and diverse market base, focused on five home markets – the US, the UK, Saudi Arabia, Australia and India. In addition, export markets provide a significant ongoing opportunity for the Group. **See (EM)** page 22 for more information

...by five reporting segments...

The Group has five principal reporting segments which align with the Group's strategic direction – Electronic Systems, Cyber & Intelligence, Platforms & Services (US), Platforms & Services (UK) and Platforms & Services (International). **See (EM)** page 24 for more information

...underpinned by key resources...

The Group's key resources and arrangements include the people it employs, its relationships with suppliers, research and development, and intellectual property. **See (EM)** pages 18 to 21 for more information

...and a strong governance framework.

The Operational Framework sets out how the Group does business, wherever it operates in the world, based on principles of good governance. It provides a stable foundation from which to deliver **our (SM)** Strategy, improve performance and develop **our (SM)** culture of Total Performance. **See (EM)** page 84 for more information

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (**see (EM)** page 31).

3 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (**see (EM)** note 8 to the Group accounts).

4 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

## CUSTOMER FOCUS

### DELIVERING ON COMMITMENTS TO **OUR (SM)** CUSTOMERS

Customer Focus means the understanding of the customers' evolving needs and expectations, and delivering on **our (SM)** commitments throughout the life of the products and services **we (SM)** deliver.

The Group's strong relationships with its customers include joint development of major platforms, transitioning technology to operational use, and providing improved training and logistics support. The provision of support services to ensure mission



accomplishment underpins the Group's focus. The Group **often (hedge)** responds to urgent operational requirements driven by a customer need for an immediate solution that can be fielded rapidly.

Delivering savings in Type 45 programme costs for the UK Royal Navy customer

A new, more effective way of working between the UK Ministry of Defence and BAE Systems has **demonstrated (booster)** significant cost and schedule adherence benefits for the customer on the six-ship Type 45 contract. The focus has been on the project plan, budgets, quality and risk mitigation, working in tandem with the customer. Issues are identified early, and solutions sought and agreed, which both protect the programme and minimise cost. A culture of co-operation is reflected in the collaborative enterprise and joint acceptance teams, comprising major **stakeholders (EM)** who meet on a regular basis to resolve issues. The project team has consistently achieved its programme delivery dates and savings of £86m have so far been attributed to this partnering approach, which is also **expected (hedge)** to enable savings on other major naval ships programmes, most notably on the Type 26 Global Combat Ship programme.

## OUR (SM) KEY RESOURCES

The Group's key resources and arrangements include the people it employs, its relationships with suppliers, research and development, and intellectual property.

Significant investment in R&D...

The Group's Research & Development (R&D) activities cover a wide range of programmes, and include technological innovations and techniques to improve the manufacturing and service of products.

Examples include: BAE Systems' latest research on an advanced positioning system that exploits existing transmissions, such as Wi-Fi, TV, radio and mobile phone signals, to calculate the user's location to within a few metres; and BAE Systems' Headborne Energy Analysis and Diagnostic System (HEADS), a small sensor mounted inside a combat helmet that records the severity of blasts or impacts during an explosion, helping to identify potential combat-related head and brain injuries. HEADS was named a US Army greatest invention of 2011.

In 2012, R&D expenditure was £1,138m (2011 £1,149m) of which £150m (2011 £222m) was funded by the Group.

Utilising systems experience on F-16 aircraft to offer avionics upgrades for South Korea

BAE Systems is a leading provider of integration, avionics and mission computers for F-16 aircraft, and has been down-selected to be the sole source systems integration contractor for upgrading more than 130 F-16s for the government of the Republic of Korea. The Korean programme will build on BAE Systems' experience with the F-16, providing cost-effective upgrade solutions. The Group supports 270 of the US Air National Guard's upgraded F-16s and 50 of the Turkish Air Force's upgraded F-16s. For the Korean fleet, BAE Systems will perform a range of services, including systems engineering and integration, software and electronics engineering, obsolescence management and logistics support.

Supporting Typhoon aircraft in service with the Royal Saudi Air Force

The Saudi Typhoon support contract is an availability contract supporting the aircraft's entry into service with the first of the Royal Saudi Air Force's (RSAF) Typhoon squadrons. Working as 'One Team' with the customer on-base, the Group has supported the RSAF in establishing and successfully delivering all key elements of their Typhoon operational readiness, including air crew and ground crew training, maintenance facilities, technical support, spares and repairs, aircraft availability, and aircraft capability upgrades.

**See (EM)** page 15 for more information on the Group's Customer Focus KPI

...generating substantial intellectual property.

Intellectual property is **important (AM)** to the Group's success in obtaining and maintaining a competitive advantage.

Like any industrial concern, BAE Systems does not just produce products or provide services for its customers; in the process, intellectual property **may (hedge)** be created which **often (hedge)** has a value to the Group far greater than is reflected in the value of the particular contract or programme of work under which it was created. It takes many forms, including products, processes and knowhow.

The Group's Operational Framework mandates a policy to protect the Group's intellectual property (including patents, registered designs, and registered trade and service marks) through appropriate use and observance of intellectual property law, so that returns made from the investment in R&D and technological innovation are protected, and commercial and business innovations are adequately safeguarded.

In 2012, the Group led patent applications covering **approximately (hedge)** 250 new inventions. One of the Group's patented inventions has assisted in BAE Systems obtaining a development contract, which in turn will create valuable future opportunities for production contracts.

At 31 December 2012, BAE Systems had a total portfolio of patents and patent applications covering more than 2,000 inventions worldwide.

## PROGRAMME EXECUTION

### DELIVERING ON PROJECTS TO QUALITY, TIME AND COST

Programme Execution means delivering on projects within tight tolerances of quality, time and cost performance in a reliable, predictable and repeatable manner.

BAE Systems utilises Lifecycle Management (LCM) as part of its project management processes to ensure effective delivery of its programmes. LCM provides a benchmark approach which includes early engagement of business leadership, applying the full set of Group capabilities, and requiring experienced independent validation of project status and results. Early identification of risk, and implementing mitigation steps, are key features. Customer interaction is essential. Opportunities for improved results are identified and included in future project phases. Whether delivering a complex system enhancing a current capability, improved operational support or a customised solution, BAE Systems uses its world-class management processes and tools.

#### Transformation of UK munitions plants under a long-term partnering agreement

Munitions Acquisition Supply Solution is a 15-year partnering agreement with the UK Ministry of Defence (MoD) to transform three UK munitions manufacturing facilities into centres of excellence. Following investment by BAE Systems, two new facilities have been created at Radway Green and Washington, with a major modernisation at Glascoed. The transformation programme is reviewed jointly by the MoD and BAE Systems against critical milestones. All major milestones have been met. Key measures met to date include improved delivery of defined munitions products, and a reduction in labour costs and scrap/rework levels.

## OUR (SM) KEY RESOURCES

The Group's key resources and arrangements include the people it employs, its relationships with suppliers, research and development, and intellectual property.

A skilled workforce of 88,200 employees<sup>1</sup> ...

BAE Systems' investment in its current and future workforce is designed to give it the capabilities to deliver its strategy, and ensure that the Group is able to grow and develop talented people to meet its challenges and opportunities. Through the Group's ability to attract, retain and engage its people, BAE Systems is able to deliver on its Total Performance goals. **See (EM)** page 26 for more information

<sup>1</sup> Including share of equity accounted investments.

#### Upgrading Saudi aircraft under the Tornado Sustainment Programme

In partnership with the Royal Saudi Air Force (RSAF), the Tornado Sustainment Programme (TSP) has successfully upgraded all of the RSAF Tornado fleet. Central to the upgrade is a new digital weapons and avionics system. New RSAF facilities were contractually placed in the custodianship of BAE Systems Saudi Arabia until completion of the TSP embodiment programme. At peak throughput, a Tornado was delivered back to the RSAF every 12 working days, all on schedule. Concurrently, 29 additional aircraft underwent major maintenance under this complex and technically challenging combined maintenance and upgrade package.

Providing maintenance and modification services to the US Navy customer

BAE Systems Ship Repair in Norfolk, Virginia, is home to **approximately (hedge)** 1,600 employees primarily working on US Navy vessels. Located at the Group's Norfolk site is the Titan drydock, the largest floating drydock on the East Coast of the US. In January 2012, the first ever tandem drydocking of two US Navy Aegis guided missile destroyers, USS Mason and USS Bulkeley, was undertaken. This unique and highly cost-effective use of the facility enabled both destroyers to stay in drydock until the end of April 2012 for routine maintenance and modifications.

**See (EM)** page 15 for more information on the Group's Programme Execution KPI

...and thousands of suppliers who share **our (SM)** values.

The Group buys a wide range of major equipment, services, materials and components that contribute to the products and services it provides to customers, and it depends on its suppliers to help it deliver these both on time and to a high quality, and to provide innovative, cost-effective solutions. The Group expects these suppliers to work to the same or equivalent standards as BAE Systems on issues ranging from responsible trading and ethical conduct to health and safety, and encourages them to adopt sustainable environmental best practices.

In the UK, the Group is the largest manufacturer and provider of complex military and security equipment and technology. It works with **approximately (hedge)** 7,500 UK suppliers, of which **approximately (hedge)** 2,200 are small and medium-sized enterprises (SMEs).

BAE Systems has a strong interest in supporting the SME sector and promoting innovation by investing in their businesses where appropriate. Many play a key role in the Group's business by supplying unique goods and expertise. In turn, they benefit from access to new markets and the financial security inherent in the long-term nature of many of the Group's projects.

BAE Systems is a founding member of the ADS Group's (Aerospace, Defence, Security and Space industries association) 21st Century Supply Chains (SC21) programme designed to improve efficiency in the UK aerospace, defence, security and space supply chains.

## AN INTERNATIONAL BUSINESS

### POSITIONS IN FIVE HOME MARKETS WITH EXPORT OPPORTUNITIES

Today, **our (SM)** business is based around five home markets – the US, the UK, the Kingdom of Saudi Arabia, Australia and India.

### TOP TEN CONTRACTOR TO THE US DEPARTMENT OF DEFENSE

BAE Systems is a top ten US defence contractor, offering a balanced portfolio of products and services in defence, aerospace and security domains, including the operational support of equipment used around the world by US forces and their allies. US 34,500 EMPLOYEES<sup>1</sup>

## OUR (SM) MARKETS

BAE Systems has a broad geographic base with business operations in five home markets around the world, in the US, the UK, the Kingdom of Saudi Arabia, Australia and India. These home markets are identified as having a significant and sustained commitment to defence and security. They are countries that welcome foreign investment to develop and sustain a domestic defence industrial capability, building long-term and trusted customer relationships. **Importantly (AM)**, they are also markets where BAE Systems can achieve and demonstrate high standards of business conduct.

1 Including share of equity accounted investments.

Established positions in five home markets...

BAE Systems is an established part of the defence industrial capability in the US, the UK, the Kingdom of Saudi Arabia and Australia where its principal operations are based, and continues to develop its position in India, the Group's newest home market.

### LARGEST SUPPLIER TO THE UK MINISTRY OF DEFENCE

BAE Systems plays a vital role in the UK's defence capabilities across air, maritime and land platforms, including military and technical service contracts. BAE Systems also plays a key role in security and intelligence with customers in both government and commercial markets.

#### LEADING IN-COUNTRY DEFENCE SUPPLIER

BAE Systems is a leading in-country defence supplier, supporting the operational capability of the Royal Saudi air and naval forces, and investing in the development of Saudi indigenous defence capabilities.

#### LARGEST IN-COUNTRY DEFENCE SUPPLIER

In Australia, BAE Systems supplies leading capability across air defence, land combat systems, naval systems and security.

#### SUPPLIER TO THE INDIAN MINISTRY OF DEFENCE

India continues to develop as a home market. BAE Systems is investing in its presence through technology sharing and inward investment in this growing defence and security market.

...delivering a broadly-based business portfolio...

With near-term budget pressures in some markets, the Group's broad geographic base provides a resilient business portfolio.

...with export opportunities in growth markets.

BAE Systems has a strong international market presence with well-established relationships, supported by regional offices. The Group's strategy continues to focus on the importance of winning international business, where growth markets remain. Success in these international defence and security markets is **evident (booster)** in the increasing order intake<sup>1</sup> in markets outside the US and UK.

#### OUTSTANDING (AM) CAPABILITIES

The Group has five principal reporting segments which align with the Group's strategic direction.

##### Electronic Systems

Electronic Systems has advanced technology, high integrity electronics capabilities with a large portfolio of annually-funded contracts, and significant Group-funded research and development invested in the business.

Electronic Combat combines the Electronic Protection, Electronic Warfare and Electronic Attack product lines, and provides a depth of capability in integrated electromagnetic systems for airborne applications.

Survivability & Targeting includes situational awareness, targeting and survivability systems, such as electro-optic sensor products, guidance systems, handheld targeting and infrared countermeasures systems for soldiers and vehicles.

Communications & Control has a strong footing in radio frequency communication and datalinks, and provides military aircraft controls and displays, together with platform integration capabilities.

##### Intelligence, Surveillance & Reconnaissance

(ISR) addresses the market for airborne persistent surveillance, identification systems, signals intelligence and space products.

Commercial Aircraft electronics addresses the commercial aircraft electronics market, including fly-by-wire flight controls, full authority digital engine controls, cockpit controls, head-up displays, cabin management systems and power management systems.

HybriDrive® propulsion delivers power and energy management solutions, including vehicle hybrid drive systems.

##### Cyber & Intelligence

Cyber & Intelligence comprises government-focused intelligence-based services, and government and commercial cybersecurity activities. Intelligence-based services include IT-based services and the provision of analysts and analysis-based services. Cybersecurity activities include product provision, service output and consulting contracts.

Intelligence & Security delivers a broad range of services, including IT, cybersecurity and intelligence analysis to enable the US military and government to recognise, manage and defeat threats.

The business delivers:

- cost-effective IT solutions that solve complex problems of collaboration and security for the US national security community;
- real-time threat assessments that rapidly inform critical security actions; and
- automated, efficient and reliable intelligence processing, data management systems and imagery mapping tools for the US intelligence and defence communities.

BAE Systems Detica collects, manages and exploits information to enable government and commercial clients to reveal intelligence, maintain security, optimise performance and manage risk. Alongside its secure government-focused activities, the business is a supplier of information assurance products and services to the financial services and telecommunications sectors. Primary operations are in the UK, Denmark, Ireland and the US.

#### A STRONG PORTFOLIO OF PRODUCTS AND SERVICES

**See (EM)** page 56 for more information

**See (EM)** page 60 for more information

#### Platforms & Services (US)

Platforms & Services (US) comprises the Land & Armaments business which includes a range of funded development activity and - fixed-price production and services contracts, and US-based services, sustainment and systems integration activities which **may (hedge)** be contracted over multi-year arrangements.

- Support Solutions is a major supplier of ship repair services to the US Navy and complex munitions facilities management for the Holston and Radford facilities. Other support activities in the US include fixed and rotary wing aircraft support services.
- Land & Armaments is engaged in the design, development, production, support and upgrade of armoured combat vehicles, tactical wheeled vehicles, artillery systems, naval guns, missile launchers and munitions.
- Vehicle Systems focuses on the tracked, wheeled and amphibious vehicle markets, servicing both US and international customers.
- Weapons Systems & Support focuses on weapons, munitions and field support markets, servicing US, UK and international customers. Weapons include the manufacture of artillery systems, such as the M777 howitzer, as well as naval guns and missile launchers. The business is the principal supplier of munitions to the British armed forces.

**See (EM)** page 64 for more information

#### Platforms & Services (UK)

Platforms & Services (UK) is the focus for the Group's UK prime contracting platform and systems integration contracts, with a large order backlog of multi-year development, production and services contracts.

- Military Air & Information includes programmes for the production of Typhoon combat and Hawk trainer aircraft, F-35 Lightning II fuselage and empennage manufacture, support for Typhoon, Tornado and Hawk aircraft, and development of next-generation Unmanned Air Systems and defence information systems, such as the Falcon secure deployable communication system.
- Maritime programmes include the manufacture of two new Queen Elizabeth class aircraft carriers for the Royal Navy, the Type 45 anti-air warfare destroyers and the Astute class submarines, the design of the Successor submarine and Type 26 frigate, and in-service support.
- Combat Vehicles (UK) includes the UK-based armoured vehicle and support services business transferred from Land & Armaments on 1 October 2012. The principal programme is for the design and manufacture of 60 Terrier combat engineer vehicles for the British Army.

**See (EM)** page 68 for more information

#### Platforms & Services (International)

Platforms & Services (International) comprises businesses in Saudi Arabia, Australia, India and Oman, as well as a 37.5% shareholding in MBDA. In Saudi Arabia, the business provides operational capability support to the country's air and naval forces on UK/Saudi government-to-government contracts. Contracts, such as the Saudi British Defence Co-operation Programme, **tend to (hedge)** be multi-year and fixed price.

- In Australia, the business delivers production, upgrade and support programmes for the Australian government across the air, maritime and land domains. Services contracts include the provision of support and upgrades. Platforms contracts include naval ships, such as the Landing Helicopter Dock programme for the Navy. Contracts are **often (hedge)** multi-year and fixed price.
- In India, the Group continues to develop its software joint venture and build on its long-standing relationship with Hindustan Aeronautics Limited, which is manufacturing Hawk aircraft under licence in India.
- The business is developing its position in Oman, building on a long history of relationships with the Omani armed forces, with resulting orders placed with the relevant reporting segments.

See (EM) page 72 for more information

INSPIRE AND DEVELOP...

...OUR (SM) PEOPLE TO DRIVE OUR (SM) SUCCESS

The Group's people strategy of through-career capability development and emphasis on high levels of employee engagement seeks to maximise the contribution that its 88,200 strong workforce<sup>1</sup> makes to the Total Performance of the business.

The people strategy enables every member of the team to full their personal potential. The success of this strategy is measured ultimately in the success of the business as a whole.

Leadership development

The Group continues to focus on the development of its current and future leaders with structured global programmes linked to Total Performance Leadership, an integrated performance management and leadership development framework. In 2012, leaders took part in development programmes designed to help participants succeed as leaders and provide a strong talent pipeline to meet the demands of changing markets. A common Management Resource Review, which includes succession and development planning, is conducted at Group and business level.

Continuous professional and personal development

The Group has continued to **demonstrate (booster)** its commitment to the continuous professional and personal development of its workforce. Development planning is supported by flexible training and education programmes that encourage a culture of lifelong learning and help employees to develop their skills to maximise their potential. In 2012, the Group continued to invest in learning programmes for all employees that support its culture of responsible business conduct. Extensive use is made of e-learning media, classroom training and partnerships with academic institutions to provide development and learning offerings. Sustaining and developing capability relies on developing the existing workforce and hiring talented people to meet current and future skills requirements.

Developing current and future leaders...

Group development programmes complement business activities, such as the Mustakbal Management Development Programme for Saudi nationals, supporting the future sustainment of leadership talent in the Kingdom of Saudi Arabia.

...recruiting talented people...

Veterans of the armed services are an **important (AM)** source of talent for the business. In the US, for example, GI Jobs Magazine rated BAE Systems in its top 100 list of military friendly employers.

<sup>1</sup> Including share of equity accounted investments.

Employee engagement

The Group recognises the importance of engaging its employees to help them make their fullest contribution to the business. Through a variety of media, the Group's leadership seeks to listen to employees' views and opinions, and keep them informed about developments and prospects for the business. In 2012, there was more frequent use of leadership blogs and other e-enabled communication channels.

A major focus for engagement has been the fostering of a more diverse and inclusive working environment. Specific development programmes have been produced to assist leaders in engaging further with their teams and demonstrating the contribution that each individual can make to the success of the Group.

When redundancies have been necessary to align with customer requirements for products and services, management works with employees, trade unions, and local and national bodies to mitigate the impact on people and communities affected.

#### Education and early careers programmes

The Group works with the education sectors in each of its home markets to help shape the workforce of the future with a particular emphasis on encouraging young people to pursue careers in science, technology, engineering and mathematics.

In the US, BAE Systems is partnering with the National Math and Science Initiative to support the development of science, technology, engineering and maths curricula to engage young students, with the goal of inspiring them to become future engineers.

In the UK, the Group has teamed with the Royal Air Force in staging a Schools Road Show, taking a theatre-based class to over 250 schools, engaging 25,000 pupils in 2012 about careers in engineering.

In Saudi Arabia, BAE Systems has established a University Collaboration Agreement with King Saud University in Riyadh, under which it will sponsor 30 engineering undergraduates.

In Australia, the business sponsors school pupils to participate in the FIRST (For Inspiration and Recognition of Science and Technology) LEGO League and FIRST Robotics Competition, both aimed at encouraging more young people to engage in science, technology, engineering and maths.

In India, BAE Systems has entered into a long-term partnership agreement with Smile Foundation, a national level development organisation with an outreach of over 200,000 underprivileged children, women and youth across 25 states. The partnership enables the Group to support development programmes in the areas of primary education and healthcare.

...improving engagement...

In 2012, the Group piloted the use of the 'Great Place to Work' Trust Index with sample surveys in each of the home markets. The Great Place to Work Institute is a globally recognised organisation that identifies, creates and sustains great workplaces, and provides a benchmark measure that supports the Group's ambition to maximise employee engagement and contribution.

...and investing in the future.

During 2012, the Group recruited 650 people globally to join its apprenticeship and graduate programmes to enrich its future workforce, some of whom **may (hedge)** potentially form part of its future leadership population.

**See (EM)** Corporate responsibility review on page 39 for more information

**See (EM)** pages 59 to 75 for more information on how the Group's reporting segments are inspiring and developing **our (SM)** people

Most people don't see a cyber attack until it's too late. **We (SM)** are not most people

Understanding and counteracting illegal cyber activities is crucial in preventing future cyber attacks and helping law enforcement professionals locate cyber criminals. Digital forensics is the process of collecting physical evidence from a digital device. Digital forensic analysis requires systematic processing, documentation and strict adherence to the chain-of-custody process.

As technology continues to advance, so do the techniques used by the digital forensic experts at BAE Systems. Digital forensic professionals stay ahead of the proliferation of new operating systems, software applications and mobile devices.

## GROUP PERFORMANCE REVIEW

*This section provides a commentary on the Group's financial and nonfinancial performance, and its approach to the management of corporate responsibility and risk.*

This section of the report covers Financial Performance from a Group perspective.

**See (EM)** pages 54 to 75 for details on Financial Performance by reporting segment

### Financial highlights

- Order backlog<sup>1,2</sup> increased by 8% to £42.4bn
- Non-US and UK order intake<sup>1</sup> increased to £11.2bn from £4.8bn in 2011
- Sales<sup>1</sup> reduced by 7%
- Underlying EBITA<sup>3</sup> reduced by 6% to £1,895m. Deferred recognition of sales and profit relating to the formalisation of price escalation on the Salam Typhoon programme
- Underlying earnings<sup>4</sup> per share down by 2% (excluding the benefit in 2011 of the UK tax settlement)
- Total dividend increased by 4% to 19.5p
- Operating business cash flow<sup>7</sup> increased to £2.7bn
- Net cash<sup>6</sup> balance of £387m
- Three-year share repurchase programme of up to £1bn initiated
- Longevity risk on £2.7bn of pension scheme liabilities transferred to the insurance market

The results of the Regional Aircraft line of business are shown within discontinued operations (**see (EM)** note 7 to the Group accounts).

### Order backlog<sup>1,2</sup>

Order backlog<sup>1,2</sup> has increased by 8% to £42.4bn driven by a high level of awards in Saudi Arabia and a contract to supply Typhoon and Hawk aircraft to Oman. Non-US and UK funded order intake<sup>1</sup> increased to £11.2bn from £4.8bn in 2011.

### Income statement

Sales<sup>1</sup> reduced by 7% reflecting lower volumes in the Land & Armaments business, and there being no contracted Typhoon aircraft deliveries in the year under the Salam Typhoon programme.

The Group's sales<sup>1</sup> performance is illustrated in the bridge chart below.

### Underlying EBITA<sup>3</sup>

Management uses an underlying profit measure to monitor the year-on-year profitability of the Group defined as earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

Underlying EBITA<sup>3</sup> was £1,895m (2011 £2,025m) giving a return on sales of 10.6% (2011 10.6%).

Non-recurring items are defined as items that are relevant to an understanding of the Group's performance with reference to their materiality and nature. Profit on disposal of businesses of £103m in 2012 includes the disposals of Safety Products and Safariland, and assets comprising the Tensylon business, which were part of the Land & Armaments business. The loss of £29m in 2011 arose on the disposals of the Advanced Ceramics and Swiss-Photonics businesses.

Amortisation of intangible assets is £13m lower at £226m **mainly (hedge)** reflecting the completion of deliveries under the Family of Medium Tactical Vehicles (FMTV) contract in 2011.

Impairment of intangible assets, including goodwill, of £86m **mainly (hedge)** relates to the Safariland and Tensylon businesses sold in July 2012, and the Commercial Armored Vehicles business **expected (hedge)** to be sold in the first quarter of 2013. In 2011, charges included those taken against the Safety Products (£66m) and Naval Ships (£34m) businesses.



Finance costs<sup>1</sup> were £275m (2011 £106m). The underlying interest charge, which excludes pension accounting, marked-to-market revaluation of financial instruments and foreign currency movements, was £204m. In the prior year, the underlying interest charge of £199m included £28m relating to the early redemption of debt in connection with the disposal of the Regional Aircraft Asset Management business. Costs in 2012 include interest on the £400m debt refinancing completed in June and a higher level of net present value charges on long-term liabilities.

Taxation expense<sup>1</sup> reflects an effective tax rate of 25%. In 2011, excluding the benefit of an agreement with the UK tax authorities addressing a number of items, including research and development tax credits, the effective tax rate was 26%. The calculation of the effective tax rate is shown below:

The underlying tax rate for 2013 is **expected (hedge)** to be between 23% and 25%, with the final number dependent on the geographical mix of profits.

1 Including share of equity accounted investments. 4 Earnings excluding amortisation and impairment of intangible assets,

2 Order backlog comprises funded and unfunded unexecuted customer orders, non-cash finance movements on pensions and financial derivatives, and is stated after the elimination of intra-group orders. non-recurring items (**see (EM)** note 8 to the Group accounts).

3 Earnings before amortisation and impairment of intangible assets, finance 6 **See (EM)** note 10 to the Group accounts. costs and taxation expense (EBITA) excluding non-recurring items. 7 **See (EM)** note 9 to the Group accounts.

Underlying earnings<sup>4</sup> per share was 38.9p, a decrease of 2% on 2011 (excluding the UK tax agreement benefit). The decrease is illustrated in the bridge chart below.

Basic earnings per share, in accordance with International Accounting Standard (IAS) 33, Earnings per Share, was 32.8p compared with 37.0p in 2011 (including the UK tax agreement benefit).

#### Dividends and share repurchase

The Board is recommending a final dividend of 11.7p per share (2011 11.3p), bringing the total dividend for the year to 19.5p per share (2011 18.8p), an increase of 4%. The total dividend for the year is covered 2.0 times by underlying earnings<sup>4</sup> from continuing operations (2011 2.1 times excluding the UK tax agreement benefit). In February 2013, the Group initiated a three-year share repurchase programme of up to £1bn. Full implementation of this programme is subject to satisfactory resolution of Salam Typhoon price escalation negotiations. Discussions with the Group's UK pension scheme trustees have commenced to address any implications for deficit funding plans.

The components of net cash/(debt) (as defined by the Group)<sup>6</sup> are as follows:

Cash inflow from operating activities<sup>5</sup> was £2,916m (2011 £951m), which includes down-payments received on new contracts to Saudi Arabia and Oman, and contributions in excess of service costs for the UK and US pension schemes totalling £507m (2011 £375m).

The outflow from net capital expenditure and financial investment of £293m (2011 £268m) was only marginally higher than 2011.

Dividends received from equity accounted investments, primarily MBDA, Advanced Electronics Company, FNSS and Eurofighter, totalled £94m (2011 £88m). This excludes a £424m non-cash special dividend received from MBDA during the year (**see (EM)** opposite).

1 Including share of equity accounted investments.

2 Order backlog comprises funded and unfunded unexecuted customer orders, and is stated after the elimination of intra-group orders.

3 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items.

4 Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (**see (EM)** note 8 to the Group accounts).

5 Excludes the £428m contribution from Trust to the UK pension schemes and the £29.5m charitable contribution for the benefit of the people of Tanzania in connection with the global settlement with the UK's Serious Fraud Office in 2010, both made in 2012, as the amounts had been deducted from the Group's net cash/(debt).

Assets contributed to Trust comprise £25m of payments made into Trust for the benefit of the BAE Systems 2000 Pension Plan. In 2011, £137m was paid into Trust for the benefit of the Group's main pension scheme. Taxation payments were £142m lower at £115m primarily reflecting tax refunds following the 2011 UK tax settlement and timing differences on UK and US tax payments, and reflect the level of pension deficit funding to the UK schemes. Net cash inflow in respect of acquisitions and disposals of £96m **mainly (hedge)** comprises the disposals of Safety Products and Safariland, and assets comprising the Tensylon business. The prior year outflow of £256m **mainly (hedge)** comprised the acquisition of L-1 Identity Solutions, Inc.'s Intelligence Services Group, Norkom Group plc, ETI A/S, Fairchild Imaging, Inc. and stratsec.net Pty Limited (£524m), less the net proceeds from the disposal of the Regional Aircraft Asset Management business (£98m) and the Group's residual shareholding in Saab AB (£152m). The net purchase of equity shares of £509m in the prior year included 184 million shares purchased under the buyback programme at a cost of £500m (excluding transaction costs of £3m). As a consequence of movements in US dollar and Euro exchange rates during the year, there has been a cash outflow from matured derivative financial instruments of £119m (2011 £34m) from rolling hedges on balances with the Group's subsidiaries and equity accounted investments. Foreign exchange translation primarily arises in respect of the Group's US dollar-denominated borrowing. Net cash (as defined by the Group)<sup>6</sup> is £387m, a net inflow from the net debt<sup>6</sup> position of £1,439m at the start of the year. Cash and cash equivalents of £3,355m (2011 £2,141m) are held primarily for pension deficit funding, payment of the 2012 final dividend, the share repurchase programme and management of working capital. In June 2012, the Group issued a £400m, ten-year bond with an annual coupon of 4.125% **intended (hedge)** for general corporate purposes, including the repayment of debt securities at maturity in 2014. The maturity profile of the borrowings component of net cash is illustrated in the chart below. Details of the Group's objectives and policies regarding net cash/(debt) are provided on page 36.

The £537m reduction in intangible assets to £10.9bn (2011£11.5bn) **mainly (hedge)** reflects amortisation (£226m), impairments (£86m) and exchange translation (£273m). Property, plant and equipment, and investment property reduced to £2.4bn (2011 £2.6bn) **mainly (hedge)** reflecting the sale of certain properties to the BAE Systems Pension Scheme and exchange translation. The reduction in equity accounted investments and other investments reflects the receipt of a £424m non-cash special dividend from MBDA. The movement in the pension deficit (as defined by the Group) during the year was as follows:

The increase in the Group's share of the pre-tax pension deficit **mainly (hedge)** reflects reductions in real discount rates in both the UK and US. A net deferred tax asset of £1.1bn (2011 £1.2bn) relating to the Group's pension deficit is included within net tax assets and liabilities, and disclosed in note 18 to the Group accounts. The Group's pension schemes are discussed in more detail overleaf. There was a £0.9bn decrease in working capital **mainly (hedge)** reflecting a net increase in advance contract funding and utilisation of provisions.

6 **See (EM)** note 10 to the Group accounts.

7 **See (EM)** note 9 to the Group accounts.

8 Cash received on customers' account is the unexpended cash received from customers in advance of delivery which is subject to advance payment guarantees unrelated to Group performance. It is included within trade and other payables in the consolidated balance sheet.

#### Pension schemes

The Group's principal pension schemes are funded defined benefit schemes. The two largest schemes are the BAE Systems Pension Scheme (Main Scheme) and the BAE Systems 2000 Pension Plan (2000 Plan). In aggregate, these two schemes represent 73% (2011 73%) of the total IAS 19, Employee Benefits, deficit at 31December 2012.

#### Investment strategy

Some 52% (2011 51%) of the Group's pension scheme assets are held in equities due to the higher **expected (hedge)** level of return over the long term. The investment portfolios are highly diversified in order to provide **reasonable (hedge)** assurance that no single security or type of security could have a materially adverse impact on the total portfolio. Some of the Group's pension schemes use derivative financial instruments as part of their investment strategy to manage the level of risk.

An analysis of pension scheme assets split between equities, bonds, property and other investments, together with the **expected (hedge)** returns on those investments, is shown in note 23 to the Group accounts.

#### Valuation

Pension plan valuations are performed by independent actuaries for both IAS 19 accounting and funding purposes.

#### Accounting valuations

A summary of the Group's pension scheme assets and liabilities is shown below:

Assets held in Trust of £428m were paid into the Main Scheme and 2000 Plan in 2012 following £25m of additional payments into Trust. Pension scheme assets are included in the valuation at bid value. The key assumptions used to calculate pension scheme liabilities for the principal schemes are shown below:

The discount rate assumptions are based on third party AA corporate bond indices using yields that reflect the maturity profile of the **expected (hedge)** benefit payments. The valuation of the Group's pension liabilities is highly sensitive to movements in the discount rate. A ten basis point movement in the rate changes the total pre-tax liability by some £0.4bn.

In the US, inflation assumptions are not significant as the Group's US schemes are not indexed with inflation.

The rate of increase in salaries for the UK schemes is **assumed (hedge)** to be 0.5% (2011 0.5%) above Retail Prices Index (RPI) inflation of 2.9% (2011 2.9%). From 1 January 2013, employees in the US schemes no longer accrue salary-related benefits.

The rate of increase in pensions in payment differs between UK schemes. Different tranches of the schemes increase at rates based on either RPI or Consumer Prices Index (CPI) inflation, and some are subject to an inflation cap. With the exception of two smaller schemes, the rate of increase in pensions in payment is based on RPI inflation.

The rate of increase in deferred pensions for the UK schemes is based on CPI inflation of 2.3% (2011 2.0%), with the exception of the 2000 Plan, which is based on RPI inflation of 2.9% (2011 2.9%).

Life expectancy assumptions use, for the UK schemes, the Self-Administered Pension Scheme S1 tables, with **assumed (hedge)** long-term future annual mortality improvements of 1%, and, for the US schemes, the 2013 Internal Revenue Service Static Tables.

In February 2013, with the agreement of the Company, the trustees of the 2000 Plan entered into an arrangement with Legal & General to insure against longevity risk for the current pensioner population, covering £2.7bn of pension scheme liabilities. This will reduce the funding volatility relating to increasing life expectancy.

A revised version of IAS 19 has been issued, which is effective from 1 January 2013. The revised standard, which is not **expected (hedge)** to have an impact on the net pension deficit, is discussed in more detail on page 121.

#### Funding valuations

Pension scheme assets are included in the valuation at market value, whilst the liabilities are determined based on prudent assumptions set by the trustees following consultation with scheme actuaries.

The latest valuations of the Main Scheme and 2000 Plan were performed as at 31 March 2011 and **showed (booster)** a funding deficit of £3bn. Deficit recovery plans agreed with the trustees of both schemes run until 2026. The **expected (hedge)** level of pension deficit funding across all Group schemes, in excess of service cost, is **expected (hedge)** to be **approximately (hedge)** £0.4bn in 2013.

The results of future triennial valuations and associated funding requirements will be impacted by the future performance of investment markets, and interest and inflation rates.

#### Deficit allocation

Certain of the Group's equity accounted investments participate in the Group's defined benefit pension schemes as well as Airbus SAS, the Group's share of which was sold in 2006. As these are multi-employer schemes, the Group allocates an **appropriate (AM)** share of the IAS 19 pension deficit to those equity accounted investments and Airbus SAS.

Capital		
Objectives	Policies	Performance
<p>Maintain the Group's investment grade credit rating and ensure operating flexibility, whilst:</p> <ul style="list-style-type: none"> <li>➤ meeting its pension obligations;</li> <li>➤ continuing to pursue organic investment opportunities;</li> <li>➤ paying dividends in line with the Group's policy of long-term sustainable cover of <b>around (hedge)</b> two times underlying earnings<sup>4</sup>;</li> <li>➤ making accelerated returns of capital to <b>shareholders (EM)</b> when the balance sheet allows; and</li> <li>➤ investing in value-enhancing acquisitions, where market conditions are right and where they deliver on the Group's strategy.</li> </ul>	<p>The Group funds its operations through a mixture of equity funding and debt financing, including bank and capital market borrowings. The capital structure of the Group reflects the judgement of the directors of an <b>appropriate (AM)</b> balance of funding required.</p>	<p>At 31 December 2012, the Group's capital was £3,782m (2011 £4,291m), which comprises total equity of £3,774m (2011 £4,299m), excluding amounts accumulated in equity relating to cash flow hedges of £8m debit (2011 £8m credit). Net cash (as defined by the Group)<sup>6</sup> was £387m (2011 net debt £1,439m). During the year, the Group returned £620m to <b>shareholders (EM)</b> in dividends.</p>
For more information <b>see (EM)</b> note 25 to the Group accounts		

Tax		
Objectives	Policies	Performance
<p>The Group's tax strategy aims to:</p> <ul style="list-style-type: none"> <li>➤ ensure compliance with all relevant statutory obligations; and</li> <li>➤ manage the Group's tax burden in a way that is consistent with its Values and its legal obligations in all relevant jurisdictions.</li> </ul> <p>For more information <b>see (EM)</b> notes 6 and 18 to the Group accounts</p>	<p>The Group seeks to build constructive, open working relationships with tax authorities through full disclosure, and actively considers the implications of tax planning for the Group's wider corporate reputation. Whilst the Group aims to maximise the tax efficiency of its business transactions, it does not use structures in its tax planning that are against the spirit of the law, nor does it engage in tax evasion. Arm's length principles are applied in the pricing of all intra-group transactions of goods and services in accordance with OECD guidelines. Where appropriate, the Group consults with tax authorities to help shape proposed legislation and tax policy. BAE Systems operates internationally and is subject to tax in many different jurisdictions. The Group employs professional tax managers and takes <b>appropriate (AM)</b> advice from reputable professional firms. The Group is routinely subject to tax audits and reviews which can take a considerable period of time to conclude. Provision is made for known issues based on management's interpretation of country-specific legislation and the <b>likely (hedge)</b> outcome of negotiations or litigation.</p>	<p>The Group's tax affairs are <b>broadly (hedge)</b> up to date in the jurisdictions in which it operates. During 2012, an Annual Compliance Agreement (ACA) was signed with the Australian Tax Office (ATO) covering income tax and goods and services tax. The ATO's Tax Commissioner said the arrangements offered an innovative way forward for business to work closely with the ATO, and that an ACA formalises the open and transparent relationship they seek to have with large business.</p>

<sup>4</sup> Earnings excluding amortisation and impairment of intangible assets, non-cash finance movements on pensions and financial derivatives, and non-recurring items (**see (EM)** note 8 to the Group accounts).

<sup>6</sup> **See (EM)** note 10 to the Group accounts.

Treasury

The Group's treasury activities are overseen by the Treasury Review Management Committee (TRMC). Two executive directors are members of the TRMC, including the Group Finance Director who chairs the Committee. The TRMC also has representatives with legal and tax expertise. The Group operates a centralised treasury department that is accountable to the TRMC for managing treasury activities in accordance with the treasury policies approved by the Board. It is an overriding policy that trading in financial instruments for the purpose of profit generation is prohibited, with all financial instruments being used solely for risk management purposes. Compliance with treasury policies is monitored and any exceptions found are reported to the TRMC. Treasury policies remain under close review given continuing volatility in financial markets.

Objectives	Policies	Performance
Net cash/(debt) For more information see (EM) note 10 to the Group accounts		
Maintain a balance between the continuity, flexibility and cost of debt funding through the use of borrowings from a range of markets with a range of maturities, currencies and interest rates, reflecting the Group's risk profile.	Material borrowings are arranged by the central treasury department. Funds raised are lent onward to operating subsidiaries as required and any surplus funds are lent back where appropriate. The Group <b>intends (hedge)</b> to continue to fund the business conservatively through proactive use of bank and capital markets.	In June 2012, the Group issued a £400m, ten-year bond with an annual coupon of 4.125% <b>intended (hedge)</b> for general corporate purposes, including the repayment of debt securities at maturity in 2014. Excluding acquisition or disposal financing and share buybacks, net cash/(debt) is driven by the Group's operational performance and receipts on major contracts. The net cash/(debt) position of the Group is <b>generally (hedge)</b> best at the end of the year.
Interest rates For more information see (EM) note 27 to the Group accounts		
Manage the Group's exposure to interest rate fluctuations on borrowings through varying the proportion of fixed rate debt relative to floating rate debt with derivative instruments, <b>mainly (hedge)</b> interest rate swaps.	A minimum of 50% and a maximum of 90% of gross debt is maintained at fixed interest rates. The Group's interest rate policy has been amended by the TRMC during the year to allow the fixed interest rate component of gross debt to increase from a maximum of 75% to 90% reflecting the current exceptionally low interest rate environment.	At 31 December 2012, the Group had 79% (2011 63%) of fixed rate debt and 21% (2011 37%) of floating rate debt based on a gross debt of £3.0bn, including debt-related derivative financial assets (2011 £3.1bn).
Liquidity For more information see (EM) note 27 to the Group accounts		
Maintain adequate undrawn committed borrowing facilities.	The Group's committed Revolving Credit Facility (RCF) is £2bn (2011 £2bn). The RCF, which is contracted until 2015, is syndicated amongst the Group's core relationship banks and is available to meet <b>expected (hedge)</b> general corporate funding requirements. The RCF also acts as a back stop to Commercial Paper issued by the Group. Cash flow forecasting is performed by the businesses on a monthly basis. The Group monitors a rolling <b>forecast (hedge)</b> of its liquidity requirements to ensure that there is sufficient cash to meet operational needs and maintain adequate headroom.	The RCF was undrawn throughout the year. The Group had no Commercial Paper in issue at 31 December 2012 (2011 £513m).
Monitor and control counterparty credit risk and credit limit utilisation.	The Group adopts a conservative approach to the investment of its surplus cash. It is deposited with financial institutions with the strongest credit ratings for short periods. A credit limit is allocated to each institution taking account of its market capitalisation, credit rating and credit default swap price.	The Group had cash and cash equivalents at 31 December 2012 of £3,355m (2011 £2,141m), which was invested with 29 financial institutions (2011 24). The maximum amount deposited with any individual bank as at 31 December 2012 was less than £300m (2011 £200m). The Group has no exposure to Greek, Irish, Italian, Portuguese or Spanish banks. Additionally, the Group monitors its

		exposure to banks which have exposure to these countries.
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Objectives	Policies	Performance
Currency	For more information see (EM) note 27 to the Group accounts	
Reduce the Group's exposure to volatility in earnings and cash flows from movements in foreign currency exchange rates, <b>mainly (hedge)</b> the US dollar, Euro and Saudi Riyal.	The Group is exposed to movements in foreign currency exchange rates in respect of foreign currency denominated transactions. All material - firm transactional exposures are hedged, unless otherwise approved as exceptions by the TRMC, and the Group aims, where possible, to apply hedge accounting to these transactions. The Group is exposed to movements in foreign currency exchange rates in respect of the translation of the net assets and income statements of foreign subsidiaries and equity accounted investments. The Group does not hedge the translation effect of exchange rate movements on the income statement or balance sheet of foreign subsidiaries and equity accounted investments it regards as long-term investments.	There was a net charge of £5m in the income statement for the year (2011 net credit £85m) in respect of market value and foreign exchange adjustments on financial instruments and investments.
Credit quality		
Maintain an investment grade rating in order to ensure access to the widest possible sources of finance, minimise the cost of debt funding and to support the efficient operation of the Group's activities.	The Group aims to deliver its planned operating cash flows and manage its relationships with debt capital market investors, banks and rating agencies.	Three credit rating agencies publish credit ratings for the Group: <ul style="list-style-type: none"> <li>➤ Moody's Investors Service – Baa2;</li> <li>➤ Standard &amp; Poor's Ratings Services – BBB+; and</li> <li>➤ Fitch's Investors Service – BBB+.</li> </ul> During the year, all three maintained their categories and outlooks for the Group as investment grade and stable, respectively.

Insurance		
Objectives	Policies	Performance
Maintain an understanding of the current and future risk profile of the Group, offer tailored risk mitigation solutions, and ensure the Group insurance protection reflects current exposures.	The Group operates a policy of partial self-insurance, with the majority of cover placed in the external market. The Group insures its export contracts and associated on-demand bank guarantees against political and corporate risks. All of the Group's insurers <b>must (EM)</b> have a minimum credit rating of A -.	The Group continues to monitor its insurance arrangements to ensure the quality and adequacy of cover. During 2012, the Group again sought external validation of the credit rating of those insurers who have a significant proportion of the insurance portfolio. The views of a number of rating agencies and insurance intermediaries were considered to assess the long-term stability of the Group's insurers. Following the flood at the Electronic Systems site in Johnson City, New York, in 2011, the Group successfully recovered \$186m (£115m) under various insurance policies.

#### Critical accounting policies

Certain of the Group's accounting policies are considered by the directors to be critical because of the level of complexity, judgement or estimation involved in their application and their impact on the consolidated financial statements. The directors

**believe (booster)** that the consolidated financial statements reflect **appropriate (AM)** judgements and estimates, and provide a **true (booster)** and **fair (AM)** view of the Group's financial performance and position. The critical accounting policies are listed below and explained in more detail in note 32 to the Group accounts. References to the relevant individual notes to the Group accounts are also provided.

#### Recognition of profit on long-term contracts (IAS 11, Construction Contracts)

Revenue on long-term contracts is recognised in the Group's income statement when performance milestones have been completed. The ultimate profitability of the contract is **estimated (hedge)** based on estimates of revenue and costs, including allowances for technical and other risks, which are reliant on the knowledge and experience of the Group's project managers, engineers, and finance and commercial professionals. Material changes in these estimates **could (hedge)** affect the profitability of individual contracts. Revenue and cost estimates are reviewed and updated at least quarterly, and more frequently as determined by events or circumstances. Profit is recognised progressively as risks have been mitigated or retired. A significant proportion of the Group's £16.6bn of revenue in 2012 was accounted for under IAS 11.

For more information **see (EM)** note 1 to the Group accounts

#### Valuation of retirement benefit obligations for defined benefit pension schemes (IAS 19, Employee Benefits)

The retirement benefit obligation recognised in the Group's balance sheet represents the present value of the defined benefit obligations as adjusted for unrecognised past service cost and as reduced by the fair value of scheme assets.

For each of the assumptions used to measure the Group's pension scheme liabilities (summarised on page 34), there is a range of possible values and management exercises judgement in deciding the point within that range that most **appropriately (AM)** reflects the Group's circumstances. Small changes in these assumptions can have a significant impact on the size of the deficit. Pension scheme accounting valuations are prepared by independent actuaries as at 30 June and 31 December each year.

The Group has allocated a share of the pension deficit to its equity accounted investments and other participating employers using a consistent method of allocation, which represents the directors' best **estimate (hedge)** of the deficit **anticipated (hedge)** to be funded by these entities.

At 31 December 2012, the Group's share of the IAS 19 pension deficit was £4.6bn, excluding amounts allocated to equity accounted investments and other participating employers.

For more information **see (EM)** note 23 to the Group accounts

#### Valuation of acquired intangible assets (IFRS 3, Business Combinations) and ongoing impairment testing (IAS 36, Impairment of Assets)

Acquired intangible assets, excluding goodwill, are valued in line with internationally used models, which require the use of estimates that **may (hedge)** differ from actual outcomes. These intangible assets are amortised over their **estimated (hedge)** useful lives. Future results are impacted by the amortisation periods adopted and, potentially, any differences between **estimated (hedge)** and actual circumstances related to individual intangible assets.

Goodwill is not amortised, but is tested annually for impairment and carried at cost less accumulated impairment losses. The impairment review calculations require the use of estimates related to the future profitability and cash-generating ability of the acquired businesses.

At 31 December 2012, total intangible assets were £10.9bn, including £10.4bn of goodwill.

For more information **see (EM)** note 11 to the Group accounts

#### CORPORATE RESPONSIBILITY REVIEW

##### **Our (SM)** approach to Corporate Responsibility

The Group's approach to Corporate Responsibility (CR) is an integral part of its strategy, with the Responsible Behaviour element of Total Performance (**see (EM)** page 16). CR is focused on embedding responsible business behaviours by placing emphasis not just on what the Group does, but how it is done.

CR supports the long-term sustainability of the Group by managing the current impacts of its operations and products, and anticipating the future global business environment to ensure that it has in place:

- responsible business practices to underpin business activities and support employees in making the right decisions to drive business performance;
- a safe work environment for employees;
- a diverse range of talented employees with a broad range of skills and capabilities to deliver against global customer requirements; and
- programmes to manage the environmental impacts of the Group's operations and products, reducing the Group's carbon footprint and that of the Group's customers.

In September 2012, BAE Systems was confirmed as a member of the Dow Jones Sustainability European Index.
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Clear governance structures and visible leadership play a vital role in embedding CR.

The Chief Executive has overall responsibility for the Group's ongoing commitment to CR. He is supported by the Board and Corporate Responsibility Committee in ensuring that appropriate policies, systems, reporting structures and metrics are in place to achieve the Group's ethical, social and environmental performance objectives.

The Group's CR team reports directly to the Chief Executive, and supports the Executive Committee in embedding and driving CR processes and performance. Performance is measured and risk monitored throughout the year via the Group's six-monthly Operational Assurance Statement (OAS) (**see (EM)** page 86) and Quarterly Business Review (QBR) (**see (EM)** page 84) processes.

The Group's Internal Audit team also assesses the effectiveness of policies and processes relating to key areas of ethical and reputational risk.

#### **Stakeholders (EM)** and materiality

The Group's principal **stakeholders (EM)** include investors, customers, employees, business partners, suppliers, non-government organisations and the communities in which it operates.

**Stakeholder (EM)** feedback informs the Group's strategy and approach to managing CR. BAE Systems aims to communicate openly with **stakeholders (EM)** about its business. Two-way dialogue helps the Group to understand their views and concerns, and explain the Group's approach.

CR covers the areas identified by internal and external **stakeholders (EM)** as having the most potential to affect the long-term sustainability of the Group, by directly impacting the Group's reputation or ability to operate (outlined below). The areas identified shape the Group's CR objectives and programmes, and are given priority.

The key CR areas and emphasis are:

- Ethics and governance
- Employee and product safety
- Diversity and inclusion
- Operational and product environmental impacts

Details of these areas are covered in this section of the report.

#### CR objectives

During 2012, the Group focused on four key areas:

- Ethics – continuing to strengthen the Group's governance processes and policies to ensure that employees have clear guidance to enable them to make ethical decisions.
- Employee safety – embedding a safety first approach to the Group's operations so that all employees understand the importance of a safe workplace.
- Diversity and inclusion – continuing to develop a diverse and inclusive workplace which encourages innovation and enhances productivity.
- Operational environmental impacts – minimising the Group's operational impacts.

Progress against the ethics objective is supported by Group-wide programmes and is discussed overleaf.

Progress against objectives in employee safety, diversity and inclusion, and operational environmental impacts is driven by programmes at reporting segment level. These objectives are bonus-related for senior executives globally (**see (EM)** page 99 of the



Remuneration report). An overview of progress against these objectives is discussed on the following pages and within the reporting segment reviews (**see (EM)** pages 59 to 75).

In 2012, the Group and individual reporting segments made **good (AM)** progress across all CR objectives.

**See (EM)** page 114 for more information on the Group's Community Investment programme

## Ethics and governance

### 2012 objective

- Continue to improve and evolve the Group's business conduct programme.

BAE Systems continues to embed its ethics programme globally. It continues to focus on driving the right behaviours by supporting employees in making good ethical decisions and embedding responsible business practices.

Supporting employees in making ethical decisions is core to the Group's ethics programme and governance framework. The Group's Code of Conduct sets out the principles and standards of business conduct **expected (AM)** of all employees wherever they operate and in whatever role. It provides them with practical guidance on how to deal with situations that **may (hedge)** arise in their day-to-day activities. It also includes guidance on where to go for advice, where to report concerns and information on the Group's Ethics Helpline.

The Code of Conduct and related policies are supported by regular mandatory training for all employees. During 2012, the Group rolled out its latest employee ethics training programme which focused on making responsible decisions. The training was based around a number of scenarios, each representing different working environments and subject areas.

Detailed mandatory policies and procedures, including the Group's policies on Fraud, Facilitation Payments, Product Trading and Export Control, are also available online for employees.

Additional compliance-based e-learning training is also targeted at employees throughout the year. For example, senior executives and business leaders undertake the Group's Integrity in Business Dealings training covering **our (SM)** policies on Gifts and Hospitality, Facilitation Payments, Company Giving and Conflicts of Interest. All employees using the Group's IT system have been required to complete a number of training modules in IT Security and Export Control.

Employees have the opportunity to get independent advice and support or report concerns via Ethics Officers, now in place across the businesses, or via the Ethics Helpline, which is also available to third parties. During 2012, 1,024 enquiries were reported to Ethics Officers and via the Helpline. The Group has seen a steady increase in reports and requests for guidance to Ethics Officers as they become more established within their businesses.

If employees are found to be in breach of the Group's Code of Conduct or related policies, they will potentially be subject to disciplinary action. In 2012, 292 employees were dismissed for reasons relating to breaches of the Group's standards and policies, primarily for personnel and workplace issues.

The Group's governance framework covers the products it makes and exports. The Group's Responsible Trading Principles, Product Trading Policy and Pursuit of Export Opportunities Policy help employees make informed decisions about the business opportunities the Group pursues and to address any responsible trading risks, including risks associated with the product and its intended end use, the country of origin and delivery, and the customer.

The Group is **committed (AM)** to respecting human rights in its operations, within its sphere of influence, including supporting conventions on child labour and minimum wages.

The Group continues to support and help improve ethical standards across the defence industry. During 2012, the Group chaired the International Forum on Business Ethical Conduct (IFBEC) for the Aerospace and Defence Industry and remained a Task Force member. IFBEC is **committed (AM)** to promoting high ethical standards through the adoption of Global Principles of Business Ethics for the Aerospace and Defence Industry.

Supplier management is **important (AM)** to the Group as it depends on its suppliers to help to deliver the products and systems its customers need, on time and to the quality they expect. Poor performance or unethical conduct by a supplier **could (hedge)** affect the Group's reputation or its ability to operate effectively.

The Group expects its suppliers to comply with local legislation and to meet equivalent standards on issues such as ethical conduct, health and safety, product safety, the environment, civil liberties and human rights. The Group also expects them to apply these standards in their own supply chains and assesses compliance during the supplier selection process.

#### 2013 objective

- Continue to improve and evolve the Group's business conduct programme.

All enquiries reported to Ethics Officers and via the Ethics Helpline were reviewed and reported either to the Ethics Review Committee or, in BAE Systems, Inc., to the Ethics Review Oversight Committee.

If an employee is found to be in breach of the Group's Code of Conduct or any other relevant policies, appropriate disciplinary action, which may include dismissal, is taken.

#### Employee and product safety

#### 2012 objectives

- Businesses to demonstrate improvement against 2011 performance on recordable accidents.
- Continue to progress against the Safety Maturity Matrix.

#### Employee safety

The safety of the Group's employees, and anybody who works on its sites, is a key priority. The Group wants everyone to return home safely at the end of each day. The Group's goal is to continue to embed a safety first approach by providing training and tools that help employees understand the importance of a safe workplace, and encouraging employees to take responsibility for their own safety and the safety of those around them.

During 2012, the Group's global Safety, Health and Environment (SHE) Steering Group focused on reviewing high risk manufacturing activities which could lead to major accidents. A working group was set up to establish minimum safety standards and processes, which will be launched during 2013. The SHE Steering Group also monitored safety performance, including progress against the Safety Maturity Matrix (SMM) which was introduced in 2008. The SMM has helped drive consistent standards of safety across the Group.

Collaboration across the Group's safety teams was recognised during 2012 with a Gold award in the BAE Systems' Chairman's Awards category of Transferring Best Practice. Safety teams worked together to support the launch of an employee safety programme that can be easily transferred across businesses (**see (EM)** page 71 for more information).

The Group uses a number of global metrics throughout the year to manage and monitor safety.

At the start of 2012, the Group changed the metric used to monitor work place injuries from the Lost Work Day Case Rate to the Recordable Accident Rate. The change in metric enables inclusion of a wider scope of accidents within its reviews, which is **expected (hedge)** to lead to improvements in accident prevention. The Recordable Accident Rate is the metric that has been linked to executive bonuses.

During 2012, the Recordable Accident Rate decreased by 30%. This was ahead of improvement targets set. This progress represents a fifth consecutive year of improvement. Individual reporting segment performance against this metric can be found on pages 59 to 75.

**Regrettably (AM)**, there was one work-related employee fatality in 2012. Each accident is thoroughly investigated and lessons learnt are applied across the Group.

#### 2013 objective

- Demonstrate improvements against key safety indicators, including a 10% improvement in the Recordable Accident Rate.

#### Product safety

It is critical that the Group's products do what they are designed for without unacceptable harm to any third parties or the people using them. No complex and innovative product, whether used in defence or civilian markets or both, is without risk. It is **essential (AM)** that the Group achieves an appropriate balance between the benefits they provide to customers and the risks associated with their use.

The Group's Product Safety Policy and practices are built on a set of product safety principles that apply throughout a product's life from concept and manufacturing through to use and disposal. The safety of the Group's products relies on the application of its safety policies and processes, and on the behaviours and attitudes of the employees working on them.

Across the Group's businesses, there are a number of working groups that **ensure (booster)** a consistent approach to product safety by sharing ideas and best practice.

During 2012, the Group continued to work with its customers to agree the level of safety required that is both ethical and lawful, the risks that are **acceptable (AM)**, and to deliver products that met that level.

The Recordable Accident Rate decreased by 30% during 2012, exceeding the 15% stretch objective set by the Group (**see (EM)** page 15). Major injuries recorded decreased during 2012 in line with the Group's overall focus on accident reduction. **See (EM)** assurance statement on [www.BAE Systems.com/deloitteassurancstatement](http://www.BAE Systems.com/deloitteassurancstatement)

## Diversity and inclusion

### 2012 objective

- Demonstrate continued progress against the Diversity & Inclusion Maturity Matrix and establish milestones/targets to underpin delivery of the stated 2015 position.

The Group is **committed (AM)** to creating an inclusive work environment in which a diverse range of talented people work together to improve business performance and productivity by helping the Group to remain competitive and innovative. A more diverse workforce has a greater range of skills and capabilities which helps to better understand customers and their requirements.

To support this commitment, the Group's long-term goal is to build a high-performing workforce that more closely reflects the diversity of the local communities in which its businesses operate.

Across the Group, businesses have put in place plans to 2015 to support and progress this aim. Highlights from these programmes can be seen within the reporting segment reviews on pages 59 to 75. Activities include the development of frameworks and steering groups, mentoring programmes, and training designed to support the improvement in the diversity of its employees and create a more inclusive work environment over the long term.

In 2012, the Executive Committee progressed actions to grow the female talent pipeline at senior executive levels, with an aspiration of continuing to achieve 25% female membership of the Executive Committee by 2015:

- Fostering a culture of inclusion – unconscious bias training for executives globally has been scoped and will be rolled out during 2013. The objective of the training is to enhance talent management decisions by raising awareness of unconscious and conscious bias that influence those decisions.
- Accelerating the development of high-potential women – an Executive Committee mentoring programme was launched during 2012 to leverage the readiness of high-potential women across the organisation and 24 high-potential women were mentored during the year. This programme was supported by increased participation by high-potential women in training and development programmes.
- Increasing leadership diversity – to ensure diverse candidate lists for leadership roles, where possible, executive search - firms were employed with a track record of open and inclusive recruitment processes, and drawing from an **appropriately (AM)** diverse pool of candidates, with the overall aim of appointing the best person for the role.
- Measuring performance – on a national basis, defined aspirational objectives and actions have been put in place to increase gender diversity. Gender diversity in leadership positions and succession plans is monitored.

At the end of 2012, 27% and 25% of the Board and Executive Committee members, respectively, were women. Globally, 20% of the Group's workforce are women.

### 2013 objective

- Increase diversity and inclusion within the organisation in accordance with business goals.

See (EM) page 26 for more information on our (SM) people

Diversity data for both gender and age remained consistent with 2011. During 2012, the Group continued to embed a diversity and inclusion strategy to support the recruitment, engagement and retention of talented employees from all backgrounds.

See (EM) assurance statement on [www.BAE Systems.com/deloitteassurancestatement](http://www.BAE Systems.com/deloitteassurancestatement)

Operational and product environmental impacts

2012 objective

- Continued progression against the Environmental Sustainability Maturity Matrix – businesses to meet 2012 targets for energy, waste and water.

Operational environment

Businesses across the Group have environmental management systems in place that monitor and manage impacts from greenhouse gas emissions, material and solvent use, waste products, and emissions to the atmosphere. The Group's goal is to reduce the environmental impact of its operations and products by using energy, waste and water more efficiently. During 2012, businesses set targets to reduce the amount of energy and water used, and the amount of waste generated. In total during the year, energy use was reduced by 12%<sup>1</sup>, water consumption was reduced by 7%<sup>1,2</sup> and waste generated was reduced by 25%<sup>1</sup>. The Group monitors and reports greenhouse gas emissions, primarily from energy use, on a Group-wide basis to understand its global contribution to climate change. This helps the Group to meet the requirements of legislation, such as the UK government's Carbon Reduction Commitment and the Australian National Greenhouse Energy Reporting Act. The Group's 2012 carbon footprint decreased by 12% against 2011 to **approximately (hedge)** one million tonnes<sup>3</sup> of CO<sub>2</sub> equivalent primarily due to the energy reduction targets achieved across the businesses during 2012. The majority of the Group's greenhouse gas emissions come from the energy it uses in manufacturing and business travel.

Product environment

The Group **ensures (booster)** that environmental considerations are taken into account throughout a product's lifecycle from concept, design and manufacture through to use and disposal via the Group's Lifecycle Management (LCM) process (**see (EM)** page 84). LCM supports the Group in identifying and managing environmental risks, including reducing the environmental impacts of the Group's products during research and development, minimising waste materials during manufacturing, and helping to reduce product impacts when being used, upgraded and disposed.

Engineers are given training and guidance via the Group-wide Environmental Policy and Product Environmental Management handbook to promote understanding of environmental product design.

The Group's Product Environmental Working Group develops guidance documents and identifies good practices to share with businesses to promote consistently high standards.

The Group works with customers to help them to understand the environmental impacts of its products and supports them on their environmental programmes. For example, the Group works with the UK Ministry of Defence on their Sustainable Procurement Strategy.

The Group also works with suppliers to reduce the environmental impact of the products and services they supply, reducing costs and the Group's environmental footprint. To support this, the Group introduced a Sustainable Procurement handbook to help purchasing teams understand and embed environmental standards into the supplier management process.

Working in partnership with a variety of organisations, the Group helps improve the environmental impacts of its business and the wider defence industry. In the UK, the Group is a member of ADS Group, the Aerospace, Defence, Security and Space industries association, to help the industry prepare for, and respond to, legislation on hazardous materials and environmental design. Also in the UK, the Group works with the Institute of Environmental Management and Assessments to develop environmental competencies for environmentalists and non-environmentalists.

2013 objectives

- Set environmental improvement targets in line with the Integrated Business Plan to include energy, water and waste.
- Establish a monitoring and recording system for air travel.

1 Data is derived from internal recording systems and is not subject to external verification or audit.

2 Data excludes Ordnance Solutions Inc. and Saudi Arabia.

3 The Group's 2012 carbon footprint was externally compiled by the Coefficient Company.

Deloitte LLP assurance statement

This year, Deloitte LLP assured the following performance indicators at Group level:

- Ethics and governance – employee and third-party enquiries to Ethics Helpline<sup>^</sup> (total number and number by category) and dismissals for reasons relating to unethical behaviour\*;
- Safety – Recordable Accident Rate\*, the number of major injuries recorded\* and causes of major injuries recorded\*;
- Diversity and inclusion – employees split by gender\* and age\*; and
- Community – total Community Investment programme donations\* (**see (EM)** page 114).

Deloitte LLP has provided limited assurance on performance indicators marked with a \* and **reasonable (hedge)** assurance on performance indicators marked with a <sup>^</sup>.

To see Deloitte LLP's assurance statement **go (EM)** to: [www.BAE Systems.com/deloitteassurancestatement](http://www.BAE Systems.com/deloitteassurancestatement)

More information

More information on the Group's CR performance is available online at: [www.BAE Systems.com/corporateresponsibility](http://www.BAE Systems.com/corporateresponsibility)

- **Stakeholder (EM)** engagement
- Support for local communities
- Internal governance controls
- Deloitte assurance statement

## RISK MANAGEMENT

Effective management of risks and opportunities is **essential (AM)** to the delivery of the Group's strategic objectives, achievement of sustainable **shareholder (EM)** value, protection of its reputation and meeting the requirements of good corporate governance.

How BAE Systems manages risk

### Board

The Board has overall responsibility for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives, and ensuring that risks are managed effectively across the Group. Risk is a regular agenda item at Board meetings and the Board reviews risk as part of its regular strategy review process. This is aimed at providing the Board with an appreciation of the key risks within the business and oversight of how they are being managed. The Board delegates certain risk management activities to the Audit and Corporate Responsibility committees as follows.

### Audit Committee

The Audit Committee monitors the Group's key risks identified by the risk assessment processes and reports its findings to the Board on a regular basis. It is also responsible for reviewing in detail the effectiveness of the Group's system of internal control policies, and procedures for the identification, assessment and reporting of risk.

### Corporate Responsibility Committee

The Corporate Responsibility Committee monitors the Group's performance in managing the Group's significant nonfinancial risks, including those arising in respect of business conduct, health and safety, and the environment, and reports its findings to the Board on a regular basis.

### Approach

The Group's approach to risk management is aimed at the early identification of key risks, to remove or reduce the likelihood and effect of those risks before they occur, and deal effectively with them if they crystallise. The Group is **committed (AM)** to the

protection of its assets, which include human, property and financial resources, through an effective risk management process, underpinned where appropriate by insurance. Reporting within the Group is structured so that key issues are escalated through the management team and ultimately to the Board where appropriate. The underlying principles of the Group's risk management policy are that risks are monitored continuously, associated action plans reviewed, **appropriate (AM)** contingencies provisioned and this information reported through established management control procedures. As with any system of internal control, the policies and processes that are mandated in the Operational Framework are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide **reasonable (hedge)**, and not absolute, assurance against material misstatement or loss.

#### Financial and non-financial risks

Financial risks expose the Group to potential costs which are quantifiable on the basis that their probability and impact can be adequately understood and related to the financial statements. Nonfinancial risks cannot readily be assessed in financial terms and, therefore, cannot be reflected reliably in the financial statements.

**See (EM)** page 78 for more information on the activities of the Board and its committees

#### Process

#### Businesses

The responsibility for risk identification, analysis, evaluation and mitigation rests with the line management of the businesses. They are also responsible for reporting and monitoring key risks in accordance with established processes under the Group's Operational Framework. The Group's risk management process is set out in the Risk Management Policy, a mandated policy under the Operational Framework, and, in respect of projects, in the Lifecycle Management Framework, a core business process under the Operational Framework. Further guidance is provided by a Risk Management Maturity self-assessment tool. Identified risks are documented in controlled risk registers showing: the risks that have been identified; characteristics of the risk; the basis for determining mitigation strategy; and what reviews and monitoring are necessary. Each risk is allocated an owner who has authority and responsibility for assessing and managing it.

Project risks are reported and monitored in Group-mandated format Contract Review Packs, which are reviewed by management at monthly Contract Reviews. The financial performance of projects is reported and monitored using Contract Status Reports, which form part of the Contract Review Pack. These include programme margin variation metrics, which are reviewed regularly by the Executive Committee and Board (**see (EM)** KPI on page 15). Project margin is recognised after making suitable allowances for technical and other risks related to performance milestones yet to be achieved.

In addition, every six months, the businesses complete an Operational Assurance Statement (OAS), which is a mandated policy under the Operational Framework. The OAS is in two parts: a self-assessment of compliance with the Operational Framework; and a report showing the key financial and nonfinancial risks for the relevant business. Together with independent reviews undertaken by Internal Audit and the work of the external auditors, the OAS forms the Group's process for reviewing the effectiveness of the system of internal controls.

#### Executive Committee

The key financial and nonfinancial risks identified by the businesses from the risk assessment processes are collated and reviewed by the Executive Committee to identify those issues where the cumulative risk, or possible reputational impacts, could be significant. Management responsibility for the management of the Group's most significant nonfinancial risks is allocated at the Executive Committee's risk workshops. The OAS and Nonfinancial Risk registers are reviewed regularly by the Executive Committee to monitor the status and progression of mitigation plans, and these key risks are reported to the Board on a regular basis.

#### Principal risks

Risks are identified as principal based on the likelihood of occurrence and potential impact on the Group. The principal risks identified by the Group using the policies and processes explained above during the year are shown on pages 46 to 51.

**See (EM)** page 83 for more information on the Group's business processes and mandated policies

## PRINCIPAL RISKS

### Summary of principal risks

The Group's principal risks are identified below, together with a description of how the Group mitigates those risks.

#### Defence spending

The Group is dependent on defence-spending.

#### Description

The Group's core businesses are primarily defence-related, selling products and services directly and indirectly, **mainly (hedge)** to the US, UK, Saudi Arabian and other national governments. Defence spending depends on a complex mix of political considerations, budgetary constraints, and the ability of the armed forces to meet Specific threats and perform certain missions, and, as such, **may (hedge)** be subject to significant fluctuations from year to year. With constraints on government expenditure in a number of the Group's markets and countries in the Eurozone area experiencing serious financial difficulties, affordability continues to be a key focus for customers.

#### Impact

A decrease in defence spending by the Group's major customers **could (hedge)** have a material adverse effect on the Group's future results and financial condition.

#### Mitigation

The Group's business is geographically spread across five home markets and its products are marketed across a range of defence markets. The Group has a highly sustainable services business, which is an area for growth as customers' operations and maintenance budgets come under pressure. Significant cost reductions continue to be made to address increased budgetary pressures in the US and UK. The Group continues to use conservative assumptions to underpin its financial and operational planning. Overhanging the US defence sector into 2013 is the potential impact of a sequestration or other budget reductions that **could (hedge)** result in indiscriminate funding cuts. The Group bases its plans on conservative assumptions and continues to address its cost base accordingly. Defence budgets in the UK are **expected (hedge)** to remain flat, but the recent stabilising of equipment and services requirements and the budget outlook has established a more predictable planning environment. In Saudi Arabia, regional tensions continue to dictate that defence remains a high priority.

**See (EM)** page 22 for more information on the Group's five home markets

#### Government customers

The Group's largest customers are governments.

#### Description

Companies engaged in the supply of defence and security-related equipment and services to government agencies are subject to certain business risks particular to the defence and security industries. These governments **could (hedge)** modify contracts or terminate them at short notice and at their convenience. For example, long-term US government contracts are normally funded annually and are subject to cancellation or delay if funding appropriations for subsequent performance periods are not made. Terms and risk sharing agreements can also be amended. In addition, the Group, as a government contractor, is subject to financial audits and other reviews by some of its governmental customers with respect to the performance of, and the accounting and general practices relating to, government contracts. As a result of these audits and reviews, costs and prices under these contracts **may (hedge)** be subject to adjustment.

#### Impact

The termination of one or more of the contracts for the Group's programmes by governments, the failure of the relevant agencies to obtain **expected (hedge)** funding appropriations for the Group's programmes, or a deterioration in the Group's relationship with

any of its key government customers and corresponding reduction in contract awards, **could (hedge)** have a material adverse effect on the Group's future results and financial condition.

#### Mitigation

The Group regularly reviews performance in its markets and the Executive Committee continues to work closely with the government customers in these markets to ensure the Group's strategy is aligned with theirs.

In the event of a customer termination for convenience, the Group **would typically (hedge)** be paid for work done and commitments made at the time of termination. Having sovereign governments as major customers offers the benefits of dealing with mature procurement organisations with which the Group can have long-standing business relationships, and well-established and understood terms of trade.

**See (EM)** page 16 for more information on the Group's strategy

#### Global market

The Group operates in a global market.

#### Description

BAE Systems is a global company which conducts business in a number of regions, including the Middle East, and, as a result, assumes certain risks associated with businesses with a broad geographical reach. In some countries, these risks include, and are not limited to, the following: political changes **could (hedge)** lead to changes in the business environment in which the Group operates; economic downturns, political instability and civil disturbances **could (hedge)** disrupt the Group's business activities; government regulations and administrative policies **could (hedge)** change quickly and restraints on the movement of capital **could (hedge)** be imposed; governments **could (hedge)** expropriate the Group's assets; and burdensome taxes or tariffs **could (hedge)** be introduced.

#### Impact

The occurrence of any such events **could (hedge)** have a material adverse effect on the Group's future results and financial condition.

#### Mitigation

The Group has a balanced portfolio of businesses across its markets.

**See (EM)** page 22 for more information on the Group's five home markets

#### Contract award timing

The Group is dependent on the timing of award of defence contracts.

#### Description

The Group's profits and cash flows are dependent, to a significant extent, on the timing of award of defence contracts.

#### Impact

Amounts receivable under the Group's defence contracts can be substantial and, therefore, the timing of awards, or failure to receive **anticipated (hedge)** awards, **could (hedge)** materially affect the Group's profits and cash flows for the periods affected. In 2012, the Group's financial performance was impacted by a delay in the award of a contract amendment from the Kingdom of Saudi Arabia relating to price escalation on the Salam Typhoon programme. Negotiations on the contract continue in 2013.

#### Mitigation

The Board regularly reviews the Group's performance with regard to contract awards, and the Executive Committee actively manages the assets and resources of the Group in line with the timing of awards.

**See (EM)** page 55 for more information on the Group's major programmes



## Large contracts

Certain of the Group's businesses are dependent on a small number of large contracts.

### Description

A significant proportion of the Group's revenue comes from a small number of large contracts. Each of these contracts, which are primarily in the Platforms & Services (UK) and Platforms & Services (International) reporting segments, is **typically (hedge)** worth or potentially worth over £1bn.

### Impact

The loss, expiration, suspension, cancellation or termination of any one of these large contracts, for any reason, **could (hedge)** have a material adverse effect on the Group's future results and financial condition.

### Mitigation

To mitigate risk on UK Ministry of Defence contracts, development programmes are normally contracted with **appropriate (AM)** levels of risk being initially held by the customer. Subsequent production programmes are priced when a platform's development has reached sufficient maturity. A variety of contract structures are used to mitigate risk on production programmes, such as incentive arrangements, whereby the customer and contractor share cost savings and overruns against target prices.

The Group has a well-balanced spread of programmes and significant order backlog, which provides long-term visibility. The Board regularly reviews the Group's performance on these large contracts and the Executive Committee continues to work closely with these customers to ensure the Group's strategy is aligned with theirs.

**See (EM)** page 55 for more information on the Group's order backlog by major programme and reporting segment

## Fixed-price contracts

The Group has fixed-price contracts.

### Description

A significant portion of the Group's revenue is derived from fixed-price contracts. An inherent risk in these fixed-price contracts is that actual performance costs **may (hedge)** exceed the projected costs on which the fixed prices for such contracts are agreed. These contracts can extend over many years and it can be difficult to **predict (hedge)** the ultimate outturn costs associated with the terms on which they are based.

### Impact

The Group's failure to anticipate technical problems, estimate costs accurately or control costs during performance of a fixed-price contract **may (hedge)** reduce the profitability of such a contract or result in a loss.

### Mitigation

The Group has reduced its exposure to fixed-price design and development activity which is **in general (hedge)** more risk intensive than fixed-price production activity. To manage contract-related risks and uncertainties, contracts are managed under the Group's mandated Lifecycle Management (LCM) process at the operational level.

Robust bid preparation and approvals processes are **well (AM)** established throughout the Group, with decisions required to be taken at the **appropriate (AM)** level in line with clear delegations of authority. The consistent application of metrics is used to support the review of individual contract performance.

**See (EM)** page 84 for more information on LCM which mandates project management processes

## Component availability, subcontractor performance and key suppliers

The Group is dependent upon component availability, subcontractor performance and key suppliers.

### Description

The Group is dependent upon the delivery of materials by suppliers, and the assembly of components and subsystems by subcontractors used in its products in a timely and satisfactory manner, and in full compliance with applicable terms and conditions.

#### Impact

Some of the Group's suppliers or subcontractors **may (hedge)** be impacted by the economic environment and constraints on available financing, which **could (hedge)** impair their ability to meet their obligations to the Group. In addition, some products require **relatively (hedge)** scarce raw materials.

The Group is **generally (hedge)** subject to Specific procurement requirements which **may (hedge)**, in effect, limit the suppliers and subcontractors it may utilise. In some instances, the Group is dependent on one or a limited number of suppliers. If any of these suppliers or subcontractors fails to meet the Group's needs, the Group **may (hedge)** not, in the short term, have readily available alternatives, thereby impacting its ability to complete its customer obligations satisfactorily and in a timely manner, which **could (hedge)** have a negative impact on the Group's future results and financial condition.

#### Mitigation

The Group's procurement function, which is led by a member of the Executive Committee, is responsible for establishing and managing end-to-end integrated supplier arrangements. The Executive Committee continues to monitor this risk and the Group has experienced no material negative impact to date. The Group reviews the financial health of strategically important suppliers globally on an ongoing basis.

**See (EM)** page 21 for more information on suppliers

#### Laws and regulations

The Group is subject to risk from a failure to comply with laws and regulations.

#### Description

The Group has contracts and operations in many parts of the world, operates in a highly regulated environment, and is subject to applicable laws and regulations of many jurisdictions. These include, without limitation, regulations relating to import-export controls, money laundering, false accounting, anti-bribery and anti-boycott provisions. Non-compliance **could (hedge)** expose the Group to fines, penalties, suspension or debarment, which **could (hedge)** have a material adverse effect on the Group. From time to time, the Group is subject to government investigations relating to its operations.

#### Impact

Failure by the Group or its sales representatives, marketing advisers or others acting on its behalf to comply with these laws and regulations **could (hedge)** result in administrative, civil or criminal liabilities resulting in significant fines and penalties, and/or result in the suspension or debarment of the Group from government contracts for some period of time or suspension of the Group's export privileges.

#### Mitigation

During the year, the Group has continued to add resources dedicated to legal and regulatory compliance in order to enhance further its capability to identify and manage the risk of compliance failure. Internal and external market risk assessments form an **important (AM)** element of the ongoing corporate development and training processes. A uniform global policy and process for the appointment of advisers engaged in business development is in effect. Pursuant to its commitments concerning ongoing regulatory compliance made in the course of the 2010 settlement with the US Department of Justice and the consequent 2011 settlement with the US Department of State, the Group appointed, respectively, an independent monitor in 2010 and a Special Compliance Official in 2011, in each case for a period of three years, to monitor the Group's compliance with its respective commitments under those settlements and its compliance obligations going forward.

**See (EM)** page 40 for more information on the Group's approach to business conduct

#### Competition

The Group's business is subject to significant competition.

#### Description

The Group's businesses are subject to competition from national and multinational firms with substantial resources and capital, and many contracts are obtained through a competitive bidding process, including contracts where the Group is the current incumbent.

The Group's ability to compete for contracts depends in particular on: the strength of its intellectual property rights and technical knowhow; the effectiveness and innovation of its research and development programmes; its ability to offer better programme performance than its competitors at a lower cost to its customers; and the readiness of its facilities, equipment and personnel to undertake the programmes for which it competes.

In some instances, governments direct a single supplier all work for a particular programme, commonly known as sole-source programmes. Although governments have historically awarded certain programmes to the Group on a sole-source basis, they **may (hedge)** in the future determine to open such programmes to a competitive bidding process. Government contracts for defence and security-related products and services can, in certain countries, be awarded on the basis of home country preference.

#### Impact

The Group's business and future results **may (hedge)** be adversely impacted if it is unable to compete adequately in the markets in which it operates.

#### Mitigation

The Group's global, multi-market presence, balanced portfolio of businesses, leading capabilities and performance continue to address this risk. In particular, the Group invests in research and development, and innovation, and continues to reduce its cost base and improve efficiencies.

**See (EM)** page 22 for more information on the Group's five home markets

#### Pension funding

The Group has an aggregate funding deficit in its defined benefit pension schemes.

#### Description

The Group operates certain defined benefit pension schemes. At present, in aggregate, there is an actuarial deficit between the value of the projected liabilities of these schemes and the assets they hold.

#### Impact

The amount of the deficits **may (hedge)** be adversely affected by changes in a number of factors, including investment returns, long-term interest rate and price inflation expectations, and **anticipated (hedge)** members' longevity. Further increases in pension scheme deficits **may (hedge)** require the Group to increase the amount of cash contributions payable to these schemes, thereby reducing cash available to meet the Group's other operating, investing and financing requirements.

#### Mitigation

Following triennial funding valuations of the Group's two largest UK pension schemes in 2011, revised deficit recovery plans were agreed during the year. The performance of the Group's pension schemes and deficit recovery plans are regularly reviewed by both the Group and the trustees of the schemes, taking actuarial and investment advice as **appropriate (AM)**. The results of these reviews are discussed with the Board and appropriate action taken.

In future, the growth of the defined benefit liabilities is **expected (hedge)** to be curtailed as follows:

- With effect from April 2012, new employees in the UK are offered membership of a defined contribution scheme rather than the previous defined benefit/defined contribution hybrid scheme. Existing members of the Group's legacy UK plans are unaffected by this change;
- With effect from January 2013, all employees in the US are offered membership of a defined contribution scheme (401(k)) and no longer accrue salary-related benefits in defined benefit schemes; and
- In February 2013, with the agreement of the Company, the trustees of the BAE Systems 2000 Pension Plan entered into an arrangement with Legal & General to insure against longevity risk for the current pensioner

population, covering £2.7bn of pension scheme liabilities. This will reduce the funding volatility relating to increasing life expectancy.

**See (EM)** page 34 for more information on the Group's pension accounting and funding valuations, and deficit recovery plans

#### Export controls and other restrictions

The Group is subject to export controls and other restrictions.

#### Description

A portion of the Group's sales is derived from the export of its products. The export of defence and security products outside the jurisdictions in which they are produced is subject to licensing and export controls, and other restrictions. No assurance can be given that the export controls to which the Group is subject will not become more restrictive, that new generations of the Group's products will not also be subject to similar or more stringent controls, or that political factors or changing international circumstances will not result in the Group being unable to obtain necessary export licences.

#### Impact

Reduced access to export markets **could (hedge)** have a material adverse effect on the Group's future results and financial condition. Failure to comply with export controls and wider regulations **could (hedge)** expose the Group to fines, penalties, suspension or debarment, which **could (hedge)** have a material adverse effect on the Group.

#### Mitigation

The Group has formal systems and policies in place which are mandated under the Operational Framework to ensure adherence to regulatory requirements and identify any restrictions that could adversely impact the Group's activities.

**See (EM)** page 23 for more information on exports

#### Acquisitions

The **anticipated (hedge)** benefits of acquisitions **may (hedge)** not be achieved.

#### Description

The Group considers investment in value-enhancing acquisitions where market conditions are right and where they deliver on its strategy. Whether the Group realises the **anticipated (hedge)** benefits from these transactions depends upon the successful integration of the acquired businesses, as well as their post-acquisition performance in the markets in which they operate.

#### Impact

The diversion of management attention to integration efforts and the performance of the acquired businesses below expectations **could (hedge)** adversely affect the Group's business, and create the risk of impairments arising on goodwill and other intangible assets.

#### Mitigation

The Group has established policies in place to manage the acquisition process, monitor the integration and performance of acquired businesses, and identify potential impairments.

**See (EM)** page 10 for more information on the Group's recent M&A activity

#### Consortia and joint ventures

The Group is involved in consortia, joint ventures and equity holdings where it does not have control.

#### Description

The Group participates in various consortia, joint ventures and equity holdings, exercising varying degrees of control. The risk of failure or the risk of disagreement, particularly in those that require the unanimous consent of all members with regard to major decisions, is inherent in any jointly controlled entity.

#### Impact

In the event of failure or disagreement within a consortium, joint venture or equity holding and the business arrangement failing to meet its strategic objectives or **expected (hedge)** benefits, the Group's business and future results **may (hedge)** be adversely affected.

#### Mitigation

The Group seeks to participate only in ventures in which its interests are complementary to those of its partners, and has formal systems and procedures in place to monitor the performance of such business arrangements.

**See (EM)** page 145 for more information on the Group's principal joint ventures

#### Exchange rates

The Group is exposed to volatility in currency exchange rates.

#### Description

The global nature of the Group's business means it is exposed to volatility in currency exchange rates in respect of foreign currency denominated transactions, and the translation of net assets and income statements of foreign subsidiaries and equity accounted investments. The Group is exposed to a number of foreign currencies, the most significant being the US dollar, Euro and Saudi Riyal.

#### Impact

Significant fluctuations in exchange rates to which the Group is exposed **could (hedge)** have a material adverse effect on the Group's future results and financial condition.

#### Mitigation

In order to protect itself against currency fluctuations, the Group's policy is to hedge all material firm transactional exposures, unless otherwise approved as exceptions by the Treasury Review Management Committee. The Group does not hedge the translation effect of exchange rate movements on the income statement or balance sheet of foreign subsidiaries and equity accounted investments it regards as long-term investments.

**See (EM)** page 36 for more information on the Group's treasury policies

#### Cybersecurity

The Group **could (hedge)** be negatively impacted by information technology security threats.

#### Description

As a defence, aerospace and security company, the security threats faced by the Group include threats to its information technology infrastructure, unlawful attempts to gain access to its proprietary or classified information and the potential for business disruptions associated with information technology failures.

#### Impact

Failure to combat these risks effectively **could (hedge)** negatively impact the Group's reputation among its customers and the public, cause disruption to its business operations, and **could (hedge)** result in a negative impact on the Group's future results and financial condition.

#### Mitigation

The Group has a broad range of measures in place, including **appropriate (AM)** tools and techniques, to monitor and mitigate this risk.

**See (EM)** page 24 for an overview of the Cyber & Intelligence reporting segment

Additional risks and uncertainties currently unknown to the Group, or which the Group currently deems immaterial, **may (hedge)** also have an adverse effect on the business or financial condition of the Group.

## Supplying and supporting Hawk trainer aircraft for the Royal Saudi Air Force

Following agreement between the governments of the Kingdom of Saudi Arabia and the UK, under the Saudi British Defence Co-operation Programme, BAE Systems has a contract to support the future aircrew training requirements of the Royal Saudi Air Force.

The contract, aimed at meeting the growing demands of a world-class air force, covers the provision of equipment and training devices, such as aircraft simulators, training aids and aircraft on which to train aircrew. Included within this requirement is the supply of 55 Pilatus PC-21 aircraft to fulfil the basic training role and 22 BAE Systems Hawk Advanced Jet Trainer aircraft, which will be used to fulfil the fast jet training part of the syllabus.

## REPORTING SEGMENTS PERFORMANCE REVIEW

This section provides summaries of the operational, financial and non-financial performance of the Group's five principal reporting segments.

## REPORTING SEGMENTS OVERVIEW

The Group's US businesses are engaged in significant multi-year contracts. Performance on many contracts beyond the first year is contingent upon the receipt of funding, which the US government **typically (hedge)** authorises on an annual basis. The order book metric presented in previous years excludes the unfunded element of these multi-year contracts. The order backlog<sup>1,2</sup> metric presented above provides visibility of the total value of contracts won, not just the funded value as recorded in the order book. In the US businesses, this metric gives a more meaningful measure of the sustaining business levels. An example of order backlog<sup>1,2</sup> is the ship repair business within Platforms & Services (US). Multi-Ship, Multi-Option contracts for five years are secured, but then only funded by the customer incrementally. Order backlog<sup>1,2</sup> recognises the remaining period of the contracts awarded, but yet to be funded.

## REPORTING SEGMENTS

### ELECTRONICSYSTEMS

Electronic Systems, with 13,000 employees<sup>1</sup>, comprises the US and UK-based electronics activities, including electronic warfare systems and electro-optical sensors, military and commercial digital engine and flight controls, next-generation military communications systems and data links, persistent surveillance capabilities, and hybrid electric drive systems.

#### Operational key points

- Sustained a leadership position in the airborne electronic warfare market
- Strengthened position in high growth commercial aircraft electronics market
- Won key development contracts in the classified area
- Continued focus on increasing productivity and efficiency
- Business recovery complete following disruption from flood damage at the Johnson City facility
- £0.2bn of research and development expenditure<sup>5</sup> in 2012

#### Financial key points

- Underlying order backlog<sup>1,4</sup> increased in challenging business environment
- Sales<sup>1</sup> reduction from operational tempo-driven activity on Thermal Weapon Sights
- Return on sales of 14.2%
- Cash flow<sup>3</sup> conversion of underlying EBITA<sup>2</sup> at 95%, before pension deficit funding

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see (EM) page 31).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Comprises funded and unfunded unexecuted customer orders.

5 Includes both Group-funded and customer-funded expenditure.

#### KEY CHARACTERISTICS

- Broad base of programmes, with more than 5,000 active contracts
- No programme greater than 5% of sales
- Over 67% of 2012 sales were fixed price-based
- Cutting-edge technology and capabilities, with significant levels of research and development invested in the business
- 17% of total sales are to commercial customers

#### Financial performance

Order backlog<sup>1,4</sup>, excluding the impact of US dollar exchange translation, increased despite the impact of contracting delays as the US administration operated federal budgets under Continuing Resolution limitations.

On a like-for-like basis, sales<sup>1</sup> reduced by 7% on 2011 primarily reflecting the completion of deliveries of Thermal Weapon Sights as operational tempo-driven activity reduces. Sales in the Commercial Aircraft electronics business increased by 11%.

Underlying EBITA2 was £356m (2011 £386m). Return on sales was 14.2% (2011 14.6%). Cash flow<sup>3</sup> conversion of underlying EBITA2 was 95%, before pension deficit funding.

#### Operational performance

Following severe flooding in September 2011, operations formerly conducted at the Electronic Systems facility in Johnson City, New York, have been moved to Endicott, New York. After a year of recovery efforts, operational capability has been restored and programmes are back on schedule.

#### Electronic Combat

The business maintains its leadership position in the electronic warfare market, with continued focus on the F-35 Lightning II Systems Design and Development programme, planning for the flight test programme starting in 2013. The business progressed Low-Rate Initial Production (LRIP) Lot 5 and 6 deliveries during the year, and has responded to the LRIP Lot 7 request for proposal, which includes production aircraft for international customers.

In support of the US Navy's Next-Generation Jammer, which will replace the ageing jammer currently on certain US Navy aircraft, a \$20m (£12m) modification was received to expand the scope of the existing technology maturation contract. BAE Systems is one of three bidders on the next phase technology development contract valued at **approximately (hedge)** \$300m (£185m).

The Digital Electronic Warfare System (DEWS) continues to secure new contract awards, including a six-year, \$0.4bn (£0.2bn) contract to upgrade 70 F-15 aircraft for the Royal Saudi Air Force. Initial flight testing providing advanced radar warning and countermeasure capabilities is scheduled to begin in March 2013. The business continues to pursue other export opportunities for the DEWS suite.

Also in international markets, the business received three contracts totalling \$86m (£53m) to provide F-16 support equipment, test systems and spares to the governments of Oman, Indonesia and Iraq for delivery by early 2014.

#### Survivability & Targeting

In early 2012, the US Army awarded the business a two-year, \$38m (£23m) contract to develop the Common Infrared Countermeasures capability. Using its Boldstroke® system, an integrated aircraft survivability system for protecting aircraft from infrared-guided missiles and other threats, the business will provide increased system capability in a smaller, more energy efficient package. Following a competitor protest, the award was upheld by the US Government Accountability Office and work restarted in June. Initial test systems are in progress, with the first units scheduled for government acceptance ahead of schedule.

The Advanced Precision Kill Weapon System programme passed tests on several airborne platforms. With deployment in theatre and positive performance feedback, the US Navy has authorised Full-Rate Production of the system and awarded a base contract valued at \$28m (£17m) for 985 units and a Full-Rate Production option of \$41m (£25m) for 1,476 units.

Under a \$37m (£23m) subcontract, BAE Systems continues to support the engineering and manufacturing development of the Joint and Allied Threat Awareness System, a next-generation warning system to enhance aircraft survivability for the US Navy.

The Thermal High-Altitude Area Defence seeker programme provides a transportable, rapidly deployable, ground-based capability to intercept and destroy ballistic missiles inside or outside the atmosphere during their final phase of flight. BAE Systems has received an initial amount of \$87m (£54m) in combined US government and Foreign Military Sales to the United Arab Emirates on the programme, including a base quantity of 146 seekers with an option for up to a further 147.

Deliveries of Thermal Weapon Sights to the US Army in support of military operations in Iraq and Afghanistan were completed.

#### Electronic Combat

BAE Systems is responsible for a number of subsystems and equipment on the F-35 Lightning II, including the electronic warfare suite. The flight test programme for the electronic warfare suite is planned to commence in 2013.

**See (EM)** page 69 for more information on the Group's involvement on F-35 Lightning II

#### Survivability & Targeting

The Advanced Precision Kill Weapon System is a laser-guided rocket that provides a low-cost surgical strike capability. In 2012, the programme passed tests on several airborne platforms and achieved initial operational capability. The system has been deployed in theatre and received positive performance feedback.

### ELECTRONIC SYSTEMS

BAE Systems has responded to a US Army request for proposal for its Joint Effects Targeting System programme, which has been designed to enhance dismounted, forward-deployed soldiers' ability to accurately locate positions and target precision-guided munitions fire support. An award decision is **expected (hedge)** in the first half of 2013 for a 26-month Engineering and Manufacturing Development phase, which will be followed by a Low-Rate Initial Production award competition.

#### Communications & Control

The F-35 Lightning II programme continues to be a key platform for the Group's avionics products.

Deliveries continue on plan for the active inceptor system out of Rochester, UK, and the vehicle management system out of Endicott, New York. The business has continued to pursue additional opportunities expanding its content on the platform.

Leveraging commercial technology to create a low size, weight and power design, the business launched the PHOENIX™ family of networking radios to integrate easily into US Army ground combat vehicles. In October, the business responded to the US Army's next-generation Mid-tier Networking Vehicular Radio request for proposal with its two-channel PHOENIX-SC radio, with an award decision **expected (hedge)** in 2013.

#### Intelligence, Surveillance & Reconnaissance (ISR)

The business continues to provide Wide Area Airborne Surveillance capability for the US Air Force and US Army. These key programmes are based on two wide-area, high-resolution imaging sensor systems, the Airborne Wide Area Persistent Surveillance System, which has been operational for over 12,000 hours in theatre, and the Autonomous Real-time Ground Ubiquitous Surveillance – Imaging System. These systems enable observation of very wide areas of interest with sufficient imagery resolution to meet intelligence and surveillance needs.

The business is providing state-of-the-art processing capabilities to Boeing for the US Navy's P8A Poseidon programme. The mission computer suite has robust, flexible and rugged open architecture providing high performance in the military environment. Over 30 initial systems have been delivered and a contract for Full-Rate Production Lot 1 has been awarded.



As a leader in the Identification Friend or Foe market, the business has a strong order backlog<sup>4</sup> driven by the Mode 5 cryptographic system upgrades, which have been incorporated into products deployed on multiple US Department of Defense platforms. Production has begun and is **expected (hedge)** to continue to the end of the decade.

#### Commercial Aircraft electronics

The business continues to be **well (AM)** positioned for growth in worldwide demand for commercial aviation through its engine and flight controls activities.

FADEC Alliance, a new joint venture between FADEC International (a joint venture between BAE Systems and Sagem) and GE Aviation, began development of the Full-Authority Digital Engine Controls for CFM International's LEAP and GE Aviation's Passport family of engines.

Ongoing development of the primary flight control electronics and active side sticks for Embraer's KC-390 military transport aircraft is raising the Group's profile in the emerging Brazilian aerospace industry. The first flight of the KC-390 is **expected (hedge)** in 2014.

HybriDrive<sup>®</sup> propulsion BAE Systems has delivered 3,800 hybrid diesel-electric propulsion systems since 2004, which are now in service with over 60 operators.

In April 2012, European bus manufacturer, Iveco Irisbus, announced that it had been awarded Europe's largest single order for 132 diesel-electric hybrid buses for Dijon and Bordeaux in France. Prior to this award, Iveco Irisbus had delivered **approximately (hedge)** 20 diesel-electric hybrid buses equipped with BAE Systems' propulsion systems.

The business has progressed solutions for battery reliability issues in the field from its first-generation lithium-ion battery packs. In addition, ownership of the current battery supplier has changed and the business is working with the new owner to minimise the impact on the Group and its customers.

#### Looking forward

Efforts to reduce the US government's budget deficit are **likely (hedge)** to impact all areas of government spend. A Continuing Resolution on the 2013 fiscal budget has been passed through to March 2013 and the risk of further reductions in US defence budgets remains, including the impact of sequestration.

4 Comprises funded and unfunded unexecuted customer orders.

#### Communications & Control

BAE Systems' research and development investment and innovations in technology have resulted in two significant helmet-mounted display products: the Striker<sup>®</sup> and the Q-Sight<sup>®</sup> helmets. The Striker<sup>®</sup> helmet variant for Typhoon integrates night vision and full crew head protection. The Q-Sight<sup>®</sup> helmet uses quantum wave guide technology to directly couple the output of an LCD projector to a combining lens, eliminating the need for intermediate lenses.

#### Intelligence, Surveillance & Reconnaissance (ISR)

BAE Systems is a leading provider of Intelligence, Surveillance and Reconnaissance capability, producing tactical identification, sensing and intelligence exploitation systems for airborne, maritime, land and space-based applications.

NASA's Curiosity rover vehicle successfully landed on Mars and began transmitting images back to Earth in August. Two BAE Systems RAD750<sup>®</sup> computers controlled the flight from Earth and the landing on Mars, and will continue to control the rover during its two-year mission.

Whilst **likely (hedge)** funding reductions and the resultant slow down or cancellation of ongoing and new programmes **could (hedge)** impact the business, Electronic Systems remains **well (AM)** positioned with a balanced portfolio that will enable it to respond to changing US Department of Defense priorities whilst maintaining its emphasis on cost reduction. The business **expects (hedge)** to benefit from its incumbent positions on core platforms, and from positions in areas such as commercial aircraft electronics and international defence programmes.

#### Non-financial performance

##### Employee safety

During 2012, safety remained a priority for Electronic Systems, achieving a 17% reduction in the Recordable Accident Rate. This performance was supported during the year by the introduction of a safety awareness campaign and training programme for employees.

#### Diversity and inclusion

Electronic Systems supported US-wide diversity and inclusion activities, including inclusive leadership training, launching a multi-cultural network, and introducing diverse candidate shortlists and panels for executive roles. Locally, Electronic Systems focused on increasing the speed and rigour of its diversity efforts. The business recruited a dedicated diversity and inclusion manager, and introduced a diversity and inclusion personal development objective for leaders.

#### Environment

To support progress in environmental sustainability, the business launched an Environment Policy to help progress business-wide reduction targets in energy, water and waste, and launched a recording system to drive consistency in data collection. To help employees support reduction targets, an education programme was launched to raise awareness of how each employee could personally contribute to reducing energy used and waste created.

#### People

Electronic Systems operates a **successful (AM)** 'One Team Award' recognition programme. Each quarter, the programme recognises teams that have been nominated for exemplifying one or more of five imperatives demonstrated through end-user impact: community focus; technology innovation; collaboration; best practices; and overall value to the business.

1 Businesses have put in place plans to 2015 to support and progress the Group's long-term goal to build a high-performing workforce that more closely reflects the diversity of the local communities in which its businesses operate.

2 Data is derived from internal recording systems and is not subject to external verification or audit.

#### Commercial Aircraft electronics

Many of the world's commercial aircraft employ BAE Systems' engine and flight controls. Worldwide demand for commercial aviation is **expected (hedge)** to grow. In 2012, BAE Systems secured a commercial aircraft electronics position in Brazil.

#### HybriDrive® propulsion

The Group's efficient, low emission HybriDrive® propulsion technology has been in service on buses since 2004. In 2012, European bus manufacturer, Iveco Irisbus, was awarded an order for 132 buses using BAE Systems' HybriDrive® propulsion systems.

## REPORTING SEGMENTS

### CYBER & INTELLIGENCE

Cyber & Intelligence, with 8,200 employees<sup>1</sup>, comprises the US-based Intelligence & Security business and UK-headquartered BAE Systems Detica business, and covers the Group's cyber, secure government, and Cyber & Intelligence, with 8,200 employees<sup>1</sup>, comprises the US-based Intelligence & Security business and UK-headquartered BAE Systems Detica business, and covers the Group's cyber, secure government, and commercial and financial security activities.

#### Operational key points

- The US-based business continues to perform **well (AM)** on existing programmes and secured strategic contract awards with existing customers
- The US-based business continues to invest in differentiating technologies, such as activity-based intelligence and cybersecurity, including a leading-edge network operations and security centre environment, to support a pipeline of submitted bids of \$2.9bn (£1.8bn) at the end of 2012
- BAE Systems Detica continues to invest in products and capability, including its Security Operations Centre
- BAE Systems Detica awarded a contract by Vodafone for next-generation enterprise secure networks for mobile devices

#### Financial key points

- Funded order intake<sup>1</sup> and sales<sup>1</sup> were **broadly (hedge)** unchanged from 2011
- Return on sales impacted by investment in the BAE Systems Detica business for future growth
- Cash flow<sup>3</sup> conversion of underlying EBITA<sup>2</sup> at 91%

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (**see (EM)** page 31).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Comprises funded and unfunded unexecuted customer orders.

Intelligence & Security:

- Delivers cost-effective IT solutions that solve complex problems of collaboration and security for the US national security community
- Delivers real-time threat assessments that rapidly inform critical security actions. The business is a leading provider of specialised security and intelligence operational support and solutions in the US
- Delivers automated, efficient and reliable intelligence processing, data management systems and imagery mapping tools for the US intelligence and defence communities

BAE Systems Detica:

- Expanding in the fast-growing cybersecurity market
- Increasing focus on products and services for the financial services and telecommunications sectors
- Providing core intelligence technology and managed services for government clients

Financial performance

Funded order intake<sup>1</sup> and sales<sup>1</sup> were **broadly (hedge)** unchanged from 2011.

Order backlog<sup>1,4</sup> reduced to £1.0bn (2011 £1.1bn). There is a significant number and value of competitive bids in the Intelligence & Security business awaiting award decisions.

Underlying EBITA<sup>2</sup> was £124m (2011 £136m). Return on sales reduced to 8.8% (2011 9.7%) reflecting increased levels of investment in the BAE Systems Detica business in support of targeted future growth in commercial and international markets.

Operating cash inflow<sup>3</sup> was £113m (2011 £123m), which represents a conversion of underlying EBITA<sup>2</sup> of 91%.

Operational performance

Intelligence & Security

The US-based Intelligence & Security business delivers a broad range of services, including secure IT solutions, cybersecurity, geospatial solutions and intelligence analysis to enable the US military and government to recognise, manage and defeat threats.

The business is structured into four key business areas that provide Specific domain expertise, whilst working closely together to provide enterprise-wide support to a range of customers, and key agencies in the intelligence, defence, homeland security and civilian markets.

Information Technology & Cybersecurity Solutions develops, deploys and maintains mission applications focused on information sharing, knowledge management and enhanced enterprise mission IT solutions for the US federal, civilian and defence intelligence communities. The business also provides analytics, cyber analysis and real-time network forensics.

Through 2012, work continued on the Solutions for the Information Technology Enterprise Indefinite Delivery, Indefinite Quantity (IDIQ) contract, with the business as the prime contractor, receiving task orders now worth a total of \$344m (£212m). Since the project began, **approximately (hedge)** 700 security-cleared IT experts, deployed across 84 locations in 14 countries, have assisted the US Defense Intelligence Agency in delivering IT services to 50,000 Department of Defense personnel by standardising global IT operations and reducing the time taken to deliver technician services.

Continuing work on the Next-Generation Desktop Environment (NGDE) programme for the US Defense Intelligence Agency, the business has virtualised hundreds of applications and deployed data centre infrastructure to 13 sites, now supporting over 12,000 global analyst workstations. The NGDE is an enterprise networking environment based on virtual desktop infrastructure.

The Security Operations Centre in the US protects the Group's networks by monitoring its global intranet, with more than 100,000 network interfaces serving employees across five home markets and offices in over 100 countries. Services include security engineering, risk analysis, support of IT hardware and software, IT engineering and applications, and global enterprise monitoring and security incident response.

GEOINT-ISR (Geospatial Intelligence – Intelligence, Surveillance and Reconnaissance) develops and supports software systems and mission applications for geospatial tasking, including data collection, processing, exploitation and dissemination, as well as mission planning, Intelligence, Surveillance and Reconnaissance (ISR), precision targeting, and command and control for the US defence and intelligence communities.

The business was awarded a five-year, \$106m (£65m) contract by the National Geospatial-Intelligence Agency (NGA), under which engineers will design, develop and implement a transformational solution enabling the US government to evolve from its current image library to a standardised image storage, management and dissemination process. This is an **important (AM)** strategic win that will drive future GEOINT and imagery systems development.

In December 2012, BAE Systems was awarded a multi-year, \$60m (£37m) contract to provide activity-based intelligence systems, tools and support for mission priorities for the NGA. This award is a task order under the NGA's Total Application Services for Enterprise Requirements programme, a five-year IDIQ contract.

Global Analysis provides mission-enabling analytic solutions and support to operations across the US homeland security, law enforcement, defence, intelligence and counterintelligence communities.

The business continues to provide **approximately (hedge)** 450 security cleared analysts working alongside forward deployed US defence personnel as part of the Counter Improvised Explosive Device (C-IED) programme, with a total value of funded orders of **approximately (hedge)** \$450m (£277m) over the two years of the contract. The business is now working with the customer to manage staffing levels in line with reducing mission requirements.

#### Information Technology & Cybersecurity Solutions

BAE Systems provides critical cybersecurity and network defence solutions in support of the US government. Capabilities, such as digital forensics and cyber investigations, play a role in the ongoing battle to protect computer networks from cyber threats.

#### GEOINT-ISR

The Group develops Geospatial Intelligence (GEOINT) and Intelligence, Surveillance and Reconnaissance (ISR) hardware and software platforms, and mission applications for the defence and intelligence communities. The Group's advanced tools and applications allow defence and intelligence communities to quickly process high volumes of data to help military and law enforcement officials confront or avoid threats on the battlefield and give troops operating around the world the accurate, real-time situational awareness they need to make informed, tactical decisions.

The business is executing **well (AM)** on the Full Motion Video and Geospatial Imagery Analysis contract awarded in 2011, with a contract value of \$402m (£248m) and over 400 employees being utilised.

SpecTal provides US government customers with specialised security and intelligence mission support, including intelligence analysis, targeting operations support, training and IT deployment.

With the 2011 acquisition of L-1 Identity Solutions' Intelligence Services Group, a key contract with an intelligence community customer was gained. The contract has since been re-competed and SpecTal was part of the winning bid team serving as a major subcontractor on the five-year programme.

#### BAE Systems Detica

BAE Systems Detica continues to build a business that provides security and intelligence products and services to both government and commercial customers. In July, the stratsec business in Australia, acquired in 2011, and a new security entity in India were integrated into BAE Systems Detica. The business is also focused on developing opportunities in the Americas' commercial market.

Cyber Security Demand is growing across both government and commercial sectors, with contracts secured with a global law firm and a US financial institution in 2012. The Security Operations Centre became fully operational in 2012, providing services to detect and remediate advanced cyber attacks for clients.

The business was one of four companies selected by the UK's Government Communications Headquarters (GCHQ) to work in partnership on a new Cyber Incident Response pilot programme, a government quality-assured service that organisations can turn to when they have suffered a cybersecurity incident.

Detica NetReveal® As a provider of risk, fraud and compliance solutions to the global financial services industry, orders of £74m were received during the year, including contracts in new business areas of healthcare and insurance in the US.

Global Communications Solutions is a provider of specialist communications equipment, including monitoring and lawful intercept solutions, for use by government and commercial clients.

During 2012, a review of routes-to-market was carried out, resulting in necessary changes which adversely impacted the 2012 financial performance of the business.

#### Services

The business, which provides consultancy, systems integration and managed services, was impacted by challenging market conditions in both the UK government and commercial sectors.

Orders in the year included a contract under a business change programme for a complex UK cross-government programme and a managed services contract with Vodafone for the provision of next-generation enterprise secure networks for mobile devices. The business was unsuccessful in its bid to provide services under the UK government's Disclosure and Barring Service.

The business continues to develop opportunities internationally, in both the Middle East and, with the addition of stratsec, the Asia Pacific region.

#### Looking forward

Efforts to reduce the US government's budget deficit are **likely (hedge)** to impact all areas of government spend. A Continuing Resolution on the 2013 fiscal budget has been passed through to March 2013 and the risk of further reductions in US defence budgets remains, including the impact of sequestration.

Growth opportunities remain, particularly in critical, mission-focused areas, such as next-generation ISR, Multi-INT fusion (the seamless synthesis of the individual intelligence disciplines to enable more complete situational awareness), counter intelligence and enterprise solutions for big data problems.

The US market is experiencing delays in procurement awards and descoping of existing contracts as US government agencies look to reduce IT budgets. Sales in 2013 are **expected (hedge)** to be impacted by the completion of the C-IED contract as the US withdraws from Afghanistan. However, the business **expects (hedge)** an enduring **need to (EM)** provide data management solutions, including the rapid collection, processing and dissemination of data to intelligence community customers and the US military. The business is **well (AM)** prepared to compete in this price-sensitive market through its customer intimacy, innovation and continued cost management.

BAE Systems Detica **expects (hedge)** growth in cyber and intelligence, both in the UK and overseas government markets, with increasing demand for products and services in commercial markets to manage cyber threats, counter financial fraud and improve compliance, including next-generation security for mobile devices.

#### Global Analysis

The US-based Intelligence & Security business provides mission-enabling analytic solutions supporting a number of US government departments.

BAE Systems' tactical analysts work alongside warfighters around the world to provide them with the insight they need to successfully complete their missions through a number of specialised analytic and support capabilities.

#### SpecTal

The US business provides specialised security and intelligence consulting services to the US government.

## Non-financial performance

### Employee safety

During 2012, the business achieved a 46% reduction in the Recordable Accident Rate. The Intelligence & Security business has continued to mature its safety culture by engaging its offsite employee population to identify workplace hazards and increase overall accountability.

BAE Systems Detica continued to progress its performance in safety. To help increase awareness and understanding of safety, a leadership toolkit and safety tours were introduced for directors, and an online safety training course was launched for employees.

### Diversity and inclusion

Intelligence & Security supported US-wide diversity and inclusion activities, including inclusive leadership training, launching a multi-cultural network, and introducing diverse candidate shortlists and panels for executive roles. At a local level, a communications programme targeted at employees was launched.

At the start of 2012, BAE Systems Detica launched its diversity and inclusion plan and steering group to drive progress throughout the year. Activities within the plan included reviewing the business's recruitment and succession planning processes. During the year, a dedicated communications campaign was aimed at engaging employees.

### Environment

Intelligence & Security focused on reducing waste during 2012, including the launch of an employee awareness programme to reduce and recycle waste within the work environment.

During 2012, BAE Systems Detica broadened its environmental impact analysis to cover two new site locations and the Australian stratsec business. This analysis enables BAE Systems Detica to understand and monitor the effect of its operations on various environmental factors, including energy consumption, waste disposal and recycling.

### People

The Intelligence & Security business employs over 5,700 people, many of whom are deployed alongside customers in the US and overseas, with the latter including active service deployments. Where people are deployed overseas, the Group makes available support services to ensure families can stay in touch.

BAE Systems Detica instigated its first apprenticeships with a new programme launched at its Leeds, UK, facility. Elsewhere, the business continues to recruit to support its growing customer base.

1 Businesses have put in place plans to 2015 to support and progress the Group's long-term goal to build a high-performing workforce that more closely reflects the diversity of the local communities in which its businesses operate.

2 Data is derived from internal recording systems and is not subject to external verification or audit.

### BAE Systems Detica – smart metering

The UK-headquartered BAE Systems Detica business has been working with energy company E.ON on its Smart Metering Customer Programme, which will see the installation of smart meters in homes across the UK. Smart metering will provide up to 35,000 gas and electricity consumption readings per household per year. Drawing on its experience, knowledge and previous central involvement in UK Smart Metering, BAE Systems Detica conducted a programme-level data security review to help ensure its security and the privacy of customers' data.

### BAE Systems Detica – analytics platform

BAE Systems Detica has a bespoke analytics platform which integrates a range of applications to identify behaviours, activities and connections in data for fraud, cyber and communications monitoring activities.

## PLATFORMS & SERVICES (US)

### Operational key points

Platforms & Services (US), with 21,300 employees<sup>1</sup>, comprises the US-headquartered Land & Armaments business, with operations in the US, UK, Sweden and South Africa, together with US-based services and sustainment activities, including ship repair and munitions services.

- Growth in US ship repair activities
- Executing munitions infrastructure and facility operations management contracts
- Strategic international win with Korean F-16 upgrade down-select
- Continued to protect Bradley franchise with \$376m (£231m) in related awards
- Awarded a \$750m (£462m) contract for CV90 armoured combat vehicles to Norway
- Letter of Request received from Indian government for 145 M777 howitzers
- Continued consolidation in the Land & Armaments business
- Business disposals of Safety Products, Safariland and Tensylon completed

#### Financial key points

- Sales<sup>1</sup> reduced by 2% in Support Solutions business and by 23% in Land & Armaments business
- Return on sales increased to 8.8% in Support Solutions business and reduced to 8.6% in Land & Armaments business
- Support business delivered an increase in order backlog<sup>1,4</sup> and strong operating cash flow<sup>3</sup>

#### Support Solutions:

- US naval ship repair and modernisation
- Complex infrastructure services and operations support
- Aircraft sustainment and modernisation
- Soldier survivability products

#### Land & Armaments:

- Tracked combat vehicles
- Tactical wheeled vehicles
- Artillery, ammunition and naval armaments

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (**see (EM)** page 31).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Comprises funded and unfunded unexecuted customer orders.

#### Financial performance

Sales<sup>1</sup> were £4.5bn (2011 £5.3bn), representing a like-for-like reduction of 13%. Sales<sup>1</sup> at Support Solutions were just 2% below 2011. Like-for-like sales<sup>1</sup> at Land & Armaments reduced by 20% primarily reflecting the completed Family of Medium Tactical Vehicles programme, and lower volumes on Bradley, Caiman and Mine Resistant Ambush Protected vehicles. Underlying EBITA<sup>2</sup> was £394m (2011 £478m). Return on sales reduced to 8.7% (2011 9.0%). Return on sales at Support Solutions increased from 7.5% to 8.8% benefiting from certain legal settlements. Return on sales at Land & Armaments reduced from 9.9% to 8.6% reflecting accelerated rationalisation charges in respect of the Newcastle vehicle manufacturing site in the UK and certain legal claims.

Operating cash inflow<sup>3</sup> reduced to £314m (2011 £410m) reflecting continued investment in the UK munitions facilities in the Land & Armaments business. Excluding pension deficit funding, cash flow<sup>3</sup> conversion of underlying EBITA<sup>2</sup> at Support Solutions and Land & Armaments was 100% and 83%, respectively.

#### Operational performance

##### Support Solutions

The US-based ship repair business achieved 2012 commitments under its Multi-Ship, Multi-Option contract vehicles with the US Navy, receiving superior scores on award fee assessments. The business was awarded new commercial maritime construction contracts totalling \$190m (£117m), including four platform supply vessels and two barges.

In the complex infrastructure services market, the business secured the Holston Army Ammunition Plant award of a follow-on five-year, \$145m (£89m) contract for facility operations. In addition, the business completed the planned transition to begin operating the Radford Army Ammunition Plant on 1 July 2012 under a contract worth **approximately (hedge)** \$850m (£523m) over ten years. In October 2012, the business was notified that it had not been awarded the Lake City Army Ammunition Plant management contract.

The business won a five-year, \$44m (£27m) Navy Munitions Command – Hawaii contract to handle and store munitions, which continues more than 27 years of distinguished service recognised by the US Navy.

The US Naval Air Warfare Center Aircraft Division awarded a follow-on five-year, \$193m (£119m) contract to provide Command, Control, Communications, Computers and Intelligence (C4I), lifecycle support, integration and test engineering, and technical services, supporting a broad range of air, land and sea platforms.

The business was awarded a \$60m (£37m) task order under the US Department of Defense's Joint Improvised Explosive Device Defeat Organization contract to develop and implement a five-year training programme.

Support Solutions continues to pursue international aircraft upgrade and modification opportunities. In August, the Republic of Korea selected BAE Systems to upgrade avionics and electronic systems on its fleet of more than 130 F-16 aircraft. The programme is **expected (hedge)** to be contracted in 2013 and is **forecast (hedge)** to be worth over \$500m (£308m) over ten years.

In November, the business was awarded a contract by the US Navy for depot level maintenance and logistics support for more than 360 T-34/T-44/T-6 training aircraft. If all options are exercised, the contract **would (hedge)** be valued at more than \$400m (£246m) over five years.

BAE Systems is pursuing a potential bid as prime contractor for the US Air Force's T-X programme to replace the T-38 jet training system with its Hawk trainer aircraft. The programme is valued at between \$11bn (£7bn) and \$17bn (£10bn). The US Air Force is **expected (hedge)** to announce the timing of its request for proposals in 2013.

In the Protection Systems business, contracts have been secured totalling over \$200m (£123m) for the supply of Enhanced Small Arms Protective Inserts, Tactical Vests and Modular Lightweight Load Carrying Equipment.

In November, the Group announced a definitive agreement to acquire Marine Hydraulics International, Inc., a marine repair, overhaul and conversion company with shipyard, pier and waterfront facilities in Norfolk, Virginia. The proposed acquisition, which is **expected (hedge)** to complete during the first quarter of 2013, complements the existing ship repair business.

#### Ship repair

BAE Systems is a leading provider of ship repair and modernisation services to the US Navy. In addition, building on the **successful (AM)** completion of the construction of the commercial tanker, American Phoenix, the business has been awarded multiple new commercial maritime construction contracts, which continue to diversify the portfolio and position the business for additional build-to-print opportunities.

#### Complex infrastructure services

In the complex infrastructure services market, the business continues to expand its portfolio, with the award of a follow-on contract for facility operations at the Holston Army Ammunition Plant. BAE Systems began operating the Radford Army Ammunition Plant in July 2012 under a ten-year contract.

#### Land & Armaments

During 2012, Land & Armaments completed the disposals of its Safety Products, Safariland and Tensylon businesses. The disposal of the Commercial Armored Vehicles business is **expected (hedge)** to complete in the first quarter of 2013. In September, the business announced that production of military equipment at its Fairfield, Ohio, facility would be moved to Sealy, Texas, in early 2013. The Protection Systems business, formerly reported in Land & Armaments, was transferred to Support Solutions at the start of the year. Management of the Combat Vehicles (UK) business was transferred to Platforms & Services (UK) from 1 October 2012.



## Vehicle Systems

This division comprises the franchises in tracked and wheeled vehicles.

The business received a \$306m (£188m) contract modification in August to upgrade 353 Bradley fighting vehicles, extending Bradley activity into 2014. This production contract is in addition to \$70m (£43m) to purchase upgrade materials for the Bradley programme.

The business has received the Paladin Integrated Management (PIM) Low-Rate Initial Production request for proposal scheduled for submission in early 2013. Testing continues on the contracted prototypes activity. An award decision is **expected (hedge)** in 2013.

On the Ground Combat Vehicle (GCV) programme, the business continues test work under the \$450m (£277m) technology development phase. Continuing development testing **demonstrates (booster)** that the technology provides more power, efficiency and vehicle performance than comparable conventional drive systems.

In January 2012, the business was awarded a £65m contract to supply 48 BvS10 armoured all-terrain vehicles and associated support to Sweden. The business was also awarded a £38m contract to regenerate the British Royal Marines' fleet of BvS10 vehicles. The last of 53 BvS10s ordered by France was delivered by year end.

In June, the business was awarded a \$750m (£462m) contract to upgrade Norway's existing 103-vehicle CV90 fleet and build new vehicle chassis to deliver 144 CV90s in five different configurations, including a variant equipped with a sensor suite for improved surveillance capability.

All deliveries of the Caiman Multi-Terrain Vehicle were delivered to contract schedule, with re-t and integration of 592 vehicles completed at the Mine Resistant Ambush Protected (MRAP) sustainment facility in November.

In August, the business was selected as part of the industry team led by Lockheed Martin for the engineering and manufacturing development phase of the US government's potentially large Joint Light Tactical Vehicle programme.

The South African business continues to execute on a £39m contract for 73 RG31 Mobile Mortar Platforms for the United Arab Emirates and a £43m order for 110 RG32 patrol vehicles for the Swedish Defence Force that were secured in December 2011.

The business secured places on all the amphibious trade studies, demonstrators and hull survivability demonstrations, allowing the US Marine Corps customer to evaluate design concepts based on a new design or an upgrade to current vehicles.

In November, Denmark announced that eight bids had been received in response to its requirement for up to 450 armoured vehicles. BAE Systems bid a version of the CV90, which Denmark already operates. The award decision is **expected (hedge)** in late 2013.

In Canada, following a one-year delay, a new request for proposal was released for up to 138 Close Combat Vehicles. BAE Systems submitted a proposal based on its CV90 armoured combat vehicle.

The business was unsuccessful in its bid for the Tactical Armoured Patrol Vehicle programme for the Canadian armed forces.

## Weapons Systems & Support

This division comprises munitions and artillery activities. In naval armaments, orders for six Mk110 57mm naval guns were received for the US Coast Guard and to equip the US Navy's Littoral Combat Ships. During the year, Australia announced its intention to buy 19 M777 howitzers to augment the 35 it already operates. In addition, the Indian government has issued a Letter of Request to the US government under the US Foreign Military Sales process for the supply of 145 M777 howitzers for the Indian Army. Under the 15-year Munitions Acquisition Supply Solution contract, the UK Ministry of Defence placed an order to meet its 2015 munitions requirement reflecting lower demand and quantities deferred from previous years. This **anticipated (hedge)** lower volume results from armed force cuts and the draw-down of Afghanistan operations. Efficiencies achieved through a £123m transformation of UK munitions manufacturing facilities and support from the UK Ministry of Defence position the business to offset this reduction with exports.

## Joint ventures

FNSS, BAE Systems' Turkish joint venture, continues to produce and upgrade tracked and wheeled military vehicles for international customers. Design work and **successful (AM)** mine testing were completed on a \$559m (£344m) programme to produce 259 8x8 wheeled armoured vehicles in 12 different variants for the Malaysian Army. Production has commenced and the first Infantry Fighting Vehicles are scheduled to be delivered in 2013.

## Tracked vehicles

The CV90 family of vehicles, manufactured in Sweden, is in service with six nations – Denmark, Finland, Norway, Sweden, Switzerland and the Netherlands. In 2012, the business won an order from Norway to upgrade its existing CV90s and supply new vehicles in multiple configurations. Incorporating lessons learned from Norwegian operations in Afghanistan, the new vehicle fleet will have enhanced protection, survivability, situational awareness, intelligence and interoperability.

## Wheeled vehicles

The RG35, manufactured in South Africa, is one variant in BAE Systems' family of wheeled vehicles. The RG35 family of vehicles can be deployed in many different roles and offers a choice of variants and configurations while maintaining 80% vehicle commonality. RG35 combines the high levels of survivability of the RG31 Mine Protected Vehicle with the tactical capability of an infantry fighting vehicle.

## Looking forward

Efforts to reduce the US government's budget deficit are **likely (hedge)** to impact all areas of government spend. A Continuing Resolution on the 2013 fiscal budget has been passed through to March 2013 and the risk of further reductions in US defence budgets remains, including the impact of sequestration.

In February 2013, the Group was notified that the US Navy was considering the potential to cancel, defer or descope 13 ship availability contracts, resulting in the decision to issue conditional Worker Adjustment and Retraining Notification (WARN) Act notices to nearly 3,600 employees in the ship repair business.

Whilst downward pressure will be seen across the services market as a whole, potential cancellations and delays in new programmes **may (hedge)** present opportunities to sustain and modernise existing platforms.

In the near term, Land & Armaments continues to operate in a challenging market environment. To offset these pressures and remain viable in the future, the business is investing to protect current programme positions like Bradley modernisation and UK munitions, establish new US domestic programmes such as PIM and GCV, and to win export programmes. The business continues to drive rationalisation efforts, Efficiencies and cost reduction in order to remain competitive.

## Non-financial performance

### Employee safety

During 2012, the business achieved a 16% reduction in the Recordable Accident Rate. Support Solutions' ship repair business built on the success of its employee 'Anchored in Safety' campaign by introducing an interactive 'Safety Boot Camp' to keep employees focused on safety. During 2012, Land & Armaments continued to increase employee awareness and understanding of safety by maintaining its 'Start Safe, Talk Safe, Home Safe' campaign, focusing on potential safety issues and safe work habits.

### Diversity and inclusion

Platforms & Services (US) supported US-wide diversity and inclusion activities, including inclusive leadership training, launching a multi-cultural network, and introducing diverse candidate shortlists and panels for executive roles. In Support Solutions, a campaign was targeted at managers to improve their awareness of diversity and inclusion. Land & Armaments introduced a mentoring programme to support successor candidates for leadership roles and introduced a Talent Committee to facilitate senior leader commitment.

### Environment

A new environmentally-friendly facility was opened in Sterling Heights, Michigan, during 2012. The new facility consolidated existing buildings into one new purpose-built campus. The building uses 15% less energy and 40% less water than a conventionally designed building, and waste generated is managed through a recycling programme.

People Support Solutions has a diverse and highly skilled workforce, which is a key discriminator and plays an **important (AM)** role in the performance of the business in an increasingly competitive market. The business remains **committed (AM)** to building a culture that recognises performance, creates new opportunities for employees, and focuses on long-term goals that promote a healthy and viable business.

Through the Land & Armaments Talent Committee, high-potential employees are being engaged to address key strategic opportunities.

By being part of the programme, which has also been designed to support the Group's commitment to diversity and inclusion, future leaders are receiving fast track development.

1 Businesses have put in place plans to 2015 to support and progress the Group's long-term goal to build a high-performing workforce that more closely reflects the diversity of the local communities in which its businesses operate.

2 Data is derived from internal recording systems and is not subject to external verification or audit.

3 Data excludes Ordnance Solutions Inc.

#### Protection Systems

Protection Systems is a leading provider of soldier protective and load carrying equipment in the US, producing a significant portion of the nation's body armour, tactical vests, combat helmets and load carrying systems. The business is focused on the design, development and production of leading-edge survivability products.

#### Artillery

The M777 howitzer is in service with US, Canadian and Australian armed forces. Production continues and further orders are **anticipated (hedge)**, including to India following the issue of a Letter of Request to the US government under the US Foreign Military Sales process.

### REPORTING SEGMENTS

#### PLATFORMS & SERVICES (UK)

Platforms & Services (UK), with 27,900 employees<sup>1</sup>, comprises the Group's UK-based air, maritime and combat vehicle activities, and certain shared services activities.

#### Operational key points

- 46 Typhoon Tranche 2 aircraft delivered to the partner nations
- £2.5bn Typhoon and Hawk contract for Oman secured
- £446m contract awarded for European support on Typhoon
- First F-35 Lightning II aircraft accepted by the UK Ministry of Defence (MoD)
- Fifth Type 45 destroyer accepted off-contract and support provided for all Royal Navy Type 45 deployments
- Settlement reached with the Government of the Republic of Trinidad and Tobago in respect of the cancelled Offshore Patrol Vessels (OPV) programme
- Two OPVs delivered to the Brazilian Navy
- £0.8bn of customer funding received for ongoing design and development of the Successor submarine, and continuing production of the fourth Astute Class submarine
- £0.7bn of research and development expenditure<sup>4</sup> in 2012

#### Financial key points

- Order backlog<sup>1</sup> increased by £2.5bn on significant awards for Oman Typhoon and Hawk and Saudi training aircraft
- 10% decrease in sales<sup>1</sup> pending recommencement of Salam Typhoon deliveries in 2013
- Return on sales improved to 12.2%
- Strong cash flow<sup>3</sup> performance on significant contract advances

#### Key Characteristics

- Multi-year through-life programmes Military Air & Information:
- Full spectrum of military aircraft capabilities, including design, development, manufacture, in-service support and training for combat and trainer aircraft, and design and development of Unmanned Air Systems
- Defence information systems, such as the Falcon secure deployable communication system

#### Maritime:

- Full spectrum of maritime systems capabilities, including design, build, integration and commissioning, in-service support and training for naval ships, submarines, radar and combat management systems, and underwater systems

#### Combat Vehicles (UK):

- Design, build and through-life support of armoured vehicles

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (**see (EM)** page 31).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

4 Includes both Group-funded and customer-funded expenditure.

#### Financial performance

Funded order intake<sup>1</sup> in the year increased to £8.1bn following the award of significant contracts for the supply of 12 Typhoon and eight Hawk aircraft to Oman (£2.5bn), and for training aircraft for the Royal Saudi Air Force (£1.6bn).

Sales<sup>1</sup> in 2012 were £5.6bn, 10% lower than 2011, reflecting no contractual aircraft deliveries on the Salam Typhoon programme in 2012 and the completion of South African Gripen aircraft deliveries in 2011.

Underlying EBITA<sup>2</sup> was £689m (2011 £658m). Return on sales increased to 12.2% benefiting from strong programme execution, particularly on the European Typhoon and Type 45 programmes.

There was an operating cash inflow<sup>3</sup> of £1,719m (2011 £69m) reflecting advances received on the Omani and Saudi contract awards. These were partially offset by the utilisation of advances on the European Typhoon programme and costs against the provision on the Omani Offshore Patrol Vessel (OPV) programme.

#### Operational performance

##### Military Air & Information

Deliveries of Typhoon Tranche 2 aircraft to the four European partner nations totalled 46 in the year. At the end of 2012, cumulative aircraft deliveries to the four nations were 169 of the contracted 236. The first ten Tranche3 front fuselage sub-assemblies were manufactured during the year. Manufacture of sub-assemblies continues in advance of recommencement of deliveries of Typhoon aircraft to Saudi Arabia in 2013.

In December 2012, a £2.5bn contract was awarded for the supply of 12 Typhoon and eight Hawk aircraft, associated training, and support to the Royal Air Force of Oman.

The business continues to support its UK and European customers' Typhoon and Tornado aircraft, and their operational commitments through availability-based service contracts and support operations. Orders of £668m were received in the year, including a contract worth £446m for Typhoon support operations across Germany, Italy, Spain and the UK. Support volumes on Tornado are **expected (hedge)** to decline as the number of aircraft and flying hours reduce in advance of the out-of-service date of April 2019.

Delivery of the first F-35 Lightning II aircraft was accepted by the UK MoD. The business has delivered a further 42 production aircraft fuselage assemblies to Lockheed Martin. Interim funding of £234m for the fifth and sixth Low-Rate Initial Production contracts was secured in the year and negotiations continue in respect of final funding. Support continues to be provided to operators of Hawk trainer aircraft around the world. In partnership with Hindustan Aeronautics Limited, production of 66 Batch 1 Hawk aircraft has been completed in India. Deliveries of materials and equipment in support of licence production of the 57 Batch 2 aircraft continue and aircraft assembly in India is ongoing. The business has provided an initial response to a request for proposal for an additional 20 aircraft to India. Following the 2011 government-to-government Memorandum of Understanding, BAE Systems and Dassault Aviation have jointly secured an order from the UK and French governments for a Future Combat Air System demonstration programme preparation phase to plan how to mature and demonstrate critical technology and operational aspects for an Unmanned Combat Air System. In the defence information domain, the Falcon secure deployable communication system is now in service with the British Army and RAF. Under a continuing focus on cost reduction and efficiency, there has been a net headcount<sup>1</sup> reduction of **approximately (hedge)** 1,400 in the year.

## Maritime

Cumulative savings of £342m have been reported to the MoD against commitments made under the 15-year Terms of Business Agreement (ToBA), significantly ahead of target. In line with the ToBA, the Group is progressing discussions with the MoD regarding future shipbuilding strategy after completion of block build for the Royal Navy's new aircraft carriers, and as the business transitions to the design and manufacture phase of the Type 26 Global Combat Ship. The largest hull section of the first of the Royal Navy's new aircraft carriers, the Queen Elizabeth, has been delivered to Rosyth for assembly with the other completed hull sections. Block manufacture for the second ship, Prince of Wales, is **well (AM)** underway. BAE Systems and its Aircraft Carrier Alliance partners are working to finalise the detailed design changes required for operation of the short take-off and vertical landing variant of F-35 Lightning II on the carriers.

## Typhoon

Typhoon is now in service with six air forces. In total, 571 Typhoon aircraft have been ordered by the four European partner nations, Saudi Arabia, Austria and Oman.

As well as Typhoon manufacture, BAE Systems also provides availability and in-service support services. In 2012, the Group was awarded a £446m contract for Typhoon support operations across Germany, Italy, Spain and the UK.

## F-35 Lightning II

BAE Systems is a major subcontractor on the F-35 Lightning II combat aircraft. The Group has the lead in manufacture of the aft fuselage, vertical and horizontal tails and wing tips, and is responsible for a number of subsystems and equipment, including the electronic warfare suite. **Almost (hedge)** 2,000 people in the US, UK and Australia are employed on the F-35 Lightning II programme.

**See (EM)** page 57 for more information on the Group's involvement on F-35 Lightning II

Defender, the fifth Type 45 destroyer, was accepted by the Royal Navy in July. The final ship, Duncan, has undertaken her sea trials and is on schedule for delivery in 2013. The Type 45 support contract met all ship deployment dates during the year. Settlement with the Government of the Republic of Trinidad and Tobago, in respect of the cancelled OPV programme, was reached in November at an amount consistent with provisions held. In January 2013, £101m of the £131m cash settlement was paid, with the remainder due in May 2013. Following the agreement in December 2011 for the sale of the OPVs to the Brazilian Navy, the first two vessels were delivered in the year, with the third ship due for delivery in 2013. Following an incident at sea during gunnery trials on the first Khareef Class corvette for Oman, detailed engineering, schedule and contract reviews have resulted in revised delivery dates for the ships. This has resulted in an increase in costs to complete the contract. The ships are **expected (hedge)** to be delivered in 2013 and 2014. The Type 26 Global Combat Ship assessment phase contract continues and is **intended (hedge)** to be completed by the end of 2014. The Type 26 is planned to replace the Royal Navy's Type 23 frigates. The warship support modernisation initiative contract, for delivery of services at Portsmouth Naval Base, continues to exceed contract performance. A new maritime support delivery framework will replace the existing contract in 2013. The Advanced Radar Target Indication Situational Awareness Navigation (ARTISAN) 3-D radar successfully passed its factory acceptance test and the first of class has been fitted to HMS Iron Duke, a Type 23 frigate. The programme continues on track towards full production.

The Maritime Composite Training System, a shore-based warfare operator training solution, was declared ready for training by the Royal Navy in August having completed a year of initial training. Over 3,000 Royal Navy personnel have now been trained through the facility.

The Sting Ray lightweight torpedo delivery contract for the Norwegian government was completed in December.

Ambush, the second of class Astute submarine for the Royal Navy, departed for sea trials in the second half of the year. The operational handovers of both HMS Astute, the first of class, and Ambush are planned for 2013. Pricing for the fourth boat has been agreed with the customer and long lead procurement has commenced on the sixth and seventh boats.

BAE Systems secured a further £383m of funding from the UK MoD for the design and development phase of the Successor submarine programme, to replace the Vanguard Class fleet, and now has **approximately (hedge)** 1,000 people engaged on the programme.

## Combat Vehicles (UK)

The Terrier combat engineer vehicle contract concluded its reliability growth confirmation trials, which identified a number of required engineering changes. This has resulted in an increase in costs to complete the contract. Final trials are complete and deliveries of the 60 vehicles will commence in 2013.

Following delivery of the Terrier vehicles, the Newcastle facility will close, and support to Terrier and existing vehicles used by the British Army customer will be provided from the remaining facility at Telford and satellite offices.

#### Looking forward

Platforms & Services (UK) has a strong order backlog of long-term committed programmes and an enduring support business.

In Military Air & Information, sales are underpinned by military aircraft production on Typhoon, Hawk and F-35 Lightning II, and in-service support for existing and legacy combat and trainer aircraft. There are significant opportunities to secure future Typhoon export contracts to Malaysia, the United Arab Emirates and Saudi Arabia.

In Maritime, sales are underpinned by the Queen Elizabeth Class carrier and Astute Class submarine manufacturing programmes, the 15-year ToBA, the maritime support delivery framework, and the design of the Successor submarine and Type 26. The through-life support of these platforms and Type 45, together with their associated command and combat systems, provides sustainable business in technical services and mid-life upgrades.

In Combat Vehicles (UK), sales beyond the Terrier programme depend upon through-life support of legacy platforms.

#### Unmanned Air Systems

In 2012, Taranis, the UK's Unmanned Combat Air System technology demonstrator, successfully completed a series of key tests on the way to commencing flight trials in 2013. BAE Systems, as prime contractor, provides many elements of Taranis, including systems integration, control infrastructure, full autonomy elements, and the creation and integration of the low observable technologies.

#### Queen Elizabeth Class carriers

The largest hull section of the first of the Royal Navy's Queen Elizabeth Class aircraft carriers has been delivered to Rosyth for assembly with the other completed hull sections. Block manufacture for the second ship, Prince of Wales, is **well (AM)** underway.

#### Non-financial performance

##### Employee safety

During 2012, the business achieved a 44% reduction in the Recordable Accident Rate. Businesses across Platforms & Services (UK) helped achieve safety targets by putting in place employee engagement programmes focused on the importance of workplace safety. Campaigns included the 'Good to Go' process in the Submarines business looking at the safety responsibilities of individuals (both office-based and operational), supervisors and managers, with specific safety information targeted at each group.

During 2012, the business's 'Safety First' programme achieved a Gold award in the Chairman's Award category of Transferring Best Practice. Safety teams worked together to develop an employee programme that improves levels of safety and can be easily transferred across sites. The programme also received external recognition, including the British Safety Council International Safety Awards, the Royal Society for the Prevention of Accidents, Gold Awards for Occupational Health and Safety, and the Safety and Health Practitioner Institution of Occupational Safety and Health Awards. The programme has been endorsed by Lloyd's Register Quality Assurance and the UK Health and Safety Executive.

##### Diversity and inclusion

Platforms & Services (UK) launched its diversity and inclusion framework during the year, the aim being to set the goals and actions for diversity and inclusion over the next five years.

To support the framework, a working group was established to help progress the following actions: develop more gender-balanced supply of appropriately qualified employees for leadership positions; hire and select a diverse mix of top-performing people; build inclusive leadership competence and capabilities; establish greater workplace flexibility; foster a more inclusive culture; and engage with employees. During the year, progress included female executives being mentored through an Executive Committee mentoring programme and unconscious bias training being scoped for senior managers.

##### Environment

During 2012, Platforms & Services (UK)'s environmental sustainability working group developed consistent environmental standards across the businesses by aligning approaches to programmes and target setting.

To further increase energy savings and actively promote awareness amongst fellow employees across the businesses, the Energy Matters campaign 'Switch on to switching off' continued to be supported. The campaign involved training energy champions across the business to actively promote the benefits of energy conservation amongst fellow employees.

## People

In 2012, there were successes for young people engaged in the Group's early careers graduate and apprenticeship programmes, including a team of apprentices winning the government-sponsored 'Make it in Great Britain' competition for the design and manufacture of an innovative rehabilitation aid for amputees. In addition, an apprentice won the inaugural Apprentice Champion of the Year Award which recognises inspirational role models and outstanding advocates for apprenticeships in the UK.

The Leading for Total Performance development programme aims to ensure that the leadership engages fully with the Group's strategy.

As part of a suite of measures designed to foster employee engagement, a new Employee Assistance Programme was launched.

1 Businesses have put in place plans to 2015 to support and progress the Group's long-term goal to build a high-performing workforce that more closely reflects the diversity of the local communities in which its businesses operate.

2 Data is derived from internal recording systems and is not subject to external verification or audit.

## Astute Class submarines

Production of the Royal Navy's Astute Class nuclear-powered submarines continues, with Ambush, the second of class, undergoing sea trials in late 2012.

The 97 metre-long Astute Class submarines are powered by a sophisticated nuclear propulsion system, which never needs refuelling. The sonar system has the processing power of 2,000 laptops and can track ships 3,000 miles away. Armed with both Tomahawk land attack missiles and Spearfish torpedoes, its missiles have a target range of 1,200 miles with accuracy measured in metres.

## UK Sport technology partnership

During 2012, BAE Systems' £1.5m, five-year technology partnership with UK Sport contributed to a significant number of medals for Team GB at the London Olympics. The Group's technology partnership enabled its employees to share its unique engineering capabilities with the sporting community and thousands of young people through its education programmes.

BAE Systems is finalising a new four-year technology partnership with UK Sport to provide £800,000 of engineering time, equipment and materials to support British athletes. The partnership will run from 2013 to 2016.

## PLATFORMS & SERVICES (INTERNATIONAL)

Platforms & Services (International), with 15,500 employees<sup>1</sup>, comprises the Group's businesses in Saudi Arabia, Australia, India and Oman, together with its 37.5% interest in the pan-European MBDA joint venture.

### Operational key points

- Salam price escalation negotiations ongoing
- £5.0bn of orders received under the Saudi British Defence Co-operation Programme (SBDGP) for training aircraft and support to the end of 2016
- First Landing Helicopter Dock hull arrived in Australia for completion and second hull launched in Spain
- MBDA export order for MICA air-to-air missiles to India

### Financial key points

- Order backlog<sup>1</sup> increased reflecting multi-year support and training awards under the SBDGP
- Like-for-like increase in sales<sup>1</sup> of 9% on increased support activity on the Salam Typhoon programme and weapons deliveries under the Tornado Sustainment Programme (TSP)
- Strong operating cash -ow<sup>3</sup> reflecting acceleration of advances on TSP Sales analysis (%)

1 Including share of equity accounted investments.

2 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense (EBITA) excluding non-recurring items (see (EM) page 31).

3 Net cash inflow from operating activities after capital expenditure (net) and financial investment, dividends from equity accounted investments, and assets contributed to Trust.

Saudi Arabia:

- Long-term contracts from the Royal Saudi Air Force for equipment, training and support, including Salam Typhoon aircraft
- Support to Royal Saudi Navy minehunter programme

Australia:

- Strategic capability and sustainment provider to the Australian Defence Force
- Delivering defence contracts across the air, land, maritime and electronics domains

India:

- Long-standing military aircraft relationships

MBDA:

- Pan-European guided weapons joint venture

Oman:

- In-service base across air, land and maritime products

Financial Performance

Order intake<sup>1</sup> increased to £5.3bn (2011 £3.3bn) reflecting the award of orders for continuing support of the operational capability and training of the Saudi armed forces under the Saudi British Defence Co-operation Programme (SBDCP) to the end of 2016. Contracts were previously let on an annual basis.

Sales<sup>1</sup> in 2012 were £4.1bn, 9% higher than 2011 on a like-for-like basis, reflecting increased support activity on the Salam Typhoon programme and weapons deliveries under the Tornado Sustainment Programme (TSP).

Underlying EBITA<sup>2</sup> was £417m (2011 £449m). Return on sales reduced to 10.2% (2011 11.8%) as 2011 benefited from strong performance and risk reduction on the Tornado upgrade and core support programmes in Saudi Arabia.

Operating cash inflow<sup>3</sup> of £506m (2011 £80m) reflected acceleration of advances on TSP.

Operational performance

Saudi Arabia

Through the entry into service of Typhoon and the continued development of the in-country industrial base, the Group remains **committed (AM)** to developing a greater indigenous capability in Saudi Arabia. On the Salam programme, UK final assembly of the remaining 48 of the 72 Typhoon aircraft has commenced and deliveries are **expected (hedge)** to resume in 2013. Work to expand the multi-role capabilities of the Royal Saudi Air Force (RSAF) Typhoon is progressing to schedule. The initial three-year Typhoon support contract finished at the end of June and two subsequent six-month extensions have been secured. Discussions continue with the customer on the next five years of support. Discussions on Typhoon price escalation with the Saudi Arabian government remain ongoing. Negotiations are also ongoing for the provision of maintenance and upgrade facilities in-Kingdom, and further capability enhancement of the aircraft. The business continues to support the operational capability of both the RSAF and Royal Saudi Naval Forces (RSNF). A £1.6bn contract was awarded in May to upgrade the RSAF's aircrew training aircraft, involving the supply of, and initial support for, Hawk Advanced Jet Trainer and Pilatus PC-21 training aircraft. The business was also awarded orders totalling £3.4bn for support to the end of 2016, including the provision of manpower, logistics and training to the RSAF. Under the Tornado Sustainment Programme (TSP), the upgrade of the RSAF Tornado fleet is complete, with all of the contracted aircraft having been delivered back into the RSAF fleet. Delivery of Storm Shadow missiles to the RSAF under the TSP is progressing in line with the agreed programme schedule. Work continues on the first ship re-fit on the minehunter mid-life update programme.



The ship is due to be handed back to the RSNF customer during the second half of 2013. On the C4I (Command, Control, Communications, Computers & Intelligence) programme, the business continues to seek an acceptable closure of the contract with the customer.

#### Australia

Integration of the first of two Landing Helicopter Docks commenced at the Williamstown shipyard following the arrival of the hull from subcontractor Navantia in Spain. The second hull was launched at Navantia's Ferrol shipyard. A total of nine hull blocks have been constructed and delivered under the A\$209m (£134m) Air Warfare Destroyer contract, completing the Group's involvement in the first two ships of the three being built. In 2012, the business completed the multi-year project to modernise 431 M113 armoured personnel carriers for the Australian Army. The first of seven Royal Australian Navy ANZAC Class frigates is being upgraded with anti-ship missile defence capability at the Henderson shipyard under a A\$267m (£171m) contract signed in January 2012. The business has been selected as the preferred tenderer to provide ongoing in-service support for the Royal Australian Air Force's Hawk Lead-In Fighter fleet and contract negotiations are ongoing. The business was awarded an in-service electronic warfare support contract for the Wedgetail airborne early warning and control aircraft fleet to 2015 with a value up to A\$68m (£43m).

#### Saudi Arabia – Typhoon manufacture and support

Final assembly of the remaining 48 of the 72 Typhoon aircraft for the Royal Saudi Air Force (RSAF) has commenced and deliveries are **expected (hedge)** to resume in 2013.

The Saudi Typhoon support contract is an availability contract supporting the aircraft's entry into service with the first of the RSAF's Typhoon squadrons.

**See (EM)** page 19 for more information

#### Saudi Arabia – Tornado Sustainment Programme

As part of the Saudi British Defence Co-operation Programme, BAE Systems has substantial training and support activities in Saudi Arabia.

In partnership with the Royal Saudi Air Force (RSAF), the Tornado Sustainment Programme has successfully upgraded all of the RSAF Tornado fleet.

**See (EM)** page 21 for more information

Whilst the business submitted a bid for the next-generation Battlespace Communications System, the decision was taken to withdraw from this competition after a breach of tender protocols had occurred during its participation in the initial tender process.

#### India

Following a strategic review of the Defence Land Systems India (DLSI) joint venture, it has been jointly agreed that Mahindra & Mahindra will acquire BAE Systems' 26% shareholding in DLSI. This decision is a reflection of the **shareholders (EM)**' belief that they can best meet customer requirements and address market opportunities on a case-by-case basis, including continuing to explore opportunities for co-operating on Specific defence projects.

BAE Systems is participating as a subcontractor to Bharat Electronics Limited (BEL) on the Tactical Communications Systems programme for the Indian military, for which BEL has been selected as one of two design authorities. The Indian government has issued a Letter of Request to the US government under the US Foreign Military Sales process for the supply of 145 M777 howitzers for the Indian Army. Together with its Eurofighter industry partners, the Group continues to monitor the Medium Multi-Role Combat Aircraft competition and stands ready to support the Indian government's procurement process. The Group has received a request for proposal for a third batch of Hawk Advanced Jet Trainer aircraft for the Indian Air Force.

#### Oman

The contract for the supply of Typhoon and Hawk aircraft awarded in December 2012 builds on the close partnership with the Omani armed forces and provides the platform to ensure this relationship is further developed. The Group has a long history of working closely with the Omani armed forces, and currently supports their existing air, land and maritime platforms, such as air defence radars, Challenger tanks, and Jaguar and Hawk aircraft.

#### MBDA

In the export market, a significant order was received from India in early 2012 for MICA air-to-air missiles as part of the Indian Air Force's Mirage 2000 upgrade. In the domestic market, the business secured an **important (AM)** support contract for the Principal Anti-Air Missile System and a development contract for the Future Local Anti-Air Defence System. The business continues to pursue the Anglo-French joint development and production opportunity for the Future Anti-Ship Guided Weapon – Anti-Navire Léger. Development programmes continue to progress **well (AM)**. The Meteor beyond visual range air-to-air missile successfully concluded its guided ring programme.

#### Looking forward

In the Kingdom of Saudi Arabia, the Group seeks to build upon its long-term presence through delivering current programmes and industrialisation, and developing new business in support of the Saudi military and security forces. Following agreement of the training aircraft and support orders under the SBDCP in 2012, the focus turns towards mobilising activities on the next phases of these programmes. In Australia, BAE Systems will continue to support the Department of Defence by working with the customer to deliver cost and service improvements. The business continues to explore and secure opportunities in adjacent markets, including commercial maritime repair and support, and commercial fabrication for the natural resources industry. In India, significant aircraft and artillery opportunities continue to be pursued. In MBDA, whilst domestic budgetary pressures continue, export markets are **anticipated (hedge)** to grow, potentially benefiting from significant military aircraft procurements.

#### Australia – Landing Helicopter Docks

BAE Systems is the prime contractor for two 27,000 tonne Landing Helicopter Docks, the largest ships ever to be built for the Royal Australian Navy. The completed hull of the first Landing Helicopter Dock arrived at the Williamstown shipyard in October from the subcontractor Navantia in Spain and integration activity has commenced.

#### Australia – air platforms

BAE Systems provides systems integration and sustainment solutions to Australia's current and future military air platforms. The Group has an F-35 Lightning II manufacturing plant in South Australia.

#### Non-financial performance

##### Employee safety

During 2012, the business achieved a 17% reduction in the Recordable Accident Rate.

**Regrettably (AM)**, during 2012, an employee died in a road traffic accident whilst at work in Saudi Arabia.

All businesses launched safety training and communications campaigns targeted at employees to increase safety awareness and to reinforce the message that safety is everyone's responsibility.

Each business addressed Specific safety priorities. In Saudi Arabia, a working group was established to progress safety performance, with key activities including safety on customer bases and road safety awareness weeks. In Australia, safety objectives for senior leaders were rolled out across the business. In India, the focus has been on embedding safety processes across its offices and a Safety, Health & Environment framework was launched.

##### Diversity and inclusion

The businesses have launched a number of initiatives to progress diversity and inclusion. In Saudi Arabia, BAE Systems has developed a female employment strategy and five-year plan to support the establishment last year of its female Office in Riyadh. In total, 117 women are now employed by the business, including 43 in Saudi Arabia.

In Australia, a Flexible Working handbook was launched to support a flexible work culture and aspirations for female representation were set for executives.

In India, a 'Diversity & Inclusion Essentials' course was rolled out to all line managers, which aims to increase awareness and understanding of how diversity and inclusion can create value for the business. A women's forum was introduced to provide personal development and networking opportunities for women in the workplace.

## Environment

In Saudi Arabia, environmental sustainability has been built into the procurement team's processes and major subcontractor reviews. This is also being done in Australia.

During the year, both Saudi Arabia and India launched environmental conservation programmes. In Saudi Arabia, water conservation and re-use is now a priority, and employee training was launched in India.

The Australian business implemented and sustained compliance processes to meet environmental regulatory reporting requirements, such as the National Greenhouse Energy Reporting Act.

## People

In Saudi Arabia, the Saudisation programme is crucial to the long-term sustainability of the business. BAE Systems remains **committed (AM)** to recruiting and training local nationals, with local employees currently filling 60% of positions in-Kingdom. In 2012, the Saudi business selected 24 high-potential people to participate in its Mustakbal Management Development Programme, which leads to Chartered Management Institute internationally recognised qualifications.

In Australia, the 'Bright Stars' programme has been launched to develop the next generation of leaders, actively engaging 13 high-performing people to provide opportunities, leadership and mentoring to fast track their career prospects.

In India, the Group has entered into a long-term partnership agreement with Smile Foundation, a national level development organisation with an outreach of over 200,000 underprivileged children, women and youth across 25 states.

1 Businesses have put in place plans to 2015 to support and progress the Group's long-term goal to build a high-performing workforce that more closely reflects the diversity of the local communities in which its businesses operate.

2 Data is derived from internal recording systems and is not subject to external verification or audit.

3 Data excludes Saudi Arabia.

## India – Hawk Advanced Jet Trainer

BAE Systems has received a request for proposal for a third batch of Hawk Advanced Jet Trainer aircraft for the Indian Air Force.

The potential addition to the Indian fleet, one of the largest fleets of Hawk in the world, **would (hedge)** take the number of Hawk aircraft ordered worldwide to over 1,000. Customers for Hawk include Australia, Canada, South Africa, Bahrain, India, the Royal Saudi Air Force and the Royal Air Force. The Royal Air Force aerobatics team, the Red Arrows, has used the BAE Systems Hawk since 1979.

## MBDA

BAE Systems is a 37.5% shareholder in MBDA, a leading global guided weapons manufacturer. MBDA is the prime contractor for a series of multi-national programmes, including Storm Shadow, an Anglo-French air-launched cruise missile that can be carried by Tornado aircraft.

## GOVERNANCE

BAE Systems places great importance on the way it conducts its business. This section explains the Group's approach to governance.

### Operating the Radford Army Ammunition Plant

BAE Systems is the operating contractor of the Radford Army Ammunition Plant in Virginia, managing, operating and maintaining the plant under an initial ten-year contract from the US Army. The Radford plant, established in 1941, is a government-owned, contractor-operated facility that manufactures propellants for military munitions.



Finance Director of GEC's Marconi Electronic Systems business, which was subsequently acquired by British Aerospace in 1999 to become BAE Systems.

#### Non-executive directors

Paul Anderson      Non-executive director

Appointed to the Board: 2009      Nationality: US

Skills and experience: Paul Anderson has extensive global business experience in the energy and mining sectors. He spent more than 20 years in two spells at Duke Energy Corporation and its predecessor companies, culminating in his appointment as Chairman, President and Chief Executive Officer. He was subsequently Chairman of Spectra Energy Corporation until 2009 and in the intervening period he served as Managing Director and Chief Executive Officer of BHP and, subsequently, of the newly merged BHP Billiton.

Other appointments: Non-executive director of BP p.l.c.

Other past appointments: Non-executive director of BHP Billiton Plc, Qantas Airways Limited and Spectra Energy Corporation.

Committee membership: Chairman of the Corporate Responsibility Committee and member of the Nominations Committee

Harriet Green      OBE      Non-executive director

Appointed to the Board: 2010 Nationality: British

Skills and experience: Appointed Chief Executive Officer and executive director of Thomas Cook Group plc in July 2012. She was previously Chief Executive Officer and executive director of Premier Farnell plc, a leading, high service, multi-channel technology distribution group. Harriet Green has significant global business experience having run volume distribution businesses in four continents for Premier Farnell and volume distributor, Arrow Electronics, Inc.

Other appointments: Non-executive director of Emerson Electric Co.

Committee membership: Corporate Responsibility Committee

Lee McIntire      Non-executive director

Appointed to the Board: 2011      Nationality: US

Skills and experience: Lee McIntire is Chairman and Chief Executive of CH2M HILL, a leader in consulting, design, design-build, operations, risk management and programme management for public and private clients. Prior to joining CH2M HILL, he was an executive at Bechtel Group Inc., where he served on the board of directors and was Executive Vice President for the parent company.

Committee membership: Remuneration Committee

Sir Peter Mason KBE      Non-executive director

Appointed to the Board: 2003      Nationality: British

Skills and experience: Chairman of Thames Water and Senior Independent Director of Subsea 7 S.A., an international offshore engineering, construction and services contractor. Non-executive member of the board of Spie S.A. Formerly Chairman and Chief Executive of Balfour Beatty Limited, and Chief Executive of AMEC plc, Sir Peter has extensive experience in engineering, construction and long-term contracting.

Other past appointments: Executive director of BICC plc and Chief Executive of Norwest Holst Group PLC.

Committee membership: Audit Committee, Corporate Responsibility Committee and Nominations Committee. He served as the Company's Senior Independent Director for a number of years before stepping down from that role in January 2013.

Paula Rosput Reynolds      Non-executive director

Appointed to the Board: 2011      Nationality: US

Skills and experience: Paula Rosput Reynolds is Chief Executive Officer and President of the business advisory group, PreferWest, LLC. She had previously spent over 20 years in the energy sector in a variety of operational roles, culminating in her appointment as President and Chief Executive Officer of AGL Resources in 2002. She subsequently served as President and Chief Executive Officer of Safeco Corporation, an insurance company located in Seattle, Washington, until its acquisition by Liberty Mutual Group in 2008. She was then appointed as Vice Chairman and Chief Restructuring Officer of American International Group, Inc. (AIG) from October 2008 to September 2009, overseeing AIG's divestiture of assets and serving as chief liaison with the Federal Reserve Bank of New York.

Other appointments: Non-executive director of Delta Air Lines, Inc., Anadarko Petroleum Corporation and TransCanada Corporation.

Other past appointments: Non-executive director of Coca-Cola Enterprises, Inc. and Air Products and Chemicals, Inc.

Committee membership: Audit Committee

Nick Rose      Non-executive director and Senior Independent Director

Appointed to the Board: 2010      Nationality: British

Skills and experience: Nick Rose held the position of Chief Financial Officer of Diageo plc for over ten years until October 2010 where, in addition to his finance responsibilities, he was also responsible for supply, procurement, strategy and IT on a global basis. His financial experience has encompassed a number of roles since joining Diageo's predecessor company, Grand Metropolitan, in 1992, including group treasurer and group controller, having spent his earlier career with Ford Finance. He assumed the chairmanship of the Company's Audit Committee in August 2011 and was appointed the Company's Senior Independent Director on 21 January 2013.

Other appointments: Chairman of Williams Grand Prix Holdings PLC and Edwards Group Limited. Non-executive director of BT Group plc.

Other past appointments: Non-executive director of Moët Hennessy SNC and Scottish Power plc.

Committee membership: Chairman of the Audit Committee, and member of the Nominations Committee and Remuneration Committee

Carl Symon      Non-executive director

Appointed to the Board: 2008      Nationality: British/US

Skills and experience: Carl Symon has an extensive background in global business operations and management, retiring in 2001 after a long career at IBM during which he held senior executive positions in the US, Canada, Latin America, Asia and Europe, including that of Chairman and Chief Executive Officer of IBM UK.

Other past appointments: Non-executive director of BT Group plc, Rexam PLC and Rolls-Royce Group plc, and Chairman of HMV Group plc.

Committee membership: Chairman of the Remuneration Committee

Company Secretary

David Parkes

#### CHAIRMAN'S CORPORATE GOVERNANCE LETTER

"Chairmen are encouraged to report personally in their annual statements how the principles relating to the role and effectiveness of the board have been applied." ... "Above all, the personal reporting on governance by chairmen as the leaders of boards might be

a turning point in attacking the fungus of “boilerplate” which is so **often (hedge)** the preferred and easy option in sensitive areas but which is dead communication.” Preface to The UK Corporate Governance Code (September 2012)

Dear **Shareholders (EM)**,

Those of **you (EM)** that have read this section of **our (SM)** report and accounts in past years will know that **I (SM) like (AM)** to reflect on certain corporate governance matters that are topical or of particular interest to **you (EM)** as BAE Systems **shareholders (EM)**. This year, **I (SM)** want to highlight how **we (SM)** use board visits to develop directors’ understanding of the business and provide an update on board diversity. However, **I (SM)** will start with a matter that generated much interest during 2012, **the board’s (SM)** decision that the Company **should (EM)** hold discussions with EADS to look at a possible combination of the two businesses.

These discussions, and the subsequent decision to terminate them, were the subject of much interest last year and **I (SM) think (booster)** it is worthwhile looking at this matter from a governance perspective.

Strategy and decision making

The UK Corporate Governance Code states that a board’s role is to provide entrepreneurial leadership for a company in setting its strategic aims. BAE Systems has a well-developed strategy and planning process that involves the Board throughout the year. Consequently, the Company’s strategy is the subject of a good deal of review that involves both the senior executive management team and Board members in analysis and discussion. As a result of this, prior to the discussions with EADS last year, **we (SM) knew (SM)** had a robust standalone strategy and business plan but if a board is to provide strategic leadership it also needs to look at wider opportunities to deliver **shareholder (EM)** value.

The UK’s Corporate Governance Code also aims to promote effective board decision-making. The **essential (AM)** elements of good governance in this area being a well-constituted board with a clear division of responsibilities between chairman and chief executive, that is able to make well-informed decisions on the basis of collective debate and deliberation, and, once a decision has been made, ongoing board oversight and supervision.

On the basis of the work that had been undertaken prior to 2012, the Board was **well (AM)** informed on strategic matters and, therefore, **well (AM)** placed to decide whether or not the Chief Executive should be given authority to engage with EADS to explore that strategic opportunity. The Board discussed this matter at length. The discussions were **well (AM)** informed with effective engagement between executive and non-executive members of the Board, following which there was **clear (booster)** agreement on how to take this forward. Thereafter, **we (SM)** took steps to ensure that directors were kept up-to-date with developments and given the opportunity to raise any matters or concerns they had. Regular conference calls and Board meetings provided this engagement, and in the period from the initial Board discussions to the termination of the talks, a total of six Board meetings and five informal telephone conference calls were held. In addition, as Chairman, **I (SM)** remained in close contact with all Board members (both executive and non-executive) to ensure that everyone remained close to developments and all had the opportunity to provide guidance or raise concerns.

Engagement with **shareholders (EM)** is a fundamental part of the UK’s corporate governance model and BAE Systems has a well-developed investor relations programme that has helped **us (SM)** to develop **important (AM)** relationships with major **shareholders (EM)**. Once the discussions with EADS became public, **we (SM)** recognised the **need to (EM)** engage with various **stakeholders (EM)**, such as **shareholders (EM)** and employees, without delay. This was a key priority for the Board and had been the subject of much debate and planning. However, it **should (EM)** be recognised that, as for all transactions governed by the UK’s code on takeovers and mergers, the strict requirement to treat all **shareholders (EM)** equally in terms of access to information and not selectively disclose information meant that **we (SM)** were inevitably restricted as to what **we (SM)** could disclose to **shareholders (EM)** and other **stakeholders (EM)** in meetings. Accepting the limitations, many **stakeholder (EM)** meetings were held and all directors received regular feedback on them.

Major strategic actions test the true effectiveness of boards. As a starting point, a **good (AM)** board needs to stay on top of market conditions and understand a company’s strengths and the challenges it faces so that it is able to make important strategic decisions when opportunities present themselves. Decisions **should (EM)** be made collectively and on a well-informed basis – where necessary, with assistance from subject experts and professional advisers. Prior to making major decisions, all directors **should (EM)** have the time and the opportunity, both formally and informally, to discuss matters and raise any concerns they **may (hedge)** have. The chairman, chief executive and senior independent director have **important (AM)** roles to play in this process. Having made a decision, a board needs to maintain oversight of matters as they develop and be given every opportunity to get involved if there are issues that need to be addressed.

When putting a board and an executive team together **you (EM)** look for people with the knowledge, experience and basic sound judgement that will enable them to guide a company through all eventualities – knowing that there will be times when the quality of **your (EM)** governance arrangements and people will be tested. As part of **our (SM)** annual performance evaluation process, **we**

**(SM)** have reviewed **our (SM)** performance in 2012 and how **we (SM)** stood up to that test, and whilst as a Board and as a Company **we (SM)** will **always (booster)** look at ways to improve **our (SM)** performance, **we (SM) believe (booster) our (SM)** board governance was, and remains, robust and effective.

#### Understanding the business

To be effective, directors **need to (EM)** develop an understanding of a company's business. For **me (SM)**, that means getting out of the boardroom and meeting employees and experiencing business operations at first-hand. Therefore, one of the highlights of 2012 from a board perspective was the visit **we (SM)** made to the Kingdom of Saudi Arabia. Over the course of the three-day visit, directors met with the customer, received direct feedback on the Company's performance and gained a valuable insight into **our (SM)** long-standing relationship with the Kingdom. **We (SM)** also spent time with the local management team reviewing the strategic and operational priorities for the business.

Visiting different locations in Saudi Arabia, Board members met with **our (SM)** employees and learnt how they work within the performance framework and values agreed by the Board. **Our (SM)** Chief Executive, Ian King, has consistently said that it is not just about what **we (SM)** do, but how **we (SM)** do it, building a culture that delivers **shareholder (EM)** value by meeting the needs of **our (SM)** customers and acting responsibly at all times. Whilst in Saudi Arabia, **we (SM)** were encouraged by the progress being made to build a sustainable long-term business shaped by **our (SM)** values and performance expectations.

In addition to the visit to Saudi Arabia, the Board also undertook similar visits to the US during the year, visiting the Company's operations at Greenlawn, New York, and holding meetings in Washington, DC, with management and members of **our (SM)** US board. **The board's (SM)** committees are also encouraged to engage with the business at first-hand, and last year the Corporate Responsibility Committee visited part of **our (SM)** UK ammunitions business at Glascoed and the Audit Committee held one of its meetings at **our (SM)** Naval Ships business in Glasgow.

#### Diversity

Last year, the Board agreed a policy statement on board diversity. As part of that statement, **we (SM)** undertook to report in future annual reports on progress against actions taken. In respect of the last 12 months **I (SM)** can report the following:

- There are currently three women on the BAE Systems Board (2012 three), 27% of the total membership (2012 25%). Below the Board, there are three women on the Executive Committee (2012 two), 25% of its total membership (2012 17%), and 20% of the Group's global workforce are women (2012 19%).
- Four of the 11 members of the Board are non-UK citizens.
- The Board and the Nominations Committee reviewed the Group's management resources during 2012 and noted the actions being taken to grow the female talent pipeline at senior executive levels. These actions included the following:
  - Initiating work aimed at developing a flexible work culture. In particular, establishing the principles, behaviours and education requirements to underpin this.
  - Planning the roll-out of unconscious bias training in 2013.
  - Establishing a senior executive mentoring programme managed by the Executive Committee.
  - Using executive search firms with a track record of open and inclusive recruitment processes.
- Certain of the Company's directors are involved in providing mentoring services to potential, and recently appointed, listed company directors. The Company is a founder member of the FTSE 100 Cross-Company Mentoring programme and **I (SM)** am a member of the 30% Club, a group **committed (AM)** to greater board diversity. Also, **we (SM)** provide mentoring services through the Chartered Management Institute.

Further details of **our (SM)** diversity and inclusion activities can be found on page 42.

#### Board evaluation

In the following Corporate governance report, **you (EM)** will find details of how the Board evaluates its own performance. **We (SM)** have undertaken such evaluations every year since my appointment as Chairman, and they have all been facilitated externally. **You (EM)** will also see over the page details of achievement against the Board evaluation objectives **we (SM)** set last year and the ones **we (SM)** have agreed for this year. Every year since 2006, **we (SM)** have provided a similar summary of the objectives agreed by the Board following its performance evaluation. **We (SM)** introduced this innovation in governance reporting to provide the **readers (EM)** of these reports with greater insight into the working of the Board, and **I (SM) believe (booster) it also shows (booster) our (SM)** commitment to transparency and the development of best practice in board governance.

Dick Oliver

Chairman



## Board performance – 2012 objectives and achievements

<b>Strategy</b> Continue to keep strategy under review and support moves to adjust the portfolio of businesses where it is in the interests of <b>shareholders (EM)</b> to do so.	As detailed on page 80, the Company held discussions with EADS looking at a possible combination of the two businesses. Minor adjustments to the portfolio of businesses have been made, with three business disposals completed in 2012.
<b>Succession planning</b> Increase focus on matching succession and development to the strategic challenges of internationalisation, and the next decade of change in the business environment.	The Board and the Nominations Committee reviewed management resources during the year, and noted the work being undertaken to understand the key attributes and behaviours required for present and future senior management roles in the Company, and the application of focused development work aimed at achieving this.
<b>Performance monitoring</b> Extract insight from the new segmentation of business results.	The revised reporting segments have improved visibility of the business, in particular, in Cyber & Intelligence, and have enabled management to bring additional strategic insight to the business and include this as part of <b>the board's (SM)</b> review of strategy.
<b>Culture and behaviour</b> Implement improvements and observations identified in the Ethical Leadership Group (ELG) report and the US monitors' reports, oversee progress against these at Board meetings.	The Board and the Corporate Responsibility Committee have maintained oversight of the implementation of the actions in the ELG report and the reports produced by the and US monitors. The monitor appointed by the Department of Justice attended Audit and Corporate Responsibility committee meetings during the year.
<b>Risk and risk management</b> Continue to review the corporate risk register, including major programme risks and crisis management plans.	During the year, the Board reviewed the different elements of risk management and how it discharged its responsibility – using the Financial Reporting Council's Boards and Risks report to inform and structure the discussion.
<b>Board development</b> Use deep dives to improve understanding of principal markets and other major business issues.	As reported above, the Board visited the Kingdom of Saudi Arabia and the US during the year, and used these visits to develop directors' understanding of these businesses and the particular markets they serve.

## Board performance – 2013 objectives

**Strategy** Continue the strategic review of the business portfolio, with focus this year on the services businesses. Work with the executive team in the development of a comprehensive narrative of the Company's strategy.

**Succession planning** The Nominations Committee to complete the recruitment of two additional non-executive directors and identify a world-class candidate to succeed Dick Oliver as Chairman.

**Culture and behaviour** Ensure that the Company remains at the forefront of developing and embedding best practice in responsible business behaviour.

**Risk and risk management** The Board to continue to review cybersecurity protection, the management of risk in major programmes and crisis management.

**Board development** Enhance **the board's (SM)** strategic understanding of geo-political and economic risks in international markets. Use Board visits to promote understanding of markets and the business development opportunities they offer.

## CORPORATE GOVERNANCE REPORT

"Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The **shareholders (EM)**' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to **shareholders (EM)** on their stewardship. **The board's (SM)** actions are subject to laws, regulations and the **shareholders (EM)** in general meeting."

## Cadbury Committee Report – December 1992

### Compliance with the provisions of the UK Corporate Governance Code

The Company was compliant with the provisions of the UK Corporate Governance Code (the Code) throughout 2012. In September 2012, a number of changes were made to the UK Corporate Governance Code. Whilst compliance with this revised code is not required until next year, the Board accepts that it represents an authoritative statement of best practice and, as such, it has reviewed its practices relative to it and this is reflected in additional information included within this report.

### The Board

In 2012, the Board was scheduled to meet seven times and, in addition, two days were spent reviewing strategy. Additional Board meetings are called as required and in total the Board met nine times during the year. The attendance by individual directors at meetings of the Board and its committees in 2012 is shown in the table below.

The Board considers all of the non-executive directors, with the exception of the Chairman, to be independent for the purposes of the Code. Each of these directors has been identified on pages 78 and 79 of this report.

The Board appointed Nick Rose as its Senior Independent Director with effect from 21 January 2013. Amongst the duties undertaken by Mr Rose since that date was to meet with the non-executive directors without the Chairman present to discuss the Chairman's performance.

In 2012, having served as a director for nine years, Sir Peter Mason's term of office was extended for a period of 12 months to 21 January 2013. The Board has asked Sir Peter to continue as a director until the Company's Annual General Meeting (AGM) on 8 May 2013. Consequently, the Board has considered whether in respect of the period 22 January to 8 May 2013 he continues to be independent notwithstanding his length of service. The Board used its externally facilitated annual evaluation process to provide Board members with the opportunity to consider individually whether they believed that Sir Peter remained independent. The directors concluded that he remains independent and, in reaching this decision, the Board noted that his period of office had not coincided to any significant degree with that of any of the current executive directors.

The Company's Articles of Association require that all new directors seek re-election to the Board at the following AGM. In addition, the Board has agreed that in compliance with the UK Corporate Governance Code, all directors shall seek re-election on an annual basis. The Board has set out in the Notice of Annual General Meeting its reasons for supporting those directors seeking re-election at the forthcoming AGM.

### Risk management and internal control

BAE Systems has developed a system of internal control that was in place throughout 2012 and to the date of this report, that encompasses, amongst other things, the policies, processes, tasks and behaviours that, taken together, seek to:

- facilitate the effective and efficient operation of the Company;
- enable it to respond appropriately to significant operational, financial, compliance and other risks that it faces in carrying out its business;
- assist in ensuring that internal and external reporting is accurate and timely, and based on the maintenance of proper records supported by robust information-gathering processes; and
- assist in ensuring that the Company complies with applicable laws and regulations at all times, and also internal policies in respect of the standards of behaviour and conduct mandated by the Board.

On pages 44 and 45 of this report, **you (EM)** will find details of the processes the Company has put in place to manage risk. For the Board, the key requirements are that the Company has robust processes to identify, evaluate and manage risk, and that the directors have visibility of the major risks.

Risks are identified on a 'bottom-up' basis as part of the Company's Operational Assurance Statement (OAS) process. This process is mandated across the Group, and requires that the heads of all businesses and functions identify their key risks. As part of this process, an assessment is made of the probability of the risk arising and its potential impact on the Group's business plan. All risks have an owner who is responsible for preparation and implementation of plans aimed at mitigating the risk.

The key financial and non-financial risks identified by the businesses from the risk assessment processes are collated and reviewed by the Executive Committee to identify those issues where the cumulative risk, or possible reputational impacts, could be significant.

Management responsibility for the management of the Group's most significant non-financial risks is allocated at the Executive Committee's risk workshops. The OAS and Non-financial Risk registers are reviewed regularly by the Executive Committee to monitor the status and progression of mitigation plans, and these key risks are reported to the Board on a regular basis.

The Audit Committee is responsible for reviewing the ongoing effectiveness of the Company's risk management processes as part of its review of the effectiveness of internal controls. Also, twice a year, the Audit Committee receives reports on the output from the OAS process, details of the changes in the risks identified by it and the status of mitigation plans. The Corporate Responsibility Committee undertakes a similar role in respect of the Non-financial Risk Register. The Board receives reports from the chairmen of these two committees, providing details of the work they have undertaken.

Each year, the Board specifically reviews the risks identified in the risk management processes. This is aimed at providing the Board with an appreciation of the key risks within the business and oversight of how they are being managed.

Reporting within the Company is structured so that key issues are escalated through the management team ultimately to the Board if appropriate. The Operational Framework provides a common framework across the Company for operational and financial controls, and is reviewed on a regular basis by the Board. The business policies and processes detailed within the Operational Framework draw on global best practice and their application is mandated across the organisation. Lifecycle Management (LCM) is such a process, and promotes the application of best practice programme execution and facilitates continuous improvement across the Group. It considers the whole life of projects from inception to delivery into service and eventual disposal, and its application is critical to **our (SM)** capability in delivering projects to schedule and cost.

Further key processes are Integrated Business Planning (IBP), Quarterly Business Reviews (QBR) and Total Performance Leadership (TPL). The IBP, approved annually by the Board, results in a five-year business plan for each business, together with detailed near-term budgets. The QBRs evaluate progress against the IBP, and business performance against objectives, measures and milestones. TPL drives business success by linking individual goals to those of the organisation, enabling employees to understand how their own success contributes to the success of the whole business.

Whilst the quality of the control processes is fundamental to the overall control environment, the consistent application of these processes is equally **important (AM)**. The consistent application of world-class control processes is a key management objective. The Company is **committed (AM)** to the protection of its assets, which include human, property and financial resources, through an effective risk management process, underpinned where appropriate by insurance.

The Internal Audit team independently reviews the risk identification procedures and control processes implemented by management. It provides objective assurance as to the operation and validity of the systems of internal control through a programme of cyclical reviews making recommendations for business and control improvements as required.

The Board has delegated to the Audit Committee responsibility for reviewing in detail the effectiveness of the Company's system of internal controls. Having undertaken such reviews, the Committee reports to the Board on its findings so that the Board as a whole can take a view on this matter. In order to assist the Audit Committee and the Board in this review, the Company has developed the OAS process. This has been subject to regular review over several years, which has resulted in a number of refinements being made.

The overall responsibility for the system of internal control within BAE Systems rests with the directors of the Company. Responsibility for establishing and operating detailed control procedures lies with the line leaders of each operating business.

In line with any system of internal control, the policies and processes that are mandated in the Operational Framework are designed to manage rather than eliminate the risk of failure to achieve business objectives, and can only provide **reasonable (hedge)** and not absolute assurance against material misstatement or loss.

The responsibility for internal control procedures with joint ventures and other collaborations rests, **on the whole (hedge)**, with the senior management of those operations. BAE Systems' employees on the boards of such entities are required to exert such influence as the Company **may (hedge) have to (EM)** encourage the adoption of a governance structure that is substantially equivalent to the Operational Framework.

#### Going concern

The Group's business activities, together with the factors **likely (hedge)** to affect its future development, performance and position are set out in the Reporting segment reviews on pages 56 to 75. The financial position of the Group, including information on cash flow, treasury policy and liquidity, can be found in the Financial Performance section on pages 30 to 38. Principal risks are detailed on pages 46 to 51. In addition, the financial statements include, amongst other things, notes on finance costs (page 129), loans and overdrafts (page 153), and financial risk management (page 164).

After making due enquiries, the directors have a **reasonable expectation (hedge)** that the Group has adequate resources to continue operational existence for the foreseeable future. For this reason they continue to adopt the going concern basis in preparing the accounts.

#### BOARD INSIGHTS >Performance evaluation

The Board undertakes an annual review of its own performance. In the last few years it has employed the services of an external facilitator, Sheena Crane. She is an independent consultant, with experience of working at the most senior levels in major companies. Within BAE Systems, her only work is with the Board and with the Executive Committee, where she has undertaken similar performance evaluation work. She was appointed to perform her Board evaluation work in consultation with the Nominations Committee. Her evaluation process is based on one-to-one interviews with each of the directors and recording their views on how the Board and its committees work, and on the performance of individual directors.

“The principles on which the Code is based are those of openness, integrity and accountability. They go together. Openness on the part of companies, within the limits set by their competitive position, is the basis for the confidence which needs to exist between business and all those who have a stake in its success. An open approach to the disclosure of information contributes to the efficient working of the market economy, prompts boards to take effective action and allows **shareholders (EM)** and others to scrutinise companies more thoroughly.”

Cadbury Committee Report – December 1992

#### Applying the principles of the UK's Corporate Governance Code

The following report details how the Board has applied the main principles in the Financial Reporting Council's UK Corporate Governance Code (the Code), as required by the UK Listing Rules.

#### Leadership

Principles – An effective board collectively responsible for the long-term success of the company • A clear division of responsibilities at the head of the company between the running of the board and the executive. No one individual **should (EM)** have unfettered powers of decision • The chairman is responsible for the leadership of the board and ensuring its effectiveness on all aspects of its role • Non-executive directors **should (EM)** constructively challenge and help develop proposals on strategy.

The Company's governance structure is based on the leadership principles in the Code. The core activities of the Board and its committees are documented and planned on an annual basis, and this forms the basic structure within which the Board operates. The Board has adopted a document, the Board Charter, in which there is a statement of governance principles that reflect principles contained in the Code, and covers the following:

- Strategy – reviewing and agreeing strategy;
- Performance – monitoring the performance of the Group and also evaluating its own performance;
- Standards and values – setting standards and values to guide the affairs of the Group;
- Oversight – ensuring an effective system of internal controls is in place, ensuring that the Board receives timely and accurate information on the performance of the Group and the proper delegation of authority; and
- People – ensuring the Group is managed by individuals with the necessary skills and experience, and that appointments to the Board are managed effectively.

The Board Charter details the separate and distinct roles of the Chairman and the Chief Executive, and also those of the Senior Independent Director and Company Secretary. It also states that the following matters are reserved specifically for the Board:

1. Approving the Company's vision, values, principles of ethical conduct, delegated authorities and overall governance structure.
2. Approving all financial and commercial matters that it has reserved for its decision.
3. Approval of the Company's strategy and business plan.
4. Approval of the Company's annual report and accounts, and the preliminary and interim statements.
5. Approval of any distributions to **shareholders (EM)** including the approval of any interim dividend payments and any recommendations to **shareholders (EM)** concerning final dividends.
6. Approval of any significant changes to accounting policies or practices.
7. Appointment or removal of any director or the Company Secretary.
8. Approval of all circulars, prospectuses and other documents sent to **shareholders (EM)** (except for documents of a routine nature).
9. Approving the issuing and allotment of shares, changes to the capital structure of the Company, its legal status as a public company, the listing of its shares and its name.

10. Recommending to **shareholders (EM)** the appointment, re-appointment or removal of the Company's auditors.
11. Forming committees of the Board and approving their terms of reference.
12. Approval of the Board Charter (including this schedule of reserved matters) and the Operational Framework (a document detailing the Company's vision, values, delegated authorities and overall governance structure).

Whilst the Board is ultimately responsible for the success of the Company, given the size and complexity of its operations, all but the most important matters are managed on a delegated basis by the Chief Executive and the executives working for him. The Board appoints the Chief Executive and monitors his performance in leading the Company, and providing operational and performance management in delivering the agreed strategy.

The Board and its committees monitor the application of values, standards and processes. This includes a range of activities such as the formal review of the effectiveness of internal controls. To ensure that non-executive directors can constructively challenge and help develop proposals on strategy, the Board has adopted a process of reviewing the development of strategy and formally approving the agreed strategy for the Company on an annual basis.

In 2012, the Board members were provided with opportunities to engage in strategy development through informal meetings and workshops as well as formal Board meetings.

#### Management resources review

Feedback on Board performance is presented to a meeting of the Board, which agrees actions and objectives for the following year based on the information the facilitator provides and the conclusions that the Board derives from this.

Individual directors are also subject to annual performance evaluation, with the Chairman providing feedback to all directors.

Committee chairmen also receive feedback on committee performance.

The Chairman's performance is discussed at a meeting of non-executive directors. Following this meeting, the Senior Independent Director meets with the Chairman to provide him with feedback on his performance during the year. Subject to continued satisfactory performance, directors seek re-election on an annual basis.

The Nominations Committee undertakes an annual review of management resources across the Group. Facilitated by the Group Human Resources Director, the Committee focuses on the detailed succession plans for all Board and Executive Committee positions, and the strategic development of the Company's management resources. Through the use of the Talent Scorecard, the Committee has access to metrics showing the Group's performance over time in populating succession plans appropriately, the level of appointments sourced internally and externally, age profiles across levels within succession plans, diversity at different management levels and attrition rates.

#### Effectiveness

Principles – Board and committees having an appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively • A formal, rigorous and transparent procedure for the appointment of new directors • All directors to be able to allocate sufficient time to the company to discharge their responsibilities effectively • All directors to receive induction on joining and **should (EM)** regularly update and refresh skills and knowledge • The board **should (EM)** be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties • The board **should (EM)** undertake a formal and rigorous annual evaluation of its performance, and that of its committees and individual directors • All directors **should (EM)** be submitted for re-election at regular intervals, subject to continued satisfactory performance.

Succession planning is used by the Board to deliver two key responsibilities, firstly to ensure that the Group is managed by executives with the necessary skills, experience and knowledge, and secondly to ensure that the Board itself has the right balance of individuals to be able to effectively discharge its responsibilities.

The Nominations Committee has specific responsibilities in this area but the Board as a whole is also involved in overseeing the development of management resources in the Group with the aim of ensuring **we (SM)** have the individuals with the right skills to meet the needs of an increasingly complex and global business. The procedures for the appointment of non-executive and executive directors are detailed in the Nominations Committee report.

Following review by the Nominations and Corporate Responsibility committees, the Board adopted the statement shown below to act as a guide to future Board succession planning activity and to make a clear public statement of its support for greater diversity in the boardroom. Details of progress against the statement can be found on page 81.

This included the following statement in respect of Board diversity:

- It shall have an aspirational target of at least 25% of the Board being women by 2015.

- In seeking candidates for appointment to the Board, the Nominations Committee shall only engage the services of search consultants who have open and inclusive recruitment processes that draw from an appropriately diverse pool of candidates.
- It shall report progress against targets and actions taken in the Annual Report and Accounts.

There are currently three women on the Board (2012 three), 27% (2012 25%) of the total membership. There are three women on the Executive Committee (2012 two), 25% of its total membership (2012 17%), and 20% of the Group's employees are women (2012 19%).

On appointment, all non-executive directors are advised of the **likely (hedge)** time commitments and are asked to seek approval from the Nominations Committee if they wish to take on additional external appointments. The ability of individual directors to allocate sufficient time to the discharge of their responsibilities is considered as part of the directors' annual evaluation process overseen by the Chairman. An induction programme is agreed for all new directors aimed at ensuring that they are able to develop an understanding and awareness of the Company's core processes, its people and businesses. In addition, as part of the induction process, new directors will **typically (hedge)** visit the Group's principal operations in order to meet employees, and gain an understanding of the Group's products and services. Ongoing training is provided for the Board and individual directors as required.

The Chairman, with the assistance of the Chief Executive and Company Secretary, is responsible for ensuring that directors are supplied with information in a timely manner that is in a form and of a quality appropriate to enable them to discharge their duties. In the normal course of business, such information is provided by the Chief Executive in a regular report to the Board that includes information on operational matters, strategic developments, reports on the performance of Group operations, financial performance relative to the business plan, business development, corporate responsibility and investor relations.

#### Accountability

Principles – The board to present a balanced and understandable assessment of the company's position and prospects • The board is responsible for determining the nature and extent of the significant risks it is willing to take in achieving its strategic objectives. The board **should (EM)** maintain sound risk management and internal control systems • The board **should (EM)** establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles, and for maintaining an appropriate relationship with the company's auditor.

Through this report and, as required, through other periodic financial statements, the Board is **committed (AM)** to providing **shareholders (EM)** with a clear assessment of the Company's position and prospects. The arrangements established by the Board for the application of risk management and internal control principles are detailed on page 83. The Board has delegated to the Audit Committee oversight of the management of the relationship with the Company's auditors, further details of which can be found in the Audit Committee report on page 88.

#### BOARD INSIGHTS >Operational Assurance Statement

The Operational Assurance Statement (OAS) process is a key element of the Company's governance that is formed of two parts: a self-assessment of compliance with mandated policies and processes; and a report showing key risks for each business and function.

Managed by the Group's Internal Audit function, an OAS return **must (EM)** be completed every six months by each operational and functional business head, recording their formal review against such matters as compliance with law and regulation, ethical business conduct, financial controls, risk management, compliance with business planning processes, health and safety, conflicts of interest, delegated authorities, appointment of advisers, and product safety.

#### Remuneration

Principles – Levels of remuneration **should (EM)** be sufficient to attract, retain and motivate directors of the quality required to run the company successfully, but a company **should (EM)** avoid paying more than is necessary for this purpose. A significant proportion of executive directors' remuneration **should (EM)** be structured so as to link rewards to corporate and individual performance • There **should (EM)** be a formal and transparent procedure for developing policy on executive remuneration, and for fixing the remuneration packages of individual directors. No director **should (EM)** be involved in deciding his or her own remuneration.

The Board has delegated to the Remuneration Committee responsibility for agreeing remuneration policy, and the individual remuneration of the executive directors, the Chairman, members of the Executive Committee and the Company Secretary (**see (EM)** Remuneration report on pages 93 to 113). The Committee is formed exclusively of independent non-executive directors.

#### Relations with **shareholders (EM)**

Principles – There **should (EM)** be a dialogue with **shareholders (EM)** based on the mutual understanding of objectives • The board as a whole has responsibility for ensuring that a satisfactory dialogue with **shareholders (EM)** takes place • The board **should (EM)** use the AGM to communicate with investors and to encourage their participation.

The Company has a well-developed investor relations programme managed by the Chief Executive, Group Finance Director and Investor Relations Director. In addition, the Chairman is available to meet with major **shareholders (EM)** and is in regular contact with them so as to keep them informed of progress on corporate governance matters. In order to assist in developing an understanding of the views of major **shareholders (EM)**, each year the Company commissions a survey of investors undertaken by external consultants. The results of the survey are presented to the Board.

The Company maintains a comprehensive Investor Relations website that provides, amongst other things, information on investing in BAE Systems and copies of the presentation materials used for key **shareholder (EM)** presentations. This can be accessed via the Company's website, [www.BAE Systems.com](http://www.BAE Systems.com). The Company's AGM provides all **shareholders (EM)** with the opportunity to vote on the resolutions put to **shareholders (EM)** either electronically via the Company's website or by post. All resolutions detailed in the Notice of Meeting are voted on by way of a poll so as to **ensure (booster)** that all votes are counted on the basis of one vote for every share held. The result of the voting on all resolutions is published on the Company's website.

Where simple yes/no answers are not appropriate, an assessment of compliance is required to be made against structured qualitative guidance. The provisions in the OAS concerning joint ventures were revised in 2012 aimed at increasing the level of assurance for such entities. The completion of a separate OAS is mandated for joint ventures and BAE Systems employees on the boards of these companies are required to exert such influence as the Company **may (hedge) have to (EM)** encourage the adoption of a governance structure that is substantially equivalent to that mandated for wholly owned or controlled parts of the Group. The Audit Committee and the Corporate Responsibility Committee review the output from the OAS process with the head of Internal Audit. It is also shared in detail with the Company's Auditors.

## Audit Committee report

### Members

Nick Rose (Chairman), Sir Peter Mason, Paula Rosput Reynolds

### Governance

The Audit Committee was in place throughout 2012 and held six meetings, plus one joint meeting with the Corporate Responsibility Committee. All its members are independent in accordance with the provisions of the Code.

### Summary of responsibilities

- Reviewing the effectiveness of the Group's financial reporting, internal control policies, and procedures for the identification, assessment and reporting of risk
- Monitoring the integrity of the Group's financial statements
- Monitoring the role and effectiveness of the Internal Audit function
- Approving an annual programme of internal audit work
- Making recommendations to the Board on the appointment of the Auditors
- Agreeing the scope of the Auditors' annual audit programme and reviewing the output
- Keeping the relationship with the Auditors under review
- Assessing the effectiveness of the audit process
- Developing and implementing policy on the engagement of the Auditors to supply non-audit services

### Dear **Shareholders (EM)**,

An **important (AM)** part of the role of the Audit Committee is its responsibility for reviewing the effectiveness of the Group's financial reporting, internal control policies, and procedures for the identification, assessment and reporting of risk. The latter two areas are integral to the Group's core management processes and the Committee devotes significant time to their review. Further information on the risk management and internal control systems is provided on page 83.

One of the key governance requirements of a group's financial statements is for the report and accounts to be fair, balanced and understandable. The co-ordination and review of the Group-wide input into the Annual Report and Accounts is a sizeable exercise performed within an exacting time-frame which runs alongside the formal audit process undertaken by the external Auditors.

Arriving at a position where initially the Audit Committee, and then the Board, are **satisfied (AM)** with the overall fairness, balance and clarity of the document is underpinned by the following:

- comprehensive guidance issued to contributors at operational level;
- a verification process dealing with the factual content of the reports;
- comprehensive reviews undertaken at different levels in the Group that aim to ensure consistency and overall balance; and
- comprehensive review by the senior management team.

The Audit Committee has also championed efforts to ‘declutter’ the document by stripping out duplication and sequencing information in as logical a manner as possible without compromising compliance with UK regulatory and accounting requirements.

An **essential (AM)** part of the integrity of the financial statements are the key assumptions and estimates or judgements that have to be made. The Committee reviews key judgements on a twice-yearly basis prior to publication of the financial statements at the full and half year, as well as considering significant issues throughout the year. In particular, this includes reviewing any materially subjective assumptions within the Group’s principal programmes to enable an appropriate determination of revenue recognition or provisioning. The Committee has also reviewed an analysis of goodwill held on the Group’s balance sheet in respect of a number of past major transactions and assumptions made in respect of the relevant cash-generating units to which goodwill has been attributed: the methodology for impairment testing used by the Group is set out in note 11 to the Group accounts on page 140.

Audit – both internal and external – plays an **important (AM)** part in assessing the effectiveness of financial reporting and internal controls and, in turn, the effectiveness and quality of audit is of key importance.

**Our (SM)** Auditors, KPMG Audit Plc, and their legacy predecessors, have been in place since 1981 and, in line with the audit profession’s own ethical guidance, the current audit engagement partner will rotate off the Company’s account in 2013 having served for a period of five years. The Committee reviews the Auditors’ independence on an annual basis and also monitors on a quarterly basis the nature and level of non-audit fees payable to them. The Committee **believes (booster)** that certain work of a non-audit nature is best undertaken by the external Auditors, and **believes (booster)** that it is not **appropriate (AM)** to limit the level of such work by reference to a set percentage of the audit fee, as this does not take into account **important (AM)** judgements that need to be made concerning the nature of work undertaken to help safeguard the Auditors’ independence. The Committee has implemented a policy on the engagement of the Auditors to supply non-audit services which aims at safeguarding audit objectivity and independence. The Committee has agreed the policy opposite regarding services provided by the Auditors. Details of fees payable to the Auditors are set out on page 127.

The Committee has reviewed the recent changes to the UK Corporate Governance Code including the new provision for FTSE 350 companies to put the external audit contract out to tender at least every ten years. Having considered the FRC’s guidance on aligning the timing of such re-tenders with the audit engagement partner rotation cycle, the Committee’s current intentions are that it will initiate a re-tendering process in 2017. This policy will be kept under review and the Committee will use its regular reviews of auditor effectiveness to assess whether an earlier date for such a re-tender would be desirable. Such regular reviews are used to assess the effectiveness of the external audit process and the Auditors’ performance, with the Committee undertaking an internal assessment of the audit effectiveness and performance which is mapped against audit appointment criteria. On an annual basis, this is undertaken through a Group-wide evaluation at management and functional level, together with input from the Audit Committee itself. In addition, the Committee undertakes a comprehensive review of the effectiveness and performance of the external Auditors every three years. The last such review was undertaken in 2011 and encompassed management performance evaluation, independent client service review, future audit strategy and fee benchmarking.

Having considered the output of this review, the Committee has recommended to the Board that it recommend that **shareholders (EM)** support the re-appointment of the Auditors at the 2013 AGM.

As reported last year, the Committee appointed a new head of Internal Audit with effect from April 2012. An external quality assessment of the Group’s Internal Audit function has been initiated and any recommendations to strengthen the function’s capabilities or enhance the service it delivers will be acted upon.

The annual internal audit programme itself is agreed jointly by the Audit and Corporate Responsibility committees to ensure that the over-arching internal audit programme includes the assessment of the effectiveness of policies and processes relating to key areas of ethical and reputational risk.

The Committee derives considerable value from discussing issues with operational management as well as seeing at first hand practical demonstrations of the Group’s core control, risk identification and risk mitigation processes. To this end, in 2012, the Committee met with senior management in the Group’s Support Solutions business as part of its visit to the US in June, as well as meeting with senior management in the UK Naval Ships business as part of a visit to the Scotstoun site in Glasgow in December.



Nick Rose

Chairman – Audit Committee

Policy on non-audit services provided by the Auditors

#### **Audit-Related Services**

- Reporting required by law or regulation to be provided by the Auditors;
- Reviews of interim financial information;
- Reporting on regulatory returns;
- Reporting to a regulator on client assets;
- Reporting on government grants;
- Reporting on internal financial controls when required by law or regulation; and
- Extended work undertaken at the request of those charged with governance on financial information (this does not include accounting services) and/or financial controls performed where this work is integrated with the audit work, and is performed on the same principal terms and conditions.

#### **Permitted Non-Audit Services, subject to approval under the policy**

- Tax compliance services;
- Tax advisory services;
- Due diligence services relating to acquisitions of new businesses or significant investments in businesses, joint ventures or strategic alliances;
- Public reporting on investment circulars;
- Private reporting to sponsors or similar parties in connection with investment circulars (including comfort letters and reporting on working capital statements);
- Preparing information for third parties relating to acquisitions and disposals, including the conversion of financial statements into other accounting standards;
- Liquidation services in respect of redundant subsidiaries or associate companies;
- Participation in the evaluation of Internal Audit;
- Accounting advice; and
- Validation and verification work in connection with bids.

#### **Prohibited Non-Audit Services**

- Book-keeping and work relating to the preparation of accounting records and financial statements that will ultimately be subject to external audit;
- Financial information system design and implementation;
- Appraisal or valuation services in respect of material assets;
- Actuarial services;
- Internal auditing;
- Investment adviser or broking;
- Advocacy services;
- Secondments to management positions that include decision-making; and
- Any work where a mutuality of interest is created that could compromise the independence of the Auditors.

Corporate Responsibility Committee report

Members

Paul Anderson (Chairman), Harriet Green, Sir Peter Mason

Governance

The Corporate Responsibility Committee was in place throughout 2012, and held four meetings and participated in three site visits. All its members are independent in accordance with the provisions of the Code.

#### Summary of responsibilities

- Assisting the Board in overseeing the development of strategy, and policy on social, environmental and ethical matters
- Keeping under review the effectiveness of the Company's internal control policies and procedures for the identification, assessment, management and reporting of reputational and other non-financial risks
- Monitoring and reviewing the role and effectiveness of the Company's Internal Audit function in relation to corporate responsibility
- Providing oversight of the Company's compliance with corporate responsibility related policies and procedures
- Reviewing audit and assurance reports produced by the Corporate Responsibility assurer
- Overseeing and supporting key **stakeholder (EM)** engagement on social, environmental and ethical issues
- Making proposals to the Remuneration Committee regarding appropriate corporate responsibility-related performance objectives for executive directors
- Reviewing the Company's arrangements for employees to obtain further advice on ethical issues in confidence
- Ensuring that the Code of Conduct is regularly reviewed and reflects best practice for such codes
- Ensuring the Company's Annual Report and Accounts includes an examination of ethical business conduct within the Company

#### Dear Shareholders (EM),

The Corporate Responsibility Committee has been in place since 2005 and over that time a good deal of its work has been focused on ethics. Founded on a robust approach, **we (SM)** have seen **good (AM)** progress in this area with **good (AM)** evidence of business conduct being embedded in the way the Company does business. There is clear leadership from the top and an ongoing education programme that provides guidance on what is **expected (AM)** of employees. This assists them in applying **our (SM)** values and behaviour expectations to workplace situations. It also includes guidance on how to validate matters and seek assistance through mechanisms such as **our (SM)** Ethics Helpline and network of Ethics Officers. As with all matters that shape the culture of an organisation, the Committee is mindful that there will be an ongoing requirement for clear leadership at all levels within the Company, and for training and education that is engaging and relevant. Alongside this, there will **always (booster)** be a need for Board oversight, supported by internal and external assurance providers, and the insight provided by employee engagement processes.

Since its formation, the Committee has also focused on safety. Here again, **we (SM)** have seen progress. In particular, **we (SM)** have seen improvements in safety leadership and the integration of safety into the core management review and reward processes that are used to drive performance throughout the Company. For 2012, the Committee agreed that **our (SM)** basic measure of safety performance – and the one used as part of **our (SM)** executive incentives – **should (EM)** change from the Lost Work Day Case Rate to the Recordable Accident Rate. Whilst progress had been made using the lost day measure, it was **felt (hedge)** that **we (SM)** needed a metric that was more responsive to actions that help embed safety into how **we (SM)** approach and manage **our (SM)** business, and also facilitates external benchmarking against leading performers. Details of 2012 performance as measured by the Recordable Accident Rate can be found on page 41.

Compared with ethics and safety, diversity and inclusion is a comparatively recent area of focus for the Committee. However, since 2009, it has been engaged in this area, supporting the Chief Executive and his management team in developing an approach to diversity and inclusion that is capable of delivering the desired result across a large and diverse company. **We (SM)** have seen **good (AM)** engagement from the senior management team, which recognises that evolving the culture of an organisation requires leadership and commitment to change. To measure performance in this area, the Company has adopted a maturity matrix approach that provides all businesses with a model describing five levels of organisational maturity. The Committee will continue to use this and other tools to monitor performance and report on **our (SM)** progress to **shareholders (EM)**.

I'm pleased that **we (SM)** have been able to increase **our (SM)** focus on environmental matters in 2012. Against a goal of reducing the environmental impact of **our (SM)** operations and products, targets have been set to reduce the amount of energy and water used, and waste generated. As with all the corporate responsibility matters mentioned in this report, environmental sustainability performance has been incorporated into the Company's core performance management processes and, therefore, has the same visibility as financial measures of performance. The Committee receives management information throughout the year that informs **our (SM)** 'meeting room' engagement with the Chief Executive and his senior operational executives. However, there is **always (booster)** a need to **(EM)** spend time as a committee out of the meeting room, meeting employees and seeing operations. Here the experience and knowledge of Committee members can be used to assist in developing an understanding of progress against **our (SM)** corporate responsibility goals. **We (SM)** did this three times in 2012, with site visits in the UK, Saudi Arabia and the US providing valuable insights.

BAE Systems does not produce a separate corporate responsibility report. Instead **we (SM)** choose to integrate these matters into this Annual Report and Accounts. If corporate responsibility considerations are managed as an integral part of how **you (EM)** do business that is how it **should (EM)** be. Within the business reporting segments (pages 56 to 75) **you (EM)** will find details of performance in the areas of safety, diversity and inclusion, and environment for each of **our (SM)** reporting segments.

Paul Anderson

Chairman – Corporate Responsibility Committee

Nominations Committee report

Members

Dick Oliver (Chairman), Paul Anderson, Sir Peter Mason, Nick Rose

Governance

The Nominations Committee was in place throughout 2012 and held four meetings. It is chaired by the Chairman of the Company. Whilst he is not deemed to be independent, the other three members of the Committee are independent non-executive directors in accordance with the provisions of the Code.

Summary of responsibilities

- Reviewing regularly the structure, size and composition of the Board, and making recommendations to the Board on any appropriate changes
- Identifying and nominating for **the board's (SM)** approval suitable candidates to fill any vacancies for non-executive and, with the assistance of the Chief Executive, executive
- Planning for the orderly succession of directors to the Board
- Recommending to the Board the membership and chairmanship of the Audit, Corporate Responsibility and Remuneration committees

Dear **Shareholders (EM)**,

Over the last few years, the Board has aimed to achieve a board membership of 12 directors, comprising a chairman, three executive directors and eight non-executive directors. It is recognised that at times **we (SM)** will be slightly above or below, but having such a target assists the Nominations Committee in its succession planning activity. Following Michael Hartnall's retirement at last year's Annual General Meeting, Board membership has been reduced to 11, plus the Committee knew **we (SM)** had to plan for Sir Peter Mason's retirement as he was in his tenth year on the Board. Consequently, the Nominations Committee initiated a search in the first half of 2012 for suitable candidates for appointment as non-executive directors of the Company. However, the discussions that the Company held with EADS last year regarding a possible combination of the two businesses could have led to the Board being re-constituted and, consequently, the pace of the search activity had to be slowed. This activity is now **well (AM)** underway with external search consultants, Zygos Partners, having been appointed by the Committee to assist. **I (SM)** manage the relationship with Zygos and they provide no other recruitment services to the Company. **We (SM) expect (hedge)** to be in a position to announce non-executive appointments shortly.

The following table summarises the membership of the Board at present:

Succession planning activity has been constant throughout my time on the Board, and rarely has there been a time when **we (SM)** have not been looking for candidates for appointment as non-executive directors. As **you (EM)** can see from the above, **we (SM)** have been **successful (AM)** in refreshing the Board, with the average time on the Board being just over four years. In discharging its succession planning duties, the Committee considers the profile of the non-executive members of the Board on a regular basis, analysing its composition in terms of knowledge, experience and skills, diversity, and length of service. Diversity is an **important (AM)** part of these considerations, and **we (SM)** look at different aspects of this, including professional background and experience, geographic/cultural diversity and gender diversity. **We (SM)** also **consider (AM)** the Company's strategy as part of **our (SM)** succession planning and, as a consequence, identify areas of knowledge and experience that will assist the Board in strategic development and delivery.

Executive director succession planning is also undertaken by the Committee, with the annual tempo of the Committee's work here focused on its oversight of the Company's executive development and succession planning processes. The effectiveness of these processes, which cover the whole of the Group's executive population, is fundamental to the future success of the Company. Identifying talented individuals with the ability to develop and grow as leaders is a core requirement for successful businesses and, in BAE Systems, this is led by the Chief Executive. He and the Executive Committee regularly review the experience and skills that **our (SM)** future leaders will require, and use this to shape **our (SM)** development activities.

The Committee's role in executive succession planning is to engage with the Chief Executive and the Group Human Resources Director in discussing **our (SM)** management development strategy and priorities, as well as the detailed succession plans for the most senior executive positions. Through such engagement, the Company draws on the knowledge and experience of the Committee's members to help shape this activity, and ensure that the analysis, objectives and processes are sound and robust. Whilst **our (SM)** internal resources will **always (booster)** be considered for any appointment, **we (SM)** will also look at external recruitment and use this in a balanced approach to meeting future management needs.

Finally, Nick Rose joined the Committee recently having been appointed to succeed Sir Peter Mason as Senior Independent Director. My term of office is due to expire next year and, in line with the UK Corporate Governance Code, Nick Rose will chair the Committee in its search to identify an individual to succeed **me (SM)** as Chairman. It is therefore **appropriate (AM)** that Nick provides **you (EM)** with the following separate statement on this matter on behalf of the Nominations Committee.

Dick Oliver

Chairman – Nominations Committee

Chairman's succession

One of the main principles in the UK Corporate Governance Code states:

"The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role."

That is a very substantial role that is critical to the performance of any board and, therefore, ultimately the performance of the company. The role of the Chairman of BAE Systems is principally as defined by the Code, but it also includes representing the Company at the highest level, and building key relationships that assist in developing **our (SM)** strategy and customer relationships worldwide. Given the nature of **our (SM)** business, the importance of this aspect of the role **should (EM)** not be overlooked.

The Board and the Committee are fully aware of the criticality of the chairman role and the **need to (EM)** plan for the appointment of Dick Oliver's successor in a thorough, well-structured and timely manner. As the Senior Independent Director, **I (SM)** am chairing the Nominations Committee as it discharges this **important (AM)** role. The Committee has structured the search process in line with best practice for such matters, including:

- I will engage with important **stakeholders (EM)** – including **our (SM)** major **shareholders (EM)** – during the search.
- The Committee will use an external search consultancy to identify possible candidates for appointment.
- The Committee will only nominate an individual for appointment who is independent at the time of appointment in accordance with Code provision B.1.1.

**We (SM)** have started the search for a successor to Dick Oliver as Chairman of the Board and **we (SM)** **expect (hedge)** to be in a position to announce the results of this later in the year.

Nick Rose

Senior Independent Director

## REMUNERATION REPORT

Remuneration Committee Report

Members

Carl Symon (Chairman), Lee McIntire, Nick Rose

Governance

The Remuneration Committee was in place throughout 2012 and held seven meetings. Details of attendance at these meetings are provided on page 83. All its members are independent in accordance with the provisions of the Code. The Chief Executive and the Company's Chairman attend meetings by invitation only. They do not attend where their individual remuneration is discussed and no director is involved in deciding his or her own remuneration.

#### Summary of responsibilities

- Agreeing a policy for the remuneration of the Chairman, executive directors, members of the Executive Committee (EC), the Company Secretary and other senior executives
- Within the agreed policy, determining individual remuneration packages for the Chairman, executive directors and EC members
- Agreeing the policy on terms and conditions to be included in service agreements for the Chairman, executive directors, EC members, the Company Secretary and other senior executives, including termination payments and compensation commitments, where applicable
- Approving any employee share-based incentive schemes and any performance conditions to be used for such schemes
- Determining any share scheme performance targets

#### Dear Shareholders (EM),

Over the last year, the Committee has focused on the simplification of **our (SM)** long-term incentive arrangements. This has been **largely (hedge)** achieved by replacing the Share Matching Plan (SMP) with an increase in the Performance Share Plan (PSP) grant which preserves the **expected (AM)** value at on-target performance and results in a better balance between Earnings per Share (EPS) and Total **Shareholder (EM)** Return (TSR) as drivers of long-term incentives, whilst balancing **our (SM)** major objectives of motivation, retention, pay for performance and long-term **shareholder (EM)** alignment.

BAE Systems is one of the world's largest and most geographically diverse defence, aerospace and security companies. **We (SM)** have a clearly defined strategy to deliver sustainable growth in value to **shareholders (EM)**, operating in a highly technologically complex market, and with a presence in five principal markets. The Group continues to face a more challenging trading environment as governments seek to reduce fiscal deficits and defence budgets are significantly reduced in certain of **our (SM)** major markets. **Our (SM)** strategy focuses on the growing importance of winning international business, where growth markets remain. The key elements of **our (SM)** strategy are to support **our (SM)** customers in safeguarding their vital interests, inspire and develop **our (SM)** people to drive **our (SM)** success, and drive **shareholder (EM)** value by improving financial performance and competitive positions across the business. The current environment is increasingly competitive and, to deliver growth in **shareholder (EM)** value, **we (SM)** are focused on generating strong cash flows and profits. Improving efficiency in **our (SM)** operations will also make **us (SM)** more competitive to win future business. Each year, the Board agrees the Executive Committee's key objectives which are critical to delivering the Group's strategy. For 2013, these are set out on page 11, and are used as the basis to set the individual objectives for the executive directors and Executive Committee members which are agreed by the Chairman, Dick Oliver, and the Remuneration Committee. These then flow down to the senior leadership team to ensure that all businesses within the Group are aligned with the overall Group strategy.

**Our (SM)** remuneration strategy is **intended (hedge)** to recognise this business environment, whilst fostering a Total Performance culture at all levels of the Group. Given the maturity of the Group, certain areas of corporate responsibility, such as diversity and inclusion, will not be specifically incentivised in 2013. In determining the levels of executive reward, the Remuneration Committee **believes (booster)** it is of utmost importance to ensure a strong link between actual remuneration received and the achievement of **our (SM)** strategic and business objectives. The remuneration strategy incentivises executives to deliver their contribution and rewards them for the achievement of the Group's strategy through a combination of short-term incentives targeted at Group performance, business performance, personal performance and leadership behaviours, and long-term incentives targeted at Group performance (and business performance in the case of **our (SM)** US senior executives). To directly align short-term and long-term reward, executive directors will be required to defer at least one-third of their net 2013 annual incentive into shares when the annual incentive is paid in 2014.

The combination of the annual incentive plan, PSP and share options provides a balance between short-term cash reward and longer-term share-based reward. The proportion of the incentive package delivered through longer-term performance is significantly higher at stretch pay-out than at on-target, demonstrating that the package supports the achievement of superior long-term performance and strongly aligns the interests of executives to those of **shareholders (EM)** by delivering long-term reward in shares. Achieving strong performance on the in-year measures is **important (AM)** but, to maximise the value of their incentive package, executives **need to (EM)** realise growth in long-term EPS, TSR and share price.

In 2012, **our (SM)** performance against targets was as follows. **Our (SM)** EPS of 38.6p (underlying EPS adjusted to exclude the effect of foreign exchange) was below threshold; the stretch target for both year-end and average cash was achieved. **Our (SM)** TSR performance reflects the sustained under-performance of **our (SM)** share price. The reported diluted underlying EPS of 38.8p is

below the level required for any vesting of PSP and SMP long-term incentives awarded in 2010. This result of 38.8p will form the baseline EPS figure against which performance of the 2013 PSP award will be measured.

Against this performance background, the main aspects of **our (SM)** remuneration policy and practice for the year were as follows:

- For 2013, the salaries of the Chief Executive, Group Finance Director and the President and Chief Executive Officer of BAE Systems, Inc. were frozen. There will be no increase in base compensation and no increase in earnings opportunity flowing through the rest of the package.
- Annual bonus pay-outs for the executive directors under the annual incentive plan ranged from 55.1% to 68.2% of maximum.
- EPS performance over the three-year performance period for the 2010 awards under the long-term incentive plans was below the minimum 5% per annum average growth requirement. Consequently:
- the SMP award granted in 2010 earned a nil match; and
- of the 50% of the awards of shares granted in March 2010 under the EPS portion of the PSP, none will vest.
- The Company's TSR for the 50% of awards of shares granted in March 2010 under the TSR portion of the PSP was below the median position when compared against the comparator group of 17 other defence and aerospace companies, and the related awards accordingly lapsed.

#### Advisers to the Remuneration Committee

The Committee appointed Kepler Associates as its Independent Adviser in 2007 to provide advice to the Committee and its individual members on all aspects of the Committee's remit. Kepler is a founding member of the Remuneration Consultants Group (RCG) and complies with the RCG's code of conduct for remuneration consultants to the FTSE 350. Kepler will not undertake any work for the Company whilst they are retained as the Committee's independent adviser.

Representatives from Kepler are **generally (hedge)** invited to attend Committee meetings unless specifically requested otherwise by the Committee and attended all but one of the Committee's seven meetings during 2012.

During the year, the Committee also received material assistance and advice on remuneration policy from the Group's Human Resources Director (Alastair Imrie until 31 March and Lynn Minella from 11 June) and the Human Resources Director, Reward, Paul Farley. DickOliver, Chairman, and Ian King, Chief Executive, also provided advice that was of material assistance to the Committee.

Legal advice to the Committee has been provided by Linklaters who are appointed by the Company and who also provided services to the Company during the year. The Committee is **satisfied (hedge)** that the services provided to it by Linklaters are of a technical nature and did not create any conflict of interest. If a conflict of interest were to arise in the future, the Committee **would (hedge)** appoint separate legal advisers from those used by the Company.

PricewaterhouseCoopers, who are appointed by the Company and also provided services to the Company during the year, provided detailed information on market trends and the competitive positioning of packages. Mercer provided data to the BAE Systems, Inc.

Compensation Committee, which was also used to support the review of competitive positioning of packages.

Hewitt New Bridge Street, who are appointed by the Committee, provided advice on the TSR figures for assessing the performance condition under the PSP.

The Committee will continue to monitor the market and will consult with **shareholders (EM)** on any further changes for 2014 to ensure that **our (SM)** plans continue to demonstrate a clear line of sight for executives to the achievement of strategic goals and strong alignment with the creation of **shareholder (EM)** value.

The Committee received **important (AM)** feedback from **shareholders (EM)** during last year's consultation **largely (hedge)** around the perceived complexity of **our (SM)** long-term incentive arrangements. Specific questions were raised about the need for the SMP and the use of EPS performance in both this plan and the PSP. The Committee is proposing the following changes to **our (SM)** executive remuneration framework for 2013:

- Elimination of the SMP, with redistribution of the associated value into the PSP. Despite the increased face value award under the PSP, the **expected (hedge)** value of the overall package remains unchanged and grants remain within the current PSP plan limits of 400%.
- The holding period under the PSP whereby vested shares are released in three tranches over years three, four and five is unchanged. The redistribution of value from the SMP into the PSP means that all of this element of reward value will be subject to phased five-year vesting compared to the current three-year vesting for the prior SMP.
- The PSP will continue to be based 50% on EPS and 50% on TSR against a comparator group comprising companies with a significant defence focus in order to ensure meaningful alignment between the Group's strategy for delivering **shareholder (EM)** value and executive performance. Elimination of the SMP (which has a sole EPS performance condition) results in an increased emphasis on TSR as a metric within the long-term incentive structure and a better balance with EPS.

- In the case of the President and Chief Executive Officer of BAE Systems, Inc., 50% of the PSP is based on a measure relating to operating cash performance of the US businesses (with the other 50% being subject to the same EPS performance condition as applies to other executive directors). The President and Chief Executive Officer of BAE Systems, Inc. also participates in the Restricted Share Plan introduced following **shareholder (EM)** approval at the 2011 AGM, which applies to US-based executives and has no performance conditions attached.
- Despite the challenging economic environment and reduction in defence budgets, no adjustments are being made to the performance conditions – which remain a challenging target of 5% to 11% growth per annum – or vesting structure within the PSP.
- The Committee **intends (hedge)** to implement a simple bonus deferral and claw back mechanism, in line with UK **shareholder (EM)** and regulatory guidance and without matching provisions. As currently, it is proposed that one third of the annual incentive will be compulsorily deferred into shares without performance conditions and will be held for a minimum of three years, with claw back provisions in the event that performance is subsequently found to have been misstated.
- **We (SM)** are retaining **our (SM)** requirement for executive directors to build up a significant personal shareholding and increasing the minimum shareholding requirements for the Chief Executive from 200% to 300% of salary. Reflecting US market practice, the shareholding requirement for the President and Chief Executive Officer of BAE Systems, Inc. was increased substantially last year from 200% to 350% of salary.
- **We (SM)** will add order intake as a third financial metric within the Annual Incentive Plan to sit alongside EPS and cash, to ensure an appropriate alignment with **the board's (SM)** strategic growth objectives.
- As part of a wider effort to strengthen the US business' competitive position across current and future markets, and consistent with the treatment of all other BAE Systems, Inc. employees, the formula for calculating pension benefits applicable to the President and Chief Executive Officer of BAE Systems, Inc. earned after 31 December 2012 will change from a 10% of plan compensation annual accrual to a -at dollar amount of \$1,000 plus, in the Non-Qualified Plan, an annual accrual of \$500.

In line with **our (SM)** ongoing commitment to keep **our (SM) shareholders (EM)** informed of developments in executive remuneration arrangements, **we (SM)** shared with **our (SM)** largest **shareholders (EM)** the Remuneration Committee's views on potential changes to executive remuneration for 2013 in late November 2012. This set out the conclusions of **our (SM)** review at that early stage, with proposals finalised and shared more widely with **our (SM)** major **shareholders (EM)** in January 2013 as part of **our (SM) usual (AM)** cycle of engagement. During consultation regarding proposed changes for 2013, **shareholders (EM)** have expressed support for the overall direction and, in particular, the structural improvement to the long-term incentive design through elimination of the SMP.

The Committee **intends (hedge)** to enact the proposed changes as soon as possible after the formal **shareholder (EM)** approval of the Remuneration report at the AGM in May 2013. Annual incentive invitations for 2013 **would (hedge)** set out the compulsory deferral requirement that **would (hedge)** apply to annual incentive payments made in March 2014. The increased face value of PSP awards **would (hedge)** coincide with this, in March 2014.

Carl Symon

Chairman – Remuneration Committee

## POLICY REPORT

### Remuneration strategy

The Company's remuneration strategy is to provide a remuneration package that:

- helps to attract, retain and motivate;
- is aligned to **shareholders (EM)**' interests;
- is competitive against the appropriate market;
- encourages and supports a Total Performance culture aligned to the achievement of the Company's strategic objectives;
- is fair and transparent;
- can be applied consistently throughout the Group; and
- balances overall commonality of design with **appropriate (AM)** tailoring to ensure competitiveness in **our (SM)** different principal markets.

### Remuneration policy

To achieve the strategy, the remuneration policy for executive directors and Executive Committee members is to:

- set base salary with reference to median of the relevant market competitive level;
- reward stretching superior performance with up to upper quartile reward;
- provide an **appropriate (AM)** balance between:
- short-term and long-term reward; and
- fixed and variable reward with the balance becoming more long term and more highly geared with seniority; and
- provide a competitive package of benefits.

#### How remuneration is reviewed

In determining the levels of executive reward, the Remuneration Committee **believes (booster)** it is of utmost importance to ensure a strong link between actual remuneration received and the achievement of **our (SM)** strategic and business objectives.

In 2012, information on the market for comparable positions was provided by PricewaterhouseCoopers so that the Committee could form a view as to where to position the various elements of the package relative to comparable companies.

**Appropriate (AM)** comparator groups are constructed for the individual positions, taking account of company size, scale of operations and breadth of role. The comparator group for the UK executive directors' review in 2012 comprised 27 FTSE 100 companies where BAE Systems was positioned towards the median in terms of market capitalisation and which the Committee **believes (booster)** is **appropriate (AM)** for benchmarking UK executive directors' packages. For the President and Chief Executive Officer of BAE Systems, Inc., the comparator group for 2012 was drawn from companies in the US aerospace, defence and general industry sector, adjusted, as **appropriate (AM)**, to produce market figures consistent with the size, scale and relative independence of the US business, and adjusting where necessary to reflect the extra responsibility for her plc Board role.

The base salary, total cash reward (base salary plus annual incentive), total direct reward (total cash reward plus long-term incentives) and total reward (total direct reward plus pension) are analysed at the lower quartile, median and upper quartile for the relevant posts in the comparator group companies. This gives the Committee a view on the competitiveness of the individual elements of the package as well as the package as a whole.

The Committee also reviews market trends around the individual elements of remuneration to ensure that the structure of the package is **appropriately (AM)** aligned with market practice. The remuneration structure overall also takes account of the performance of the individual, the Company as a whole, and the pay and conditions of Group employees. For 2012, the review **indicated (hedge)** that the structure is **broadly (hedge)** in line with the relevant market.

In setting remuneration levels, the Committee is also sensitive to the pay and conditions of other employees within the Group. Many of **our (SM)** employees work at the very leading edge of technology. **We (SM)** have a diverse workforce operating in many countries. Employee remuneration packages are therefore determined locally to meet local needs, whilst respecting **our (SM)** culture and values. In 2012, general salary increases for **our (SM)** two largest employee populations in the UK and US **typically (hedge)** averaged 3% and 3.5%, respectively.

The Committee **intends (hedge)** to continue to flow down executive remuneration policy as detailed in this report to Executive Committee members and to the most senior executives within the Group globally to maintain a consistent approach to global reward. The principles of the remuneration strategy are applied consistently across the Group below this level, taking account of seniority and local market practice.

Elements of package	Purpose and link to strategy
Base salary	Recognise market value of role and individual's skills, experience and performance to ensure the business can attract and retain talent.
Annual incentive	Drive and reward annual performance of individuals, teams and the Company on both financial and nonfinancial metrics, including behaviours.
Performance Share Plan	Drive and reward delivery of sustained long-term EPS and TSR performance aligned to the interests of <b>shareholders (EM)</b> .
Share Option Plan	Drive and reward delivery of TSR performance and sustained improvement in the Company's share price.
Restricted Share Plan	Provide long-term reward and address retention issues, through time-vesting awards principally in the Company's US market.
Pension provision	Provide competitive retirement benefits which reward long-term performance through seniority and loyalty through long service.
Other benefits	Provide competitive cost-effective benefits through leveraging the Company's size and scale.

#### Base salary



The Committee reviewed base salaries, taking into account the current economic climate, the challenges facing the business, their respective positions against benchmark and the pay environment for employees in general. No changes have been made to annual base salary levels for executive directors in 2013, which remain as follows:

#### Annual incentive plan

The annual incentives for 2013 continue to focus on a combination of in-year financial performance, and longer-term performance and risk management (both business risk and reputation risk). Four fifths is driven off in-year financial performance, and one-fifth based on driving performance and improvement in the area of corporate responsibility and safety, combined with the other nonfinancial objectives supporting the Group's strategy.

The financial targets are derived from the IBP, and are based on earnings, cash and order intake targets. These are seen as the key indicators of both short-term and long-term financial performance and value creation. At Group level, EPS is used whereas EBITA1 is used to measure earnings performance at a business level. To incentivise improved phasing of cash generation throughout the year, a combination of year-end and average quarterly net cash/debt has been in place since 2009 and will continue for 2013. Due to the stretching nature of the plan, the payout structure includes threshold, target and stretch levels for both EPS and cash measures. Order intake has target and stretch levels only. The payout for on-target performance is 50% of maximum. The payout for achieving a threshold performance is 20% of the maximum, with no payout for achieving less than this. Payout for performance between targets is calculated on a straight-line basis.

The table below summarises the overall structure of the annual incentives for executive directors.

In setting targets for the annual incentive plan, the Committee **expects (hedge)** that these **should (hedge)** represent positive progression relative to the level of performance achieved in the prior year.

The Committee **believes (booster)** that the annual incentive targets for the executive directors are stretching but achievable. The structure of the 2013 annual incentive plan for executive directors is summarised in their individual sections on pages 101 to 103.

#### Long-Term Incentive Plans (LTIPs)

The Company currently operates four LTIPs – the Performance Share Plan (PSP), the Share Option Plan (ExSOP2012), the Share Matching Plan (SMP) and, for US executives only, the Restricted Share Plan (RSP) – the details of which are set out on pages 104 to 106.

The proposed simplification changes to **our (SM)** long-term incentive structure for 2013 are set out in the Committee Chairman's report on pages 93 to 95.

The following graphs show at on-target and stretch performance the proportion of the incentive package delivered by the various plans, and which performance metrics are driving the value of the incentive.

#### 1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.

It is the Committee's policy that executive directors **should (EM)** normally have service contracts that provide for the Company to give the individual 12 months' notice of termination. This policy has been chosen because it provides a **reasonable (hedge)** balance between the **need to (EM)** retain the services of key individuals and the **need to (EM)** limit the liabilities of the Company in the event of the termination of a contract. The executive directors have service contracts with Group companies and details of these are shown below.

In the event of the termination of an executive director's contract it is the Committee's policy to seek to limit any payment made in lieu of notice to a payment equal to the amount of one year's base salary. The service contracts for Ian King and Peter Lynas contain Specific provisions to the effect that the Company has the right to pay a sum equivalent to 12-months' salary in lieu of notice.

Linda Hudson's contract of employment automatically renews for one-year periods from 31 December each year, unless one party gives notice of non-renewal. Separately, there is a 90-day termination provision. If the employment is (a) terminated by the Company (other than for cause as defined in the contract or in the event it is not extended following her 65th birthday) or (b) she

resigns for a 'Good Reason' (as defined in her contract), she is entitled to a termination payment equal to (i) one year's base salary, (ii) a pro-rated bonus for the relevant financial year, and (iii) the continuation of 18-months' medical Benefits, plus a further 18-months' subsidy of a portion of the premiums (or a cash payment in lieu of this benefit).

No executive director has provisions in his or her service contract that relate to a change of control of the Company (and neither does the Chairman nor the non-executive directors in their letters of appointment).

#### Policy on external board appointments

The long-standing policy of allowing executive directors to hold external non-BAE Systems-related non-executive directorships with the prior approval of the Committee will continue. The Committee **considers (AM)** that external directorships provide valuable experience that is of benefit to BAE Systems. It is also considered **appropriate (AM)** for BAE Systems to contribute to the pool of non-executive expertise available for the benefit of the wider business community, thereby reciprocating the benefit that it in turn has received from other organisations which have permitted members of their senior management teams to serve on the BAE Systems Board. The Committee **believes (booster)** that it is **reasonable (AM)** for the individual executive director to retain any fees received from such appointments given the additional personal responsibility that this entails. Such fees retained by executive directors in 2012 were as follows: Ian King £47,000 in respect of his non-executive directorship of Rotork p.l.c.; and Linda Hudson \$56,550 in respect of her non-executive directorship of Bank of America since her appointment in 2012.

#### Chairman's appointment, term and fees

Dick Oliver was appointed Chairman on 1 July 2004. His appointment was for an initial fixed three-year term with effect from 17 May 2004 (the date that he was appointed to the Board as a non-executive director) and was subsequently extended in 2007 for a second term of three years to 16 May 2010. Following the approval of the Board under the chairmanship of the Senior Independent Director, it was extended again in 2009 for a third term to 16 May 2013, and subsequently in 2011 to 16 May 2014 unless terminated earlier in accordance with the Articles of Association or with either party giving the other not less than six months' prior written notice.

The Chairman's appointment is documented in a letter of appointment which is not a contract of employment and he is required to devote no fewer than two days a week to his duties as Chairman. His appointment as Chairman will automatically terminate if he ceases to be a director of the Company. Recognising that the Chairman's fees had not changed since 2007, the Remuneration Committee undertook a review of the level of his fees in 2011 taking into account, amongst other things, the scope of the duties performed by the Chairman of the Company. As a result, his fee was set at £725,000 per annum with effect from 1 June 2011. This fee will not be reviewed again during his current term of office, which ends on 16 May 2014.

#### Non-executive directors' appointment, term and fees

The non-executive directors do not have service contracts but do have letters of appointment detailing the basis of their appointment. The dates of their original appointment were as follows:

The non-executive directors are normally appointed for two consecutive three-year terms subject to review after the end of the first three-year period and with any third term of three years being subject to rigorous review and taking into account the need progressively to refresh the Board. They do not have periods of notice and the Company has no obligation to pay compensation when their appointment terminates. Under the Company's Articles of Association, they are subject to re-election at the AGM following their appointment and subsequently at intervals of no more than three years.

Michael Hartnall retired from the Board on 2 May 2012 having originally been appointed to the Board on 10 June 2003. Sir Peter Mason will retire from the Board at the AGM on 8 May 2013.

In compliance with the UK Corporate Governance Code, all members of the Board submit themselves for re-election on an annual basis at the AGM.

Non-executive directors are proposed by the Nominations Committee and are appointed by the Board on the basis of their experience to provide independent judgement on issues of strategy, performance, resources and standards of conduct.

Following publication of the UK Corporate Governance Code in 2010, the time commitment expectations for non-executive directors were reviewed and, with their agreement, their Letters of Appointment were amended to reflect that they **need to (EM)** commit **approximately (hedge)** two days for each of the Board meetings scheduled during the year, to cover attendance and preparation for the meeting. Additional time commitments will include attending scheduled Board committee meetings, strategy review meetings and ad hoc meetings of the Board (or sub-committees of the Board) that **may (hedge)** be called from time to time.

The non-executive directors are aware that it is not possible to be Specific as to exact time commitments as this will vary according to the nature of the matters that the Board is required to deal with at any point in time.

Newly appointed non-executive directors also **have to (EM)** dedicate additional time to induction activities. The level of their fees is set by the Non-Executive Directors' Fees Committee to reflect this time commitment and responsibility, and after reviewing practice in other comparable companies.

The Non-Executive Directors' Fees Committee comprises Dick Oliver, Philip Bramwell, Linda Hudson and Ian King. Having undertaken its review in January 2013, the Committee decided that the non-executive directors' fees **should (EM)** remain unchanged at the current time as follows:

The table below summarises the fee structure for 2012 and 2013:

## IMPLEMENTATION REPORT

### Financial performance

2012 was a challenging year with both constraints in **our (SM)** principal markets due to wider economic pressures, and the ongoing negotiations to formalise the price escalation on the Salam Typhoon programme. The Group failed to achieve its EPS target, as referred to on page 12, but stretch performance for both cash targets was achieved. At the operating group level, Programmes & Support missed its stretch profit target but achieved stretch performance on both cash targets. International achieved its threshold profit target, missed its year-end cash target and missed its stretch average cash performance. BAE Systems, Inc. achieved stretch performance for both cash targets and achieved its EBITA1 target.

### Non-financial performance

Page 12 sets out the Executive Committee's key objectives for 2012 and the assessment of performance against these, whilst pages 41 to 43 provide more detailed information on performance against the Specific objectives relating to safety, diversity and inclusion, and environment.

- Safety – The Group has continued to drive improvement of safety management, using its Safety Maturity Matrix (SMM) as the mechanism to measure and drive performance. All businesses reported progress against the SMM. The Group achieved a 30% reduction in the Recordable Accident Rate, exceeding the stretch target of 15%.
- Diversity and inclusion – The Group targeted progress against diversity and inclusion maturity matrices, which delivered to plan across all parts of the business.
- Environment – The Group has continued to drive progress against environmental maturity matrices, and to meet Specific targets for energy, water and waste for 2012. Businesses met the targets they set for improvement and the cumulative impact at Group level was a 12% reduction in energy, 7% reduction in water consumption and 25% reduction in waste.
- Key strategic objectives – Of the remaining key strategic objectives for individual executive directors in 2012, the Committee agreed assessments taking account of overall performance and leadership behavioural performance of the individual executive. This produced an average overall assessment of 71% of maximum.

Accordingly, the Committee determined the payout under the 2012 annual incentive plan as follows:

In addition:

- the growth in EPS over the three years to 2012 was below the performance range of 5% to 11% per annum. Consequently:
  - the SMP award granted in 2010 earned a nil match; and
  - none of the awards granted in March 2010 under the EPS portion of the PSP vest.
- the Company's TSR for the 50% of awards of shares granted in March 2010 under the TSR portion of the PSP was below the median position when compared against the comparator group of 17 other defence and aerospace companies, and the related awards lapsed accordingly.

### Personal shareholding policy

The Committee has agreed a policy whereby all executive directors are required to establish and maintain a minimum personal shareholding equal to a fixed percentage of base salary. These limits are reviewed periodically. For 2013, the minimum shareholding requirement for the Chief Executive has been increased from 200% to 300% of base salary. The minimum requirement for the Group Finance Director remains at 200% of base salary, and at 350% in the case of the President and Chief Executive Officer of BAE Systems, Inc. As a minimum, a holding equal to 100% (175% for the President and Chief Executive Officer of BAE Systems, Inc.) of base salary **must (EM)** be achieved as quickly as possible using shares vesting or options exercised through the executive share option schemes or long-term incentive schemes, by using 50% of the shares that vest or 50% of the options which are exercised on each occasion. Thereafter, executive directors are required to increase their personal shareholding gradually, on each occasion using 25% of the shares that vest or 25% of the options exercised each year, until a personal shareholding equal to the levels cited above is achieved and maintained. A similar arrangement applies to senior executives eligible for share-based long-term incentives with limits aligned to the levels of awards made under these plans.

Details of the directors' personal shareholdings are shown in Table A on page 107.

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.

#### Post-retirement benefits

##### UK pension benefits

UK executive directors are members of the BAE Systems Executive Pension Scheme (ExPS) and members of the underlying employee pension plans. As such, they are subject to the same contribution rates payable by employees of the underlying plans, and the benefit changes introduced in 2006 for post-April 2006 service including the introduction of the Longevity Adjustment Factor, a reduction in the maximum level of pension increases and a change in the definition of Pensionable Pay.

The ExPS tops up the underlying employee plan to provide a target benefit for executive directors payable from normal retirement age of 1/30th of Final Pensionable Pay (FPP) for each year of ExPS pensionable service (subject to a maximum of two-thirds of FPP). FPP is defined as annual base salary averaged over the last 12 months prior to leaving service in respect of service accrued to 5 April 2006 and 36 months prior to leaving in respect of service from 6 April 2006. The ExPS also provides a lump sum death-in-service benefit equal to four times base salary at date of death, and a spouse's death-in-service pension equal to two-thirds of the prospective pension at normal retirement age. Children's allowances are also payable, **usually (hedge)** up to the age of 18. Spouses' pensions and children's allowances are also payable upon death in retirement and death after leaving the Company's employment with a deferred pension. Once in payment, pensions are increased annually by the rise in the Retail Prices Index subject to a maximum increase of 5% per year in respect of pre-6 April 2006 service and 2.5% per year in respect of service from 6 April 2006.

As a result of the 2006 age discrimination legislation, executive directors' retirement age is 65 but they retain any previous rights they had to retire and draw their pensions without actuarial reduction for early payment at an earlier age.

Following the changes made to take account of the Pensions Simplification tax changes which came into effect from April 2006, UK executives reaching the Lifetime Allowance (LTA) were given a number of choices as previously reported. These were:

- remain in the pension scheme and pay any additional tax charge; or
- opt out of the pension scheme (and so earn no further pension benefits in respect of future service) and instead receive a taxable salary supplement. This supplement will be 30% of salary and 20% of salary for those senior executives with a two-thirds salary target after at least 20 years' and 30 years' service, respectively; or
- restrict scheme benefits to the value of the LTA with the remainder being provided directly from the Company as an unfunded promise. At retirement, the unfunded Company benefits can be either taken as pension or commuted in full for a taxable lump sum.

The Committee reviews these arrangements each year in the light of developing market practice, and **believes (booster)** they remain **appropriate (AM)** as they provide executives with competitive pension benefits and choices for dealing with the LTA which **may (hedge)** better suit their needs whilst being **broadly (hedge)** cost neutral to the Company, are in line with market practice and do not compensate executives for changes in taxation.

The review carried out in 2010 concluded that the arrangements **should (EM)** continue to be based on the Company's registered pension schemes and that, in appropriate circumstances, the Company will continue to have the option to offer an unfunded pension promise so as to mitigate the impact of further reductions to the Lifetime Allowance (introduced in 2006) and the impact of the reduced Annual Allowance. This arrangement addresses tax-inefficiencies arising for existing employees as a consequence of the pension tax changes although members will be given the choice to remain in the current arrangement and pay the increased

tax. The Committee has decided that in cases where the Company is to pay an unfunded promise, executives will be given the choice to commute some or all of the benefit for a taxable lump sum, or take it as pension.

Ian King and Peter Lynas already have an unfunded promise from the Company arising from the 2006 changes, which has been extended to cover the reduced Annual Allowance at no additional cost to the Company.

Ian King and Peter Lynas are both members of the BAE Systems 2000 Pension Plan (the 2000 Plan), applicable to former employees of Marconi Electronic Systems (MES), and members of the ExPS with a normal retirement age of 62. The 2000 Plan provides a pension of 1/50th of Final Pensionable Earnings (FPE) for each year of pensionable service, payable from a normal retirement age of 65 and members pay contributions of 8% of Pensionable Earnings. FPE under the 2000 Plan is the best consecutive three-year average of base salary and bonus in the ten Plan Years prior to leaving, less an offset for State pensions. The Company decided in 2006 to limit pensionable bonuses in the 2000 Plan in the 2006/07 Plan Year to 20% of base salary and to 10% of base salary for the 2007/08 Plan Year and thereafter. However, there is a guarantee that the FPE figure for benefits in respect of service prior to 6 April 2007 will not be less than the FPE figure at 5 April 2007 to ensure that employees do not lose the benefit of contributions paid on past bonuses. Ian King and Peter Lynas joined the ExPS in 1999 following the BAe/MES merger. Therefore their individual total pensions are the sum of their 2000 Plan benefits plus the top up from the ExPS, some of which is provided through the unfunded promise referred to above.

#### US pension benefits

Linda Hudson is a member of the 2006 Plan and a Non-Qualified Plan which provided a cash sum at retirement equal to a percentage of career average pay (salary plus bonus subject to a maximum bonus of 150% of salary). The cash accrual rate of the combined plans from 1 January 2010 was 14.1% of career average pay. From 1 January 2013, future accrual in the US pension arrangements changed for all employees and Linda Hudson will now receive a \$1,000 annual accrual from the 2006 Plan and, from the Non-Qualified Plan, a \$500 annual accrual and an annual accrual of 4.1% of salary plus bonus (subject to a maximum bonus of 150% of salary). Linda Hudson also receives a company match on her contributions to her 401(k) plan up to a maximum contribution of 6% of salary, up to regulatory limits (for 2013, \$255,000). From 1 January 2013, the company match is 100%.

Details of post-retirement benefits for each of the executive directors who served during 2012 are shown in Table D on page 113 and are calculated in accordance with the requirements of Schedule 8 of the Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2008.

#### Other benefits

Other benefits provided to executive directors are detailed under Table C on page 112.

Further to his appointment as Group Finance Director, it was agreed that Peter Lynas would be provided with Company support to establish a second home in London as the Committee **believed (booster)** this to be a more cost-effective option for the Company than requiring full relocation of his principal residence from outside London. This support is in accordance with Company policy, and consists of a lump sum of £22,200, together with a monthly allowance totalling £33,300 in year one declining on a uniform basis to £6,660 in year five (such monthly allowances over the five-year period totalling £99,900), and zero thereafter. Clawback provisions operate during years one and two of this arrangement whereby he **would (hedge)** be required to repay these monies on a pro-rata basis should he leave the Company in certain circumstances, e.g. resignation or termination. No payments have yet been made under this arrangement.

#### Summary of Long-Term Incentive Plans

##### Plan provisions

Performance conditions for grants of awards to be made under the Performance Share Plan, the Share Option Plan and investment of the 2012 annual incentive deferral into the Share Matching Plan in 2013 are detailed below. Performance conditions for grants of awards made prior to 2013 are detailed on page 111.

Clawback arrangements have operated in respect of the Performance Share Plan and Share Matching Plan from the 2010 awards onwards, and have operated for grants under the Share Option Plan since its inception. The arrangements are **intended (hedge)** to cover situations, for example, where results are restated or otherwise turn out to be materially inaccurate or where the executive's employment can be terminated for cause.

##### Performance Share Plan (PSP)

#### Key features for PSP awards in 2013:

- awards of shares are granted based on a percentage of salary and share price at the date of grant;
- the shares are subject to satisfaction of three-year performance conditions;
- half the PSP award will be based on a Total **Shareholder (EM)** Return (TSR) performance condition (PSPTSR) and the other half on an Earnings per Share (PSPEPS) performance condition. For US participants, the first half of the award will be based on long-term operating cash performance measured at the level of the US businesses, reflecting an increased emphasis from **shareholders (EM)** on cash flow generation;
- in addition, there is a further test on the PSPTSR element to ensure that the TSR performance is supported by the underlying performance of the Company;
- shares under award after satisfaction of the performance condition vest at the end of year three. Awards that vest are exercisable in three tranches between the third and seventh anniversary of vesting. For US participants, the awards are automatically delivered at the end of years three, four and five, subject to the performance condition being achieved; and
- shares under award attract dividends prior to vesting.

The proportion of the award capable of exercise is determined by the rate of average annual EPS growth over the three-year performance period, with nil vesting at average annual EPS growth of 5% and 100% vesting at 11% growth as set out opposite (15% to 33% growth over three years).

The rationale for the EPS performance measure is that major investors consider EPS to be a key indicator of long-term financial performance and value creation.

#### Summary of EPS performance to 31 December 2012

2012 EPS was 38.8p compared with the 2009 EPS baseline figure of 40.6p. This is below the performance range of 5% to 11% growth per annum. Accordingly, none of the EPS portion of the March 2010 PSP awards vest.

#### Performance condition – PSP<sup>TSR</sup>

The proportion of the award capable of exercise is determined by:

- (I). the Company's TSR (share price growth plus dividends) ranking relative to a comparator group of 12 other international defence companies as shown in the table opposite\*. Reflecting the Group's strategy to transition from a more diversified portfolio, the comparator group comprises those companies with a significant focus on defence and security. None of the shares vest if the Company's TSR is outside the top 50% of TSRs achieved by the sectoral comparator group, with 25% vesting at median, and 100% vesting if it is in the top quintile (i.e. top 20%) as set out opposite; and
- (II). whether there has been a sustained improvement in the Company's underlying financial performance and whether it is appropriate to release some or all of the awards. In taking such a view, the Committee **may (hedge)** consider (but not exclusively) the following financial metrics: net cash/debt; EBITA1; order book; turnover; risk; and underlying project performance.

The rationale for TSR performance measures is that major investors regard TSR as an important indication of both earnings and capital growth relative to other major companies in the same sector and to ensure that awards only vest if there has been a **clear (booster)** improvement in the Company's performance over the relevant period.

\* The previous comparator group for 2011 and prior years is also shown opposite.

#### Summary of TSR performance to 31 December 2012

The chart opposite summarises the position on the TSR element for all outstanding awards under the PSP as at 31 December 2012. The coloured box shows the range of TSR required for 25% vesting to full vesting, and the diamond shows BAE Systems' TSR. The proportion that **would (hedge)** vest is shown in the boxes at the top of the chart. This **shows (booster)** that the TSR portion of the March 2010 PSP award lapsed as the Company's TSR was below that of the comparator group.

1 Earnings before amortisation and impairment of intangible assets, finance costs and taxation expense.

### Share Option Plan (ExSOP2012)

Key features for option grants in 2013:

- options granted under the Share Option Plan are normally exercisable between the third and tenth anniversary of their grant; and
- for share option awards made to the executive directors only, exercise is subject to a TSR performance condition such that:
  - 25% of each option grant is exercisable if the Company's TSR (share price growth and dividends) is at the median relative to the comparator group (using the same 12 companies included in the sectoral peer group for the 2013 PSPTS performance condition listed on page 105).
  - 100% of each option grant is exercisable if the Company's TSR (share price growth and dividends) is in the upper quintile relative to the comparator group. For performance between median and upper quintile, the proportion of options exercisable will be calculated on a straight-line basis.

Rationale for performance measure: major investors regard TSR as an important indication of both earnings and capital growth relative to other major companies in the same sector.

### Share Matching Plan (SMP)

It has been proposed to eliminate the Share Matching Plan and as such this plan will operate for the last time in 2013 in respect of the deferral of 2012 annual incentive. Key features for grants of awards in 2013:

- stand-alone share investment plan with the investment linked to the award under the annual incentive plan;
- participants are granted a conditional award of matching shares against the gross value of the annual incentive invested;
- matching shares attract dividends during the three-year deferral period, released on vesting of any matching shares;
- executive directors are required to invest one-third of their 2012 net annual incentive into the SMP; and
- maximum level of investment will be 50% of the net annual incentive.

### Match and performance condition

- Nil match for average EPS growth of 5% per annum increasing uniformly to a 1:1 match at 8% per annum and a maximum 2:1 match at 11% per annum growth (i.e. 15% to 33% growth over three years).
- Rationale for performance measure: major investors consider EPS to be a key indicator of long-term financial performance and value creation.

### 2010 SMP award

The 2010 SMP awards were based on nil match for average EPS growth of 5% per annum increasing uniformly to a maximum 2:1 match at 11% per annum growth. 2012 EPS was 38.8p and is below the 2009 EPS of 40.6p. Accordingly, none of the EPS portion of the March 2010 PSP awards vest.

### Restricted Share Plan (RSP)

Key features of awards in 2013:

- conditional awards of shares are granted based on a percentage of salary and share price at the date of grant;
- the shares are subject only to the condition that the participant remains employed by the Group at the end of the vesting date (three years after the award date); and
- shares under award attract dividends prior to vesting.

The RSP is not subject to a performance condition as it is designed to address retention issues principally in the US. Clawback arrangements operate in respect of this Plan.

### Other share schemes and share usage

#### Share Incentive Plan (SIP)

During 2012, the UK executive directors were eligible to participate in the all-employee free shares element of the SIP. As a result of the Company's performance in 2012, all eligible employees (including the UK executive directors) will be entitled to receive

shares worth **approximately (hedge)** £365. A similar arrangement operates for non-UK employees on a cash or shares basis depending on local tax and security laws.

The Company operates a share purchase arrangement (Partnership Shares) under the SIP. Under this arrangement, UK-based employees (including executive directors) may purchase ordinary shares in BAE Systems by either monthly investments of between £10 and £125, or lump sum investments of between £10 and £1,500 in a tax year, both limited to 10% of salary if less. The Partnership Shares attract matching shares. As the plan is an all-employee plan, the matching shares are not subject to performance conditions in accordance with legislation. One free matching share is awarded for each Partnership Share up to a maximum of £63 per month. Dividends paid in respect of the shares in the SIP for UK-based employees are reinvested as Dividend Shares.

#### Share usage for employee share schemes

The Committee has agreed that, in respect of new issue or treasury shares, shares representing no more than 1% (and no more than 0.5% for the executive schemes) of the Company's issued share capital will be used in any one financial year for the grant of incentives under all of the Company's employee share schemes. The table below sets out the available dilution capacity for the Company's employee share schemes on this basis.

The Company currently **intends (hedge)** to use new issue or treasury shares to satisfy future share awards under the executive long-term incentive plans and share option plans up to the 0.5% annual dilution limit, and to use treasury shares to satisfy awards of free shares and matching shares under the all-employee Share Incentive Plan.

Where it is appropriate to use shares purchased in the market to satisfy employee share scheme commitments, a discretionary ESOP Trust is used to acquire Company shares using funds loaned by the Group. Further detail on the ESOP Trust is provided in note 25 to the Group accounts.

On behalf of the Board

Dick Oliver

Chairman

20 February 2013

## OTHER STATUTORY AND REGULATORY INFORMATION

### Principal activities

BAE Systems is a global defence, aerospace and security company. The BAE Systems Group delivers, through its subsidiaries and equity accounted investments, a wide range of products and services for air, land and naval forces, as well as advanced electronics, security, information technology solutions and support services.

### Company registration

BAE Systems plc is registered in England and Wales with the registered number 1470151.

### Directors

The current directors who served during the 2012 financial year are listed on pages 78 and 79. In addition, Michael Hartnall retired from the Board on 2 May 2012.

### Dividend

An interim dividend of 7.8p per share was paid on 30 November 2012. The directors propose a final dividend of 11.7p per ordinary share. Subject to **shareholder (EM)** approval, the final dividend will be paid on 3 June 2013 to **shareholders (EM)** on the share register on 19 April 2013.



### Annual General Meeting (AGM)

The Company's AGM will be held on 8 May 2013. The Notice of Annual General Meeting is enclosed with this Annual Report and details the resolutions to be proposed at the meeting.

### Office of Fair Trading undertakings

As a consequence of the merger between British Aerospace and the former Marconi Electronics Systems businesses in 1999, the Company gave certain undertakings to the Secretary of State for Trade and Industry (now the Secretary of State for Business, Innovation and Skills). In February 2007, the Company was released from the majority of these undertakings and the remainder have been superseded and varied by a new set of undertakings.

Compliance with the undertakings is monitored by a compliance officer. Further information regarding the undertakings and the contact details of the compliance officer may be obtained through the Company Secretary at the Company's registered office or through the Company's website.

### Profit **forecast (hedge)**

In its full year results announcement on 16 February 2012 and Annual Report 2011, the Group made the following statement, which is regarded as a profit **forecast (hedge)** for the purposes of the Financial Services Authority's Listing Rule 9.2.18:

"Whilst little sales growth can be expected for the Group in 2012 in the current market conditions, modest growth in underlying earnings per share is anticipated, assuming a satisfactory conclusion to Salam negotiations in 2012 and excluding the benefit of the 2011 Research & Development tax settlement."

On 19 December 2012, the Group announced that discussions continued towards agreement of definitive pricing for the supply of 72 Typhoon aircraft to the Royal Saudi Air Force contracted in 2007 under the government-to-government Salam programme and that, in the event of an acceptable agreement not being reached before the Group's full year results announcement on 21 February 2013, the impact on 2012 trading guidance **would (hedge)** be to reduce the Group's underlying earnings per share by **approximately (hedge)** 3 pence per share. At 20 February 2013, discussions continue and, consequently, modest growth in underlying earnings per share in 2012 has not been achieved. Underlying earnings per share (excluding the R&D tax benefit) was 39.7p in 2011. In 2012, underlying earnings per share was 38.9p.

### Supplier payment policy

It is Group policy that suppliers **should (EM)** be paid in accordance with the payment terms and conditions stated in the applicable purchase order. In the UK, the Group is a signatory to the government's Prompt Payment Code (**see (EM)** [www.promptpaymentcode.org.uk](http://www.promptpaymentcode.org.uk)), under which it has undertaken to pay suppliers on time, give clear guidance on payment procedures and encourage the adoption of the code throughout its supply chain.

The average number of days' credit provided in 2012 by suppliers was 30 days (2011 35 days).

### Employees

Regular internal communication, including newsletters, management meetings and the intranet, keeps employees informed, involved and motivated.

The Group has constructive relationships with trade unions, and regularly communicates and discusses business developments which impact the Group and its employees.

The Group **welcomes (AM)** employees becoming **shareholders (EM)** in BAE Systems, and offers a number of employee share plans to support this.

The Group is **committed (AM)** to giving full and fair consideration to applications for employment from disabled people who meet the requirements for roles, and making available training opportunities and **appropriate (AM)** accommodation to disabled people employed by the Group.

### Principal customers

The Group's most significant customers are the governments of the US, UK, Kingdom of Saudi Arabia and Australia. In the US, BAE - Systems is subject to a Special Security Agreement that safeguards US national security interests, as a result of which BAE Systems is allowed to supply products and services of a highly sensitive nature to the US government. Agreements between the

governments of the UK and Kingdom of Saudi Arabia relating to defence co-operation programmes remain **essential (AM)** to the development of the Group's business in Saudi Arabia. In Australia, BAE Systems is subject to an Overarching Deed with the Commonwealth of Australia that protects their national security and other interests, and allows the Group to own certain Australian defence-related industrial assets.

Indian government policy on Foreign Direct Investment mandates that foreign partners can hold a maximum of 26% equity in defence ventures.

#### Charitable donations

During 2012, the amount donated for charitable purposes in the UK was £1.8m (2011 £1.4m). In line with the Community Investment programme, this included:

- £688,800 given to armed forces charities, including donations to Combat Stress and Soldiers, Sailors, Airmen and Families Association (SSAFA) Forces Help;
- £893,800 donated to education charities, with major donations being made to Enthuse Charitable Trust, Engineering UK, the Queen Elizabeth Prize for Engineering Foundation and The Prince's Trust; and
- the remaining £249,100 donated for other charitable purposes, including the advance of health and culture/heritage.

Globally, the Group and its employees through its Community Investment programme contributed over £11m\* to local, national and international charities and not-for-profit organisations.

#### Political donations

No political donations were made in 2012.

#### Issued share capital

As at 31 December 2012, BAE Systems' issued share capital of £89,691,828 comprised 3,587,673,101 ordinary shares of 2.5p each and one Special Share of £1.

#### Treasury shares

As at 1 January 2012, the number of shares held in treasury totalled 351,756,854 (having a total nominal value of £8,793,921 and representing 9.8% of the Company's called up share capital at 1 January 2012). During 2012, the Company used 14,942,858 treasury shares (having a total nominal value of £373,571 and representing 0.4% of the Company's called up share capital at 31-December 2012) to satisfy awards under the Free and Matching elements of the Share Incentive Plan (8,867,329 shares in aggregate), awards vested under the Performance Share Plan (2,728,737 shares), the Restricted Share Plan (47,568 shares) and the Share Matching Plan (2,916,565 shares), and options exercised under the Executive Share Option Plan (382,659 shares).

\* **See (EM)** assurance statement on [www.BAE Systems.com/deloitteassurancestatement](http://www.BAE Systems.com/deloitteassurancestatement)

The treasury shares utilised in respect of the Share Incentive Plan, the Performance Share Plan, the Restricted Share Plan and the Share Matching Plan were disposed of by the Company for nil consideration. The 382,659 shares disposed of by the Company in respect of the Executive Share Option Plan were disposed of by the Company for an aggregate consideration of £902,164. As at 31-December 2012, the number of shares held in treasury totalled 336,813,996 (having a total nominal value of £8,420,350 and representing 9.4% of the Company's called up share capital at 31-December 2012).

The rights to treasury shares are restricted in accordance with the Companies Act and, in particular, the voting rights attaching to these shares are automatically suspended.

#### Rights and obligations of ordinary shares

On a show of hands at a general meeting every holder of ordinary shares present in person and entitled to vote shall have one vote, and every proxy entitled to vote shall have one vote (unless the proxy is appointed by more than one member in which case the proxy has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution; or if the proxy has been instructed by one or more **shareholders (EM)** to vote either for or against a resolution and by one or more of those **shareholders (EM)** to use his discretion how to vote). On a poll, every member present in person or by proxy and entitled to vote shall have one vote for every ordinary share held. Subject to the relevant statutory provisions and the Company's Articles of Association, holders of ordinary shares are entitled to a dividend where declared or paid out of profits available for such purposes. Subject to the relevant statutory provisions and the Company's

Articles of Association, on a return of capital on a winding-up, holders of ordinary shares are entitled, after repayment of the £1 Special Share, to participate in such a return. There are no redemption rights in relation to the ordinary shares.

#### Rights and obligations of the Special Share

The Special Share is held on behalf of the Secretary of State for Business, Innovation and Skills (the 'Special Shareholder'). Certain provisions of the Company's Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

The holder of the Special Share is entitled to attend a general meeting, but the Special Share carries no right to vote or any other rights at any such meeting, other than to speak in relation to any business in respect of the Special Share. Subject to the relevant statutory provisions and the Company's Articles of Association, on a return of capital on a winding-up, the holder of the Special Share shall be entitled to repayment of the £1 capital paid up on the Special Share in priority to any repayment of capital to any other members.

The holder of the Special Share has the right to require the Company to redeem the Special Share at par or convert the Special Share into one ordinary share at any time.

#### Restrictions on transfer of securities

The restrictions on the transfer of shares in the Company are as follows:

- the Special Share may only be issued to, held by and transferred to the Special **Shareholder (EM)** or his successor or nominee;
- the directors shall not register any allotment or transfer of any shares to a foreign person, or foreign persons acting in concert, who at the time have more than a 15% voting interest in the Company, or who **would (hedge)**, following such allotment or transfer, have such an interest;
- the directors shall not register any person as a holder of any shares unless they have received: (i) a declaration stating that upon registration, the share(s) will not be held by foreign persons or that upon registration the share(s) will be held by a foreign person or persons; (ii) such evidence (if any) as the directors may require of the authority of the signatory of the declaration; and (iii) such evidence or information (if any) as to the matters referred to in the declaration as the directors consider appropriate;
- the directors may, in their absolute discretion, refuse to register any transfer of shares which are not fully paid up (but not so as to prevent dealings in listed shares from taking place);
- the directors may also refuse to register any instrument of transfer of shares unless the instrument of transfer is in respect of only one class of share and it is lodged at the place where the register of members is kept, accompanied by a relevant certificate or such other evidence as the directors **may (hedge)** reasonably require to show the right of the transferor to make the transfer;
- the directors may refuse to register an allotment or transfer of shares in favour of more than four persons jointly;
- where a **shareholder (EM)** has failed to provide the Company with certain information relating to their interest in shares, the directors can, in certain circumstances, refuse to register a transfer of such shares;
- certain restrictions **may (hedge)** from time to time be imposed by laws and regulations (for example, insider trading laws);
- restrictions may be imposed pursuant to the Listing Rules of the Financial Services Authority whereby certain of the Group's employees require the Company's approval to deal in shares; and
- awards of shares made under the Company's Share Incentive Plan are subject to restrictions on the transfer of shares prior to vesting.

The Company is **not aware (hedge)** of any arrangements between its **shareholders (EM)** that may result in restrictions on the transfer of shares and/or voting rights.

#### Significant direct and indirect holders of securities

As at 31 December 2012, the Company had been advised of the following significant direct and indirect interests in the issued ordinary share capital of the Company:

#### Exercise of rights of shares in employee share schemes

The Trustees of the employee trusts do not seek to exercise voting rights on shares held in the employee trusts other than on the direction of the underlying beneficiaries. No voting rights are exercised in relation to shares unallocated to individual beneficiaries.

#### Restrictions on voting deadlines

The notice of any general meeting shall specify the deadline for exercising voting rights and appointing a proxy or proxies to vote in relation to resolutions to be proposed at the general meeting. The number of proxy votes for, against or withheld in respect of each resolution are publicised on the Company's website after the meeting.

#### Appointment and replacement of directors

Subject to certain nationality requirements mentioned below, the Company may by ordinary resolution appoint any person to be a director.

The majority of directors holding office must be British. Otherwise, the directors who are not British shall vacate office in such order that those who have been in office for the shortest period since their appointment shall vacate their office first, unless all of the directors otherwise agree among themselves. Any director who holds the office of either Chairman (in an executive capacity) or Chief Executive shall also be British.

The Company must have six directors holding office at all times. If the number is reduced to below six, then such number of persons shall be appointed as directors as soon as is **reasonably (hedge)** practicable to reinstate the number of directors to six. The Company may by ordinary resolution from time to time vary the minimum number of directors.

At each AGM of the Company, any director who was elected or last re-elected at or before the AGM held in the third calendar year before the then current calendar year must retire by rotation and such further directors must retire by rotation so that in total one-third of the directors retire by rotation each year. A retiring director is eligible for re-election. It is **the board's (SM)** intention that all directors will stand for election or re-election in 2013 in compliance with the UK Corporate Governance Code.

#### Amendment of the Company's Articles of Association

The Company's Articles of Association may only be amended by a special resolution at a general meeting of **shareholders (EM)**. Where class rights are varied, such amendments must be approved by the members of each class of shares separately.

In addition, certain provisions of the Articles of Association cannot be amended without the consent of the Special Shareholder. These provisions include the requirement that no foreign person, or foreign persons acting in concert, can have more than a 15% voting interest in the Company, the requirement that the majority of the directors are British, and the requirement that the Chief Executive and any executive Chairman are British.

#### Powers of the directors

The directors are responsible for the management of the business of the Company and may exercise all powers of the Company subject to applicable legislation and regulation, and the Articles of Association.

At the 2012 AGM, the directors were given the power to buy back a maximum number of 323,805,150 ordinary shares at a minimum price of 2.5p each. The maximum price was the higher of (i) an amount equal to 105% of the average of the middle market quotations of the Company's ordinary shares as derived from the London Stock Exchange Daily Official List for the five business days immediately preceding the day on which such ordinary shares are contracted to be purchased, and (ii) the higher of the price of the last independent trade and the highest current independent bid on the London Stock Exchange as stipulated in Article 5(1) of the Buy-back and Stabilisation Regulation. This power will expire at the earlier of the conclusion of the 2013 AGM or 30 June 2013. A special resolution will be proposed at the 2013 AGM to renew the Company's authority to acquire its own shares.

At the 2012 AGM, the directors were given the power to issue new shares up to a nominal amount of £26,981,064. This power will expire on the earlier of the conclusion of the 2013 AGM or 30 June 2013. Accordingly, a resolution will be proposed at the 2013 AGM to renew the Company's authority to issue further new shares. At the 2012 AGM, the directors were also given the power to issue new issue shares up to a further nominal amount of £26,981,064 in connection with an offer by way of a rights issue. This authority too will expire on the earlier of the conclusion of the 2013 AGM or 30 June 2013, and a resolution will be proposed at the 2013 AGM to renew this additional authority.

#### Conflicts of interest

As permitted under the Companies Act 2006, the Company's Articles of Association contain provisions which enable the Board to authorise conflicts or potential conflicts that individual directors may have.

To avoid potential conflicts of interest the Board requires the Nominations Committee to check that any individuals it nominates for appointment to the Board are free of potential conflicts. In addition, **the board's (SM)** procedures and the induction programme for new directors emphasise a director's personal responsibility for complying with the duties relating to conflicts of interest. The procedure adopted by the Board for the authorisation of conflicts reminds directors of the **need to (EM)** consider their duties as directors and not grant an authorisation unless they believe, in good faith, that this **would (hedge)** be likely to promote the success of the Company. As required by law, the potentially conflicted director cannot vote on an authorisation resolution or be counted in the quorum. Any authorisation granted may be terminated at any time and the director is informed of the obligation to inform the Company without delay should there be any material change in the nature of the conflict or potential conflict so authorised. The Nominations Committee has been asked to review on an annual basis any authorisations granted and to make recommendations to the Board as appropriate.

#### Directors' indemnities

The Company has entered into deeds of indemnity with all its current directors and those persons who were directors for any part of 2012 which are qualifying indemnity provisions for the purpose of the Companies Act 2006. The directors of BAE Systems Pension Funds Trustees Limited, BAE Systems 2000 Pension Plan Trustees Limited, BAE Systems Executive Pension Scheme Trustees Limited and Alvis Pension Scheme Trustees Limited benefit from indemnities in the governing documentation of the BAE Systems Pension Scheme, the BAE Systems 2000 Pension Plan, the BAE Systems Executive Pension Scheme and the Alvis Pension Scheme, respectively, which are qualifying indemnity provisions for the purpose of the Companies Act 2006. All such indemnity provisions are in force as at the date of this Directors' Report.

#### Change of control – significant agreements

The following significant agreements contain provisions entitling the counterparties to exercise termination, alteration or other similar rights in the event of a change of control of the Company:

- The Group has entered into a £2bn Revolving Credit Facility dated 8 December 2010 which provides that, in the event of a change of control of the Company, the lenders are entitled to renegotiate terms, or if no agreement is reached on negotiated terms within a certain period, to call for the repayment or cancellation of the facility. The Revolving Credit Facility was undrawn as at 31 December 2012.
- The Company has entered into a Restated and Amended **Shareholders (EM)** Agreement with European Aeronautic Defence and Space Company EADS N.V. (EADS) and Finmeccanica S.p.A. (Finmeccanica) relating to MBDA S.A.S. dated 18 December 2001 (as amended). In the event that control of the Company passes to certain specified third-party acquirors, the agreement allows EADS and Finmeccanica to exercise an option to terminate certain executive management level nomination and voting rights, and certain **shareholder (EM)** information rights of the Company in relation to the MBDA joint venture. Following the exercise of this option, the Company **would (hedge)** have the right to require the other **shareholders (EM)** to purchase its interest in MBDA at fair market value.
- The Company and EADS have agreed that if Finmeccanica acquires a controlling interest in the Company, EADS will increase its shareholding in MBDA to 50% by purchasing the appropriate number of shares in MBDA at fair market value. The Company, BAE Systems, Inc., BAE Systems (Holdings) Limited and BAE Systems Holdings Inc. entered into a Special Security Agreement dated 8 November 2010 with the US Department of Defense regarding the management of BAE - Systems, Inc. in order to comply with the US government's national security requirements. In the event of a change of control of the Company, the Agreement may be terminated or altered by the US Department of Defense.
- In July 2009, BVT Surface Fleet Limited (now BAE Systems Surface Ships Limited) and the UK MoD entered into a definitive Terms of Business Agreement (ToBA) which sets out a 15-year partnering arrangement, including lead roles for the BVT business on defined surface shipbuilding and support programmes. Where the MoD **considers (AM)** that a proposed Change in Control of BAE Systems Surface Ships Limited **would (hedge)** be contrary to the defence, national security or national interest of the UK, then the Change in Control shall not proceed until agreement with the MoD is established. In the event that there is a Change in Control of BAE Systems Surface Ships Limited notwithstanding the objection of the MoD on such grounds, the MoD shall be entitled to terminate the ToBA immediately without compensation or termination charges.

In addition, the Company's share plans contain provisions as a result of which options and awards may vest and become exercisable on a change of control of the Company in accordance with the rules of the plans.

#### Auditors

KPMG Audit Plc, the auditors for the Company, have indicated their willingness to continue in office and a resolution proposing their re-appointment will be put to the AGM.

## Strategic approach

### The Whitbread Way Forward

- **We (SM)** will grow legendary brands by building a strong customer heartbeat and innovating to stay ahead.
- **Our (SM)** Genuine, Confident and Committed teams make everyday experiences special for customers so they come back time and again, driving profitable growth.
- Good Together will make **us (SM)** a force for good in **our (SM)** communities.

**Our (SM)** strategy is to create substantial sustainable value for **our (SM) shareholders (EM)**, by building strong brands based on consistently delivering a great customer experience. Internally **we (SM)** refer to this under the heading of 'Success to Legend'. This is because a successful company becomes a legend by delivering outstanding results for all its **stakeholders (EM)** decade after decade.

In the UK **we (SM)** already have strong brands in Premier Inn and Costa and **we (SM) intend (hedge)** to continue to expand those brands into selected attractive international markets. Strong brands are built on a strong customer heartbeat and it is vital that **we (SM)** continue to provide a superior experience for every one of the 19 million customers a month who visit one of **our (SM)** brands.

**We (SM)** will achieve this by motivating **our (SM)** 40,000 team members to provide consistently high levels of customer service and maintaining high levels of team engagement is key to that aim. As well as providing **our (SM)** customers with the quality of service that will delight them, **we (SM) must (EM)** also ensure that the environments **we (SM)** provide for them, and for **our (SM)** teams, are well-maintained, clean and welcoming. It is **important (AM)** therefore that **we (SM)** continue to re-invest in the quality of **our (EM)** estate.

**We (SM) intend (hedge)** to create substantial value for **our (SM) shareholders (EM)** by delivering on **our (SM)** five-year growth milestones and by increasing return on capital. This is why ROCE is, subject to **shareholder (EM)** approval, being introduced as a central measure in a revised long-term incentive scheme for senior management. An integral part of **our (SM)** approach is the Good Together programme. **We (SM)** want Whitbread to be a force for good in all the communities in which **we (SM)** operate.

Good Together encompasses a range of corporate responsibility activities including training to enrich the lives of **our (SM)** team members, improving the nutritional content of the food **we (SM)** serve to aid the well-being of **our (SM)** customers and a reduction in energy consumption, which saves the Company money as well as having a positive impact on the environment. More details on Good Together can be found on page 17 and details of **our (SM)** achievements in this area can be found in the sections on team engagement, customer heartbeat and profitable growth on pages 11 to 16.

The customer heartbeat schematic

The schematic at the top of the page illustrates **our (SM)** strategic approach. The following sections of this report describe each of the three key elements of **our (SM)** philosophy and explain how **we (SM)** have performed in those areas in 2011/12. **You (EM)** will also see the schematic in other parts of the report to demonstrate how risk management, governance and remuneration are also linked to **our (SM)** strategy.

### The WINcard

The WINcard is **our (SM)** balanced scorecard and contains **our (SM)** key performance indicators. It is used throughout the Company and measures **our (SM)** performance in each of the key strategic areas. It also reinforces the customer heartbeat schematic. The WINcard results for 2011/12 can be seen in the following sections. These results have a direct link to remuneration and information about how the executive directors are rewarded for WINcard performance can be found in the remuneration report on page 39.

**In general (hedge)**, a green WINcard score is achieved where performance is better than both target and the prior year performance. An amber score is for performance better than the prior year but below target and a red score is for a result worse than the prior year. Targets are set for each measure at the start of the year.

### Team engagement

**We (SM) believe (booster)** that if **we (SM)** create a great place to work for **our (SM)** people, they will provide **our (SM)** customers with special experiences so that they come back time and time again.

**We (SM)** measure **our (SM)** success in creating a great place to work through the Your Say survey, with the key metrics being the response rate and the engagement score.

### Your Say

Your Say, **our (SM)** employee opinion survey, is conducted twice a year and provides **us (SM)** with great insight into what matters most to **our (SM)** teams. Action plans are developed after each survey to focus on improving **our (SM)** team members' ability to provide a great experience for **our (SM)** customers.

The Your Say results for 2011/12 are based on feedback from 31,000 employees and **demonstrate (booster) good (AM)** progress as shown below:

Work has recently begun to refresh the survey to help deliver greater insights and understanding of **our (SM)** teams. This in turn will lead to stronger and more effective action planning which **we (SM) believe (booster)** will enable engagement levels to improve further.

### Leadership

A critical focus area for the year ahead is to build **our (SM)** talent and succession pipeline to meet **our (SM)** ambitious growth strategy. **We (SM)** continue to invest in building leadership capability and have developed a leadership framework which describes the leadership behaviours **we (SM) believe (booster)** will make **us (SM)** successful. **Our (SM)** two-day leadership development programme allows space and time for **our (SM)** leaders to understand how they can engage with their teams to create an environment for success. To date more than 320 leaders have experienced this programme and benefited from the intensive focus on their personal development. The programme is run and facilitated by **our (SM)** own leadership team and continues to receive **excellent (AM)** feedback.

### Skills development

An **important (AM)** component of improving team engagement is providing Whitbread people with the ability to progress through the organisation. **We (SM)** operate a number of programmes aimed at giving team members the tools to help them develop as individuals. In March, a new Advanced Apprenticeship in Hospitality Supervision and Leadership, integrated into **our (SM)** management development programmes, was launched with a commitment to pilot a Higher Apprenticeship, which is new to the hospitality sector and equivalent to a Foundation Degree.

The four key elements of **our (SM)** skills development programme continue to be:

- English and mathematics;
- Whitbread Apprenticeships;

- specialist technical skills training; and
- management skills and development.

This growing range of opportunities is critical to attracting and developing great people, who value the chance to progress.

In **our (EM)** Costa stores **we (SM)** serve an **unbeatable (AM)** cup of handmade coffee. All Baristas begin their coffee-making education in store with **us (SM)** as soon as they join. **We (SM)** continue to nurture their skill and development through **our (SM)** Barista Maestro programme. With a commitment to on-the-job learning and career progression, **our (SM)** Baristas and assistant managers need expert coaching and leadership from **our (SM)** store managers. To achieve this **we (SM)** have stepped up **our (SM)** management training through Costa's leadership development programme.

3,600 Skills based qualifications achieved

650 Team members currently 'in learning'

93% Success rate for mathematics course students

90% Success rate for English course students

29% Apprentices progressing onto 'Shooting Stars' management development programme

500 Number of participants in 'Shooting Stars' management development programme

12,000 Management skills modules/courses completed in 2011/12

4,000 Number of Costa Baristas attending a Costa Academy in 2011/12

800 Number of Costa managers attending the leadership development programme

### Job opportunities

**Our (SM)** growth strategy makes Whitbread an **exciting (AM)** place to work with numerous opportunities available for talented people to progress. **We (SM)** are **proud (AM)** of **our (SM)** ability to develop people throughout **our (SM)** business and to build **exciting (AM)** and diverse careers for them.

As well as the opportunities presented by UK growth, **our (SM)** international expansion through Costa and Premier Inn offers **exciting (AM)** opportunities for some of **our (SM)** talented team members to experience working overseas in **our (SM)** international business.

**We (SM)** focus **our (SM)** energy on developing the skills that equip **our (SM)** teams to confidently deliver an unbeatable customer experience. **We (SM)** recognise **(AM)** this is pivotal to **our (SM)** commitment to maintaining **our (SM)** highly engaged teams, who in turn serve **our (SM)** customers with pride for the product and pride for their place of work.

### UK opportunities

Whitbread created 2,500 new jobs during the year, with half of these roles being filled by the young or long-term unemployed. **We (SM)** are focused on providing long-term career opportunities for all of **our (SM)** people by creating a great place to work. In total there were 10,000 roles filled in the hotels and restaurants businesses and from **our (SM)** management appointments 82% were filled internally.

Within **our (SM)** Costa business **we (SM)** also **believe (AM)** in developing **our (SM)** talent internally and this year **we (SM)** have celebrated the graduation of over 2,500 of **our (SM)** team members from **our (SM)** talent development programmes – Barista Maestro and Stars.

### International opportunities

**Our (SM)** talent management and global mobility strategies are developing the international leadership capability to support **our (SM)** expansion plans. **We (SM)** are working with **our (SM)** business partners to ensure that there are innovative ways of involving people that:



- enable the delivery of the brand promise;
- support the creation of a high team engagement culture; and
- drive high performance.

**Our (SM)** aim is to develop a global people framework that will enable **our (SM)** leaders to meet future organisational challenges and opportunities and to deliver sustainable performance.

#### **WINcard and link to remuneration strategy**

As explained on page 8, team engagement is key to the Company's ability to achieve its strategic aims. For this reason, leaders throughout the organisation, including the executive directors, are incentivised to achieve excellent levels of engagement within their teams.

In addition, **we (SM)** measure how well **we (SM)** take care of **our (SM)** people and **our (SM)** customers via **our (SM)** health and safety audits. **You (EM)** will see **we (SM)** have achieved a green health and safety audit score for 2011/12, which is a fundamental hurdle to achieve bonus payouts across other WINcard measures.

The Your Say measure was amber for the Group.

As shown on page 9 the team engagement score was 73% which didn't quite meet the stretching target set despite being an improvement on the prior year. Team turnover was also amber at the Group level in 2011/12, driven by a green score for Costa and a red score for Hotels & Restaurants. The Hotels & Restaurants team turnover target was very challenging for 2011/12, although the trend has improved over a longer period, with a 6%pts improvement since 2009. **Our (SM)** team turnover remains consistently better than it is for **our (SM)** competitors.

**"We (SM) will create the conditions for all to flourish in a high performance, customer focused organisation"**  
(Louise Smalley, Group HR Director)

Team members – opportunities to share in Whitbread's success

**Our (SM)** teams are integral to Whitbread's ability to deliver its strategy. Providing opportunities for them to earn additional rewards for contributing to great results and to share in Whitbread's success is very **important (AM)**.

New incentive schemes	In 2011 <b>we (SM)</b> launched 'Feel Good' in Costa and 'Guest Promise' in WHR which provides an incentive for all team members to really care for <b>our (SM)</b> customers and be inspired to deliver great service. All <b>our (SM)</b> front line teams now have an opportunity to earn additional rewards above their base pay and <b>we (SM)</b> have made over 15,000 team member awards since the launch of the two schemes in the second half of 2011.
Sharesave	<b>We (SM)</b> actively encourage <b>our (SM)</b> teams to connect to the success of the organisation through <b>our (SM)</b> Sharesave scheme, which is available to all employees and offers an option price discounted by 20%. The three and five year schemes which matured in February 2012 delivered a return of <b>approximately (hedge)</b> £4.3 million, shared between more than 1,100 employees. This is an <b>excellent (AM)</b> way for <b>our (SM)</b> teams to share in the success of the Company.
Pay for progression	Giving team members the opportunity to develop and progress is very <b>important (AM)</b> , but it is equally <b>important (AM)</b> that <b>we (SM)</b> reward them appropriately as they do progress. Offering a clear route of pay progression to all team members will drive team engagement and help to create a great place to work and learn. All team members currently have the opportunity to progress their pay through development into more skilled roles or into management through 'Shooting Stars'. <b>Our (SM)</b> growth depends on attracting bright people with potential and retaining <b>our (SM)</b> skilled team members. <b>Our (SM)</b> aim is to map out a clear route to pay progression for all roles, motivating and inspiring all to achieve their potential.
Recognition and celebration	Recognition and the celebration of success help to create an environment in which people see that their work is valued and <b>important (AM)</b> and are inspired to achieve. Whether it is <b>our (SM)</b> 'Team Member of the Quarter' award, <b>our (SM)</b> 'General Manager of the Year' award or one of the many customer compliments recognising the day-to-day service excellence of <b>our (SM)</b> teams, <b>we (SM)</b> want it to be meaningful recognition which is celebrated and shared.

'Good Together' people pledges

**We (SM)** have developed a new set of people pledges that feed into **our (SM)** 'Good Together' corporate responsibility programme. **Our (SM)** people pledges are focused on improving the lives of the people who work for

and the lives within the communities in which **we (SM)** operate. **Our (SM)** aim is to positively impact the following social issues:

- reducing the skills gap;
- reducing youth unemployment;
- championing healthier lifestyles; and
- supporting charities and good causes.

#### Awards

BITC CR Index 2012	Payroll Giving	CRF Institute
Platinum standard	Best overall campaign 2012	One of Britain's top employers 2012

#### Good Together Results 2011/12

- 3,600 skills-based nationally recognised qualifications awarded to **our (SM)** Hotels & Restaurants team members, with a further 650 people in learning;
- 558 Costa team members have graduated from **our (SM)** development programme and **we (SM)** have trained 2,000 Barista Maestros;
- In **our (EM)** restaurants **we (SM)** worked with the Prince's Trust to pilot a two week Work Inclusion scheme with 12 disadvantaged young people – four of whom now have jobs with **us (SM)**. Following this success **we (SM)** will be rolling this programme out across **our (EM)** hotels and restaurants;
- **Our (SM)** charity target of raising £1 million for WaterAid was achieved in late 2011, helping more than 66,000 people in India gain access to a long-term supply of safe water, improved sanitation and hygiene education;
- This year **we (SM)** have raised £750,000 for the Costa Foundation, bringing **our (SM)** total to £2.5 million enabling the opening of 24 schools, providing education to 14,518 children and jobs to 312 teachers and support staff;
- A further £421,000 has been raised for other charities through **our (SM)** Raise and Match and Payroll Giving schemes; and
- 74% of respondents to **our (SM)** Your Say survey believe that the Company is working hard to operate according to the principles of Good Together.

#### Customer heartbeat

**We (SM) believe (booster)** that to achieve **our (SM)** vision to become a legendary business the customer has to be at the heart of everything **we (SM)** do. Building a strong customer heartbeat is the key to delivering outperformance across all **our (SM)** brands.

**We (SM)** build a strong customer heartbeat by listening to and understanding **our (SM)** customers better; providing outstanding value; delighting them with innovative new products; and making everyday experiences special through great service provided by **our (SM)** 40,000 team members.

#### Customer insight

##### Hotels & Restaurants

Premier Inn is passionate about listening to and learning from customers. As well as running regular focus groups, Premier Inn has one of the UK's largest and most robust customer satisfaction surveys with over 800,000 responses a year, up 20% on last year.

The survey rates customer satisfaction across 200 areas of the business from comfort of the bed to friendliness of the team.

Listening to customers in this way has led to some significant operational changes designed to improve the customer experience:

What <b>we (SM)</b> learnt from customers	Action taken	Result
Scores for the comfort of pillows were not as high as those for the comfort of the bed.	The pillow specification was changed and customers were given a choice of hard or soft pillows.	Satisfaction scores for comfort of pillows have increased by 15%pts.
Customers, particularly business customers, told <b>us (SM)</b> that they wanted an improved WiFi facility in their rooms.	WiFi access is now free for 30 minutes in Premier Inn rooms.	Satisfaction scores for WiFi increased by 17%pts.

In September 2011 Restaurants introduced a new mystery diner programme whereby each site receives a visit twice a month. The mystery diners are real customers who are asked to test out a customer journey with 25 key touch points and scores are running at an industry-leading 85%. **We (SM)** also operate a Guest Recommend programme that allows customers to give their feedback either via telephone or online. **We (SM)** have introduced a new incentive for customers to complete the survey. This has led to a doubling of responses with each site receiving an average of 60 per month giving the management team a much better understanding of the customer experience on a site-by-site basis.

As with Premier Inn, monthly customer focus groups are a valuable means of gaining insight for the Restaurants team. A direct learning from one of these groups was a better understanding of what customers like about the breakfast offer, which led to greater focus on the breakfast proposition, helping to drive breakfast sales up by 14% in the year.

Restaurants have also increased their Customer Relationship Management capabilities growing the CRM database to over 770,000 customers, up from 450,000 in February 2011. This provides a targeted way of communicating with customers who are sent three to four emails a month that are relevant to them. Brewers Fayre, Beefeater Grill and Table Table have all launched new websites in the year, where customers can submit online booking requests and find out information about individual restaurants. The new websites have seen traffic increase by over 100% since launch.

#### Costa

Central to developing Costa's understanding and insight into the customer has been the introduction of the 'Listen and Learn' scheme across the entire UK estate. Launched in September 2011 'Listen and Learn' provides real time customer feedback by store. The online survey consists of just six key questions based on the consumer hierarchy of needs. Customers are then able to give verbatim feedback on their visit, which is analysed and categorised by the system. This allows Costa to understand what is important to customers and act on their feedback. 97% of all feedback comes from **our (SM)** Coffee Club database as customers are sent an email on a quarterly basis asking for feedback on their recent store visit.

#### Costa Coffee Club – Facts and Figures

2	Two-years old
6.5m	6.5 million activated cards
1.9m	1.9 million members registered on the website
+5%	Members spend 5% more than non-members on average
+31%	Visit frequency of members increased by 31% since 2010
12.9m	12.9 million promotional emails sent to members in 2011/12
£1.9m	Emails drove an average incremental spend of 15p each, producing £1.9 million of additional turnover.

The impact of this scheme has been tremendous in driving team engagement and enabling store managers to address any concerns, significantly improving the quality of the customer experience. In addition the business has used key insights from the data, as well as insights gained from research and focus groups, to inform business and marketing strategies. This measure will become bonusable from 2012/13 onwards, cementing the customer's place at the heart of the business.

#### Making everyday experiences special

##### Hotels & Restaurants

The secret of Premier Inn's success is **our (SM)** focus on delivering a 'good night guaranteed' for 12 million customers a year. Testament to this is the low level of invocations of the guarantee (when a customer asks for their money to be refunded) at just 0.64% of total rooms sold.

These invocations are used positively to signpost where the Company should focus to improve its customer experience. For example, the most common reason for a customer invoking the guarantee is noise. To address this issue the building specifications have been enhanced to reduce the amount of noise in rooms. At the new Leicester Square hotel, due to open in May 2012, **we (SM)** have created a 'room within a room' for additional soundproofing.

Customers have also been given new rates to choose from this year with the introduction of great value 'Premier Savers' ranging from £19 to £99. Over 1.8 million of these Premier Savers have been sold this year, representing £56 million worth of revenue. For customers that value flexibility Premier Inn has also introduced the 'Premier Flex' product, which is available at a higher rate and allows them to cancel the room up until the day of arrival with no charge.

#### Premier Inn awards

World Travel Awards	British Travel Awards	Business Travel Awards
World's Leading Budget Hotel Brand	Hotel Chain of the Year Best CR programme	Best Budget Hotel Brand

In a highly value sensitive market **our (SM)** Restaurant brands have been innovating new value-led menus and concepts to attract more covers. Within Brewers Fayre the Buffet Place concept is proving hugely popular with customers. Converted sites have seen a sales uplift of c6%. 71 new Buffet Place sites opened in 2011/12 taking the total to 95 and it will be rolled out to the remaining 34 Brewers Fayre sites in 2012/13. New food nights such as 'Mexican Night' keep the concept fresh but the most popular remain 'Curry Night' and 'Chip Shop Night'.

Beefeater Grill and Table Table both introduced new £4.99 menus this year to meet the increasing demand for greater value dishes. These menus still include the customers' favourite dishes such as fish and chips. Beefeater Grill has dialled up the brand's steak credentials with new steak seasonings and butters to appeal to its core customer. New styles of food, presented in creative ways, such as dipping breads, bottomless salads and the use of wooden boards instead of plates ensure the quality and style of food remains enticing.

In October 2011 **we (SM)** implemented a new organisation structure in **our (SM)** Hotels & Restaurants business. **We (SM)** put in place a dedicated management team for Restaurants to focus on delivering a best-in-class customer experience. Key drivers include the introduction of a team member incentive scheme launched in September, which enables team members to earn bonus payments based on their guest promise scores.

New Skills Academies have been set up to train people in food quality and service. The first of these opened in April in Hockley followed by Swindon and Manchester in January 2012. Already 1,700 delegates have passed through these Academies and there are plans for 9,000 team members to attend in 2012/13. Both the Academies and incentive scheme are having a direct impact on the customer service experience and the results can be seen in improved guest scores and like for like sales since the half year.

Alison McCaig-White, Regional Operations Manager for Beefeater, saw sites in her region improve their guest scores by 24% in the three months after they had attended the Beefeater Perfect programme.

#### Costa

Once again Costa has enjoyed external independent recognition as the UK's No. 1 coffee brand. YouGov's U&A study conducted in January 2012 **showed (booster)** that Costa still has the highest levels of usage in the UK of the key branded coffee shop chains and when it comes to 'preference' 30% of the UK adult population said they **would (hedge)** choose Costa, compared to 24% who **would (hedge)** choose Starbucks and 10% for Caffé Nero.

Costa's success comes from giving customers a quality coffee experience at their convenience whether it's from a Costa Express self-serve coffee bar, a new Metro store, a concession in Tesco or a Beefeater Grill restaurant. Over 2011/12 Costa invested in 128 store refurbishments and opened four of their new Metro design stores, including the first outside of London in Leeds.

Over the course of the year Costa has delighted customers with a number of new products including Costa Light, the 'Have it Your Way Costamisation' campaign and delicious new flavours in the Ice Cold Costa range.

#### Costa awards

Marketing Week Engage Awards 2011	European Coffee Awards 2011	Data Strategy Awards 2011
Brand of the Year	Best Branded Coffee Shop Chain – UK & Ireland Best Branded Coffee Shop Chain – Europe	Winners in Retail and Home Shopping

Last summer's Ice Cold Costa campaign was the most **successful (AM)** ever; with sales up over 40% driven by best sellers 'Mango and Passion Fruit Cooler' and a new 'Coffee Cooler'. Costa Light was launched in July 2011 and was a direct response to customer insight that **showed (booster)** customers wanted lower calorie coffee products. This is now **around (hedge)** 2% of the coffee drinks sales mix.

WINcard performance Although like for like sales were positive, the WINcard score was red for both the Group and Hotels & Restaurants as performance was impacted by challenging economic conditions. All businesses achieved green scores for brand standards, whilst Costa achieved amber scores for like for like sales and 'guest heartbeat' as they narrowly failed to meet challenging targets.

#### Good Together Results 2011/12

- **We (SM)** serve 100% RFA certified Costa coffee globally (in India **we (SM)** will meet this target in June 2012);
- **We (SM)** introduced calorific values on the Thyme menus within Premier Inn and provide full nutritional information online for every dish **we (SM)** serve in **our (EM)** restaurants, whilst Costa will be providing calorie information in-store from May 2012 across the UK;
- **We (SM)** are on track to meet the Department of Health's 2012 salt targets which will deliver a further 15% reduction on 2010 targets;
- **We (SM)** offer more choice of fruit and vegetables on **our (SM)** children's menus in line with the Food Standards Agency's 5-a-day guidelines;
- All pork, beef and poultry sourced for Costa in the UK is from British Farms;
- All **our (SM)** meat, wherever it is sourced, is produced to stringent animal welfare standards which meet the international Farm Animal Welfare Council's (FAWC) Five Freedoms principles; and
- **We (SM)** achieved several awards this year, including: Platinum status on the BITC CR Index, inclusion in the FTSE4Good Index and Best CR Programme at the Business Travel Industry Awards.

#### Profitable growth

**Our (SM)** strategy is designed to deliver outstanding results for all **our (SM)** stakeholders **(EM)** decade after decade. **We (SM)** **intend (hedge)** to create **shareholder (EM)** value by delivering on **our (SM)** five-year growth milestones, growing like for like sales and driving returns on capital.

#### Growth

During 2011/12 **we (SM)** continued with **our (SM)** expansion plans in Hotels & Restaurants and opened 4,055 new bedrooms in 29 hotels as well as 12 new restaurants delivering **our (SM)** highest organic growth to date. There are now 619 hotels (47,274 rooms) in the UK and 387 restaurants, of which the great majority are adjacent to a Premier Inn.

**We (SM)** plan to open a further 4,200 new rooms by the end of 2012/13. This, combined with the remainder of the committed pipeline of 6,300 rooms, puts **us (SM)** on track to achieve **our (SM)** milestone of 65,000 UK rooms by 2016.

As well as **our (SM)** expansion plans **we (SM)** also continue to invest in **our (EM)** existing estate and over the two financial years to February 2013 **we (SM)** plan to have invested **around (hedge)** £70 million refurbishing some 13,000 rooms. This aligns with **our (SM)** strategy of delivering quality and consistency across **our (EM)** estate. Furthermore **we (SM)** have implemented a new cluster management system to enhance the efficiency and structure of **our (SM)** business and to strengthen **our (SM)** position for future growth.

Overseas, **we (EM)** now have four hotels in the Middle East and two hotels in India. **We (SM)** will continue to expand **our (SM)** presence in these markets, with five hotels in the pipeline. Beyond the pipeline, **we (SM)** will pursue a 'capital right' strategy to grow Premier Inn's presence in international markets. This means increasingly concentrating new developments on management contracts once **we (SM)** have established **our (SM)** brand in each market with owned hotels.

In Costa, **we (SM)** had a strong store opening programme during the period and opened a total of 332 net new stores. **Our (SM)** international presence continued to grow as **we (SM)** opened 157 net new stores, including 69 in China while **our (SM)** UK business further strengthened through the addition of 175 net new stores. This increased **our (SM)** total number of stores to 2,203: 1,392 in the UK and 811 overseas.

Following the acquisition of Coffee Nation in March last year and subsequent launch of Costa Express, **we (SM)** are pleased by the progress made during the year with **our (SM)** growth plans ahead of **our (SM)** original expectations. **We (SM)** ended the year with 1,192 Costa Express units which included 622 conversions.

In early 2012, **we (SM)** organised Costa into four divisions: Costa UK Retail; Costa Enterprises (which includes **our (SM)** key contract businesses of wholesale, corporate franchise and Costa Express); Costa Europe, Middle East and India (EMEI); and Costa Asia. This reflects the increasing breadth and globalisation of Costa and supports **our (SM)** growth strategy for the future.

#### Return on capital

**Our (SM)** growth plans require a significant investment of capital and in 2011/12 **we (SM)** invested £307.9 million in new and existing units. It is **important (AM)** therefore that **we (SM)** invest this money well and deliver a good return for **our (SM) shareholders (EM)**. The hotels and restaurants that **we (SM)** have opened in the last three years are currently on track to deliver a ROCE in excess of 20% at maturity.

In 2011/12 Costa delivered a ROCE of 32.4%, with Hotels & Restaurants delivering a ROCE of 12.4%. The importance of delivering strong returns is **demonstrated (booster)** by the proposed changes to the LTIP performance conditions. The Remuneration Committee has concluded that, in order to more closely align the LTIP to the strategic aims of the Company, it **would (hedge) be appropriate (AM)** to include ROCE both as a hurdle and a multiplier to a base award generated by performance against an EPS measure. Further details on the proposed changes, which are subject to approval at the AGM in June, can be found on page 40.

#### Like for like growth

Whilst it is **important (AM)** that **we (SM)** deliver on **our (SM)** growth milestones and re-invest in **our (EM)** estate to maintain the quality of **our (SM)** customer proposition, it is equally **important (AM)** that **we (SM)** deliver good like for like growth.

In 2011/12, strong initiatives combined with **our (SM)** continued focus on customer propositions drove Group like for like sales up by 2.6%. Premier Inn delivered a like for like sales increase of 3.2% despite an overall slowdown in the hotel market in the second half of the year, particularly in the regions. Like for like revpar grew by 1.8% for the year. Revpar growth remains a key focus for Premier Inn and during the second half of the year **we (SM)** trialled **our (SM)** new pricing system for both Premier Saver and Premier Flexible rates. **We (SM)** are pleased with the success of this trial and plan to roll it out to the remainder of the estate during 2012/13.

Restaurants like for like sales fell by 0.2% for the full year with an improvement in the second half as management actions drove covers growth of 4.8%. Costa delivered another **outstanding (AM)** performance with like for like sales up 5.5%. Meanwhile, Costa's international business continued to strengthen with positive like for like sales growth across all regions except Europe which has been affected by the financial crisis in Greece.

#### 2011/12 performance

Whitbread delivered a **good (AM)** performance in 2011/12 amid a challenging economic backdrop for the UK of low consumer confidence and **poor (AM)** economic growth. For the full year total Group sales rose by 11.2% to £1,778.0 million and Group underlying profit before tax increased by 11.3% to £320.1 million. **Our (EM)** hotels and restaurants achieved a solid performance during the year in an increasingly competitive and challenging environment. Total revenues increased by 5.3% to £1,239.0 million with underlying operating profit up 4.3% year on year to £295.6 million.

In the midscale and economy hotel market which became progressively more challenging, particularly outside of London, Premier Inn continued to outperform its competitive set and delivered a resilient performance with total sales up 8.3% to £755.9 million (2010/11: £697.8 million).

Overseas, Premier Inn continued to perform **well (AM)** with revpar and occupancy increasing across the board as the Premier Inn brand established its position within the Middle East and India.

**Our (EM)** restaurants made steady progress during the second half of the year. A key feature has been a more focused management team for **our (EM)** restaurants which are predominantly located alongside a Premier Inn. In addition **we (SM)** have improved **our (SM)** customer offering through better value food and drink. Revenues have increased by 1.8% to £483.4 million (2010/11: £474.9 million) with covers growth of 1.5%.

Costa has produced another **excellent (AM)** performance during the year, with total sales increasing by 27.5% driven by **good (AM)** like for like sales growth and a strong store opening programme. Following a strong top line performance, underlying operating profit increased by 38.0% to £69.7 million.

Total system sales, which are sales derived from Costa owned and franchise stores, were up 24.3% to £819.3 million.

## WINcard performance

Hotels & Restaurants achieved its WINcard performance target for brand expansion, but missed its INcard profit target for the year. Costa achieved its targets for brand expansion, profit and system sales. At a Group level, Whitbread achieved its expansion targets, but marginally failed to meet a stretching profit target.

### Good Together Results 2011/12

- **We (SM)** lead **our (SM)** sector in sustainable construction and energy efficiency – opening **our (SM)** tenth ‘green’ site in January 2012: The Beefeater restaurant and Premier Inn in Camborne, Cornwall includes numerous energy and water-saving features including solar PV and electric car charging pods;
- **Our (SM)** significant investment and innovation in energy reduction initiatives has enabled **us (SM)** to achieve an absolute carbon emission reduction of 0.75% whilst opening 29 new sites (incorporating 4,055 new bedrooms) and growing revenue by 11.2%. Relative to sales, **our (SM)** carbon emission efficiency has improved by 11.0%. This puts **us (SM) well (AM)** on track to meeting **our (SM)** carbon reduction target of 25% by 2016/17;
- These achievements helped to secure **our (SM)** recertification by the Carbon Trust and **our (SM)** score in the 2011 Carbon Disclosure Project placed **us (SM)** ahead of the majority of **our (SM)** competitors;
- **We (SM)** achieved ISO 500001 compliance for the Energy Management System at **our (EM)** Costa Roastery in Lambeth;
- **We (SM)** achieved a 5% reduction in water use relative to sales; and
- **We (SM)** diverted 83% of waste from **our (EM)** hotels and restaurants away from landfill.

### Good Together

**We (SM)** have continued to develop **our (SM)** corporate responsibility programme, Good Together, this year to establish **ourselves (SM)** as sector leaders.

**We (SM)** have more closely aligned the programme to **our (SM)** business model and now have three clear pillars of activity: team & community, customer well-being and environment. **Our (SM)** new five-year targets, which **we (SM)** aim to meet by 2016/17, are shown below and are firmly embedded in **our (SM)** strategic plans.

### Targets 2016/17

Team & community	Customer well-being	Environment
Charitable activity • £5 million to be raised for charities by WHR. Costa Foundation to educate 50,000 children and build 50+ schools.	• Accreditation and sustainable supply of: Tea/coffee; Timber; Palm oil; Fish; and Meat.	• 25% carbon reduction*;
Qualifications and training • 6,000 recognised qualifications for WHR team members (including 1,100 apprenticeships) and 1,000 structured school placements created (16 to 18 year olds). • Enhanced skills training provided to 20,000 Costa team members.	• Costa hot drinks will be Rainforest Alliance certified.	• 15% reduction in water consumption* ; and
Job creation • Group – 10,000 new UK jobs created.	• <b>We (SM)</b> will progressively improve the nutritional content across <b>our (SM)</b> food and drink portfolio, enabling customers to make informed choices. As part of this, calorific labelling will be introduced into outlets.	• Zero waste to landfill.*
*From Whitbread direct operations and based on 2009 baseline.		

### WINcard

Hotels & Restaurants achieved the Good Together WINcard target during the year as significant investment and innovation in energy reduction initiatives enabled **us (SM)** to achieve an absolute carbon emission reduction of 0.75% whilst opening 4,055 new rooms and growing revenue by 11.2%. Relative to sales, **our (SM)** carbon emission efficiency has improved by 11.0%.

The Costa WINcard target was to reduce food wastage as a percentage of sales. While the WINcard target was marginally missed, Costa saw an improvement in food wastage as a percentage of sales over the second half of the year.

To learn more about **our (SM)** Good Together programme, **our (SM)** business specific targets and **our (SM)** achievements **please (EM)** visit the corporate responsibility pages on **our (SM)** website: [www.whitbread.co.uk/whitbread/responsibility.html](http://www.whitbread.co.uk/whitbread/responsibility.html)

## Finance Director's review

### Revenue

Group revenue increased by 11.2% year on year to £1,778.0 million.

### Revenue by business segment

The growth in revenue during the year was driven by a combination of new openings and improved sales in like for like units. 332 net new Costa Stores, eight net new Restaurants and 4,430 net new Premier Inn rooms opened and 315 net Costa Express machines were added. Like for like sales across the Group grew by 2.6% with Costa up 5.5% and Hotels & Restaurants up 1.8%.

The growth in Premier Inn rooms included 375 net international rooms split across the Middle East and India with one new hotel opened in each region. In the UK and Ireland 4,055 new rooms were opened. At Costa 175 net stores opened in the UK and 157 net internationally. The development of Costa Express continues at a pace with 315 net new machines installed and 622 rebranded to Costa Express from Coffee Nation. The installed base of the business is now 1,192 machines.

Like for like sales growth in Premier Inn benefited from the further development of dynamic pricing which saw the business continue to outperform its midscale and economy sector competitors. In Restaurants the establishment of a focused team is driving covers growth, which was up 3.7% in the year, although a reduction in spend per head resulted in like for like sales falling marginally in the year by 0.2%. Costa achieved 5.5% like for like sales growth driven by a strong brand preference, further take-up of the loyalty card and product innovation both in the food and the drink ranges.

### Results

Underlying profit before tax for the year is £320.1 million, up 11.3% on last year. The underlying profit before tax measure excludes the pension interest charge, the amortisation of acquired intangibles and exceptional items. Underlying diluted earnings per share is 134.1p compared to 116.4p last year, up 15.2%.

Total profit for the year is £266.0 million which compared to £222.1 million last year, up 19.8%.

### Exceptional items

Exceptional items are set out in detail in note 6. In total they amount to a £2.3 million benefit before tax and £42.6 million after tax. A net profit on disposal of assets of £14.4 million has been offset by the net impairment of tangible and intangible assets amounting to £11.3 million and an increase in the interest charged on provisions of £0.8 million. Taken together these make up a total pre tax exceptional credit of £2.3 million.

The exceptional tax credit of £40.3 million comprises four items: a credit of £16.6 million arising from the agreement of capital allowance claims by HMRC following the review carried out after the abolition of Industrial Buildings Allowances; the enactment during the year of the reduction in the rate of Corporation Tax to 25% from 1 April 2012 giving rise to a deferred tax credit of £17.0 million; a reduction in deferred tax liabilities of £9.2 million in respect of roll over gains; and finally a charge of £2.5 million for tax on exceptional items.

### Interest

The underlying interest charge for the year is £25.3 million compared to £24.3 million in 2010/11. Although average net debt during the year fell just over £10 million to £441.3 million, the blended interest charged on borrowings rose as a result of the refinancing that took place during the year. Further details are set out below.



The total pre exceptional interest cost amounted to £39.3 million. Included within this figure is an IAS 19 pension charge of £14.0 million (2010/11: £11.5 million). This charge represents the difference between the **expected (hedge)** return on scheme assets and the interest cost of the scheme liabilities.

#### Tax

An underlying tax expense of £84.4 million represents an effective tax rate of 26.4% on the underlying profits, which compares with 29.1% last year. This reduction in rate is **largely (hedge)** due to the reduction in UK Corporation Tax of 2%pts to 26.2% for 2011/12. In 2012/13 the effective tax rate is **expected (hedge)** to be **around (hedge)** 25%.

#### Earnings per share

Underlying diluted EPS increased by 15.2% to 134.1p.

Further details can be found in note 11.

#### Dividend

Following a decision last year end to rebalance the dividend between the interim and final payments, the interim dividend was increased by 56%. As a consequence, the recommended final dividend of 33.75p represents an increase on last year of 1.5%. The proposed final dividend will take the total dividend for the year to 51.25p, an increase of 15.2%. The dividend is planned to be paid on 13 July 2012 to all **shareholders (EM)** on the register at the close of business on 18 May 2012. A scrip dividend alternative will again be offered.

#### Net debt and cashflow

The principal movements in net debt are as follows:

The Group has again generated strong cash flows from operations in the year which are up on last year by £63.1 million to £478.3 million. The Group, as announced, has increased its investment in new and existing units by increasing capital expenditure to £307.9 million, up 52.3% on the prior year.

During the year the Group undertook a sale and leaseback transaction selling seven properties for £53.8 million.

The low level of cash tax reflects tax relief on recovery plan payments to the pension fund plus a £23 million cash tax benefit from the re-submission of capital allowance claims following the abolition of Industrial Buildings Allowances for hotels.

The total payments to the pension scheme were £95.4 million, an increase of £86.5 million. Further details are set out below.

Net debt as at 1 March 2012 was £504.3 million, an increase in the year of £16.4 million. This compares to a weighted average debt in the year of £441.3 million which is £10.5 million less than last year.

During the year, the Group issued further private placement loan notes in both US dollars and £ sterling in line with the policy to diversify both sources and maturity of debt. These loan notes were issued in four series with maturities of seven and ten years and coupons from 3.9% to 4.9%. The US dollar component was swapped to £ sterling with the total transaction having a value of £156.4 million and £ sterling interest rates were fixed, ranging from 4.3% to 5.2%. The proceeds, which were receivable in two tranches in September 2011 and January 2012, were used to repay drawings under the shorter maturity bank debt. In November 2011 the Group completed a new £650 million five year revolving credit facility with its relationship banks to replace the pre-existing facilities amounting to £855 million as at December 2011. This was the final step in the Group's medium-term financing plan. The Group now has total facilities of £908 million, of which £535 million was drawn at the year end.

The policy of the Board continues to be to manage its financial position and capital structure in a manner consistent with Whitbread maintaining its investment grade status.

#### Capital expenditure

Total Group cash capital expenditure on property, plant and equipment and intangible assets during the year was £307.9 million with Hotels & Restaurants spend amounting to £244.2 million and Costa £63.7 million. Capital expenditure is split between development expenditure, which includes the acquisition and development of properties, and maintenance expenditure. Development expenditure has increased by £65.3 million to £196.0 million as the Group stepped up its investment in new units and maintenance expenditure increased by £40.4 million to £111.9 million. A large part of the maintenance expenditure was on room refurbishment to maintain Premier Inn's consistent standards.

**Our (SM)** current plans **indicate (hedge)** that total Group capital expenditure for the year ahead will be at similar levels to 2011/12. In addition a further sale and leaseback, similar in size to that in the last financial year, is planned.

#### Pensions

As at 1 March 2012, there was an IAS 19 pension deficit of £598.7 million, which compares to £488.0 million as at 3 March 2011. The main movement in the deficit from year to year is the actuarial loss of £177.2 million in the year on the scheme liabilities principally as a result of the 95 basis point fall in the discount rate. This has been offset by amounts paid into the fund of £95.4 million.

The payments into the scheme of £95.4 million include the agreed deficit funding of £60.0 million for 2011/12 and an advanced payment of £25.0 million in respect of the agreed deficit funding for 2012/13. This early payment is part of the ongoing triennial valuation discussions. These discussions will be finalised in 2012.

Christopher Rogers

Finance Director

25 April 2012

#### Risk management

Risk at Whitbread is measured by reference to the strategic goals and reputational interests of the Company. The link between the Company's strategy and the six categories of risk used can be seen in the schematic below.

#### Structure

The structure of the risk management process at Whitbread is shown in the diagram at the bottom of the page. Both Whitbread Hotels & Restaurants and Costa maintain risk matrices aligned to their respective strategic goals. The matrices analyse the risks to the achievement of those goals and prioritise those risks as low, medium or high based on both the likelihood and potential impact of each risk. The matrices are accompanied by supporting schedules outlining the controls in place to manage each risk. These matrices, together with controls and mitigations, are reviewed on a quarterly basis by the respective management boards.

The outputs from the process carried out at business level form the basis of a Group-level risk matrix. This includes the most significant business risks as well as other risks specific to the Group. The Group risk matrix is reviewed quarterly by the Board and annually by the Audit Committee.

The process:

- links risks to strategic objectives;
- prioritises risks based on likelihood and impact;
- articulates the key controls on which the business relies in mitigating and/or monitoring the key risks; and
- drives quarterly updates to the status of risks and controls.

The risk and control matrices are used as the foundation on which to develop the annual assurance map, which **ensures (booster)** risks and controls are reviewed and tested either by Ernst & Young, CMI or PwC as part of the operational audit. Operational audit work provides a level of independent assurance on the application of key controls put in place by management to mitigate both the likelihood and impact of key risks to the Group and its businesses.

The current status

In total, there were 18 risks identified on the Group risk matrix considered by the Audit Committee in March 2012. These risks were categorised into the following six categories: health and safety; reputational; market; financial; third-party; and operational.

Mitigating controls are in place for all 18 risks, together with **appropriate (AM)** assurance processes. After taking account of these controls the Audit Committee and the Board considered that 13 of the risks either had a low likelihood of occurring or **would (hedge)** have a low impact in the event that they did occur. For this reason, these 13 risks have not been categorised as principal risks for the purposes of this report. The Board **considers (hedge)** that for all 13 of these risks there has been no deterioration of the position during the year.

The five principal risks identified, together with details of mitigating controls, monitoring and assurance processes and an indication of the current trend for each are summarised in the table on page 21. The Board does not **consider (hedge)** any of these risks to have a high likelihood of occurring.

#### Principal risks

Risk	Mitigation controls	Monitoring and assurance	Current trend
Health and safety risk: serious health or provenance issue relating to food.	The quality of expertise of members of the procurement, food development and safety and security teams mitigates the risk of serious food safety or provenance issues. The Company monitors media reports to help it to <b>predict (hedge)</b> future issues and the Board emphasises the importance of this area. The Company has stringent food safety policies and a detailed sourcing policy.	CMI, an independent company, carries out regular audits on all outlets to measure their performance against a range of health and safety standards, including food safety standards. Health and safety is a hurdle on the WINcard and influences bonus payments to employees. Regular updates are provided to the management boards and to the Whitbread PLC Board.	Stable
Market risk: consumer spending being adversely affected by the macro-economic environment.	Commercial action plans have been developed by the Group's businesses in order to ensure that, in the challenging consumer economy, <b>we (SM)</b> continue to offer <b>excellent (AM)</b> value to <b>our (SM)</b> customers so that <b>our (EM)</b> hotels, restaurants and coffee shops are the number one choice in their market. Trading results and economic indicators are monitored to allow for speedy action when required.	The executive teams and the Whitbread PLC Board review the commercial plans and monitor performance.	Stable
Market risk: change in the market or competitor activity adversely affecting trading in any of the Company's businesses.	Actions to outperform the competition are developed on a strategic and tactical basis. Significant customer research is carried out with Premier Inn, for example, receiving more than 800,000 responses in 2011/12. The customer insight received is used to develop action plans. Consumer trends, both in the UK and overseas, are analysed and competitor activity is monitored. Monthly reports are produced by each business for the Board.	Relative market share information and timely trading performance data is produced and monitored by the executive teams and the Board.	Premier Inn Stable  Restaurants Stable  Costa Improving
Financial risk: significant increase in the pension scheme's actuarial and/or statutory deficit resulting in higher pension contributions or the re-rating of the Company's credit.	The Company's defined benefit pension scheme is closed to new members and, for future service, to existing members. The Pension Investment Committee and its advisers, as well as the internal pensions team, have significant expertise in the area and provide <b>good (AM)</b> quality oversight. The investment strategy has been designed to reduce volatility and risk and hedging opportunities are utilised as appropriate.	Lane Clark & Peacock have been appointed as pensions advisers to the Company. Pension fund reports are reviewed by the Board.	Deteriorating
Third-party risk: third-party failing	Credit control checks are carried out on parties to significant contracts, along with the continued auditing	Credit controllers monitor risks and there is a regular	Stable

and consequently breaching the terms of a significant contract or giving rise to a privity of contract claim.	and monitoring of those contracts. Regular reviews are carried out on the potential for privity of contract claims and, when they are received, all efforts are made to lessen the financial liability through negotiation with the landlord or sale of the lease.	review of the debtors registers by the management boards.	
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### Board of directors (SM)

"The Board functions **well (AM)** and in line with first class corporate governance" Lorna Parker, External Board evaluation March 2012

Anthony Habgood  
Chairman (since August 2005)  
Date of appointment to the Board: May 2005  
Age: 65  
External appointments: Reed Elsevier plc and NV (Chairman)  
Preqin Holding Limited (Chairman)  
Committee membership:  
Nomination Committee (Chairman)  
Remuneration Committee  
Experience: Between 1991 and 2009 Anthony served first as Chief Executive and then as Chairman of Bunzl plc. Prior to that he had served as Chief Executive of Tootal Group plc and as a director of the Boston Consulting Group Inc. In addition, Anthony has held the role of Chairman of Molnlycke Healthcare (UK) Limited and non-executive directorships at Geest plc, Marks and Spencer Group plc, National Westminster Bank Plc, SVG Capital plc and Powergen plc.

Patrick Dempsey Executive director  
Date of appointment to the Board: January 2009  
Age: 53  
External appointments: Business in the Community – talent and skills leadership team member British Hospitality Association (Council member) Hospitality Action (Trustee) Committee membership: None  
Experience: Patrick joined Whitbread in 2004 as Managing Director of Marriott in the UK, and has been in the hotel and restaurant business for 30 years. He was with Forte Hotels for 20 years, prior to joining Compass Group as Chief Executive of Restaurant Associates. In 2005, Patrick became Managing Director of Premier Inn.

Andy Harrison  
Chief Executive  
Date of appointment to the Board: September 2010  
Age: 54  
External appointments: None  
Committee membership: None  
Experience: Andy served as Chief Executive of easyJet plc from 2005 to 2010 and was Chief Executive of RAC plc (previously Lex Services plc) from 1996-2005. Prior to this, he held the roles of Managing Director of Courtaulds International Fabrics and Finance Director of Courtaulds Textiles plc. In the past, Andy has also held a non-executive directorship at Emap plc, where he was Chairman of the audit committee.

Christopher Rogers  
Finance Director  
Date of appointment to the Board: May 2005  
Age: 52  
External appointments: HMV Group plc (NED)  
Committee membership: None  
Experience: Christopher joined Whitbread over seven years ago from Woolworths Group plc where he was Finance Director and also held the position of Chairman of the Woolworths Group Entertainment business. He originally qualified as an accountant with Price Waterhouse before joining Kingfisher plc in 1988. Christopher held a number of roles in his time at Kingfisher, including Group Financial Controller, Finance Director and Commercial Director of Comet Group plc.

Stephen Williams  
 Senior Independent Director  
 Date of appointment to the Board: April 2008  
 Age: 64  
 External appointments: Croda International Plc (NED) Eversheds LLP (NED)  
 Committee membership: Remuneration Committee Nomination Committee  
 Experience: Stephen retired as General Counsel and Chief Legal Officer of Unilever during 2010, having originally joined them in 1986. Prior to that, Stephen spent 11 years at Imperial Chemical Industries plc. He was a non-executive director of Bunzl plc and Senior Independent Director of Arriva plc.

Richard Baker  
 Independent non-executive director  
 Date of appointment to the Board: September 2009  
 Age: 49  
 External appointments: Virgin Active Group (Chairman) European Advisory Board, Aimia (Chairman) Advent International Plc (Operating Partner) DFS Furniture Holdings Plc (Chairman)  
 Committee membership: Audit Committee Remuneration Committee  
 Experience: Previously Richard served as Chief Executive of Alliance Boots Group plc and Chief Operating Officer at Asda Group plc.

Wendy Becker  
 Independent non-executive director  
 Date of appointment to the Board: January 2008  
 Age: 46  
 External appointments: Ocado Group plc (NED)  
 Committee membership: Audit Committee Remuneration Committee  
 Experience: Wendy was Managing Director of TalkTalk and Group Chief Marketing Officer for Vodafone. Prior to this, Wendy held the position of partner at McKinsey & Company for 14 years. In the past, Wendy also held the roles of brand manager with Procter & Gamble and consultant with Boston Consulting Group.

Ian Cheshire  
 Independent non-executive director  
 Date of appointment to the Board: February 2011  
 Age: 52  
 External appointments: Kingfisher Plc (Group Chief Executive) Department for Work and Pensions (Lead Non-Executive Director) Cambridge Programme for Sustainability Leadership (Chairman of Advisory Board)  
 Committee membership: Remuneration Committee (Chairman) Nomination Committee  
 Experience: Ian is currently Group Chief Executive of Kingfisher plc, having previously served as Chief Executive of B&Q UK from June 2005. Prior to joining Kingfisher in 1998, he worked for a number of retail businesses including Sear & Guinness.

Susan Hooper  
 Independent non-executive director  
 Date of appointment to the Board: September 2011  
 Age: 52  
 External appointments: Acromas Travel (Chief Executive)  
 Committee membership: Audit Committee  
 Experience:  
 Susan was Senior VP, EMEA at Royal Caribbean Cruises International, where she also represented them on the board of First Choice Holidays PLC. Prior to that she worked at Pepsico International. Susan previously served as a member of the SC Johnson European Advisory Board and as a non-executive director of Transcom, Royal & Sun Alliance, Courtaulds Textiles and the Suzy Lamplugh Trust.

Simon Melliss  
 Independent non-executive director

Date of appointment to the Board: April 2007

Age: 59

External appointments: Member of the Committee of Management of Hermes Property Unit Trust University College London (Member of the Council)

Committee membership: Audit Committee (Chairman) Nomination Committee

Experience:

Simon, a chartered accountant, was Chief Financial Officer of Hammerson plc from 1995 to 2011, having originally joined the company in 1991 as Group Financial Controller. Prior to that, he served as the Group Financial Controller of Sketchley PLC and held senior finance positions with Reed International. Simon also previously held a nonexecutive directorship at Associated British Ports Holdings plc.

Susan Taylor Martin

Independent non-executive director

Date of appointment to the Board: January 2012

Age: 48

External appointments: Thomson Reuters (President, Media)

Committee membership: Audit Committee

Experience: Susan previously held a number of other roles at Thomson Reuters including President, Global Investment Focus Accounts and Managing Director, UK and Ireland within Thomson Reuters Markets. Prior to this she was Global Head, Corporate Strategy for Reuters, which she joined in 1993.

#### Directors' report

The directors present their report and accounts for the year ended 1 March 2012.

Certain information required for disclosure in this report is provided in other **appropriate (AM)** sections of the Annual Report and Accounts. These include the business review, the corporate governance and remuneration reports and the Group financial statements and notes to those financial statements and accordingly these are incorporated into the report by reference.

#### Principal activities and review of business

The principal activities of the Group are the operation of a hotels and restaurants business and a coffee shop business. These operations are **largely (hedge)** carried out in the UK, although Premier Inn operates one hotel in Ireland, two hotels in India, one hotel in Abu Dhabi and three hotels in Dubai via a joint venture. Costa operates coffee shops in 25 overseas markets through joint ventures or on a franchise basis, and wholly owns coffee shops in Eastern Europe.

Details of the Group's activities, developments and performance for the year, the main trends and factors **likely (hedge)** to affect its future development and performance and information required by the Companies Act 2006 are set out on pages 2 to 21. Details of the Company's WINcard, containing the key performance indicators can be found on pages 8, 10, 14, 16 and 17.

#### Results and dividends

Subject to approval at the Annual General Meeting, the final dividend will be payable on 13 July 2012 to the **shareholders (EM)** on the register at the close of business on 18 May 2012.

#### Board of directors (SM)

The directors at the date of this report are listed on page 22. All except Susan Hooper and Susan Taylor Martin served throughout the year. Susan Hooper joined the Board on 1 September 2011 and Susan Taylor Martin joined on 1 January 2012.

Details of the executive directors' service contracts are given in the remuneration report on page 41. None of the non-executive directors has a service contract.

Details of directors' training are given in the corporate governance report on page 30.

#### Powers of directors

The business of the Company is managed by the directors who may exercise all the powers of the Company, subject to the Company's Articles of Association, any relevant legislation and any directions given by the Company by passing a special resolution at a general meeting. In particular, the directors may exercise all the powers of the Company to borrow money, issue shares, appoint and remove directors and recommend and declare dividends.

#### Appointment and replacement of directors

Directors shall be no less than two and no more than 20 in number. Directors may be appointed by the Company by ordinary resolution or by the **Board of directors (SM)**.

In accordance with the UK Corporate Governance Code 2010 it has been decided that all directors will stand for annual re-election at each AGM.

The Company may by special resolution remove any director before the expiration of his or her term of office.

Directors automatically stop being a director if:

- they give the Company a written notice of resignation;
- they give the Company a written notice in which they offer to resign and the other directors decide to accept the offer;
- all of the other directors (who must comprise at least three people) pass a resolution or sign a written notice requiring the director to resign;
- they are or have been suffering from mental or physical ill health and the directors pass a resolution removing the director from office;
- they have missed directors' meetings (whether or not an alternate director appointed attends those meetings) for a continuous period of six months without permission from the directors and the directors pass a resolution removing the director from office;
- a bankruptcy order is made against them or they make any arrangement or composition with their creditors generally;
- they are prohibited from being a director under any applicable legislation; or
- they cease to be a director under any applicable legislation or are removed from office under the Company's Articles of Association.

#### Directors' indemnity

A qualifying third-party indemnity provision (as defined in Section 236 (1) of the Companies Act 2006) is in force for the benefit of the directors.

#### Compensation for loss of office

There are no agreements between the Company and its directors or employees providing for compensation for loss of office or employment that occurs as a result of a takeover bid.

#### Directors' share interests

Further details regarding the interests of the directors in the share capital of the Company, including with respect to options to acquire ordinary shares, are set out in the remuneration report. There has been no change to the interests shown above between the end of the financial year and the date of this report.

#### Share capital

Details of the issued share capital can be found in note 28 to the accounts.

Holders of ordinary shares are entitled to attend and speak at general meetings of the Company, to appoint one or more proxies and, if they are corporations, corporate representatives to attend general meetings and to exercise voting rights. Holders of ordinary shares may receive a dividend and on a liquidation may share in the assets of the Company. Holders of ordinary shares are entitled to receive the Company's annual report and accounts. Subject to meeting certain thresholds, holders of ordinary shares may requisition a general meeting of the Company or the proposal of resolutions at annual general meetings.

#### Voting rights

On a show of hands at a general meeting of the Company, every holder of ordinary shares present, in person or by proxy, and entitled to vote, has one vote (unless the proxy is appointed by more than one member in which case the proxy has one vote for and one vote against if the proxy has been instructed by one or more members to vote for the resolution and by one or more members to vote against the resolution) and on a poll every member present in person or by proxy and entitled to vote has one vote for every ordinary share held. Voting rights for any ordinary shares held in treasury are suspended. None of the ordinary shares carry any special rights with regard to control of the Company. Electronic and paper proxy appointments and voting instructions must be received by the Company's registrars not later than (i) 48 hours before a meeting or adjourned meeting (excluding nonworking days), or (ii) 24 hours before a poll is taken, if the poll is not taken on the same day as the meeting or adjourned meeting.

Unless the directors decide otherwise, a **shareholder (EM)** cannot attend or vote at any general meeting of the Company or at any separate general meeting of the holders of any class of shares in the Company or upon a poll or exercise any other right conferred by membership in relation to general meetings or polls if he has not paid all amounts relating to those shares which are due at the time of the meeting.

Where a **shareholder (EM)** with at least a 0.25% interest in a class of shares has been served with a disclosure notice in relation to a particular holding of shares and has failed to provide the Company with information concerning those shares, those shares will no longer give that **shareholder (EM)** any right to vote at a **shareholders (EM)**' meeting.

#### Restrictions on transfer of shares

There are the following restrictions on the transfer of shares in the Company:

- certain restrictions which may from time to time be imposed by laws and regulations (for example, insider trading laws);
- pursuant to the Company's share dealing code, the directors and senior executives of the Company require approval to deal in the Company's shares;
- where a person with at least a 0.25% interest in a class of shares has been served with a disclosure notice and has failed to provide the Company with information concerning interests in those shares;
- the subscriber ordinary shares may not be transferred without the prior written consent of the directors;
- the directors can, without giving any reason, refuse to register the transfer of any shares which are not fully paid;
- transfers cannot be in favour of more than four joint holders; and
- the directors can refuse to register the transfer of an uncertificated share in the circumstances set out in the uncertificated securities rules (as defined in the Company's Articles of Association).

The Company is **not aware (hedge)** of any agreements between **shareholders (EM)** that may result in restrictions on the transfer of shares or on voting rights.

#### B shares and C shares

Holders of B shares and C shares are entitled to receive an annual non-cumulative preferential dividend calculated at a rate of 75% of 6 month LIBOR on a value of 155p per B share and 159p per C share respectively, but are not entitled to any further right of participation in the profits of the Company. They are also entitled to payment of 155p per B share and 159p per C share respectively on a return of capital on winding-up (excluding any intra-group reorganisation on a solvent basis).

Except in limited circumstances, the holders of the B shares and C shares are not entitled in their capacity as holders of such shares, to receive notice of any general meeting of the Company nor to attend, speak or vote at any such general meeting.

#### Purchase of own shares

The Company is authorised to purchase its own shares in the market. Approval to renew this authority will be sought from the **shareholders (EM)** at the 2012 AGM. The Company did not purchase any of its own shares during the year. 14.1 million shares (representing 7.35% of the total called up share capital at the beginning of the year) are held as treasury shares (3 March 2011: 14.3 million). During the course of the year, the Company transferred 143,000 shares from treasury to the Employee Share Ownership Trust for the future satisfaction of awards under the Long Term Incentive Plan.

#### Employee share schemes

Whitbread does not have any employee share scheme with shares which have rights with regard to the control of the Company that are not exercisable directly by the employees.

#### Major interests



As at the end of the financial year, the Company had received formal notification, under the Disclosure and Transparency Rules, of the following material holdings in its shares:

No changes to the above have been disclosed to the Company in accordance with rule 5 of the Disclosure and Transparency Rules between the end of the financial year and 25 April 2012.

#### Employment policies

Whitbread has a range of employment policies covering such issues as diversity, employee well-being and equal opportunities. The Company takes its responsibilities to the disabled seriously and seeks not to discriminate against current or prospective employees because of any disability. Full and **fair (AM)** consideration is given to applications for employment made by disabled persons, having regard to their aptitudes and abilities. Employees who become disabled during their career at Whitbread will be retained in employment wherever possible and given help with rehabilitation and training.

#### Employee involvement

The importance of good relations and communications with employees is fundamental to the continued success of **our (SM)** business. Each of the Group's operating businesses maintains employee relations and consults employees as **appropriate (AM)** to its own particular needs.

In addition, **our (SM)** employee opinion survey Your Say, is conducted twice a year to provide insight in to the views of employees. **Our (SM)** employees are actively encouraged to take part in **our (SM)** Sharesave scheme, which is available to all employees and offers an option price discounted by 20%. Regular internal communications are made to all employees to ensure that they are kept well informed of the performance of the Group and of financial and economic factors that may affect the Company's performance.

Further information on employee involvement can be found in the section 'Team engagement' on pages 9 to 11.

#### Amendment of the Company's Articles of Association

Any amendments to the Articles of Association of the Company may be made in accordance with the provisions of the Companies Act by way of special resolution.

#### Significant agreements

The Company's facility agreements and the private placement loan notes agreement, details of which can be found in note 22 to the accounts, contain provisions entitling the counterparties to exercise termination or other rights in the event of a change of control of the Company.

#### Contractual arrangements

The Group has contractual arrangements with numerous third parties in support of its business activities, none of which are considered individually to be **essential (AM)** to its business and accordingly, it has not been considered necessary for an understanding of the development, performance or position of the Group's business to disclose information about any of those third parties.

#### Financial instruments

Information on the Company's use of financial instruments, financial risk management objectives and policies and exposure is given in note 25 of the consolidated financial statements.

#### Supplier payment policy

The Company has no trade creditors (3 March 2011: nil). The Group has a standard term of 60 days in respect of payments to suppliers. Where this standard term does not apply, operating companies are responsible for agreeing terms and conditions for their business transactions when orders for goods and services are placed, so that suppliers are aware of the terms of payment and the relevant terms are included in contracts where appropriate. The Group keeps to the payment terms which have been agreed with suppliers.

Where payment terms have not been specifically agreed, it is the Group's policy to settle invoices close to the end of the month following the month of invoicing. The Group's ability to keep to these terms is dependent upon suppliers sending accurate and adequately detailed invoices to the correct address on a timely basis. The Group had 47 days' purchases outstanding at 1 March 2012 (3 March 2011: 48 days) based on the trade creditors at that date and purchases made during the year.

#### Charitable and political donations

No direct charitable donations have been made by the Company. Costa Limited, a subsidiary of the Company, made a direct donation of £368,014 to the Costa Foundation. Further details about the Costa Foundation can be found on pages 11 and 17. In addition, the Company organised and supported a number of charitable events and a number of its employees carried out charitable activities during working hours. The value of these activities has not been quantified.

More information on charitable activities can be found on page 17.

The Company has not made any political donations during the year and **intends (hedge)** to continue its policy of not doing so for the foreseeable future.

#### Auditor

Ernst & Young LLP have expressed their willingness to continue in office as auditor of the Company and a resolution proposing their re-appointment will be put to **shareholders (EM)** at the 2012 AGM. After proper consideration, the Audit Committee is **satisfied (hedge)** that the Company's auditor, Ernst & Young LLP, continues to be objective and independent of the Company. In coming to this conclusion, the Audit Committee gave full consideration to the non-audit work carried out by Ernst & Young LLP. The Audit Committee has considered what work should not be carried out by the external auditor and have concluded that certain services will not be carried out by Ernst & Young LLP.

#### Disclosure of information to auditor

The directors have taken all **reasonable (hedge)** steps to make themselves aware of relevant audit information and to **establish (booster)** that the auditor is aware of that information. The directors are **not aware (hedge)** of any relevant audit information which has not been disclosed to the auditor.

#### Going concern

The Group's business activities, together with the factors **likely (hedge)** to effect its future development, performance and position are set out in the business review on pages 2 to 21. The financial position of the Company, its cash flows, net debt and borrowing facilities and the maturity of those facilities are set out in the Finance Director's review on pages 18 and 19. In addition there are further details in the financial statements on the Group's financial risk management, objectives and policies (note 25) and details of the financial instruments (note 26).

A combination of the strong operating cash flows generated by the business and the significant headroom on its credit facilities support the directors' view that the Group has sufficient funds available for it to meet its foreseeable working capital requirements. The directors have concluded that the going concern basis remains appropriate.

#### Annual General Meeting

The AGM will be held at 2.00pm on 19 June 2012 at the Queen Elizabeth II Conference Centre, Broad Sanctuary, Westminster, London SW1P 3EE. The Notice of Meeting is enclosed with this report for **shareholders (EM)** receiving hard copy documents, and available at [www.whitbread.co.uk](http://www.whitbread.co.uk) for those who elected to receive documents electronically. At the 2012 AGM, all voting will be by poll. Electronic handsets will be utilised and results will be displayed on the screen at the meeting.

Approved by the Board on 25 April 2012 and signed.

Simon Barratt

General Counsel and Company Secretary

Registered Office:

Whitbread PLC

Whitbread Court

Houghton Hall Business Park

Porz Avenue

Dunstable

Bedfordshire

LU5 5XE

Registered in England: No. 4120344

The directors' report that has been drawn up and presented in accordance with and in reliance upon applicable English company law and any liability of the directors in connection with this report shall be subject to the limitations and restrictions provided by such law. The directors' report includes the business review on pages 2 to 21 and this report on pages 24 to 27.

The Annual Report and Accounts contain certain statements about the future outlook for the Group. Although the Company **believes (booster)** that the expectations are based on **reasonable (AM)** assumptions, any statements about future outlook may be influenced by factors that **could (hedge)** cause actual outcomes and results to be materially different.

## Corporate governance

Introduction from Anthony Habgood, Chairman

As **I (SM)** mentioned in my statement on page 3, **I (SM) believe (AM)** that corporate governance is not simply something for the Board to consider as an agenda item at **our (SM)** monthly meetings. For **me (SM)**, corporate governance is something that touches all aspects of **our (SM)** business and affects all of **our (SM)** employees in many different ways.

At an executive level this includes managers ensuring that decisions are taken by the right people in the Company in accordance with the schedule of matters reserved to the Board and other relevant policies. For **our (SM)** employees this includes having access to **our (SM)** whistleblowing system so that any potential problems can be raised in confidence through independent channels.

Although corporate governance flows through all of **our (SM)** operations, the Board takes responsibility for leading on high standards of accountability and ethical behaviours. During this year key governance activities have included:

- a review of the Company's compliance with the updated UK Corporate Governance Code which came into force for financial years commencing on or after 29 June 2010;
- an evaluation of the Board by an independent external consultant;
- a talent review and succession plan for key executive roles;
- a Nomination Committee review of the Board composition and completion of a recruitment process resulting in the appointment of two new non-executive directors; and
- the Audit Committee's review of the external and operational audits.

**I (SM)** am **proud (AM)** of **our (SM)** core commitment to high standards of governance as this is key to supporting **our (SM)** financial performance and protecting **your (EM)** Company. Simon Barratt **our (SM)** General Counsel and Company Secretary provides further details below on how Whitbread complied this year with corporate governance requirements.

Simon Barratt, General Counsel and Company Secretary

The new UK Corporate Governance Code ('CG Code') came into effect in 2010 and 2011/12 was the first financial year in which it was applicable to Whitbread.

This is the key source of guidance on corporate governance matters. In light of the CG Code, and as part of **our (SM)** commitment to high standards of governance, **we (SM)** undertook a thorough review of Whitbread's corporate governance arrangements including reviewing **our (SM)**:

- overall compliance with the CG Code with respect to business and corporate practices;
- matters reserved to the Board; and
- terms of reference for each of the three Board committees.

The results of this review were presented at the January Board meeting and formally adopted by the Board. During the year the Company complied with all provisions set out in the CG Code.

Details of how Whitbread has applied the main and supporting principles of the CG Code with regard to remuneration can be found in the remuneration report on pages 35 to 44. Details of the membership and activities of the Remuneration Committee can be found on page 37.

In addition to this, a new global code of conduct has been adopted to take into account the 2010 UK Bribery Act and has been briefed to employees.

The information below sets out Whitbread's compliance in the following areas:

- The Board;
- **Shareholder (EM)** relations;
- Internal control; and
- Board committees.

## The Board

### Who is on the **Board of directors (SM)? (EM)**

There are eleven members of the Board including the Chairman, Chief Executive and Senior Independent Director.

As announced in April 2012, Christopher Rogers will become Managing Director of Costa in August 2012. He will remain a director when he takes on his new role and, as the Board **intends (hedge)** to appoint a new Group Finance Director, it is **anticipated (hedge)** that the number of executive directors will increase at that time.

Details of each of the directors can be found by folding out page 23. In that section, **we (SM)** have provided information on the mix of skills and experience represented on the Board. The Board brings together individuals with a diverse range of experience and expertise, which contributes to a positive culture of mutual respect and constructive challenge.

### What were the key activities of the Board this year? **(EM)**

The Board holds meetings at monthly intervals during the year and on an ad hoc basis as and when required. During the year, 11 meetings were held. Attendance at meetings by directors is set out in the chart on page 34. A set of Board papers, including monthly financial and trading reports, is circulated in advance of each meeting so that directors have sufficient time to review them and arrive at the meeting fully prepared.

At each meeting, the Board starts with a review of the minutes from the previous meeting, matters arising and progress on action points. This is followed by reports from the Chief Executive and the Finance Director describing the operational and functional performance. Reports from specific parts of the business and new business opportunities are presented before a review of the secretariat report which sets out any updates on best practice and corporate legislation.

The Board has a rolling agenda which sets out matters to be considered throughout the year. This allows all directors to contribute to the setting of the agenda. Having a rolling agenda **ensures (booster)** that there is a structured approach to the consideration of recurring issues with such items being evenly spread across the calendar. This facilitates **good (AM)** management of the agenda providing sufficient time for the Board to discuss ad hoc items that arise during the year without any loss of focus on standing items. The rolling agenda is structured such that the Board gives its attention to each area of the business in turn so that a strong understanding of the entire Company is maintained.

This year, the Board has considered a range of matters, details of which can be found on page 23.

There is a schedule of matters reserved exclusively to the Board. These matters include:

- approval of Group financial statements and the preliminary announcement of half and full year results;
- changes relating to the Group's capital structure;
- the annual budget and the Group's business plan;
- approving acquisitions and disposals over a certain threshold value;

- interim dividends and recommendation of final dividends;
- establishment of Board committees, terms of reference and membership of Board committees; and
- maintaining sound risk management and internal control systems.

The schedule of matters reserved was reviewed at the January 2012 Board meeting and was updated to take account of best practice guidelines. The full schedule of matters reserved to the Board is available on **our (SM)** website.

#### How and why did the Board appoint new non-executive directors this year? (EM)

This year, a routine review of Board composition led to the conclusion that two new non-executive directors could enhance **the board's (SM)** performance. The starting point for this review was for the Nomination Committee to determine the additional skills and experience necessary. This was then compared with the range of expertise of current Board members to identify any areas which required increased representation. The Committee then prepared a description of the capabilities required.

The Committee recommended that the Board could be strengthened with the appointment of candidates with experience of finance, hospitality, consumer-branding, digital media and international businesses. An external search consultancy, Spencer Stuart, was engaged and a number of candidates were identified. Selected candidates met with the Nomination Committee. Further discussion by the Committee led to a recommendation to the Board for the appointment of Susan Hooper and Susan Taylor Martin.

#### How does the Board keep up to date with new developments? (EM)

A monthly report, prepared by the Company Secretary, is presented at each Board meeting. This report provides updates on corporate legislation and best practice on matters including corporate governance.

Formal training events were attended by Board members during the year on a range of issues including:

workshops on cyber security, managing risk and corporate governance. Investor relations and market updates were also considered by the Board.

All directors have access to independent professional advice at the Company's expense. Directors serving on Board committees confirmed they are **satisfied (AM)** that they receive sufficient resources to enable them to undertake their duties effectively. Each director has access to the Company Secretary for advice on governance.

#### How does the Board identify and consider directors' conflicts of interest? (EM)

A formal process is undertaken each year in February when each director discloses to the Board details of their external interests including any other directorships which they hold. The list of interests is assessed by the Board to determine whether the director's ability to act in the best interests of the Company could be compromised. If there are no such potential or actual conflicts, the external interests are authorised by the Board. All authorisations are for a period of 12 months. No director is counted as part of a quorum in respect of the authorisation of his or her own conflict situation. It is recognised that all organisations are potential customers of Whitbread and, in view of this, the Board has authorised all directors' current external directorships.

#### Case study with Susan Taylor Martin

##### Induction process

The induction process was tailored for Susan and focused on Whitbread's businesses. Initial meetings were held with the Chairman, Chief Executive, the Group HR Director, the Finance Director and the Company Secretary, followed by time with:

- the Managing Director of Hotels & Restaurants, visiting Premier Inn sites;
- the Managing Director of Restaurants, visiting sites for each of the restaurant brands;
- the Managing Director of Costa, visiting Costa outlets; and
- the Group's lawyers and brokers.

Training and development goes well beyond the induction process and is an ongoing process for all Board members. Further training opportunities will be offered to Susan depending on her needs. The Chairman facilitates training for all Directors in this way to ensure that the Board is able to perform at an optimum level.

#### How is the independence of directors assessed? (EM)

The Board has a majority of independent non-executive directors. Independence is assessed annually against the CG Code. None of the provisions listed in the CG Code which may compromise independence apply to any of Whitbread's non-executive directors.

Does the Company have appropriate insurance cover in respect of legal action against its directors? **(EM)**

The Company has appropriate directors & officers liability insurance in place. In addition to this, the Company provides an indemnity for directors against the costs of defending certain legal proceedings. These are reviewed periodically.

What are each of the Board members responsible for? <b>(EM)</b>		
All Board members have responsibilities in the areas of strategy, performance, risk and people. Specific duties of the Chairman, Chief Executive and Senior Independent Director are set out below:		
Chairman	Chief Executive	Senior Independent Director
<ul style="list-style-type: none"> <li>• leadership of the Board and setting its agenda including approval of the Group's strategy, business plans, annual budget and key areas of business importance;</li> <li>• ensuring, through the General Counsel, that the members of the Board receive accurate, timely and clear information;</li> <li>• ensuring a culture of openness and debate around the Board table;</li> <li>• ensuring that Board members understand the views of major investors; and</li> <li>• leading the annual evaluation of the Board, the committees and individual directors.</li> </ul>	<ul style="list-style-type: none"> <li>• optimising the performance of the Company;</li> <li>• ensuring effective communication with <b>shareholders (EM)</b> and employees;</li> <li>• the creation of <b>shareholder (EM)</b> value by delivering profitable growth and a good return on capital;</li> <li>• ensuring the Company has a strong team of high-calibre executives, and putting in place appropriate management succession and development plans; and</li> <li>• leading the activities of the Whitbread Leadership Forum – a group of the Company's most senior executives.</li> </ul>	<ul style="list-style-type: none"> <li>• being available to <b>shareholders (EM)</b> if they have concerns which the normal channels have failed to resolve or which <b>would (hedge)</b> be inappropriate to raise with the Chairman or the executive team;</li> <li>• supporting the Chairman in the delivery of his objectives;</li> <li>• providing a sounding board for the Chairman;</li> <li>• being available to serve as an intermediary for the other directors if necessary; and</li> <li>• leading the evaluation of the Chairman on behalf of the other directors.</li> </ul>

How is performance evaluated? **(EM)**

Board and committees:

There were three aspects to this year's evaluation:

- as in previous years, each director completed a formal questionnaire on the performance of the Board and each of the Board committees;
- the Chairman also met or spoke to all directors on a one-to-one basis; and
- an external evaluation of the Board was facilitated this year by Lorna Parker, an independent consultant and former Managing Director and Partner of Spencer Stuart. As part of this review, Lorna met each of the directors, the Company Secretary and the Group HR Director to discuss the effectiveness of the Board and its processes.

The outcome of the review was discussed with the Chairman and Senior Independent Director and then as an agenda item at the Board meeting in March 2012, which was attended by Lorna Parker. The review concluded that there is "an open, supportive, cohesive but challenging and disciplined culture within the board room." All the directors expressed a high degree of satisfaction with their experience on the Board.

Suggestions for improvement included:

- the introduction of a formal annual update from the Company Secretary and auditors on legal or regulatory issues directly affecting the Company;
- holding meetings at Company sites when there are new concepts/developments; and
- holding the planning and review meeting for the Nomination Committee in March each year when confirming the recommendation for re-election of directors.

Individual directors:

The Chairman has one-to-one meetings with each director to discuss their performance.

Chairman:

Every year the Senior Independent Director meets with the non-executive directors without the Chairman present to discuss the performance of the Chairman. The Senior Independent Director also speaks with the executive directors to gain their views before discussing the results of the evaluation with the Chairman.

## Shareholder (EM) relations

### How does the Company interact with **shareholders (EM)**? (EM)

<p><b>All shareholders (EM)</b></p> <p>The Company communicates with both institutional and private <b>shareholders (EM)</b> through the following means:</p> <ul style="list-style-type: none"> <li>• the Company's website (www.whitbread.co.uk), where information and news is regularly updated;</li> <li>• the Annual Report, which sets out details of the Company's operations and performance over the past financial year and plans for future growth;</li> <li>• the Annual General Meeting, where all <b>shareholders (EM)</b> have the opportunity to vote on the resolutions proposed and to put questions to the executive team; and</li> <li>• presentations of full and half-year results to analysts and <b>shareholders (EM)</b>.</li> </ul> <p>In addition, all <b>shareholders (EM)</b> are able to contact the Company by email, telephone or post to raise issues. The Company also takes opportunities to interact more directly with institutional and private <b>shareholders (EM)</b>.</p> <p>During 2011/12 this included the following:</p>	
<p><b>Institutional shareholders (EM)</b></p> <ul style="list-style-type: none"> <li>• the Chief Executive and Group Finance Director held meetings with institutional investors following the full year and interim results;</li> <li>• the Board received regular updates on the views of major <b>shareholders (EM)</b> from the Company's stockbrokers and independent researchers;</li> <li>• an 'Investor Day' was organised by Costa; and</li> <li>• a consultation was held with major <b>shareholders (EM)</b> on the proposed amendments to the LTIP (Long Term Incentive Plan) scheme.</li> </ul>	<p><b>Private shareholders (EM)</b></p> <ul style="list-style-type: none"> <li>• live webcast presentations of the annual and interim results;</li> <li>• electronic communications with <b>shareholders (EM)</b> including use of the online share portal; and</li> <li>• executives presented to members of the UK <b>Shareholders (EM)</b> Association.</li> </ul>

### How are **shareholders (EM)** able to participate in the AGM? (EM)

The Notice of AGM and related papers are sent to all **shareholders (EM)** at least 20 working days before the meeting. The Company proposes a separate resolution on each substantially separate issue including a specific resolution to approve the report and accounts. For each resolution, proxy appointment forms provide **shareholders (EM)** with the option to vote in advance of the AGM if they are unable to attend in person. All valid proxy votes received for the AGM are properly recorded and counted by Whitbread's registrars.

As in previous years, all voting by **shareholders (EM)** will be by poll using electronic handsets. The voting results, including proxy votes received, will be displayed on a screen at the meeting. In addition, the audited poll results will be disclosed on the Company's website following the meeting, and announced through the regulatory news service.

The information that is required by DTR 7.2.6, relating to the share capital of the Company can be found within the directors' report on pages 25 and 26.

## Internal Control

### How does the Company maintain adequate systems of internal control? (EM)

The Board is responsible for the Group's systems of internal control and risk management, and for reviewing their effectiveness. These systems are designed to manage rather than eliminate risk of failure to achieve business objectives. They can only provide **reasonable (hedge)**, and not absolute, assurance against material misstatement or loss.

The Board has established an ongoing process for identifying, evaluating and managing the Group's significant risks. This process was in place throughout the 2011/12 financial year and up to the date of this report. The process is regularly reviewed by the Board and accords with the internal control guidance for directors in the CG Code. A report of the key risks can be found on pages 20 and 21.

Key elements of the Group's risk management and internal control system include:

- the formulation, evaluation and annual approval by the Board of business plans and budgets. Actual results are reported monthly against budget and the previous year's figures. Key risks are identified and action plans prepared accordingly;

- the production by each business of a risks and controls matrix, covering major risks and plans which are considered regularly by the management boards and form the basis of the Group risks matrix considered by the Audit Committee;
- a regular review by the Board of changes in the major risks facing the Group and development of appropriate action plans;
- the consideration of risks and appropriate action plans, when appraising and approving all major capital and revenue projects and change programmes. A post completion review of each major project is undertaken;
- financial policies, controls and procedures manuals, which are regularly reviewed and updated;
- the limits of authority, which are prescribed for employees. Whitbread's organisational structure allows the appropriate segregation of tasks;
- the code of conduct, which is communicated to employees;
- the PwC operational audit team activity, which reports on the effectiveness of operational and financial controls across the Group; and
- the Audit Committee regularly reviews the major findings from both operational and external audit.

Management and specialists within the finance department are responsible for ensuring the appropriate maintenance of financial records and processes that ensure all financial information is relevant, reliable, in accordance with the applicable laws and regulations, and distributed both internally and externally in a timely manner. A review of the consolidation and financial statements is completed by management to ensure that the financial position and results of the Group are **appropriately (AM)** reflected. All financial information published by the Group is subject to the approval of the Audit Committee.

The Board assesses the appropriate areas of risk upon which assurance **should (EM)** be sought. The Committee approves a rolling audit programme, ensuring that all significant areas of the business are independently reviewed within at least a three-year period. The programme and findings of the reviews are continually assessed to ensure they take account of the latest information and, in particular, the results of the annual review of internal controls. The effectiveness of the operational audit team is reviewed annually by the Audit Committee. The Audit Committee considers the principal risks identified by the risk management process which are also considered by the Board and the management boards throughout the year.

An annual review of internal controls is undertaken by the Board with the assistance of the Audit Committee, which reports to the March Board meeting.

#### Going concern

The directors' going concern statement can be found in the directors' report on page 27.

#### Business model and strategy

Information on the Group's business model and strategy can be found in the business review on pages 2 to 21.

#### Board Committees

The Board is supported by three committees, the Audit Committee, the Nomination Committee and the Remuneration Committee. The terms of reference for each committee are reviewed annually and updated in line with best practice. They are available in full on the Company's website.

A detailed report from the Chairman of the Remuneration Committee is set out on pages 35 to 44. Summary reports for the Audit and Nomination Committees can be found on page 33 and 34 respectively, followed by details of directors' attendance at meetings during this financial year.

#### Audit Committee report

Members of the Audit Committee	<p>Simon Melliss (Chairman)</p> <p>Richard Baker</p> <p>Wendy Becker</p> <p>Susan Hooper</p> <p>Susan Taylor Martin</p> <p>Simon Barratt (Secretary)</p> <p>All members of the Committee are independent non-executive directors.</p> <p>The Board regards Simon Melliss, with his previous experience as Finance Director at Hammerson plc, to have recent and relevant financial experience as required by the CG Code.</p>
Key duties (Full terms of reference)	<p>Monitor, review and report to the Board on the:</p> <ul style="list-style-type: none"> <li>• financial statements, risk management system and internal controls; and</li> <li>• objectivity and effectiveness of the operational auditors and the external auditor.</li> </ul>



are available on the Company's website)	Manage the engagement and review of performance of the external auditor including approval of their remuneration. Hold meetings with external and operational auditors without management being present. Assist the Board in fulfilling its corporate governance and oversight responsibilities. Develop policy on the supply of non-audit services by the external auditor. Review the adequacy and security of the Company's whistleblowing facilities. Review the Company's systems and controls for the prevention of bribery.
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#### Audit Committee agenda – 2011/12

Quarter 1	Review of effectiveness of internal controls Review of risk matrix Agreed scope of operational audit Review of year end items including draft accounts and an update on tax matters Review of whistleblowing incidents Approval of Audit Committee terms of reference Review of 2010/11 financial statements and auditor's report Operational audit report on year-end processes Meeting of Committee with external auditor without executive directors present
Quarter 3	Approval of interim results for 2011/12 Interim review of external auditor including review of audit planning report Interim review of operational audit Tax update Meeting of Committee with auditor without executive directors present
A statement relating to non-audit work carried out by the auditor is included in the directors' report on page 27.	

#### Nomination Committee report

Members of the Nomination Committee	Anthony Habgood (Chairman) Ian Cheshire Simon Melliss Stephen Williams Simon Barratt (Secretary)
Key duties (Full terms of reference are available on the Company's website)	Review the size, structure and composition of the Board and its committees Manage the selection and appointment process for new directors to be recommended to the Board Agree the recommendation for re-election of directors at the AGM

#### Nomination Committee agenda – 2011/12

Quarter 1	Commenced appointment process for two new non-executive directors Review of committee membership Review of terms of reference Review of directors for re-election at the AGM
Quarter 2	Final decision on the appointment of two new non-executive directors

#### How does the Company approach the annual re-election of directors? (EM)

As required by the CG Code, all directors will be subject to re-election at the next AGM. The Nomination Committee has reviewed the contribution and commitment of each member of the Board and has recommended their re-appointment at this year's AGM.

Details setting out why each director is deemed to be suitable for re-appointment will be included with the AGM papers circulated to all **shareholders (EM)**.

None of the non-executive directors has been a director for a term longer than six years. If any nonexecutive director was to serve for more than six years, the Nomination Committee's policy **would (hedge)** be to scrutinise their role more closely before recommending re-appointment to ensure that the Board remains fresh and dynamic.

In accordance with the CG Code, none of the executive directors has more than one non-executive directorship in a FTSE-100 company or a chairmanship of a FTSE- 100 company.

## Remuneration report

Parts of this report have been audited and these are clearly marked as 'audited information'.

### Introduction from Ian Cheshire

This was my first full year as Chairman of the Remuneration Committee. In this report, **you (EM)** will see that **we (SM)** have taken the opportunity to re-define Whitbread's remuneration principles. In doing so **we (SM)** aimed to ensure that remuneration arrangements are aligned with and support the delivery of the Group's business strategy and **shareholder (EM)** value creation.

The Whitbread strategy, which is to invest in growing its leading brands, Premier Inn and Costa, has stretching targets which if delivered successfully will create significant value for **our (SM) shareholders (EM)**. The Committee **believes (booster)** that the executive team **should (EM)** be rewarded for the achievement of the strategy and therefore incentives **should (EM)** be clearly aligned to delivering earnings growth and returns above **our (SM)** cost of capital. To this end, amendments to the Long Term Incentive Plan (LTIP) have been proposed and are outlined later in this report.

The WINcard is a key element of **our (SM)** remuneration structure. It is designed to ensure that executives are incentivised on both non-financial and financial measures. The customer heartbeat schematic, which is described on page 8 shows how **we (SM) intend (hedge)** to deliver **our (SM)** strategic aims by providing a great place to work for **our (SM)** people, so that they care for **our (SM)** customers and provide them with an experience that will make them come back time and time again. The diagram below shows how measures driving remuneration are linked to this model:

### 2011/12 highlights

#### Performance in 2011/12

The Group had another **successful (AM)** year, with sales growth of 11.2% and pre-tax profits up 11.3%. This profit growth, combined with **good (AM)** return on capital, produced an operating cash inflow which funded reinvestment of £307.9 million in maintaining **our (EM)** estate and the proposed growth in the dividend.

Despite achieving double-digit profit growth, at Group level **we (SM)** did not quite reach **our (SM)** profit target for the year.

On the WINcard measures, which are outlined on page 39 **we (SM)** achieved four green scores, one amber score and one red score. **You (EM)** also will see on page 39 that the combination of these results has led to reduced bonus awards to the executive directors under the Annual Incentive Scheme when compared to the prior year.

The performance conditions for the 2009 Long Term Incentive Plan were met in full. There were two independently operating conditions each relating to half of the total award. Whitbread achieved top quartile TSR performance against its comparator group over the last three years, which was a very **good (AM)** result. The 2011/12 EPS target required for full vesting was set, at a time of great economic uncertainty, at 107p. The actual EPS achieved was 134.35p. This represents growth of RPI +9.6% per annum, which is an **excellent (AM)** result in turbulent economic times.

#### Remuneration principles review

During the course of 2011, the Remuneration Committee undertook a review of Whitbread's approach to senior executive remuneration to ensure that the remuneration arrangements were aligned with and supported the delivery of the Group's current business strategy and **shareholder (EM)** value creation. Updated remuneration principles were agreed and details can be found on page 38.

As part of the review it was agreed that the LTIP scheme **should (EM)** be adapted so that it would be more closely aligned to the Group's strategic aims. After consulting with the top 20 **shareholders (EM)**, as well as with the ABI and RREV, **we (SM) intend**

**(hedge)** to seek approval for changes to the LTIP at the AGM in June 2012, with awards being made under the amended plan soon after the AGM rather than in April under the current arrangements.

#### Clawback

The rules of the Annual Incentive Scheme were amended in November 2011 to allow the Committee, in the exceptional circumstances of a material misstatement of the results on which an award was based, to adjust unvested share awards.

#### 2012 salary review

When reviewing the salaries of the executive directors **we (SM)** take into account a range of factors including changes to salaries across the Group, the personal performance of the director measured against agreed objectives, current trading circumstances and market data.

The general level of salary increases across Whitbread in May 2012 will be 2.25%. In a year when levels of inflation are **expected (hedge)** to produce budgetary pressure it was decided that a lower increase of 1.5% for members of the Whitbread Directors' Forum (the top 40 executives) **would (hedge)** be appropriate. As members of the Whitbread Directors' Forum, the executive directors are eligible for an increase of 1.5%. However, Andy Harrison and Christopher Rogers confirmed to the Committee that they did not wish to receive a salary increase in 2012, so their salaries will be the same as those reported last year.

The basic salaries of the executive directors with effect from 1 May 2012 will be:

#### Total remuneration received by executive directors

The following table shows the total amount of remuneration received by each of the executive directors in 2011/12. This includes their salary and bonus (cash bonus applicable to the 2011/12 financial year and to be paid in May 2012), any cash paid in lieu of pension or other benefits and an amount representing the vesting of any share awards during the year. For deferred equity awarded under the Annual Incentive Scheme in 2009 this is the actual gain made at the point of vesting on 1 March 2012. For the 2009 LTIP this is based on the share price at the close of business on 1 March 2012 as the awards will not become exercisable until after the date of this report. The table does not include share awards made during the year, which are due to vest in 2015.

#### Christopher Rogers – new role

As announced earlier this month, Christopher Rogers will become Managing Director of Costa with effect from 1 August 2012. The Committee considered how this change **would (hedge)** impact his remuneration package and agreed that:

- his basic salary will remain unchanged as a result of the change of role;
- the quantum available to him under the Annual Incentive Scheme will be unchanged at 167% of salary, but that the WINcard element will be based on the Costa WINcard results and the profit element will be based on a 50:50 split between Costa PBIT and Group underlying profit; and
- the level of his LTIP award will remain unchanged at 125%.

The changes to the method of calculating awards due under the Annual Incentive Scheme will be made at the half year, with Group performance still being used as the measure in the first half of the year.

#### Remuneration Committee – membership, key duties and advisers

Members of the Remuneration Committee	Ian Cheshire (Chairman) Richard Baker Wendy Becker Anthony Habgood Stephen Williams Simon Barratt (Secretary)
Key duties (Full terms of reference are available on the Company's website)	Set the broad policy for the remuneration of the Chairman and the executive directors; Within the terms of the agreed policy, to determine the total individual remuneration package (including bonuses, incentive payments, share awards and other benefits) of the Chairman and each executive director; Monitor the structure and level of remuneration of executive committee members; Approve the design of and determine the targets for incentive schemes;

	Approve awards to be made to executive directors and other senior executives under incentive schemes; and Ensure that contractual terms on termination, and any payments made, are fair to the individual and the Company, that failure is not rewarded and that the duty to mitigate loss is fully recognised.
Internal advisers	Simon Barratt – General Counsel Louise Smalley – Group HR Director
External advisers	Towers Watson – Remuneration Consultants (appointed by the Committee; a separate part of Towers Watson provides accounting services in relation to the pension fund.) Slaughter and May – Legal Advisers (they also provide legal services to the Company.)

#### Remuneration Committee agenda – 2011/12

Quarter 1	Approval of 2011 LTIP awards and performance conditions. Approval of matching award, as agreed on his appointment, for Andy Harrison. Approval of 2011/12 WINcard incentive targets. Approval of awards of cash and deferred equity to executive directors under the Annual Incentive Scheme. Executive directors' salary review. Confirmation of the vesting percentages for the LTIP awards made in 2008 and vesting in 2011. Approval of updated terms of reference Approval of new rules for the Sharesave Scheme, subject to <b>shareholder (EM)</b> approval at the AGM. Noting of the salary review and incentive payments to executives below Board level.
Quarter 2	Discussion about the terms of the planned remuneration review. Review of the Chairman's fee.
Quarter 3	Approval of senior executive remuneration principles, including the introduction of clawback provisions in the Annual Incentive Scheme. Changes to the performance conditions for future LTIP awards, subject to <b>shareholder (EM)</b> approval at the AGM. Adjustments to the 2011/12 incentive targets to reflect changes to the business during the year, including the acquisition of Coffee Nation.
Quarter 4	Approval of a letter to the 20 largest <b>shareholders (EM)</b> , the ABI and RREV to request views on the proposal to amend the LTIP performance conditions. Consideration of responses to the <b>shareholder (EM)</b> consultation on proposed amendments to the LTIP performance conditions. Proposed incentive framework for the 2012/13 Annual Incentive Scheme.

#### Remuneration principles and structure for 2012/13

In November 2011, the Committee approved the following remuneration principles:

##### Overall Remuneration Principles

**Our (SM)** approach to senior executive remuneration is designed to:

- provide an appropriate balance between remuneration elements that attract, retain and motivate the right calibre of executive talent;
- be aligned to the business strategy and the achievement of planned business goals;
- encourage a high-performance culture by ensuring performance-related remuneration constitutes a substantial proportion of the remuneration package and by linking maximum payout opportunity to outstanding results; and
- support the creation of sustainable long-term **shareholder (EM)** value.

The table below outlines the principles behind each key element of remuneration, the opportunity for each director in the year ahead and a brief summary of how it works. A more detailed explanation of how the incentive schemes work can be found on pages 39 and 40.

	Principles	How it works	2012/13 potential remuneration
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Base salary	<ul style="list-style-type: none"> <li>• Sufficient to attract and retain the highest calibre executive talent needed to support the long-term interests of the business; and</li> <li>• Periodically reviewed taking into account the organisation's annual review process, business performance, appropriate market data and an individual's contribution to the Group.</li> </ul>	<p>Salaries are reviewed annually taking account of:</p> <ul style="list-style-type: none"> <li>• changes to salaries across the Group;</li> <li>• trading circumstances;</li> <li>• personal performance against agreed objectives; and</li> <li>• benchmarking data against the FTSE 51-150.</li> </ul>	<ul style="list-style-type: none"> <li>• Patrick Dempsey £426,300</li> <li>• Andy Harrison £717,500</li> <li>• Christopher Rogers £504,700</li> </ul>
Annual Incentive Scheme	<ul style="list-style-type: none"> <li>• To provide a direct link between annual performance and reward;</li> <li>• To incentivise the achievement of outstanding results across appropriate key <b>stakeholder (EM)</b> measures;</li> <li>• To use a consistent profit incentive range which will only be altered for a new incentive year in exceptional circumstances; and</li> <li>• To align with the long-term interests of <b>shareholders (EM)</b> and help participants build a significant stake in the business over time, by awarding a material part of the annual bonus in deferred equity.</li> </ul>	<ul style="list-style-type: none"> <li>• Targets for both financial and non-financial measures set at the beginning of the bonus year;</li> <li>• Cash awards paid in May following the end of the financial year;</li> <li>• Deferred shares awarded and, under normal circumstances, released three years after the date of award; and</li> <li>• Clawback provisions apply to unvested deferred shares in the event of a material misstatement of results.</li> </ul>	<ul style="list-style-type: none"> <li>• On-target performance: 80% of salary (38.5% paid in cash, 41.5% paid in deferred shares)</li> <li>• At stretch performance: 167% of salary (79% paid in cash, 88% paid in deferred shares)</li> </ul>
Long Term Incentive Plan	<ul style="list-style-type: none"> <li>• To closely align the interests of senior executives with sustainable long-term <b>shareholder (EM)</b> value creation;</li> <li>• To focus rewards on both the sustained delivery of absolute long-term earnings growth and the efficient use of capital over the long-term; and</li> <li>• To retain executives over the three-year performance period of the awards.</li> </ul>	<ul style="list-style-type: none"> <li>• Awards made annually;</li> <li>• Awards vest after three years subject to performance conditions;</li> <li>• 75% of award based on EPS growth, subject to a ROCE hurdle*; and</li> <li>• ROCE also acts as a multiplier on a straight-line sliding scale to increase the EPS element by up to a further third.*</li> </ul>	<ul style="list-style-type: none"> <li>• Patrick Dempsey: 100% of salary;</li> <li>• Andy Harrison: 125% of salary; and</li> <li>• Christopher Rogers: 125% of salary.</li> </ul>
*Subject to approval at the AGM			

#### Annual Incentive Scheme

The Annual Incentive Scheme is the Company's annual bonus scheme, which applies to **around (hedge)** 76 executives. The scheme has been designed to incentivise outstanding performance across a number of key **stakeholder (EM)** measures and it rewards executives with both a cash payment and an award of deferred shares. The scheme operates over a four-year period as outlined at the foot of the page.

There are two elements to the scheme. There is a profit measure and there are a number of WINcard measures, as shown below, which are subject to a health and safety hurdle. The scheme is designed to incentivise executives to deliver great results by providing an excellent environment for **our (SM)** people, in which they in turn can make everyday experiences feel special for **our (SM)** customers. The team engagement and guest heartbeat scores are up-weighted to reflect the importance of those elements to

Whitbread's success. Further information on the WINcard targets can be found earlier in this report on pages 8 to 17. For executive directors, awards will be calculated as follows at the end of 2012/13:

The following graph shows the percentage of salary received at different levels of profit performance as well as the split between cash and deferred equity in respect of the profit element.

For the WINcard element 80% of any awards are made in cash with the remaining 20% in deferred equity.

Awards for 2011/12

For 2012, Andy Harrison and Christopher Rogers received 76.1% of salary and Patrick Dempsey received 60.5% of salary under the Annual Incentive Scheme.

These awards were split between cash and deferred shares as follows:

For Andy Harrison and Christopher Rogers, incentive awards were based on Group performance. As the profit target was not quite met they each received 53.6% of salary split between cash and deferred equity based on the profit element. They also received 22.5% of salary based on the WINcard measures, with four green scores, one amber score and one red score.

Patrick Dempsey's awards were based on a combination of Group and Whitbread Hotels & Restaurants targets. He received 38% of salary based on the profit element and 22.5% based on the WINcard element.

Long Term Incentive Plan (LTIP)

While the Annual Incentive Scheme rewards sustainable performance in the prior year and a long-term commitment to the Company, the LTIP is all about the future. **Approximately (hedge)** 40 executives are invited to participate in the LTIP.

Executives receive an annual grant of shares under the LTIP, based on a percentage of their salary, which will then vest three years later in the event that performance conditions are met over the three-year period. In 2011, the awards made were subject to an EPS performance condition for half of the award and a Total **Shareholder (EM)** Return (TSR) condition for the other half as described on page 44.

Proposed changes to the LTIP

The Committee has agreed that it **would (hedge)** be appropriate to make changes to the LTIP for future awards in order to align them more closely with the Company's strategic aims (as shown at the foot of this page). The proposed changes, which are subject to approval at the AGM are as follows:

- Independently operating EPS (underlying basic EPS) and TSR measures **would (hedge)** be replaced by EPS and ROCE measures operating on a matrix basis;
- the ROCE measure **would (hedge)** operate as both a hurdle and a multiplier to a base award generated by performance against the EPS measure;
- up to 75% of the award **would (hedge)** be dependent on EPS growth over the three-year performance period subject to a satisfactory return on capital performance;
- ROCE **would (hedge)** be used as a multiplier on a straight-line sliding scale basis to increase the EPS element by up to a further third;
- no element of the award **would (hedge)** vest if a minimum threshold level of ROCE in 2014/15 (final year of the 2012 award) of 12% is not achieved; and
- the Committee will have the discretion to reduce the vesting of awards if it believes that performance has not been sufficiently value-enhancing during the period.

**We (SM) believe (booster)** it is the combination of the two measures that will incentivise executives to deliver on the stretching growth plans and create significant long-term **shareholder (EM)** value. No changes to the quantum of awards is proposed.

## Proposed awards for 2012

If the proposals are approved at the AGM, grants to senior executives, including the executive directors, will be made shortly after the meeting.

The matrix at the top of the page shows the potential vesting under the proposed 2012 LTIP awards based on the new approach:

It is **intended (hedge)** that Patrick Dempsey **would (hedge)** receive an award to the value of 100% of his salary, with Andy Harrison and Christopher Rogers receiving awards to the value of 125% of their salaries.

## Awards vesting in 2012

The LTIP awards made to executives in 2009 were subject to independently operating performance conditions as set out in the table, which also outlines the outcome:

As a result, 100% of the shares awarded under the 2009 LTIP have vested. The awards vesting to the executive directors are as follows:

Link between strategy and LTIP reward	
Strategy	LTIP reward
Whitbread's strategy is to invest in growing its leading brands, Premier Inn and Costa. Last year <b>we (SM)</b> set milestones for the next five years which will take Premier Inn to at least 65,000 rooms and double the size of Costa to 3,500 stores. This will involve substantial capital commitment as <b>we (SM)</b> continue to grow in the UK and develop in <b>our (SM)</b> international markets.	To reward executives for those elements of performance responsible for the achievement of the strategy and therefore clearly realign incentives towards delivering earnings growth and strong returns on capital. There are no proposals to change the ongoing award levels of the plan which are currently set at a maximum of 125% of salary for executive directors. Details of the changes can be found above.

## Other information relating to executive directors

### Pension

In addition to the main elements of the remuneration package shown on page 38, executive directors are entitled to a Company pension contribution of 25% of salary, with these contributions increasing by a further 2.5% of salary after each of five and ten years' service. Alternatively, executives can elect to receive a monthly amount in cash (less an amount equal to the employer's national insurance contribution) in lieu of the pension contribution. Currently, Andy Harrison and Christopher Rogers have elected to receive a cash payment, while Patrick Dempsey receives a pension contribution and a cash supplement representing the balance over and above the £50,000 annual allowance set by HMRC for pension contributions.

### Other benefits

All executive directors are entitled to life assurance and private health cover. Non-core benefits, for which cash alternatives are available, are family health cover and a fully expensed company car.

### Shareholding guidelines

Executive directors are required to build and hold a shareholding equal to 100% of salary within five years of appointment, whilst other senior executives are **expected (hedge)** to reach a holding to the value of 50% of salary. The table below shows the holdings of executive directors as at 1 March 2012:

## Terms of executive directors' service contracts

The key terms of the contracts of the executive directors are as follows:

- Notice period – six months by the director and 12 months by the Company;
- Termination payment – under none of the contracts is any specific compensation payable on termination of employment. For Andy Harrison, the Company may terminate his contract by paying his salary, together with pension contributions (or cash in lieu of pension) and benefits for a 12-month period, with payments ceasing to the extent he obtains another remunerated post. For Patrick Dempsey, the Company may, if it chooses, terminate his employment by making a payment of 140% of basic salary;
- Sickness – full salary for a maximum of 12 months in any three-year period or for a maximum of nine consecutive months; and
- Non-compete – for six months after leaving.

The dates of the executive directors' service contracts are as follows:

#### Executive directors – fees from external directorships

The executive directors are entitled to retain fees from any external directorships. Christopher Rogers is a non-executive director of HMV Group plc and received £45,000 during the year as a result of that directorship.

Neither Andy Harrison nor Patrick Dempsey received any fees from external directorships.

The Chairman and the non-executive directors Anthony Habgood has been Chairman since August 2005 and, during his time as Chairman, he has overseen a very **successful (AM)** period in Whitbread's history. The fee paid to him had remained unchanged since 2007. In July 2011 the Remuneration Committee met without Anthony to discuss his fee and determined that it **would (hedge)** be appropriate to increase his fee to £325,000 with effect from 1 August 2011. The date of his letter of appointment is 14 April 2005.

Also in July 2011, the Board met (excluding the non-executive directors) to discuss the ongoing appropriateness of the fee structure for non-executive directors. This structure had also remained unchanged since 2007. It was agreed that, whilst the base fee continued to be appropriate, the fee for being the Chairman of the Audit or Remuneration Committees would increase from £10,000 to £15,000 and a new fee would be introduced of £5,000 for being a member of those two committees.

As a result, the non-executive director fees were changed with effect from 1 August 2011 and the current position is shown in the table at the foot of this page.

Neither the Chairman nor any of the non-executive directors has a service contract. The dates of their letters of appointment, all of which are available for inspection at the Company's registered office, are also shown in the table below.

#### Employee Share Ownership Trust (ESOT)

The Company funds an ESOT to enable it to acquire and hold shares for the Annual Incentive Scheme, the LTIP and the matching share award made to Andy Harrison on his appointment in 2010. In addition, the Company transferred 143,000 shares from treasury to the ESOT during 2011 to be utilised for the future satisfaction of vested LTIP awards.

As at 25 April 2012, the ESOT held 942,938 shares. The executive directors each have a technical interest in these shares as potential beneficiaries of the Trust, but no shares in the ESOT have been earmarked to any individual. All dividends on shares in the ESOT are waived by the trustee. During the period from 2 March 2012 to 25 April 2012, no director has exercised an option to call for the transfer of shares from the ESOT.

#### Share price information

The mid-market price of a Whitbread PLC ordinary share on 1 March 2012 was 1687p (3 March 2011: 1708p). The highest and lowest price paid for ordinary shares during the year were 1737p and 1409p respectively.

#### Changes since 1 March 2012

There have been no changes in the directors' interests in ordinary shares since 1 March 2012.



## Dilution limits

Whitbread's share plans comply with recommended guidelines on dilution limits and the Company has **always (booster)** operated within these limits. The current Association of British Insurers ('ABI') guidance on headroom limits provide that overall dilution under all plans should not exceed 10% over a ten-year period in relation to the Company's issued share capital, with a further limitation of 5% in any ten-year period on executive plans. Assuming none of the extant options lapse and will be exercised, and having included all exercised options as well as shares transferred from treasury in order to settle LTIP awards, the Company has utilised 3.24% of the 10% in ten years and 1.24% of the 5% in ten years in accordance with the ABI guidance on dilution limits.

Signed and approved on behalf of the Board.

Ian Cheshire

Chairman, Remuneration Committee

25 April 2012

## UK: Giving **our (SM)** customers the best shopping trip

**We (SM) always (booster)** want to provide **our (SM)** customers with the best shopping experience and set the standard in the UK. Focusing on food first, **we (SM)** are making a £1 billion commitment this year to improve the shopping trip, driving a strong pace of improvement in the things that matter for customers – service, range, quality, price, availability and the store environment.

More staff, better service

One of the largest elements of **our (SM)** investment is in increased staffing levels, training and equipment for key departments in existing stores – such as produce and meat. **We (SM)** saw marked improvements in customers' perceptions and sales performance of 200 pilot stores. This success has given **us (SM)** the confidence to move quickly to apply these changes to all of **our (EM)** large stores – an investment of over £200 million.

**We (SM)** are improving the look and feel of many of **our (SM)** fresh departments using more engaging signage, stronger graphics, warmer colours and better lighting

Creating more **good (AM)** jobs and careers

Over the next two years, **we (SM)** will create 20,000 new jobs to deliver new levels of excellence in customer service. Customers will benefit from more staff on the shop floor at busy times, greater staff expertise and enhanced service across the store.

The investment goes to the heart of **our (SM)** promise to create **good (AM)** jobs and careers, with opportunities focused on young people who are currently unemployed. British Prime Minister David Cameron described the investment as "a massive confidence boost for the UK economy".

The Fruit and Veg team

Fresh food is an area where customers **really (booster)** appreciate having dedicated, specially trained and knowledgeable staff. With the additional investment in staffing, training and equipment, the Fruit and Veg team can focus on fresh produce, improving product availability and presentation for customers.

**We (SM)** are also increasing the number of staff across the whole of fresh food – meat, produce and chilled convenience foods.

The best shopping experience

- ✓ 20,000 more staff
- ✓ 8,000 refreshed products
- ✓ Over 3,000 lower prices
- ✓ 430 refreshed stores ->Over the page
- ❖ No one tries harder for customers

Quality and innovation

**We (SM)** are reviewing and refreshing **our (SM)** entire range of over 8,000 Tesco brand products starting with the relaunch of Tesco Value as Everyday Value, with quality improvements to hundreds of products. Helping customers manage on tight budgets, Value was already growing at twice the rate of the market as a whole: these changes will further strengthen its position.

**We (SM)** will also be comprehensively updating **our (SM)** other Tesco ranges this year.

**We (SM)** have already stepped up the pace of innovation with **our (SM)** new Venture Brand exclusive products – such as Chokablok ice cream, Parioli authentic Italian ranges and the Latham's range of premium pet food. With such a strong variety of ranges to

appeal to the needs of different customers, **we (SM)** will also be applying more personalisation and localisation in stores to help them tailor their ranges much more for their local area.

#### The Big Price Drop

In September 2011, **we (SM)** launched The Big Price Drop, investing more than £500 million to reduce the prices of over 3,000 everyday products. Big Price Drops target the products that customers buy week in, week out. The progress is **encouraging (AM)** and we're now more competitive. It's an **important (AM)** step in the journey but there's more to do to get the blend right on price, promotions, couponing and loyalty.

#### UK: Refreshing **our (EM)** stores for customers and staff

The way stores look and feel is an **important (AM)** part of the shopping trip. Customers wanted a warmer, friendlier look and feel, so **we (SM)** have accelerated **our (SM)** Refresh programme to improve the environment in all **our (EM)** stores.

Investing over £200 million of additional capital, **we (SM)** will refresh 430 stores in the coming year, representing **about (hedge)** 25% of **our (SM)** UK space. Bringing in a warmer, friendlier look and feel will go hand in hand with **our (SM)** work on quality and range, so that **we (SM)** offer customers great products displayed in an attractive, inviting store environment.

#### Listening to **our (SM)** staff

Most of **our (SM)** changes are visible to customers but **we (SM)** are making some equally **important (AM)** changes behind the scenes. **We (SM)** ran a programme this year for staff to email or text in comments about what they felt needed to be fixed in their stores. With 40,000 comments received, we've responded by rolling out new and better equipment, like checkout chairs and handheld printers. This has helped deliver the best staff Viewpoint feedback survey results for five years.

#### The Extra format

Customers are noticing the changes **we (SM)** are making in stores across all of **our (SM)** formats – Extra, Superstores, Metro and Express particularly affect **our (EM)** larger stores. We're drawing on the great success of **our (SM)** new Extra format in Europe to make **sure (booster)** that **our (SM)** UK Extras continue to meet **our (SM)** customers' changing needs, as they increasingly combine shopping in store and online.

#### Future investment

In the last few years, both convenience and online shopping have been growing rapidly. While **our (EM)** existing large stores in the UK perform very **well (AM)**, recognising the current economic climate and the growing importance of online shopping, **we (SM)** are not planning to open many more of the very biggest. Instead, more of **our (SM)** investment is going into refreshing **our (SM)** existing stores.

New investment will be channelled into Express stores and **our (SM)** online offer.

#### Bakery

Customers love being able to choose from freshly baked breads and cakes and see **our (SM)** bakers at work in the background. Displaying the goods in baskets, not on standard shelves, also helps to make **our (EM)** bakeries much more appealing.

#### Fixtures and fittings, lighting and space

**We (SM)** are refreshing **our (EM)** stores, inside and out, to make them more inviting. Wooden cladding and brighter signage welcome customers into the store. Inside, different areas are being given a more distinctive look and feel, such as wooden fixtures in Bakery, or sleek shelving and lighting in Health & Beauty. **Our (SM)** produce aisles are more spacious, and **our (SM)** counters have less functional, more engaging signage, flat glass fronts and better lighting, to show off **our (SM)** meat, fish, cheese and deli products at their best.

#### Click & Collect

As the option of ordering online and picking up in store continues to grow in popularity, **our (EM)** stores are ideal collection points. **We (SM)** will add 700 new collection points for Tesco Direct orders in the next year – customers can already collect from over 770 stores, including 70 Express stores. **We (SM)** will also continue to increase the number of stores with collection points for grocery, as well as trialling convenient joint collection points.

#### Retail services

The services **we (SM)** offer in store – like an optician, pharmacy, phone shop or customer restaurant – all help customers to get more out of their everyday shopping trip. **We (SM)** ended the year with over 180 opticians and are planning to increase the number of **our (EM)** phone shops to over 260 in the coming year.

### Clothing

The UK clothing market, worth £33 billion, is one of the few areas of discretionary spend that continues to grow and is a category where the internet has so far had a limited impact. **Our (EM)** Central European Extras have **shown (booster) us (SM)** that Clothing **tends to (hedge)** benefit from more space and better lighting on the shop floor, as customers love seeing more of **our (SM)** range. As well as giving Clothing more space in store, **we (SM)** will be improving the ranges and quality **we (SM)** offer to ensure broad appeal.

### Online: Making 'Clicks & Bricks' a reality for customers

Growing **our (SM)** online businesses in all **our (SM)** markets is a strategic priority for **us (SM)** and it shows how **we (SM)** are adapting to **our (SM)** customers' changing needs. Stores continue to sit at the heart of **our (SM)** business, but **we (SM)** are aiming to become a multi-channel retailer wherever **we (SM)** trade.

Customers increasingly expect to be able to shop where, when and how they want: the boundary between stores and online is blurring. In developing **our (SM)** online offer, **we (SM)** are drawing on **our (SM)** convenient store network and **our (SM)** expertise to meet **our (SM)** customers' needs and help make their lives easier, progressing towards an offering where customers can shop with **us (SM)** 'anywhere, any time, any how'.

We've taken online far beyond everyday grocery shopping. Digital technology allows **us (SM)** to meet the 'on the go' needs of **our (SM)** customers – with BLINK-BOX **you (EM)** can stream entertainment on the move and with **our (SM)** virtual stores in South Korea **you (EM)** can **even (AM)** shop during **your (EM)** commute to work.

**We (SM)** want to offer **our (SM)** customers convenient options to shop with **us (SM)** using those access points – stores, computers and mobile devices – which are part of their daily lives. Whether customers want to shop on the move using their smartphones, or take their time at home, **we (SM)** are innovating to help them shop however they want, with quick and easy apps and improved platforms.

### Tesco Direct

**We (SM)** have upgraded **our (SM)** Tesco Direct website to better showcase **our (SM)** great quality range and offer customers improved functionality and ease of use. For the first time it is now configured for mobile devices. **We (SM)** will be moving **our (SM)** other UK Clothing and Entertainment websites onto the same platform later in the year.

By Christmas **we (SM)** will have increased **our (SM)** Direct range to 200,000 items, thanks in part to third-party Sellers. Having introduced **our (SM)** first Sellers at Tesco Direct recently, **we (SM)** are offering **our (SM)** customers additional ranges teamed with Clubcard points and convenient store collection points, while **our (SM)** Seller Partners benefit from **our (SM)** volume of online traffic and expertise.

### Online grocery

When **we (SM)** first launched a grocery home shopping service in 1997 **we (SM)** were viewed as pioneers, and **we (SM)** have grown to be the world's largest and most profitable online grocery retailer with sales of well over £2 billion.

As technology moves forward so do **we (SM)**. **We (SM)** use it to help make shopping easier for customers with a mobile web platform for shopping on the go, features like 'Favourites' and tailored online offers developed for Tesco via analysis from dunnhumby, **our (SM)** marketing insight business.

Where customer demand is very high **we (SM)** have complemented **our (SM)** in-store picking model with a number of specialised dotcom-only stores. In January, **we (SM)** opened **our (SM)** fourth in Enfield. **We (SM)** currently fulfil over 80% of London orders from **our (SM)** dotcom-only stores, providing **our (SM)** customers with **our (SM)** total food range – more than can be offered from any one store.

### Click & Collect

Click & Collect is a key component of **our (SM)** multi-channel offering. **Our (SM)** store and distribution networks mean **we (SM)** can give customers the opportunity to pick up products whenever it suits them from over 770 stores, close to where they live or work. 70% of online general merchandise orders are handled in this way.

Click & Collect is becoming increasingly relevant for all product groups. **We (EM)** currently have 45 stores that offer grocery Click & Collect and **we (SM)** **expect (hedge)** this number to increase quickly. **Our (SM)** customers appreciate this innovative, quick and convenient service which fits **well (AM)** into their busy schedules.

### Social media

As **our (SM)** customers spend an increasing amount of time online **we (SM)** are able to use social media to build trust and understanding of **our (SM)** business. This in turn helps to drive loyalty.

**We (SM)** have built **our (SM)** business on listening to **our (SM)** customers and acting on their feedback. Social media allows **us (SM)** to have conversations with them on any issue at any time – in the UK, **we (SM)** now have more than 680,000 'likes' on **our (SM)** Facebook page.

In 2011 **we (SM)** acquired BzzAgent – a unique business combining word-of-mouth marketing with a commercial application of social media, helping to drive consumer advocacy and broaden **our (SM)** capability and innovation in product marketing. Social media also helps **us (SM)** to be more effective and innovative in existing tasks such as recruitment and staff communication. For example, **our (SM)** staff use Yammer – a private social network for businesses – to share best practice and celebrate success, **often (hedge)** by posting photos, and **we (SM)** use it operationally for sharing messages and asking for feedback.

#### International growth

**We (SM)** already have profitable online grocery businesses in South Korea and the Republic of Ireland, launched dotcom in the Czech Republic this year and are planning to begin soon in Warsaw. In the next few years, **we (SM)** are planning to launch online grocery shopping in at least one major city in each of **our (SM)** markets, using **our (SM)** operating model to roll this out quickly and cost-effectively.

In Asia, we're innovating to access the biggest opportunities – for example, in addition to **our (SM)** online grocery service, **our (SM)** virtual stores in South Korea enable busy customers to shop on their way to work. The Homeplus app has been downloaded over a million times.

#### International: Moving into the next phase of growth

Since the mid-1990s, **we (SM)** have built an international business of more than 3,200 stores, which delivered more than £1 billion trading profit for the first time this year. As **we (SM)** strive to become an outstanding international retailer, **we (SM)** are drawing on Tesco's skill and scale to move into the next phase of growth.

Retailing is a local business. Customers love local and regional products; **we (SM) pride (AM) ourselves (SM)** on having local people running **our (SM)** operations; and **we (SM)** use local knowledge to source and to allocate space to the most popular products. However, lots of what **we (SM)** do – especially behind the scenes – is best done in the same way across **our (SM)** markets.

**We (SM)** are increasingly realising **our (SM)** vision to win locally by applying **our (SM)** skills globally. 'Group skill and scale' describes this step in **our (SM)** evolution to becoming a global business.

By Group skill, **we (SM)** mean applying expertise from individual countries to all of **our (SM)** markets:

Clubcard is a great example. Having invested millions of pounds to develop the UK scheme in the late 1990s, **we (SM)** have been able to introduce a loyalty scheme to each of **our (SM)** markets for a fraction of the cost.

By Group scale, **we (SM)** mean using the size of the Tesco business to benefit **our (SM)** customers by lowering prices, improving quality, and sourcing new and different products from the best suppliers around the world. Globally sourcing food, general merchandise, and the goods that **we (SM)** use in store is one way that **we (SM)** are doing this. **We (SM)** buy some products from the same source for all **our (SM)** markets, such as bananas, and **we (SM)** buy others for a whole region, such as F&F clothing for Central Europe. Buying on a larger scale means that **we (SM)** can achieve a better cost price and create headroom to invest in improving the shopping trip for customers.

#### Winning locally, applying **our (SM)** skills globally

- Invest in the best local offer
- Identify best practice and roll out in all markets
- Work together where it makes sense

#### Consistent property blueprints

As **we (SM)** continue to grow **our (SM)** international businesses there is a significant opportunity to make savings from applying standardised property blueprints. With the same specialist team designing the stores, **we (SM)** can build great stores for customers more quickly, more cheaply and with a reduced carbon footprint. **We (SM)** also ensure the new space is best used by reducing the space given to offices and chillers in the back, providing more room on the shop floor.

#### Smaller format stores

Smaller format stores complement **our (SM)** established store networks to meet growing demands for convenience. These formats are not only great for customers but are also cost-effective, utilising **our (SM)** existing distribution networks and requiring less capital.

#### One platform, many markets – the best everywhere

Rolling out the same processes and systems across the Group delivers a better shopping trip for lower cost. Shelf-ready packaging and best practice replenishment processes support great availability for customers in store, while warehouse processes minimise stock loss and wastage. **We (SM)** increase back-office efficiency through **our (SM)** shared service centre in India with the same team designing common features, such as self-service checkouts, for all **our (SM)** markets.

#### Reaping the benefits of centralised distribution

As **we (SM)** buy more and more products on a regional or global scale, it becomes easier and more effective to organise **our (SM)** distribution across borders. **We (SM)** have opened new depots in Poland and China this year, building them to a Group blueprint and implementing best practice processes, equipment and systems.

#### Rolling out services

At year end, **we (EM)** had 47 of **our (EM)** Extra format stores internationally. These stores offer customers a whole range of services, such as photo shops, opticians and phone shops, for **relatively (hedge)** low investment as they use existing hypermarket space and customer footfall. Retail financial services are **well (AM)** established in Thailand and South Korea, where Tesco partners with leading financial services providers, and in an earlier stage of development in another seven of **our (SM)** markets.

#### **Our (SM)** evolution to becoming a global business

Since the mid-1990s, **we (SM)** have built an international business with more stores than **we (EM)** have in the UK, which has delivered more than £1 billion trading profit for the first time – larger than any of **our (SM)** UK competitors. With strong market positions, **we (SM)** are **well (AM)** positioned to move into the next phase of growth.

\* 11/12 trading profit excludes Japan, which has been treated as discontinued following **our (SM)** decision to sell the business. 10/11 has been re-presented to be consistent. The data up to and including 05/06 is statutory operating profit; from 06/07 it is trading profit.

#### International: Footholds in newer markets

China: three regions the size of countries

A large, rapidly growing market, China offers real long-term potential for growth, despite a currently challenging consumer environment.

**Our (SM)** strategy in China is to focus on building scale in three regions which together have a population of over 600 million.

#### South region

Present in this region for only four years, **we (SM)** continue to adapt **our (SM)** offer to meet consumer needs in this warmer part of China

#### North region

Hymall opened here in 2001 and 11 years later **we (EM)** have 39 stores trading. **our (EM)** first Extra opened in Shenyang in December. Freezing cold in winter, **our (SM)** clothing and food ranges are very different to the East and South

#### East region

The 'home' of Tesco in China is Shanghai and here **we (SM)** are trading **our (EM)** first Express convenience stores

#### Diversity and complexity

A market of China's scale brings not only significant opportunities but also huge diversity and complexity. To be successful, **we (SM)** need a deep understanding of regional, provincial and city-level differences, as well as an ability to leverage **our (SM)** global expertise and systems in order to build scale. **Our (SM)** vision of winning locally by applying **our (SM)** skills globally is key to **our (SM)** ambition to drive long-term, sustainable growth in China.

The importance of being local...

Even within a single region temperatures, tastes and preferred brands can all vary, so **our (SM)** operation is 'local' in many ways.

For example, **our (SM)** buying teams are based in different regions and **even (AM)** in specific provinces and cities to be close to **our (SM)** customers and suppliers. **We (SM)** have appointed more local Directors this year to strengthen **our (SM)** China Board and have ongoing plans to recruit and develop local talent.

... and operating responsibly

**Our (EM)** stores are active in their local communities, for example through 'Care for the Needy', where **we (SM)** donate daily essentials to elderly and infirm people. Drawing on **our (SM)** Group expertise and technologies, **our (EM)** new distribution centre in Jiashan uses 45% less energy than a traditional depot. These are just two examples of how **we (SM)** operate responsibly through a combination of being local and applying **our (SM)** skills globally.

#### Group skill and scale

Tesco's skill and scale are crucial to differentiating **our (SM)** business in China. **Our (EM)** new distribution centre was an **important (AM)** first step to streamlining **our (SM)** supply chain, allowing **us (SM)** to buy on a greater scale and giving **us (SM)** more control over the storage and transportation of fresh produce. Drawing on **our (SM)** brand capabilities, **we (SM)** have recently relaunched the packaging for 250 of **our (SM)** own-brand products, with hundreds more to follow in the coming year. **Our (EM)** Shenyang Extra store has benefited from the success of **our (SM)** new format in Europe, with the senior team trained in **our (EM)** Extra store in Bratislava, Slovakia.

Fresh & Easy: progress in the United States







The changes **we (SM)** have made to stores this year are building real momentum in Fresh & Easy, driving growing customer numbers and sales and delivering reduced losses for the first time.

The Fresh & Easy shopping trip

**Our (SM)** Fresh & Easy business is about wholesome, fresh, high-quality food in the heart of the neighbourhood, with great staff giving the best customer service. **We (SM)** have made changes this year to bring out these features and give them more prominence in **our (EM)** stores. With a friendlier store environment and atmosphere, the quality of **our (SM)** fresh and prepared produce more apparent and the launch of **our (SM)** Friends card to **thank (AM) our (SM)** loyal customers, **we (SM)** have driven 12% like-for-like sales growth this year and total sales growth of 27%.

The journey to profitability

The results of these changes mean that **we (SM)** are more **confident (AM)** about the outlook for the business, although **clearly (booster)** much remains to be done. **We (SM)** have reduced trading losses by 18% and are on track for another significant reduction in 2012/13, even if the timing of break-even will now be later than **our (SM)** earlier expectation. This is because **we (SM)** will focus on more stores reaching profitability first, before pushing on faster with the expansion **we (SM) need to (EM)** create sufficient scale to cover **our (SM)** overheads. **We (EM)** ended the year with 185 stores and will have approaching 230 stores by the end of the coming year.

-  Doors on **our (SM)** fridges and freezers, wooden floors and brighter walls all make **our (EM)** stores more inviting for customers
-  New prepared ranges from the Fresh & Easy Kitchen, offering wholesome, natural and tasty meals
-  Fresh & Easy superstars go the extra mile for customers and help create a culture of personal service
-  Customers can see and feel the quality of **our (SM)** loose fresh produce
-  Friends loyalty card thanks **our (SM)** customers for shopping with Fresh & Easy
-  Welcoming customers with new fresh ranges: flowers, fresh bread and coffee to go

Retail services: A Tesco Bank for Tesco customers

Tesco Bank brings Tesco's Values, customer focus and trusted brand name to a big market and is differentiated by being a bank that has Tesco at its centre. **We (SM)** offer simple, convenient, value for money products in what can be a highly complex market.

Since **we (EM)** took full ownership of Tesco Bank in 2008 **we (SM)** have been in a period of transition. In just over three years **we (SM)** have developed a completely new infrastructure for the business, built up a new team and brought in new expertise – effectively building a new bank from scratch. **We (SM)** are now completing the very final stages of this huge project, as **we (SM)** move towards offering a full-service retail bank.

At its core, Tesco Bank is underpinned by the Tesco brand and Clubcard, and its operations are effective because of **our (SM)** people, systems and IT.

Being part of Tesco delivers benefits for customers and Tesco Bank. For example, the insight **we (SM)** gain from Clubcard allows **us (SM)** to understand **our (SM)** customers' needs **well (AM)**, helping **us (SM)** to provide them with the most relevant offers in a clear and simple way and at a great price.

Tesco Clubcard credit card rewards customers with Clubcard points whenever they use their card. Clubcard customers can also receive preferential deals when buying Tesco Bank products – including discounts on car, home, pet and travel insurance – and can use Clubcard points to buy Tesco Bank insurance. This year, Tesco Bank gave customers **around (hedge)** £70 million of Clubcard points to spend in store or on Clubcard rewards.

The Tesco Values sit at the heart of Tesco Bank. **Our (SM)** core purpose is 'To create value for customers to earn their lifetime loyalty', so **our (SM)** people focus on providing great customer service. At **our (EM)** Glasgow and Newcastle customer service centres, staff are not incentivised to sell, which means that discussions with customers can focus solely on meeting their banking and insurance needs. Over the last three years, **we (SM)** have built a strong team with experience and expertise, growing dramatically from 300 to 2,800 people.

In terms of systems and IT, **our (SM)** new platforms have enabled some significant customer service improvements. Instant decisions are now available on loan applications, and customers can open and fund savings accounts in just ten minutes, which had previously taken **around (hedge)** two weeks.

While **we (SM)** have completed the majority of the transition from The Royal Bank of Scotland's ('RBS') systems and platforms to **our (SM)** own, **we (SM)** did encounter some technical issues during the summer of 2011. **We (SM) pride (AM) ourselves (SM)** on being a bank that customers can rely on and trust, and to ensure that the continuing process was as smooth as possible for customers and staff, **we (SM)** decided to slow the remaining transition of **our (SM)** 2.8 million credit card accounts. This is now nearing completion.

Even with all this work going on, **we (SM)** have grown the business during 2011/12. The savings book was up 7% versus a market of 3%, and the underlying performance of the Bank remained **good (AM)**, with strong growth in baseline profit (which excludes key nontrading provisioning movements).

In the last three years, **we (SM)** have seen significant growth across key Bank products. **We (SM)** have laid **our (SM)** foundations for growth and, with the transition from RBS **almost (hedge)** complete, **we (SM)** are now in a position to grow the business faster.

Savings and loans:

**Our (SM)** savings book continues to grow **well (AM)**, with retail savings deposits increasing by **around (hedge)** £330 million this year. Clubcard insight supports **our (SM)** competitive customer offering and high quality loan book. Even though loan balances have been temporarily reduced this year as **we (SM)** have undergone migration, customer accounts in loans and savings have increased by 30% since 2008. **We (SM)** are continuing to attract new customers who know that the Bank is reliable, trustworthy and **good (AM)** value.

Transaction services:

**Our (SM)** transaction services – ATMs and travel bureaux – offer customers convenience while they are on the go. Both saw strong growth in the year, with ATM transactions up 9% and travel money transactions up 12%. **We (EM)** ended the year with 3,265 ATMs, up from 2,600 three years ago, and **we (EM)** have close to 200 travel bureaux across **our (EM)** store network.

Insurance:

**Our (SM)** products help support customers in their daily lives, giving them peace of mind wherever they are. Simple to understand, **our (SM)** range of products continues to **prove (booster)** popular with customers. **Around (hedge)** 1.5 million people now insure their cars and homes with Tesco Bank. Since 2008, **our (SM)** car insurance gross written premiums have increased by 39% and pet insurance gross written premiums are up by 44%.

New products:

Tesco Bank has been growing **well (AM)** **even (AM)** without new product launches, but the products we've launched on **our (SM)** own systems have enjoyed huge success. **Our (SM)** Fixed Rate Saver, launched in October 2010, has grown to £1.5 billion and **our (SM)** retail bonds have attracted investments of £185 million.

These initiatives diversify **our (SM)** funding base and increase the long-term funding available to the Bank. **We (SM)** **always (booster)** want to give **our (SM)** customers the best products and the best experience, so **we (SM)** **believe (booster)** getting it right at launch is more **important (AM)** than rushing the process. Once **we (SM)** have completed the final stage of migration, **we (SM)** can push on faster with more substantial new products, starting with mortgages. Current accounts are planned to follow and **we (SM)** **welcome (AM)** the recommendation of the Independent Commission on Banking to make it easier for customers to switch between banks.

Credit cards:

**We (SM)** are increasing **our (SM)** share of the market, with 57% growth in credit card transactions since 2008. Three years ago, Tesco Bank credit cards made up 9% of all MasterCard and Visa credit card transactions in the UK – that figure is now 12%. Customers benefit from the added 'Tesco' extras that come with their credit card, such as collecting one Clubcard point for every £4 spent.

**Our (SM)** dedication to the community: Thailand

**Our (EM)** stores are **important (AM)** parts of local communities. **We (SM)** are **committed (AM)** to being a **good (AM)** neighbour and making a difference to the communities **we (EM)** live and work in, including supporting the causes that matter to **our (SM)** customers and **our (SM)** people.

In 2011, Thailand suffered its worst floods in 70 years. At Tesco Lotus **our (SM)** staff went to incredible lengths through immensely difficult conditions to get **essential (AM)** supplies into **our (EM)** stores for customers.

Events such as the floods are a reminder of the strength of local communities and how people turn to them in times of need. They are also a reminder of the importance of providing customers with good quality, safe, affordable food, whenever they need it.

Business model

**Our (SM)** strategy is put into action through **our (SM)** business model. At its heart is **our (SM)** core purpose: 'To create value for customers to earn their lifetime loyalty'.

Business model

Core activities

**Our (SM)** core business model is simple: **we (SM)** buy, move and sell products and services to **our (SM)** customers and use customer insight to do this slightly better each time.

Insight: Improving the customer offer

Listening to customers in a wide variety of ways is key to what **we (SM)** do. **We (SM)** engage with customers through a range of focus groups and ongoing research trackers, and actively seek feedback on what is good or not so good, such as through **our (SM)** Every Comment Helps scheme in the UK. Online and social media make it easier to listen and respond to large numbers of

customers in real time, through webchats, Facebook and Twitter. The insight from all of these conversations increasingly feeds into the customer offer so that **we (SM)** can continually drive incremental improvements for customers.

**Our (SM)** loyalty schemes, such as Clubcard or Legou Tesco Membercard in China, are not only great for **our (SM)** customers but also provide data insight to enable **us (SM)** to continually improve the shopping trip. With a loyalty scheme in all of **our (SM)** markets and **around (hedge)** 44 million active customers in total, **we (SM)** are in a unique position to understand customers' shopping patterns. **Our (SM)** marketing insight business, dunnhumby, provides analysis which **we (SM)** feed back into **our (SM)** business model, shaping **our (SM)** product and range development and enabling **us (SM)** to offer customers the best products and promotions for their particular needs.

Buy: A great range of products

In food, general merchandise and services, **we (SM)** work with **our (SM)** suppliers and develop **our (SM)** brands to bring a great range to **our (SM)** customers. The relationship with **our (SM)** suppliers is the foundation of **our (SM)** customer offer. **We (SM)** work with a broad range of suppliers, from global produce suppliers and international FMCG companies to local suppliers who provide products for a single region in one of **our (SM)** markets. **We (SM)** sell over £1 billion of local products annually in the UK and, across Europe, **our (SM)** series of 'meet the buyer' events helped **us (SM)** to stock hundreds of new local products this year.

With **our (SM)** established private label programme, **we (SM)** produce great quality Tesco brands at a range of price points, from Everyday Value up to Finest. **Our (SM)** product brands also have established market positions.

For example, F&F, which is the market leader in clothing in the Czech Republic, Slovakia and Hungary, is itself diversified into distinct subbrands for different clothing styles.

In services, **we (SM) often (hedge)** work with specialist partners to source the best product offerings. For example, **we (SM)** created a joint venture between Vodafone and Tesco Hungary this year, and Tesco Bank insurance underwriting is primarily provided in partnership with Ageas Insurance Limited.

Move: The right products at the right time

**Our (SM)** network of distribution centres ('DCs') and advanced technology support a modern, efficient and cost-effective supply chain. An efficient distribution system starts with understanding which products **our (EM)** stores need. **We (SM)** do this in two ways. First, **we (SM) forecast (hedge)** what customers will buy, using sophisticated, detailed models to consider variables such as seasonality, weather forecasts and **likely (hedge)** response to promotions. Second, **our (SM)** ordering systems automatically update in real time based on what customers do **actually (booster)** buy, so that **we (SM)** can quickly and accurately supply stores with the right products at the right time.

**We (SM)** plan **our (SM)** distribution processes, systems and network of DCs to maximise efficiency. Labour scheduling and transport planning systems enable **our (SM)** pickers and drivers to operate highly effectively, and **we (SM)** develop **our (SM)** distribution networks to minimise the mileage needed to get products to store in perfect condition. **We (SM)** also use transport other than lorries such as **our (SM)** four train services in the UK, which save 15,000 tonnes of CO2 per year.

Continually striving to make every part of the process productive, through primary distribution, **we (SM)** use **our (SM)** network to pick products up from some of **our (SM)** suppliers and transport them to **our (SM)** depots, which can be more cost-effective than individual suppliers delivering to **us (SM)**. **We (SM)** also use return journeys from stores to depots to pick up waste materials which **we (SM)** sell for recycling.

Sell: The best shopping trip

Whether in store, online or a combination of both, **we (SM) pride (AM) ourselves (SM)** on delivering a great shopping trip for **our (SM)** customers, week in, week out.

One of Tesco's Values is 'No one tries harder for customers', and this can be seen in how **we (SM)** strive to improve the shopping trip. This represents every element of the customer shopping experience, including price, range, quality, availability and service.

**Our (SM)** loyalty schemes are key to the customer offering, thanking customers each time they shop at Tesco.

**We (SM)** take a multi-format approach to **our (SM)** store network, to be able to meet **our (SM)** customers' needs for different types of shopping trip, from large Extra stores that offer a full range of food, general merchandise and services, to Metro and Express convenience stores.

'Selling' refers to a broader and broader range of activities as **we (SM)** develop **our (SM)** multi-channel offer. **We (SM)** launched a grocery home shopping service in the UK in 1997. Since then, **we (SM)** have grown this business to over £2 billion of annual sales, launched grocery home shopping in South Korea, the Republic of Ireland and the Czech Republic, and launched further online businesses, such as Direct, Clothing and Entertainment. **We (SM)** are increasingly offering customers the option of combining stores and online with Click & Collect, which makes the most of **our (SM)** convenient store locations, giving customers an easy way to pick up products ordered online.

**We (SM)** also offer a wide range of services to **our (SM)** customers. With opticians, pharmacies and phone shops available in **our (SM)** larger stores, and Tesco Bank products available to buy in store, over the phone or online, **we (SM)** are deepening **our (SM)** customers' relationship with Tesco, bringing **our (SM)** values of convenience, simplicity, reliability and great customer service into what can be complex markets.

**We (SM)** don't always sell **our (SM)** products **ourselves (SM)**. In South Korea and the Czech Republic, **we (SM)** operate franchise chains alongside **our (SM)** own stores, and **we (SM)** have also recently announced a new franchise model for **our (SM)** F&F clothing brand in Saudi Arabia.



#### The virtuous volume circle

By keeping **our (SM)** customer focus central to **our (SM)** business model, **we (SM)** are able to provide a leading customer offer: a broad range of products and services at great prices, sold in shops in convenient locations and, increasingly, available online. A great customer offer drives the virtuous volume circle, which means that **we (SM)** can continuously improve **our (SM)** offer. By selling more products, **we (SM)** are able to work with **our (SM)** suppliers to drive mutually beneficial economies of scale, creating headroom to invest and to offer lower prices to customers. An **important (AM)** element of **our (SM)** Plan to improve business performance in the UK is centred on investing in the shopping trip so that customers will reward **us (SM)** by buying more from Tesco.

#### Enablers

**Our (SM)** core business model is supported by enablers which maximise the potential of **our (SM)** core activities to give **our (SM)** customers the best shopping trip and ensure that **our (SM)** activities are carried out in a sustainable way.

#### Leveraging Group skill and scale:

Making **our (SM)** business Better, Simpler, Cheaper, Faster

Sharing best practice systems, processes and approaches across all of **our (SM)** markets takes **our (SM)** business model to the next level. By identifying best practice in each market, **we (SM)** can improve **our (SM)** offering around the Group. For example, some of the very popular brands **we (SM)** have developed in Fresh & Easy in the US have recently been introduced into the UK and South Korea. As **our (SM)** international experience grows, **we (SM)** are increasingly benefitting from sharing best practice – with **our (SM)** UK Operating Board all having spent some of their careers in **our (SM)** international businesses.

Group skill and scale supports each of **our (SM)** core activities: utilising Insight, Buying, Moving and Selling. Utilising Insight as a Group, with a loyalty scheme in all of **our (SM)** markets, means **we (SM)** can continually innovate the customer offer. **Our (SM)** Turkish business launched Clubcard this year, which **would (hedge)** not normally be possible for a business of its size. Buying as a Group is cost-effective, creating headroom to invest in the customer shopping trip, such as by sourcing consumables in Central Europe as a Group. Moving as a Group, with distribution centre blueprints, systems, and the early stages of borderless distribution, makes **our (SM)** deliveries simpler and faster, with new distribution centres opened in both Poland and China this year. Selling as a Group, with **our (SM)** Extra format already in eight international markets, including the Czech Republic, Thailand and China, offers customers a better shopping experience. **Of course (booster) we (SM)** don't **believe (AM)** in 'one size fits all'. There are many things that are best done locally because customer tastes and lifestyles are not uniform. **Our (SM)** businesses are run predominantly by local teams, not by expats, so that **our (SM)** operations can be close to the customers **we (SM)** serve, and **our (SM)** local ranges both support **our (SM)** smaller suppliers and give customers a tailored product offering.

#### Developing **our (SM)** people:

**Our (SM)** most **important (AM)** asset

Great service can make a customer's day, and **we (SM)** achieve this when **our (SM)** people live the Tesco Values: 'No one tries harder for customers' and 'Treat people how **we (SM)** like to be treated'. **Our (SM)** business is built on the commitment of more than half a million people across the world and, in return for their commitment, **we (SM)** offer them **good (AM)** jobs and careers with Tesco. Developing **our (SM)** people takes many forms, from training in **our (SM)** state-of-the-art training academy in Asia, to offering jobs to the long-term unemployed through Regeneration Partnerships and supporting the development of women to management positions.

#### Creating valuable property:

The best located and best designed stores

**Our (SM)** site research and property capabilities enable **us (SM)** to identify and develop the best sites for **our (EM)** stores. Tesco has great depth of experience in property development all around the world. Optimal sites for new store developments and extensions are identified by **our (SM)** site research departments. **We (SM)** have a flexible approach to property acquisition, considering both freehold and leasehold sites and assessing each opportunity on its merits. Using a range of data, such as demographics and competitor activity, **we (SM)** **forecast (hedge)** sales for a new store to a high degree of accuracy, so that **we (SM)** can develop the stores with the greatest potential.

Once a site has been identified, approved and secured, **our (SM)** property development and construction teams design and develop the site. Years of experience have fed into Group-wide blueprints and specifications so that all of **our (SM)** development takes place to the highest standard. In many of **our (SM)** international markets, Tesco owns or leases whole malls, which are anchored by a Tesco hypermarket. Operating the mall and renting out the space to other retailers, cafes and cinemas creates a great destination shopping centre for customers, as well as bringing in significant rental income, which makes Tesco one of the largest mall operators in the world.

#### Operating responsibly:

Ensuring that growth is sustainable

By operating responsibly, **we (SM)** not only benefit and secure the future of **our (SM)** business but **we (SM)** can bring real benefits to the communities in which **we (SM)** operate.

At the heart of **our (SM)** commitment to operating responsibly is providing **our (SM)** customers with good quality, safe and affordable food. This is easily taken for granted in developed economies, but can be a real challenge in economies with low penetration of modern retail and underdeveloped supply chains.

**We (SM)** can only achieve this by working with **our (SM)** suppliers to ensure **our (SM)** supply chain is both resilient and efficient. Strong, fair, mutually beneficial, long-term partnerships with suppliers, from local to global, are at the heart of this. The strength of **our (SM)** supply network was **evident (booster)** during the Thai floods this year, enabling **us (SM)** to secure **essential (AM)** supplies from Malaysia and other markets.

**We (SM)** are **committed (AM)** to the responsible sourcing of raw materials, ensuring the resilience of **our (SM)** supply chain and managing **our (SM)** impact on the environment. **We (SM)** work with the wider industry on core issues, such as water scarcity, and co-chair the Sustainability Steering Group of the Consumer Goods Forum, which has pledged to help end deforestation by 2020.

**We (SM)** aim to be a zero-carbon business by 2050 and are mapping the biggest opportunities to cut carbon in **our (SM)** supply chain, as well as continually exploring new energy efficiency measures to be introduced across the Group.

Innovating **our (SM)** offer:

Constantly improving **our (SM)** customer offer

To continue to meet customers' changing needs, **we (SM)** are constantly innovating **our (SM)** offer in a whole variety of ways.

Innovation can bring greater convenience to an existing way of shopping, as with self-service checkouts. It can offer customers a new way of shopping, as with Click & Collect grocery or **our (SM)** virtual stores in South Korea. It can combine **our (SM)** presence in shops and online into a compelling customer proposition: for example, a customer registered with Blinkbox can automatically receive a digital copy of most new Hollywood releases when they buy the DVD with a Clubcard in store. By drawing on the breadth of **our (SM)** expertise and by **always (booster)** putting the customer first, **we (SM)** continue to serve customers how they want to be served in a changing and increasingly joined-up world.

Building the Tesco Brand:

To be seen as the most highly valued business in the world

Through everything **we (SM)** do, **we (SM)** strive towards **our (SM)** vision of being seen as the most highly valued business in the world – valued not only by **our (SM)** customers, but also by the communities **we (SM)** serve, **our (SM)** staff and **our (SM) shareholders (EM)**. Protecting and developing **our (SM)** brand reputation is the foundation of customer loyalty and of how **we (SM)** are seen by **our (SM)** many **stakeholders (EM)** and enables **our (SM)** business model to operate effectively. For example, **our (SM)** diversification into services such as Tesco Bank is built on customers' trust in the Tesco brand to offer good value, simple solutions and great customer service; and **our (SM)** recruitment and retention of great staff depends on **our (SM)** reputation for customer service and offering good jobs and careers.

Key performance indicators

**Our (SM)** KPIs measure how **we (SM)** are doing across the Group in terms of both operational and financial performance in the context of the key elements of **our (SM)** strategy.

More detailed definitions for **our (SM)** Group performance and Group financial KPIs can be found in the glossary on the inside back cover. All KPIs exclude the results from **our (SM)** operation in Japan for 2011/12 unless stated otherwise.

Group performance

Growth in underlying profit before tax 1.6%

Definition

**Our (SM)** underlying profit provides information on the underlying trend and performance of the business. It is adjusted for a number of (non-cash) accounting adjustments and one-off costs.

Performance

**We (SM)** saw modest progress in the year, with the rate of improvement impacted by two events: the Hungary crisis tax (£38 million) and the increase in provision for Payment Protection Insurance ('PPI') in Tesco Bank (£57 million). Growth before these impacts was 5.4%.

\* Restated for IFRS 2 and IFRIC 13.

Return on Capital Employed ('ROCE') 13.3%

Definition

ROCE is a relative profit measurement that demonstrates the return the business is generating from its gross assets.

Performance

Although **our (SM)** UK performance was weaker than planned, ROCE improved by 40 basis points, benefiting from Japan now being classified as a discontinued operation.

Growth in underlying diluted earnings per share (at a constant tax rate) 2.1%

Definition

Underlying diluted earnings per share ('EPS') is the amount of underlying profit, adjusted for the number of shares in issue.

## Performance

The growth in underlying diluted EPS reflects modest progress in earnings in the year. The proposed full year dividend per share grew by 2.1%, in line with this, to 14.76p, continuing **our (SM)** unrivalled record of consecutive years of dividend growth in the FTSE 100.

## Total shareholder (EM) return ('TSR')

### Definition

TSR is the notional annualised return from a share: the percentage change in the share price, plus the dividends paid and reinvested, over the last five years. For example, five-year TSR for 11/12 is the annualised growth in the share price from 06/07 and dividends paid and reinvested in Tesco shares, as a percentage of the 06/07 share price.

### Performance

Returns reduced reflecting the effect on **our (SM)** share price of **our (SM)** decision to invest significantly in the customer offer in the UK.

## Capital expenditure ('capex') % of sales

### Definition

Capex is the investment in property, plant and equipment, investment property and intangible assets. This is divided by Group sales (inc. VAT, inc. petrol) to show a relative investment to sales.

### Performance

This year **we (SM)** reduced **our (SM)** rate of capital investment to reflect the challenging trading environment and increased **our (SM)** focus on lower capital-intensive investments with high returns, such as online and convenience. Last year **we (SM)** set a target of 5% to 5.5% of sales. **We (SM)** will reduce capex to £3.3 billion in 12/13 and, beyond that, comfortably less than 5.0% of sales.

## Net indebtedness

### Definition

Net indebtedness shows debt in relation to operating cashflow ('EBITDAR'). Debt is adjusted net debt, calculated as net debt, the pension deficit and the net present value of lease obligations.

### Performance

Net indebtedness remained **broadly (hedge)** flat, reflecting a slower than **expected (AM)** working capital improvement and higher pension deficit, offset by cash generated from retail operations (excluding working capital). **Our (SM)** target for net indebtedness is 2.5 times.

## Gearing

### Definition

The proportion of net assets financed through debt rather than equity, calculated as net debt divided by total equity.

### Performance

**Our (SM)** gearing continued to decrease, reflecting **our (SM)** stable debt position despite **our (SM)** investment in assets growing.

\* Restated for IFRS 2 and IFRIC 13.

† Includes Japan.

## Fixed charge cover

### Definition

The number of times that **our (SM)** operating cashflow ('EBITDAR') covers **our (SM)** debt obligations (**largely (hedge)** rent and interest payments).

### Performance

**Our (SM)** fixed charge cover remained **broadly (hedge)** flat due to increased rent offsetting **our (SM)** reduced interest and increase in operating cashflow ('EBITDAR'). **Our (SM)** target is a level of cover in the band of 4 to 4.5 times.

## Group strategy: To grow the UK core

## UK like-for-like (inc. VAT, exc. petrol)

### FOCUS FOR 2012/13

### Definition

The growth in sales from stores that have been open for at least a year.

### Performance

Having delivered a **disappointing (AM)** performance, particularly during the second half, **our (SM)** UK Plan aims to drive stronger like-for-like sales.

## UK trading profit

## Definition

The profit generated from the UK business in its retail operations.

## Performance

Having delivered a solid first half profit outcome, profits weakened in the second half, reflecting a **disappointing (AM)** sales performance and the initial investment in improving the shopping trip for customers which **we (SM)** began during the second half of the year.

Customer rating of overall shopping experience as excellent or good Growth in UK online sales 76%

Source: Marketing Sciences.

FOCUS FOR 2012/13

## Definition

Percentage of customer ratings, measured in exit interviews.

## Performance

Three quarters of customers find their shopping experience good or excellent, and 98% find it reasonable, good or excellent. With **our (SM)** UK Plan, **we (SM)** aim to improve customers' shopping experiences from reasonable to good and from good to excellent.

Growth in UK online sales +10%

## Definition

The year-on-year sales growth from total tesco.com and online telecoms.

## Performance

**We (SM)** are pleased with the performance of **our (SM)** online businesses. **Our (SM)** largest business, grocery, accelerated its already strong rate of growth through the year.

Group strategy: To be an outstanding international retailer in stores and online

## International trading profit

## Definition

The profit generated from **our (SM)** international businesses in their retail operations.

## Performance

**We (SM)** delivered strong profit growth of 18% against a background of very difficult economic conditions in several of **our (SM)** large markets.

Proportion of customers pleased with their shopping trip  $\geq 95\%$  in 9 markets

Source: Country customer satisfaction tracker.

## Definition

The number of markets where at least 95% of customers asked were very or fairly satisfied with their overall shopping experience, the top two ratings.

## Performance

The **pleasing (AM)** results reflect the improvements **we (SM)** have been driving internationally through different customer initiatives.

Growth in international online sales +40%

## Definition

The year-on-year sales growth from **our (SM)** international online businesses.

## Performance

From a low base **we (SM)** are starting to see accelerating growth, with **our (SM)** established international online operations in South Korea and the Republic of Ireland doing **well (AM)**.

Group strategy: To be as strong in everything **we (SM)** sell as **we (SM)** are in food

UK general merchandise, clothing and electricals range image

1st supermarket Source: Marketing Sciences.

## Definition

**Our (SM)** relative position among competitors, as rated by customers.

## Performance

With a leading position among **our (SM)** supermarket peers, **we (SM)** are driving substantial improvements to **our (SM)** range in order to increase **our (SM)** competitiveness among specialist retailers, with plans for 200,000 products on Tesco Direct by Christmas.

Proportion of UK customers buying general merchandise, clothing and electricals 37% down from 39% last year

## Definition

The average weekly proportion of UK Clubcard customers who bought a general merchandise, clothing or electricals item.

Performance

With the current economic conditions, **we (SM)** are seeing subdued demand for discretionary items.

International general merchandise, clothing and electricals range image

9 markets – 1<sup>st</sup> or 2<sup>nd</sup> place Source: Country image tracker.

Definition

The number of international markets where **we (SM)** are ranked first or second by customers for **our (SM)** general merchandise range. This excludes the US, where **we (SM)** operate convenience stores.

Performance

**Our (SM)** position reflects the strength of the F&F brand and of **our (SM)** Extra stores, which are introducing **our (SM)** customers to different ways of shopping, with stronger ranging and a distinctive look and feel for different categories.

Proportion of general merchandise, clothing and electricals sourced as a Group 27%

Definition

The proportion, by sales, of general merchandise, clothing and electricals **we (SM)** buy together, through **our (SM)** Group Commercial function.

Performance

From this already substantial proportion of Group sourcing, **we (SM) expect (hedge)** to increase the amount that **we (SM)** buy together in the coming years as **we (SM)** leverage Group skill and scale.

Group strategy: To grow retail services in all **our (SM)** markets

Bank profit

Definition

Trading profit measures the profit generated by the business in its operations. Baseline profit is measured before key non-trading provisioning movements, including Payment Protection Insurance ('PPI'), and before fair value, and provides information on business performance.

Performance

Baseline profit rose 29% in the year, reflecting strong business growth. By contrast, trading profit fell 36%, impacted by the increase in a provision for claims from historic sales of PPI; and the unwinding of the fair value provision, an accounting adjustment made at the time of acquisition in 2008.

Group strategy: To put **our (SM)** responsibilities to the communities **we (SM)** serve at the heart of what **we (SM)** do

Reduction in CO2 emissions

Definition

The year-on-year reduction in greenhouse gas emissions from existing stores and distribution centres built before 2006/07, adjusted to exclude emissions from acquisitions and extensions.

Performance

**We (SM)** met **our (SM)** target for 2011/12 to reduce **our (SM)** CO2 emissions by 5%. Cumulatively, **we (SM)** have reduced **our (SM)** emissions from existing stores and distribution centres by 26% since 2006/07.

Supplier Viewpoint 74%

Definition

The percentage of positive scores from **our (SM)** annual survey of suppliers, Supplier Viewpoint, when **we (SM)** ask whether Tesco treats them with respect.

Performance

In 2011/12, **we (SM)** exceeded **our (SM)** target of 70%, representing **generally (hedge)** strong supplier relationships.

Donation of pre-tax profits to charities and good causes 1.9% over £ 74.5m in total

Definition

**Our (SM)** contribution to charities and good causes through direct donations, cause-related marketing, gifts in kind, staff time and management costs.

Performance

**We (SM)** exceeded **our (SM)** target of donating 1% of pre-tax profits to charities and good causes, contributing over £74.5 million.

For further Corporate Responsibility KPIs, please see **(EM) our (SM)** Corporate Responsibility Review 2012 at [www.tescopl.com/crreview](http://www.tescopl.com/crreview).

Group strategy: To be a creator of highly valued brands

Customer loyalty 9 markets – 1st or 2nd place  
Source: Market research (GfK, Ipsos, Kantar).

#### Definition

The number of markets where **we (SM)** are placed 1st or 2nd for the proportion of customers who do over 50% of their shopping with a single retailer.

#### Performance

**We (SM)** are particularly pleased that **we (SM)** lead on loyalty in four of **our (SM)** markets and are second in a further five. This is an **important (AM)** indicator of **our (SM)** customers' satisfaction with the shopping trip and the Tesco brand and is supported by a loyalty scheme in each of **our (SM)** markets.

Group-wide own-label participation 38%

#### Definition

Own-label sales as a proportion of total Group sales. Own-label sales include Tesco brands (such as F&F, Finest or Venture brands) and unbranded products, such as produce. Tesco Bank and Tesco Mobile are not included.

#### Performance

Group own-label participation was stable in the year. Range & Quality is one part of **our (SM)** Plan for the UK, with Tesco Value now relaunched as Everyday Value and upgrades to over 8,000 Tesco standard lines planned.

Group strategy: To build **our (SM)** team so that **we (SM)** create more value

Staff retention 90% in the UK

#### Definition

The proportion of staff with over a year's service who have worked for Tesco in the UK throughout the year.

#### Performance

**Our (SM)** strong retention rate in the UK reflects **our (SM)** focus on creating good jobs and long-term careers, providing career development and an **excellent (AM)** benefits package.

Staff being trained for their next role 5.9% across the Group

#### Definition

The proportion of staff who are on development programmes training for their next role.

#### Performance

**We (SM)** exceeded **our (SM)** 5.6% target this year, demonstrating **our (SM)** commitment to supporting and developing **our (SM)** people so that they are able to advance their careers.

#### Financial review

Laurie McIlwee

Chief Financial Officer

"**Our (SM)** financial results **demonstrate (booster)** the breadth of the Tesco Group. Thanks to strong performances internationally – particularly in Asia – **we (SM)** have been able to deliver modest profit growth for the Group. Going forward, a financial strategy of increased capital discipline and restraint will support the changes **we (SM)** are making for customers and will drive higher cash generation and higher returns for **shareholders (EM)**."

#### Group resultsΔ

Δ Group results exclude the results from **our (SM)** operation in Japan which have been treated as discontinued following **our (SM)** decision to sell the business.

In a challenging year for consumers in many of **our (SM)** markets, as they try to manage household budgets pressured by inflation, austerity and high fuel prices, **we (SM)** have made modest progress at a Group level. The international businesses performed strongly, delivering an 18% increase in profits, which helped to compensate for the reduction in trading profit in the UK.

**We (SM)** have acted where **our (SM)** strategy was not delivering as **we (SM)** had hoped. In the United States, **we (SM)** reduced losses, moving towards break-even, before accelerating investment; in Japan, **we (SM)** announced **our (SM)** decision to exit the market after eight years; in China, **we (SM)** stepped back from the freehold shopping centre programme and have decided to hold back on the pace of new leasehold hypermarket development for the time being; at the Bank, **we (SM)** slowed down the migration to **our (SM)** own platforms to ensure it was as smooth as possible; and in the UK, **we (SM)** took a significant step to correct **our (SM)** pricing position with The Big Price Drop and, in January, acted decisively to address the underperformance in **our (SM)** home market. These actions will make Tesco better for **our (SM)** customers and are supported by a financial strategy that will also make Tesco better for **shareholders (EM)**.

## Segmental results

### UK

In the UK **we (SM)** saw strong total sales growth driven by a **good (AM)** new store performance, but **our (SM)** like-for-like growth was **disappointing (AM)**, particularly in the second half of the year. This was not helped by reduced inflation resulting from **our (SM)** Big Price Drop and a weak Christmas, which was affected by the substantial increase in competitor couponing activity. Like-for-like sales growth recovered **somewhat (hedge)** after Christmas.

### UK trading profit

Against this background of slower than planned like-for-like growth and a further weakening in **our (SM)** performance relative to the wider industry, **we (SM)** took the decision in January to accelerate a plan – which had been developed over the course of 2011 – to make substantial changes to the UK business. The combined revenue and capital investment involved in these initiatives will exceed £1 billion, supported by a significant reset to the level of UK margins in order to give **us (SM)** the financial resources **we (SM) need to (EM)** make comprehensive improvements for customers.

### Asia†

**We (SM)** delivered a **good (AM)** performance across all **our (SM)** markets in Asia, with solid like-for-like growth. **Our (SM)** performance in Thailand was **obviously (booster)** impacted by the devastating floods but the business has returned to strong growth as the country gets back to normal. Asia margins grew by over 60 basis points in the year, **mainly (hedge)** due to the swift resolution of **our (SM)** insurance claim in Thailand, which has mitigated the profit impact of store closures during the flooding. South Korea and Malaysia both had a **good (AM)** year for sales and margin growth, although this was offset by increased losses in China where, in common with other businesses, **we (SM)** faced a challenging year.

† Asia results from 2011/12 exclude results from **our (SM)** operation in Japan which have been treated as discontinued following **our (SM)** decision to sell the business. 2010/11 results have been re-presented to be consistent.

### Europe

A resilient overall performance in Europe was impacted by two factors. Despite a strong sales performance in Poland, profits were held back by significant disruption connected to the opening of **our (SM)** new distribution centre and a non-food stock write-off. The crisis tax of £38 million in Hungary had a material impact on profits. Excluding this, **we (SM)** saw double-digit profit growth for the Central European businesses – a **pleasing (AM)** performance in light of the broader economic issues affecting the eurozone. **Our (SM)** Irish business delivered a robust performance in the context of the severity of the recession there. The particular circumstances of the Republic of Ireland and Hungary have led **us (SM)** to focus on driving trade from **our (SM)** existing stores and **we (SM)** have scaled back **our (SM)** investment in new space. Focusing **our (SM)** efforts on **our (SM)** existing stores has driven strengthening like-for-likes and continued increases in market share in both markets.

### United States

In the US, Fresh & Easy delivered another strong sales performance and **we (SM)** have reduced losses by nearly 18% year-on-year – the first full-year reduction in losses since **our (SM)** entry into the market.

An increasing number of stores are reaching shop-door profitability, which means that they are operating profitably, before taking account of central costs. Thirty stores are already making a positive contribution to cashflow, and 118 more are very close to doing so. **We (SM) intend (hedge)** to focus on delivering this store-level profitability, before pushing on faster with expansion in the number of stores. As a result of this more measured approach to new capital expenditure, **we (SM)** now **anticipate (hedge)** crossing into break-even in the US during 2013/14.

### Tesco Bank

Tesco Bank increased its baseline profitability very strongly by 29%. This measures business growth, before key non-trading provisioning movements. This performance was particularly **pleasing (AM)** given the **need to (EM)** take a conservative approach on new savings and loans business during the final stages of systems migration. As **we (SM)** put more than three years of transition behind **us (SM)**, the Bank is **well (AM)** placed to deliver **good (AM)** growth, starting in the coming year. Trading profit was impacted by a number of factors. The unwind of the fair value provision, dating from the time of acquisition in 2008, reduced by £133 million in the year, to £22 million, and will be immaterial going forward. **We (SM)** increased **our (SM)** provision against possible claims arising from the sale of PPI by £57 million in the first half of the year. With no further adjustments in the second half, **we (SM)** ended the year with a net provision of £75 million. **Our (SM)** decision to slow down the final stages of migration also impacted profit by **around (hedge)** £40 million which will now begin to reverse.

Bad debts reduced by 5.2% in the year due to the application of **our (SM)** robust credit policy. The Bank's overall capital position improved, from an already **good (AM)** position. Liquidity has also improved, with the retail bond issues giving **us (SM)** greater diversity in the Bank's funding position.

#### Group balance sheet

Net debt remained stable for the year at £6.8 billion. This is a little behind **our (SM)** expectations at the half-year, due to the impact of the Christmas trading result on cash flow and to lower working capital inflow, linked to higher stock levels than planned. Group capital expenditure was slightly below **our (SM)** half-year expectation, at £3.8 billion, due to tight control of spending. Operating cash flow from retail operations was down slightly year-on-year, at £3.8 billion, again affected by lower working capital inflow. **Our (SM)** strategy to release value from **our (SM)** property portfolio has had another **successful (AM)** year, generating £376 million of property profits from **around (hedge)** £1 billion of disposals. The launch of **our (SM)** first property fund in Asia completed successfully after the year end, raising over £379 million from 17 mature stores and malls in Thailand. With the fund seeing strong demand on launch, and since trading above its listing price, this is a strong indication of the overall value of **our (SM)** operations in Thailand and elsewhere in Asia. The market value of **our (SM)** global property currently exceeds £37 billion. Finally, **our (SM)** IAS 19, or accounting, pension deficit increased to £1.4 billion after tax, **largely (hedge)** as a consequence of market conditions. **We (SM)** announced proposed changes to the terms of **our (SM)** defined benefits scheme in March, in order to make it more sustainable over the long term. **We (SM)** also made a one-off cash contribution of £180 million to the scheme after the year end, in anticipation of the forthcoming outcome of the triennial actuarial valuation, which **we (SM)** believe **(booster)** gives a more accurate indication of the **likely (hedge)** costs of future funding of the scheme.

#### Group financial metrics

A year ago **I (SM)** set out four key financial metrics or measures to help investors monitor **our (SM)** capital returns performance, debt and overall balance sheet. Taking each in turn, **we (SM)** have improved return on capital employed ('ROCE') from 12.9% last year to 13.3%. This improvement benefits from Japan now being classified as discontinued as a result of **our (SM)** decision to exit the market.

**We (SM)** held **our (SM)** two debt metrics, fixed charge cover and net indebtedness, **broadly (hedge)** flat this year. Both measures will **of course (booster)** be directly affected by the UK investment plan **we (SM)** have announced for the coming year. **Our (SM)** target for fixed charge cover is between 4 and 4.5 times and, for net indebtedness, is 2.5 times. On **our (SM)** fourth key metric, capital expenditure as a proportion of sales, **we (SM)** were exactly in the middle of **our (SM)** target range of 5 to 5.5%.

"**Our (SM)** financial strategy of capital discipline and restraint supports a more sustainable level of growth, which focuses on getting more out of the businesses **we (EM)** currently have, benefits from less capital-intensive forms of investment and applies higher hurdle rates to new opportunities."

#### Looking forward

##### Capital expenditure

**Our (SM)** future plans include a reduced level of Group capital expenditure: down to £3.3 billion in 2012/13 and, beyond that, comfortably less than 5% of sales. This reflects **our (SM)** movement into a new phase of growth for the Group, moving beyond the diversification and expansion phase, to a phase where the allocation of capital is based on the balance of growth and returns that each investment can deliver.

##### Capital allocation

**Our (SM)** plans lead to further significant changes in **our (SM)** capital allocation for the Group. Having already started some of this work in the UK, **we (SM)** are seeing higher returns on the new space that **we (SM)** have opened as a result.

Across the Group more of **our (SM)** capital is going into smaller, higher-returning store formats.

**We (SM)** will be investing less overall capital in **our (SM)** UK business, as **we (SM)** reduce the net new space opening programme by 38% in the coming year, and focus store openings on smaller stores, and on food more than non-food.

Within the overall UK spend, **we (SM)** will be spending much more on the refresh of **our (SM)** existing stores, increasing **our (SM)** investment to over £200 million, in addition to an increase in **our (SM)** online investment to **around (hedge)** £150 million.

##### Capital work-in-progress

The level of capital work-in-progress ('WIP') on the UK balance sheet now stands at **around (hedge)** £2 billion. Building out stores faster than **we (SM)** acquire new sites will be a key contributor to UK space growth over the next few years, and will reduce this level of WIP. The completion of mixed use schemes within the WIP balance will also play a significant role in bringing it down to a more appropriate level, although the construction phase on these schemes will add to the WIP balance in 2012/13, followed by a rapid reduction thereafter. In some instances, **we (SM)** may also dispose of standalone sites that do not meet **our (SM)** new, more rigorous returns hurdles.

#### Cash



This financial strategy means an increasingly cash generative outlook for Tesco in the next few years, with an overall reduction in Group capital expenditure, a return to growth in the cash contribution from the UK business, the international businesses making an increasingly positive contribution and a return to strong cash inflows from working capital.

#### Returns

Capital restraint and improved cash generation both result in an improving ROCE. Last year, **we (SM)** laid out **our (SM)** commitment to improve ROCE to 14.6% by 2014/15. **Our (SM)** investment plans in the UK make it **likely (hedge)** that **we (SM)** will see a small reduction in 2012/13. However, **we (SM)** described a number of significant opportunities to increase returns last year, such as driving growth in the Bank, benefiting from regional scale in Central Europe and moving the US to profitability, as well as the structural benefit of maturing international businesses. These opportunities still exist and **indeed (booster)** **our (SM)** decision to divest the Japanese business has already made a contribution. **Our (SM)** financial strategy of capital discipline and restraint supports a more sustainable level of growth, which focuses on getting more out of the businesses **we (EM)** currently have, benefits from less capital-intensive forms of investment and applies higher hurdle rates to new opportunities. This in turn drives higher returns and a higher level of cash generation. In supporting the plans that make Tesco better for customers, **I (SM) believe (booster)** this financial strategy is also better for **shareholders (EM)**.

#### Board of directors (SM)

**Our (SM)** Board currently comprises the Chairman, Sir Richard Broadbent, five Executive Directors and eight independent Non-executive Directors. Biographies for each of **our (SM)** Directors and **our (SM)** Company Secretary are set out below.

##### 1. Sir Richard Broadbent – 58==

Non-executive Chairman

Sir Richard Broadbent joined the Board of Tesco PLC on 2 July 2011 and was appointed Chairman on 30 November 2011. He started his career at HM Treasury before joining Schroders in 1986. In 2000, Sir Richard was appointed Executive Chairman of HM Customs and Excise. He also joined the Management Board of the UK Civil Service, serving in both roles until 2003. In 2003 he was appointed to the Board of Barclays plc, becoming Senior Independent Director in September 2004 and Deputy Chairman in 2010. He stepped down from the Board of Barclays on 30 September 2011. Sir Richard joined the Board of Arriva plc in July 2004 and served as Chairman from November 2004 until 2010. He is also a trustee of the charity Relate.

##### 2. Philip Clarke – 51

Group Chief Executive

Philip Clarke was appointed to the Board on 16 November 1998. Prior to his appointment as CEO in March 2011 he was Asia, Europe & IT Director. Philip began his career with Tesco in store during 1974 and continued to work part-time through school and university. After graduating with a degree in Economic History, he joined the Tesco Management Training Programme and then spent nine years in store management before holding a number of roles in commercial and marketing. In 1994 he was appointed Stores Director and a year later promoted to Regional Managing Director, before joining the Tesco PLC Board as Supply Chain Director and a year later adding Information Technology to his responsibilities.

##### 3. Tim Mason – 54

Deputy Group CEO and CMO and CEO Fresh & Easy

Tim Mason has been President and Chief Executive Officer, Fresh & Easy Neighborhood Market since January 2006 and became Deputy Group CEO and Chief Marketing Officer in March 2011. He was appointed to the Board on 16 February 1995. He joined Tesco in 1982.

##### 4. Andrew Higginson – 54

CEO – Retail Services

Andrew Higginson was appointed to the Board on 17 November 1997. Prior to his appointment as Chief Executive of Retail Services in July 2008 he was Group Finance and Strategy Director. He was Chairman of Tesco Bank until 26 February 2012 and will retire from Tesco PLC on 1 September 2012. He is a Non-executive Director of BSKyB plc.

##### 5. Laurie McIlwee – 49

Chief Financial Officer

Laurie McIlwee was appointed to the Board on 27 January 2009 as Chief Financial Officer. He began his career with Tesco in 2000 as UK Finance Director and after four years, became Distribution Director. Prior to Tesco, Laurie worked for Pepsico in a variety of Finance and General Management roles in the UK, USA, Central Europe and the Middle East. Laurie is a Fellow of the Chartered Institute of Management Accountants and a member of The Hundred Group of Finance Directors.

##### 6. Lucy Neville-Rolfe, CMG – 59

#### Executive Director (Corporate and Legal Affairs)

Lucy Neville-Rolfe was appointed to the Board on 14 December 2006. She joined Tesco in 1997 from the Cabinet Office. She is Deputy Chair of the British Retail Consortium, a Non-executive Director of ITV plc and of the Carbon Trust. She is also a member of the London Business School's Governing Body, the China Britain Business Council, the UK India Business Council and the Corporate Leaders Group on Climate Change.

#### 7. Patrick Cescau – 63===

##### Senior Independent Director

Patrick Cescau was appointed a Non-executive Director on 1 February 2009 and became Senior Independent Director in July 2010. He was Group Chief Executive of Unilever from 2005 to 1 January 2009, and prior to this he was Chairman of Unilever plc and Vice Chairman of Unilever NV. He has also been a Non-executive Director of Pearson plc since 2002, becoming Senior Independent Director in April 2010, and IAG (International Airlines Group) since September 2010. Patrick was appointed a Chevalier de la Legion d'honneur in 2005. In June 2009, Patrick joined the Board of INSEAD.

#### Committee membership (from 26 February 2012)

= Nominations Committee

= Audit Committee

= Remuneration Committee

= CR Committee

#### 8. Gareth Bullock – 58=

##### Non-executive Director

Gareth Bullock was appointed a Non-executive Director on 3 July 2010 and will (subject to approval by the FSA) be appointed to the Board of Tesco Bank as a Non-executive Director. He was Group Executive Director of Standard Chartered PLC until his retirement in April 2010. He was also responsible for the Group's risk and special asset management function. He is Senior Independent Director and Chairman of the Remuneration Committee of Spirax-Sarco Engineering Plc.

#### 9. Stuart Chambers – 55==

##### Non-executive Director

Stuart Chambers was appointed a Non-executive Director on 3 July 2010 and will (subject to approval by the FSA) be appointed to the Board of Tesco Bank as a Non-executive Director. He was Group Chief Executive of NSG Group from 2008 to 2009. Prior to NSG's acquisition of Pilkington plc in 2006, Stuart was Group Chief Executive of Pilkington plc. Previously he held a number of senior roles at Pilkington plc and the Mars Corporation. He is a Non-executive Director of Smiths Group PLC, where he is Chairman of the Remuneration Committee, and of Manchester Airport Group PLC. Stuart was appointed Nonexecutive Director of Rexam PLC on 1 February 2012 and Nonexecutive Chairman effective from 22 February 2012.

#### 10. Karen Cook – 58=

##### Non-executive Director

Karen Cook was appointed a Non-executive Director on 1 October 2004. She is a Managing Director of Goldman Sachs International and President of Goldman Sachs, Europe. She is also a member of the firm's European Management Committee and Partnership Committee.

#### 11. Ken Hanna – 58===

##### Non-executive Director

Ken Hanna was appointed a Non-executive Director on 1 April 2009. He is Chairman of Inchcape PLC and a Non-executive Director of Aggreko plc. He was previously Chief Financial Officer of Cadbury plc until March 2009 and prior to that an Operating Partner of Compass Partners and CFO and then CEO of Dalgety PLC. He has also been CFO of United Distillers and Avis Europe plc.

#### 12. Ken Hydon – 67=

##### Non-executive Director

Ken Hydon was appointed a Non-executive Director on 23 February 2004 and is Chairman of the Audit Committee. He retired from the position of Finance Director of Vodafone Group Plc in 2005. He is also a Non-executive Director of Reckitt Benckiser plc and Pearson plc, and was a Non-executive Director at The Royal Berkshire NHS Foundation Trust from 2005 until 2012.

#### 13. Deanna Oppenheimer – 53=

##### Non-executive Director

Deanna Oppenheimer was appointed a Non-executive Director on 1 March 2012 and will (subject to approval by the FSA) be appointed to the Board of Tesco Bank as a Non-executive Director. Deanna held various senior roles between 2005 and 2011 at Barclays, initially as Chief Executive of UK Retail and Business Banking, Vice Chair of Global Retail Banking and also as Chief Executive of Europe Retail and Business Banking. Prior to Barclays, she was Marketing Director and later President of Consumer Banking of Washington Mutual. She has also served as a Non-executive Director of Catellus and Plum Creek Timber.

## 14. Jacqueline Tammenoms Bakker – 58==

Non-executive Director

Jacqueline Tammenoms Bakker was appointed a Non-executive Director on 1 January 2009. She was a Director General at the Ministry of Transport in the Netherlands from 2001 to 2007 and has held senior positions at Quest International, McKinsey & Co and Shell. Jacqueline is a Non-executive Director of Vivendi and was appointed a Chevalier de la Legion d'honneur in 2006.

## 15. Jonathan Lloyd – 45

Company Secretary

Jonathan Lloyd was appointed Company Secretary to the Board in December 2006. He joined Tesco as Deputy Company Secretary and Corporate Secretariat Director in April 2005 from Freshfields Bruckhaus Deringer. Jonathan is also Company Secretary of Tesco Bank.

Ages as at 25 February 2012.

## Principal risks and uncertainties

Risk is an accepted part of doing business. The real challenge for any business is to identify the principal risks it faces and to develop and monitor appropriate controls.

A **successful (AM)** risk management process balances risks and rewards and relies on a sound judgement of their likelihood and impact. The Board has overall responsibility for ensuring that the Group has an appropriate approach to risk management and internal control within the context of achieving the Group's objectives. **Our (SM)** process for identifying and managing risks is set out in more detail from page 60 of the Directors' report on corporate governance.

The table below sets out the principal risks faced by the Group, their movement during the year and examples of relevant key controls and mitigating factors. The Board **considers (hedge)** these to be the most significant risks and, whilst they are not directly comparable, they have been ranked in terms of relative importance to the Group at this time. They do not comprise all risks associated with the Group. Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business. The principal risks associated with operating Tesco Bank are considered separately in the section of the table below headed 'Tesco Bank/ Financial Services Risks'.

## KEY

Arrows: change in net risk assessment from 2010/11

> Net risk has increased

= Level of net risk is unchanged

< Net risk has decreased

Principal risks	Change from 2010/11	Key controls and mitigating factors
<b>Performance risk in the business</b>  Risk that business units (including the UK) underperform against plan and against competitors and <b>our (SM)</b> business fails to meet the stated strategy in full. Like all retailers, the business is susceptible to economic downturn affecting consumer spending	>	<ul style="list-style-type: none"> <li>Board, Executive Committee and various operational committees meet regularly to review performance risks</li> <li>All business units have stretching targets based on the Steering Wheel balanced scorecard system; performance against budgets and KPIs are monitored continually and reported regularly to Board</li> <li>Clear goals and objectives set for subsidiary CEOs, with high proportion of reward based on achievement</li> <li>Diversification strategy minimises impact of changes in economic climate</li> </ul>
<b>Operational threats to the business</b>  Risk that the business fails to maintain an optimum level of investment in capital, revenue or people and thus is limited in its ability to serve customers and grow	=	<ul style="list-style-type: none"> <li>Operational threats reviewed regularly by Board, Executive Committee, UK Trading Group and various operational committees</li> <li>Governance committees, including Compliance Committees, guide and monitor policies</li> <li>All business units have stretching operational targets based on the Steering Wheel balanced scorecard system; KPIs are monitored continually and reported regularly to Board</li> </ul>

		<ul style="list-style-type: none"> <li>○ Clear goals and objectives set for subsidiary CEOs, with high proportion of reward based on achievement</li> <li>○ People Matters Group regularly reviews talent planning, appointments and new roles</li> <li>○ Diversification strategy minimises impact of changes in economic climate</li> </ul>
<p>Reputational risk</p> <p>Failure to protect the Group's reputation and brand <b>could (hedge)</b> lead to a loss of trust and confidence, a decline in customer base and affect <b>our (SM)</b> ability to recruit and retain good people</p>	>	<ul style="list-style-type: none"> <li>○ Tesco Values embedded in how <b>we (SM)</b> do business at every level</li> <li>○ An embedded Group Code of Business Conduct guides <b>our (SM)</b> behaviour in dealing with customers, employees and suppliers</li> <li>○ <b>Stakeholder (EM)</b> communication and engagement to understand their views and reflect them in <b>our (SM)</b> strategy</li> <li>○ Commitment to tackling societal and environmental issues through <b>our (SM)</b> Community Plan and activities</li> <li>○ Governance committees, including Corporate Responsibility, Sustainability, Compliance and Information Security Committees, guide and monitor policies</li> </ul>
<p>People</p> <p>Failure to attract, retain, develop and motivate the best people with the right capabilities at all levels <b>could (hedge)</b> limit <b>our (SM)</b> ability to succeed</p>	>	<ul style="list-style-type: none"> <li>○ Significant investment in training, development and incentives, including Executive Committee Talent Cycle, Talent Planning, Leadership Development and succession planning for future needs of the business</li> <li>○ Clear processes to understand and respond to employees' needs through <b>our (SM)</b> People Matters Group, staff surveys, regular performance reviews, involvement of trade unions in relevant markets and regular communication of business developments</li> <li>○ Pay, pension and share plan arrangements help <b>us (SM)</b> to attract and retain good people</li> </ul>
<p>Business strategy</p> <p>If <b>our (SM)</b> strategy follows the wrong direction or is not effectively communicated or implemented then the business may suffer</p>	>	<ul style="list-style-type: none"> <li>○ Diversification and pursuit of growth in emerging markets under <b>our (SM)</b> strategy is reducing reliance on limited business areas</li> <li>○ Regular review of strategic matters by Board and Executive Committee; Board dedicates two full days a year to Group strategy</li> <li>○ Significant resource invested to communicate strategy effectively to those delivering it</li> <li>○ Consistent Operational Plans developed throughout the Group to ensure delivery</li> <li>○ Steering Wheel balanced scorecard system helps monitor delivery</li> <li>○ Structured <b>stakeholder (EM)</b> engagement programmes</li> </ul>
<p>Competition and consolidation</p> <p>Failure to compete on areas including price, product range, quality and service in increasingly competitive UK and overseas retail markets <b>could (hedge)</b> impact <b>our (SM)</b> market share and adversely affect the Group's financial results</p> <p>The consolidation of competitors, key geographical areas or markets through mergers or trade agreements <b>could (hedge)</b> also adversely impact <b>our (SM)</b> market share</p>	<p>Competition (UK, US and Asia) =</p> <p>Competition (Europe) &lt;</p> <p>Consolidation =</p>	<ul style="list-style-type: none"> <li>○ Strategy to have broad appeal on price, range and store format to allow <b>us (SM)</b> to compete in different markets</li> <li>○ Regular review of markets, trading opportunities and competitor activities, including online</li> <li>○ Performance tracked against relevant KPIs and measures that customers tell <b>us (SM)</b> are critical to their shopping experience</li> <li>○ Constant monitoring of customer perceptions of Tesco and competitors to ensure <b>we (SM)</b> can respond quickly as appropriate</li> <li>○ Monitoring of legislative changes, legal framework and compliance</li> </ul>

<p>Financial strategy</p> <p>Risks relate to an incorrect or unclear financial strategy or plans</p>	<	<ul style="list-style-type: none"> <li>Regular review of strategy, risks and financial performance by Board and Executive Committee, with external advice as required</li> <li>Consistent Operational Plans and Budgets developed throughout the Group to ensure delivery</li> <li>Steering Wheel balanced scorecard system helps monitor delivery</li> </ul>
<p>Fraud, compliance and internal controls</p> <p>As the business grows in size and geographical scope, the potential for fraud and dishonest activity by <b>our (SM)</b> suppliers, customers and employees increases</p>	=	<ul style="list-style-type: none"> <li>Appropriate procedures and controls, including segregation of duties, are set out and audited across the business to reduce fraud risks; Internal Audit and Loss Prevention &amp; Security undertake detailed investigations into all business areas and report their findings to the Audit Committee</li> <li>Clear behavioural guidance given to employees through Tesco Values and the Group Code of Business Conduct</li> <li>Compliance Committee formulates and monitors implementation of, and compliance with, relevant policies and procedures; annual governance returns completed by each business unit</li> <li>External Audit rotational coverage of areas and assessment of controls</li> <li>Updated policies and procedures for Bribery Act compliance</li> </ul>
<p>IT systems and infrastructure</p> <p>Any significant failure in the IT processes of <b>our (SM)</b> retail operations <b>would (hedge)</b> impact <b>our (SM)</b> ability to trade. Failure to invest appropriately in IT <b>would (hedge)</b> constrain the growth of the business and fail to safeguard personnel, supplier or customer data</p>	=	<ul style="list-style-type: none"> <li>Extensive controls and reviews to maintain integrity and efficiency of IT infrastructure and data</li> <li>Rigorous governance processes for new and modified systems implementations</li> <li>Processes to deal with significant IT security incidents</li> <li>Sharing of systems across international operations to ensure consistency of delivery</li> <li>Investment in IT systems and innovations to improve business efficiency and customers' shopping experience</li> <li>Information Security Committee meets regularly to review the development and implementation of IT policies</li> </ul>
<p>Group Treasury (excluding Tesco Bank)</p> <p>Risks relate to the availability of funds across the Group to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by counterparties to financial transactions. The principal risks associated with operating Tesco Bank are covered in the Tesco Bank/Financial Services Risks section below. Further detail on the management of financial risks by the Group can be found in the 'Financial risks review' section following this table and in Note 22 of the financial statements</p>	<	<ul style="list-style-type: none"> <li>Regular review of strategy, risks and financial performance by Board and Executive Committee, with external advice as required</li> <li>Financial risks relating to underlying business needs are mandated to <b>our (SM)</b> Treasury function which has clear policies and operating parameters and its activities are routinely reviewed and audited</li> <li>Internal Audit reports on financial control systems</li> <li>Development of cross-functional Eurozone Committee to monitor and manage the risks associated with instability in the eurozone as a result of the depth of the financial crisis</li> </ul>
<p>Property</p> <p>Continuing acquisition and development of property sites carries inherent risk; targets to deliver new space may not be achieved; challenges may arise in relation to finding suitable sites, obtaining planning or other consents and compliance with varying country design and construction standards</p>	<p>UK &lt;</p> <p>International =</p>	<ul style="list-style-type: none"> <li>Property Acquisition and related committees closely control all aspects of property acquisition, planning and construction processes to ensure standards are met and risks are minimised</li> <li>Group and country Compliance Committees monitor legal and regulatory compliance in property activities</li> <li>China Property Company Board closely monitors property matters in China</li> <li>Mall management systems in place to assist tenant management</li> </ul>

<p>Product safety</p> <p>Failures <b>could (hedge)</b> damage customer trust and confidence, impacting <b>our (SM)</b> customer base and therefore financial results</p>	<p>UK and US =</p> <p>International (exc. US) =</p>	<ul style="list-style-type: none"> <li>○ Detailed, established procedures, operating globally, to ensure product integrity</li> <li>○ Strict trading law and technical safety testing regime with regular reporting; Group</li> <li>○ Compliance Committee reviews compliance with laws and policies</li> <li>○ Partnering with suppliers for mutual understanding of required standards</li> <li>○ Monitoring of developments to respond to changing customer trends and legislation such as labelling and dietary responsibilities</li> <li>○ Clear and tested crisis management processes</li> </ul>
<p>Climate change and sustainability</p> <p>The main environmental risk <b>we (EM)</b> face is climate change. It is <b>essential (AM)</b> <b>we (SM)</b> work to mitigate it through energy efficiency, the sustainable management of other resources and waste minimisation. <b>We (SM)</b> are also <b>committed (AM)</b> to supporting customers by giving them the information they need to make their own choices</p>	=	<ul style="list-style-type: none"> <li>○ Engagement with key <b>stakeholders (EM)</b> and experts in developing environmental policy, including through the Sustainable Consumption Institute <b>we (SM)</b> endowed at Manchester University</li> <li>○ Climate change strategy is part of <b>our (SM)</b> Community Plan and is reviewed regularly by <b>our (SM)</b> Sustainability Committee and Executive Committee and reported to the Board</li> <li>○ Targets are regularly reviewed as part of the Community segment of the Steering Wheel balanced scorecard system</li> </ul>
<p>Economic and political risks</p> <p>In each country where <b>we (SM)</b> operate, <b>we (EM)</b> may be impacted by legal, regulatory and tax changes, increased scrutiny by competition authorities, political developments and the economic environment</p>	<p>Economic &gt;</p> <p>Political =</p>	<ul style="list-style-type: none"> <li>○ External uncertainties carefully considered when developing strategy and reviewing performance</li> <li>○ Ongoing monitoring of developments through local CEOs</li> <li>○ <b>We (SM)</b> try to <b>anticipate (hedge)</b> and contribute to important changes in public policy wherever <b>we (SM)</b> operate</li> <li>○ Engagement with governmental and non-governmental organisations to represent views of <b>our (SM)</b> customers and employees</li> <li>○ Business development follows thorough due diligence work</li> </ul>
<p>Pension risks</p> <p><b>Our (SM)</b> IAS 19 deficit <b>could (hedge)</b> increase if returns on corporate bonds are higher than the investment return on the pension scheme's assets. There are also increasing risks of legal and regulatory changes introducing more burdensome requirements</p>	=	<ul style="list-style-type: none"> <li>○ Diversified investment strategy with increased control and visibility through the appointment of an in-house investment team</li> <li>○ Changes to benefits proposed which will reduce the scheme's life expectancy and inflation risks</li> <li>○ Monthly review by Pensions and Treasury Directors</li> <li>○ External advisors and pension fund trustees fully engaged to consider deficit and fund performance and legislative and regulatory changes and their impact</li> </ul>
<p>Activism and terrorism</p> <p>A major incident or terrorist event <b>could (hedge)</b> impact on staff safety or the Group's ability to trade</p>	<	<ul style="list-style-type: none"> <li>○ Appropriate contingency plans</li> <li>○ Security systems and processes that reflect best practice</li> </ul>
<p>Health and safety</p> <p>Failure to provide safe environments for <b>our (SM)</b> staff and customers <b>could (hedge)</b> lead to injuries or loss of life</p>	=	<ul style="list-style-type: none"> <li>○ Operation of stringent processes that reflect best practice; policies are monitored and audited regularly</li> <li>○ KPIs across the business help prevent incidents with quarterly reporting of performance against KPIs</li> <li>○ Group Compliance Committee and business unit Compliance Committees regularly monitor compliance with laws and internal policies</li> <li>○ Lucy Neville-Rolfe is the Executive Director responsible for health and safety issues</li> </ul>

Tesco Bank ('the Bank') primarily operates in the UK retail financial services market offering savings products, unsecured consumer lending products and general insurance products as well as travel money and ATM services. The section below sets out principal risks relating specifically to the Bank.

The Bank's Enterprise Wide Risk Management Framework identifies the main controls and actions. There are a number of key components of the framework common to all of the major risk categories, including the following:

Component	Description of the component
Independent Risk function	Reporting to the Chief Risk Officer ('CRO') and responsible for designing and implementing risk management frameworks and for independently monitoring the risk profile, providing oversight and challenge to the business
Three lines of defence	Line managers are responsible for establishing an effective control framework within their area of operations and for identifying and controlling all risks within risk appetite and policy limits (first line of defence). The second line of defence is the independent Risk function. Internal Audit is the third line of defence and is responsible for the independent assessment of the effectiveness of the implementation of the overall risk and control measures
Policy framework	Risk is responsible for the policy framework, with the Bank's policy documents providing the rules and guiding principles that define the approach to specific subjects and covering all aspects of risk
Integrated risk reporting	Reporting is provided monthly to senior governance committees. Exposures are monitored against triggers and limits on a daily, weekly or monthly frequency as required. Exceptions are reported monthly to the Bank's Asset & Liability Management Committee ('ALCO'), the Risk Management Committee ('RMC') and to each meeting of Board Risk Committee ('BRC')
Stress testing	Stress testing is the process under which the Bank's business plans, capital and liquidity are subjected to severe adverse impacts. Stress testing is a mandatory requirement of the FSA who require that banks implement their own stress testing processes. Stress testing is <b>essential (AM)</b> to effective risk management and is a key component of the Bank's Internal Capital Adequacy Assessment Process ('ICAAP') and Internal Liquidity Adequacy Assessment ('ILAA') processes

The table below sets out the principal risks currently faced by the Bank, their movement during the year and provides examples of relevant key controls and mitigating factors. The Bank's Board **considers (hedge)** these to be the most significant risks but has not set them out in any order of priority. They do not comprise all risks associated with the Bank. Additional risks not presently known to management, or currently deemed to be less material, may also have an adverse effect on the business.

Principal risks	Change from 2010/11	Key controls and mitigating factors
<p>Transformation risk</p> <p>The Transformation Programme is a significant change programme designed to develop platforms and processes to enable the Bank to conduct banking and insurance business independently of The Royal Bank of Scotland Group ('RBS'). The key remaining component of the Transformation Programme is the migration of the credit card portfolio. In addition, the Bank has well-developed plans for launching mortgages, subject to FSA approval</p>	<	<ul style="list-style-type: none"> <li>There is strong programme governance in place with a tiered committee structure headed by the Bank's Executive-level Project Assessment Committee ('PAC')</li> <li>The Bank operates standard project management disciplines which are employed to deliver effective programme and risk and issue management</li> </ul>
<p>Credit risk – external environment</p> <p>The downside risks to the UK economy remain high, including fragile consumer confidence, a squeezing of real incomes, increasing unemployment and some consumers increasing borrowing and switching to variable rate mortgages</p> <p>On the wider economic front subdued UK growth,</p>	>	<ul style="list-style-type: none"> <li>The Bank's credit risk appetite is based on lending responsibly to manage the credit risk profile of its portfolio within agreed parameters</li> <li>Credit portfolios continue to be closely monitored with changes made to acquisition and limit management strategies to mitigate, as far as possible, downside economic risks</li> <li>The Bank has minimal direct exposure to non-UK sovereigns and proactively monitors and manages the</li> </ul>

continued fiscal austerity and the continuing eurozone debt crisis is impacting confidence and may impact the ability to sustain debt servicing and repayment in the event of an economic shock		non-retail portfolios to reduce exposure to specific names or geographies
<p>Legal and regulatory compliance risk</p> <p>Legal and regulatory compliance risk is the risk of consequences arising as a result of non-compliance with the laws and regulations affecting the Bank's governance, prudential arrangements, business activities, risk management and its conduct with customers</p> <p>Conduct risk</p> <p>There remains significant regulatory focus in relation to 'Conduct risk' or 'Treating Customers Fairly'. Specifically there has been continued industry-wide focus on provision of redress in relation to past sales of Payment Protection Insurance ('PPI')</p>	=	<ul style="list-style-type: none"> <li>○ The Bank's aim is to meet all legal and regulatory requirements by maintaining an effective control framework</li> <li>○ A dedicated risk team is responsible for the identification of regulatory risks, the management and oversight of policies and processes and the provision of assurance in relation to regulatory risk and compliance</li> </ul>
<p>Insurance risk</p> <p>The Bank defines insurance risk as the risk <b>we (EM)</b> accept through <b>our (EM)</b> insurance products in return for a premium. These risks <b>may (hedge)</b> or may not occur as <b>expected (hedge)</b> and the amount and timing of these risks are <b>uncertain (hedge)</b> and determined by events outside of <b>our (SM)</b> control</p> <p>The Bank is exposed to insurance risks through its historic distribution arrangement with RBS, which is <b>expected (hedge)</b> to terminate in quarter four of 2012, and through its ownership of 49.9% of Tesco Underwriting Limited ('TU')</p>	<	<ul style="list-style-type: none"> <li>○ The Bank's aim is to actively manage insurance risk exposure with particular focus on those risks that impact profit volatility</li> <li>○ Regular, independent reviews of reserves are undertaken with reporting to the Bank's RMC, Audit Committee, BRC and Board</li> <li>○ The Bank uses reinsurance to limit exposure above pre-determined limits</li> <li>○ Risk appetite and a suite of risk policies are in place to manage risk in TU</li> <li>○ The Bank's Insurance Risk function provides independent oversight of TU which is appropriate to the Bank's role as key shareholder</li> </ul>
<p>Funding/liquidity risk</p> <p>Liquidity risk is the risk that the Bank has insufficient cash resources to meet its obligations as they fall due or can do so only at excessive cost</p> <p>Funding risk is the risk that the Bank does not have sufficiently stable and diverse sources of funding or the funding structure is inefficient</p> <p>External market conditions continue to exhibit signs of stress (with wholesale funding markets constrained) and significant competition for retail deposits</p> <p>The Group relies on significant amounts of on demand retail funding</p>	=	<ul style="list-style-type: none"> <li>○ The Bank aims to have a conservative Balance Sheet structure with prudent risk appetite supported by explicit targets and metrics which enable it to meet its financial obligations, including under stressed conditions</li> <li>○ The Bank holds a significant and diversified stock of highly marketable liquid assets, in excess of internal and regulatory requirements</li> <li>○ The Bank's significant retail deposit base means that there is currently less reliance on wholesale markets as a source of funding and historic practice <b>indicates (hedge)</b> that such deposits <b>tend to (hedge)</b> be <b>relatively (hedge)</b> stable</li> </ul>
<p>Operational risk</p> <p>Operational risk is the potential error, loss, harm or failure caused by ineffective or inadequately defined processes, system failure, improper conduct, human error or from external events</p> <p>Outsourcing risk</p>	=	<ul style="list-style-type: none"> <li>○ The Bank's aim is to minimise all operational risks and reputational impacts</li> <li>○ A Risk and Control Self Assessment process is used by the business to identify, assess, quantify, monitor and report its operational risks and management's effectiveness in mitigating them. Regular reporting is provided to RMC and remedial actions taken as required</li> </ul>



<p>A significant number of services and processes are provided by third party service providers and a key operational risk is the failure of an outsourced service provider</p> <p>People risk</p> <p>Increased market demand for specialist personnel <b>could (hedge)</b> result in increased costs of recruitment and retention or reduced organisational effectiveness if a sufficient number of skilled staff cannot be employed</p>	<p>&gt;</p> <p>&gt;</p>	<ul style="list-style-type: none"> <li>○ The Procurement policy provides consistent and robust standards for supplier sourcing and selection</li> <li>○ The Bank's Strategic Relationship Management process enables the monitoring of the performance of third-party outsourcers and suppliers against agreed service level agreements, the management of the relationships and the improvement of supply or termination of contract where appropriate</li> <li>○ The Bank's People Matters Group, an Executive committee of the Bank, oversees key aspects of people risk, including talent management, performance management, retention and succession planning</li> </ul>
<p>Market risk</p> <p>Market risk is defined as the risk that the value of the Bank's assets, liabilities, income or costs might vary due to changes in the value of financial market prices; this includes interest rates, foreign exchange rates, credit spreads and equities</p>	<p>=</p>	<ul style="list-style-type: none"> <li>○ The Bank has no trading book</li> <li>○ There is low appetite for exposure to interest rate risk in the banking book ('IRBB') and other market risks, such as credit spreads, which are monitored and reported through ALCO and RMC</li> </ul>

#### Financial risks review

The main financial risks faced by the Group relate to the availability of funds to meet business needs, fluctuations in interest and foreign exchange rates and credit risks relating to the risk of default by counterparties to financial transactions. The management of these risks is set out below. Details of the main financial risks relating to Tesco Bank and the management of those risks can be found in the principal risks and uncertainties table above and in Note 22 to the financial statements on page 126.

#### Funding and liquidity

The Group finances its operations by a combination of retained profits, disposals of property assets, long- and medium-term debt capital market issues, short-term commercial paper, bank borrowings and leases. The objective is to ensure continuity of funding. The policy is to smooth the debt maturity profile, to arrange funding ahead of requirements and to maintain sufficient undrawn committed bank facilities and a strong credit rating so that maturing debt may be refinanced as it falls due. Tesco Group has a long-term rating of A- (stable) from Fitch, Baa1 (stable) from Moody's and A- (stable) from Standard & Poor's. New funding of £2.5 billion was arranged during the year, including a net £1.1 billion from property disposals and £1.4 billion from long-term debt. At the year end, net debt was £6.8 billion (2011: £6.8 billion).

#### Interest rate risk management

**Our (SM)** objective is to limit **our (SM)** profit and loss downside from rising interest rates. Forward rate agreements, interest rate swaps, caps and floors are used to achieve the desired mix of fixed and floating rate debt. **Our (SM)** policy is to fix interest rates for the year on a minimum of 40% of actual and projected debt interest costs of the Group excluding Tesco Bank. At the year end the percentage of interest bearing debt at fixed rates was 90% (2011: 71%). The remaining balance of **our (SM)** debt is in floating rate form. The average rate of interest paid on an historic cost basis this year, excluding joint ventures and associates, was 4.8% (2011: 5.4%).

#### Foreign currency risk management

**Our (SM)** principal objective is to reduce the effect of exchange rate volatility on operating margins. Transactional currency exposures that could significantly impact the Group Income Statement are managed, **typically (hedge)** using forward purchases or sales of foreign currencies and purchased currency options. At the year end, forward foreign currency transactions, designated as cash flow hedges, equivalent to £1,944 million were outstanding (2011: £1,615 million) as detailed in Note 21. **We (SM)** translate overseas profits at average foreign exchange rates which **we (SM)** do not currently further manage. **We (SM)** only hedge a proportion of the investment in **our (EM)** international subsidiaries as well as ensuring that each subsidiary is **appropriately (AM)** hedged in respect of its non-functional currency assets. During the year, currency movements decreased the net value, after the effects of hedging, of the Group's overseas assets by £22 million (last year decrease of £344 million).

#### Credit risk

The objective is to reduce the risk of loss arising from default by parties to financial transactions across an approved list of counterparties of **good (AM)** credit quality. The Group's positions with these counterparties and their credit ratings are routinely monitored.

#### Insurance

**We (SM)** purchased assets, earnings and combined liability protection from the open insurance market for higher value losses only. The risk not transferred to the insurance market is retained within the business with some cover being provided by **our (SM)** captive insurance companies, ELH Insurance Limited in Guernsey and Valiant Insurance Company Limited in the Republic of Ireland. ELH Insurance Limited covers Assets, Earnings and Combined Liability, while Valiant Insurance Company Limited covers Combined Liability only.

#### Statement of compliance

The Business Review contained within this document has been prepared in accordance with the requirements for a business review under the Companies Act 2006. The intent is to provide information to **shareholders (EM)** and this document **should (EM)** not be relied on by any other party or for any other purpose.

#### Cautionary statement regarding forward-looking information

Where this document contains forward-looking statements, these are made by the Directors in good faith based on the information available to them at the time of their approval of this report. These statements **should (EM)** be treated with caution due to the inherent risks and uncertainties underlying any such forward-looking information. The Group cautions investors that a number of **important (AM)** factors, including those in this document, **could (hedge)** cause actual results to differ materially from those contained in any forward-looking statement. Such factors include, but are not limited to, those discussed under 'Principal risks and uncertainties' on pages 40 to 47 of this Annual Report.

#### General information

##### Principal activity, business review and future developments

The principal activity of the Group is retailing and associated activities in the UK, China, the Czech Republic, Hungary, the Republic of Ireland, India, Malaysia, Poland, Slovakia, South Korea, Thailand, Turkey and the US. The Group also provides retail banking and insurance services through its subsidiary, Tesco Bank. The Group is currently in the process of disposing of its Japan operations.

##### Group results

Group revenue (excluding VAT) rose by £4 billion to £64.5 billion, representing an increase of 6.8%. Group profit before tax increased by £194 million to £3,835 million. Profit for the year was £2,814 million, of which £2,806 million was attributable to equity holders of the parent company.

##### Dividends

The Directors recommend the payment of a final dividend of 10.13p per ordinary share, to be paid on 6 July 2012 to members on the Register at the close of business on 27 April 2012. Together with the interim dividend of 4.63p per ordinary share paid in December 2011, the full year dividend will be 14.76p compared with 14.46p for the previous year, an increase of 2.1%.

##### Fixed assets

Capital expenditure (excluding business combinations) amounted to £3.8 billion compared with £3.7 billion the previous year. In the Directors' opinion, the properties of the Group have an open market value well in excess of the book value of £27.7 billion which has been included in these financial statements.

##### Share capital and control of the Company

Details of the Company's share capital, including changes during the year in the issued share capital and details of the rights attaching to the Company's ordinary shares, are set out in Note 27 on page 136. No **shareholder (EM)** holds securities carrying special rights with regards to control of the Company and there are no restrictions on voting rights.

During the financial year, the Company purchased and cancelled 70.8 million ordinary shares of 5p each in the capital of the Company, representing 0.9% of its issued share capital as at 25 February 2012, for a total consideration of £290 million (including expenses). The shares were purchased in order to offset dilution resulting from the issue of shares in connection with the Company's employee share incentive schemes. The Company was subsequently authorised by **shareholders (EM)** at the 2011 AGM to purchase its own shares in the market up to a maximum of **approximately (hedge)** 10% of its issued share capital. No shares were purchased under that authority during the financial year. The Company is seeking to renew the authority at the forthcoming AGM, within the limits set out in the notice of that meeting.

Shares held by the Company's Employee Share Incentive Plan Trust, International Employee Benefit Trust, Tesco Ireland Share Bonus Scheme Trust and Tesco Employee Share Scheme Trust rank pari passu with the shares in issue and have no special rights. Voting rights and rights of acceptance of any offer relating to the shares held in these trusts rests with the trustees, who may take account of any recommendation from the Company. Voting rights are not exercisable by the employees on whose behalf the shares are held in trust.

The Company is not party to any significant agreements that **would (hedge)** take effect, alter or terminate following a change of control of the Company. The Company does not have agreements with any Director or Officer that **would (hedge)** provide compensation for loss of office or employment resulting from a takeover, except that provisions of the Company's share plans may cause options and awards granted under such plans to vest on a takeover.

##### Company's **shareholders (EM)**

The Company has been notified of the following significant holdings of voting rights in its shares as at 25 February 2012 and as at the date of this report:

#### Articles of Association

The Company's Articles of Association may only be amended by special resolution at a general meeting of the **shareholders (EM)**.  
Directors and their interests

The Directors who served during the year were: Richard Brasher; Sir Richard Broadbent; Gareth Bullock; Patrick Cescau; Stuart Chambers; Philip Clarke; Karen Cook; Ken Hanna; Andrew Higginson; Ken Hydon; Sir Terry Leahy; Tim Mason; Laurie McIlwee; Lucy Neville-Rolfe CMG; David Potts; Sir David Reid; and Jacqueline Tammenoms Bakker. The biographical details of the present Directors are set out on pages 38 and 39 of this Annual Report.

The interests of Directors and their immediate families in the shares of Tesco PLC, along with details of Directors' share options, are contained in the Directors' Remuneration Report set out on pages 64 to 86.

At no time during the year did any of the Directors have a material interest in any significant contract with the Company or any of its subsidiaries. A qualifying third-party indemnity provision as defined in Section 234 of the Companies Act 2006 is in force for the benefit of each of the Directors and the Company Secretary (who is also a Director of certain subsidiaries of the Company) in respect of liabilities incurred as a result of their office, to the extent permitted by law. In respect of those liabilities for which directors may not be indemnified, the Company maintained a directors' and officers' liability insurance policy throughout the financial year.

#### Employment policies

The Group depends on the skills and commitment of its employees in order to achieve its objectives and **we (SM)** strive to ensure that **our (SM)** company Values are reflected in **our (SM)** policies. Ongoing training programmes seek to ensure that employees understand the Group's customer service objectives and strive to achieve them. The Group's selection, training, development and promotion policies ensure everyone is **welcome (AM)** and equal opportunities for all employees regardless of factors such as gender, marital status, race, age, sexual preference and orientation, colour, creed, ethnic origin, religion or belief, disability or trade union affiliation. All decisions are based on merit. Internal communications are designed to ensure that employees are **well (AM)** informed about the business of the Group. Employees are encouraged to become involved in the financial performance of the Group through a variety of voluntary schemes, principally the Tesco employee profit-sharing scheme (Shares in Success), the savings-related share option scheme (Save As **You (EM)** Earn) and the partnership share plan (Buy As **You (EM)** Earn).

#### Political and charitable donations

Cash donations to charities amounted to £25,646,209 (2011: £15,613,319). Total contributions to community projects including cash, cause-related marketing, gifts-in-kind, staff time and management costs amounted to £74,588,818 (2011: £64,254,910). There were no political donations (2011: £nil). During the year, the Group made contributions of £28,137 (2011: £55,085) in the form of sponsorship for political events: Conservative Party £4,790; Labour Party £12,011; Liberal Democrat Party £6,636; Scottish National Party £4,700.

#### Supplier payment policy

Tesco PLC is a signatory to the Prompt Payment Code in the UK. More information about the Code can be found at [www.promptpaymentcode.org.uk](http://www.promptpaymentcode.org.uk). Payment terms and conditions are agreed with suppliers in advance and the Group pays its creditors in accordance with those terms. Payment terms vary according to the type of product and territory in which the suppliers operate. Tesco PLC is a holding company and therefore has no trade creditors on its Balance Sheet.

#### Compliance with the Groceries (Supply Chain Practices) Market Investigation Order 2009 and the Groceries Supply Code of Practice ('Code')

The Code came into force on 4 February 2010 in the UK and places obligations on grocery retailers with a turnover greater than £1 billion to build a compliance programme, which includes training staff and providing information to the OFT as requested. In addition the Code sets out a number of provisions which relate to different aspects of the relationship between a retailer and supplier.

**We (SM)** are **committed (AM)** to treating **our (SM)** suppliers fairly and work in collaboration with them wherever possible. It is in **our (SM)** nature to treat compliance with the Code very seriously.

**We (SM)** have in place a Code Compliance Officer ('CCO') supported by a small team including an auditor. **We (SM)** have developed an audit plan and **our (SM)** approach enables **us (SM)** to identify any gaps in **our (SM)** processes so they can be quickly fixed. This approach is working **well (AM)**, as evidenced by **our (SM)** having identified a gap relating to the information given to suppliers in connection with delisting. **We (SM)** responded immediately by strengthening internal processes to ensure that all information provided to suppliers complies with the Code requirements in this area.

**We (SM)** also have in place an ongoing compliance training programme for **our (SM)** buying teams, and a comprehensive training course is provided for relevant new starters. **We (SM)** identified some non-compliance with the Code relating to the training of some new starters within the period mandated by the Code. **We (SM)** responded immediately by ensuring that all relevant personnel were trained by year end and strengthening internal processes to ensure that all new starters are trained within Code timelines. Annual refresher training is provided via a bespoke e-learning programme.

All alleged breaches of the Code raised by suppliers this year have been dealt with internally. **We (SM)** have had no instance this year of a supplier initiating the Dispute Resolution Procedure set out in the Code. The CCO submits reports to the Audit Committee, which **considers (hedge)** that it retains effective oversight of **our (SM)** compliance with the Code.

#### Going concern

The Directors **consider (hedge)** that the Group and the Company have adequate resources to remain in operation for the foreseeable future and have therefore continued to adopt the going concern basis in preparing the financial statements.

#### Events after the Balance Sheet date

On 5 March 2012, Ek-Chai Distribution System Co. Ltd. ('Tesco Lotus'), announced the final offering price of the Initial Public Offering of Tesco Lotus Retail Growth Freehold and Leasehold Property ('TLGF'). Tesco Lotus subscribed for 25% of the available units in TLGF. The units commenced trading on the Stock Exchange of Thailand on 19 March 2012. On 30 March 2012, the Company paid a contribution of £180 million into the UK defined benefit pension scheme.

#### Auditors

A resolution to reappoint PricewaterhouseCoopers LLP as auditors of the Company and the Group will be proposed at the 2012 AGM.

#### Directors' statement of disclosure of information to auditors

Having made the requisite enquiries, the Directors in office at the date of this Annual Report and Financial Statements have each confirmed that, so far as they are aware, there is no relevant audit information (as defined by Section 418 of the Companies Act 2006) of which the Group's auditors are unaware, and each of the Directors has taken all the steps he/she **ought to (EM)** have taken as a Director to make himself/ herself aware of any relevant audit information and to **establish (booster)** that the Group's auditors are aware of that information. This confirmation is given and **should (EM)** be interpreted in accordance with the provisions of Section 418 of the Companies Act 2006.

#### Corporate governance

"Governance provides the framework supporting the core values which define what is and what is not **acceptable (AM)**. It informs **our (SM)** actions and decisions and supports the culture and behaviours that **we (SM)** wish to foster."

Sir Richard Broadbent  
Chairman

#### Introduction from the Chairman

**Our (SM)** approach to governance begins with the recognition that it is not a set of rules but the framework supporting the core values which define what is and what is not **acceptable (AM)**. It is an expression of the way **we (SM)** want to conduct **ourselves (SM)** which informs actions and decisions whether or not there is a specific rule for the situation, and which supports the culture and behaviours that **we (SM)** wish to foster.

**We (SM)** are introducing a number of changes to **our (SM)** governance framework from the beginning of 2012/13 to keep it aligned with this vision and relevant to **our (SM)** growing business. The main features of the new arrangements, which are described more fully below, are:

- a revised definition of Matters Reserved to the Board;
- an updated delineation of the roles of Chairman and Chief Executive;
- updated and expanded terms of reference for Board Committees;
- the elimination of a number of existing Committees and the creation of one new Committee to oversee Corporate Responsibility; and
- clarification of the role and structure of the independent Board of Tesco Bank and its relationship with the PLC Board.

A governance framework requires appropriate processes to support it, which achieve a balance between prompting thoughtful judgement when required and not stifling commercial behaviour through delay, risk aversion or rigidity. The new governance framework has given **us (SM)** the opportunity also to review the processes which support and underlie it and **we (SM)** are introducing a number of improvements in 2012/13.

Governance also requires the active and committed engagement of Board and management. The development of the Board, to ensure that its skills, balance and experience are optimum, is a continuous process and the developments of the past year are described more fully below. The Executive Committee and its supporting governance framework and processes have also been developed during the year by the Chief Executive, Philip Clarke.

**We (SM) believe (booster)** that these changes will enhance the way that the Group operates. **Our (SM)** aim is to ensure that the Group continues to benefit from structures and processes which support effective strategic debate and questioning; appropriate

monitoring of performance; the capacity to formulate the right questions; and the strength to hold difficult questions on behalf of **shareholders (EM)**.

Sir Richard Broadbent  
Chairman

#### Governance structures

Over the past few months, **we (SM)** have been reviewing and updating the Group's corporate governance framework, to ensure that it remains relevant to the business both today and in future and supports **our (SM)** management in discharging their responsibilities. Copies of all the documents referred to below are available in full on the Company's website at [www.tescopl.com/plc/ir/corpgov/boardprocess](http://www.tescopl.com/plc/ir/corpgov/boardprocess).

The Matters Reserved to the Board and the delineation of responsibilities between the Chairman and Chief Executive have both been clarified and updated to reflect best practice, while taking into account the needs of the business.

**We (SM)** have taken the opportunity to simplify the Board Committees. There are now four committees:

- Audit;
- Remuneration;
- Nominations; and
- Corporate Responsibility.

The remit of the Audit and Remuneration Committees is substantially unchanged, although the terms of reference of both of these Committees have been reviewed in line with best practice to ensure that they remain relevant to the business. The remit of the Nominations Committee has been broadened so that it can deepen its focus on succession planning and the development of talent and, in addition, consider governance matters, including overseeing the structure and remit of the Board and its Committees. The number of meetings is being increased to four a year. A new Corporate Responsibility Committee has been created to ensure that the Board maintains an adequate focus on corporate responsibility in its widest sense. This reflects the importance to the Group of how it is perceived externally. The new Committee is responsible for defining and overseeing the Group's corporate and social obligations. **We (SM)** have also reviewed the governance framework for Tesco Bank (which, in line with regulatory requirements, has an independent Board) to ensure that the importance of robust, independent and competent challenge at the level of the Bank's Board is balanced with appropriate alignment with, and oversight of, the PLC Board. The structure of the Bank Board and its Committees remains unchanged and the Bank Board continues to have three Board Committees: Audit; Risk; and Remuneration. The constitution of the Bank Board has, however, been revised and will now comprise a Non-executive Chairman, together with **broadly (hedge)** equal representation of the Bank's executive management, Tesco PLC Non-executive Directors and independent Non-executive Directors.

#### Compliance with the UK Corporate Governance Code

The UK Corporate Governance Code (the 'Code') sets out the main principles and specific provisions on how companies should be directed and controlled to follow good governance practice. The rules of the Financial Services Authority (the 'FSA') require companies listed in the UK to disclose, in relation to the Code, how they have applied those principles and whether they have complied with the provisions throughout the financial year. Where the provisions have not been complied with, companies must provide an explanation for this.

Provision B.1.2 of the Code requires at least half of the Board, excluding the Chairman, to comprise Non-executive Directors determined by the Board to be independent. Tesco has complied with this provision except for the first four days of the financial year, when it had one more Executive Director than Non-executive Directors (excluding the Chairman). However, following Sir Terry Leahy's retirement and the appointment of Philip Clarke as his successor as CEO in March 2011, there has been at least an equal number of Non-executive and Executive Directors.

Prior to 2 March 2011 Philip Clarke was the Executive Director responsible for Asia, Europe & IT.

Provision B.6.3 of the Code requires the Non-executive Directors, led by the Senior Independent Director, to evaluate the performance of the Chairman, taking into account the views of Executive Directors. As the new Chairman, Sir Richard Broadbent, only assumed his role of Chairman on 30 November 2011, it has been adjudged too soon in his tenure to make a fair and reasonable assessment of his Chairmanship.

The Board **considers (hedge)** that Tesco PLC complied in all material respects with the Code for the whole of the year ended 25 February 2012. Further information on Code can be found at [www.frc.org.uk](http://www.frc.org.uk).

#### Board composition and independence

As at 25 February 2012, the Board of Tesco PLC comprised the Nonexecutive Chairman, Sir Richard Broadbent, six Executive Directors and seven independent Non-executive Directors. Sir Terry Leahy retired as Group CEO on 2 March 2011 and was replaced by Philip Clarke. Sir David Reid retired as Chairman on 30 November 2011 and was replaced by Sir Richard Broadbent. David Potts stepped down as a Tesco PLC Executive Director on 7 December 2011.

The following changes have been announced since the end of the 2011/12 financial year: Deanna Oppenheimer joined the Board as a Non-executive Director on 1 March 2012 and Richard Brasher stepped down from the Board of Tesco PLC on 15 March 2012. Andrew Higginson will retire on 1 September 2012.

Board development is a continuous process, but **we (SM) believe (booster)** that the size and experience of the Board is appropriate given the diverse markets the Group operates in and the breadth of operations and services offered by the Group. Biographies for the Directors can be found on pages 38 and 39 of this Annual Report.

#### Election of Directors

The Directors will comply with the requirement in paragraph B.7.1 of the Code to each submit themselves for re-election every year, if they wish to continue serving, and are considered by the Board to be eligible. The Company's Articles of Association require all new Directors to be submitted for election by **shareholders (EM)** in their first year following appointment. Accordingly the whole Board will be proposed for re-election or election, as the case may be, at this year's AGM.

#### The Chairman and CEO

There is a clear and effective division of accountability and responsibility between the roles of **our (SM) Chairman and CEO** and this is set out in writing. The Chairman leads the Board, ensuring its effectiveness whilst taking account of the interests of **stakeholders (EM)** and promoting the highest standards of corporate governance. The Chairman has regular one-to-one meetings with the CEO and other members of the executive team and also has separate group and individual meetings with the Nonexecutive Directors. The CEO has executive responsibility for the day-to-day operations and performance of the Group, making proposals to the Board for the strategic development of the Group and ensuring effective communication to employees and **shareholders (EM)**.

#### Senior Independent Director

Patrick Cescau was the Senior Independent Director ('SID') throughout the year. Patrick was selected in July 2010 for the role because of his experience and expertise, both as an Executive and as a Non-executive Director. Patrick was Group Chief Executive of Unilever from 2005 to 2009. Prior to that he was Chairman of Unilever plc and Vice Chairman of Unilever NV. He has been a Non-executive Director of Pearson plc since 2002 and a Director of INSEAD since 2009.

In his role as SID, Patrick Cescau is available to assist in resolving **shareholder (EM)** concerns should alternative channels be exhausted. The SID's role includes responsibility for Chairman appraisal and succession.

#### Non-executive Directors

**Our (SM) Non-executive Directors** have a wide range of skills and experience. They provide constructive challenge and help to develop **our (SM)** strategy. The Non-executive Directors have **satisfied (AM)** themselves with regard to the integrity of the Group's financial information, financial controls and risk management systems.

The independence of each Non-executive Director is assessed annually and the Board makes a careful assessment of the time commitment required from the Chairman and Non-executive Directors to discharge their roles properly.

**Our (SM) Non-executive Directors** are appointed for an initial period of three years subject to (a) remaining independent; and (b) provision B.7.1 of the Code, which requires all directors to be re-elected by **shareholders (EM)** annually. The terms and conditions of appointment of **our (SM) Nonexecutive Directors** are available for inspection at the Company's registered office. All Directors have access to the services of the Company Secretary and may take independent professional advice at the Company's expense in conducting their duties. The Company provides insurance cover and indemnities for its Directors and Officers.

#### Company Secretary

The role of the Company Secretary is to develop, implement and sustain good corporate governance, including:

- keeping abreast of legislation, regulation and corporate governance developments which impact the business and advising the Board accordingly;
- supporting the Chairman and other Board members as necessary, including the management of Board and Committee meetings and their evaluation;
- supporting the Board as necessary, including advising on Directors' duties;
- when appropriate, providing a discreet but challenging voice to the Board;
- ensuring that appropriate Directors' and Officers' insurance is in place;
- ensuring that the granting of share awards is in accordance with long-term incentive plans;
- ensuring that the Board is kept informed of **shareholder (EM)** opinion; and
- ensuring that the Company is compliant with statutory and regulatory governance requirements.

#### Diversity

At Tesco, **we (SM) are proud (AM)** to be a diverse business and **we (SM) have always (booster)** valued the benefits which diversity brings. Developing a more inclusive and diverse workforce, reflecting the communities in which **we (SM)** do business, supports **our (SM)** stated strategic priority to build a team to create more value than any other, and developing talent at every level in the

organisation has **always (booster)** been a core value for Tesco. **We (SM)** approach diversity in its widest sense, recognising that successful world-class businesses flourish through embracing geographical, ethnic, skill, age and gender diversity. Within this context **we (SM)** accept the spirit and aspirations of the Davies Report, including the representation of women at the highest levels in the organisation. The fact that women represent 60% of **our (SM)** workforce in the UK gives **us (SM)** a real opportunity to develop female leaders. **We (SM)** have made significant progress in recent years in developing and bringing through senior women. In the last four years (since 2007), the number of female directors at Tesco has increased by 45, an increase of nearly 76%, and **we (SM)** are working hard to help women succeed in senior roles more generally throughout the Company. There are currently four women on **our (SM)** PLC Board (29%) and women in senior management positions account for 31% across the Group as a whole. **We (SM)** believe **(AM)** that the focus **must (EM)** remain firmly on understanding what it takes to develop women and to retain them in senior positions, and to help all of **us (SM)** create the necessary conditions both at home and overseas. Senior roles are very demanding for all – regardless of gender – and **we (SM)** are **determined (AM)** to develop a culture and an environment where **our (SM)** people can advance whilst having the time to be good parents, partners and active members of their local community.

#### Participation in corporate governance discussions

Outside the Boardroom there has been a substantial level of discussion of corporate governance and remuneration issues over the past year and **we (SM)** have been an active participant in the debate, responding to a number of consultations, including those carried out by the Department of Business, Innovation and Skills in relation to Narrative Reporting and Executive Remuneration, the EU Green Paper on Corporate Governance and the debate led by Lord Davies on Women on Boards.

#### Board responsibilities

The Board held eight scheduled meetings during the last year. It also held a strategy off-site meeting. **The board's (SM)** agenda is managed to ensure that **shareholder (EM)** value, societal issues and governance all play an appropriate part in its deliberations and judgements.

The Board delegates to management the day-to-day operation of the business, in accordance with appropriate risk parameters. The Board monitors compliance with policy and achievement against objectives, by holding management accountable for its activities through regular updates. In addition, each business unit within the Group is required to update the Board on a regular basis, giving the Board the opportunity to understand and explore issues in depth as appropriate.

During the year ended 25 February 2012, the Board considered a wide range of issues, including:

- receiving reports from key businesses within the Group;
- receiving regular reports on the financial position of the Group and the various businesses within the Group;
- approving the budget and long-term plan for the Group;
- approving interim and full-year results;
- discussing and approving Group strategy;
- considering opportunities for business development;
- discussing risk management and controls within the Group, including a detailed review of the Key Risk Register;
- receiving reports from the Remuneration Committee, Audit Committee and Nominations Committee and other key committees within the Group including the Compliance Committee and Corporate Responsibility Committee;
- receiving reports on governance issues affecting the Group; and
- conducting a review of the effectiveness of the Board.

#### Directors' conflicts of interest

The Company has comprehensive procedures in place to deal with any situation where a Director has an actual or potential conflict of interest. Under these procedures members of the Board are required to:

- consider each conflict situation separately on its particular facts;
- consider the conflict situation in conjunction with the rest of their duties under the Companies Act 2006;
- keep appropriate records and Board minutes demonstrating any authorisation granted by the Board for such conflict and the scope of any approvals given; and
- regularly review conflict authorisations.

#### Training and development

All new Directors receive a personalised induction programme, tailored to their experience, background and particular areas of focus, which is designed to develop their knowledge and understanding of the Group's culture and operations. The programme has evolved over time to take into account feedback from new Directors and the development of best practice, and will **usually (hedge)** include a combination of meetings with senior management from across the Group, comprehensive briefing materials and opportunities to visit the Group's operations across the world. The Chairman agrees the personalised induction plan for each new Director and **ensures (booster)** that it meets the individual needs of that Director. Directors also receive a tailored induction in relation to those Board Committees they will serve on.

The need for Director development is regularly assessed by the Nominations Committee and training sessions are arranged to help upskill the Directors on a variety of areas relevant to the Group's business, including social, environmental and ethical issues. In the last year the Board received training focusing, inter alia, on recent corporate governance developments, risk reporting by Tesco

Bank and the challenges and opportunities offered by the internet. Further training in a number of key areas is planned for the coming year.

The Board holds at least one in-depth session a year focusing on one of the Group's key areas of business, with the aim of broadening and deepening the Directors' understanding of that business. In March 2011 the Board spent several days looking at the US operations and in March 2012 the Board carried out an in-depth review of **our (SM)** UK business. Board trips allow the Directors to view first-hand the progress, development, challenges and direction of **our (SM)** businesses, as well as meeting **our (SM)** teams in those businesses.

#### Board performance evaluation

The Board conducted an external Board evaluation during the year. The review was led by an experienced facilitator and combined in-depth interviews with each Director and a questionnaire completed by members of the Board. The results of the review were considered in detail by the Board. The review recognised that with both a new Chairman and a new Chief Executive appointed during the year this was a time of transition. The Board **welcomed (AM)** the opportunity this presented to complete a broad updating of governance and Committee structures. Overall, the review **suggested (hedge)** that there was **good (AM)** engagement between Board members and that Board processes (including the performance of Committees, a new forward agenda and the quality of information flows) were of a **good (AM)** standard. There was a high level of alignment about the key strategic issues facing Tesco.

An **important (AM)** part of the review was establishing criteria against which the future performance of the Chairman, the Directors individually and the Board as a team could be reviewed. The Board endorsed a set of criteria under these headings as follows:

Annual reviews of the performance of the Remuneration and Audit Committees have been carried out, led by each Committee's Chairman. These reviews have confirmed that each Committee continues to operate effectively. For further details, please **refer (EM)** to the sections dealing with the Audit Committee (on page 58) and the Remuneration Committee (on page 57).

**Our (SM)** CEO reviews the performance of each Executive Director and the outgoing Chairman has reviewed the performance of the CEO and each Non-executive Director. Having completed these evaluations, the CEO and Chairman have confirmed that each individual whose performance they have assessed continues to be effective and **committed (AM)** to their role. The new Chairman, Sir Richard Broadbent, only assumed his role on 30 November 2011, so it was judged to be too soon for the Senior Independent Director to carry out a performance assessment.

During the year, both the outgoing Chairman and the new Chairman met with the Non-executive Directors, without the Executive Directors present, to discuss Board issues and how to build the best possible team.

#### Board attendance

The Board held eight scheduled meetings in the year ended 25 February 2012, including the AGM, and ad hoc meetings were also arranged to deal with matters between scheduled meetings as appropriate. It is **expected (AM)** that all directors attend scheduled Board and relevant Committee meetings, unless they are prevented from doing so by prior commitments, and that all Directors will attend the AGM. Where Directors are unable to attend meetings, they receive the papers scheduled for discussion in the relevant meetings, giving them the opportunity to raise any issues and give any comments to the Chairman in advance of the meeting. Following the meeting the Chairman briefs any member not present on the discussions and any decisions taken at the meeting. Directors leave the meeting where matters relating to them, or which may constitute a conflict of interest for them, are being discussed. None of the Executive Directors holds more than one FTSE 100 external Non-executive Directorship and Philip Clarke resigned his position as Non-executive Director of Whitbread PLC effective from 1 March 2011, immediately prior to taking up his role as CEO. The other directorships held by the Non-executive Directors are set out in their biographies, which can be found on pages 38 and 39.

#### Nominations Committee

"The Nominations Committee plays an **essential (AM)** role in leading the process of assessing the skills the Board needs to discharge its duties competently. It also reviews **the board's (SM)** composition, structure and size, to assist the ongoing development of the Board over time."

Sir Richard Broadbent

Nominations Committee Chairman

The Nominations Committee met once in the year to discuss the ongoing shape and capability of the Board. There were also a number of ad hoc meetings during the year to discuss Board succession matters, as well as reviewing the performance and development of the Executive Directors and the senior executive levels below the Board. In future, it is **intended (hedge)** that there will be four scheduled meetings a year of the Committee.

The remit of the Nominations Committee was expanded with effect from 26 February 2012, so that, in addition to its existing responsibility for reviewing **the board's (SM)** structure, size and composition, identifying, nominating and reviewing candidates for appointment to the Board and putting in place plans for succession, the responsibilities of the Committee will include:

- reviewing the leadership needs of the organisation, both executive and non-executive;



- reviewing the Group's talent management programmes;
- reviewing Board succession over the longer term, in order to maintain an appropriate balance of skills and experience and to ensure progressive refreshing of the Board; and
- monitoring of the Group's compliance with corporate governance guidelines.

The Committee was chaired by Sir David Reid during his tenure and is now chaired by Sir Richard Broadbent following his appointment as Chairman. The Company Secretary attends meetings in his capacity as Secretary of the Committee. Where matters discussed relate to the Chairman, the Senior Independent Non-executive Director chairs the meeting. During the year consideration was given to finding an appropriate replacement for retiring Chairman, Sir David Reid. The Nominations Committee considered the skills and experience that **would (hedge)** be required for this position and to create a detailed role description. After a rigorous selection process, which was led by the Senior Independent Director and included interviews with the Executive and Non-executive Directors, Sir Richard Broadbent was chosen as the strongest candidate for Chairman.

The Committee's revised terms of reference, which were approved by the Board on 14 February 2012, are available at [www.tescopl.com/plc/ir/corgov/boardprocess](http://www.tescopl.com/plc/ir/corgov/boardprocess).

#### Remuneration Committee

"The Remuneration Committee assesses executive remuneration arrangements which are used to attract, retain and motivate senior management and provide appropriate alignment between reward and performance."

Stuart Chambers

Remuneration Committee Chairman

The Remuneration Committee's role is to determine and recommend to the Board the remuneration policy for Executive Directors and oversee the level and structure of remuneration of senior management, ensuring that the remuneration arrangements attract, retain and motivate the Executive Directors and senior management needed to run the Company successfully.

The Chairman of the Board, the CEO, Group Personnel Director and external advisors normally attend meetings, although some part of every meeting is devoted to discussion among only the Non-executive Directors. The Company Secretary attends in his capacity as Secretary of the Committee.

The Committee met five times this year. The responsibilities of the Remuneration Committee and an explanation of how it applies the Directors' remuneration principles of the Code and other applicable rules and regulations governing remuneration, are set out in the Directors' Remuneration Report on pages 64 to 86.

The Committee received training this year on a range of areas, including disguised remuneration, Department for Business, Innovation and Skills reporting requirements, ABI principles, market practice and trends in best practice.

The Committee conducted a review of its effectiveness during the year, which confirmed that the Committee operates effectively.

The Committee reviews its membership regularly to ensure that it is refreshed and that no undue reliance is placed on particular individuals. Deloitte are the appointed remuneration consultants and details of all connections with the Company are given on page 78: Remuneration Report. The Committee approved new terms of reference on 14 February 2012 and these are available at [www.tescopl.com/plc/ir/corgov/boardprocess](http://www.tescopl.com/plc/ir/corgov/boardprocess).

#### Audit Committee

"The Audit Committee plays a key role in reviewing the effectiveness of the Group's internal controls, external auditors and internal audit department. It also provides assurance on the Group's risk management processes."

Ken Hydon

Audit Committee Chairman

Regular attendees at the invitation of the Committee include:

- Chairman of the Board;
- Chief Executive Officer;
- Chief Financial Officer and his team;
- Head of Internal Audit;
- Executive Director (Corporate and Legal Affairs);
- Other Executive Directors as appropriate; and
- External Auditors.

The Company Secretary attends in his capacity as Secretary of the Committee.

The Chairman of the Tesco Bank Audit Committee attends the Committee twice a year to provide an update on the work of the Bank's Audit Committee in overseeing the Bank's internal control and risk assurance processes.

The Audit Committee structure requires the inclusion of at least one member with recent and relevant financial experience. The Committee Chairman and at least one other member fulfil this requirement, and all other Committee members have an appropriate understanding of financial matters.

The Audit Committee's primary responsibilities include, to:

- consider the appointment of the external auditors, their reports to the Committee and their independence, including an assessment of their appropriateness to conduct any non-audit work;
- review the financial statements and announcements relating to the financial performance of the Company;
- review the internal audit programme and ensure that the Internal Audit function is adequately resourced and has appropriate standing within the Company;
- discuss with the external auditors the nature and scope of the audit;
- review, and challenge where necessary, the actions and judgements of management, in relation to the interim and annual financial statements before submission to the Board;
- review formally the effectiveness of the external and internal audit processes;
- consider management's response to any major external or internal audit recommendations;
- review the Company's coordinated plans for business continuity; and
- review the Company's plans for the prevention and detection of fraud, bribery and corruption.

The Committee met five times this year. While fulfilling the above responsibilities, during the year the Committee received detailed updates from several businesses within the Group, as well as discussing a number of topics, including:

- fraud risks;
- business continuity and crisis management;
- whistle-blowing;
- Groceries Supply Code of Practice;
- property risks; and
- IT controls.

A Board visit is organised each year to one or more of the Group's businesses and the Committee takes advantage of these visits to meet with local management and discuss how the Group's internal controls and risk management processes are embedded in those businesses. There were also regular meetings via videoconference with local management in several of **our (EM)** international companies.

The need for training is kept under review and the annual agenda **ensures (booster)** substantial time is dedicated to technical updates, which are **generally (hedge)** provided by external experts. This year training was provided, inter alia, on accounting standards, emerging issues, true and fair requirements and corporate reporting. In addition, while in the US, training was given on US risk and control processes. Training is also provided on an ongoing basis to meet the specific individual needs of Committee members.

The Committee carried out an effectiveness review during the year, which concluded that the Committee was effective and had been provided with sufficient resources to carry out its duties.

The Committee also regularly reviews its membership, to ensure that it is refreshed and that no undue reliance is placed on particular individuals. It was **felt (hedge)** unnecessary to make changes this year. The Committee considered the appointment of auditors and recommended PricewaterhouseCoopers LLP's ('PwC') reappointment. Their remuneration is disclosed in Note 3 of the financial statements.

The Committee has regular private meetings with the external auditors and the Head of Internal Audit during the year, at which an honest and open working relationship is maintained and developed. The Committee approved revised terms of reference on 14 February 2012, which are available at [www.tescopl.com/plc/ir/corpgov/boardprocess](http://www.tescopl.com/plc/ir/corpgov/boardprocess).

## Management of the Group

### Executive Committee

The CEO is supported in formulating and implementing the Group's strategic plan and in managing the Group by the Executive Committee, which is chaired by the CEO. Membership comprises the Executive Directors and seven senior executives:

1. Gordon Fryett CEO Europe and Group Property Director – Gordon Fryett joined Tesco in 1969 and has held a number of roles including Operations Director, International Support Director, CEO of Republic of Ireland and UK Property Director. He is a Non-executive Director of Severn Trent Plc.
2. Kevin Grace Group Commercial Director – Kevin Grace joined Tesco in 1982 and has held a number of roles including Support Office Director, COO of South Korea, CEO of Poland and UK Property Director.
3. Alison Horner Group Personnel Director – Alison Horner joined Tesco in 1999 as a Personnel Manager, moving to UK and Ireland operations in 2003 where she held a number of line management roles including Operations Director.
4. Trevor Masters CEO Asia – Trevor Masters joined Tesco in 1979 and has held a number of roles including Store Manager, Store Director, Operations Director for Extras, and CEO of Central Europe.
5. Mike McNamara Chief Information Officer – Mike McNamara joined Tesco in 1998 and has held a number of roles in IT and Operations Development.

6. Bob Robbins Group Business Improvement Director – Bob Robbins joined Tesco in 1975 and has held a number of roles including CEO of Asia, CEO of Central Europe, Strategy and Development Director Asia and various retail, marketing and general management roles.
7. Ken Towle Online Food and Internet Retailing Director – Ken Towle joined Tesco in 1985 and has held a number of roles including various UK operations roles and President and CEO of Tesco China.

The Executive Committee has authority for decision-making in all areas except those set out in the Schedule of Matters Reserved for the Board, and meets formally on a regular basis. The Company Secretary attends in his capacity as Secretary of the Committee. The Executive Committee is responsible for implementing Group strategy and policy and for monitoring the performance and compliance of the business, drawing on the work of relevant committees, and reporting on these matters in full to the CEO and by him to the Board.

The Committee has set up further subcommittees, focusing on Commercial, Compliance, Internet Retailing, People Matters, Property

Strategy, Sustainability and Technology. These subcommittees have as members an appropriate mixture of Executive Directors and senior management from relevant functions.

#### Risk Management and Internal Controls

Accepting that risk is an inherent part of doing business, **our (SM)** risk management systems are designed both to encourage entrepreneurial spirit and also provide assurance that risk is fully understood and managed. The Board has overall responsibility for risk management and internal control within the context of achieving the Group's objectives. Executive management is responsible for implementing and maintaining the necessary control systems. The role of Internal Audit is to monitor the overall internal control systems and report on their effectiveness to Executive management, as well as to the Audit Committee, in order to facilitate its review of the systems.

#### Background

The Group has a three-year rolling business plan to support the delivery of its strategy. Every business unit and support function derives its objectives from the three-year plan and these are cascaded to managers and staff by way of personal objectives. Key to delivering effective risk management is ensuring that **our (SM)** people have a good understanding of the Group's strategy and **our (SM)** policies, procedures, values and **expected (hedge)** performance. **We (SM)** have a structured internal communications programme that provides employees with a clear definition of the Group's purpose and goals, accountabilities and the scope of permitted activities for each business unit, as well as individual line managers and other employees. This **ensures (booster)** that all **our (SM)** people understand what is **expected (AM)** of them and that decision-making takes place at the appropriate level. **We (SM) recognise (AM)** that **our (SM)** people may face ethical dilemmas in the normal course of business so **we (SM)** provide clear guidance based on the Tesco Values. The Values set out the standards that **we (SM)** wish to uphold in how **we (SM)** treat people. These are supported by the Group's Code of Business Conduct, which offers guidance on relationships between the Group and its employees, suppliers and contractors.

#### Risk management

The Group maintains a Key Risk Register. The Register contains the key risks faced by the Group, including their impact and likelihood, as well as the controls and procedures implemented to mitigate these risks (**see (EM)** diagram below). The content of the Register is determined through regular discussions with senior management and review by the Executive Committee and the full Board. A balanced approach allows the degree of controllability to be taken into account when **we (SM)** consider the effectiveness of mitigation, recognising that some necessary activities carry inherent risk which may be outside the Group's control. **Our (SM)** key risks are summarised on pages 40 to 47 of the Principal risks and uncertainties section of this Annual Report. The risk management process is cascaded through the Group, with operating subsidiary boards maintaining their own risk registers and assessing their control systems. The same process also applies functionally in those parts of the Group requiring greater overview. For example, the Audit Committee's terms of reference require it to oversee the Finance Risk Register.

The Board assesses significant social, environmental and ethical ('SEE') risks to the Group's short and long-term value, and incorporates SEE risks into the Key Risk Register where they are considered material or appropriate. During the year the Board regularly reviewed the Risk Register and also undertook an in-depth assessment of product safety.

**We (SM) recognise (AM)** the value of the ABI Guidelines on Responsible Investment Disclosure and confirm that, as part of its regular risk assessment procedures, the Board takes account of the significance of SEE matters to the business of the Group. **We (SM) recognise (AM)** that a number of investors and other **stakeholders (EM)** take a keen interest in how companies manage SEE matters and so **we (SM)** report more detail on **our (SM)** SEE policies and approach to managing material risks arising from SEE matters and the KPIs **we (SM)** use both on **our (SM)** website ([www.tescopl.com/plc/corporate\\_responsibility/](http://www.tescopl.com/plc/corporate_responsibility/)) and in **our (SM)** Corporate Responsibility Review 2012. To provide further assurance, the Group's Corporate Responsibility KPIs are audited on a regular basis by Internal Audit.

#### Internal controls

The Board is responsible for the Company's system of internal controls and for reviewing the effectiveness of such a system. **We (SM)** have a Group-wide process for clearly establishing the risks and responsibilities assigned to each level of management and the controls which are required to be operated and monitored.

The CEO of each subsidiary business is required to certify by way of an annual governance return that the Group's governance and compliance policies and processes have been adopted. The returns received from across the Group are reviewed and discussed by the Compliance Committee and the results of that review are also considered by the Audit Committee as part of the Annual Assessment of Risk Management and Internal Controls, which is prepared by Internal Audit as part of the year end process. For certain joint ventures, the Board places reliance upon the internal control systems operating within **our (SM)** partners' infrastructure and the obligations upon partners' boards relating to the effectiveness of their own systems.

Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can only provide **reasonable (hedge)** and not absolute assurance against material misstatement or loss. In respect of Group financial reporting, Group Finance is responsible for preparing the Group financial statements, using a well-controlled consolidation process. Group Finance contains a technical accounting team, which reviews external technical accounting developments, financial reporting and accounting policy issues. It is also responsible for the maintenance of the Group's accounting policy manual, which is in accordance with International Financial Reporting Standards. Group Finance maintains its own risk register and assesses its own controls systems. This incorporates risks such as wrong or unclear accounting policies, ineffective financial close processes, inaccurate or incomplete Group financial and management accounts, reputational risk, IT risks, fraud and people risks. Group Internal Audit also reviews the effectiveness of controls operating in the Group Finance function. The results of Group Finance's risk register review and Group Internal Audit's findings are reported to the Audit Committee on an annual basis. The Board has conducted a review of the effectiveness of internal controls and is **satisfied (hedge)** that the controls in place remain appropriate.

#### Monitoring

The Board oversees the monitoring system and has set specific responsibilities for itself and the various committees as set out below. Both Internal Audit and **our (SM)** external auditors play key roles in the monitoring process, as do several committees including the Compliance Committee and the Corporate Responsibility Committee. The minutes of the Audit Committee and the other Board committees are distributed to the Board and each Committee submits a report for formal discussion at least once a year. These processes provide assurance that the Group is operating legally, ethically and in accordance with approved financial and operational policies.

#### Audit Committee

The Audit Committee reports to the Board each year on its review of the effectiveness of the internal control systems for the financial year and the period to the date of approval of the financial statements. Throughout the year the Committee receives regular reports from the external auditors covering topics such as quality of earnings and technical accounting developments. The Committee also receives updates from Internal Audit and has dialogue with senior managers on their control responsibilities. It **should (EM)** be understood that such systems are designed to provide **reasonable (hedge)**, but not absolute, assurance against material misstatement or loss.

#### Internal Audit

The Internal Audit department is independent of business operations and has a Group-wide mandate. It undertakes a programme to address internal control and risk management processes with particular reference to the Turnbull Guidance. It operates a risk-based methodology, ensuring that the Group's key risks receive appropriate regular examination. Its responsibilities include maintaining the Key Risk Register, reviewing and reporting on the effectiveness of risk management systems and internal control with the Executive Committee, the Audit Committee and ultimately to the Board. Internal Audit facilitates oversight of risk and control systems across the Group through risk committees in Asia, Europe and Tesco Bank and audit committees in a number of **our (SM)** businesses and joint ventures. The Head of Internal Audit also attends all Audit Committee meetings.

#### External audit

PwC, the Company's external auditor, contributes a further independent perspective on certain aspects of **our (SM)** internal financial control systems arising from its work, and reports to both the Board and the Audit Committee. The engagement and independence of external auditors is considered annually by the Audit Committee before it recommends its selection to the Board. The Company has a Non-audit services policy for work carried out by PwC. This is split into three categories as explained below:

- pre-approved for the external auditors – is predominantly the review of subsidiary undertakings' statutory accounts and is audit-related in nature;
- work for which Committee approval is specifically required – transaction work and corporate tax services, and certain advisory services; and
- work from which the external auditors are prohibited.

The Audit Committee concluded that it was in the best interests of the Company for the external auditors to provide a number of non-audit services during the year due to their experience, expertise, and knowledge of the Group's operation.

Auditor objectivity and independence was achieved by ensuring that personnel involved in the non-audit work were not involved in the audit, and by ensuring that management took responsibility for all decisions made.

The fees paid to the Auditors in the year are disclosed in Note 3 to the Group financial statements.

PwC also follows its own ethical guidelines and continually reviews its audit team to ensure its independence is not compromised. PwC's independence is also considered by the Audit Committee regularly.

#### Tesco Bank

The management of risk is an integral part of the Bank's business. Tesco Bank has established an Enterprise Wide Risk Management Framework, designed to support the identification, assessment, management and control of the material risks that threaten the achievement of the Bank's strategic business objectives. The Bank has developed a risk strategy which is designed to support the successful delivery of strategic business objectives through clearly defined strategic risk objectives which support risk appetite. The risk appetite reflects the level and type of risks that the Bank is willing to take to deliver its strategic business objectives.

The Bank's Board has overall responsibility for the Bank business. It agrees the strategy for the business, approves the risk appetite of Tesco Bank as well as specific high level policies and the delegated authorities. The Bank's Board monitor's the risk profile of the Bank. Executive management is responsible for establishing an effective control framework and ensuring all risks are identified and controlled within the risk appetite and policy limits. The independent Risk function is responsible for developing risk appetite and the policy framework and for independently monitoring the risk profile, providing assurance where required. Risk also provides frameworks, tools and techniques to assist management in meeting their responsibilities, as well as acting as a central coordinator to ensure that enterprise wide risks are being effectively addressed. Tesco Bank Internal Audit is responsible for the independent assessment of the effectiveness of the implementation of the risk and control measures across the business. They assess whether the internal control systems are effective both in design and practice.

The Internal Capital Adequacy Assessment Process ('ICAAP') is the Bank's internal assessment of capital adequacy designed to address the requirements under Pillar 2 of the Basel II framework. The ICAAP process considers all of the risks faced by the Bank, the **likely (hedge)** impact of them if they were to occur, how these risks can be mitigated and the amount of capital that is prudent to hold against them both currently and in the future. The Bank performs a full ICAAP regularly which is reviewed and approved by its Board. The Bank holds a liquid asset portfolio that its Board deem to be sufficient to cover potential future stressed cash outflows. Through its Internal Liquidity Adequacy Assessment ('ILAA') process, stress events are simulated and the impact on cash flows, including any available contingency funding, is assessed and reviewed against the current and planned liquid asset portfolio. The ILAA is reviewed and approved by the Bank's Board regularly.

The Bank maintains a Key Risk Register, which is subject to regular review to enable management to identify all key risks, current and emerging. As the risk profile shifts over time the potential impact on the business is considered in terms of additional management action required and/or possible extra capital or liquidity requirements. The content of the Register is developed by the Risk function through ongoing discussion with senior management and is reviewed on a regular basis.

#### Whistle-blowing

The Group operates a whistle-blowing policy which is reviewed annually. In every business **we (SM)** operate a confidential telephone and email service which enables concerned employees to report, anonymously if they choose, any instances of inappropriate behaviour or malpractice within the business. Such issues include unethical or illegal behaviour such as bribery and corruption, fraud, dishonesty and any practices that endanger **our (SM)** staff, customers or the environment. During the year 2011/12 the majority of the calls related to personnel issues, which is common in most businesses, with a number of security issues also raised.

All complaints made are treated as confidential and are investigated by the relevant department and where **we (SM)** know the individual, the callers are updated. Where there is a serious issue, this will be escalated to the country CEO. This policy is monitored by the Compliance Committees in country, by the Group Compliance Committee annually and by the Group Audit Committee annually. In addition the whistle-blowing line was previously internally audited in 2010 and will be audited again during the current year.

#### Anti-corruption

**We (SM)** maintain the highest standards of ethics and integrity in the way **we (SM)** do business around the world. Bribery and corruption in all forms is illegal and **unacceptable (AM)**. It damages competition and markets, increases costs, reduces quality for customers and damages trust. Wherever **we (SM)** operate **we (SM)** will **always (booster)** abide by the law. Any act of fraud, bribery or corruption **would (hedge)** be treated with extreme seriousness by Tesco. **We (SM)** expect **our (SM)** business partners to adopt the same approach. Those breaking these laws are liable to be prosecuted. Alleged offenders who are UK citizens may also be prosecuted in the UK, no matter where the offence was committed.

In accordance with **our (SM)** Anti-corruption Guidelines, the CEO of each business is responsible for ensuring compliance with all local legislation and Company policies and report adherence to this to the Tesco Group Executive Committee and the Group Compliance Committee. To ensure the implementation of **our (SM)** bribery and corruption policy, a message has been sent to staff from their CEO reminding them of both **our (SM)** Values and **our (SM)** zero tolerance approach to all forms of bribery and corruption. The policy is available on **our (SM)** Group Intranet and staff are made aware of it. In addition, key staff across the business have completed anti-bribery training, using an e-learning tool which includes training on the new Bribery Act, as well as **our (SM)** policy, and which also requires them to pass an assessment. The e-learning tool has been translated into all of the principal languages used in the countries in which **we (SM)** operate. There will be annual refresher training.

## Code of Business Conduct

The Code of Business Conduct explains to staff their most **important (AM)** individual responsibilities and obligations while working for Tesco. All members of staff **must (EM)** comply with the Code of Business Conduct. Acting legally and following **our (SM)** Group and local policies and best practice are some of the ways in which **we (SM)** **ensure (booster)** that **we (SM)** **always (booster)** do **our (SM)** best for **our (SM)** customers and for each other. The Code provides guidance on key issues which may arise as staff work for Tesco and indicates who they should contact if they think that they, or another member of staff, may have breached those rules. Key members of staff are required to provide an annual statement of compliance with the terms of the Code. Disciplinary action may result for breaches of the Code.

The areas covered by the Code include:

### The way **we (SM)** trade

- Competition
- Trade restrictions and sanctions
- Relationships with commercial suppliers

### Personal and business integrity

- Fraud, bribery and corruption
- Conflicts of interest
- Insider dealing and market abuse
- Gifts and improper payments
- Political activity

### The resources of the Company and **our (SM)** customer

- Intellectual Property
- Responsible use of Company IT
- Confidential Information and data protection
- Accurate accounting and money laundering

### **Our (SM)** people

- Equal opportunities
- Unacceptable behaviours

## Relations with **stakeholders (EM)**

**We (SM)** are **committed (AM)** to having a constructive dialogue with **stakeholders (EM)** to ensure that **we (SM)** understand what is important to them and allow **ourselves (SM)** the opportunity to present **our (SM)** position. Every year **we (SM)** carry out a survey of a cross section of **shareholders (EM)** in order to assess **shareholder (EM)** perceptions of the Company. The results of this survey are reviewed by the Board. Engagement helps **us (SM)** identify new risks and opportunities to ensure that **our (SM)** long-term strategy is sustainable. In some instances **we (SM)** **find (booster)** that working with **stakeholders (EM)** in partnership can help deliver shared goals. **We (SM)** might not be able to satisfy all **stakeholder (EM)** concerns all the time but through engagement **we (SM)** can do **our (SM)** best to balance competing demands. **We (SM)** **know (booster)** that customers **need to (EM)** be able to trust **our (SM)** business and they will only trust **us (SM)** if they believe that **we (SM)** are engaging on an appropriate basis with **our (SM)** **stakeholders (EM)**.

**We (SM)** engage regularly with **our (SM)** employees to invite them to give **us (SM)** their thoughts on how the business is run and how they feel about working for Tesco. **We (SM)** also engage with unions in the UK and **our (SM)** other markets to discuss employee matters and business developments. **Our (SM)** programme of engaging with **stakeholders (EM)** including customers, staff, suppliers, investors, government, regulators, non-governmental organisations and others, is set out in more detail in **our (SM)** Corporate Responsibility Review 2012 and on **our (SM)** website.

## Shareholder **(EM)** engagement

**We (SM)** maintain a dialogue with **shareholders (EM)** through organising meetings and presentations as well as responding to a wide range of enquiries. **We (SM)** seek **shareholder (EM)** views on a range of issues from strategy to corporate governance and SEE issues. **We (SM)** **recognise (AM)** the importance of communicating appropriately any significant Company developments. During the year, **our (SM)** CEO and Finance Director met with a number of **our (SM)** leading **shareholders (EM)** to discuss issues relating to the performance of the Group and its strategy, as well as new developments within the business. **Our (SM)** outgoing and incoming Chairmen also met with a number of **our (SM)** leading **shareholders (EM)** to discuss the Group's strategy and a range of governance matters.

In addition to this, **our (SM)** Investor Relations team engages with **shareholders (EM)** on a regular basis and on a wide range of issues. **Our (SM)** Corporate and Legal Affairs Director, Lucy Neville-Rolfe, leads the Company's contact with socially responsible investors and has regular meetings, on both a one-to-one and group basis, to discuss the work the Group is doing on corporate responsibility and governance-related issues.

An Investor Relations report is produced for the Board biannually. This report summarises feedback from **shareholders (EM)**, particularly in terms of **our (SM)** management and strategy, and **ensures (booster)** the Board has a balanced perspective on the views of **our (SM)** major **shareholders (EM)**. It is normal that institutional **shareholders (EM)** may be in more regular contact with the Group than other **shareholders (EM)**, but care is exercised to ensure that any price-sensitive information is released to all

**shareholders (EM)**, institutions and private, at the same time in accordance with applicable legal and regulatory requirements. All major presentations to institutional **shareholders (EM)** are made available to private **shareholders (EM)** through the Tesco PLC website. Every **shareholder (EM)** may choose to receive a full Annual Report and Financial Statements or the Annual Review and Summary Financial Statements, either in paper or electronic form. These reports, together with publicly made trading statements, are available on the Group's website, [www.tescopl.com](http://www.tescopl.com).

#### The Tesco PLC AGM

The Annual General Meeting offers the opportunity for the Board, including the Chairmen of the Audit, Corporate Responsibility, Remuneration and Nominations Committees, to communicate the Company's progress directly to **shareholders (EM)**. **Our (SM)** last Annual General Meeting in July 2011 was held in Nottingham. The 2012 AGM will be held in Cardiff at 11am on Friday 29 June. The choice of location is based on **our (SM)** policy of widening the opportunity for **our (SM) shareholders (EM)** to attend the AGM, by moving to different locations in the UK each year. The whole Board attends the AGM and is available to answer questions from **shareholders (EM)** present. To encourage **shareholder (EM)** participation, **we (SM)** offer electronic proxy voting and voting through the CREST electronic proxy appointment service. At **our (SM)** Annual General Meeting, all resolutions are proposed and voted upon individually by the **shareholders (EM)** or their proxies. All votes taken during the AGM are by way of electronic poll. This follows best practice guidelines and allows the Company to count all votes, not just those of **shareholders (EM)** attending the meeting. The Chairman announces the provisional voting results at the meeting, and the final results are announced the same day through the Regulatory News Services and the Tesco PLC website.

By Order of the Board

Jonathan Lloyd

Company Secretary

4 May 2012

Tesco PLC

Registered Number: 445790 Registered in England and Wales

Registered Office: Tesco House, Delamare Road, Cheshunt,  
Hertfordshire EN8 9SL

VAT Registration Number: GB 220 4302 31

#### Directors' remuneration report

"**Our (SM)** remuneration arrangements are simple, aligned with strategy and targeted to be consistent with **shareholder (EM)** expectations."

Stuart Chambers

Remuneration Committee Chairman

This report sets out the remuneration policy for the Executive and Non-executive Directors of Tesco PLC and describes the individual remuneration of the Directors for the year ended 25 February 2012.

#### Dear Shareholder

As outlined in last year's report, **we (SM)** introduced new remuneration arrangements for the 2011/12 financial year following detailed discussions with **shareholders (EM)**. The new arrangements provide simpler, more strategically aligned incentives that are consistent with **our (SM) shareholders (EM)**' expectations.

**We (SM)** simplified pay by reducing the number of incentive plans in which Executives participate (to an annual bonus and a performance share plan) and by reducing the number of performance measures. Executives are now incentivised to achieve underlying profit growth and strategic objectives over an annual period and to deliver sustained earnings and return on capital performance in the long term.

**We (SM)** have also returned to a collegiate remuneration approach with all Executives participating in the same plans and being paid in relation to delivery of the same performance. This philosophy applies throughout the organisation at Group as well as at business and country level, with over 5,000 of **our (SM)** senior managers globally participating in reward arrangements linked to local business performance but consistent in structure with those of the Executive Directors.

At the heart of Tesco's remuneration arrangements is a performance focused culture. For many years the business has delivered strong underlying profit growth and improved returns for **shareholders (EM)**. Underlying profit between 2007 and 2011 improved 50% and despite a period of increased investment, return on capital has **shown (booster)** an improving trend. Remuneration paid during this period reflected this performance.

Although sales and profits increased in 2011/12 over the previous year to a record level for the Group, the threshold profitability for the annual bonus (representing 70% of the annual bonus opportunity) was not achieved and therefore no bonus will be paid in respect of the financial part of the bonus. A number of the strategic targets were delivered and a payout of 13.54% of the maximum was approved in respect of this performance. The overall payout is significantly lower than for 2010/11. Half the bonus

will be paid in cash and half will be deferred into shares for a further three years. The CEO has, however, elected to not take any bonus for 2011/12.

**Our (SM)** long-term rewards are assessed based on earnings and return on capital employed over a three-year period. Despite the challenges in 2011/12, the three-year performance **shows (booster)** progress with underlying diluted earnings per share growth of 29% and reported ROCE performance improving by 50 basis points. The Remuneration Committee therefore determined that 46.5% of the Performance Share award and 100% of the share options granted in 2009 would vest, reflecting this progress made over the longer term.

As announced in January 2012, **our (SM)** plan for 2012/13 is to substantially increase investment in the shopping trip – particularly in the UK. Consequently **we (SM)** **anticipate (hedge)** minimal Group trading profit growth for the year. The objective is that this investment in customer experience will strengthen **our (SM)** underlying business and generate long-term sustainable growth. **We (SM)** will also reduce levels of capital expenditure as **we (SM)** modify **our (SM)** approach to UK expansion. In this context, the Committee has set performance targets for 2012/13 awards that remain motivational for management while still ensuring that significant rewards can only be earned if there has been exceptional value delivered for **shareholders (EM)**. No bonus will be paid to Executives unless performance is greater than budget, representing year-on-year growth in profit. For the performance share plan **we (SM)** have repositioned **our (SM)** earnings targets for initial vesting but earnings growth required for maximum vesting and **our (SM)** ROCE goals remain the same.

**We (SM)** are not proposing any other changes to Executive Director remuneration arrangements in 2012/13. However, **we (SM)** will continue to monitor **our (SM)** approach to pay against the backdrop of evolving regulation and the wider climate on executive pay, to ensure that remuneration remains simple, aligned with **our (SM)** strategy and **fair (AM)** to Executives and **shareholders (EM)**.

**We (SM)** have made a number of changes to the way in which **we (SM)** present information in **our (SM)** Remuneration Report this year to make it more accessible and easy to understand. While the Department of Business, Innovation and Skills ('BIS') proposals are not yet final **we (SM)** have taken steps to disclose, in advance, additional information in certain areas which **we (SM)** **believe (booster)** will be helpful for **shareholders (EM)**. **We (SM)** have included more detail on how bonus and long-term incentive payouts were determined and details of remuneration paid over the past five years.

**I (SM)** hope **you (EM)** will find this summary clear and informative. However, if **you (EM)** would like further detail **I (SM)** **would (hedge)** direct **you (EM)** to the full Directors' Remuneration Report which follows this introductory letter.

Stuart Chambers  
Chairman of the Remuneration Committee

#### Remuneration strategy

##### Executive Directors' remuneration strategy

Tesco has a long-standing strategy of rewarding talent and experience. **We (SM)** seek to provide incentives for improving the underlying drivers of performance, delivering strong, sustainable and profitable growth, thereby creating long-term substantial additional value for **shareholders (EM)**. **We (SM)** operate in a keenly competitive and rapidly changing retail environment. Business success depends on the talents of the key team, but outstanding business performance comes only from teamwork. **Our (SM)** success is predicated on the abilities of a strong management team across all levels and geographical locations of the business. Motivating and incentivising this team to deliver sustainable long-term performance is fundamental to **our (SM)** ongoing success. During 2012/13 **we (SM)** are making significant investments in **our (SM)** business foundations to ensure a strong platform for future sustained growth. **We (SM)** are investing in the customer experience in the UK as well as **our (SM)** online platforms to ensure that customers receive value for money and the high level of service they expect from Tesco. **We (SM)** are also continuing to invest in **our (SM)** international portfolio where **we (SM)** see significant opportunities for growth.

**We (SM)** strongly **believe (AM)** that **our (SM)** incentives **should (EM)** support the continued growth and strengthening of **our (SM)** returns from across the Group, and that all **our (SM)** staff **should (EM)** share in the success of the business alongside **our (SM)** **shareholders (EM)**.

#### Remuneration policy

The Remuneration Committee undertook a detailed review of executive remuneration arrangements during 2010/11, the outcome of which was set out in last year's Directors' Remuneration Report. The Committee **believes (booster)** that the new remuneration arrangements provide a simplified, more collegiate remuneration package, with an enhanced focus on meeting both **our (SM)** short-term and long-term, operational and strategic goals. 2012/13 will be a challenging year for the business and **our (SM)** remuneration arrangements **should (EM)** reflect this. The Committee **believes (booster)** that the structure implemented last year remains appropriate and supports long-term growth.

The key features of **our (SM)** remuneration policy at Tesco are:

- Alignment with strategy – **Our (SM)** remuneration arrangements are designed to ensure that Executive Directors are aligned with the delivery of **our (SM)** long-term strategic objectives and the creation of **shareholder (EM)** value. The majority of **our (SM)** reward is linked to the delivery of stretching performance over the short and long term and is delivered in shares. **Our (SM)** short-term performance is measured in relation to underlying profit performance and the



delivery of key strategic objectives. **Our (SM)** long-term performance is measured by assessing the growth in **our (SM)** earnings per share and the level of **our (SM)** return on capital, measures which are central to **our (SM)** long-term strategy.

- Simple, collegiate approach to remuneration – **Our (SM)** remuneration arrangements are designed to be simple to provide clarity to both **our (SM)** Executives and to **shareholders (EM)**. All Executives participate in a common incentive framework to ensure teamwork in delivering **our (SM)** key strategic goals.
- Creating alignment with **shareholders (EM)** by building a shareholding in **our (SM)** business – **We (SM) believe (booster)** that it is **important (AM)** that **our (SM)** employees are **shareholders (EM)** in the business to create alignment with **our (SM) shareholders (EM)**. The CEO is required to hold shares with a value of four times salary with other Executives being required to hold shares with a value of three times salary. Most Executives already hold shares in excess of this requirement.

**We (SM)** are not proposing any significant changes to the structure of remuneration for 2012/13, as these arrangements were only introduced a year ago. **We (SM)** will, however, continue to monitor **our (SM)** approach to pay to ensure that it remains appropriate, aligned with **our (SM)** strategy and **fair (AM)** to Executives and **shareholders (EM)** in the context of the rapidly evolving environment around executive pay.

#### Remuneration arrangements throughout the Group

Remuneration arrangements at Executive Director level and throughout the Group are designed around a set of common Tesco pay values. Ensuring that employees are focused on delivering the same core objectives is an **important (AM)** part of Tesco's reward philosophy:

- Annual bonus – Annual bonuses throughout the Group are linked to local business performance but are consistent in structure to that of the Executives with a focus on underlying profit growth and performance against key strategic objectives.
- Share incentives – Over 5,000 of **our (SM)** senior employees across the globe participate in the Performance Share Plan based on the same performance conditions as Executive Directors. This senior population also receives some of their bonus in Tesco shares deferred for a period.
- Employees as **shareholders (EM)** – It is an **important (AM)** part of the Tesco values that all of **our (SM)** employees, not just senior management, have the opportunity to become Tesco **shareholders (EM)**. Over 210,000 of **our (SM)** people participate in **our (SM)** all-employee schemes and **we (SM)** delivered over 26 million shares in 2011 under **our (SM)** Shares In Success Plan, a plan which awards free shares to all UK employees based on Company performance.

When determining Executive remuneration arrangements the Committee takes into account pay conditions throughout the Group to ensure that the structure and quantum of executive pay remains appropriate in this context. When considering salary increases the Committee considers the general Group wage increase. In the last few years executive salary increases have been at a similar level to the general employee increase.

#### Remuneration framework

The following chart and accompanying table on page 67, provide a summary of the different elements of pay, their purpose and linkage to **our (SM)** strategy, and the key features of each component:

#### Remuneration policy for Executive Directors

At a glance summary of Executive Directors' remuneration for 2012/13

Element	Link to strategy/performance measures	CEO	Other Directors	Changes to the policy for 2012/13
Base salary	Set at levels to attract and retain talented individuals. When determining pay the Committee examines salary levels at the major retailers, the leading FTSE companies and gives consideration to appropriate international competitors.	£1,100,000  Next review 1 July 2012 For the last three years base salary increases have been similar to the increase awarded to other employees.	Executive directors £852,000  Corporate and Legal Affairs Director - £639,000	No changes to the policy.
Annual bonus (One-year	70% of bonus based on underlying profit performance. 30% of bonus based on performance against key strategic objectives.	Maximum opportunity of 250% of base salary.  50% in cash	Maximum opportunity of 200% of base salary.	No changes to the policy.

performance) (Cash and shares)	These measures have been selected as they are considered to be closely aligned to long-term <b>shareholder (EM)</b> value creation. All objectives are specific and measurable and a number relate to financial performance. Strategic objectives include specific measures based on environmental, social and governance ('ESG') factors, an integral part of the corporate strategy. The inclusion of these specific measures will help reinforce positive and responsible behaviour by senior management in relation to the underlying drivers of performance.	Clawback applies to allow the Committee to scale back deferred share awards in the event that results are materially misstated.	50% in shares which are deferred for three years.	
Performance share plan (Three-year performance) (Shares)	Based on a matrix of ROCE/EPS growth performance. To enhance <b>shareholder (EM)</b> value by incentivising Executives to grow earnings over the long term while maintaining a sustainable level of return of capital. To provide alignment of the economic interests of Executives and <b>our (SM) shareholders (EM)</b> and to act as a retention tool.	Maximum award of 275% of base salary.  Maximum awards of up to 250% of base salary can also be granted under the Discretionary Share Option Plan. However, it is not <b>intended (hedge)</b> that this plan will be used and it will only be used in exceptional circumstances.	Maximum award of 225% of base salary.  Clawback provisions apply to awards, allowing the Committee to scale back awards in the event that results are materially misstated.	No changes to the policy.
Pension (Cash)	To provide a market-leading retirement benefit that will foster loyalty and retain experience, which supports <b>our (SM)</b> culture of developing talent internally. A key incentive and retention tool throughout the organisation.	Current pension provision of defined benefit pension of up to two-thirds of base salary at retirement with a 10% employee contribution.	This is provided through registered arrangements up to approved HMRC limits, with the remainder provided through secured unfunded arrangements (other than for Tim Mason).	No changes to the policy.  The company is currently consulting with employees regarding some changes to the pension scheme which will also impact Executive Directors. <b>See (EM)</b> page 68 for more details.
Benefits	To provide a market-competitive level of benefits for <b>our (SM)</b> Executive Directors.	Core benefits – Benefits include car allowance, life assurance, disability and health insurance, and staff discount.  US CEO-allowance – The US CEO receives a net expatriate allowance of £282,000 to cover costs incurred in relation to his US assignment.	All employee share plans – Executives are eligible to participate in the Company's all-employee share schemes on the same terms as UK employees.	No changes to the policy.

## Base salary

### Policy

- Base pay is designed to attract and retain talented individuals.
- It is set to reflect individual capability, responsibilities and market-competitive positioning.

### Benchmarking group

- The Committee examines salary levels at the major retailers, the leading FTSE companies and **ensures (booster)** consideration is also given to appropriate international competitors.

### Relationship to all employee pay

- The Committee also takes into account pay conditions throughout the Group in deciding executive annual salary increases.
- The average increase for established Executive Directors last year was 2.4%. The average increase for senior management below Board level last year was 2.4%, and for other employees the average increase was **typically (hedge) around (hedge) 2.5%**.
- Pay levels Group-wide are determined with consideration to a number of factors, including the prevailing economic environment, discussions with employee representative groups, and current market practice.

### Review date

- Base salaries are **typically (hedge)** reviewed with effect from 1 July each year.
- The next salary review will be 1 July 2012 and salaries following this review will be disclosed in next year's report.

## Pension

### Philosophy

- Pension provision is central to **our (SM)** ability to foster loyalty and retain experience, which is why Tesco wants to ensure that the Tesco PLC Pension Scheme is a highly valued benefit.

### Pension policy

- All Executive Directors are members of the Tesco PLC Pension Scheme, which provides a pension of up to two-thirds of base salary on retirement, normally at age 60, dependent on service.
- Pension drawn before age 60 will be actuarially reduced to reflect early retirement.
- The Final Salary Scheme is now closed to new entrants and has been replaced in the UK for new entrants throughout the organisation by a defined benefit pension scheme based on career average earnings.
- **Our (SM)** defined benefit pension is a key incentive and retention tool throughout the organisation and remains an **important (AM)** part of **our (SM)** reward package for all UK employees.

### SURBS

- Since April 2006, following implementation of the regulations contained within the Finance Act 2004, and the subsequent changes to the annual allowance in 2010, Executive Directors have been eligible to receive the maximum pension that can be provided from the registered pension scheme.
- The balance of any pension entitlement for all Executive Directors is delivered through an unapproved retirement benefits scheme ('SURBS'). Except for Tim Mason (US CEO), the SURBS is 'secured' by using a fixed charge over a cash deposit in a designated account.

### Employee contribution

- Over the last few years employee pension contributions by **our (SM)** Executive Directors have been increasing progressively.
- In 2011/12 the level of employee contribution was 10% of salary which is in line with contribution levels by senior management below Board level. Contributions for 2012/13 will remain at this level.

The Company is currently consulting with employees regarding some proposed changes to the pension scheme. These changes, which **would (hedge) be expected (hedge)** to come into effect from 1 June 2012 and only apply to benefits that build up in the future, will apply to all participants in the scheme including the Executive Directors. There are two proposed changes. The first is that, whilst the Normal Pension Age remains unchanged, the age at which a full pension is paid will increase by two years – and which will be adjusted up or down to reflect any further unexpected changes in life expectancy. Secondly, **we (SM)** will increase pensions, up to 5%, by CPI instead of RPI.

Further details of the pension benefits earned by the Directors can be found on page 80.

## Share ownership guidelines

### Guidelines

#### Four times base salary for the CEO

- The purpose of this is to create alignment with interests of **shareholders (EM)**

#### Three times base salary for other Executive Directors

- This requirement is at the upper end of **typical (hedge)** market practice for similar sized companies

The Remuneration Committee **believes (booster)** that a significant shareholding by Executive Directors aligns their interests with **shareholders (EM)** and **demonstrates (booster)** their ongoing commitment to the business.

#### Policy for calculating shareholding

- Shares included – Shares held in plans which are not subject to forfeiture will be included (on a net basis) for the purposes of calculating Executive Directors' shareholdings, as will shares held by an executive's spouse. Vested but unexercised market value share options are not included in the calculation.
- Five years for new appointees to build shareholdings – New appointees will **typically (hedge)** be **expected (AM)** to achieve this minimum level of shareholding within five years of appointment.
- PSP participation may be subject to maintaining holding – Full participation in the long-term Performance Share Plan will **generally (hedge)** be conditional upon maintaining the minimum shareholding.
- Holding of 50% of vesting awards until requirement met – Most executives already meet the shareholding requirement but those who do not will **generally (hedge)** be required to hold, and not dispose of, at least 50% of the net number of shares which vest under incentive arrangements until they meet this requirement.

#### Shares held by Executive Directors at 25 February 2012

The chart below illustrates the value of Executive Directors' shareholdings, based on the three-month average share price to 25 February 2012 of 359p per share compared to the shareholding guideline. The shareholding guideline has been shown based on the full requirement of four times salary for the CEO and three times salary for other directors. When the shareholding guidelines were increased last year, Executives were given a period of five years to meet this enhanced requirement and therefore **should (EM)** meet the requirement by June 2016.

#### Share dealing policy

Tesco has a share dealing policy in place for Executive Directors and for members of the Executive Committee. This policy prevents Executive Directors and Executive Committee members and their connected persons dealing in shares at times when this **would (hedge)** be prohibited by the Model Code. At all other times, Executive Directors and Executive Committee members must seek advance clearance from the Chairman before dealing in shares on their own behalf or in respect of their connected persons.

#### Service agreements

##### Key provisions

Provision	Current service contracts	Policy for new appointments
Notice period	12 months' notice by the Company and six months notice by the Executive For new appointments the Committee reserves the right to vary this period to 24 months for the initial period of appointment and for the notice period to then revert to 12 months. No Executive currently has a notice period of greater than 12 months.	
Expiry date	Rolling service contract No fixed expiry date	
Termination payments (Does not apply if notice as per the service agreement is provided or for termination by reason of resignation or unacceptable performance or conduct)	Termination payments in lieu of notice calculated based on basic salary and the average annual bonus paid for the last two years. No account will be taken of pension. Termination payments will be subject to mitigation and normally paid in instalments to facilitate this (other than for long serving Executives). If the termination occurs within one year of retirement, the termination payment will be reduced accordingly.	Termination payments in lieu of notice based on basic salary and benefits only.

The Committee has taken into account the feedback received from **shareholders (EM)** and **shareholder (EM)** representative bodies regarding best practice in relation to the inclusion of bonuses in Directors' termination arrangements. To ensure full alignment with best practice, the Committee has decided that the policy for new executives joining the Board will be to restrict termination payments in lieu of notice to a sum based on salary and benefits only. This was reflected in the new service contract for Philip Clarke on his appointment to CEO.

The service agreements are available to **shareholders (EM)** to view on request from the Company Secretary.

#### Performance related remuneration for 2012/13

##### Short-term performance

The table below sets out a summary of the maximum opportunity under the short-term remuneration arrangements for 2012/13:

At a glance short-term bonus opportunity
--

- Maximum opportunity of 250% of salary for the CEO.
- Maximum opportunity of 200% of salary for the other Executive Directors.
- Half payable in cash and half payable in shares which are deferred for three years.
- Clawback provisions apply to the deferred shares element.

The following short-term performance measures apply for the 2012/13 annual bonus arrangements:

#### Short-term performance measures for 2012/13

Profitability (70% of short-term performance)	Strategic (30% of short-term performance)
Measured in relation to underlying profit performance.	Based on performance against key metrics. For 2012/13 these metrics will be: <ol style="list-style-type: none"> <li>1. UK like-for-like sales growth</li> <li>2. UK return on capital employed</li> <li>3. Customer experience</li> <li>4. Group internet sales</li> <li>5. Group employee satisfaction</li> <li>6. Group CO2 reduction</li> </ol>
Link to strategy – This measure incentivises the delivery of strategy by encouraging the creation of annual <b>shareholder (EM)</b> value through improved bottom-line financial results.	<p>Link to strategy – These measures contain a mix of financial, strategic and corporate responsibility targets and were selected to incentivise sustainable improvements in the underlying drivers of performance.</p> <p>In light of <b>our (SM)</b> strategic focus on the customer shopping trip over the next 12 months, for the annual bonus for 2012/13 <b>we (SM)</b> have replaced <b>our (SM)</b> Group new space expansion metric with an objective focused on customer experience. This will allow <b>us (SM)</b> to directly measure whether or not <b>our (SM)</b> investment in customers is feeding through to an improved customer experience.</p> <p>In addition for 2012/13 the Committee is introducing an underpin to the annual bonus so that no portion of the annual bonus related to strategic measures can be earned unless a minimum level of profit growth has been achieved.</p>

85% of bonus entitlement is based directly or indirectly on financial metrics. These measures are considered to be **important (AM)** for laying foundations for future performance improvement.

The balance of measures is illustrated in the pie chart below:

This balance of both profitability metrics, and specific measures based on environmental, social and governance ('ESG') factors, will support the delivery of **our (SM)** corporate strategy, and help reinforce positive and responsible behaviour by senior management. This will ensure that the value that is delivered to **shareholders (EM)** is sustainable.

Given their commercial sensitivity, **we (SM)** do not publish the details of targets in advance. However, targets are considered to be measurable and **appropriately (AM)** stretching. If they are achieved the Committee **considers (AM)** that value will have been added for **shareholders (EM)**. The Committee will provide an explanation of the rationale for the level of bonus paid in the 2012/13 Directors' Remuneration Report to ensure transparency for **shareholders (EM)** regarding the level of reward paid in the context of performance delivered.

Clawback applies to deferred shares to allow the Committee to scale back deferred share awards (potentially to zero) in the event that results are materially misstated.

#### Long-term performance

At a glance long-term plan opportunity for 2012/13

- Maximum award of 275% of salary for the CEO
- Maximum award of 225% of salary for the other Executive Directors.
- Shares vest in three years' time subject to performance targets being met.
- Clawback provisions apply.

Tesco **believes (booster)** that the best way to enhance **shareholder (EM)** value is to grow earnings over the long term while maintaining a sustainable level of return on capital employed – in other words to keep growing the size of the business in an efficient way.

As applied for the first time in 2011, 2012 awards will be subject to performance against a matrix of stretching earnings growth targets and sustainable return on capital performance. The Committee **believes (booster)** that this combination of EPS growth and ROCE performance is strongly aligned with **our (SM)** strategic objectives and also reflects the drivers of long-term **shareholder (EM)** value.

As announced in January 2012, **our (SM)** plan for 2012/13 is to substantially increase investment in the delivery of an **even (AM)** better shopping trip for customers – particularly in the UK. The objective is that this investment in customer experience will strengthen **our (SM)** underlying business and generate long-term sustainable earnings growth and returns. In light of this the Committee has reviewed targets for the 2012 PSP award to ensure that they remain motivational for management while still representing long-term value creation for **shareholders (EM)**.

While **we (SM)** have lowered the EPS growth vesting entry point compared to 2011/12 (from 7% p.a. to 5% p.a.) to ensure that it remains appropriate and motivational for management, **we (SM)** have kept the maximum vesting point the same, at 12% p.a. growth, to ensure that awards are only paid in full if there has been significant value creation for **shareholders (EM)**. In April 2011, **we (SM)** set a target to increase **our (SM)** already strong level of ROCE to 14.6% by 2014/15. **We (SM)** have improved ROCE from 12.9% to 13.3% in the last year and remain **committed (AM)** to **our (SM)** target. Therefore the ROCE target remains unchanged. The Committee **believes (booster)** the targets remain stretching and the combination of growing earnings while improving capital returns will result in value creation for **shareholders (EM)**.

#### Targets for 2012/13 awards

The vesting matrix and targets for the three years to 2014/15 are illustrated below:

#### Targets for 2011/12 awards

The vesting matrix for 2011 awards is provided below:

Prior to 2011 PSP awards, ROCE performance outcomes were adjusted to take into account acquisitions which were not envisaged when the targets were set. The Remuneration Committee reserves the right to make such adjustments under the new plan but will only do so when the impact is material.

Clawback provisions apply to awards, allowing the Committee to scale back awards (potentially to zero) in the event that results are materially misstated.

#### Remuneration decisions for Executive

##### Directors in 2011/12

Despite achieving record sales and profits and improved ROCE performance, 2011/12 has been a challenging year for Tesco, particularly in the UK and Tesco Bank. Nevertheless there were **encouraging (AM)** signs for the future in many of **our (SM)** key growth opportunities. **Our (SM)** International business performed strongly, with promising sales growth in all three regions; Asia, Europe and particularly the United States. Online sales, a key strategic area, also grew strongly.

Against this performance background, the main aspects of executive remuneration practice for the year were as follows:

#### At a glance remuneration decisions for 2011/12

##### Base salary

- Salary for CEO agreed at appointment (March 2011) at £1,100,000
- Salaries for Executive Directors increased by 2.4% with effect from 1 July 2011, in line with the general increase for other employees.
- Next review is with effect from 1 July 2012.

##### Annual bonus

- Despite year-on-year profit growth to record levels, **our (SM)** stretching underlying profit growth targets were not met and therefore no bonus will be paid in respect of this portion of the bonus. However, **satisfactory (AM)** performance was delivered in respect of a number of **our (SM)** strategic objectives and therefore a total of 13.54% of the maximum bonus (27% of salary) will be paid to Executive Directors.
- The CEO elected not to take any bonus for 2011/12.

##### Long-term incentives

- **Our (SM)** long-term rewards were assessed based on earnings growth and return on capital employed delivered over the past three years.
- Despite the challenges in 2011/12, performance over the long-term was still strong compared to 2008/9. The Remuneration Committee therefore determined that 46.5% of the performance share award (69.7% of the Group element and 0% of the international element) and 100% of the share options (granted under the old framework in 2009) **would (hedge)** vest, reflecting the progress made over the longer term.

The following provides further detail on these decisions.

#### Salaries 2011/12

The base salaries of the Executive Directors following the 2011 review were:

The average increase for established Executive Directors last year was 2.4%, which was **broadly (hedge)** the same as the increase for other senior executives and employees throughout the Group. Salary increases over the last three years have been aligned with those of other employees.

#### Short-term performance

##### Performance measures and payouts

Performance measures		Maximum opportunity	2011/12 payout
70% based on profitability	Underlying profit performance	CEO – Maximum bonus opportunity of 250% of base salary.	13.54% of maximum opportunity. The CEO elected not to take a bonus.
30% based on strategic performance	1. UK like-for-like sales growth 2. UK return on capital employed 3. Group new space expansion 4. Group internet sales 5. Group CO2 reduction 6. Group employee satisfaction	Other Executive Directors – Maximum bonus opportunity of 200% of base salary.	0% of salary for the CEO and 27% of salary for other Directors.  0% of financial performance met and 45% of strategic performance objectives met.

The following illustrates performance against short-term targets.

Despite year-on-year profit growth, **our (SM)** stretching underlying profit growth targets were not met and therefore no bonus will be paid in respect this portion of the bonus. However, **satisfactory (AM)** performance was delivered in respect of a number of **our (SM)** strategic objectives, particularly Group internet sales, Group CO2 reduction and Group employee satisfaction and therefore a total of 13.54% of the maximum bonus will be paid to Executive Directors. The CEO elected not to take a bonus for 2011/12.

#### Long-term performance

##### Vesting of 2009/10 to 2011/12 awards

Awards vesting in the year were made under the previous long-term incentive arrangements, comprising both share options and performance related shares. The performance conditions applying to these awards and achievement against these targets are summarised below:

Performance measures and payouts			
		Maximum opportunity	2011/12 payout
Earnings per share	<ul style="list-style-type: none"> <li>First 100% subject to the achievement of underlying diluted EPS growth of at least RPI plus 9% over three years and the balance vesting for achieving growth of at least RPI plus 15% over three years.</li> <li>Granted in 2009/10</li> <li>Performance period ended 2011/12</li> </ul>	<ul style="list-style-type: none"> <li>Share options with a face value of 200% of salary at the date of grant.</li> </ul>	<ul style="list-style-type: none"> <li>100% of maximum opportunity vested.</li> </ul>
<ul style="list-style-type: none"> <li>Underlying diluted EPS for 2011/12 excludes the discontinued Japan business and was 37.41p. The Committee determined, however, that it was appropriate to base vesting of share option awards on EPS including the impact of Japan to ensure alignment with <b>shareholders (EM)</b>.</li> <li>On this basis, the growth in undiluted EPS above RPI during the performance period exceeded 15% over three years and these options will therefore vest in full on the third anniversary of their grant.</li> <li>Despite the challenges in 2011/12 earnings, performance is still significantly ahead of 2008/9 performance representing significant value creation for <b>shareholders (EM)</b> over this period.</li> <li>The exercise price for awards is 338.4p per share. At the year end the share price was 318.2p and the share options granted in 2009 were therefore underwater. No value will be delivered to Executives unless the share price increases significantly above this level.</li> </ul>			

Performance measures and payouts			
Return on	<ul style="list-style-type: none"> <li>Maximum vesting for group ROCE of 13.3% with</li> </ul>	<ul style="list-style-type: none"> <li>Maximum</li> </ul>	<ul style="list-style-type: none"> <li>69.7% of</li> </ul>

capital employed – Group	<ul style="list-style-type: none"> <li>threshold vesting for Group ROCE of 12.2%.</li> <li>75% based on performance against target with 25% based on the Committee's assessment of the quality of ROCE performance.</li> <li>Granted in 2009/10</li> <li>Performance period ended 2011/12</li> </ul>	award of 100% of salary	maximum opportunity vested
Return on capital employed – International	<ul style="list-style-type: none"> <li>Maximum vesting for international ROCE of 7.0% with threshold vesting for International ROCE of 5.5%.</li> <li>75% based on performance against target with 25% based on the Committee's assessment of the quality of ROCE performance.</li> <li>Granted in 2009/10</li> <li>Performance period ended 2011/12</li> </ul>	<ul style="list-style-type: none"> <li>Maximum award of 50% of salary (except for Tim Mason, US CEO).</li> </ul>	0% of maximum opportunity vested.

Group performance 2011/12			
<ul style="list-style-type: none"> <li>Performance for 2011/12 – Post Tax Group ROCE performance was adjusted down to take account, inter alia, of the Japan business which has been discontinued. Based on this performance, 69.7% of the first 75% of the award will vest.</li> <li>Reported ROCE – Reported ROCE for 2011/12 excludes the discontinued Japan business and was 13.3%. The Committee determined, however, that it was appropriate to base vesting of PSP awards on ROCE including the impact of Japan to ensure alignment with <b>shareholders (EM)</b>.</li> <li>Assessment of the quality of ROCE – The Committee also exercised its judgement as to the extent to which the remaining 25% of the PSP award should vest by reference to the overall quality of ROCE performance, taking into account factors including: <ul style="list-style-type: none"> <li>the level of ROCE achieved;</li> <li>the expected ROCE for additional and existing capital investment;</li> <li>whether capital spend was in line with strategic objectives and balanced short-term and long-term investment needs; and</li> <li>the level of sales and underlying profit growth and whether this reflected other developments in the marketplace.</li> </ul> </li> <li>The Committee considered these factors and concluded that there were no reasons to treat the remaining 25% of the award differently and therefore determined that the vesting for the remaining 25% of the award <b>should (EM)</b> be in line with vesting for the first 75% of the award. Overall therefore 69.7% of the maximum award vested.</li> </ul>			
International ROCE performance 2011/12			
<ul style="list-style-type: none"> <li>Post Tax International ROCE 2011/12 including the discontinued Japan business was below the level of International ROCE required for threshold levels of vesting and therefore <b>0%</b> of the International award will vest.</li> </ul>			

Leaving arrangements for Andrew Higginson, David Potts and Richard Brasher

Andrew Higginson will retire from the Board on 1 September 2012 after 14 years with the business. David Potts stepped down from the Board on 7 December 2011 and will retire from the Company on 30 June 2012 after 39 years with the business. Shortly after the year end, **we (SM)** also announced the departure of Richard Brasher who will leave the Company on 31 July 2012 after 26 years with the business. Cessation arrangements for these Executives will be in accordance with their contracts and the rules of the applicable share plans. Details will appear in next year's Directors' Remuneration Report.

Other information

Outside appointments

Tesco recognises that its Executive Directors may be invited to become Non-executive Directors of other companies. Such non-executive duties can broaden experience and knowledge which can benefit Tesco. Subject to approval by the Board, Executive Directors are allowed to accept Non-executive appointments and retain the fees received, provided that these appointments are not **likely (hedge)** to lead to conflicts of interest.

Executive Directors' biographies which include details of any outside appointments can be found on page 38 of this report. Fees retained for any Non-executive Directorships are set out below.

There were no increases to the Non-executive Director fee levels in the year.

The current Non-executive Director fees are as follows:

Gareth Bullock, Stuart Chambers and Deanna Oppenheimer will be appointed to the Board of Tesco Personal Finance Group Limited subject to FSA approval. They will be paid a fee in respect of this which will be in line with other members of the Board of Tesco Personal Finance Group Limited.



- Letters of appointment – Non-executive Directors have letters of appointment setting out their duties and the time commitment **expected (AM)**. The letters are available to **shareholders (EM)** to view from the Company Secretary upon request.
- Review of performance – The Chairman meets with each Non-executive Director separately to review individual performance.
- Reappointment policy – In line with the UK Corporate Governance Code, all Non-executive Directors will submit themselves for re-election by **shareholders (EM)** every year at the Annual General Meeting. All Non-executive Director appointments can be terminated by either party without notice.
- Policy for determining Non-executive Director remuneration – The remuneration of the Non-executive Directors is determined by the Chairman and the Executive Committee after considering external market research and individual roles and responsibilities.

#### Chairman

The Remuneration Committee determines the Chairman's remuneration, having regard to time commitment and remuneration arrangements to Chairmen of other companies of a similar size and complexity.

Sir Richard Broadbent was appointed Non-executive Chairman from 30 November 2011, and has the benefit of a company car and driver.

Between 2 July and 30 November, Sir Richard worked with the former Chairman Sir David Reid to transition the role. During this period he was paid 50% of this annual fee, £312,500 p.a. (£130,208 for this five-month period) reflecting the time commitment required in relation to the transition of the role.

Sir David Reid was Non-executive Chairman until 30 November 2011. He received an annual fee of £640,000 and had the benefit of a company car and driver.

#### Funding of equity awards

Executive incentive arrangements are funded by a mix of newly issued shares and shares purchased in the market. Where shares are newly issued the Company complies with ABI dilution guidelines on their issue. The current dilution usage of Executive plans is c.4% of shares in issue. Where shares are purchased in the market, these may be held by Tesco Employees Share Schemes Trustees Limited, in which case the voting rights relating to the shares are exercisable by the trustees in accordance with their fiduciary duties.

#### Change of control

Long-term incentive awards may vest or become exercisable before their normal vesting date in the event of a change of control of Tesco PLC subject to the rules of the applicable plans.

Corporate governance	
Membership of the Remuneration Committee	<p>Stuart Chambers (Committee Chairman)</p> <p>Patrick Cescau (to 25 February 2012)</p> <p>Karen Cook</p> <p>Ken Hanna</p> <p>Jacqueline Tammenoms Bakker</p> <p>The directors' biographies can be found on pages 38 and 39 of this Report.</p> <p>Members' attendance at committee meetings is listed in the Corporate governance section on page 57 of this Report</p> <p>No member of the committee has any personal financial interest in the matters being decided, other than as a <b>shareholder (EM)</b>, nor any day-to-day involvement in running the business of Tesco</p>
Role of the Remuneration Committee	<p>The Committee's key responsibilities are to:</p> <ul style="list-style-type: none"> <li>○ Determine and recommend to the board the remuneration policy for Executive Directors and the Chairman.</li> <li>○ Ensure the level and structure of remuneration is designed to attract, retain, and motivate the Executive Directors needed to run the Company while remaining appropriate in the context of the remuneration arrangements throughout the Group.</li> <li>○ Ensure that the structure of remuneration arrangements is aligned with the creation of sustainable returns for <b>shareholders (EM)</b> and that the level of reward received by Executives reflects the value delivered for <b>shareholders (EM)</b>.</li> </ul> <p>As required by the FSA, Tesco Bank has a separate independent remuneration committee. The Group Remuneration Committee is consulted on, and makes recommendations in relation to the remuneration arrangements for Tesco Bank employees, with the aim of encouraging consistency with Group remuneration policy, but it does not make decisions in relation to, or direct, how remuneration is managed within Tesco Bank.</p>

#### Governance Oversight Committee

The Governance Oversight Committee was established following the introduction of the Group New Business Incentive Plan, with a remit to review the allocation of capital across the Group to ensure that it was appropriate and aligned with **shareholders (EM)**' interests. Following a review of the Company's corporate governance structure, the outcomes of which are outlined in more detail in the Corporate Governance report, it was determined that this oversight role would be performed by other Committees.

#### Compliance

In carrying out its duties, the Remuneration Committee gives full consideration to best practice. The Committee was constituted and operated throughout the period in accordance with the principles outlined in the Listing Rules of the Financial Services Authority derived from the UK Corporate Governance Code. The auditors' report, set out on page 89, covers the disclosures referred to in this report that are specified for review by the Financial Services Authority. The report has been drawn up in accordance with the UK Corporate Governance Code, Schedule 8 of the Large and Medium sized Companies and Groups (Accounts and Reports) Regulations 2008 and the Financial Services Authority Listing Rules.

This report also complies with disclosures required by the Directors' Remuneration Report Regulations 2002. Details of Directors' emoluments and interests are set out on pages 80 to 86 of this Report.

Stuart Chambers

Chairman of the Remuneration Committee

#### Our (SM) Year in Review

##### New Silver Refinery Commissioned

In Q3 FY 2012 **our (SM)** new silver refinery came on stream, taking **our (SM)** capacity to 16moz of silver. The ramp up of the Sindesar Khurd mine combined with the contribution from the silver refinery delivered an **impressive (AM)** 35% increase in silver production, with production reaching a record 7.8moz.

##### Acquired Iron Ore Assets in Liberia

In August 2011, **we (SM)** acquired iron ore deposits in Liberia, West Africa, with Reserves and Resources **estimated (hedge)** at over 1 billion tonnes. Currently, an Aeromagnetic study has been completed, and the Feasibility study is under way. Initial drilling **indicates (hedge)** potential upside.

##### Acquired and Integrated Cairn India

During the year **we (SM)** completed the integration of Cairn India, following the acquisition of a majority stake in December 2011. Cairn India is the largest private crude oil producer in India and this acquisition extended **our (SM)** portfolio into oil & gas.

##### Group Consolidation and Simplification Announced

In February 2012, **we (SM)** announced the consolidation and simplification of Group structure in line with **our (SM)** stated strategy. This includes a merger of Sesa Goa Ltd and Sterlite Industries **(India) (CG)** Ltd to create Sesa Sterlite Ltd.

#### Market Overview

Emerging markets continue to drive global demand

## The Global Economy and Commodity Markets

Economic growth was led by emerging markets including China and India, albeit at a slower rate as their central banks tightened monetary policies. Developed countries retained expansionary monetary policies to sustain growth, given the eurozone financial crisis and high unemployment levels.

Commodity demand grew in absolute terms as emerging economies continued to invest in infrastructure, leading to higher levels of per capita metal consumption. Consensus view among economists **indicates (hedge)** that China's growth will transition towards consumption. With infrastructure continuing to be a bottleneck to industrial growth in India, evolving government policies and a focus on investment in infrastructure remain key to mitigating supply constraints, even as consumption growth is driven by increasing urbanization and favourable demographics. Overall, growing prosperity in emerging market economies underpins their robust fundamentals, and Vedanta remains well-positioned with a strong operational and market presence in India, and proximity to China and other emerging markets.

Growth in commodity supply remained low, due to a variety of factors affecting output across the world, including rising capital and operating costs, declining grades, and many large mines nearing depletion. Political instability in the Middle East resulted in shocks to oil supply, leading to higher oil prices. Besides, evolving regulatory environments added to the political risk of mining and oil projects. With a well-invested capital expenditure program nearing completion, Vedanta remains focused on ramping-up projects to nearly double capacity in the near term, and create value on a long term basis.

Commodity prices were affected by the dynamics of physical supply-demand, the varying impact of financial contracts and slower economic growth, falling sharply in the October-December quarter, especially in the case of base metals like Aluminium, and Zinc, before partially rebounding in the next quarter. Marginal costs of production for each commodity provided support to prices, as high-cost producers curtailed production. Overall, average prices of most commodities in FY 2012 were higher than the previous year. In such a volatile environment, Vedanta benefited from a diversified portfolio of assets with low cost operations across base and precious metals, bulks and oil & gas.

### Outlook

Fundamental demand for natural resources remains robust with metal consumption poised to increase as emerging economies progress on the road to development. Despite volatility in the short term and cost pressures, favourable supply-demand dynamics underpin strong support for long-term commodity prices. A more detailed review of market trends for each of Vedanta's businesses is included in the Operational Review on pages 38 to 57.

## Business Model

### Creating and Preserving Value

#### What **we (SM)** do and how **we (SM)** add value

Vedanta operates across the natural resources value chain undertaking exploration, asset development, extraction, processing and value addition. **We (SM)** capitalise **our (SM)** strategic capabilities including **our (SM)** strengths, resources and relationships, to create and preserve value for **our (SM)** wide **stakeholder (EM)** groups.

The Group's principal commodities are priced with reference to standard global benchmark prices such as London Metal Exchange prices, Brent and WTI, etc. **We (SM)** maximise returns through a strong focus on low-cost production.

**We (SM)** take a long-term view and **we (SM)** are **committed (AM)** to the highest standards of sustainable development in all aspects of **our (SM)** business. **Our (SM)** Sustainability Framework aligns strategic thinking with sustainability, and underpins everything **we (SM)** do.

### Value Chain

#### Exploration

Reserves and Resources ('R&R') have finite lives, and **our (SM)** key focus is to increase the lives of **our (SM)** R&R base. **We (SM)** target to add more to **our (SM)** R&R than what **we (SM)** extract out, thereby adding to the R&R life each year. **Our (SM)** exploration programmes comprise brown field and green field activities, to extend the lives of **our (SM)** existing mines and oilfields.

#### Asset Development

Following successful exploration, **we (SM)** develop the resource base to optimise production and life of the resource. **We (SM)** also strategically develop processing facilities. Across **our (SM)** businesses, **we (SM)** have a strong track record of executing projects on time and within budget.

#### Strategic Capabilities

##### Project Execution

**We (SM)** are nearing completion of a US\$18 billion capital investment programme to expand **our (SM)** capacities and have honed **our (SM)** project execution skills, delivering multi-billion dollar programmes on schedule and on budget.

##### Inorganic Growth

**We (SM)** have a strong track record of successfully acquiring, integrating and growing the companies **we (SM)** have acquired. These acquisitions have extended **our (SM)** commodity and geographic footprint. Following integration, **we (SM)** focus on asset optimisation and organic growth through expansion projects.

##### Operational Excellence

**Our (SM)** strength in production is driven by **our (SM)** focus on debottlenecking processes, improving operational and cost efficiencies, and reducing **our (SM)** specific consumption of inputs including energy and water.

##### Low-cost Focus

All **our (SM)** operations have a sustainable cost position in the lower half of the global cost curve. **We (SM)** aim to achieve and sustain this cost positioning by an integrated approach to producing natural resources, and a focus on Operational Excellence.

##### Extraction

**Our (SM)** operations are focused on mining metals, extracting oil & gas and generating power. **We (SM)** operate **our (SM)** mines in India, Africa, Australia and Ireland, extracting zinc, lead, silver, iron ore, bauxite and copper. **We (EM)** have three operating blocks in India producing oil & gas.

##### Processing

In line with **our (SM)** integrated business model, **we (SM)** produce refined metals by processing and smelting the extracted resources at **our (SM)** zinc, lead, silver, copper, and aluminium smelters, and other processing facilities in India and Africa. **We (SM)** generate power for captive use across most of **our (SM)** operations and sell any surplus power. **We (SM)** sell power generated by **our (SM)** independent power plants.

##### Value Addition

**We (SM)** meet market requirements by selectively adding value and converting the primary metals produced into higher margin products such as sheets, rods, bars, rolled products, etc. at **our (SM)** zinc, aluminium and copper businesses.

##### Exploration Focus

**Our (SM)** skill in exploration has delivered consistent increases in **our (SM)** R&R over the years, extending the life of **our (SM)** resource base even as **we (SM)** have increased production levels. Additionally, recent acquisitions of Zinc-International, Liberia Iron Ore and Cairn India have added considerable potential for future expansion of R&R.

##### Financial Strength

**We (EM)** have a strong balance sheet with capital employed of US\$18.4 billion, cash and liquid investments of US\$6.9 billion and net gearing of 35% as at 31 March 2012. With projects ramping up and delivering strong production growth, **we (SM)** expect (hedge) higher EBITDA and free cash flows. **We (SM)** delivered robust free cash flow before expansion capital expenditure of US\$2.5 billion in FY 2012.

##### People and Culture

With a 32,000 strong workforce and a talent pool of technical, engineering and business professionals, **we (SM)** focus on offering **our (SM)** employees the opportunity to develop their potential within a high growth, entrepreneurial culture.

#### Relationships and Partnerships

**We (SM)** seek to build long-term, mutually beneficial, long-term relationships with **our (SM) stakeholders (EM)** including **shareholders (EM)** and lenders, suppliers and contractors, customers, employees, governments, communities and civil society.

**We (EM)** are a substantial contributor to the economies and communities where **we (SM)** operate. For example, in India **we (EM)** are one of the largest contributors to the exchequer, with US\$4.4 billion of taxes and levies paid in FY 2012 (including US\$2.4 billion by Cairn India during the full year).

#### Strategic Framework

##### Vision

To be a world class, diversified resources company providing superior returns to **our (SM) shareholders (EM)**, with high quality assets, low-cost operations and sustainable development.

##### Strategy

To deliver growth, long-term value and sustainable development through **our (SM)** diversified portfolio of large, long-life, low-cost assets.

##### Growth

##### Organic Growth

**We (SM)** focus primarily on extending **our (SM)** resource base and growing **our (SM)** assets organically, investing in projects that expand **our (SM)** capacity and increase production volumes.

##### Selective and Value Accretive M&A

In addition to organic growth, **we (SM)** look to acquire large proven assets where **we (SM)** can add significant value with **our (SM)** strategic capabilities.

##### Long-term Value

##### Optimise Returns

**We (SM)** aim to optimise **our (SM)** cost and operational performance through a culture of continuous improvement to achieve and maintain a low cost position in all **our (SM)** businesses.

##### Reserves and Resources

**We (SM)** aim to continue to add to **our (SM)** Reserves and Resources ('R&R') at a faster rate than **we (SM)** deplete them through a continued focus on exploration.

##### Group Structure

Consolidation and simplification of **our (SM)** Group structure remains a strategic objective as **we (SM)** seek to drive synergies from integrating the Group and build long-term value.

##### Sustainability

##### Responsible Stewardship

**We (SM)** are **committed (AM)** to providing a safe, secure and healthy workplace for all employees by optimising **our (SM)** specific consumption of inputs and minimising **our (SM)** environmental footprint.

##### Building Strong Relationships

**We (SM)** aim to forge strong partnerships by engaging with **our (SM)** key **stakeholders (EM)** including **shareholders (EM)** and lenders, suppliers and contractors, customers, employees, governments, communities and civil society.

#### Adding and Sharing Value

**We (SM)** aim to create and sustain policies and processes that will contribute to the well-being and development of **our (SM)** employees and deliver sustainable benefits to the local communities where **we (SM)** operate.

#### Delivering on **our (SM)** Strategy

##### What **We (SM)** Said **We (SM)** Would Do

- Deliver significant total volume growth
- Complete the Cairn India acquisition and integrate the Zinc-International assets acquired
- Seek further organic growth opportunities
- Grow R&R by exploration
- Re-invest strong free cash flow and maintain strong balance sheet
- Focus on cost optimisation
- Rationalise Group structure
- Comply with Scott Wilson report and develop a comprehensive sustainability model
- Continue to focus on health and safety improvement targeting zero harm
- Manage **our (EM)** plants more efficiently to reduce **our (SM)** environmental footprint
- Extend **our (SM)** outreach to help the communities where **we (SM)** operate

##### How **We (SM)** Performed

- Achieved year-on-year EBITDA growth of 13%
- Zinc-India delivered 16moz silver capacity
- Zinc-International and Cairn India successfully integrated
- Significant iron ore assets acquired in Liberia, West Africa. Feasibility study under way
- Significant additions to R&R at iron ore, zinc and oil & gas
- Free cash flow maintained at US\$2.5 billion
- Low cost advantage maintained
- Simplification of the Group structure announced. Sesa Goa and Sterlite merged into Sesa Sterlite, combined with the consolidation of VAL and MALCO, forming one of the largest natural resources players by EBITDA<sup>1</sup>
- New Sustainability Framework rolled out
- Exco sustainability subcommittee formed to focus on performance
- LTIFR reduced by 10% during the year
- Doubled water recycling across the Group to 55.72 million cubic metres from 27.91 million cubic metres last year
- US\$57 million invested in environment management activities
- US\$38 million invested in community programme reaching 3.1 million people

1 Subject to customary regulatory and **shareholder (EM)** approval.

#### Future Priorities

- Ramp-up of oil production at Rajasthan field to 240kbopd by CY 2013 (basin potential of 300kbopd)
- Recover iron ore volumes and ramp up at Konkola mine and Power operations
- Focus on future drivers of growth: Liberia, Gamsberg, Zinc-India
- Continue to add R&R in oil & gas, iron ore and zinc
- Reduce gearing through strong free cash flow
- Continued focus on securing coal and bauxite
- Complete simplification of the Group structure
- Continue to improve **our (SM)** safety performance
- Continue to improve **our (SM) stakeholder (EM)** engagement
- Improve process of identifying issues that are material to **our (SM) stakeholders (EM)** and to the business

- Expand **our (SM)** structured educational, healthcare and community programmes

Sustainability Report [www.vedantaresources.com/sustainability](http://www.vedantaresources.com/sustainability)

Growth

Industry

Growth

- Record silver production of 7.8moz during the year
- 100kt Dariba lead smelter commissioned and ramped up
- Integrated copper production ramped-up with higher output from the Nchanga open pits
- Second and third units of 2400MW power plants at Jharsuguda commissioned

+35.0% Record silver production up for the year

+31.0% Increase in production for alumina at Lanjigarh

Leading Growth Profile

Organic Growth

With strong commodity demand in countries where **we (SM)** operate and leading market shares across most of **our (SM)** businesses in India, **we (SM)** have once again successfully delivered significant organic growth and expanded **our (SM)** assets and resource base across **our (SM)** businesses. **We (SM)** continue to build and operate assets with a low cost base, which **ensures (booster) we (SM)** remain competitive through business cycles.

**“We (SM)** have once again successfully delivered significant organic growth and expanded **our (SM)** assets and resource base across **our (SM)** businesses.”

**We (SM)** have already invested US\$14 billion of **our (SM)** US\$18 billion capital expenditure (capex) programme, and are reaching an inflection point as free cash flow post expansion capital expenditure turns positive.

**We (SM) expect (hedge)** strong free cash flow going forward as **our (SM)** existing organic growth programme nears completion, and projects continue to ramp up.

During FY 2011–12, **we (SM)** invested US\$2.4 billion in organic growth capex across **our (SM)** businesses, **mostly (hedge)** in Aluminium and Power.

During the year **we (SM)** delivered record production of refined zinc-lead, silver, copper, aluminium and power.

Significant Increases in Capacity

- Record silver production of 7.8moz during the year, up 35% driven by the ramp up of the silver-rich Sindesar Khurd zinc-lead mine in Rajasthan, India and commissioning of the new 350tpa silver refinery. During the year, **we (SM)** achieved **our (SM)** targeted capacity of 16moz for silver.
- The new 100kt Dariba lead smelter in Rajasthan, India was commissioned, resulting in a record production of lead in Q4 of 37kt at Zinc-India. Development of the 1mtpa underground Kayar zinc-lead mine has commenced, and commissioning is **expected (hedge)** in FY 2013–14.
- At **our (SM)** Copper Zambia operations, integrated copper production ramped-up with higher output from the Nchanga open pits, completion of TLP-IV debottlenecking to 75ktpa and commissioning of the new 7.5mtpa Nchanga East Concentrator.
- A second cobalt recovery furnace was also commissioned at Copper Zambia. Integrated production volumes and costs are **expected (hedge)** to improve, with **successful (AM)** trial mining at the Nchanga Upper Ore Body project confirming higher copper and cobalt grades, and commissioning of the new 3mtpa Nchanga West concentrator by mid FY 2012–13.
- The 1mtpa alumina refinery in Lanjigarh, India is now operating at its rated capacity driving a 31% increase in alumina production to 928kt. Work on the 1.25mtpa aluminium smelter expansion at Jharsuguda, India is progressing **well (AM)**.

- First metal tapping at the 325ktpa BALCO-III aluminium smelter in Korba is **expected (hedge)** in the third quarter of FY 2012–13.
- The first 300MW unit of the 1,200MW captive power plant at Bharat Aluminium Company (BALCO) will be synchronised shortly. Environmental clearance for the 211mt BALCO coal block has been received, and **we (SM) expect (hedge)** to obtain the second stage forest clearance and start coal production in FY 2012–13.
- The second and third units of the 2,400MW power plant project at Jharsuguda were commissioned during the year. Three units are now operational, with the fourth unit generating under trial run.
- The 150MW wind power expansion project was completed at Zinc- India, taking **our (SM)** green energy power generation capacity at Zinc-India to 274MW.

## Growth

### Extending **our (SM)** Portfolio

#### In Brief

- **Successful (AM)** completion of the acquisition of a majority interest in Cairn India Limited
- Acquisition of 51% stake in brown field and green field iron ore assets in Liberia in Western Africa
- **Successful (AM)** integration of Zinc-International assets acquired from Anglo American plc

58.8% Acquired stake in Cairn India Limited

51.0% Acquired stake in brown field and green field iron ore assets, Liberia, West Africa

### Selective and Value Accretive M&A

Over the years, Vedanta has supplemented organic growth with selective acquisitions. **Our (SM)** strategy has been to acquire assets that provide significant potential for further growth and value creation.

Consistent with this approach, **we (SM)** successfully completed two significant acquisitions, in the oil & gas and iron ore sectors.

#### Extending **our (SM)** Portfolio into Oil & Gas

During the year, **we (SM)** successfully completed the acquisition of a majority interest in Cairn India Limited, acquiring a 59% stake for a consideration of US\$8.67 billion. Primarily based in Rajasthan, where **we (SM)** already have a strong presence, Cairn India is a unique exploration and production platform, that enhances Vedanta's growth profile, as well as adding further diversification to **our (SM)** portfolio. Cairn India has the second largest reserves in India among private sector oil companies, a lowest decile cost position and a proven management team.

Cairn India's world-class resource base includes interests in nine blocks in India and one in Sri Lanka, of which three are operating blocks. The 10 blocks are located in three strategically focused areas – one block in Rajasthan, three on the west coast of India, five on the east coast of India and one block in Sri Lanka. The Rajasthan block is India's largest oil discovery in the last 20 years, with over 7.3 billion barrels of oil Reserves and Resources in place.

#### Building a Significant Iron Ore Platform for Growth

In addition, during the year **we (SM)** also acquired a 51% stake in brown field and green field iron ore assets in Liberia in Western Africa, with over 1 billion tonnes of Reserves and Resources for a cost of US\$90 million. West Africa is an emerging hub for iron ore. The region has **around (hedge)** 34 billion tonnes of Reserves and Resources, with the potential to become a 100 million tonnes per annum iron ore exporting region.

The acquired assets are 70–140km from the coast, comprising three deposits at Bomi Hills, Bea Mountain and Mano River. The project broadly involves exploration drilling, development of mining and port infrastructure, and development and refurbishing of the logistics infrastructure. **We (SM)** recently completed an aeromagnetic survey and are carrying out scoping and feasibility studies, with the aim of making the first shipment by FY 2013–14.

#### **Successful (AM)** Integration of Zinc-International



The Zinc-International assets acquired from Anglo American plc in FY 2010–2011 have been successfully integrated. **We (SM)** delivered strong operational performance with a total full year production of 444kt of refined zinc and zinc-lead metal in concentrate ('MIC') from the Lisheen mine in Ireland, the Skorpion mine in Namibia and the Black Mountain Mine ('BMM') in South Africa. The acquisition also included the Gamsberg deposit in South Africa which is one of the largest undeveloped zinc deposits in the world. With **estimated (hedge)** zinc resource deposits of 186mt, this deposit has the potential to deliver over 400ktpa with a mine life of more than 20 years. A feasibility study is under way to scope the project.

#### Long Term Value

#### Optimising Returns

**We (SM)** aim to optimise **our (SM)** costs through a culture of continuous improvement and maintain **our (SM)** position as a low cost producer in all **our (SM)** businesses. During the year, **we (SM)** maintained **our (SM)** low cost base across **our (SM)** portfolio.

#### Reserves and Resources

During FY 2011–12, **our (SM)** exploration activities resulted in the **successful (AM)** addition of Reserves and Resources at **our (SM)** zinc, iron ore and oil & gas businesses.

#### Key Achievements

- 1.4mt contained metal added to Reserves and Resources in Zinc- India, prior to depletion of 0.8mt, which was **around (hedge)** 1.75 times more than **we (SM)** mined during the year.
- Cairn India's exploration programme in Sri Lanka yielded **successful (AM)** results, with two out of three exploration wells resulting in gas discoveries. Cairn India has now entered the second stage of exploration in Sri Lanka. The other exploration success at Cairn India came from the second successive discovery Nagayalanka-SE-1 in the KG-ONN-2003/1 block. This is the largest onshore discovery in the KG basin to date and has helped establish a resource of **around (hedge)** 550mmboe.
- Significant exploration success in the iron ore business, with the net addition of 68mt to Reserves and Resources, extending the mine life to 18 years.

#### Group Structure

This has been an **important (AM)** year for Vedanta in creating long-term value for **shareholders (EM)**. In line with **our (SM)** stated strategy to unlock value for **shareholders (EM)** by simplifying **our (SM)** Group structure, in February 2012 **we (SM)** announced a consolidation and simplification of the Group. As part of this consolidation, Sesa Goa and Sterlite will merge to form a new company to be called Sesa Sterlite Ltd.

Additionally, Vedanta Resources' stake in Vedanta Aluminium and Cairn India will move to Sesa Sterlite, and MALCO will merge into Sesa Sterlite. The new entity, Sesa Sterlite, will be one of the world's largest diversified natural resources companies, with exposure to base metals, bulk commodities and oil and gas.

This consolidation will remove all cross-holdings within the Group, create a more efficient capital structure by better aligning assets and liabilities, enhance visibility of earnings and cash flows, and generate capital, tax and operational synergies. **We (SM) believe (booster)** the simplified and more efficient structure will unlock and create significant value for **shareholders (EM)**. The transaction is **expected (hedge)** to be completed in CY 2012, and is subject to regulatory and **shareholder (EM)** approvals.

#### Sustainability

#### Creating Long-term Sustainability

During the year **we (SM)** rolled out **our (SM)** Sustainability Framework across the Group including revised sustainability policies, technical and management standards, with a particular focus on alignment to ensure that all new projects are carried out as per this new framework.

#### The pillars of **our (SM)** Sustainability Framework

### 1. Responsible stewardship

Responsible stewardship is the foundation on which **we (SM)** build **our (SM)** business – the way in which **we (SM)** respond to and manage, **our (SM)** business. This includes; how **we (SM)** manage **our (SM)** employees and their health and safety, the management of **our (SM)** land and **our (SM)** environmental impact and **our (SM)** supporting business processes.

### 2. Building strong relationships

**We (SM)** work hard to engage with **our (SM) stakeholders (EM)** to understand their key concerns and expectations of **our (SM)** business and practices. Proactive engagement also enables **us (SM)** to identify opportunities and mitigate risks by understanding and responding to issues rather than reacting to them.

### 3. Adding and sharing value

**We (SM)** seek to add and share value through everything that **we (SM)** do. As a business **we (SM)** make a considerable economic impact; through employment, the payment of taxes, royalties and other contributions to local, state and national governments. **We (SM)** also, however, build local infrastructure that benefits local communities in the form of roads, schools and health care centres.

Sustainability is integral to the way **we (SM)** operate and this Annual Report includes a comprehensive overview of **our (SM)** non-financial performance. **We (SM)** provide more detailed information on **our (SM)** sustainability performance in **our (SM)** separate Sustainable Development Report which can be found on **our (SM)** corporate website.

## Responsible Stewardship

Within **our (SM)** Sustainability Framework, responsible stewardship is the foundation pillar that defines how **we (SM)** operate. All the businesses in the Group are required to have management systems in place to achieve **our (SM)** goals. 38 of **our (SM)** 44 major plants have systems certified to ISO 9001, 14001 and OHSAS 18001.

**Our (EM)** plant at Lanjigarh is the first in **our (SM)** industry in India to receive ISO 50001 and one of **our (SM)** companies, Sesa Goa, has achieved SA8000.

## Performance Highlights

### Health and Safety

Health and Safety remains a key priority and whilst **we (SM)** work in an inherently risky business, it is with **regret (AM)** that **we (SM) have to (EM)** report the loss of six employees and sixteen contractors during the year.

**We (SM)** have renewed **our (SM)** management commitment to a structured programme to reduce fatalities by eliminating unsafe conditions through **our (SM)** business.

Quarterly results **show (booster)** that **we (SM)** are making progress but more needs to be done. **Our (SM)** Lost Time Injury Frequency Rate ('LTIFR') continues to fall – it is down 48% over the last five years but **we (SM)** continue to seek ways to drive this further.

### Environment

During the year, HZL added another 103MW to its existing 171MW wind power generation capacity, making Vedanta one of the largest wind power producers in India. **Our (SM)** integrated carbon strategy is beginning to yield results. To date, **we (SM)** have registered five Clean Development Mechanism ('CDM') projects, which have enabled **us (SM)** to accrue **around (hedge)** 335,000 Certified Emission Reductions ('CERs') or carbon credits.

### Waste Management

**We (SM)** are **committed (AM)** to minimising the impact of waste from **our (SM)** operations, using water and energy more efficiently and recycling wherever possible. During the year, 3.6 million mt of the ash was used in cement and brick manufacturing and in raising the height of ash pond dyke. Energy efficiency initiatives by subsidiary companies saw significant reductions in energy consumption and **good (AM)** progress was made in reducing water consumption.

## Building Strong Relationships

**We (SM)** engage with a large number of different **stakeholders (EM)** on a regular basis through **our (SM)** investor relations, human resources, community relations and government relations departments. **Our (SM)** engagement process uses a three-pronged approach – keeping the **stakeholders (EM)** informed, engaging with them and forging partnerships to address their needs and concerns.

### Performance Highlights

Throughout the year **around (hedge)** 3,000 **stakeholder (EM)** engagement meetings took place, with community leaders, Non-Governmental Organisations ('NGOs'), governments and government bodies, academic institutions and private hospitals and 147 partnerships are now in place. **We (SM)** have **always (booster)** placed great importance on supporting local communities and the number of villages **we (EM)** cover in India are over 1,000 in FY 2012.

## Adding and Sharing Value

How **we (SM)** contribute to the lives of the people **we (SM)** affect is **important (AM)** in maintaining **our (SM)** social licence to operate over the long term and thus making **our (SM)** business sustainable.

### Performance Highlights

As a significant employer **we (SM)** are **committed (AM)** to the development and well-being of **our (SM)** workforce. **Our (SM)** current employee attrition rate is low and stable at **around (hedge)** 5% and employees benefited from over 52,000 man days of training, over 14 hours on average per employee.

**Our (SM)** community investment hit US\$38 million this year, reaching 3.1 million people and providing support for schools, hospitals, health centres and farmers.

## Key Performance Indicators

Vedanta has identified the key performance indicators that it **believes (booster)** are useful in assessing how well the Group is performing against its strategic aims. They encompass both financial and non-financial measures and are set out opposite.

### GROWTH

#### Revenue

#### Description

Revenue represents the value of goods and services provided to third parties during the year.

#### Commentary

Revenues grew by 22.6% to US\$14.0 billion, due to higher volumes at most businesses with production ramping up as **our (SM)** growth projects were completed. Revenue also increased due to the acquisition of Cairn India and incremental revenue from full year consolidation of the Zinc-International operations acquired last year.

### EBITDA

#### Description

Earnings Before Interest, Taxes, Depreciation and Amortisation ('EBITDA') is a factor of volumes, prices and cost of production. This measure is calculated by adjusting operating profit for special items, and adding depreciation and amortisation.

#### Commentary

EBITDA was 12.9% higher reflecting increased volumes, diversification into the high margin oil & gas sector and full year consolidation of the Zinc- International operations acquired last year. The impact of inflationary cost pressures, particularly the cost of raw materials, were partially offset by improved operational performances.

#### Free cash flow

##### Description

This represents net cash flows before financing activities, investing activities in expansion projects and dividends paid out by Vedanta. This measure **ensures (booster)** that the profit generated by **our (SM)** assets is reflected by cash flow in order to fund future growth.

##### Commentary

**We (SM)** generated strong free cash flow of US\$2.5 billion, representing a 62.9% conversion of EBITDA to free cash flow, marginally lower than the 65.8% conversion in FY 2011. This reduction is **mainly (hedge)** attributable to higher interest on borrowing for the Cairn India acquisition and increased sustaining capital expenditure.

#### Capex spent

##### Description

This represents the amount invested in **our (SM)** organic growth programme during the year.

##### Commentary

**We (SM)** invested US\$2.4 billion in expansion capital expenditure to increase the scale of **our (SM)** operations. **We (SM)** spent US\$386.2 million on sustaining capital expenditure to modernise **our (EM)** plant and equipment, and to continually optimise and improve operational standards.

#### LONG-TERM VALUE

##### ROCE

##### Description

This is calculated on the basis of operating profit before special items and net of tax as a ratio of capital invested in operations as at the balance sheet date, and excludes investment in project capital work in progress. The objective is to consistently earn a post-tax return above the weighted average cost of capital.

##### Commentary

ROCE without project capital work in progress in FY 2011–12 was 7.7% as compared to 21.0% in the previous year as a result of higher depreciation and amortisation, interest expense and mark-to-market losses on foreign currency borrowings.

#### Underlying EPS

##### Description

This represents net profit attributable to equity **shareholders (EM)** and is stated before special items and their attributable tax and minority interest impacts. By producing a stream of profits and EPS **we (SM)** will be able to pay a progressive dividend to **our (SM) shareholders (EM)**.

##### Commentary

Underlying EPS at US\$1.42 per share was lower compared to the previous year of US\$2.63 per share. This was due to a fall in attributable profit affected by increased amortisation and depreciation charges, interest expenses related to funding for the Cairn India acquisition and losses at VAL.

#### Dividends (US\$ per share)

##### Description

Dividend per share ('DPS') is the total of final dividend recommended by the Board in relation to the year and interim dividend paid out during the year.

#### Commentary

**We (SM)** have been able to maintain **our (SM)** commitment to a progressive dividend policy, raising the total dividend to 55 US cents per share this year, up 5%.

#### SUSTAINABILITY

##### LTIFR (million man hours)

##### Description

The Lost Time Injury Frequency Rate ('LTIFR') is the number of lost-time injuries per million man-hours worked. This includes **our (SM)** employees and contractors working in **our (SM)** operations but not incidents in **our (SM)** projects.

#### Commentary

**We (SM)** have been able to sustain reduction in LTIFR with a 41% fall over the last four years. Additionally, **we (SM)** have initiated structured programmes to review and remove any unsafe conditions at **our (EM)** plants. **Our (SM)** LTIFR targets are 0.80 and 0.50 for FY 2013 and FY 2016 respectively.

##### Women workforce (%)

##### Description

The percentage of women in the total permanent employee workforce.

#### Commentary

**We (SM)** nurture young, enthusiastic talent and provide equal opportunities to men and women. During FY 2012, women employees comprised 8.16% of **our (SM)** employees. **We (SM)** initiated special recruitment drives for providing career advancement to women, like planned rotation through corporate functions.

##### CSR footprint

##### Description

Total number of beneficiaries through **our (SM)** community development programmes across all **our (SM)** operations.

#### Commentary

**We (SM)** benefitted over 3 million people this year through **our (SM)** continuous efforts in the community development projects comprising community health, nutrition, education, water and sanitation, sustainable livelihood, women empowerment and bio-investment.

#### Principal Risks and Uncertainties

The management of risk is critical to the success of the Vedanta Group. The Group is exposed to a variety of risks which are inherent in an international mining and resources business. Understanding **our (SM)** risk and developing an adequate risk management system is critical to allow **us (SM)** to pursue growth opportunities, increase **shareholder (EM)** value and also manage a variety of risks which could have a strategic, financial, operational or reputational impact.

**We (SM)** are **committed (AM)** to a robust system of risk identification, backed by a robust risk management framework.

**Our (SM)** risk management framework acts as an effective tool in mitigating the various risks which **our (SM)** businesses are exposed to in the course of their operations as well as in their strategic actions. **We (SM)** have a continuous process to identify, analyse, evaluate and respond to possible future events or risks that might impact the achievement of objectives.

**We (SM)** are planning to set up an Risk Management Committee to be chaired by the Group Chief Executive Officer (CEO). This committee will meet quarterly to review risks as well as progress against the planned actions. Risk officers will be nominated both at Vedanta as well as operating company level.

The committee will be briefed every quarter on risk management. The role of Chief Risk Officers (CRO) is being created to heighten awareness of the risk management framework at senior management level. The CRO will help the organisation to enhance its risk management progress and ensure that the risk management framework matures and grows with the organisation.

A consistently applied methodology using the Turnbull matrix is used to identify risk at the individual company level covering operations and projects. All the risks related to **our (SM)** businesses are identified and the top 20 risks are reviewed. Risk identification is also undertaken for support and corporate functions. Risk management is undertaken through a series of meetings at Company level and at key stages of projects. An update is performed periodically through the internal audit process.

Once identified, the risk evaluation is done using a matrix to establish financial and non-financial impacts, the likelihoods of occurrence and the root causes analysis of the risk. The current controls to mitigate the risk are then reviewed to enable the development of a prioritised risk management plan.

The risk matrix is then reviewed by a committee comprising of the Group CEO, Group Chief Financial Officers ('CFO') and the Director-Management Assurance. The committee reviews the risks, changes in the nature and extent of the major risks since the last assessment, controls and action plans.

Many of the mitigation measures stated in the risk matrix relate to Group policies, the audit process and the audit plan to cover the key risks identified through the risk management programme. The control measures stated in the risk matrix are closely reviewed by the operating management teams to verify their effectiveness.

#### External Risks

##### Commodity Prices

Commodity prices **may (hedge)** be volatile, which **may (hedge)** have a material adverse effect on the Group's revenue and operating results. Commodity prices and demand are cyclical and strongly influenced by world economic conditions. Commodity price volatility can result in material and adverse movements in the Group's revenue and operating results and a sustained drop **would (hedge)** have a material adverse effect on its businesses, operating results, financial conditions and/or prospects.

The Group's normal policy is to sell its products at prevailing market prices and not to enter into price hedging arrangements other than for businesses which are not fully integrated where back to back hedging is used to mitigate pricing risks. In rare circumstances **we (SM) may (hedge)** enter into strategic commodity hedging but only with prior approval of the Executive Committee. Persistent economic imbalances that have led to recent volatility in commodity prices and demand **may (hedge)** continue.

The key commodity price sensitivities on EBITDA resulting from a 10% increase in commodity prices are set out below:

The above sensitivities are based on FY 2011–12 volumes, costs and exchange rates and provide the **estimated (hedge)** impact on EBITDA of changes in prices assuming that all other variables remain constant.

##### Regulatory, Economic, Social and Political Uncertainty

Regulatory, economic, social and political uncertainty in any of the countries and jurisdictions in which the Group operates including changes to fiscal regimes or other regulatory regimes.

**Our (SM)** mining, smelting and oil & gas operations are located in India, Zambia, Namibia, South Africa, Ireland, Australia, Sri Lanka and **our (SM)** holding and investment companies are located in jurisdictions including the United Kingdom, Jersey, Mauritius, the Netherlands, Cyprus and Australia.

The operation and expansion of various assets within the Group remain subject to legal proceedings, most notably the expansion of the Lanjigarh refinery in VAL, the Tuticorin smelter in Sterlite and the mines in the Karnataka area within Sesa Goa. Progress has been made during the year to clarify the actions needed to settle these matters and **we (SM) are hopeful (AM)** that the necessary approvals will be obtained within the foreseeable future.

The political, legal, fiscal and other regulatory regimes in these countries **may (hedge)** result in higher operating costs or restrictions such as the imposition or increase in royalties or taxation rates, impact on mining rights and change in legislation pertaining to repatriation of money. Changes to government policies such as changes in royalty rates, a reduction in import tariffs in India, a reduction in assistance given by the GoI for exports and the reduction or curtailment of income tax benefits available to

some of **our (SM)** operations in India, Namibia and Zambia are some of the examples of risks under this category. **We (EM) may (hedge)** also be affected by the political acts of governments in these countries over which **we (SM)** have no control.

For example, the GoI has increased the cess on crude production by 81% which impacts the oil assets **we (SM)** recently acquired with Cairn India. The Government of India has also significantly revised the export duty on Iron Ore from 20% to 30% during FY 2011–12 impacting the profitability of **our (SM)** iron ore operations.

Any change in government policies and legislation, including resource nationalisation, **may (hedge)** also affect **our (SM)** business and profitability, including any retrospective changes in government policy and legislation.

The majority of **our (SM)** Group revenues and profits are derived from commodities sold to customers in India. Any downturn in the overall health of the Indian economy or any political or regional instability **may (hedge)** impact revenue margins, including any impact arising as a result import tariffs prevailing in India. For example in July 2011, the Supreme Court of India banned the mining of iron ore in the State of Karnataka in India, which affected **our (SM)** iron ore production and profitability during the year.

## Financial Risks

### Currency Fluctuations **May (hedge)** Negatively Affect **our (SM)** Financial Results

**Our (SM)** assets, earnings and cash flows are influenced by a variety of currencies due to the diversity of the countries in which **we (SM)** operate. Fluctuations in the exchange rates of those currencies **may (hedge)** have a significant impact on **our (SM)** financial results.

Although the majority of the Group's revenue is tied to commodity prices that are **typically (hedge)** priced by reference to the US dollar, most of its expenses are incurred and paid in local currency such as the Indian rupee and, to a lesser extent, the Australian dollar, the South African rand, the Zambian kwacha and the euro. The exchange rates between the various currencies in which **we (SM)** incur expenses have changed substantially in recent years and **may (hedge)** fluctuate substantially in the future.

**Our (SM)** Group borrowings are predominantly denominated in US dollars while a large percentage of cash and liquid investments are held in other currencies, **mainly (hedge)** in the Indian rupee. Some financial assets and liabilities are not held in the local currency of the respective subsidiary. For the financial year 2011–12 there was volatility in the Indian currency vis a vis the US dollar and the Indian rupee depreciated significantly, which increased **our (SM)** mark-to-market losses on US dollar loans. **Our (SM)** attributable profit is also impacted significantly where **our (SM)** companies have higher attributable shares.

The Group seeks to mitigate the impact of short-term movements in currency on its businesses by hedging its short-term exposures progressively based on their maturity. However, large or prolonged movements in exchange rates **may (hedge)** have a material adverse effect on the Group's businesses, operating results, financial condition and/or prospects.

### Liquidity Risks in Terms of Being Able to Fund Operations and Growth

**We (SM)** require funds both for short-term operational needs as well as for long-term investment programmes **mainly (hedge)** in growth projects.

If the Group is unable to obtain sufficient credit due to capital market conditions, it **may (hedge)** not be able to raise sufficient funds to develop new projects, fund acquisitions or meet its ongoing financing needs. As a result, revenues, operating results, cash flows or financial position **may (hedge)** be adversely affected.

The Group generates sufficient cash flows from the current operations which together with the available cash and cash equivalents and liquid financial asset investments provide liquidity both in the short term as well as in the long term.

**Anticipated (hedge)** future cash flows and undrawn committed facilities of US\$2,897.3 million, together with cash and liquid investments of US\$6,885.4 million as at 31 March 2012, are **expected (hedge)** to be sufficient to meet the ongoing capital investment programme and liquidity requirement of the Group in the near future.

The Group has a strong balance sheet that gives sufficient headroom to raise further debt should the need arise. The Group's current ratings from Standard & Poor's, Moody's & Fitch Ratings are BB, Ba1 and BB+ respectively (2011: BB, Ba1 and BB+ respectively). These ratings support the necessary financial leverage and access to debt or equity markets at competitive terms. The Group **generally (hedge)** maintains a healthy net debt-equity ratio and retains flexibility in the financing structure to alter the ratio when the need arises.

## Strategic Risks

### Delays in Expansions and New Projects

If the Group's planned expansions and new projects are delayed, this **could (hedge)** have a material adverse effect on the Group's businesses, operating results, financial condition and/or prospects.

The Group has a number of significant expansion plans for its existing operations and planned green field projects, which involve significant capital expenditure. The timing, implementation and cost of these expansion projects are subject to a number of risks, including the failure to obtain necessary licences, permits, consents and approvals, or funding for the projects. Any failure to obtain the requisite regulatory approvals **may (hedge)** delay or prevent the Group from commencing commercial operations at certain of these projects.

For instance, the Group does not currently have all of the required environmental approvals for the proposed expansion at the alumina refinery at Lanjigarh and related mining operations in Niyamgiri Hills in the State of Orissa. These are subject to the outcome of certain legal proceedings pending before the Supreme Court of India.

In order to satisfy **our (SM)** bauxite requirements, **we (SM)** are in communications with the Orissa Government and other sources regarding the allocation of new mining leases.

Sourcing of bauxite from mines in neighbouring states is also being pursued.

Any delay in completing planned expansions, revocation of existing clearances, failure to obtain or renew regulatory approvals, non-compliance with applicable regulations or conditions stipulated in the approvals obtained, suspension of current projects or cost overruns or operational difficulties once the projects are commissioned **may (hedge)** have a material adverse effect on the Group's businesses, operating results, financial condition and/or prospects. Any delay in completing planned expansions **could (hedge)** have a material adverse effect on Vedanta's credit rating, which **may (hedge)** increase its borrowing costs.

The Company is also trying to develop relationships with private coal mines as well as actively working with the Government of India on how coal stock movement bottlenecks can be eliminated at State mines.

### Health, Safety, Environmental Risks

Health, safety, environmental risks and related regulations **may (hedge)** adversely affect **our (SM)** operations and reputation or licence to operate.

**We (SM)** are engaged in mining activity, power generation and now oil and gas and **our (SM)** operations are subject to extensive health, safety and environmental ('HSE') regulations and legislations. As regulatory standards and expectations are constantly developing, **we (SM) may (hedge)** be exposed to increased litigation, compliance costs and unforeseen environmental rehabilitation expenses.

Potential health, safety, environmental and community events that may have a material adverse impact on **our (SM)** operations include rock fall incidents in underground mining operations, well blow-outs, explosions or gas leaks, uncontrolled tailings breaches, escape of polluting substances, uncontrolled releases of hydrocarbons, human rights breaches and community protests or civil unrest.

Longer-term health impacts **may (hedge)** arise due to unanticipated workplace exposures or historical exposures to employees or site contractors. These effects **may (hedge)** create future financial compensation obligations. **We (SM) may (hedge)** continue to be exposed to increased operational costs due to the costs and lost time associated with infectious diseases such as HIV/AIDS and malaria **mainly (hedge)** within **our (SM)** African workforce and the increasing global burden of chronic disease. **We (SM)** have a structured programme of proactive engagement with **our (SM)** stake-holders on sustainability related matters..

### Employee Risks

The Group depends on the experience and management skill of certain of its key employees.

The Group's efforts to continue its growth will place significant demands on its management and other resources and the Group will be required to continue to improve operational, financial and other internal controls, both in and outside India across all locations. The Group's ability to maintain and grow its existing businesses and integrate new businesses will depend on its ability to maintain the necessary management resources and on its ability to attract, train and retain personnel with the skills that enable it to keep pace with growing demands and evolving industry standards.



The Group is, in particular, dependent to a large degree on the continued service and performance of the executive management team of Vedanta and other key team members in the Group's business units. These key personnel possess technical and business capabilities that are difficult to replace. The loss or diminution in the services of Vedanta's executive management or other key team members, or its failure otherwise to maintain the necessary management and other resources to maintain and grow its businesses, **could (hedge)** have a material adverse effect on its businesses, operating results, financial condition and/or prospects.

#### Operational Risks

##### Discovery Risks

Failure to discover new reserves, maintain or enhance existing reserves or develop new operations **could (hedge)** negatively affect **our (SM)** future results and financial condition.

The increased demand for **our (SM)** products and increased production rates from **our (SM)** operations in recent years has resulted in existing reserves being depleted at an accelerated rate.

Actual reserves, resources or mineral potential **may (hedge)** not conform to the geological, metallurgical or other expectations and the volume and grade of ore and/or hydrocarbons recovered **may (hedge)** be below the **estimated (hedge)** levels.

As **our (SM)** revenues and profits are related to minerals and resource operations, **our (SM)** results and financial condition are directly related to **our (SM)** ability to replace existing reserves and the success of **our (SM)** exploration.

A failure in **our (SM)** ability to discover new reserves, enhance existing reserves or develop new operations in sufficient quantities to maintain or grow the current level of **our (SM)** reserves **could (hedge)** negatively affect **our (SM)** results, financial condition and prospects. There are numerous uncertainties inherent in estimating ore and oil & gas reserves, and geological, technical and economic assumptions that are valid at the time of estimation **may (hedge)** change significantly when new information becomes available. The uncertain global financial outlook **may (hedge)** affect economic assumptions related to reserve recovery and require reserve restatements which **could (hedge)** negatively affect **our (SM)** results and prospects.

##### Failure to Meet Production and Costs Targets

**Our (SM)** operations are subject to conditions and events beyond **our (SM)** control that **could (hedge)**, among other matters, increase **our (SM)** mining, transportation or production costs, disrupt or halt operations at **our (SM)** mines, smelters and power plants and production facilities for varying lengths of time or **even (AM)** permanently. These conditions and events include disruptions in mining and production due to equipment failures, unexpected maintenance problems and other interruptions, non-availability of raw materials of appropriate quantity and quality for **our (SM)** energy requirements, disruptions to or increased cost of transport services or strikes and industrial actions or disputes. While many of these risks are beyond **our (SM)** control, **we (SM)** have adequate and competent experience in these areas and have consistently **demonstrated (booster)** **our (SM)** ability to manage these problems proactively.

The newly acquired oil & gas operations are also subject to common operational risks such as interruptions to power supplies, technical facilities, flooding, or other accidents. Such risks and hazards **may (hedge)** result in damage or harm to, or destruction of, properties, production, facilities, people and the environment. In addition, if a spill or other contamination results from production, storage, export, shipment or sale of oil or other hydrocarbon products occurs, this **could (hedge)** result in significant environmental liabilities.

It is **our (SM)** policy to realise market prices for **our (SM)** commodities and the profitability of **our (SM)** operations is dependent upon **our (SM)** ability to produce metals at a low cost which in turn is a factor of **our (SM)** commercial and operational efficiencies and productivity. The prices of many of **our (SM)** input materials are influenced by a variety of factors including demand and supply as well as inflation. An increase in the cost of such input materials **would (hedge)** adversely impact **our (SM)** competitiveness.

#### Financial Review

"**Our (SM)** investment in growth projects is nearing completion and **we (SM)** have now reached an inflection point where **we (SM)** have positive free cash flow after growth capex for the first time."

#### Highlights

- Revenues up 22.6% to US\$14.0 billion

- EBITDA up 12.9% to US\$4.0 billion
- Underlying EPS at 142 US cents per share
- Acquisition of Cairn India has provided entry into the oil & gas sector: the acquisition is immediately EPS accretive
- Free cash flow of US\$2.5 billion, translating into 63% EBITDA conversion
- Investment of US\$2.4 billion in growth projects, strong project execution capabilities
- Net gearing of 35% and cash and liquid investments of US\$6.9 billion

2011–12 has been a year of mixed fortunes due to the significant change and volatility in the global economy. The eurozone crisis downgrade of sovereign credit ratings of various eurozone countries, sluggish growth in many industrialised countries including the USA, political unrest on the African continent and the resulting escalation in crude oil prices had all dampened the growth euphoria. Despite these challenges commodity prices **generally (hedge)** averaged higher than during FY 2010–2011.

Demand for commodities in 2012 will be supported by improving global economic growth particularly in Chinese and emerging markets, which are **expected (hedge)** to remain **relatively (hedge)** robust. The global developments constrained the Indian growth story, with India's GDP growing by 6.5% during FY 2011–12. India is **expected (hedge)** to maintain its robust economic growth over the long term, due to its domestic market size and demographic advantage.

Group revenues in FY 2011–12 grew strongly to US\$14,005.3 million, up 22.6% as compared with the previous year. Most of **our (SM)** businesses delivered higher volume growth as several of **our (SM)** growth projects were completed with production ramping up. Revenue increased due to the value accretive acquisition of Cairn India completed during the year and also the incremental revenue from a full year of operation at Zinc International. The volume growth in **our (SM)** power business, **mainly (hedge)** at Sterlite Energy Ltd ('SEL'), and the doubling of silver revenues in Zinc-India also contributed to the revenue increase.

Iron ore revenues were impacted by lower sales volumes caused by the mining ban in Karnataka and the transport and logistics bottleneck in Goa. Iron ore sales were further reduced by US\$201 million due to the rise in export duty to 20% in March 2011 and from 20–30% in the last quarter of FY 2011–12.

Turbulence in the global market and the cost-inflationary environment prevailing in the metal and mining industry impacted **our (SM)** profitability in FY 2011–12. During the year, total cash costs increased due to mining sector inflation stemming from increased energy and fuel costs together with higher maintenance, labour and contractor costs, in line with the mining industry in general. The EBITDA margin in **our (SM)** aluminium business reduced by 10.1%, due to an 11.3% increase in cost of production **mainly (hedge)** due to higher alumina, carbon and coal costs. The EBITDA margin also reduced in **our (SM)** power business due to an 18.6% reduction in the sales price per unit.

Despite these tough conditions, **we (SM)** reported EBITDA of US\$4.0 billion, 12.9% higher when compared with the previous year, underpinned by **our (SM)** diversified business portfolio which helps to insulate **us (SM)** from adverse performance in any one of **our (SM)** businesses.

**Our (SM)** diversification into the high margin oil & gas sector through **our (SM)** acquisition of Cairn India during the year and the full year benefit of operations from the Zinc-International business acquired in FY 2010–11, combined with **our (SM)** continued focus on cost control measures and operational improvements also contributed to the improvement in EBITDA for FY 2011–12. However, EBITDA growth did not keep pace with revenue growth as operating costs rose, **mainly (hedge)** due to higher coal costs and commodity linked costs. Lower sales of iron ore coupled with the hike in export duty also impacted EBITDA during the financial year. EBITDA margin was 28.7% in FY 2011–12 compared with 31.2% in FY 2010–11. Excluding **our (SM)** copper custom smelting operations, **our (SM)** EBITDA margin in FY 2011–12 was 40.6% (FY 2010–11: 44.6%). Conversion of EBITDA to free cash flow for the financial year was marginally lower at 62.9% compared with 65.8% in FY 2010–11. This reduction is **mainly (hedge)** attributable to higher interest on borrowing for the Cairn India acquisition and higher ongoing capital expenditure. **We (SM)** continued to maintain **our (SM)** strong balance sheet and funding position, with cash and liquid investments totalling US\$6.9 billion. **We (SM)** generated free cash flow of US\$2.5 billion which met the growth capital expenditure requirement of US\$2.4 billion. **Our (SM)** investment in growth projects is nearing completion and **we (SM)** have now reached an inflection point where **we (SM)** have positive free cash flow after growth capex for the first time.

After investing US\$8.7 billion in acquisitions, net debt as at 31 March 2012 was US\$10.1 billion (31 March 2011: US\$1.97 billion) and **our (SM)** gearing ratio was 35%. During the year depreciation and amortisation increased by US\$539.3 million to US\$1.4 billion. Depreciation charges during the year increased by US\$372.7 million **mainly (hedge)** due to additional depreciation of US\$180.2 million for Cairn, US\$90.7 million due to the full year of operation for Zinc International and the commissioning of the SEL power plant accounting for the balance.

Amortisation charges during the year increased by US\$166.6 million **mainly (hedge)** due to additional amortisation of reserves of US\$166.5 million at Cairn, US\$92.4 million at Zinc International, partially mitigated by a decrease at Sesa Goa due to lower output.

Oil & gas assets are amortised on a unit of production basis over the total remaining proven and probable reserves. Special items comprises of US\$21 million spent on voluntary redundancy charges at some of **our (SM)** operations.

A provision of US\$89 million was made by Sterlite towards possible incidental damages payable to ASARCO as per the verdict of the bankruptcy court of the Southern District of Texas, US. **We (SM)** also spent US\$73 million on costs relating to the acquisition of Cairn India and IPO expenses of US\$13 million, for **our (SM)** subsidiary Konkola Copper Mines were also written off during the year. US\$31 million was due to loss on revaluation of previously held interest in Cairn India as associate.

As explained above, the operating profit for the year was US\$2.4 billion, marginally lower than in the previous year reflecting higher depreciation, amortisation charges and special items, despite the increase in EBITDA.

#### Group Operating Results

Group operating results for FY 2011–12 are set out below:

Gross finance costs increased to US\$1,170.5 million in FY 2011–12, up from US\$718.0 million in FY 2010–11. Costs increased as a result of higher average debt at US\$13,750.4 million in FY 2011–12, up from US\$8,895.7 million in the previous year. Gross debt during the year increased **mainly (hedge)** to finance the Cairn India acquisition and to fund **our (SM)** growth projects. Interest costs also increased due to a higher interest rate for rupee borrowing in India.

Of the total interest cost, US\$224.8 million relating to **our (SM)** ongoing capital expansion projects was capitalised as compared with US\$183.3 million in FY 2010–11, reflecting the increased capitalisation in **our (SM)** ongoing projects at Vedanta Aluminium Ltd (VAL), BALCO and Talwandi Sabo.

Investment income in FY 2011–12 was US\$525.4 million, compared with US\$431.6 million in FY 2010–11, **mainly (hedge)** due to the higher interest rate environment. **We (SM)** recognised a loss of US\$314.2 million as a result of mark-to-market losses on **our (SM)** foreign currency borrowings primarily at **our (SM)** Indian entities, and following changes in the fair value of embedded derivatives relating to foreign currency convertible bonds at Sterlite and Sesa Goa. During FY 2011–12, the mark-to-market loss on borrowings was US\$411.3 million against a gain of US\$63.7 million in the previous year. These mark-to-market losses were caused by volatility in the Indian rupee/dollar exchange rate, which depreciated sharply by 14.7% in the year, moving from US\$1 = Rs44.65 to US\$1 = Rs51.16. The rupee depreciation impacted the uncovered loans denominated in US dollars. By contrast, **we (SM)** experienced a mark-to-market gains on **our (SM)** embedded derivatives of US\$97.1 million primarily on the foreign currency convertible bonds at Sterlite and Sesa Goa. Since the issue of these bonds the cumulative gain has been US\$211.0 million. The gain is primarily correlated with the movement in the respective subsidiary's share price and **may (hedge)** reverse in the future. Profit before taxation also decreased by 35.0% to US\$1.7 billion compared against US\$2.7 billion achieved during FY 2010–11. Profit after tax decreased by 39.6% to US\$1.2 billion due to higher interest costs, mark-to market losses on **our (SM)** foreign currency borrowings and higher tax rates. **Our (SM)** effective tax rate increased from 24.2% in FY 2010–11 to 29.6% during FY 2011–12 as a result of changes in profit mix at the operating companies during the year and also due to losses at VAL.

The tax charge decreased to US\$516.7 million in FY 2011–12, 20% down from US\$649.5 million in FY 2010–11 reflecting the lower profit before tax. Attributable profit for the year at US\$59.8 million is significantly lower than the US\$770.8 million in the previous year which was impacted by increased amortisation and depreciation charges, interest expenses related to funding for the Cairn India acquisition, mark-to-market losses on foreign currency borrowings at **our (SM)** Indian entities and losses at VAL.

Basic Earnings per Share ('EPS') for FY 2011–12 was 21.9 US cents per share compared to 283.2 US cents per share in FY 2010–11, reflecting the fall in attributable profit. Fully diluted EPS was 21.6 US cents per share (FY 2010–11: 270.2 US cents per share). Underlying EPS was 142.0 US cents per share as against 262.8 US cents per share in the previous year. These factors, combined with the fact that Cairn India only contributed to profitability for less than four months, resulted in returns generated on operating capital reducing to 7.7%. Using 12 month proforma earnings from Cairn, **our (SM)** return on operating capital **would (hedge)** be 10.7%.

#### Balance Sheet and Cash Flow

**We (EM)** continue to have a strong balance sheet with capital employed of US\$18.4 billion and net debt of US\$10.1 billion. Net debt comprised debt of US\$17.0 billion offset by US\$6.9 billion of cash and liquid investments. **Anticipated (hedge)** future cash flows and undrawn committed facilities of US\$2,897.3 million, together with cash and liquid investments of US\$6,885.3 million as at 31 March 2012, are **expected (hedge)** to be sufficient to meet the ongoing capital investment programme and liquidity requirements of the Group in the near future. The Company continued to maintain its ratings from Standard & Poor's, Moody's & Fitch Ratings are BB, Ba1 and BB+ respectively. The Company **generally (hedge)** maintains a healthy net debt-equity ratio and retains flexibility to raise funds as and when required. Even though FY 2011–12 witnessed a rise in debt of US\$7.2 billion to fund

the Cairn India acquisition and planned expansion programme, **our (SM)** balance sheet remained strong with net gearing of 35.3%. On a proforma basis, as at 31 March 2012, **we (SM)** had a multiple of 1.9x net debt/EBITDA, 4.5x EBITDA/ gross interest expenses and 2.5x net asset/debt, which reflects a robust and strong balance sheet.

Of **our (SM)** total gross debt of US\$17.0 billion, debt at **our (SM)** subsidiaries is US\$7.7 billion with the balance in the holding company. Following the Group structure simplification, debt liability at the holding company reduced by 65% to US\$3.2 billion and debt service costs reduced significantly. Dividend policies at subsidiaries will result in significantly higher dividends at the holding company which will cover debt servicing.

#### Finance Strategy

The Company's capital management objectives are to safeguard continuity, maintain a strong credit rating and healthy capital ratios in order to support its business and provide adequate return to **shareholders (EM)** through continuing growth. The movement in net (debt)/cash in FY 2011–12 is set out below.

The Company sets the amount of capital required on the basis of annual business and long-term operating plans which include capital and other strategic investments. The funding requirement is met through a mixture of equity, internal accruals, convertible bonds and other long-term and short-term borrowings.

The Company monitors capital using a gearing ratio, (the ratio of net debt as a percentage of total capital) which at 31 March 2012 was 35.3%. **Our (SM)** investments are consistent with **our (SM)** policy of investing in funds and banks with a low credit risk and high credit ratings. Investment portfolios of **our (SM)** Indian subsidiaries have been independently reviewed by the rating agency CRISIL as "Very Good".

**We (SM)** believe **(booster)** **our (SM)** strengthening presence across diverse businesses **should (hedge)** further strengthen **our (SM)** credit profile and **we (SM)** are working towards improving **our (SM)** ratings to investment grade. Post the acquisition of Cairn India, **our (SM)** priority is to reduce the debt at the holding company level. **We (SM)** are **committed (AM)** to maintain net debt to EBITDA at less than 2.75 times and net gearing below 40% through the cycle, as a prudent measure in **our (SM)** cyclical industry. **We (SM)** achieved net debt to EBITDA of 2.5 times and net gearing of 35% at the end of FY 2011–12. In an effort to further reduce these metrics, **we (SM)** continue to focus on higher

EBITDA-free cash flow conversion by prioritising cost control and reviewing the capital expenditure programme.

**We (SM)** have also announced a new simplified corporate structure, which once approved by stake holders and regulatory authorities, **should (hedge)** yield significant benefits through a more efficient capital structure, increased flexibility to allocate capital, broader access to markets and enhanced visibility of earnings and cash flow.

The conversion of EBITDA to free cash was at the rate of 62.9% in FY 2011–12 as compared to 65.8% in FY 2010–11. This decline, despite the release of working capital of **approximately (hedge)** US\$375.1 million, was due to higher routine capital expenditure and interest payments.

#### Investing in Organic Growth

**We (SM)** spent US\$2,398.2 million on capital expenditure for growth projects in FY 2011–12 which was in line with **our (SM)** project capital expenditure spend in FY 2010–11. During the last five years **we (SM)** have invested US\$12.6 billion in growth projects. In its Power business, the Company has decided to pursue only the 1,980MW (3x660MW) thermal coal based power plant at Talwandi Sabo and the project work is progressing **well (AM)**.

**We (SM)** also spent US\$386.2 million on routine capital expenditure in FY 2011–12, higher than the previous year's expenditure of US\$239.5 million. This expenditure is for the upkeep of **our (EM)** plant and equipment, to continually optimise and improve operational standards and to increase the scale of **our (SM)** operations.

Return on Operating Capital ('ROOC') during FY 2011–12 was 7.7%, lower than the 21.2% generated during FY 2010–11. This reflected the fact that the investment in Cairn generated returns for a period of less than four months (as a subsidiary from 8 December 2011). On an annualised basis, the returns from Cairn stood at 10.7% during the year. ROOC is an **important (AM)** Key Performance Indicator ('KPI') for **our (SM)** businesses. Capital productivity is a high priority and **we (SM)** plan to enhance this ratio by optimising asset performance.

Based on the expansion projects currently under way, **approximately (hedge)** US\$4.6 billion of funds are required to complete these projects over the next three years. This will be financed from existing cash resources, internal accruals and project financing. In the coming year, US\$4,152 million of debt falls due for repayment. **Our (SM)** cash and liquid investments, free cash generation and funds investment are sufficient to meet **our (SM)** capital and debt commitments. **We (SM)** have cash and liquid investments of US\$6,885.3 million as at 31 March 2012 along with unused funding facilities of US\$2,897.3 million, providing **good (AM)** liquidity.

**Our (SM)** debt maturity now averages 3.46 years as at 31 March 2012, as compared with three years as at 31 March 2011. **Our (SM)** current debt maturity profile in US\$ million is outlined below:

#### Acquisitions

On 8 December 2011 **we (SM)** completed the acquisition of Cairn India Limited by acquiring 59% for an aggregate consideration of US\$8.67 billion. A 39% stake is held by Vedanta Resources plc with the balancing 20% stake held through the Group's subsidiary Sesa Goa. **Roughly (hedge)** 50% of the acquisition consideration was funded through internally generated cash flows, and only US\$4.43 billion was funded through external debt. In accordance with the requirement of the reverse takeover rules prescribed under the UK Listing Authority ('UKLA'), an application was made to the UKLA and the London Stock Exchange for readmission to listing of the Company's shares on the official list.

During the FY 2011–12, Sesa Goa acquired Iron Ore deposits in Liberia in Western Africa for a total consideration of US\$90 million. In addition US\$25 million of licence fees was paid to the Government of Liberia. This iron ore project comprises three deposits in Bomi Hills, Bea Mountain and Mano River with **estimated (hedge)** deposits of over 1 billion tonnes of iron ore. On 1 March 2012, Vedanta Resources plc, through its subsidiary Sesa Goa, acquired a 100% stake in Goa Energy Private Limited ('GEPL') from Videocon Industries at a consideration of US\$9.5 million. The operating and financial results of GEPL have been consolidated from 1 March 2012. GEPL is in the business of power generation. **We (SM)** continue to focus on enhancing the returns to **our (SM) shareholders (EM)** through periodic buyback of shares. During FY 2011–12 **we (SM)** had spent US\$60.3 million on buying back shares in Sterlite. The Government of India ('GoI') holds the minority stake in two of **our (SM)** Group companies – HZL (29.5%) and BALCO (49%). In line with **our (SM)** commitment to enhance the returns to **our (SM) shareholders (EM)**, **we (SM)** approached the GoI communicating **our (SM)** desire to purchase its stake in both companies. Whilst the GoI did not respond, **we (SM) believe (booster)** purchasing this stake **would (hedge)** further improve the returns to **our (SM) stakeholders (EM)**.

#### Operational review

##### Zinc-India

##### Key Achievements

- Highest ever refined zinc and lead production of 759kt and 99kt, respectively
- Record silver metal production of 7.8moz, up 35% over previous year
- Maintained lowest quartile cost position
- FY 2012 gross addition of 27mt to Reserves and Resources
- Commissioned 100ktpa lead smelter at Dariba increasing total refined lead capacity to 185ktpa
- 350 tonne per annum (tpa) silver refinery taking total silver refining capacity to 518tpa

##### Strategic Priorities

- Continue to focus on adding resources
- Achieving 1mt capacity operations
- Realising full potential of SK Mine and silver production capability
- Rampura Agucha underground mine development

#### Market Overview

##### Zinc

Strong demand created by growth from emerging economies more than offset weaker demand from developed economies, leading to global zinc demand growth of 4% in 2011 reaching 12.5mt. Growth focused on near-term demand is at a similar level of 4–5% on the back of strong demand from emerging economies. It is predicted that shortly the net surplus position **may (hedge)** turn into a net deficit position. Closure of several mines at the end of their mine life may significantly impact the supply/ demand equation. It is predicted that this **could (hedge)** happen in 2014–15. India, the home market for **our (SM)** Zinc-India operations, continues to **demonstrate (booster)** healthy growth in zinc consumption **largely (hedge)** driven by consumption in galvanising/ construction

sector/infrastructure sector. The near-term demand growth focus in India remains at a robust level of 6–7% per annum with the potential to reach much higher levels considering India's **quite (hedge)** low per capita consumption of zinc.

## Lead

Driven by demand **essentially (hedge)** arising from emerging economies, global lead consumption in 2011 increased by 4% to **around (hedge)** 9.8mt whereas the total refined lead supply for the calendar year 2011 was 9.9mt, a modest surplus.

**We (SM) expect (hedge)** strong growth in lead consumption to continue as demand for automation, power back-up and the other applications are **expected (hedge)** to be strong, particularly in the emerging economies. The market is **expected (hedge)** to be in balance in 2012.

In 2011–12, Indian lead consumption registered a growth of 11%, **essentially (hedge)** driven by strong growth in the automation sector.

## Silver

India is the fourth largest consumption centre for silver. In 2012, the demand for silver globally is **expected (hedge)** to increase by 4%, driven by growth in consumption in fabrication, industrial applications, coins and as an investment asset. It is **estimated (hedge)** that demand for silver in India will grow by 3–4% in FY12.

## Operations

Refined zinc production for the year was a record 759kt, an increase of 6.6% over the previous year's production of 712kt. The production increase was primarily due to higher utilisation of new-generation smelters in Rajasthan despite the ramp down of the high cost Vizag smelter in Q4. Refined lead production volume improved by 57% during the year due to volume contribution from the newly commissioned 100kt Dariba lead smelter. Silver production also registered record growth of 35% to 7.8moz, compared with 5.8moz during FY 2010–11. This increase was **mainly (hedge)** attributable to higher production from the Sindesar Khurd ('SK') mines and a 1.4moz contribution from the new 350tpa silver refinery commissioned during the year. The unit cost of zinc production during FY 2011–12 increased marginally by 2% to US\$1,010 per tonne as against US\$990 per tonne incurred in FY 2010–11. This change in cost was primarily due to interplay of several factors – on the positive side, improved efficiency in smelting operations, INR depreciation, improved by-product realisation and on the negative side, higher coal prices, lower ore grade during the year and higher mine development expenses as per the mining plan.

EBITDA for FY 2011–12 increased to US\$1,245 million, as compared to US\$1,220 during FY 2010–11. Increased production volumes and improved operational efficiencies contributed to this increase.

## Projects

During the year, **we (SM)** commissioned the Dariba lead smelter and a 350mt silver refinery, both of which are performing **well (AM)**. Sindesar Khurd mine achieved a 1.8mtpa run-rate towards the end of Q4 FY 2012. The progress of underground mine development work at the Rampura Agucha mine and the green field Kayar mine is as planned.

With the commissioning of the 150MW of **our (SM)** wind power generation capacity in FY 2011–12, **we (SM)** have now reached a total of 274MW, making **us (EM)** one of the largest wind power producers in India.

## Innovative techniques stabilise waste dump at Rampura Agucha mine

Managing the waste dumps produced by the world's biggest zinc mine in the hot, dry climate of Rajasthan India, presented a considerable challenge. Dust blowing in the wind, soil erosion and an unsightly barren environment were all problems faced at the Rampura Agucha mine, operated by HZL.

As part of an innovative initiative, 12,000 square metres of waste dump was levelled and covered with geo-textiles to stabilise the slopes. The soil was then conditioned and planted with Vetiver grass seedlings. During the rains, **around (hedge)** one ton of seeds were sprayed on the stabilised slopes and along the periphery of the mine. With regular watering and a protective soil cover, the slopes are now coming to life, bringing greenery to this industrial landscape and reducing the environmental impact of mining operations.

## Exploration

**We (SM)** continue to meet success in **our (SM)** exploration activities and during the year **we (SM)** added 27.1 million tonnes to **our (SM)** Reserves and Resources ('R&R'), prior to depletion of 8.04 million tonnes. With a total Reserves and Resources of 332.3 million tonnes containing 35 million tonnes of zinc lead and 912 million ounces of silver as on 31 March 2012, **we (SM)** continue to maintain **our (SM)** prominent position with over 25 years of remaining mine life.

In line with the Company's growth vision, **we (SM)** continue to invest **our (SM)** resources in identifying new world-class resources. A total of 94,250 m of drilling was completed at various exploration sites in FY 2011–12. During the year, **we (SM)** performed systematic green field exploration over 4,500 sq km and applied for new Reconnaissance Permits for **around (hedge)** 18,700 sq km.

## Outlook

In line with the mine plan, mined metal production in FY 2012–13 is **expected (hedge)** to be slightly higher than this financial year. Production in the first half of FY 2012–13 is **expected (hedge)** to be marginally lower than that last year, but will be more than made up in the second half of FY 2012–13. The SK mine is **expected (hedge)** to deliver volumes near its capacity of 2.0mtpa in FY 2012–13. Total integrated silver production is projected to be **around (hedge)** 350 tonnes in FY 2012–13. The average cost of production for FY 2012–13 is **expected (hedge)** to be in line with this year however there **could (hedge)** be quarterly variations in line with the mine plan.

## Zinc-International

### Key Achievements

- Integration successfully completed
- Stable operating performance, higher volume over previous period
- Mine life extended at all three locations

### Strategic Priorities

- Feasibility of Gamsberg project in South Africa
- Work on other satellite opportunities at all locations > Increase in mine life through extensive exploration programme

## Operations

The increase in production level is the highlight of the first complete year of operations post the acquisition of these assets during FY 2010–11. Total production of zinc and lead metal-in-concentrate and zinc metal as 444kt, comprising 299kt of zinc and lead metal-in-concentrate at Lisheen and BMM and 145kt of refined zinc at Skorpion. This compared **well (AM)** with last year's production of 434kt.

The unit cost of production in FY 2011–12 rose by 4% to 52.9 US cents/lb compared with 50.7 US cents/lb in FY 2010–11, primarily due to higher energy costs and lower by-product credit.

EBITDA for the FY 2011–12 was US\$366.0 million and operating profit was US\$129.2 million. The lower operating profit is due to higher amortisation of mine properties charges of US\$117.8 million based on the existing mine life in addition to depreciation charges of US\$119.0 million. Prior year performance is not comparable as the acquisition was completed over the period from December 2010 to February 2011.

## Exploration

**We (SM)** have extended the life at all three of **our (SM)** mines during the year. Mine life increased to 2017 at Skorpion with some additional work to be done to convert resources to reserves. Gross addition of more than 2mt to Reserves and Resources was made at Black Mountain mine, extending the mine life. Similarly, Lisheen mine life was extended by one year to **approximately (hedge)** three years now. A feasibility study is under way as the first step towards the development of the Gamsberg project. The Gamsberg project contains the largest undeveloped zinc deposit in the world. With an **estimated (hedge)** 186mt deposit, this discovery has the potential to deliver over 400ktpa over a mine life of more than 20 years.

## Outlook

In FY 2012–13, production at Zinc- International is **expected (hedge)** to be impacted by a fall in grades, which will lead to lower production by **about (hedge)** 5–7%. Success in enhancing resource position and ongoing exploration work has significantly enhanced the value of the assets as compared with the data available at the time of acquisition.

## Iron Ore

### Key Achievements

- Acquired majority stake in WCL which is **estimated (hedge)** to have over 1 billion tonnes of iron ore deposits
- Net addition of 68mt Reserves and Resources in Indian mines

### Strategic Priorities

- Resume mining and export from Karnataka
- Commissioning of 375kt pig iron expansion project along with sinter plant, expanded met coke capacity and power plant
- Continue to expand Reserves and Resources by active exploration and selective acquisitions
- Complete ongoing logistic improvement and debottlenecking programme
- Develop WCL as a large integrated mining operation and establish **our (SM)** presence in Liberia
- New phase of growth to 36mt p.a. in Indian operations

### Market Overview

Demand for iron ore globally is linked primarily to the state of the global steel industry and, more specifically, to steel manufacturing in China. China is the largest steel producer and consumer in the world, accounting for more than two-thirds of global seaborne iron ore imports. In 2011, global steel production increased 6% to 1.5 billion tonnes, of which 683mt were produced in China, an increase of 7%. China's iron ore needs were also met by domestic iron ore production, which rose by **approximately (hedge)** 7% to 305mt.

Recovery of steel demand in the world is **expected (hedge)** to be slow while in the emerging and developing economies it **should (hedge)** continue to enjoy moderate to robust growth. In 2012, it is **forecast (hedge)** that world steel demand will grow further by 5.4%. In 2012, the emerging and developing economies will account for 73% of world steel demand in contrast to 61% in 2007.

In 2011, India's **apparent (hedge)** steel use grew by 2.5% to reach 67.7mt in contrast to 2012, when the growth rate is **forecast (hedge)** to accelerate to 6.9%. However, rises in export taxes and rail freight costs have significantly increased Indian export costs. With the continued ban on exports from Karnataka and high costs, iron ore exports from India dropped to 79mt in 2011, a drop of 18.5% as compared to the previous year which impacted the performance of **our (SM)** iron ore business.

### Operations

**Our (SM)** iron ore operations were constrained during 2011–12, as the Supreme Court's revocation of the earlier state-wide ban on exports in Karnataka during April 2011 was subsequently followed by the imposition of iron ore mining ban in the State from August 2011.

**We (SM)** also faced logistics constraints in Goa, which further impacted **our (SM)** operations. **We (SM)** are expanding existing roads and establishing dedicated road corridors in Goa to overcome these constraints.

As a result, production of saleable iron ore was lower at 13.8mt in FY 2011–12 as compared with 18.8mt in the previous year. The Karnataka mining ban matter is being heard by the Supreme Court and **we (SM) expect (hedge)** a resolution soon. The Court has directed that a Reclamation and Rehabilitation plan for each mine, including fixing capacities, has to be completed by the Indian Council of Forestry Research and Education ('ICFRE'), and then approved by the State Government and the Central Empowered Committee ('CEC'). The ICFRE has visited **our (SM)** mine and will issue their report. The CEC has informed the Court that Reclamation and Rehabilitation of all A and B category mines +50ha will be completed by mid June 2012.

The Court is now closed for the holiday period and will be hearing the case again after reopening.

Iron ore sales were 16.0mt, down by 11.6% as compared to the previous year due to the reasons mentioned above. Export sales were 13.0mt in FY 2011–12 as compared to 16.3mt in FY 2010–11. Domestic sales were 3.0mt in FY 2011–12 compared with 1.9mt in the previous year. The production of pig iron was 249kt during FY 2011–12, lower than FY 2010–11 by 9.8%. This shortfall was due to fluctuating demand throughout the year, as well as a lack of supply of high grade iron ore from Karnataka.



#### Debottlenecking iron ore transportation at Sesa Goa

Sesa Goa operations have the unique advantage of access to the river to transport iron ore from the Company's mines to the port. As a result, transportation logistics are critical to overall capacity, particularly the effective use of the Company's fleet of barges. With the aim of extending the Company's capability to handle higher volumes, Sesa's River Fleet Services team targeted barge turnaround times as a key contributor to improving transportation efficiency. Analysis using LEAN industrial engineering techniques – mapping processes combined with root cause analysis and cross functional brain storming sessions – identified areas for improvement in the process.

New barge management software was rolled out to track, monitor and schedule barges in real time using a Global Positioning System ('GPS'). As a result, barge turnaround time has been reduced by an **impressive (AM)** 37%, down from 38 hours to 24 hours, maximising barge utilisation and optimising barge capacity.

EBITDA in FY 2011–12 was lower at US\$721.4 million compared with US\$1,174.1 million in the previous year. Lower EBITDA was **mainly (hedge)** due to the increase in export duty, sales volume impact due to the mining ban, logistics constraints and lower mine grade of iron ore. The export duty on iron ore fines and lumps was increased by the Government of India from 5% and 15%, respectively, to 20% on both fines and lumps effective from March 2011; and subsequently this was increased from 20% to 30% with effect from the end of December 2011 which impacted EBITDA by US\$201 million.

Operating profit was lower at US\$481.3 million in FY 2011–12 as compared with US\$757.6 million in FY 2010–11, reflecting the fall in EBITDA.

#### Projects

##### Expansion of Iron Ore Mining Capacity

**We (SM)** remain **committed (AM)** to expand iron ore mine capacity and have taken multiple steps to upgrade the infrastructure and enhance mining capacity to attain 36mt capacity. However, due to the uncertain environment, there **may (hedge)** be delays in getting the requisite approvals.

##### Expanding Pig Iron and Met Coke Production Capacity

Expansion of the pig iron capacity to 625ktpa and metallurgical coke capacity to 560ktpa is progressing **well (AM)** and will be commissioned in the first quarter of FY 2012–13.

#### Exploration

The Company's strong focus on exploration activities at its operations at Goa and Karnataka has yielded significant Reserves and Resources accretion, with a net addition of 68mt to the Reserves and Resources base during the year. Total Reserves and Resources as at 31 March 2012 stands at 374mt (at the mines that the Company holds on lease and/or right to mine) as compared with 306mt as at 31 March 2011.

##### Acquisition of Western Cluster Limited (WCL)

**We (SM)** acquired 51% of the equity of WCL, which is a company registered in Liberia for a total consideration of US\$90 million. In addition US\$25 million licence fees were paid to the Government of Liberia. WCL is an iron ore project comprising three deposits – Bomi Hills, Bea Mountain and Mano River with Bea Mountain (923mt), Mano River (80mt) and Bomi Hills (50mt) located at a distance of 70–140 km from Monrovia port. The Company has been given right of access to an old rail corridor to Monrovia port and two piers in Monrovia port. WCL will develop the Western Cluster Iron ore project in Liberia, and the Group is **committed (AM)** for the development and operation of this asset. It is envisaged that the project will be executed in phases starting with the brownfield mines at Bomi Hills. The mines at Bomi Hills and Mano River are brownfield in nature and were major producers of iron ore in 1980s. The presence of significant resources in close proximity to the port positions Sesa strongly in West Africa. **We (SM)** have completed an aeromagnetic survey of the deposits which has **indicated (hedge)** a significant potential upside to the existing **estimated (hedge)** resource base of little over 1 billion tonnes. **We (SM)** are in the process of completing the project scoping study and commencing exploration activity. **We (SM) expect (hedge)** the first shipment from these Liberian assets by end of FY 2013–14.

The presence of significant resources in close proximity to these logistics facilities positions Sesa strongly in West Africa. **We (SM)** have completed an aeromagnetic survey of the deposits which has **indicated (hedge)** a significant potential upside to the existing resource base of 1 billion tonnes. **We (SM)** are in the process of completing the project scoping study and commencing exploration activity. **We (SM) expect (hedge)** the first shipment from these Liberian assets by FY 2013–14.

#### Outlook

**We (SM) expect (hedge)** the Karnataka mining ban to be resolved soon, in line with the observations made by the CEC and Supreme Court. A multifaceted approach covering mining, infrastructure upgrade initiatives and securing regulatory approvals is progressing **well (AM)** and **should (hedge)** result in a healthy growth rate.

## Copper-India and Australia

### Key Achievements

- Achieved highest ever Copper recovery of 98.28%
- Achieved zero costs of production
- Mechanical completion of first 80MW unit of the captive power plant at Tuticorin
- Higher TC-RC

### Strategic Priorities

- Commissioning of captive power plant
- Continue to retain and further sharpen cost efficiency
- Secure approval to implement 400kt smelter project
- Improve by-product and precious metal realisation
- Commission captive power plant and continue to drive operational excellence initiatives

### Market Overview

Global refined copper production in 2011 was reported as 19.6mt, an increase of **about (hedge)** 3% over the 2010 figure of 19.0mt despite uncertain macroeconomic conditions in 2011. Global refined consumption exceeded supply by **about (hedge)** 93,000 tonnes. Global mine production growth slowed to 0.6% in 2011, hampered by falling copper grades and labour disputes. Global copper consumption is **estimated (hedge)** to increase by **about (hedge)** 4% during 2012.

China, with the biggest consumption of copper in the world (with 40% consumption of total copper produced), remains the preferred destination for the exports. In the first half of the year, the spot concentrates market was dominated by the impact of the Japanese tsunami on smelter production, which drove spot treatment and refining charges to high levels and resulted in a mid-year benchmark settlement of US\$85 per tonne and 8.5 US cents/lb. However, growing rates of mine supply disruption during the second half tightened the market and generated a sharp decline in spot treatment and refining charges. 2012 annual copper concentrate TC-RC settlement were in the range of 15.4 to 16.3 cents/ lb against 14.4 cents/lb in 2011. Similar to the previous year, overall Indian copper consumption grew by 6% in FY 2011–12, constrained by increased imports of finished electrical machinery.

**We (SM)** sold 61% of production in the Indian local market and the remaining 39% was exported to China and South East Asia. Growth in the power sector in India, and increased spending on infrastructure including housing, continued to drive the growth of copper consumption.

Over the medium to long term it is **expected (hedge)** to grow at **about (hedge)** 7–8%.

### Operations

Production of cathodes at **our (SM)** Copper India business was 326kt in FY2011–12, up 7.2% year on year due to improved operational performance and also reflecting the impact in the previous year of a 22 day bi-annual maintenance shutdown undertaken and of a temporary shutdown due to a High Court order in September 2010. Mined metal production at **our (SM)** Australian mines was flat at 23kt in FY2011–12. Benefiting from improved by-product sales of sulphuric acid and improved operational performance, Copper India performed **well (AM)** delivering a reduction in unit conversion cost from 4.0 US cents per lb to a zero cost per lb during FY 2011–12. Sulphuric acid sales were up 14.2% over the previous year. Treatment and refining charges ('TC/RCS') received in FY 2011–12 were marginally higher at 14.5 US cents per lb compared with 11.9 US cents per lb in FY 2010–11.

The unit cost of production at **our (SM)** Australian operations, including TC/RCS and freight, in FY 2011–12 was 233 US cents per lb up from 191 US cents per lb in FY 2010–11, **mainly (hedge)** due to higher mining costs. EBITDA for FY 2011–12 was US\$298.0 million, up 22.7% over the previous year (FY 2010–11: US\$241.5 million). This was primarily due to higher TC/RC realisations, higher volumes and better margins on acid sales.

Operating profit was US\$164.0 million in FY 2011–12 as compared with US\$196.5 million in FY 2010–11, despite an increase in EBITDA due to an exceptional charge of US\$88.6 million relating to the ASARCO legal dispute. In reference to the Special Leave Petition filed by the Company in the Honourable Supreme Court, the Company has complied with all the TNPCB directions due to date and is in the process of progressively complying with all the remaining directions. The smelter continues to operate at its rated

capacity. The matter is being heard by the Supreme Court. ASARCO filed a suit in the US Courts against Sterlite for the alleged breach of the Purchase and Sale Agreement signed in May 2008. The Court ruled in February 2012 that ASARCO is entitled to net incidental damages of US\$88.6 million after adjustment of US\$50 million paid to ASARCO in December 2009.

## Projects

### 160MW Captive Power Plant

The first 80MW unit of the captive power plant at Tuticorin has been mechanically completed and commissioning is **expected (hedge)** by Q1 FY 2012–13. The second unit is **expected (hedge)** to be commissioned during the second quarter of Q2 FY 2012–13.

### 400ktpa Copper Smelter

**We (SM)** have received Ministry of Environment and Forests ('MoEF') clearance for the 400ktpa copper smelter expansion project at Tuticorin. A Public Interest Litigation ('PIL') challenging the clearance issued by MoEF is being heard at the Chennai High Court. Activities have been put on hold. Expansion activities will resume after the matter is cleared by the Court.

## Outlook

Once the power plant at Tuticorin is commissioned, it is **expected (hedge)** that the cost of power incurred in smelting and refining will come down substantially and will reduce gross cost of production by 3 US cents/lb **approximately (hedge)**.

## Copper-Zambia

### Key Achievements

- Integrated production up by 4.5% at 139kt
- Nchanga East concentrator and cobalt recovery furnace commissioned
- Key infrastructure for KDMP completed including commissioning of the mid-shaft loading station
- Continued exploration success with Reserves and Resources as at 31 March 2012 stands at 689mt

### Strategic Priorities

- Deliver multi-source production growth
- Drive cost reduction through productivity enhancement and by-product strategy
- Completion of the Shaft 4 infrastructure by Q3 FY12
- Ramp-up mine development at Konkola to increase production
- Completion of the new West Mill concentrator at Nchanga
- Start production at the Nchanga UOB mine
- Enhancing options through brown field and green field exploration

### Improved water pumping processes reduce energy consumption

The Konkola Mine in Zambia, one of the world's wettest mines, has seen dramatic improvement in the efficiency of its water pumping operations. The mine currently pumps out close to 350,000 cubic meters of water per day. This water forms a major lifeline for the Kafue river. The management of underground water is critical to avoid flooding, which could result in a long-term impairment of the mine and it also accounts for a significant portion of the Company's total power consumption. As the efficiency and life of the pumps are influenced by the amount of suspended solids in the water being pumped, the Konkola mine management has focused on reducing this. Steps taken have included the installation of a separate slurry pumping system, cleaning of drain drives and the desludging and overhaul of existing settlers, launders and drain pits. This has resulted in a substantial reduction in the level of suspended solids from over 600mg/litre in 2008 to less than 100mg/litre today. This reduction in suspended solids has significantly improved the efficiency of the pumps and reduced power consumption by 0.5KW per cubic metre of water pumped, resulting in an overall reduction of 7MW of electricity.

## Market Overview

The Zambian copper belt has in the recent past attracted substantial, high profile investment interest with its large, higher grade deposits with growth opportunities in a stable political environment. This is against the global backdrop of declining production and continued strong demand. Since **our (SM)** acquisition of KCM **we (SM)** have invested US\$2.5 billion principally on developing the Konkola Deep Mine Project ('KDMP') and the new 311ktpa capacity Nchanga smelter along with sustaining and other Capex. With

this renewed investment focus by major players including Konkola, Zambia copper production is on a trajectory to reach a record production of 1 million tonnes per year by 2013. This growth will contribute to Africa achieving the fastest growth rate in mined metal production over the next few years.

Copper demand in Africa is growing due to better economic conditions and improving consumption patterns amongst the African demographics. The commitment by the government to reforms seen over the past few years has helped to improve the political stability in Zambia which has encouraged investors into the country.

#### Operations

Integrated copper production was 4% higher at 139kt for the full year. Total copper cathode production was 7% lower at 200kt for the full year, due to lower volumes from custom smelting on account of lower availability of concentrate. The unit cost of production was 237 US cents per lb in FY 2011–12, up 19.9% compared with FY 2010–11. The cost increased due to higher pre-stripping cost, wages and higher power costs. EBITDA in FY 2011–12 was US\$387.9 million (FY 2010–11: US\$439.9 million), impacted by higher production costs.

#### Projects

The new 7.5mtpa Nchanga East concentrator and the second cobalt recovery furnace were commissioned during the quarter and are ramping up **well (AM)**. The new 3mtpa Nchanga West concentrator is now **expected (hedge)** to be commissioned in Q1 FY 2012–13. At KDMP, work is progressing on schedule, and the bottom shaft loading is **expected (hedge)** to be completed by Q3 FY 2012–13.

#### Exploration

The Company continued its extensive exploration programme resulting in no depletion of its Reserves and Resources (excluding tailings and refractory stockpiles). The ore bodies at Kakosa and Mimbula have been **well (AM)** defined, adding potential in open pit mining. The Company is also seeking new large prospecting licences for additional exploration.

#### Outlook

Given the strong outlook of the copper market fundamentals and the investments in Konkola, the Company is **well (AM)** poised to deliver results in line with expectations.

### Aluminium

#### Key Achievements

- Highest ever alumina production – up by 31.3% to 928kt
- Record aluminium production of 675kt
- Value added product volume increase of 24% from 325kt to 404kt

#### Strategic Priorities

- Further improve operating efficiencies to optimise costs, including logistics costs
- Expedite development of captive coal block
- Secure captive bauxite mine
- Enhance prices achieved for value added products, enhancing operating margins
- Complete ongoing expansion projects
- Secure additional coal blocks under the new policy **expected (hedge)** to be announced soon

#### Market Overview

Due to a rise in CT Pitch and CP Coke prices globally and additional cost pressures due to the increase in the cost of coal used for CPPs, **almost (hedge)** 50% of global capacity is said to be operating with cash costs higher than current aluminium prices, resulting in the announcement of significant closures by the marginal cost smelters. The global aluminium industry recorded a 7.8% growth in production and a 9.3% growth in consumption during CY 2011. In the longer term, the fundamentals of the aluminium industry remain strong, with aluminium demand **forecast (hedge)** to grow by **almost (hedge)** 6% in the current decade. The robust growth is **expected (hedge)** to be driven by emerging economies and a growing perception among end users in developed markets of aluminium's advantages. The underlying factors that are driving strong demand growth for structural commodities remain

unchanged, as continued urbanisation and industrialisation in large, populous nations such as China and India drive demand for aluminium. India is **relatively (hedge)** insulated from the economic fluctuations in mature economies and is projected to become the second largest consumer of aluminium in Asia during CY 2012, with the electrical sector the main driver of demand.

As the largest producer of aluminium in India, **we (SM)** are **well (AM)** positioned to cater to its growing demand for aluminium. In addition to the electrical sector, the automotive and construction sectors are also projected to undergo a healthy growth in demand. As per **forecast (hedge)**, the primary aluminium demand in India is **expected (hedge)** to reach 6 million tonnes by 2025, which equates to 4.1kg of per capita aluminium consumption in 2025. When compared to the current per capita aluminium consumption of **around (hedge)** 1.5kg and aluminium demand of 1.8 million tonnes, this underscores the immense potential for demand growth in India.

#### Operations

Production of aluminium in FY 2011–12 was 675kt, an increase of 5% compared with the corresponding prior period. This increase is primarily attributable to the production of 430kt from the Jharsuguda 500ktpa aluminium smelter. Following a serious setback of power outages experienced in June, the Jharsuguda smelter has fully stabilised, with most of its key parameters including power consumption **almost (hedge)** reaching normal operating levels. The remaining pots and ongoing operational improvements are **expected (hedge)** to further enhance the operating efficiencies. Operations at the Korba smelter were stable and it continued to operate at its rated capacity. The Lanjigarh alumina refinery produced 928kt of alumina in FY 2011–12, an increase of 31% compared with 707kt in FY 2010–11. Total sales of aluminium were 5.7% higher at 669kt in FY 2011–12.

Sales of aluminium in the domestic market increased 6.8% to 534kt in FY 2011–12. Sales of value added products increased by 24.9% compared with last year. The share of value added products was 59% of total sales in FY 2011–12, significantly higher compared with 50% in FY 2010–11. **We (SM)** continue to focus on increasing **our (SM)** domestic sales, as **our (SM)** sales in the domestic market are higher than **our (SM)** exports. A full year unit cost of production of US\$2,188 per tonne as compared with US\$1,940 in FY 2011 is a resultant of a very high operating cost, in H1 due to power outage and subsequent normalisation of operating performance resulting in Q4 COP of US\$1,930 at VAL. Operating costs at the Korba smelter were higher, primarily due to higher coal, carbon and alumina costs. Overall, the cost of aluminium in FY 2011–12 was US\$2,091 against US\$1,878 during FY 2010–11 and the same price for Q4 was US\$1,898 in FY 2011–12 and US\$1,889 for FY 2010–11. EBITDA for FY 2011–12 was US\$182.5 million, 48.3% lower than achieved in FY 2010–11. EBITDA fell due to the pot outage incident in the Jharsuguda unit during June 2011, low LME prices during the second half of the year and higher costs.

#### Projects

The first unit of the 1,200MW (4x300MW) captive thermal power plant at Korba, Chhattisgarh is **expected (hedge)** to be synchronised in Q1 FY 2012–13. The 211mt coal block at the Bharat Aluminium Company ('BALCO') received approval from the Environment Appraisal Committee ('EAC') in November. **We (SM)** are in the process of obtaining second stage forest clearance. **We (SM)** **expect (hedge)** to commence production of coal in FY 2012–13. The first metal tapping from the 325ktpa aluminium smelter at Korba is scheduled by Q3 FY 2012–13. Further construction at the Lanjigarh alumina refinery project is on hold while **we (SM)** continue to work on completing the 1.25mt smelter expansions at Jharsuguda.

#### Outlook

**We (SM)** **expect (hedge)** **our (SM)** existing facilities to operate at close to their rated capacity in the coming year. The resultant increased volumes, combined with the **expected (hedge)** higher proportion of value added products and further improvement in operating costs **should (hedge)** provide improved returns.

#### Power

#### COMMERCIAL ENERGY

#### Key Achievements

- Record sales of 6,554 million units, up 248.8% from previous year
- Commissioned two 600MW units in the independent power plant ('IPP') at Jharsuguda and the fourth unit has been synchronised
- 150MW wind power project commissioned, taking green power generation capacity to 274MW

#### Strategic Priorities

- Commission the fourth unit of the 2,400MW project at Jharsuguda by Q1 FY 2012–13
- Power sales and transmission strategy
- Coal sourcing
- Develop Sterlite Energy Limited ('SEL') captive coal block
- Complete 1,980MW project at Talwandi Sabo power project with minimal time/cost overrun

## Operations India

### Market Overview

The Indian power sector has achieved a compound annual growth of 7.6% in its installed capacity since the end of the Government of India's tenth five year plan, to achieve an installed capacity of 190.6GW at the end of February 2012. Of this, 65.4% represented thermal capacity, while 11.7% was from renewable energy sources. Despite the market growth, power supply has lagged behind demand, with supply falling short of India's peak energy demand for FY 2011–12 by 12.1%, as anticipated by the Central Electricity Authority ('CEA'). Per capita consumption of electricity in the country of **about (hedge)** 814kwh in 2011 was only **about (hedge)** 24% of the world's average, highlighting the growth prospects for the future. Coal deficits and higher costs due to imports has adversely impacted the industry in recent years. However, the Government of India's efforts to ensure a minimum of 80% of fuel supply to power producers is **expected (hedge)** to improve the performance of the power sector.

### Operations

Power sales were 6,554 million units during FY 2011–12, compared with 1,879 million units during the corresponding prior period, as the three 600MW units at the Jharsuguda 2,400MW power plant came into operation. During Q4, the third 600MW unit started commercial production and the fourth 600MW unit was synchronised.

Average power sales prices in FY 2011–12 were US cents 7.5 per unit compared with US cents 9.7 per unit in FY 2010–11. Average power generation costs in FY 2011–12 were US cents 5.5 per unit compared with US cents 6.2 per unit in FY 2010–11.

### Financial Performance

EBITDA in FY 2011–12 was US\$122.0 million, higher than the EBITDA of US\$43.9 million in FY 2010–11. EBITDA rose primarily due to higher volumes partially offset by a fall in power tariffs and higher operating costs, primarily coal.

### Projects

#### Talwandi Sabo IPP

Work at the 1,980MW power project at Talwandi Sabo is progressing as scheduled. The first unit of the 660MW is **expected (hedge)** to be commissioned during Q4 FY 2012–13. In view of the current environment of coal and power tariffs, **we (SM)** have decided to drop the expansion plan of the fourth unit. Jharsuguda IPP Transmission lines are being set up to enhance existing transmission capacity to meet the requirements for the new units being commissioned and are **expected (hedge)** to be completed by Q3 FY 2012–13.

### Outlook

**We (SM)** plan to complete the ongoing projects on schedule and to continue **our (SM)** focus on improving coal logistics and expediting coal block development at SEL.

## Oil & Gas

### Key Achievements

- Commenced production of Bhagyam field in January 2012
- Mangala field consistently producing 125,000 barrels of oil per day (bopd)
- FY 2011–12 exited with 175,000bopd gross

### Strategic Priorities

- Further develop the hydrocarbon-rich Barmer basin in Rajasthan, India
- Exploration in Sri Lanka 1 Numbers post completion of acquisition on 8 December 2011.

## Market Overview

2011 was an eventful year for oil markets with the spot price of North Sea Brent crude averaging over US\$111 per barrel for the first time during the year. Political tensions in the Middle East and North Africa, which produce 42% of the world's oil requirements, impacted supply, combined with an increase in demand for liquid natural gas and oil following the shutdown of major nuclear power plants in Japan after the Fukushima nuclear disaster. Looking forward, this volatility looks set to continue with the unresolved dispute between Iran and the United Nations raising the prospects of sanctions from Western nations, combined with technological advances in production and shifts in trading balances.

## Operations

The year saw three new fields start up in the Rajasthan block – Bhagyam, Raageshwari and Saraswati – in addition to a ramp-up in production in the Mangala field.

The Mangala field, the largest discovery in Rajasthan, commenced production in August 2009 following a period of five years from discovery to production. The field has consistently produced at its previously approved rate of 125,000 barrels of oil per day (bopd) for 18 months.

On 19 April 2012, approval to increase production was received and output has been ramped up to 150,000bopd. At the gross production of 175,000bopd, the Rajasthan fields are cumulatively contributing more than one fifth of current domestic crude production.

Cairn India and its JV partner ONGC continue to develop the hydrocarbon resources in the state of Rajasthan with a continued focus on cost and the application of innovative technologies. The use of high density 3D seismic surveys has enhanced the understanding of the subsurface and helped to identify well locations more precisely. Since production start-up, the Mangala Processing Terminal has delivered efficient and safe operations. The plant uptime stood at over 99% during the year, among the top decile globally. The other producing blocks i.e. Ravva and CB/OS-2 continue to perform in line with the expectations. While both these fields are mature, through continuous investment in technology **we (SM)** have been able to slow down the pace of decline. For example, over the course of 17 years **we (SM)** have recovered 245 million barrels of oil and 330 billion cubic feet of gas in the Ravva field, more than double the original estimates. CB/OS 2, which started as a group of gas fields, is producing over 60% oil now. **We (SM)** plan to use the spare gas processing capacity of the CB/OS-2 facilities to process ONGC's gas from its North Tapti field (adjacent to the Lakshmi field).

## Mangala Development Pipeline

The Mangala Processing Terminal ('MPT') to Salaya section has continued to safely deliver crude oil to IOCL and private refiners for a year now, and has recorded more than 3.7 million Lost Time Injury-free man hours to date. This section provides **us (SM)** with access to over 1.6 million barrels per day of refining capacity. The current pipeline capacity is at 175,000bopd. However, this will be debottlenecked in the coming months to add some ~10% of additional capacity. In parallel, further capacity is being augmented with additional investment in order to handle higher volumes in line with the basin potential.

## Sales

Crude oil sales from Rajasthan block were ramped up in line with the production ramp up. Crude oil sales agreements for Rajasthan crude have been renewed with buyers for volumes in excess of 175,000bopd for FY 2012–13. The Rajasthan crude is **well (AM)** established in the market, generating higher demand for this grade. In accordance with the RJ-ON-90/1 PSC, this crude is benchmarked to Bonny Light, a comparable low sulphur crude that is frequently traded in the region, with **appropriate (AM)** adjustments for crude quality. The implied crude price for this year (an average of 12 months to March 2012) represents a lower discount than the stated guidance of 10–15% discount to Brent, due to the prevailing global macro-economic conditions.

## Rajasthan Block Resource Base

A comprehensive review of the resource potential in the block has been carried out by Cairn India through detailed studies involving the use of innovative technologies and advanced geo-science. In addition, DeGolyer and MacNaughton ('D&M') have conducted an independent estimate of reserves and contingent resources, and have also reviewed the majority of the leads and prospects in prospective resources. A separate reserves certification process is being undertaken by D&M on behalf of the RJ-ON-90/1 Joint Venture collectively, which is independent of the resources **estimate (hedge)** made by Cairn India.

## Oil &amp; Gas

## Enhancing oil recovery in the Mangala oil field

The Mangala oil field in Rajasthan is being developed with the help of water injection. The field contains moderately viscous oil, with a consistency **almost (hedge)** like honey and with nearly 20–40 times the viscosity of the injected water. This contrast in viscosity reduces the efficiency of the water in displacing the oil and ultimately reduces the overall oil recovery in a given time period. Increasing the viscosity of the injected water is one of the ways of decreasing this contrast and improving oil displacement. Extensive screening studies were done to select the most suitable Enhanced Oil Recovery ('EOR') method for the Mangala field, with chemical EOR emerging as the best option. Polymer flooding is the simplest of the chemical EOR methods in which the viscosity of injected water is increased by adding small amounts of Polymers. A pilot was implemented in CY 2010 and is proving to be effective under actual field conditions, showing significant potential for accelerating and increasing oil production from the Mangala field on a larger scale. The application of chemical EOR methods can contribute to the commercialisation of over 300 million barrels of oil from Rajasthan's Mangala, Bhagyam and Aishwariya fields cumulatively.

Based on Cairn India's assessment, the potential resource for the Rajasthan block is now **estimated (hedge)** to be 7.3 billion boe in place. This is primarily due to an increase in the exploration upside with the prospective resource base now **estimated (hedge)** at 3.1 billion boe in place from an earlier estimate of 2.5 billion boe in place. Rajasthan recoverable risked prospective resource has increased from 250mmboe to 530mmboe on a risked basis, primarily due to generation of additional leads and prospects. Cairn India and ONGC are working with the GoI to obtain the necessary approvals required for carrying out exploration and appraisal activity in the block. The discovered resource base increased from 4 to 4.2 billion boe in place due to an increase in Stock Tank Oil Initially In Place ('STOIIP') from the Mangala and other Rajasthan fields. Rajasthan **Expected (hedge)** Ultimate Recovery ('EUR') has increased from 1.4 billion boe to 1.7 billion boe as a result of increased recoverable risked prospective resource estimates. The Mangala, Bhagyam and Aishwariya ('MBA') fields have gross recoverable oil Reserves and Resources of over 1 billion barrels, which includes proven plus probable (2P) gross reserves and resources of 636mmboe with a further 308mmboe or more of EOR resource potential. **We (SM)** achieved a gross Reserve and Resource replacement ratio of 175% during the year with the net addition of ~50mmboe. The total resource base now provides a basin potential to produce 300,000bopd, (equivalent to a contribution of ~40% of India's current crude production), subject to further investments and regulatory approvals.

## Financial Performance

The transaction completed on 8 December 2011 so the financials are from the date of the transaction completion until 31 March 2012. EBITDA during the period was US\$713.0 million **mainly (hedge)** due to increased production from the Rajasthan block and the higher crude price realisation. Operating profit for the period was US\$366.3 million. The operations during the year helped in reducing oil imports by US\$6.0 billion and contributed US\$2.4 billion to the National Exchequer on a gross basis. The Cairn India Board approved its first Dividend Policy that aims to maintain a dividend payout ratio of **around (hedge)** 20% of annual consolidated net profits to its **shareholders (EM)**. Whilst formulating the policy, the intent was to maintain a balance between stable dividend payouts and retaining the flexibility to invest in growing the resource base to protect equity value.

## Exploration

The exploration strategy is based on building a portfolio of high reward prospects across the risk spectrum in a diversity of basins, plays and operating environments. Cairn India has a total of 10 blocks in its portfolio in three strategically focused areas comprising of one block in Rajasthan, three on the West coast of India, five on the East coast of India and one in Sri Lanka. Of these, eight, including the three producing blocks, are operated by Cairn India. The net unrisked exploration potential for the entire portfolio stands at 2.1 billion boe. The year was marked by exploration successes in two blocks and **our (SM)** first in international waters – Sri Lanka. The discoveries in Sri Lanka were the first in 30 years and helped open up the frontier Mannar Basin for future opportunities. **We (SM)** have entered into Phase 2 and have acquired 600 sq km of 3D seismic data and plan for further exploration drilling in CY 2013. The other exploration success came from the second successive discovery Nagayalanka-SE-1 in the KG-ONN-2003/1 block. This is the largest onshore discovery in the KG basin to date and has helped establish an in place resource of **around (hedge)** 550mmboe.

## Outlook

The year 2011 was eventful for oil markets, as reflected both in price trends and developments that **may (hedge)** presage broader structural shifts over the coming years. The spot price of North Sea Brent crude averaged over US\$111 per barrel in 2011, marking it for the first time, the global benchmark averaged more than US\$100 per barrel for a year. The year bygone witnessed many dramatic events. However the short-term, oil market impact of the various events, their full transformative effect on the oil industry can be assessed only in the context of broader structural changes. The multiple factors driving these shifts **may (hedge)**



not individually be seen as game-changing, but collectively they **may (hedge)** prove sufficient to make 2011 something of a turning point, be it the Middle East unrest, the Fukushima nuclear disaster following the earthquake and the tsunami or Europe's renewed economic woes. India is a crude oil deficit country and currently imports more than 2.4 million bopd of crude oil which is ~80% of the demand.

#### **Board of directors (SM)**

Anil Agarwal, 59

Executive Chairman

Background and experience

Mr Agarwal, who founded the Group in 1976, is also Chairman of Sterlite and is a Director of BALCO, HZL, and Vedanta Aluminium Ltd. Since 1976 the Group has grown under his leadership, vision and strategy. Mr Agarwal has over 30 years' experience as an industrialist.

Date of appointment

Mr Agarwal was appointed as the Executive Chairman in May 2003.

Committee membership

Mr Agarwal is Chairman of the Nomination Committee.

Navin Agarwal, 51

Deputy Executive Chairman

Background and experience

Mr Agarwal has played a key role in strategic planning for Vedanta, and drives the execution of organic growth and acquisitions. He also oversees capital raising initiatives, global investor relations and talent development at the management level, and has over 25 years of experience.

Date of appointment

Mr Agarwal was appointed to the Vedanta **Board of directors (SM)** in November 2004.

Committee membership

Mr Agarwal chairs the Group's Executive Committee. In this role, he provides strategic direction and guides the sharing and implementation of best management practices across the group.

MS Mehta, 56

Chief Executive Officer

Background and experience

Mr Mehta was previously CEO for Hindustan Zinc Ltd. Since joining the group in 2000, he has held various positions including the Head of Copper Business and as Group Commercial Director (Base Metals). Prior to joining the group, he has worked for **about (hedge)** 20 years in the steel sector. Mr Mehta is a Bachelor of Engineering (Mechanical) and an MBA from the Indian Institute of Management, Ahmedabad.

Date of appointment

Mr Mehta was appointed to the Vedanta **Board of directors (SM)** in October 2008.

Committee membership

Mr Mehta is a member of the Executive Committee and the Sustainability Committee.

Naresh Chandra, 77

Non-Executive Director

Background and experience

Mr Chandra was Home Secretary in India in 1990, Cabinet Secretary from 1990 to 1992, Senior Adviser to the Prime Minister of India from 1992 to 1995 and the Indian Ambassador to United States of America from 1996 to 2001. He was Chairman of the Indian Government Committee on Corporate Governance & Audit from 2002 to 2003 and was Chairman of the Committee on Civil Aviation Policy in 2004–2005. Mr Chandra is currently the Chairman of the National Security Advisory Board of the Government of India. In 2007, Mr Chandra was awarded the prestigious Padma Vibhushan award by the President of India. Mr Chandra has a Master's degree in Mathematics from Allahabad University.

Date of appointment

Mr Chandra joined the Board in May 2004.

Committee membership

Mr Chandra chairs the Remuneration and the Sustainability Committee and is a member of the Audit Committee and the Nominations Committee.

Aman Mehta, 65

Non-Executive Director Background and experience In 1999, Mr Mehta was appointed Chief Executive Officer of the Hong Kong and Shanghai Banking Corporation, a position he held until his retirement. Mr Mehta has a degree in Economics from Delhi University. He now resides in Delhi and is a member of a number of Corporate and Institutional Boards in India as well as overseas. In addition, he is currently a member of the Board of Governors of the Indian School of Business in Hyderabad, India.

Date of appointment

Mr Mehta, a senior banker, joined the Board in November 2004.

Committee membership

Mr Mehta chairs the Audit Committee and is a member of the Nominations Committee and the Remuneration Committee.

Euan MacDonald, 72

Non-Executive Director

Background and experience

Mr Macdonald spent over 20 years with SG Warburg, specialising in emerging market finance. From 1995 to 1999, Mr Macdonald was Chairman of SBC Warburg India, responsible for all the bank's activities in India, and from 1999 to 2001, he was Executive Vice Chairman of HSBC Securities and Capital Markets, India. Mr Macdonald has a degree in Economics from Cambridge University and a Master's degree in Finance and International Business from Columbia Business School.

Date of appointment

Mr Macdonald joined the Board in March 2005.

Committee membership

Mr Macdonald is a member of the Remuneration Committee, Nominations Committee and the Audit Committee.

Senior Management Team

The Executive Committee supports the Board and **essentially (hedge)** supervises the operational performance of the Group. The Executive Committee is chaired by Mr Navin Agarwal and comprises of Mr Anil Agarwal, Mr MS Mehta and the following members:

Tarun Jain

Director of Finance, Sterlite

Mr Jain joined Sterlite in 1984 and has over 27 years of experience in corporate finance, accounts, audit, taxation and secretarial practice. He is responsible for Sterlite's strategic financial matters, including corporate finance, corporate strategy, business development and mergers and acquisitions. Mr Jain is a graduate of the Institute of Cost and Works Accountants of India and a fellow member of both the Institute of Chartered Accountants of India and the Institute of Company Secretaries of India.

DD Jalan

Chief Financial Officer

Mr DD Jalan is the Chief Financial Officer of Vedanta Resources Plc. Mr Jalan joined Sterlite in January 2001 as President of Australian Operations and was responsible for its mining operation. He has held the position of Chief Financial Officer of Sterlite Industries Ltd. and at Vedanta Resources Plc. Mr Jalan is a Chartered Accountant with over 32 years' experience in senior positions within the engineering, mining and nonferrous sectors.

Akhilesh Joshi

Chief Executive Officer and Whole Time Director, Hindustan Zinc Limited ('HZL')

Mr Akhilesh Joshi is the Chief Executive Officer and Whole Time Director of Hindustan Zinc Limited and was appointed to the Board in October 2008 as Chief Operating Officer and Whole Time Director. He joined the Company in 1976. Prior to becoming the Chief Operating Officer of Hindustan Zinc, he was Senior Vice President (Mines), responsible for the overall operations at all mining units. Mr Joshi has a Mining Engineering degree from MBM Engineering College, Jodhpur and a Post Graduate Diploma in Economic Evaluation of Mining Projects from School of Mines, Paris. He also has a first class Mine Manager's Certificate of Competency. He was the recipient of National Mineral Award in 2006 for his **outstanding (AM)** contribution in the field of Mining Technology. He is also the Director of Madanpur South Coal Company Limited.

PK Mukherjee

Managing Director, Iron Ore Business

Mr Mukherjee has been the Managing Director of **our (SM)** Iron Ore business since April 2006. Mr Mukherjee holds a Bachelor of Commerce (Honours) from Calcutta University and has 33 years' experience in finance, accounts, costing, taxation, legal and general management. Mr Mukherjee joined Sesa Goa in April 1987 and held various positions before assuming the position of Director – Finance in July 2000. In April 2006, he became the Managing Director of Sesa Goa Limited. Mr Mukherjee is a fellow member of the Institute of Chartered Accountants of India and an associate member of the Institute of Cost Accountants of India. Mr Mukherjee was rated as one of India's Best Chief Financial Officers ('CFOs') in 2005 by the Business Today magazine, and in 2009 Business World magazine declared Mr Mukherjee as India's most Valuable CEO. He is a member/office bearer of various professional and industry forums, such as the Federation of Indian Mineral Industries where he currently holds the position of President.

Sushil Kumar Roongta

Managing Director of VAL, Vice- Chairman of Bharat Aluminium Company Limited ('BALCO')

Mr Roongta is responsible for the Aluminium and Power business (with effect from June 11). Prior to joining Vedanta, Mr Roongta worked with the Steel Authority of India Limited (SAIL) for over 4 decades, holding key positions in the marketing division before being appointed as Director (Commercial) in 2004 and later as Chairman of the SAIL Board in August 2006. Mr Roongta has a Bachelor of Engineering degree from the Birla Institute of Technology and Science ('BITS'), Pilani, and was a gold medal in his Post Graduate Diploma in Business Management in International Trade from the Indian Institute of Foreign Trade ('IIFT'), Delhi. He is also a fellow member of All India Management Association. He serves as an Independent director on the Boards of Neyveli Lignite Corporation Limited, The Shipping Corporation of India Limited, Jubilant Industries Limited, Hindustan Petroleum Corporation Limited and ACC Limited. He is also a member of the Board of Governors of Indian Institute of Technology ('IIT'), Bhubaneswar.

M Siddiqi

#### Group Director, Projects

He joined Vedanta in 1991 and was responsible for Vedanta's Copper Rod plant. He then moved to the Copper smelter and refinery at Tuticorin and subsequently to the Aluminium business at Korba where he was responsible for the overall commissioning of the Korba plant as Project Director. He was also responsible for overall Aluminium and power projects in Orissa as CEO Aluminium Sector and now holds the position of Group Director (Projects). Prior to joining the Group, Mr Siddiqi held senior positions in Hindustan Copper Limited. He has over 35 years of industry experience, including more than 20 years at senior level project management positions within Vedanta. Mr Siddiqi received his Bachelors degree in Mechanical Engineering from the Indian Institute of Technology, New Delhi in 1976.

#### Pramod Suri

Chief Executive Officer, Vedanta

Aluminium Limited ('VAL') and Whole Time Director, Sterlite Energy Limited ('SEL')

Mr Suri is the Chief Executive Officer, VAL and Whole Time Director of SEL. He was the CEO of Aluminium Operations from February 2008 to April 2011. He has been responsible for Vedanta's Aluminium business at BALCO as President and Whole Time Director from December 2006. Prior to this role, he was the Senior Vice President – Operations and Head of the new Korba Smelter from September 2004 to December 2006. He has held various positions, including at Indian Aluminium Company, CEAT Ltd, Goodyear South Asia Tyres and JK Tyres Pvt Ltd. He completed his M.S. (Chem.) at the Indian Institute of Technology, Delhi.

#### Gunjan Gupta

Chief Executive Officer and Whole Time Director, BALCO

Mr Gupta joined the Group in September 2005 as the Vice President for Marketing & Sales at Balco. He took over as the Head of Smelting at Balco in February 2007 and later became the Chief Executive Officer and Whole Time Director of BALCO in 2008. Prior to joining the Group, Mr Gupta has worked in the sales and marketing division at Tata Steel in various capacities. He has also worked with the Arcelor Mittal Group and was the Director of Global Sales of long steel products produced at the Central European Steel operations of the group. He is a chemical engineer from IIT Roorkee and has an MBA, specialising in Marketing and Finance, from FMS Delhi.

#### Rajagopal Kishore Kumar

Chief Executive Officer, Zinc

International Business

Mr Kumar joined the Group in April 2003 as Vice President – Marketing for Hindustan Zinc Limited. He was Senior Vice President – Marketing for **our (SM)** copper India division from June 2004 to December 2006 and, thereafter, secured the position of the CEO of Sterlite Industries India Ltd and Konkola Copper Mines Plc in Zambia. He moved to the Zinc International business in early 2011 with the acquisition of Anglo American's Zinc assets. He has 28 years of experience and expertise in accountancy, commercial, marketing, supply chain management, mergers and acquisitions and human capital development. Prior to joining the Group, Mr Kumar was employed by Hindustan Lever Ltd for 12 years. Mr Kumar is a member of the Institute of Chartered Accountants of India.

#### Jeyakumar Janakaraj

Chief Executive Officer and Whole Time Director, Konkola Copper Mines

Mr Janakaraj joined the Group in September 1995 at Sterlite Copper and moved to HZL in July 2002 to head the expansion projects. He has a Mechanical Engineering degree from PSG College of Technology, Coimbatore. He has expertise in operations, maintenance and projects. Mr Janakaraj was with ESSAR steel between from 1992 to 1995. He is the gold medalist from the Indian Institute of Metals in 2006 and 2008 for his contribution and leadership in the Indian non-ferrous sector. He is also distinguished and listed by the International Who's Who Professionals in 2009.

#### Dilip Golani

Director, Management Assurance Function

Management Assurance function in the Group is currently headed by Dilip Golani, a position he had earlier held during the period April 2000 to July 2004. Mr Golani headed Sales & Marketing for Hindustan Zinc Limited and the Group Performance Management function during the period August 2004 to November 2005. Prior to joining the Group in April 2000, Mr Golani worked with Unilever. He was a member of the Unilever Corporate Audit Team, responsible for auditing Unilever group companies in Central Asia, the Middle East and the Africa region. Mr Golani was initially responsible for managing Operations & Marketing functions for one of the exports businesses of Unilever India (Hindustan Unilever Limited). He has over 20 years' experience and has previously worked with Ranbaxy Laboratories Limited and Union Carbide India Limited. He is a Mechanical Engineering graduate and completed his postgraduate degree at NITIE, Mumbai in Industrial Engineering & Management.

A Thirunavukkarasu

President, Group Human Resources

Mr Thirunavukkarasu joined the Group in April 2004 as General Manager – HR. He became Senior Vice President – HR for **our (SM)** Copper Division, heading the human resources, total quality management, corporate social responsibility and public relation functions, prior to becoming the Head of Group Human Resources in July 2007. He held positions in English Electric, Hindustan Lever and TVS Electronics before joining **our (SM)** Group. He holds a bachelor degree in Literature and master's degree in Social Work, specialising in Personnel Management and Organisational Behaviour, from Loyola College, Chennai.

## Corporate Governance Report

### Highlights

- Review of corporate governance policies and procedures
- Debate on Board composition and diversity
- Roll out of anti-bribery programme

Dear **Shareholder (EM)**,

### **Our (SM)** Governance Philosophy

How **we (SM)** ensure **(booster)** the Board provides effective leadership is a combination of many factors. Good leadership stems from having the right people on the Board, with clear lines of responsibility, sound Board processes with access to comprehensive information on which to base decisions. **I (SM)** believe **(booster)** one of **our (SM)** strengths is the ability to have open and frank debate about the issues put to **us (SM)** and the challenges **we (SM)** face. **We (SM)** are proud **(AM)** of **our (SM)** experienced Board members and have the support of an **excellent (AM)** management team. However, **we (SM)** are not complacent and use the annual performance evaluation process and feedback from **stakeholders (EM)** to implement improvements to **our (SM)** way of operating.

### **Our (SM)** Governance Year

The focus by regulators, government and investors on governance issues and how companies and Boards conduct themselves rightly continued during the year. Several key developments in particular have received **our (SM)** attention. This was the first full year that the new UK Corporate Governance Code ('2010 Code') applied to Vedanta, the publication of the Davies Report (Women on Boards), the introduction of the UK Bribery Act and the continued spotlight on executive remuneration. How **we (SM)** addressed these issues is set out below. UK Corporate Governance Code Whilst **we (SM)** already complied with nearly all of the new 2010 Code's provisions **we (SM)** took the opportunity to review certain of **our (SM)** governance policies and practices to ensure they meet best practice standards.

### Davies Report

**We (SM)** continued **our (SM)** internal debate on Board composition set in the context of the aim to have female representation on **our (SM)** Board. Whilst **we (SM)** operate in traditionally male orientated industries and cultures, **we (SM)** have taken steps to encourage the recruitment and career progression of women professionals throughout **our (SM)** Group. As Chairman of the Nominations Committee, **I (SM)** personally conducted workshops covering different sections of the work force to ascertain and aid empowerment of women in **our (SM)** Group.

### Anti-bribery Programme

A comprehensive Anti-Bribery Programme was implemented across the Group. Going forward it will be the remit of the Audit Committee to ensure that **our (SM)** anti-bribery and corruption programmes are robust.

#### The Year Ahead

The Board has set the following objectives for the coming year:

##### >Strategy

Continue to develop and review Vedanta's strategic direction and make amendments as appropriate.

##### >Succession planning

**We (SM)** are aware of the tenure of **our (SM)** Non-Executive Directors, make-up of the Board and input from **shareholders (EM)** on Board composition. This is an issue that has been continuously debated and will be addressed during the year.

##### >Remuneration

As a result of the continued debate around executive remuneration there is **likely (hedge)** to be legislation governing how remuneration is set and approved. In any event **we (SM)** will seek to have best practice in terms of **our (SM)** remuneration policies and ensure remuneration is linked to strategy and Company performance.

##### >Risk

Further development of **the board's (SM)** view of risk tolerance and risk appetite.

##### >Branding

Review of Group-wide branding.

Lastly, **we (SM)** value contact and input from **our (SM) shareholders (EM)** throughout the year and also at **our (SM)** Annual General Meeting. Please **be assured (EM)** that **we (SM)** do take note of the issues raised which helps to inform future decisions.

Anil Agarwal

Chairman

16 May 2012

#### The UK Corporate Governance Code

As a company with a premium listing on the London Stock Exchange, Vedanta is subject to the UK Corporate Governance Code issued by the Financial Reporting Council in June 2010 (the '2010 Code'). The 2010 Code is available from the Financial Reporting Council's website, [www.frc.org.uk](http://www.frc.org.uk). The Code is centred around the themes of leadership, effectiveness, accountability, remuneration and relations with **shareholders (EM)**. This Corporate Governance Report provides details of **our (SM)** approach to governance, **our (SM)** policies, processes and structures and explains how **we (SM)** have complied with the main principles of the 2010 Code.

Disclosures on share capital and related matters as required by the Disclosure and Transparency Rules (DTR7.2.6) may be found in the Directors' Report.

#### Compliance With the 2010 Code

With the exception of the following matters, the Company has throughout the year ended 31 March 2012, fully complied with all of the provisions of the 2010 Code:

##### Code Provisions A.3.1

Anil Agarwal was appointed as Executive Chairman in 2005. Mr Agarwal was the founder of the businesses of Vedanta Resources and steered the phenomenal growth of the Group since its inception in 1976 including the flotation of Vedanta Resources plc on the London Stock Exchange and promotion to a FTSE 100 company. This meant that Mr Agarwal did not meet the strict independence criteria as defined in Code Provision B.1.1 on his appointment in 2005 because he was previously the Chief Executive and, through Volcan Investments Ltd ('Volcan'), members of his family have a controlling interest in the Company. Mr Agarwal is

pivotal in helping to achieve the strategic objectives of Vedanta through his skills in seeking out value creating acquisitions and projects. In addition, the fact that he dedicates himself full time to his role of Executive Chairman, enables him to balance executive duties with providing leadership to the Board. As its Chairman Mr Agarwal encourages debate and challenge and sets high ethical standards. For these reasons the Board is unanimously of the opinion that his continued involvement in an executive capacity is vitally **important (AM)** to the success of the Group.

#### Code Provision B.2.1

Under the Relationship Agreement put in place at the time of Listing, Volcan will be consulted on all appointments to the Board. The Nominations Committee therefore works collaboratively with Volcan when making appointments to the Board and, to this extent, differs from the process set out in Code Provision B.2.1 which stipulates that the Nominations Committee should lead the process for Board appointments.

#### How does the Board Provide Effective Leadership? (EM)

##### Members of **our (SM)** Board

The Board, chaired by Anil Agarwal, currently has six Directors comprising the Executive Chairman, two Executive Directors and three independent Non-Executive Directors. Membership of the Board as at the date of this report and attendance of the Directors at Board meetings for the year are shown below. Board composition is reviewed regularly by the Nominations Committee.

##### Board Culture

Board culture has been cited as having played an important part in corporate failures in recent years. Within Vedanta the cornerstone's of open debate, high ethical standards and professionalism **ensures (booster)** that the Group can grow and develop within an ethical and professional framework which balances risk and entrepreneurship.

**"We (SM) believe (booster)** that ethical and economic values are interdependent and that the business community **must (EM) always (booster)** strive to operate within accepted norms established by national and international authorities."

From Vedanta's Code of Business Conduct and Ethics

##### The Role of **our (SM)** Board

At the highest level the Board operates by setting strategy and objectives, reviewing progress against these objectives and incorporating feedback into its decision making processes.

It is the role of the Board to promote the success of the Company with a view to increasing its long-term value. As part of their decision making processes the Directors have a responsibility to consider the long-term consequences of their decisions, the interests of the Company's employees, the **need to (EM)** foster relationships with other **stakeholders (EM)**, the impact of the Company's operations and the environment and the **need to (EM)** maintain high standards of business. This is achieved by ensuring its governance processes, as described below, are comprehensive and robust.

##### What are **the board's (SM)** Responsibilities? (EM)

**The board's (SM)** responsibilities are set out in a formal schedule of matters reserved for its attention. This schedule of matters has been reviewed in light of the introduction of the 2010 Code to ensure new provisions, such as responsibility for risk appetite, were properly reflected. In summary the main areas of **the board's (SM)** remit covers:

- Setting of Group strategy and objectives;
- Setting of the Group's values and standards;
- Review of performance against strategy, objectives, business plans and budgets and agreeing corrective action where necessary;
- Approval of major business acquisitions and disposals;
- Approval of major capital projects;
- Review of nature and extent of risks;
- Ensuring maintenance of effective systems of internal control and risk;
- Review and approval of Group policies including those on health and safety and the Group's Code of Conduct;

- Approval of dividend policy

The Role of **our (SM)** Board Committees Certain of **the board's (SM)** responsibilities are delegated to Board Committees, which operate within defined terms of reference. The main Board Committees are the Executive, Remuneration, Audit, Nominations, and Sustainability Committees. The relationship between the Board, its Committees, Group subsidiaries and information flows are shown below.

#### **Our (SM) Governance Framework**

The relationship between the Board, Board Committees and subsidiary companies with their individual written responsibilities and the reporting structure as shown below forms the backbone of the governance framework.

All of the committees are authorised to obtain legal or other professional advice as necessary, to secure the attendance of external advisers at their meetings and to seek information from any employee of the Company in order to perform their duties. Under the terms of reference of the committees only the members of each committee have the right to attend committee meetings. However, other Directors or management together with other expert persons may attend meetings at the invitation of the Committee Chairman. The Secretary to the committees is Deepak Kumar, apart from the Sustainability Committee whose secretary is Tony Henshaw, Chief Sustainability Officer. The full terms of reference of the committees are available from the Company's website [www.vedantaresources.com](http://www.vedantaresources.com).

The Executive Committee is comprised of three Board members and 12 members of senior management whose biographies are given on pages 58 to 61. The Executive Committee is responsible for supervising all aspects of the operational performance of the Group. It implements strategic plans formulated by the Board, monitors operational and financial performance of the Group's subsidiaries, allocates resources in line with delegated authorities, develops and reviews the budgets of subsidiary companies. The Executive Committee therefore has a key role in putting **the board's (SM)** plans and policies into action. The Chief Executive Officer, MS Mehta, keeps the Board informed of the Executive Committee's activities through his standing reports made to the Board.

The Finance Standing Committee enables efficient consideration and approval of routine bank and financing issues and allotment of shares under the Group's Long- Term Incentive Plan. All minutes of the Finance Standing Committee are reviewed by the Board. The committee Chairman also reports to the Board on the outcome of Committee meetings at the next subsequent Board meeting. Details of the membership, terms of reference and attendance at meetings of the Audit, Remuneration, Nominations and Sustainability Committee are given in their respective reports on pages 75 to 91.

#### **What are the Roles of **our (SM)** Board Members? (EM)**

There is a clear division of responsibility between the functioning of the Board and executive responsibility for running the business. The Board has an established policy which sets out the key responsibilities of the Executive Chairman, Deputy Executive Chairman, Senior Independent Director and the Chief Executive Officer. These responsibilities were reviewed during the year to account of the new requirements of the 2010 Code and are summarised below.

##### **Executive Chairman's Role**

As Executive Chairman, Anil Agarwal devotes the majority of his time to the Company's business. The Chairman's other current responsibilities are set out in the biographies on page 58. There have been no changes to the Chairman's other commitments during the year:

- Leading the Board, ensuring its effective functioning and setting its agenda
- Upholding the highest standards of integrity and governance practices throughout the Group
- Facilitating constructive relationships between Directors
- Review of induction and training needs of the Directors
- Development of strategy and objectives for approval by the Board
- Seeking new business opportunities
- Ensuring communication and dialogue with **shareholders (EM)** and effective use of the AGM

##### **Chief Executive Officer's Role**

Mehandra Mehta is the Chief Executive Officer:

- Recommending to the Board annual budgets and delivery of the same
- Optimising the Group's assets and management and allocation of resources



- Creating and maintaining a sound control environment
- Implementation of strategy and Group policies and procedures
- Supporting the Executive Chairman in effective communication with various **stakeholders (EM)**
- Providing leadership to the senior management team and nurturing the talent pool
- Managing ESG issues in conjunction with the Sustainability Committee

#### Deputy Executive Chairman's Role

Navin Agarwal is the Deputy Executive Chairman:

- Chairman of the Executive Committee
- Supports the Chairman in leadership of the Board
- Delivery of Group's strategy in conjunction with the CEO
- Development of fund raising initiatives
- Global investor relations
- Oversees execution of Greenfield projects
- Overseeing development of top talent throughout the Group

#### The Senior Independent Directors' Role

Naresh Chandra is the Senior Independent Director. Given the executive nature of the Chairman's position the Senior Independent Director's position is key in achieving a balance between the executive and non-executive functions:

- To provide a channel of communication between the Chairman and Non-Executive Directors
- To ensure that views of Non-Executive Directors are given due consideration
- To provide a point of contact for **shareholders (EM)** who wish to raise concerns which the normal channels of communication through the Chairman and Chief Executive have failed to resolve
- To act as a sounding board for the Chairman
- To meet with the Non-Executive Directors at least once a year to appraise the Chairman's performance and on such other occasions as are deemed appropriate

#### The Role of the Non-Executive Directors

The Non-Executive Directors are of high calibre bringing a variety of rich experiences in different fields which range from holding senior positions within the Indian Government, (including roles with responsibilities for corporate governance), to banking and emerging market finance. This enables them to bring independent judgement on issues of strategy, performance and resources which are vital to the success of the Group. They play a key part in challenging the performance of management.

#### Board Balance and Independence

With the exception of the Chairman, who is presumed under the 2010 Code not to be independent, the Board considers all of the Non-Executive Directors to be independent. In making its assessment, the Board has considered the fact that Aman Mehta and Euan Macdonald previously held senior management positions within subsidiary companies of HSBC Holdings plc (which acted as the joint global co-ordinator and book runner when the Company listed in 2003). They retired from these roles in 2003 and 2002 respectively. The Board considered that neither Mr Mehta nor Mr Macdonald had any involvement with the Group prior to their appointment. The Board therefore remains of the view that they are independent.

The Nominations Committee considers the question of independence of the Non-Executive Directors prior to recommending their annual re-election and particular scrutiny is given to the performance of those Non- Executive Directors who have served on the Board for six years or more. In 2012 Naresh Chandra and Aman Mehta will have served on the Board for seven and eight years respectively. In addition both Directors serve on the Board of Cairn India as Non-Executive Directors. The Nominations Committee concluded that Messrs Chandra and A Mehta continue to be independent in nature. In reaching this decision the Nominations Committee considered all of the criteria set out in the 2010 Code in relation to determining independence and in addition that both Directors:

- Robustly challenge, express views and actively contribute to Board Meetings;
- Bring differing skill sets and experience to the Board make up;
- Absent themselves in the event that there are any conflicting issues arising from their Directorships with Cairn India

## Relationship Agreement

At the time of Listing, the Company and Volcan, the majority shareholder, entered into a relationship agreement to regulate the ongoing relationship between them. A new relationship agreement was entered into in December 2011 (the 'Relationship Agreement') the terms of which are the same as that entered into on Listing updated for legal and regulatory requirements where appropriate. The principal purpose of the Relationship Agreement is to ensure that the Group is able to carry on business independently of Volcan, the Agarwal family and their associates. Under the terms of the Relationship Agreement, the Board, and Nominations Committee will at all times consist of a majority of Directors who are independent of Volcan and the Agarwal family. Whilst the Remuneration and Audit Committees shall at all times comprise only of Non-Executive Directors, Volcan is entitled to nominate for appointment as Director such number of persons as is one less than the number of Directors who are independent of Volcan, the Agarwal family and their associates. The Board **considers (AM)** these to be adequate safeguards in that Directors who are independent of Volcan make up a majority of the Board and Vedanta's ability to operate independently of Volcan is protected by the Relationship Agreement. In addition, in accordance with Provisions B.1.2 of the 2010 Code, at least half of the Board, excluding the Chairman, comprise Non-Executive Directors determined by the Board to be independent.

The Audit Committee is responsible for reviewing matters arising in relation to the Relationship Agreement and related party transactions on behalf of the Board.

## Conflicts of Interest

The Board has established a procedure for the disclosure of interests and other related matters in line with published guidance and the Companies Act 2006. Each Director must disclose actual or potential conflicts to the Board and any changes are disclosed and noted at each Board meeting.

The Board will authorise potential or actual conflicts as appropriate. Directors with a conflict will not participate in the discussion or voting concerning the matter in question.

These procedures have **proved (booster)** to be effective during the year. Related party transactions, which include those in respect of any Director, are disclosed in Note 38 on pages 160 to 161.

## How **our (SM)** Board Operates

### Board Meetings

The Board meets on a regular basis and met formally on 10 occasions during the year. As well as formal meetings, written resolutions are passed with the approval of the whole Board on routine matters as required in order to facilitate efficient decision making processes. In addition ad hoc discussions take place between the Directors on a variety of topics throughout the year. The Chairman and the Non-Executive Directors met without the Executive Directors present during the year. The Chairman, assisted by the Company Secretary, is responsible for ensuring that the Directors receive accurate, timely and clear information on all relevant matters in order to take informed decisions and to discharge its duties. Directors are provided with regular detailed briefings on the Group's business, the markets within which it operates and the overall economic environment and updates on fiscal policy changes. The Board also routinely receives before each Board meeting detailed information on business and financial performance, ongoing projects, fund raising initiatives, activities of the Board Committees and investor relation updates. Presentations and verbal updates are also given at Board meetings by the Executive Directors and senior management as appropriate. Directors are encouraged to challenge and make further enquiries from the Executive Directors and senior management.

### What the Board Did During the Year

The main items of business considered by the Board during the year are summarised below:

### How are Appointments to the Board Made? **(EM)**

The Nominations Committee is responsible for succession planning and making recommendations concerning candidates for appointments to the Board. Under the terms of the Relationship Agreement entered into with Volcan as the major shareholder, Volcan will be consulted by the Nominations Committee on appointments to the Board.

The selection process will entail preparing a job description for the role, benchmarking and interviews with a selection of candidates. External search agencies will also be used where this is **felt (hedge)** to be appropriate and adds value to the process. It is part of the Nominations Committee remit to consider candidates from a wide range of backgrounds, based on objective criteria

and merit of the candidate. As part of this consideration the Nominations Committee will consider diversity, including gender, and the benefits this can have for a balanced decision making process. **Our (SM) Directors' Commitment**

In respect of the appointment of Non-Executive Directors to the Board, the candidates will be made aware of the time commitment **expected (AM)** of them which will be reflected in their letter of appointment. Candidates are also required to disclose their other time commitments to ensure that they have sufficient time to fulfil their role as a Director. The terms and conditions of appointment of the existing Non-Executive Directors sets out their duties and time commitments and are available on request from the Company's registered office.

There is a policy in place in respect of a full time Executive Director taking on a Non-Executive directorship in a listed company. The approval of the Chairman must be sought before an Executive Director may take on a Non-Executive directorship outside of the Group.

#### Development and Training of **our (SM) Directors**

**Appropriate (AM)** induction is provided to all Directors on appointment to the Board and programmes of continuing professional development are arranged as required, taking into consideration the individual qualifications and experience of the Director. In addition Directors have access to the Company's professional advisers whom they can consult where they find it necessary in order to better discharge their duties.

During the year, the Directors received legal and regulatory updates. In particular this year a full briefing was given on the new UK Corporate Governance Code and the UK Bribery Act. Directors undertake visits to operations and have discussions with management on an ongoing basis.

The Directors have access to the advice and services of the Company Secretary, who is responsible to the Board for ensuring that Board procedures are followed. The Company Secretary is also responsible for advising the Board through the Chairman on governance matters.

Under the Company's Articles of Association the appointment and removal of the Company Secretary is a matter for the Board as a whole.

#### How are the Board, its Committees and Individual Directors Evaluated? **(EM)**

During the year, the performance of the Board, its main committees and the individual Directors were formally and rigorously evaluated under the direction of the Chairman. The evaluation was carried out by circulation of a detailed questionnaire concerning the Board, its Committees and the individual Director's performance. The responses were collated and summarised. The Chairman spoke individually to all the Directors in respect of the results and the Board also collectively discussed the results. A summary of the areas reviewed and results of the evaluation are shown below.

Area Assessed	Main Comments	Action
<b>The Board</b> <ul style="list-style-type: none"> <li>○ Leadership</li> <li>○ Setting strategy</li> <li>○ Risk management</li> <li>○ Management of resources</li> <li>○ Reviewing performance</li> <li>○ Communication with <b>shareholders (EM)</b></li> <li>○ Board composition and structure</li> </ul>	<p>Strong entrepreneurial leadership with sound management of risk and human and financial resources. Board process and provision of information was <b>good (AM)</b></p> <p>The <b>need to (EM)</b> develop relationships with <b>stakeholders (EM)</b> was recognised. There was also awareness of <b>need to (EM)</b> review Board composition</p>	<p>Continue active engagement with <b>stakeholders (EM)</b> re social responsibility issues in particular</p> <p>Review recruitment possibilities in light of Board composition</p>
<b>Individual Directors</b> <ul style="list-style-type: none"> <li>○ Preparation</li> <li>○ Contribution</li> <li>○ Development of knowledge and skills</li> <li>○ Contribution to strategy and risk</li> <li>○ Relationships with Board</li> </ul>	<p>Directors were <b>well (AM)</b> prepared and contributed effectively to meetings. A variety of methods were used for training <b>Good (AM)</b> strategy and risk management discussions were held and Board relationships were very <b>good (AM)</b></p>	<p>Chairman to review training/development needs</p>

<ul style="list-style-type: none"> <li>members</li> <li>○ Training needs</li> </ul>		
Performance of Board Committees <ul style="list-style-type: none"> <li>○ Performance against the Committee's remit</li> </ul>	Performance of all the Committees remains effective with the Audit Committee in particular receiving <b>excellent (AM)</b> comments	Nomination Committee to focus on succession planning and nurturing top talent Sustainability Committee to engage and develop Group wide policy

As in previous years, the Non-Executive Directors, led by the Senior Independent Director, considered as part of the evaluation process, the performance of the Chairman and provided him with feedback.

#### Re-election of Directors

The Company's Articles of Association stipulate that all Directors must submit themselves for election at the annual general meeting following their appointment and thereafter by rotation at least once every three years. However, in accordance with the 2010 Code it is proposed that all Directors will stand annually for re-election beginning with the 2012 Annual General Meeting. Non-Executive Directors are only put forward for re-election if, following performance evaluation, the Board believes the Director's performance continues to be effective and demonstrates commitment to the role.

#### How do **we (SM)** ensure **(booster)** Accountability and Manage Risk? **(EM)**

The Board has a responsibility to ensure that financial information provided is accurate and balanced as well as ensuring that its activities are properly controlled and risk assessed and monitored. Vedanta has in place **well (AM)** established reporting and management assurance systems that ensure rigorous standards are maintained.

#### Financial and Business Reporting

The Group has a comprehensive financial reporting system, which is reviewed and modified in line with Accounting Standards. These procedures ensure that all published financial information is accurate. Vedanta's Financial reporting procedures are based on five main elements:

- Financial information supplied by subsidiary companies and consolidated at central level
  - Management accounts are prepared on a monthly basis and reviewed by the Executive Committee;
  - Management accounts are reviewed by the Board at least quarterly;
  - Performance is monitored against key performance indicators throughout the financial year and forecasts are updated as appropriate;
  - Annual operational budgets are prepared by each operating subsidiary and consolidated into a Group Budget which is reviewed and approved by the Board
- Internal audit provides assurance concerning processes and accuracy at each operating company
- External auditor assurance
  - Full year audits and half year review are carried out on the published financial statements
- Review by the Audit Committee of:
  - Year-end reporting plans
  - Briefings on legal, tax and accounting issues;
  - Consideration of the financial statements and disclosures in accordance with financial reporting standards;
  - Going concern statements with supporting cash flow, liquidity and funding forecasts.
- Review by the Audit Committee and the Board of the preliminary and half year announcements, the annual report and accounts and any other announcements including financial information.

The Directors' statement of responsibilities for preparing the accounts may be found on page 97 and the auditor's statement about their reporting responsibilities may be found on page 98. A statement on **the board's (SM)** position regarding the Group as a going concern is contained in the Directors' Report on page 95.

#### Risk Management and Internal Control

It is **the board's (SM)** responsibility to determine the nature and extent of the risks it is willing to take to achieve its strategic objectives. The Directors also have overall responsibility for ensuring that the Group maintains a robust system of internal control

to provide them with **reasonable (hedge)** assurance that all information within the business and for external publication is adequate. Because of the limitations inherent in any system of internal control, this system is designed to meet the Group's particular needs and the risks to which it is exposed rather than eliminate risk altogether.

Consequently it can only provide **reasonable (hedge)** and not absolute assurance against material misstatement or loss. There is an established process for identifying, evaluating and managing significant risks faced by the Group in accordance with the Turnbull Guidance on Internal Control published by the Financial Reporting Council. This includes financial, operational and compliance control and risk management, to ensure **shareholders (EM)**' interests and the Company's resources are safeguarded. The process also covers significant risks that may arise from environmental, social and governance matters. At the operational level specialists are brought in where appropriate to review working practices and recommendations are implemented with the purpose of creating safe working environments. The Board has approved the appointment of a Chief Risk Officer to further strengthen risk management processes. In line with best practice, the Board has reviewed the internal control system in place during the year and up to the date of the approval of this report. **The board's (SM)** review includes the Audit Committee's report on the risk matrix, significant risks and actions put in place to mitigate these risks. This review **ensures (booster)** that the internal control system remains effective. Where weaknesses are identified as a result of the review, new procedures are put in place to strengthen controls and these are in turn reviewed at regular intervals. Every risk has an owner who is responsible to ensure that controls are put in place in order to mitigate the risk. During the course of its review of the system of internal control, the Board has not identified nor been advised of any weaknesses or control failure that is significant. The Group's internal audit activity is managed through the Management Assurance Services ('MAS') function and is an **important (AM)** element of the overall process by which the Board obtains the assurance it requires to ensure that risks are properly identified, evaluated and managed. The scope of work, authority and resources of MAS are regularly reviewed by the Audit Committee and its work is supported by the services of leading international accountancy firms (but specifically excluding the Group's external auditors). The responsibilities of MAS include recommending improvements in the control environment and ensuring compliance with the Group's philosophy, policies and procedures. The planning of internal audit is approached from a risk perspective. In preparing an internal audit plan, reference is made to the Group's risk matrix, inputs are sought from senior management, project managers and Audit Committee members and reference is made to past audit experience, financial analysis and the current economic and business environment.

Each of the Group's principal subsidiaries has in place procedures to ensure that sufficient internal controls are maintained. These procedures include a monthly meeting of the relevant management committee and quarterly meeting of the audit committee of that subsidiary. Any adverse findings are reported to the Audit Committee. The Audit Committee Chairman on occasions requests MAS to look at specific items and in addition asks the external auditors to focus their audit work on a specific area to be reported to him.

The responsibilities, processes and information flows for ensuring that significant risks are recognised and reported up to Board level are shown below.

#### The Board

- Sets 'risk appetite'
- Reviews significant reported risks
- Reviews internal control and risk systems

#### The Audit Committee

- Reviews effectiveness of internal control/risk systems and reports to the Board
- Reviews risk matrix/significant risks/status of risks/ mitigating factors
- Considers/approves remedial actions where appropriate
- Reviews Action Plans put in place to mitigate risks
- Reviews significant findings reported by MAS
- Reviews internal audit plans
- Assesses effectiveness of internal audit
- Reviews whistleblower reports presented to MAS

#### Management Assurance Services (MAS – Internal Audit Function)

- Plans and carries out internal audits on a continuing basis
- Recommends improvements to the control system
- Reviews compliance with Group policies and procedures
- Prepares risk matrix and Group's significant risks for review
- Reports to the Audit Committee

- Reviews findings with senior management
- Investigates and takes action on whistleblower cases

The Head of MAS attends all Executive Committee and Audit Committee meetings of Vedanta. The MAS team plays a key role in SOX compliance at SIIL and its subsidiaries.

How do **we (SM)** ensure **(booster)** that the Board is Responsibly Rewarded? **(EM)**

Level and Make-up of Remuneration

The Board is sensitive to the **need to (EM)** achieve a balance between attracting and retaining the quality of directors required to run and manage a company of Vedanta's size and complexity and to avoid excessive pay awards. In the Remuneration Committee's terms of reference approved by the Board the Remuneration Committee is required to consider and give due regard to the recommendations of the 2010 Code and other guidelines published in respect of the remuneration of directors of listed companies such as that produced by the Association of British Insurers and National Association of Pension Funds.

A significant proportion of the Executive Directors' remuneration is performance related through the annual bonus and long-term incentive schemes. The fees of the Non-Executive Directors are independently reviewed and take into account the time commitments and responsibilities of the role. Additional fees are paid for acting as Chairman or being a member of one of the Board Committees.

The Remuneration Committee is responsible for setting the levels of remuneration for the Chairman and Executive Directors and also monitors the level and structure of remuneration for senior management. This is carried out with the assistance of the President – Group HR. The remuneration of the Non-Executive Directors is decided by the Board as a whole. No Director is involved in deciding his own remuneration. Further details of remuneration policy, Directors' remuneration, bonus, service contracts, shares interests and the activities of the Remuneration Committee are set out in the Remuneration Report on pages 83 to 91.

How do **we (SM)** Engage with **our (SM) Shareholders (EM)**? **(EM)**

Communication with **our (SM) shareholders (EM)** takes many forms and is a continuous process. **We (SM) welcomed (AM)** the introduction of the Stewardship Code in 2010 to encourage the debate between companies and their **shareholders (EM)** and **intend (hedge)** to do **our (SM)** part in engaging with **our (SM)** major **shareholders (EM)**. The main channels of communication with the investment community are through the Chairman, Deputy Chairman, Chief Executive Officer, Chief Financial Officer and Senior Vice President, Investor Relations. The Senior Independent Director and other Non-Executive Directors are also available as appropriate. The Directors as a whole keeps abreast of **shareholder (EM)** sentiment through regular detailed investor relations reports made to the Board.

Channels of Communication

Full year and half year results announcements

- Released to the market
- Chairman, CEO and Chief Financial Officer presentations to institutional **shareholders (EM)**, analysts and the media

Production update/interim management statements

- Released quarterly to the market followed by a conference call

Annual Report and Accounts

- Available to all **shareholders (EM)** electronically, including interactively on the Company's website or hard copy on request

Press releases

- Press releases are made to the market and media on key developments throughout the year

Meetings with institutional investors, analysts and brokers

- Part of the investor relations programme initiated either by the Company or analysts and investors and managed at Group level through Ashwin Bajaj (Senior Vice President, Investor Relations). Site visits are organised for Analysts and Brokers for them to understand operation

#### Website

- A wide range of information on the Company and its operations is available including the annual report and accounts, half yearly results, Sustainability Report, market announcements, press releases, share price and links to subsidiary company websites

#### Annual General Meeting

- Attended by all of the Directors and members of senior management.
- As well as the formal business **Shareholders (EM)** can ask questions and talk to the Directors after the meeting

#### Responses to **shareholder (EM)** and **stakeholder (EM)** communications

- There is ongoing dialogue with **shareholders (EM)** and other interested parties via email, letter and meetings particularly in relation to sustainability issues. The Chief Sustainability Officer meets with **shareholder (EM)** groups every quarter physically or via teleconferencing

The Board has adopted a communications policy to ensure that other price-sensitive information is announced to the market in a timely and considered manner.

With over 60% of shares being held by management or Directors the investor relations process focuses on institutional and retail categories.

#### Our **(SM)** Annual General Meeting

The Board uses the annual general meeting ('AGM') to communicate with **shareholders (EM)** and **welcomes (AM)** their participation and questions. This year's AGM will be held on 28 August 2012. Further details are given in the Notice of Meeting accompanying this Annual Report including the business to be considered at the meeting. The Notice is sent out at least 20 working days before the AGM. Voting at the AGM on all resolutions is by poll on a one share, one vote basis and the results of votes cast for, against and abstentions are available on the Group's website following the meeting. The Board **believes (booster)** that voting by poll allows the views of all **shareholders (EM)** to be taken into account regardless of whether or not they can attend the meeting and **shareholders (EM)** are actively encouraged to register their votes electronically in advance of the meeting All of the Directors, including the Chairmen of the Audit, Remuneration, Nominations and Sustainability Committees, attend the AGM in order to answer **shareholders (EM)** questions.

Last year's AGM was attended by institutional and retail **shareholders (EM)**. There was active and robust debate on a variety of topics including Company performance and sustainability issues. All of the resolutions were passed with an average vote in favour of 97%. The major geographical locations of **shareholders (EM)** are India and Europe. Therefore the use of channels of communication instantly accessible from anywhere in the world, such as the web, are key communication tools.

#### The Audit Committee Report

##### Highlights

- Embedding of acquisitions into control and risk management systems
- UK Bribery Act roll out of policies

**We (SM)** are aware of the increasing importance of the Audit Committee's role not just in reviewing financial performance but in ensuring robust risk management and control systems are in place to assist the Board assess the potential risks inherent in its strategic plans and objectives. Pivotal to this role is the operation of **our (SM)** Management Assurance Services function and the information they provide to the Audit Committee. Another key function of the Committee is to oversee the external audit and ensure that the external auditors' relationship with the Company remains independent and objective. Further details on the external auditors can be found in **our (SM)** report. In order to carry out **our (SM)** duties effectively **we (SM)** receive high quality and

detailed information from **our (SM)** finance function and internal and external auditors which is questioned, debated and challenged by members of the Audit Committee.

#### The Audit Committee's Year

The Audit Committee has had a busy year. In particular attention has been focused on acquisition activity such as Anglo Zinc assets and Cairn India to ensure they are embedded into the audit and risk assessment processes. In addition time has been spent on reviewing steps put into place in light of the UK Bribery Act. The Bribery Act programme included engaging professional assistance, amending existing policies, putting together a training pack, carrying out awareness sessions for employees and implementing new procedures such as a Suppliers' Code of Conduct. In addition an Ethics Committee consisting of the CEO's of all business units has been formed.

#### The Year Ahead

The Audit Committee's objectives for the forthcoming year include:

- Review of changes to risk profile and support the Board debate on risk tolerance and appetite;
- Review of Audit Committee membership;
- Continuing to ensure that Cairn India operations are embedded into the Group's financial reporting procedures and risk profile;
- Monitor progress on implementation of anti-bribery programme and roll out Code of Ethics;
- Discuss with management the need to carry out a review of the external auditor position in line with developing regulation.

A Mehta

Chairman, Audit Committee

#### How **our (SM)** Audit Committee Operates

The Committee meets at least three times a year based on **appropriate (AM)** times in the financial reporting calendar. The Chairman of the Company, Executive Directors, Chief Financial Officer, Head of Internal Audit and other members of the senior management team (as invited by the Committee) together with the external auditors, regularly attend meetings. The Committee meets at least twice during the year with representatives from the external auditors without management being present. Regular reports are made to the Board of the Committee's activities. The Committee's agenda is based on its remit outlined below as appropriate to the stage in the reporting cycle. All items put to the Audit Committee receive in depth review and questioning.

Performance Evaluation of the Audit Committee Annual performance evaluation is used to feedback any concerns or improvements to how the Committee operates. The evaluation is carried out by detailed questionnaire of all Board members. The Audit Committee's performance in particular received high scores for its work and was assessed as carrying out its role effectively. The Group's main subsidiaries, a number of which are listed on stock exchanges in India, have their own audit committees in accordance with local corporate governance requirements. By monitoring their discussions the Audit Committee gains further insights into the quality of financial reporting and internal controls throughout the Group. Furthermore the internal audit function presents issues arising from the subsidiaries to the Audit Committee on a regular basis. The external auditor partner, India, regularly attends both the subsidiary and Board Audit Committee meetings.

#### What are the Responsibilities of the Audit Committee? **(EM)**

The Audit Committee's remit falls into four main areas: financial reporting, risk and the internal control environment, and oversight of external and internal audit processes. The detailed responsibilities of the Audit Committee are set out in its terms of reference which are available from the Company Secretary.

The main responsibilities of the Audit Committee are to:

- Monitor the integrity of the financial statements, including its annual and half-year results;
- Review the Group's internal controls and risk management systems and consider the effectiveness of these systems;
- Make recommendations to the Board concerning the appointment of the external auditor;
- Review the independence of the external auditors;
- Develop policy in relation to the provision of non-audit services by the external auditor;
- Discuss with the external auditor the nature and scope of the audit;



- Approve the remuneration of the external auditor;
- Consider any matters arising in respect of the Relationship Agreement and related party transactions
- Monitor the activities and effectiveness of the internal audit function (MAS) and consider their reports;
- Review the Group's arrangements for its employees to raise concerns through its whistleblowing policy;
- Monitor anti-bribery policies and procedures; and
- Review reports from subsidiary company audit committees.

#### What the Audit Committee did During the Year

The main areas of activity of the Audit Committee during the year are summarised below.

Area of Responsibility	Topic
<b>Financial Reporting</b> It is one of the Committee's key duties to monitor the integrity of the financial statements. As part of this process it reviews in detail the preliminary results statements, the Annual Report and accounts and half year report. The appropriateness of accounting policies used is considered and external audit findings discussed. Details of financial reporting procedures in place are given on page 70 of the Corporate Governance Report.	<ul style="list-style-type: none"> <li>➤ Review and approval of Preliminary Announcement, Annual Report and financial statements</li> <li>➤ Year End review of significant issues – impairment review, acquisition of Anglo Zinc Assets and Cairn India accounting</li> <li>➤ Half year report planning and approval of half year report</li> <li>➤ Discussions on impairment reviews</li> <li>➤ Six monthly review of all pending tax issues</li> <li>➤ Review of Audit Committee Report for the Annual Report and Accounts</li> <li>➤ Six monthly review of legal cases to ensure appropriate provisions are made and disclosed</li> </ul>
<b>Internal Controls and Risk Management</b> Details of the Company's internal control and risk management processes are discussed on pages 71 to 72. The Audit Committee reviews these processes and output from the regular review of risks carried out during the year by internal audit.	<ul style="list-style-type: none"> <li>➤ Internal audit review, review of control framework, review of whistleblowing cases, formation of ethics committee, review of legal cases</li> <li>➤ Review of Subsidiary Audit Committee reports</li> <li>➤ Going concern review of working capital forecasts, monthly projections, funding requirements</li> <li>➤ Review of risk management programme, risk profile, significant risks, risk matrix and review of resulting action plans</li> <li>➤ Review of 2012–13 internal audit plan</li> <li>➤ Assessment of the performance of MAS (internal audit function)</li> <li>➤ Review of Foreign Exchange policy</li> </ul>
<b>The Audit and External Auditors</b>	<ul style="list-style-type: none"> <li>➤ Consideration of external Audit findings</li> <li>➤ Review of key audit issues</li> <li>➤ Review of materiality figure for the Audit</li> <li>➤ Review of independence of the external Auditor and provision of non-audit services</li> <li>➤ Performance review of the external Auditor</li> <li>➤ Consideration of Audit fee</li> <li>➤ Recommendation on reappointment of the external auditor</li> <li>➤ Review of Management Representation Letter</li> <li>➤ 2012 Audit Plan review</li> <li>➤ Cairn India Audit Plan review</li> </ul>
<b>Governance</b>	<ul style="list-style-type: none"> <li>➤ Briefing on UK Bribery Act, review of Anti Bribery Act programme</li> <li>➤ Review of Committee's Terms of Reference</li> </ul>

#### External Auditors

The Audit Committee is pivotal in monitoring the external audit and the relationship with the external auditor and further information on how this is achieved is set out below.

#### The Audit Plan

A detailed Audit Plan is prepared by the external Auditors, Deloitte LLP, ('Deloitte') which is reviewed by the Audit Committee in depth. The Audit Plan sets out the audit scope, key audit risks identified, materiality issues, the client team working on the audit

and the audit timetable. The audit scope covers the significant components of the audit and audit plans for each component and location. Each of the key audit risks is considered and the external auditors' response of how it will investigate these risks. This year a supplementary audit plan was prepared and reviewed for Cairn India as a recent acquisition.

#### Auditor Independence

One of the key tasks of the Audit Committee is to review the external auditor's independence and monitor their continued effectiveness. The Audit Committee and the Board place great emphasis on the objectivity of the external auditor. The current external auditor, Deloitte LLP, have been the Company's auditors since listing in 2003. The rotation of the audit partner's responsibilities within Deloitte is required by their profession's ethical standards and there is also rotation of key members within the audit team. Deloitte are required to rotate the audit partner responsible for the Group audit every five years and the last audit partner rotation was in 2010. The Audit Partner responsible for the audit of Indian subsidiaries is being rotated this year. To ensure effective communication of matters relating to the audit, the Audit Partner and senior manager are present at Audit Committee meetings. A key part of ensuring the independence of the external auditor is to have in place robust policies concerning matters that may affect their independence. The Company has in place policies on:

- The independence and objectivity of the external auditor
- Employment of former employees of the external auditor
- Use of the external auditors for non-audit services

These policies are based on the APB Ethical Standards for Auditors and are regularly reviewed to ensure they are in line with best practice. These controls provide the Audit Committee with confidence that the independence of Deloitte in their audit function will be maintained.

**Provision by the External Auditor of Non-audit Services** The policy specifies certain services which the external auditors are prohibited from undertaking in order to safeguard their independence, such as work relating to the financial statements that will ultimately be subject to final audit and the provision of internal audit services. The policy also identifies those services which the external auditor is permitted to deliver to the Group. These include tax advisory services, and work on mergers, acquisitions and disposals. Of the permitted services any assignment in excess of US\$100,000 may only be awarded to the external auditor with prior approval of the Audit Committee.

All other permitted non-audit services will be reviewed by the Audit Committee on a bi-annual basis. The Audit Committee receives a report every six months analysing the fees paid for non-audit work. This report includes safeguards put into place to ensure that any threats to the independence of the external auditor are mitigated. The majority of non-audit services provided by the external auditor are tax advisory services and corporate finance related work or transaction related work. A separate team within Deloitte LLP is used to carry out non-audit service work which is overseen by a separate partner. An analysis of non-audit fees can be found in Note 10 to the financial statements.

#### Performance and Reappointment

The overall performance and effectiveness of the auditor is reviewed annually taking into account the views of management. Feedback is provided on the evaluation to senior members of Deloitte who are unrelated to the audit. This activity also forms part of Deloitte's own system of quality control. The performance evaluation was carried out using a detailed questionnaire the results of which were considered by the Audit Committee. In addition this year the Audit Inspection Unit ('AIU'), part of the Financial Reporting Council, carried out a routine inspection of Vedanta's audit file. The AIU's findings are considered by the Audit Committee as part of the review of the external auditor.

Having reviewed the independence and effectiveness of Deloitte and being fully **satisfied (AM)** with the performance of Deloitte, the Audit Committee has recommended to the Board that the existing auditors, Deloitte, be reappointed as the Company's auditors and an ordinary resolution to reappoint Deloitte will be proposed at the forthcoming Annual General Meeting. There are no contractual obligations that restrict the Audit Committee's choice of auditor.

On behalf of the Board

A Mehta

Chairman, Audit Committee

16 May 2012

## Nominations Committee Report

### Highlights

- Extensive debate on Board composition
- Focus on encouraging diversity throughout the Group

The Nominations Committee's role within Vedanta is seen as increasingly **important (AM)**. In reviewing Board composition it **ensures (booster)** that the right mix of skills and independent thought is represented on the Board. It also has a key role to play in bringing on talent from within the organisation.

### The Nominations Committee's Year

The focus this year has been on issues of diversity, succession planning and Board composition due to the Committee's awareness of the tenure of its Non-Executive Directors and publication of the Davies Report concerning representation of women on Boards. Both the Committee and Board have discussed at length the need for refreshing of the Board. Plans are **well (AM)** in hand to bring a new Non- Executive Director onto the Board to address these issues.

### The Year Ahead

The Nominations Committee objectives for the coming year are:

- Finalise the review of Board and Committee membership;
- Continue diversity drive within the Group;
- Succession planning for senior management;
- Plans on how to nurture talent from within Vedanta.

A Agarwal

Chairman, Nominations Committee

### Membership, Meetings and Attendance

Membership of the Nominations Committee is in line with the requirements of the 2010 Code and is comprised of the following Directors:

### How **our (SM)** Nominations Committee Operates

The Committee meets at least two times a year. Other Executive Directors and members of the senior management team may attend meetings at the invitation of the Committee as appropriate. Reports are made to the Board of the Committee's activities. Performance Evaluation of the Nominations Committee Annual performance evaluation is used to assess how the Nominations Committee is performing and feedback any suggested improvements. The performance of the Nominations Committee was assessed during the year and was considered to be effective in all areas of its remit.

### What are the Responsibilities of the Nominations Committee? **(EM)**

The responsibilities of the Nominations Committee are set out in its terms of reference which are available from the Company Secretary. The main responsibilities of the Nominations Committee are to:

- Review the structure, size and composition of the Board (including the skills and experience required of its members) and make recommendations to the Board accordingly of adjustments that are deemed necessary;
- Establish a policy in respect of diversity on the Board and consider Board composition in light of the benefits of diversity, including gender;
- Consider candidates for appointment as either Executive or Non-Executive Directors and plan for succession in particular to the positions of the Board Chairman and Chief Executive;
- Before an appointment is made prepare a description of the role and capabilities required;
- In identifying suitable candidates consider the use of open advertising or external advisers to facilitate the search, consider candidates from a wide range of backgrounds;

- Ensure that Non-Executive Directors receive a letter of appointment setting out what is **expected (AM)** from them in terms of time commitment;
- Recommend to the Board whether to reappoint a Non-Executive Director either at the end of their term of office or when put forward for re-election, having regard to their performance and ability to continue to contribute to the Board. The Committee will confer with Volcan Investments Limited in this respect under the terms of the Relationship Agreement.

#### What the Nominations Committee Did During the Year

The main areas of activity of the Nominations Committee during the year are summarised below.

Area of Responsibility	Item
Board Composition and succession planning	<ul style="list-style-type: none"> <li>➤ Discussions of succession planning processes to ensure selection procedures incorporate Davies Report recommendations</li> <li>➤ Approval of Policy on diversity</li> </ul>
Performance of Directors	<ul style="list-style-type: none"> <li>➤ Consideration of performance of N Chandra and recommendation that he be reappointed as Non-Executive Director and Senior Independent Director for further one year term</li> <li>➤ Review of A Mehta and N Agarwal performance prior to recommendation to <b>shareholders (EM)</b> to re-elect to the Board</li> </ul>
Governance	<ul style="list-style-type: none"> <li>➤ Review and approval of new Terms of Reference</li> </ul>
Annual Report	<ul style="list-style-type: none"> <li>➤ Approval of Nominations Committee Report</li> </ul>

#### Diversity

**We (SM)** announced **our (SM)** aspirations for Board diversity during the year which is to have 25% of women on the Board by 2015. However, all appointments will continue to be made on merit. To achieve this target **we (SM)** will ensure that women candidates are considered routinely as part of the recruitment process. **We (SM)** will also monitor and encourage the progress of women in senior positions throughout the Group.

Vedanta operates within a traditionally male dominated industry. The current proportion of men to women within the Group is 92% men and 8% women whereas in the professional population the proportion is 88% men and 12% women. **We (SM)** are pleased to report that **we (SM)** do have a number of women in senior positions including in the areas of legal, Investor relation and Corporate Finance. **We (SM)** have also constantly improved the women professionals' intake from campuses from 10% to 20% thus ensuring improved talent pipeline for senior leadership roles in the future.

On behalf of the Board

A Agarwal

Chairman

16 May 2012

#### Sustainability Committee Report

"Sustainability is one of Vedanta Resources' five core values. It is built on Responsible Stewardship, **Stakeholder (EM)** Engagement and the Value Added to People. The Sustainability Committee is adding value to the Group by applying its collective mind to the development, implementation and assurance of Sustainability Management Systems across the businesses." Naresh Chandra  
Chairman, Sustainability Committee

#### Membership, Meetings and Attendance

Membership of the Sustainability Committee and attendance at meetings is shown below.

### The Sustainability Committee's Year 2011–12

The Sustainability Committee met on four occasions in the FY 2011–12 on the 12 July 2011, 3 October 2011, 18 October 2011 and the 3 February 2012.

The Sustainability Committee approved the Sustainability Model and Framework, 2010–11 Sustainable Development Report and specifically each of the following Policies: HSE amendment, Biodiversity, Water, Energy and Carbon, Supplier and Contractor Management, Social, Human Rights and HIV/Aids.

The Sustainability Committee reviewed the investigation report and recommendations for each fatality that occurred in the Group.

The Sustainability Committee oversaw the following programmes:

- Accident reduction and the prevention of harm to employees and contractors and reviewed the results
- Reduction in Water use
- Reduction in Energy and Carbon use
- Clean Development Mechanism programmes
- Implementation of the Scott Wilson Report recommendations including approval of the formal submissions to the lenders.
- Waste Management

The Sustainability Committee debated and opined on the following topics:

- Medium Term Sustainability Target
- The need for an ExCo Sustainability Sub-committee

### The Year Ahead

**We (SM) expect (hedge)** the Sustainability Committee to maintain its focus on the above topics and to approve the medium term Sustainability targets, and **Stakeholder (EM)** Engagement Plan. Further, **we (SM) expect (hedge)** to oversee human rights due diligence, while confirming **our (SM)** methodology for materiality, developing **our (SM)** sustainability risk profile and beginning a programme of supply chain audits.

Naresh Chandra

Chairman, Sustainability Committee

### Performance Evaluation of the Sustainability Committee

Annual performance evaluation is used to assess how the Sustainability Committee is performing and feedback any suggested improvements. The performance of the Sustainability Committee was assessed during the year and was considered to be effective in all areas of its remit.

### What are the Responsibilities of the Sustainability Committee? (EM)

The responsibilities of the Sustainability Committee are set out in its terms of reference which are available at [www.vedantaresources.com/sustainability/hse\\_policy.html](http://www.vedantaresources.com/sustainability/hse_policy.html)

The main responsibilities of the Sustainability Committee are:

- To recommend to the Board Group Sustainability policies, clearly setting out the commitments of the Group to manage matters of Sustainable Development effectively.
- To advise the Board to enable it to discharge its responsibilities, having regard to the law and the expected international standards of governance.
- To outline initiatives required to institutionalise a Sustainability culture through involvement of the employees at all levels.
- To review and report to the Board the performance of the Group and its Group companies with respect to the implementation of a Sustainability Management System.

### What the Sustainability Committee Did During the Year

The main areas of activity of the Sustainability Committee during the year are summarised below.

Area of Responsibility	Item
Health and Safety	<ul style="list-style-type: none"> <li>➤ Unsafe condition elimination programme</li> <li>➤ Review of accident root causes and action plans to eliminate fatalities and harm to employees and contractors</li> <li>➤ Behavioural safety for all line management.</li> <li>➤ Safety KPIs and medium-term targets</li> <li>➤ Review of the Vedanta near miss reporting system</li> <li>➤ Emergency planning</li> </ul>
Environment	<ul style="list-style-type: none"> <li>➤ Review of environmental incidents</li> <li>➤ Environment KPIs and medium-term targets</li> <li>➤ Review of waste utilisation plans and initiatives</li> <li>➤ Review of environmental footprints</li> <li>➤ Strategy for water management</li> <li>➤ Strategy for energy consumption and climate change</li> <li>➤ Clean development mechanism programmes</li> </ul>
System Development and Performance Reporting	<ul style="list-style-type: none"> <li>➤ Approval of Vedanta Sustainability Report 2010–11</li> <li>➤ Oversaw the implementation of the recommendations of the Scott Wilson Report</li> <li>➤ Approval of Scott Wilson update report to the lenders</li> <li>➤ Approval of Vedanta sustainability policies</li> </ul>

On behalf of the Board

Naresh Chandra

Chairman

16 May 2012

## Remuneration Report

Dear **Shareholder (EM)**,

**I (SM)** am pleased to present the Remuneration Report for the year to 31 March 2012. This report provides details of the Group's remuneration policy and the remuneration of the Executive and Non-Executive Directors for the year. This year has been challenging with continuing global economic uncertainty. In spite of the difficult operating environment, Vedanta has delivered enhanced performance in operational deliverables. **Our (SM)** achievements during the year include:

- **good (AM)** progress in organic growth,
- **successful (AM)** integration of zinc assets acquired from Anglo American,
- acquisition of mining assets in Liberia,
- completion of the Cairn India acquisition, and
- Increase in Reserve and Resource

The achievements of the business during the year are set out in the Business Review on pages 6 to 57 and principal risks facing the Company are set out on pages 26 to 31. The Remuneration Committee's Year During the year, the Remuneration Committee carried out a review of the performance related elements of Directors' pay (i.e. the Long-Term Incentive Plan and Annual Performance Bonus) with particular regard to the provisions within the 2010 UK Corporate Governance Code. The conclusion of this review was that the Remuneration Committee **believes (booster)** the performance related elements of remuneration are aligned to the business performance and long-term strategy of the Company, and that they are in line with the Company's risk policies.

## The Year Ahead

As a result of the continued debate around executive remuneration there is **likely (hedge)** to be legislation in the UK governing how remuneration is set and approved. **We (SM)** will seek to have best practice in terms of **our (SM)** remuneration policies and ensure

remuneration is linked to the Company's strategy and performance. A resolution to approve this report will be proposed at the Annual General Meeting to be held on 28 August and **I (SM)** hope that **you (EM)** will support this resolution.

Naresh Chandra

Chairman, Remuneration Committee

16 May 2012

#### Membership, Meetings and Attendance

The members of the Remuneration Committee who served during the year, all of whom are independent Non-Executive Directors, are shown below together with their attendance at Remuneration Committee meetings:

#### Overview

This Remuneration Report provides details of the operation of the Remuneration Committee and gives information about remuneration policies and practices adopted by the Company in respect of members of the Board. The report also reviews general remuneration policy in relation to senior management within the Group. It has been prepared in accordance with the Listing Rules of the UK Listing Authority, Schedule 8 of the Large and Medium Companies and Groups (Accounts and Reports) Regulations 2008 and the UK Code on Corporate Governance (the 'Code'). The Companies Act 2006 requires the auditors to report to the Company's members on certain parts of the Directors' Remuneration Report and to state whether in their opinion those parts of the report have been properly prepared in accordance with the Accounting Regulations. Those areas which are audited are indicated in the report.

#### What are the Responsibilities of the Remuneration Committee? (EM)

The Committee's responsibilities are set out in its terms of reference which are available from the company secretary. The Committee's Terms of Reference were reviewed and amended during the year. Amendments made included clarifying that the Committee is exclusively responsible for selection criteria and appointment of any remuneration consultants and that the Committee may commission any reports or surveys necessary for carrying out its work.

The Committee's responsibilities primarily include:

- the Company's overall policy on executive and senior management remuneration;
- determining the remuneration packages for individual Executive Directors, including basic salary, performance-based short- and long-term incentives, pensions and other benefits;
- the design and operation of the Company's share incentive schemes; and
- reviewing and determining the terms of the service agreements of the Executive Directors.

The Committee gives full consideration to the Code and published guidelines regarding the remuneration of directors of listed companies including those published by the Association of British Insurers and National Association of Pensions Funds. The Committee is **committed (AM)** to ensuring that remuneration policy reflects, to the extent practicable, global corporate governance guidance on executive remuneration.

#### Advisers to the Committee

The Committee engages independent consultants for advice on specific aspects of directors' remuneration, as appropriate. Given the India-focused approach as most of **our (SM)** operations are based in India, it has not been **felt (hedge)** necessary to appoint permanent independent remuneration consultants to advise the Committee except for need based advice. Those who advised the Committee during the year and their roles are set out below.

Mr A Thirunavukkarasu

(President – Group HR)

- Inputs on general policies and practices followed in India and global market
- Inputs into discussions concerning the Executive Directors remuneration and benefits
- Remuneration policy applicable to employees at large

#### Executive Directors

- Provide inputs on remuneration packages for senior executives to ensure parity amongst senior executives in different businesses but at similar roles
- Other Directors may attend meetings at the invitation of the Chairman but no Director is present during discussions of their own remuneration

#### New Bridge Street ('NBS') (Brand of Aon Hewitt Limited, an Aon Company)

- Ad hoc advice on particular aspects of Directors' remuneration
- NBS subscribe to the Remuneration Consultants Group's Code of Conduct. Neither NBS nor any part of Aon Hewitt Corporation provided other services to the Company during the year

#### Ernst & Young LLP

- Review and confirmation of the Company's TSR performance in respect of the Long-Term Incentive Plan
- Ernst & Young LLP provide some tax and internal audit services to the Group

#### Remuneration Policy for Executive Directors

The key objective of the Group's broad remuneration policy is to enable a framework that allows for competitive and fair rewards for the achievement of key deliverables and also aligns with practice in the industry and **shareholders (EM)**' expectations.

When setting remuneration for the Executive Directors' the Committee takes into account the market sector, business performance and the practices in other comparable companies. Since Vedanta Resources plc operates in global and local markets with the majority of operations in India, additional data is obtained from high-performing companies that are comparable in terms of revenue, market capitalisation, diversity and growth.

A summary of current remuneration arrangements for the Executive Directors is set out below:

Area of Responsibility	Item	Description	Policy
Base Salary	<ul style="list-style-type: none"> <li>➤ Reflects individual's experience and role within the Group</li> <li>➤ Reward for performance of day-to-day activities</li> </ul>	<ul style="list-style-type: none"> <li>➤ Fixed element of the remuneration package</li> <li>➤ Paid in cash on a monthly basis</li> </ul>	<ul style="list-style-type: none"> <li>➤ <b>Typically (hedge)</b> positioned at the median of the identified comparator</li> </ul>
Group Short-term Incentive	<ul style="list-style-type: none"> <li>➤ Incentivise executives to achieve specific, predetermined goals during the financial year</li> </ul>	<ul style="list-style-type: none"> <li>➤ Variable component of remuneration</li> <li>➤ Paid annually in cash</li> </ul>	<ul style="list-style-type: none"> <li>➤ Determined by the Committee after year-end, based on performance against the pre-determined financial and non-financial metrics</li> </ul>
Long-Term Incentive Plan	<ul style="list-style-type: none"> <li>➤ Drive and reward delivery of sustained long-term total <b>shareholder (EM)</b> return ('TSR') performance aligned to the interests of <b>shareholders (EM)</b></li> </ul>	<ul style="list-style-type: none"> <li>➤ Variable long-term remuneration element</li> <li>➤ Performance measured over three years and paid in shares</li> </ul>	<ul style="list-style-type: none"> <li>➤ Awards of conditional shares made periodically with vesting levels dependent on relative TSR performance at the end of the 36-month performance period</li> </ul>



Post employment benefits	➤ Provide for sustained contribution	➤ Accrues depending on length of service	➤ In line with statutory requirements
Benefits in kind	➤ To provide market competitive benefits	➤ Non-monetary in nature	➤ In line with local market practices

#### Remuneration Policy for the Senior Management Group

A geography wise approach is followed across the Group in determining the remuneration of key operational and financial heads within the Group (the 'Senior Management Group'). Both variable and fixed components of the remuneration packages for the Senior Management Group are therefore set by reference to local market practice in India and other geographies and in alignment with the Group's strategy. The remuneration packages of the Senior Management Group comprise:

- A salary for day-to-day performance of duties. This year the average salary increase for members of the Senior Management Group was 23%
- A performance bonus as an incentive to meet yearly targets – these are set by reference to individual key result areas ('KRAs'), personal qualities and the financial performance of the Company
- Awards under the long-term incentive plan ('LTIP', referred to below) to incentivise long-term and strategic performance
- Relevant pension provision and benefits in kind in accordance with local market practices
- Special monetary rewards for the successful integration of M&A activities (applies to certain roles only)

#### Remuneration Mix

The total remuneration package is designed to provide an **appropriate (AM)** balance between fixed and variable components with focus on long-term variable pay so that strong performance is incentivised but without encouraging excessive risk taking.

The chart below **demonstrates (booster)** the balance of fixed and variable pay in these circumstances for the executive Directors assuming: (i) maximum bonuses were paid and full vesting of LTIP awards ('Stretch Performance'); and (ii) actual bonus pay outs as earned in 2012 and median vesting of LTIP awards ('Target Performance').

#### Base Salary

The Executive Directors are based in India (with the exception of Mr Anil Agarwal, who is UK-based), along with the majority of the Group's professional management. Consequently their remuneration is set by reference to the prevailing rates within that market. In addition, salaries for Executive Directors and members of the Senior Management Group are set by reference to those positions of comparable status, skill and responsibility in the metals and mining industries, and in the manufacturing and engineering industries more generally.

The basic remuneration of executives in India is referred to as 'cost to company' ('CTC') which represents an aggregate figure encompassing basic salary and allowances such as housing and other benefits.

The Chairman, Mr Anil Agarwal, has a service agreement with Vedanta Resources plc. His salary is approved by the Board (without the Chairman present) on the recommendation of the Remuneration Committee.

Mr Navin Agarwal and Mr MS Mehta have service agreements with Sterlite Industries (**India**) (**CG**) Ltd ('Sterlite') which have been augmented by letters of appointment to the Board of the Company. Mr Navin Agarwal and Mr MS Mehta receive a salary under their Sterlite contract and an annual fee paid to them from the Company to reflect the amount of time they spend on Board business. Details of their salary and fees are shown below. Salaries are reviewed on an annual basis and changes are implemented with effect from 1 April each year taking into account the period of service during the year. The review in relation to the salaries to be paid to the Executive Directors for 2012 considered a broad range of comparative information and Annual Salary Survey Reports of country of operation.

Details of salary levels for the Executive Directors for 2012 are set out below:

The above salaries were set taking into account the Executive Directors' relative positioning against a peer group of UK Listed Mining comparator companies (excluding the largest global stocks which are **felt (hedge)** to be too large for pay comparison). The Committee **believes (booster)** this is the most relevant group for benchmarking the main Board executives. In particular it was noted that the competitiveness of the Deputy Chairman and Chief Executive's salaries was heavily impacted by the relative weakening of the Indian rupee during the financial year.

#### Annual Performance Bonus

The Company operates a performance bonus scheme providing the Executive Directors and the Senior Management Group with an opportunity to earn a cash amount based on the achievement of stretching performance targets. The bonus is non-pensionable. In determining the actual bonus payments, the Committee takes into consideration such factors as performance related to the Group's financial KPIs, operational performance against budget, safety performance, and performance against industry peers in local as well as global markets. In addition, the Committee **believes (booster)** that the bonus arrangements **should (EM)** neither encourage nor reward inappropriate risk-taking. Specific targets are not disclosed as they **would (hedge)** give a clear indication of the Group's business targets which are commercially sensitive. For the year ended 31 March 2012, the payment of the annual bonus was dependent on business operational performance and projects, including greenfield and expansion projects. In addition it was also linked to strategic initiatives in mergers and acquisitions and effective **stakeholder (EM)** management which resulted in recognition and achievement of awards in CSR, safety, quality, business excellence and best employer status.

The overall level of performance, as elaborated below, resulted in annual bonus awards in the range of 37% to 40% of base salary. The actual bonus payments received by them are shown in the table on page 91. Key highlights of performance which led to this bonus assessment are set out below.

#### Operational Performance

- Refined Zinc production was a record 759,000 tonnes, 7% higher than corresponding prior period.
- Mined zinc-lead production was marginally lower at 830,000 tonnes.
- Full year silver production was at a record 35% higher at 7.78 million ounces.
- Iron ore production for the full year was lower at 13.8 million tonnes owing to Karnataka mining ban and discontinuation of Orissa operations.
- Total copper cathode production in India was 326,000 tonnes, 7% higher than the corresponding period. In Zambia it was 8% lower at 200,000 tonnes and the mined metal production at Australia was 23,000 tonnes in line with the prior period.
- The Jharsuguda-I Aluminium smelter has stabilised with most of the key parameters, including power consumption, at normal operating levels. The BALCO-II smelter operated at its rated capacity for the full year.
- The 1mtpa Lanjigarh Alumina refinery has been operating near its rated capacity, and its Alumina production was 31% higher at 928,000 tonnes for the full year.
- The first metal tapping from the 325ktpa BALCO-III Aluminium smelter is **expected (hedge)** by Q3 FY 2012-13. The first 300MW unit of the 1,200MW captive power plant at BALCO will be synchronised in the current quarter.
- Power sales were 6,544 million units during full year, as compared with 1,879 million units during the corresponding prior period, as the three new 600MW units of the Jharsuguda 2,400MW power plant come into operation. During the last quarter, Unit-3 started commercial production and Unit-4 was synchronised.
- Work at the 1,980MW power project at Talwandi Sabo is progressing **well (AM)** and the first 660MW unit is on track for synchronization in Q4 FY 2012-13. The 150MW wind power expansion at HZL was completed during the quarter, taking **our (SM)** wind power generation capacity to **around (hedge)** 274MW.
- Significant early progress made on the integration of Cairn India following its acquisition in December 2011. For example, the gross Oil production from operating units was 160,635bopd during the full year, as compared with 135,811bopd during the corresponding prior period. This was higher due to the ramp-up of Rajasthan operations during the year, including commencement of oil production at Bhagyam, the second largest field in the Rajasthan block.

#### Long-Term Incentive Plan ('LTIP')

The Company operates a Long-Term Incentive Plan for Executive Directors, senior management and select wider management team. Under the LTIP, awards of nominal-cost options may be granted in line with **the board's (SM)** objective of incentivising and developing the potential within the wider management group. Each year the aim has been to broaden the constituency of employees eligible to participate in the LTIP so as to encourage equity ownership amongst employees.

It is the Committee's intention that the LTIP will continue to be operated for these purposes and in the way described below during the forthcoming year.

#### LTIP Performance Measures

The vesting of LTIP awards is subject to measurement of the Company's performance in terms of Total **Shareholder (EM)** Return ('TSR'), being the movement in the Company's share price (plus reinvested dividends), compared over a three-year period from the date of grant with the performance of a specific list of companies, selected as being the Group's main peers and competitors. This performance condition was selected as it provides a strong alignment between the interests of **shareholders (EM)** and the wider management team. The full list of companies against whose performance Vedanta's TSR is measured is as follows (the 'Comparator Group'):

1. Anglo American
2. BHP Billiton
3. Rio Tinto
4. Xstrata
5. Vale
6. Antofagasta
7. Grupo Mexico
8. Hindalco
9. Alcoa
10. Teck

There have been no changes to the Comparator Group during the year.

The extent to which an award vests will depend on the Company's TSR ranking against the Comparator Group at the end of the three-year performance period.

The vesting schedule is shown in the table below, with straight-line vesting in between the points shown rounded down to the nearest whole share.

The information to enable this calculation to be carried out on behalf of the Committee is provided by Ernst & Young LLP. As the majority of the Group's employees are domiciled in India and Africa, the Remuneration Committee has to be cognisant of relevant local market practice in order to be sure of retaining high calibre employees in that market. The most common form of long-term incentive in India is an executive share option scheme in which a certain percentage of options vest every year, and with options vesting fully (100%) over three to four years (**often (hedge)** not subject to any performance conditions). However, no awards vest under the Vedanta LTIP before three years. In addition, LTIP awards vest subject to the relative TSR performance condition described above. Considering the multiplicity of factors (including vesting term duration, the use of a pre-vest condition that measures performance relative to peer group companies and the **relatively (hedge)** modest maximum award level under the LTIP compared to other companies of a similar size) that determine benefits under the LTIP, the Remuneration Committee **believes (booster)** that 40% vesting for median performance is warranted, and the minimum required to maintain the LTIP's role as a strong motivational and retention tool for the high calibre management team. However, the Committee continues to monitor the appropriateness of this approach and **may (hedge)**, for the benefit of the LTIP awardees at large (excluding EDs), improve the vesting proportion considering the average TSR performance over the 36-month performance period.

#### Operation of the LTIP

The maximum value of awards that can be conditionally awarded to an Executive Director in a year is 100% of the aggregate of annual salary and CTC fees. Details of the awards held by the Executive Directors as at 31 March 2012 are shown in the table of Directors' Long-term Incentive Awards on page 91. LTIP awards are also made to the Senior Management Group and select employees across the Group. The maximum value of awards that can be awarded to the employees is calculated by reference to the average 'CTC' of each grade and individual performance level. Nominations for awards under the LTIP are made by the chief executive Officers of each operating company and heads of large independent projects based on guidelines issued by the Group. Individuals are assessed and categorised by reference to the importance of their roles to the relevant business unit, past performance and future potential.

#### Grant of LTIP awards

During the year, it was highlighted that the Group's employees in India were working in an increasingly competitive market with talented management remaining scarce. As a result, the Remuneration Committee resolved to award a total of 2,862,100 LTIP options to **approximately (hedge)** 2,684 employees effective 1 August 2011. The awards ranged from 70% to 165% of annual 'CTC'. In addition, select employees who had joined during the year were also awarded LTIP options in line with terms and conditions of appointment.

Post acquisition of Zinc assets of Anglo Zinc, employees of the erstwhile Anglo Zinc were also covered under Vedanta LTIP scheme in lieu of the performance-based reward scheme of Anglo Zinc effective 1 April 2012 as a good corporate governance practice.

#### Equity Dilution Resulting from Employee Share Schemes

The dilution limits set out in the rules of the Employee Share Schemes established in December 2003 (including the LTIP) allow up to an aggregate of 10% of the Company's issued share capital to be issued or issuable pursuant to awards under any of the Company's employee share schemes over a period of 10 years. Up to 5% of the Company's issued share capital may be used for the Company's discretionary schemes (such as the LTIP) over a 10-year period. Shares issued or issuable pursuant to awards made under the Vedanta Resources Share Reward Plan (the 'Reward Plan') are not counted for these purposes. The Reward Plan was used solely to reward employees who contributed to the Company's development up to the listing in 2003. No further awards have been made under this Plan. Currently 1.55% (2011: 0.75%) of the Company's issued share capital is issuable in respect of outstanding awards under the LTIP.

#### Total Shareholder (EM) Return Performance Graph

The graph below shows the TSR performance of the Company in comparison with that of the FTSE All Share Mining Index for the period from 31 March 2007 to 31 March 2012. The FTSE All Share Mining Index was chosen as it is the most relevant to compare the Company's performance against its peers.

#### Executive Directors' Service Contracts

Mr Anil Agarwal is employed under a contract of employment with the Company for a rolling term but which may be terminated by not less than six months' notice. Provision is made in Mr Agarwal's contract for payment to be made in lieu of notice on termination which is equal to basic salary and costs to the Company for providing certain benefits during the notice period or part thereof.

Mr Navin Agarwal has a letter of appointment with Vedanta which is a rolling contract and may be terminated by giving six months' notice. Mr Navin Agarwal has a service agreement with Sterlite which expires on 31 July 2013, with a notice period of three months or salary in lieu thereof. Mr Mahendra Singh Mehta has a letter of appointment with Vedanta and a service contract with Sterlite which expires on 31 December 2013, with a notice period of three months or salary in lieu thereof.

It is the Group's policy that no Directors' service contract **should (EM)** be terminable on more than 12 months' notice. Copies of all Executive Directors' service contracts and the letters of appointment of the Non-Executive Directors are available for inspection during normal business hours at the registered office of the Company.

#### External Appointments

**The board's (SM)** policy on external appointments is that an Executive Director may, only with the prior approval of the Board, accept an appointment external to the Group (other than any appointment to related parties or Volcan Investments Limited ('Volcan')) in the case of Messrs Anil Agarwal and Navin Agarwal as a Non-Executive Director of a publicly listed company anywhere and that the fees for any such appointment may be retained by the individual. Currently, none of the Executive Directors holds any such outside appointments.

#### Non-Executive Directors

##### Non-Executive Directors' Fees

The Board is responsible for setting policy in relation to the Non-Executive Directors' fees and reviews them periodically. General policy is to provide fees in line with market practice for similar Non-Executive Director roles in international mining groups. Fees paid to the Non-Executive Directors also take account of the Group's complexity, the significant travel and time commitments required for attending Board and other meetings in India and the UK and the risk profile of the Company. The last review was carried out in 2010 at which time it was agreed that the fees would be frozen for a period of three years. Mr Aman Mehta and Mr Naresh Chandra are also paid a salary of US\$125,000 each from a subsidiary of Cairn India Limited and a sitting fee of INR2,40,000 each from Cairn India Limited.

Non-Executive Directors' fees payable for chairing or being a member of a Board committee are as follows:

#### Non-Executive Directors' Letters of Appointment

The Non-Executive Directors have letters of appointment which may be terminated by either party by giving three months' notice. The Non-Executive Directors' letters of appointment set out the time requirements **expected (AM)** of them in the performance of their duties. Non-Executive Directors are normally **expected (AM)** to spend at least 20 days per year on Company business. There is no provision in the letters of appointment of the Non-Executive Directors for compensation to be paid in the event of early termination. Details of the Non-Executive Directors' Letters of Appointment are shown below.

#### Information on Director's shareholdings

##### Shareholding Guidelines

There are at present no formal shareholding guidelines for the Executive Directors. The Remuneration Committee **believes (booster)** formal guidelines are not necessary at this time due to the existing holdings held by the Executive Directors and participation in the LTIP which encourages share ownership. Shareholding guidelines may be introduced at a future date if this is felt to be appropriate.

##### Directors' Interests in Ordinary Shares

The interests of the Directors (which are beneficial unless otherwise stated) in ordinary shares at 31 March 2012 were:

There have been no changes in the beneficial shareholdings of the Directors between the end of the financial year and the 15 May 2012.

#### (Audited Information)

##### Directors' Remuneration for the Year Ended 31 March 2012

The following table sets out an analysis of the pre-tax remuneration for the year ended 31 March 2012 for individual Directors who held office in the Company during this period. All amounts are in UK pounds sterling although payments in India under service contracts with Sterlite are paid in Indian rupees.

The mid-market price of the shares at 31 March 2012 was 1,228 pence and from 1 April 2011 to 31 March 2012, the share price varied between 895.78 pence and 2,600.00 pence

This Remuneration Report was approved by the Board on 16 May 2012 and signed on behalf of the **Board of directors (SM)** by:

Naresh Chandra

Chairman of the Remuneration Committee

16 May 2012

#### The Directors' Report

##### Purpose of the Directors' Report

The Directors are pleased to present their Annual Report on the business of the Group, together with the financial statements and auditors' report, for the year ended 31 March 2012. The purpose of the Directors' Report is to provide **shareholders (EM)** with certain statutory information about the Company, its Directors and operations. The Business Review, which forms part of the Directors' Report, informs **shareholders (EM)** and helps them assess how the Directors have performed their duty to promote the

success of the Company. In addition, as a company listed on the London Stock Exchange, it is required to provide information which includes amongst other things, details of the Company's share capital, voting rights, rules on directors' appointments and significant agreements that alter on change of control.

#### Principal Activities

Vedanta Resources plc is the UK parent company of a diversified metals and mining group. The Group's principal operations are in India, Zambia, Australia, Namibia, South Africa, Liberia and Ireland. The major metals produced are aluminium, copper, zinc, lead, silver and iron ore. The Group is also developing a commercial power generation business. The Group recently entered into the oil and gas sector after completing an acquisition of a controlling stake in Cairn India Limited. Analysis of revenue, operating profit, principal activities and geographical origins appears in Note 3 of the financial statements and a list of the principal subsidiaries and of the Group may be found in Note 41 to the financial statements.

#### Business Review

The Business Review has been prepared in accordance with the Companies Act 2006 which requires the Company to set out a fair review of the business of the Group during the financial year, including an analysis of the position of the Group at the end of the financial year and the trends and factors **likely (hedge)** to affect the future development, performance and position of the business. The Business Review is comprised of the Overview, Strategy and Performance sections within this annual report on pages 2 to 38.

Specifically, the information that fulfils the requirements of the Business Review, including principal risks and uncertainties and key performance indicators, can be found within the following sections, which are incorporated in this report by reference:

Information	Location in the Annual Report	Page
Key Performance Indicators	Strategy section	24
Description of the principal risks and uncertainties facing the Group	Strategy section	26
Strategy	Chairman's Statement and Strategy section	7 & 14
Future developments	Market Overview	10
Review of operations	Operational Review	38
Financial Review	Financial Review	32
Environmental matters	Contained within separate Sustainable Development Report	
Health and safety matters	Contained within separate Sustainable Development Report	
Community issues	Contained within separate Sustainable Development Report	

The Business Review and other sections of this annual report contain forward looking statements. By their nature, forward looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future and may be beyond the Company's ability to control or predict.

Forward looking statements and past performance are therefore not guarantees of future performance. The information contained in the Business Review has been prepared on the basis of information and knowledge available to Directors at the date of preparation and the Company does not undertake to update or revise the content during the year ahead.

#### Corporate Governance

In accordance with the Financial Services Authority's Disclosure and Transparency Rules ("DTR") 7.2.1 the disclosures required by DTR7.2.2R to DTR7.2.5 and DTR7.2.7 may be found in the Corporate Governance Report on pages 62 to 68. Information referred to in DTR7.2.6 is located in this Directors' Report.

#### Important (AM) Events Subsequent to the Year End

Events since the balance sheet date are summarised in Note 40 on page 162 of the financial statements.

#### Dividends

The Directors recommend a final dividend for the year ended 31 March 2012 of 35.0 US cents per ordinary share (2011: 32.5 US cents per ordinary share). Subject to **shareholders (EM)** approving this recommendation at the Annual General Meeting on 28 August 2012, the final dividend will be paid on 5 September 2012 to **shareholders (EM)** on the register of members as at 17 August 2012.

Taken together with the interim dividend of 20.0 US cents per ordinary share paid to **shareholders (EM)** on 15 December 2011, the total dividend for the year is 55.0 US cents per ordinary share (2011: 52.5 US cents per ordinary share).

## Directors

The names, specific responsibilities and biographical details of the current **Board of directors (SM)** are shown on pages 58 to 59 and details of the Directors who held office during the year ended 31 March 2012 are shown in the Corporate Governance Report on page 64. Details of the remuneration of the Directors, their interests in the shares of the Company and service contracts are contained in the Remuneration Report on pages 83 to 91.

## Appointment and Replacement of Directors

The Company's Articles of Association specify that the minimum number of Directors of the Company, unless determined by ordinary resolution, shall be two. There is no limit on the maximum number of Directors. The Company or the Board may appoint any person to be a Director. Any Director appointed by the Board shall hold office only until the next general meeting and is then eligible for election by the **shareholders (EM)**. The Articles specify that at least one-third of the Directors, or if their number is not three or multiple of three, the number nearest to one-third, shall retire from office. The Directors to retire by rotation are those who have been longest in office since appointment or reappointment. However, in accordance with the requirements of the UK Corporate Governance Code all of the Directors will retire at the forthcoming Annual General Meeting and being eligible will offer themselves for re-election.

## Powers of the Directors

Subject to the provisions of the Companies Acts and the Articles of Association and to any directions given by special resolution, the business of the Company is to be managed by the Board which may exercise all the powers of the Company.

## Directors' and Officers' Liability Insurance and indemnities

The Company purchases and maintains liability insurance for its Directors and Officers and those of the subsidiaries of the Group, as permitted by the Companies Act 2006. The insurance policy does not provide cover where the Director has acted fraudulently or dishonestly. The Company **believes (booster)** that it is **appropriate (AM)** to provide such cover to protect Directors from innocent error as the Directors carry significant liability under criminal and civil law and under the UK Listing, Prospectus and Disclosure and Transparency Rules, and face a range of penalties.

In addition the Articles of Association of the Company contain an indemnity provision in favour of the Directors of the Company against proceedings brought by third parties, subject to the Companies Act 2006, to allow the Company to pay defence costs for the Director where the Director is exonerated.

## Employees

Information on the Group's employees and its policies with respect to employees can be found in the Sustainable Development Report.

## Charitable Donations

During the year, the Group made charitable donations of a total of US\$3.12 million (2011: US\$3.03 million). US\$2.31 million was paid to the Vedanta Foundation (2011: US\$1.68 million) and other charitable donations of US\$0.81 million (2011: US\$1.35 million) were made. Further details about the Group's involvement with local communities during the year can be found in the Sustainable Development Report.

## Political Donations

It is **the board's (SM)** policy that neither Vedanta nor any of its subsidiary companies may, under any circumstances, make donations or contributions to political organisations within the United Kingdom or European Union. In exceptional circumstances, where such political donations or contributions are to be paid in the United Kingdom and European Union, and if deemed necessary for legitimate business reasons, they will not be made without the approval of the Board and the **shareholders (EM)** in the general meeting.

During the year, the Group made political donations in India of US\$2.01 million (2011: US\$0.02 million) either through a trust or directly in respect of the Indian general election. The Board **believes (booster)** that supporting the political process in India will encourage and strengthen the democratic process.

## Supplier Payment Policy

The responsibility for determining payment terms is delegated to the individual businesses within the Group, which take into consideration the commercial circumstances, local market and industry practice. The Group's policy is either to settle terms of payment with suppliers when agreeing the terms of each transaction or to ensure that the supplier is aware of the individual business's usual payment terms. Payment is made in accordance with contractual and other legal obligations and reflects local market practices.

Trade creditor days of the Company at 31 March 2012 were 30 days (2011: 42 days).

## Value of Land

Land is carried in the Balance Sheet at historic cost. It is not practical to estimate the market value of land at each balance sheet date.

## Research and Development

The Group's business units carry out research and development activities necessary to further their operations.

## Material Shareholdings

As at 18 June 2012, the Company had been notified under the Disclosure and Transparency Rules, of the following significant voting rights in its shares:

**Articles of Association, Share Capital and Voting Rights** The following description summarises certain provisions in the Company's Articles of Association (the 'Articles') and applicable English law concerning companies (the Companies Act 2006, the 'Act'). This is a summary only and the relevant provisions of the Act or the Articles **should (EM)** be consulted if further information is required. Copies of the Company's current Articles are available for inspection at the Company's registered office.

## Amendments to the Articles of Association

The Articles may be amended by only by special resolution passed by the Company's **shareholders (EM)**.

## Share Capital

As at 31 March 2012 the issued share capital of the Company was comprised of 296,908,045 ordinary shares of US\$0.10 each and 50,000 deferred shares of £1 each.

## Rights and Obligations Attaching to Shares

The rights and obligations attaching to the ordinary and deferred shares are set out in the Articles of Association. Details of the authorised and issued share capital together with movements in the Company's issued share capital during the year are shown in Note 33 of the financial statements.

6,904,995 ordinary shares of US10 cents each were issued on the conversion of certain convertible bonds issued by one of the company's subsidiaries. These 6,904,995 ordinary shares are held through a global depository receipt and carry no voting rights. Apart from the above, each ordinary share carries the right to one vote at general meetings of the Company. Holders of deferred shares are not entitled to attend, speak or vote at any general meeting of the Company, nor are they entitled to the payment of any dividend or to receive notice of general meetings.

Further details of the rights attaching to the deferred shares are set out in the Articles and summarised in Note 33 of the financial statements.

## Variation of Rights

Subject to the provisions of the Act, the rights attached to any class may be varied with the consent of the holders of three-quarters in nominal value of the issued shares of the class or with the sanction of an extraordinary resolution passed at a separate general meeting of the holders of the shares of the class.



### Deadlines for Exercising Voting Rights

Votes may be exercised at general meetings in relation to the business being transacted either in person, by proxy or, in relation to corporate members, by corporate representative. The Articles provide that forms of proxy shall be submitted not less than 48 hours before the time appointed for holding the meeting or adjourned meeting.

### Restrictions on Voting and the Transfer of Shares

No member shall be entitled to vote at a general meeting or at a separate meeting of the holders of any class of shares in the capital of the Company, either in person or by proxy, in respect of any share held by him unless all moneys payable by him in respect of that share have been fully paid. Furthermore, no **shareholder (EM)** shall be entitled to attend or vote either personally or by proxy at a general meeting or at a separate meeting of the holders of that class of shares or on a poll if he has been served with a notice after failing to provide the Company with information concerning interests in his shares that is required to be provided under the Act.

### Issue of Shares

Under the Articles of Association, the Company has authority to allot new shares in the Company. Such authority **would (hedge)** be exercised having regard to the Statement of Principles published by the Pre-emption Group.

### Shares Held in Uncertificated Form

Subject to the provisions of the Uncertificated Securities Regulations 2001, the Board may permit the holding of shares in any class of shares in uncertificated form and the transfer of title to shares in that class by means of a relevant system and may determine that any class of shares shall cease to be a participating security.

### Dividends and Distributions

Subject to the provisions of the Act, the Company may by ordinary resolution declare dividends in accordance with the respective rights of the members, but no dividend shall exceed the amount recommended by the Board. The Board may pay interim dividends if it appears to the Board that they are justified by the profits of the Company available for distribution. The treasury shares directly held by the Company are not entitled to receive a dividend.

Dividends may be declared and paid in any currency or currencies that the Board shall determine. The Board may also determine the exchange rate and the relevant date for determining the value of the dividend in any currency.

### Purchase of the Company's Own Shares

At the end of the year, the Directors had authority, under a **shareholders (EM)**' resolution dated 27 July 2011, to make market purchases of up to **approximately (hedge)** 10% of the Company's ordinary shares.

The authority expires at the conclusion of the Annual General Meeting of the Company in 2012 or on 1 October 2012, whichever is the earlier. A resolution to obtain a further authority will be proposed at the 2012 Annual General Meeting.

During the year the Company did not purchase any shares under its previously announced share buyback programme.

As at 31 March 2012 the Company held a total of 24,206,816 ordinary shares in treasury equal to 8.15% of the issued share capital.

### Significant Agreements: Change of Control

There are a number of agreements that take effect, alter or terminate upon a change of control of the Company such as commercial contracts, bank loan agreements, and capital market borrowing. The following are considered to be significant in terms of their **likely (hedge)** impact on the business of the Group as a whole:

1. The US\$1.25 billion 5.50% guaranteed convertible bonds issued in July 2009 and the US\$883 million 4.0% guaranteed convertible bonds issued in March 2010, where a change of control gives investors the option to require the issuer to redeem their bonds at the principal amount, together with any accrued and unpaid interest, or convert their bonds at an adjusted exchange price for a certain period following the relevant event.

2. The US\$500 million 8.75% bonds due 2014 and US\$750 million 9.5% bonds due 2018, where a change of control requires the Company to make an offer to purchase all of the outstanding bonds at 101% of the principal amount together with any accrued and unpaid interest with a rating decline.
3. The US\$1 billion and US\$373 million syndicated loan and US\$200 million loan from ICICI Bank UK plc, where a change of control gives the majority lenders the right to declare the loans immediately payable.
4. In Cairn Financing where a change of control gives the majority lenders the right to declare the loans immediately payable.

All of the Company's share plans contain provisions relating to a change of control. Outstanding awards and options **would (hedge)** normally vest and become exercisable on a change of control, subject to the satisfaction of any performance conditions.

There is no contract between the Company and its Directors or employees that provide for compensation for loss of office or employment that occurs because of a takeover bid.

#### Disclosure of Information to Auditors

In accordance with section 418 of the Companies Act 2006, each Director who held office at the date of approval of this Directors' Report confirms that:

- so far as they are aware, there is no relevant audit information of which the Company's auditors are unaware; and
- they have taken all the steps that he **ought to (EM)** have taken as a Director to make himself aware of any relevant audit information and to **establish (booster)** that the Company's auditors are aware of that information.

#### Reappointment of Auditors

A resolution to reappoint the auditors, Deloitte LLP, will be proposed at the forthcoming Annual General Meeting. The reappointment of Deloitte LLP has been approved by the Audit Committee, which will also be responsible for determining the auditors' remuneration on behalf of the Board, subject to the approval of **shareholders (EM)** at the forthcoming Annual General Meeting.

#### Policy on Derivatives and Financial Instruments

An explanation of the Group's financial management objectives and policies together with details of the Group's exposure to price risk, credit risk, liquidity risk and foreign currency risk appears in Note 27 to the financial statements.

#### Going Concern

The Group's business activities, together with the factors **likely (hedge)** to affect its future development, performance and position are set out in the Business Review on pages 6 to 57.

The financial position of the Group, its cash flows, liquidity position and borrowing facilities are described in the Finance Review on pages 32 to 37. In addition Note 27 to the financial statements includes the Group's objectives, policies and processes for managing its capital; its financial risk management objectives; details of its financial instruments and hedging activities; and its exposures to credit risk and liquidity risk.

The Group requires funds both for short-term operational needs as well as for long-term investment programmes **mainly (hedge)** in growth projects. The Group generates sufficient cash flows from its current operations which, together with the available cash and cash equivalents and liquid financial asset investments, provide liquidity both in the short term as well as in the long-term. **Anticipated (hedge)** future cash flows and undrawn committed facilities of US\$2,897 million, together with cash and liquid investments of US\$6,885 million as at 31 March 2012, are **expected (hedge)** to be sufficient to meet the ongoing capital investment programme and liquidity requirement of the Group in the foreseeable future.

The Group has a strong Balance Sheet that gives sufficient headroom to raise further debt should the need arise. The Group's current ratings from Standard & Poor's, Moody's and Fitch are BB, Ba1 and BB+ respectively. These ratings support the necessary financial leverage and access to debt or equity markets at competitive terms, taking into consideration current market conditions. The Group **generally (hedge)** maintains a healthy gearing ratio and retains flexibility in the financing structure to alter the ratio when the need arises. As a consequence, the Directors **believe (booster)** that the Group is **well (AM)** placed to manage its business risks successfully despite the current uncertain economic outlook.

After making enquiries, the Directors have a **reasonable expectation (hedge)** that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and Accounts.

## Annual General Meeting

The ninth Annual General Meeting of the Company will be held on 28 August 2012 at 3pm. The Notice convening the Annual General Meeting accompanies this Annual Report and sets out details of the business to be considered.

Signed on behalf of the Board

Deepak Kumar

Company Secretary

16 May 2012

Vedanta Resources plc

2nd Floor, Vintners Place

68 Upper Thames Street

London EC4V 3BJ

Registered in England Number 4740415

## SALG OG MARKEDER

Den organiske salgsvækst var 4% i 2012. Vaskemiddelenzymer og mikroorganismer var de største bidragydere til væksten med en salgsvækst på henholdsvis 14% og 23%. I Latinamerika steg salget 13%. Vaskemiddelenzymer og foder- og andre tekniske enzymer bidrog mest til væksten i regionen.

Det samlede salg i 2012 var 11.234 mio. kr., en stigning på 7% i forhold til 2011. Valutakurserne påvirkede salget i positiv retning, og salget i lokal valuta steg 3%. Opkøb og frasalg havde tilsammen en svagt negativ effekt på salgsvæksten, og salget steg 4% organisk.

## ENZYME BUSINESS

Salget i Enzyme Business var 10.163 mio. kr., en stigning på 7% i forhold til 2011. Salget i lokal valuta steg 3%. Salget af vaskemiddel- og foderenzymer var de største bidragydere til væksten i 2012. Det globale marked for industrielle enzymer steg **ca. (hedge)** 7% til 21 mia. kr. i 2012. Novozymes fastholdt sin markedsandel på 47%.

### Vaskemiddelenzymer

Salget af enzymer til vaskemidler steg 14% i danske kroner og 12% i lokal valuta i forhold til 2011. Den markante salgsvækst skyldes den fortsat øgede penetration af enzymer i vaskemidler i alle prislag med henblik på at øge vaskeevnen, muliggøre vask ved lave temperaturer og erstatte traditionelle kemikalier i vaskemiddelformuleringer. Salget af vaskemiddelenzymer til nye vækstmarkeder bidrog betydeligt til den globale salgsvækst.

### Føde- og drikkevareenzymer

Salget af enzymer til føde- og drikkevarer steg 5% i danske kroner og 1% i lokal valuta i forhold til 2011. Salget af enzymer til fremstilling af sunde fødevarer var den største bidragyder til salgsvæksten i 2012. Salget til stivelses- og bageriindustrien var **stort set (hedge)** uændret, mens salget til drikkealkoholindustrien var lavere end i 2011.

### Bioenergienzymer

Salget af enzymer til bioenergi faldt 2% i danske kroner og 9% i lokal valuta i forhold til 2011. Ethanolproduktionen i USA er af den amerikanske Energy Information Administration **anslået (hedge)** til at være faldet **ca. (hedge)** 5% i løbet af 2012 i forhold til 2011. Faldet i salget af bioenergienzymer i 2012 skyldes lavere ethanolproduktion i USA, lavere indhold af enzymer pr. produceret gallon ethanol samt ændringer i pris- og produktmiks. I oktober 2012 lancerede Novozymes et nyt produkt til bioenergiindustrien, Novozymes Avantec®, som gør det muligt for producenter af majsbaseret ethanol at øge ethanoludbyttet af den samme mængde majs med op til 2,5%. Det nye produkt har efter en vellykket lancering haft en svagt positiv effekt på salgsvæksten i 4. kvartal.

### Foder- og andre tekniske enzymer

Salget af foder- og andre tekniske enzymer steg 7% i danske kroner og 3% i lokal valuta i forhold til 2011. Salget af enzymer til foderindustrien var den største bidragsyder til væksten som følge af fortsat øget salg af RONOZYME® ProAct på det latinamerikanske, asiatiske og europæiske marked samt øget salg af fytaseenzymer. Salget af enzymer til andre tekniske industrier, herunder tekstilindustrien, var lavere end i 2011.

#### VASKEMIDLER – VÆKST PÅ ET MODENT MARKED

I 2012 opnåede Novozymes en kraftig salgsvækst på 14% inden for vaskemiddelenzymer ved at kombinere øget markedspenetration globalt med stigende salg på nye vækstmarkeder som Asien & Oceanien, Mellemøsten og Latinamerika.

**Vores (SM)** øgede markedspenetration skyldes vaskemiddelproducenternes ønske om at kunne bruge innovative enzymløsninger til dels at forbedre deres produkters vaskeevne og dels at reducere udsvingene i deres produktionsomkostninger.

Innovation øger markedsandelen

En bedre vaskeevne kan opnås på to måder: ved at opdage en ny enzymklasse eller ved at optimere en eksisterende løsning. Blandt de nye enzymklasser, der er kommet til i de senere år, kan nævnes Novozymes Mannaway®, som er effektiv mod pletter fra fødevarer, som indeholder guar gummi, som for eksempel is, samt Novozymes Xpect®, der er effektiv mod frugtpletter. Innovation handler imidlertid først og fremmest om at optimere eksisterende teknologier, så vaskeevnen forbedres, og vaskemiddelteknologien kommer op på et niveau, hvor højt koncentrerede flydende vaskemidler og vaskepulvere kan vaske tøj rent i koldt vand. Hvis alle europæere vaskede tøj i koldt vand, **ville (hedge)** tre store kulkræfter blive overflødige, og kontinentets CO<sub>2</sub>-udledning **ville (hedge)** kunne reduceres med 12 mio. tons om året. Det er **vores (SM)** mål, at kunderne vil spare 75 mio. tons CO<sub>2</sub>-udledning i 2015 gennem anvendelse af **vores (SM)** produkter, herunder vaskemiddelprodukter.

**Vores (SM)** salgsvækst inden for vaskemidler hænger også tæt sammen med de stadigt kraftigere udsving i prisen på buildere og oliebase tensider, der er centrale ingredienser i vaskemidler, samt stigende efterspørgsel efter bæredygtige vaskemidler.

Enzympriserne har ligget forholdsvis stabilt gennem tiden, og det **forventer (hedge) vi (SM)** også, at de vil gøre fremover. Som følge heraf afsøger kunderne mulighederne for at øge indholdet af enzymer, så produktionsomkostningerne kan stabiliseres, samtidig med at vaskemidlernes kemikalieindhold og miljøpåvirkning reduceres. Takket være **vores (SM)** innovative enzymer er **vi (SM)** allerede i dag i stand til at levere løsninger, der kan nedbringe brugen af tensider og buildere, og **vi (SM) forventer (hedge)**, at det i endnu højere grad vil være tilfældet i fremtiden.

Middelklassen skaber væksten

Den økonomiske vækst på de nye vækstmarkeder åbner nye muligheder for at bruge enzymer i vaskemidler, eftersom flere mennesker får råd til vaskemaskiner og kvalitetsvaskemidler. Desuden betyder mere effektive vaskemidler, at tøjvask og opvask kan klares hurtigere – en luksus, som den hastigt voksende middelklasse værdsætter.

Novozymes har haft stort udbytte af stærke partnerskaber med globale vaskemiddelproducenter i takt med deres indtrængen på de nye vækstmarkeder, ligesom **vi (EM)** nyder godt af tætte forhold til regionale og lokale producenter. Det har givet **os (SM)** en **god (AM)** forståelse for de særlige behov på hvert enkelt marked og sat **os (SM)** i stand til at tilpasse **vores (SM)** enzymløsninger til alt fra grundlæggende produkter til de mest avancerede vaskemidelformuleringer.

En lys fremtid

**Vi (SM)** er **overbeviste om (booster)**, at innovativ teknologi, produktudvikling og stærke partnerskaber med kunderne vil gøre det muligt at fastholde **vores (SM)** solide vækst inden for vaskemidler. **Vi (SM)** kan tilbyde vaskemiddelproducenterne meget konkurrencedygtige og unikke løsninger. **Vi (SM) erkender (booster)** dog, at væksten ikke kommer af sig selv, og at **vi (SM)** hele tiden skal være et skridt foran konkurrenterne. Når **vi (SM)** erobrer markedsandele fra kemikalieproducenterne, **må (EM) vi (SM)** forvente, at de svarer igen med knivskarp konkurrence. Novozymes vil fortsat udvikle innovative teknologier til alle markedssegmenter med det formål at forbedre vaskeevnen og afholde kunderne fra at købe lavkvalitetsvaskemidler med færre enzymer.

Mange steder i verden står forbrugerne over for store økonomiske udfordringer, men med innovative kvalitetsvaskemidler kan kunderne **faktisk (booster)** spare penge og bidrage til øget bæredygtighed, fordi produkterne forlænger tøjets levetid og gør det muligt at vaske i koldt vand. I Novozymes ser **vi (SM)** det som **vores (SM)** opgave at gøre det lettere, bedre og billigere for forbrugere overalt i verden at anvende bæredygtige kvalitetsvaskemidler.

#### BIOBUSINESS

Salget i BioBusiness var 1.071 mio. kr., en stigning på 5% i danske kroner i forhold til 2011. Salget i lokal valuta var uændret i forhold til 2011. Når der ses bort fra frasalget af Novozymes' biofarmaaktiviteter i Sverige i 2011 og effekten af opkøbet af EMD/Merck Crop BioScience, steg salget i BioBusiness 10% organisk.

#### Mikroorganismer

Salget af mikroorganismer steg 23% i danske kroner og 18% i lokal valuta i forhold til 2011. Salget steg 17% organisk, når der justeres for opkøbet af EMD/Merck Crop BioScience i 2011. Salget af mikroorganismer til bæredygtigt landbrug (BioAg) var den største bidragsyder til væksten i 2012 som følge af en positiv salgsudvikling i Latinamerika, Europa og Asien. Salgsvæksten i mikroorganismer skyldes i overvejende grad en eksklusiv aftale om salg og marketing, der blev indgået i 4. kvartal. Salget af mikroorganismer til spildevandsindustrien og til rengøringsmidler var **stort set (hedge)** uændret i lokal valuta i forhold til 2011.

## Biofarma

Biofarmasalget faldt 50% i danske kroner og 53% i lokal valuta i forhold til 2011. Frasalget af Novozymes' biofarmaaktiviteter i Sverige i slutningen af 2011 havde en betydelig negativ effekt på salgsudviklingen i 2012. Organisk faldt salget 23% i forhold til 2011, idet en stor ordre fra en kunde i 2011 ikke blev gentaget i 2012.

### BIOBUSINESS BANER VEJEN FOR VÆKST

BioBusiness blev dannet i 2007 med det formål at udvikle den del af bioteknologien, som ligger uden for enzymområdet, og udgangspunktet er Novozymes' stærke videnbase og innovationskultur. En række vigtige fremskridt har i 2012 styrket fundamentet for kommerciel succes inden for mikroorganismer og biofarmaceutiske ingredienser.

I maj påbegyndte **vores (EM)** nye fabrik i Kina den kommercielle produktion af Novozymes Hyasis®, som er en hyaluronsyre af farmaceutisk kvalitet til blandt andet behandling af gigt og grå stær. Fabrikken opfylder de strengeste standarder for farmaceutisk produktion – ICH Q7 GMP – og repræsenterer en investering på over 350 mio. kr. i et marked med en **anslået (hedge)** værdi på 1 mia. kr. årligt. Novozymes' Bacillus-baserede, ikkeanimalske produkt er udviklet i tæt samarbejde med kunder og giver brugerne det hidtil højeste niveau af sikkerhed, fordi det ikke indebærer de risici, som normalt er forbundet med kommercielle kilder til hyaluronsyre.

#### Partnerskaber for innovation i 2012

I august indgik Novozymes partnerskab med BASF og Cargill, to globale ledere inden for hver deres respektive områder, om udviklingen af en industriel bioteknologisk produktionsproces til fremstilling af akrylsyre baseret på fornybare råvarer. Akrylsyre fremstilles i store mængder og indgår i en lang række produkter som for eksempel bleer, coatings og klæbemidler. Novozymes' mikroorganismer omdanner fornybare råvarer til 3-hydroxypropionsyre (3-HP), en kemisk forløber for akrylsyre, som bidrager til at reducere afhængigheden af begrænsede ressourcer som olie.

I oktober blev partnerskabet mellem Novozymes BioAg og Syngenta udvidet, så det foruden JumpStart® omfatter det biologiske svampemiddel Taegro®, som er en bæredygtig biologisk løsning til bekæmpelse af svampesygdomme i landbrugsafgrøder. Syngenta bliver således ansvarlig for salg, marketing og distribution, mens Novozymes vil stå for produktion og registrering. BioAg er nu det største forretningsområde i BioBusiness, hvad angår salg.

#### Parat til vækst

BioBusiness har i løbet af sine første fem år opbygget en solid forretningsplatform. **Vi (SM)** har udvidet **vores (SM)** kompetencer, implementeret nye forretningsmodeller og målrettet **vores (SM)** ressourcer til de muligheder, der passer i **vores (SM)** strategi.

Som resultat heraf er **vi (SM)** overbeviste om **(booster)**, at BioBusiness har lagt grunden til en årlig tocifret organisk vækst.

#### Store risici, store gevinster

Det har **altid (booster)** været en del af BioBusiness' DNA omhyggeligt at opveje store risici mod potentielle gevinster i søgningen efter innovative løsninger, der kan ændre markeder. **Vi (SM)** har bevæget **os (SM)** ind på områder med betydeligt potentiale, men også med betydelig risiko for fiasko, når **vi (SM)** har udforsket mulighederne for at udvikle løsninger på globale udfordringer som forbedret sundhed, fødevarerelgængelighed, vandmangel og vedvarende alternativer til olie. I mange tilfælde er **vi (SM)** pionerer i industrien. Kunsten har været at udnytte **vores (SM)** evner, etablere nyttige partnerskaber, lære nye industrier at kende og derigennem mindske de indbyggede risici ved at opbygge et nyt forretningsområde. Desuden er **vi (EM)** afhængige af partnere, godkendelsesprocesser og markedets accept af de nye løsninger.

**Vi (SM)** følger **os (SM)** stadig frem. **Vi (SM)** har en pipeline fyldt med nye aktiviteter, som strategisk passer ind i Novozymes' overordnede mål og kan sikre en velafbalanceret portefølje, når det gælder risici, fremtidig værdiskabelse og udnyttelse af ressourcer. BioBusiness Portfolio Board arbejder aktivt på at afdække og undersøge nye muligheder og vil fortsat opkøbe, frasælge og afslutte aktiviteter efter behov for at sikre en velafbalanceret portefølje.

### GEOGRAFISK FORDELING AF SALGET

Salget i Europa, Mellemøsten & Afrika (Europa/MEA) steg 8% både i danske kroner og i lokal valuta i forhold til 2011. Stigningen skyldes især øget salg af vaskemiddelenzymer og mikroorganismer. Frasalget af Novozymes' biofarmaaktiviteter i Sverige havde en negativ påvirkning i 2012.

Salget i Nordamerika steg 1% i danske kroner og faldt 6% i lokal valuta i forhold til 2011. Salget af vaskemiddelenzymer bidrog mest positivt til udviklingen, mens salget inden for bioenergienzymer og biofarma var lavere i 2012 end i 2011.

Salget i Asien steg 12% i danske kroner og 5% i lokal valuta i forhold til 2011. Vaskemiddelenzymer og mikroorganismer bidrog mest til den positive udvikling, mens salget af foder- og andre tekniske enzymer trak ned.

Salget i Latinamerika steg 13% både i danske kroner og i lokal valuta i forhold til 2011. Vaskemiddelenzymer og foder- og andre tekniske enzymer var de største bidragydere til væksten, mens salget af føde- og drikkevarenszymer faldt i 2012.

### FØDEVARESTANDARDE SÆTTER DAGSORDENEN

Inden for de seneste år er fødevarsikkerhed blevet en væsentlig kilde til bekymring hos offentligheden. Derfor har

tilsynsmyndigheder verden over indført strengere kvalitetsstandarder for at beskytte forbrugerne. Det påvirker hele værdikæden – fra ingrediensfremstillere til mærkevareproducenter. Novozymes hjælper aktivt kunderne med at opfylde de skærpede myndighedskrav og har således positioneret sig som kvalitetsleder inden for enzymindustrien.

Enzymer til føde- og drikkevarer udgør Novozymes' næststørste produktområde med 28% af salget i 2012 og er også det næststørste globale enzymmarked med en årlig værdi på over 1 mia. dollar. Selv om enzymer anvendes bredt på tværs af produktkategorier, producenter og lande, er der stadig tale om en nicheteknologi, hvilket gør udviklingen af forarbejdede fødevarer til en af Novozymes' **vigtigste (AM)** vækstfaktorer på længere sigt.

Føde- og drikkevareproducenterne kræver i stigende grad innovative, effektive og sunde produkter, som lever op til de skrappe myndighedsstandarder. Novozymes' enzymløsninger opfylder disse behov. For eksempel er det påvist, at Novozymes Acrylaway® i væsentlig grad reducerer dannelsen af det potentielt kræftfremkaldende stof akrylamid i en lang række fødevarer som kaffe, kiks, morgenmads- og kartoffelprodukter. Takket være **vores (SM)** løsninger til juiceindustrien kan producenterne levere mere attraktive og nærende produkter og samtidig optimere udbyttet, så de kan producere mere med mindre.

Førende på kvalitet og opfyldelse af myndighedskrav

To nylige tiltag illustrerer, hvordan Novozymes' evne til at levere kvalitet og opfylde myndighedernes krav bidrager til at nedsætte risikoen for forbrugerne og kundernes varemærker, indfrier myndighedernes og kundernes forventninger og styrker virksomhedens konkurrenceevne:

I 2009 vedtog EU den såkaldte FIA-pakke (forordninger om tilsætningsstoffer, aromaer og enzymer) med det formål at harmonisere den europæiske lovgivning om fødevaringredienser. FIA-pakken er kompleks og kræver omfattende ny dokumentation. Ved at trække på sin knowhow, netværk og erfaring i håndtering af kompliceret tværfagligt samarbejde med kunderne indleverede Novozymes som den første enzymproducent i Europa dossierer til godkendelse i maj 2012, **næsten (hedge)** tre år før fristen i marts 2015. Eftersom **vi (SM)** var først på banen, har **vi (SM)** spillet en **vigtig (AM)** rolle i fastsættelsen af forventningerne til den dokumentation, der i de kommende år skal indleveres til EU, og det har styrket Novozymes' position som kvalitetsleder inden for enzymindustrien.

Et stigende antal fødevarerproducenter forlanger, at deres leverandører tredjepartscertificeres i henhold til en anerkendt fødevarer sikkerhedsstandard. Det sikrer en uafhængig bekræftelse af, at de opfylder generelt accepterede krav, og kan spare producenterne for selv at skulle auditere. Novozymes var tidligt ude og opnåede FSSC 22000-certificering for en række fødevarer enzymer allerede i 2010 og kan nu **konstatere (booster)**, at adskillige kunder selv har indført denne standard og kræver, at andre vigtige leverandører også certificeres.

Fremtiden

**Vi (SM) formoder (hedge)**, at myndigheder og kunder vil stille større og større krav. Skærpede krav **kan (hedge)** naturligvis opfattes som en risiko set fra et omkostnings- og procesorienteret synspunkt, men **vi (SM)** ser reguleringsændringerne som en grundlæggende markedsudvikling, hvor en begrænset startinvestering **kan (hedge)** give et fornuftigt udbytte. **Vi (SM)** vil fortsat udnytte **vores (SM)** ekspertise, globale tilstedeværelse og mangeårige erfaring som international leverandør af fødevarer enzymer til at fastholde og udvikle **vores (SM)** førende position, når det handler om opfyldelse af myndighedskrav og fødevarer sikkerhed.

## PRODUKTLANCERINGER I 2012

### 1. kvartal 2012

Novozymes Cellic® CTec3: Et avanceret cellulase-/hemicellulasekompleks, der muliggør omkostningsbesparende omdannelse af forbehandlede lignocellulosematerialer til forgærbare sukkerarter.

### 1. kvartal 2012

Novozymes Sanferm® Yield: Et forbedret glukamylaseenzym, hvormed destillerierne kan opnå forbedret gæringseffektivitet og dermed højere alkoholudbytte og kortere gæringstid.

### 1. kvartal 2012

Taegro®: Et biologisk svampemiddel til bekæmpelse af jordbårne patogener som Rhizoctonia og Fusarium på forskellige høvjærtafgrøder (tomater, jordbær, salat mv.).

### 2. kvartal 2012

Novozymes Panzea®: Et xylanaseenzym til dejforarbejdning i bageriindustrien. Blandt de væsentligste fordele er en **klar (AM)** forbedring af brøddets udseende og af bagte produkters tekstur samt en tør, stabil dej.

### 3. kvartal 2012

Novozymes Saczyme® Plus 2X: En forbedret blanding af glukamylaseenzymer, som øger udbyttet i produktionen af drikkealkohol.

#### 4. kvartal 2012

Novozymes Avantec®: Et alfa-amylaseenzym med sideeffekter af glukamylase- og proteaseenzym, som øger ethanoludbyttet ved produktion af majs-baseret ethanol med op til 2,5%.

#### FINANSIEL REDEGØRELSE OG BÆREDYGTIGHEDSREDEGØRELSE

I det følgende redegøres for de realiserede finansielle, miljømæssige og sociale data for året. I "Regnskab" findes data og nøgletal, mens oversigten over Novozymes' rapportering i overensstemmelse med retningslinjerne fra Global Reporting Initiative (GRI) findes i The Novozymes Report 2012 på [www.report2012.novozymes.com](http://www.report2012.novozymes.com) under "Supplementary", hvor også vores (SM) redegørelse om fremskridt i forhold til FN's Global Compact findes.

#### SALG

Det samlede salg i 2012 var 11.234 mio. kr., en stigning på 7% i forhold til 2011. Valutakurserne påvirkede salget i positiv retning, og salget i lokal valuta steg 3%. Opkøb og frasalg havde tilsammen en svagt negativ effekt på salgsvæksten, og salget steg 4% organisk.

#### OMKOSTNINGER, ANDRE DRIFTSINDTÆGTER OG RESULTAT AF PRIMÆR DRIFT

##### Samlede omkostninger

De samlede omkostninger, eksklusive nettofinansomkostninger og skat, var 8.567 mio. kr., en stigning på 4% i forhold til 2011.

##### Bruttoresultat

Bruttoresultatet steg 9% i forhold til 2011 og resulterede i en bruttomargin på 57,2%, en stigning på 1 %-point i forhold til 2011. Justeret for opkøbs-effekten i 2011 steg bruttomarginen 0,4 %-point. Fortsatte produktivitetsforbedringer, gunstige ændringer i produktmiks og den afsluttede IFRS-justering for overtagne varebeholdninger i EMD/Merck Crop BioScience i 2011 mere end opvejede de højere råvarepriser og højere omkostninger i forbindelse med den nye hyaluronsyrefabrik i Kina og den nye enzyffabrik i Nebraska, USA.

Bruttomarginen for Enzyme Business var 58,2%, et fald på 0,5 %-point i forhold til 2011. Højere råvarepriser og omkostninger relateret til den nye enzyffabrik i Nebraska, USA, var hovedårsagerne til den lavere bruttomargin, mens fortsatte produktivitetsforbedringer og gunstige ændringer i produktmiks til dels opvejede de højere produktionsomkostninger.

Bruttomarginen for BioBusiness var 47,7%, en stigning fra 33,3% i 2011 og fra **ca. (hedge)** 44%, når der justeres for den afsluttede IFRS-baserede justering i forbindelse med opkøbet af EMD/Merck Crop BioScience i 2011.

##### Andre driftsomkostninger

Andre driftsomkostninger var 3.756 mio. kr., en stigning på 4% i forhold til 2011. Andre driftsomkostninger set i forhold til salget udgjorde 33%, et fald på 1 %-point i forhold til 2011. En omkostningsbevidst tilgang påvirkede fortsat driften positivt.

- Omkostninger til salg og distribution, herunder forretningsudvikling, steg 3% og udgjorde 13% af salget
- Omkostninger til forskning og udvikling steg 4% og udgjorde 14% af salget
- Omkostninger til administration steg 4% og udgjorde 7% af salget

##### Andre driftsindtægter

Andre driftsindtægter steg til 78 mio. kr. i 2012 mod 50 mio. kr. i 2011. Milepælsbetalinger inden for BioBusiness var den primære årsag til stigningen.

##### Afskrivninger og amortiseringer

Afskrivninger og amortiseringer var 703 mio. kr. i 2012 mod 786 mio. kr. i 2011. Faldet i afskrivninger og amortiseringer skyldes hovedsagelig lavere afskrivninger i biofarma som følge af frasalget i 2011, der medførte ophør af af- og nedskrivninger. Når der ses bort herfra, var der en svag stigning i afskrivninger og amortiseringer.

##### Resultat af primær drift

Resultat af primær drift steg 17% til 2.745 mio. kr. i forhold til 2.340 mio. kr. i 2011.

Overskudsgraden var 24,4% i 2012, en stigning på 2,1 %-point i forhold til 2011 og en stigning på **ca. (hedge)** 1,8 %-point, når der justeres for opkøbs effekt i 2011. Overskudsgraden var positivt påvirket af øget salg og en gunstig udvikling i driftsomkostninger og valutakurser.

#### NETTOFINANSPOSTER OG ÅRETS RESULTAT

##### Nettofinansomkostninger

Nettofinansomkostningerne var 161 mio. kr. i 2012, en stigning på 236 mio. kr., mod nettofinansindtægter på 75 mio. kr. i 2011. Stigningen skyldes hovedsagelig et nettotab på valutasikring/omvurdering på 83 mio. kr. i 2012 i forhold til en gevinst på 190 mio. kr. i 2011. I forhold til 2011 faldt nettorenteomkostningerne 15 mio. kr. til 61 mio. kr.

##### Resultat før skat

Resultat før skat steg 7% til 2.584 mio. kr. fra 2.415 mio. kr. i 2011.

Den effektive skatteprocent i 2012 var 22,0 mod 24,3 i 2011. Den effektive skatteprocent er i 2012 positivt påvirket af udnyttelsen af den i 2010 opnåede "U.S. Advanced Energy Manufacturing tax credit" relateret til den nye fabrik i Nebraska.

##### Årets resultat

Årets resultat var 2.016 mio. kr., en stigning på 10% i forhold til 2011. Stigningen i resultat af primær drift samt den lavere skatteprocent havde en positiv effekt på årets resultat, mens de højere nettofinansomkostninger havde en negativ virkning.

#### PENGESTRØMME OG BALANCE

##### Pengestrømme

Pengestrømme fra driften var 2.758 mio. kr. i 2012 mod 2.709 mio. kr. i 2011. Stigningen skyldes primært et højere resultat for året. Nettoinvesteringer før opkøb udgjorde 1.177 mio. kr. mod 1.316 mio. kr. i 2011. Frie pengestrømme før opkøb var 1.581 mio. kr. i 2012, en stigning fra 1.393 mio. kr. i 2011. Stigningen skyldes højere pengestrømme fra driften.

##### Balance

Egenkapitalen udgjorde 9.568 mio. kr. pr. 31. december 2012, en stigning på 8% fra 8.824 mio. kr. ultimo 2011. Egenkapitalen blev forøget med årets resultat, hvilket dog blev delvist opvejet af især udbetalt udbytte og køb af aktier i forbindelse med aktietilbagekøbsprogrammet. Egenkapitalen udgjorde 63% af balancen mod 64% ultimo 2011.

Pr. 31. december 2012 var den nettorentebærende gæld 1.430 mio. kr. mod 1.019 mio. kr. ultimo 2011. Hovedårsagerne til stigningen i den nettorentebærende gæld var udbyttebetaling til Novozymes' aktionærer på 600 mio. kr. i marts 2012, aktietilbagekøb for 832 mio. kr. i 2012 og det strategiske partnerskab med og køb af en ejerandel af Beta Renewables i 2012.

Nettorentebærende gæld/egenkapital-andelen var 15% pr. 31. december 2012, en stigning fra 12% pr. 31. december 2011.

Afkast af investeret kapital (ROIC), inklusive goodwill, var 19,9% mod 21,3% i 2011. Det lavere afkast skyldes primært den øgede investerede kapital, især som følge af opkøbet af EMD/Merck Crop BioScience i 2011 og det strategiske partnerskab med og køb af en ejerandel i Beta Renewables i 2012.

##### Egne aktier

Den 31. december 2012 var beholdningen af egne B-aktier 12,77 mio. stk., svarende til 3,9% af aktiekapitalen.

I perioden fra 20. januar til 29. oktober 2012 tilbagekøbte Novozymes 5.247.588 aktier til en værdi af **ca. (hedge)** 832 mio. kr. inden for det toårige aktietilbagekøbsprogram på 2 mia. kr., der blev påbegyndt den 20. januar 2012. Tilbagekøbsprogrammet blev afsluttet den 29. oktober 2012 i forbindelse med offentliggørelsen af det strategiske partnerskab med og køb af en ejerandel af Beta Renewables.

B-aktiekapitalen **forventes (hedge)** at blive reduceret med 10.600.000 kr. fra 542.512.800 kr. til 531.912.800 kr. ved annullering af en del af beholdningen af egne B-aktier. Aktieannulleringen er betinget af generalforsamlingens godkendelse den 28. februar 2013.



# STYRING AF LEVERANDØRKÆDEN BRINGER os (SM) TÆTTERE PÅ KUNDERNE

Novozymes sætter kunderne i centrum for sit arbejde med styring af leverandørkæden, hvilket blandt andet vil sige indkøb, transport og logistik samt koordinering med kunderne. For at maksimere driftseffektivitet og bæredygtighed styrker **vi (SM)** dialogen med kunderne, så **vi (SM)** bedre kan vurdere deres behov og bringe produktionen tættere på dem. Det giver omkostningsbesparelser og reducerer CO2-udledningen.

**Vores (SM)** globale leverandørkæde er baseret på nærhedsprincippet: **Vi (SM)** fremstiller produkterne så geografisk tæt på kunderne som muligt. Det giver **typisk (hedge)** billigere transport og gør det muligt at tilpasse færdigvarerne til kundernes behov på et sent stadie. Derudover transporterer **vi (SM)** flere produkter i koncentreret form, som fylder mindre, mellem **vores (EM)** fabrikker.

Mindre transportvolumener

**Vi (SM)** har udviklet **vores (SM)** leverandørkædefunktioner på steder som Suzhou nær Shanghai i Kina og Blair i Nebraska, USA, så **vi (SM)** kan øge leveringsfleksibiliteten og minimere transportomkostningerne. Dermed kan **vi (SM)** reducere CO2-udledningen, fordi transportafstandene mindskes.

Novozymes **forventer (hedge)** at reducere den interne transport mellem Suzhou og Blair med 37% i 2012-2013, svarende til **ca. (hedge)** 300 tons CO2, og nedbringe den samlede interne transportvolumen med op til 8% i 2013.

**Vi (SM)** arbejder også på at effektivisere transporten af råvarer, der indkøbes i hele verden. I et forsøg i Danmark har Novozymes i visse tilfælde skiftet fra vej- til søtransport. Skibe med råvarer til Novozymes' produktion sejler nu direkte til Kalundborg frem for at lægge til i København og læsse varerne på lastbiler. Det har mindsket antallet af lastvognstransporter mellem København og Kalundborg med 800 og reduceret den årlige CO2-udledning med **ca. (hedge)** 148 tons.

Mindre kompleksitet gennem dialog

Et andet **vigtigt (AM)** mål er at reducere kompleksiteten af **vores (SM)** leverancer, hvilket betyder, at **vi (SM)** foretager en bedre vurdering af kundernes behov gennem øget dialog. I maj 2012 lancerede **vi (SM)** en ny treårig strategi, der fokuserer på kundeforhold og kompleksitetsstyring, og som skal hjælpe **os (SM)** med at opfylde de globale markedsbehov og tackle udfordringer som svingende råvarepriser og skiftende behov.

Nærmere bestemt har **vi (SM)** udviklet 12 initiativer med det formål at øge dialogen med kunderne og forbedre driftseffektiviteten gennem programmer som brugertilpasning i sene stadier, ordreproduktionslinjer, mindre varebeholdninger og planlægning af placeringen af fremtidige produktionsanlæg.

Et konkret resultat er, at **vi (SM)** er begyndt at gennemgå ordremønstre med faste kunder og drøfte den optimale planlægning af langsigtede og gentagne ordrer. Ud fra de mønstre, der tegner sig, forsøger **vi (SM)** at reducere antallet af sjatpaller, hvor der leveres færre varer pr. transport. I stedet prøver **vi (SM)** at samle mindre ordrer og transportere flere varer med samme energiforbrug, hvilket giver omkostningsbesparelser og lavere CO2-udledning. Samtidig fastholder **vi (SM)** fleksibiliteten til at kunne levere til tiden og sende små leverancer til kunder, som har behov for det.

Fremtiden

I en rundspørge foretaget i 2012 var **vores (SM)** kunders højeste prioritet pålidelige leverancer efterfulgt af kvalitet og dokumentation, og 75% kunne se en fordel i en partnerskabsorienteret tilgang til styring af leverandørkæden. Novozymes arbejder derfor stadig på at reducere leveringsrisikoen og øge pålideligheden samt optimere leverandørkæden sammen med kunderne og dermed styrke loyaliteten.

En bedre dialog med leverandørerne øger også driftseffektiviteten. I løbet af de seneste tre år har **vi (SM)** implementeret et styringssystem for leverandørpræstation, hvor præstationen vurderes på basis af kommercielitet, kvalitet og bæredygtighed med henblik på at identificere og reducere risici i den globale leverandørbase. **Vi (SM)** har sat det mål for 2015, at 100% af **vores (SM)** leverandører med en årlig fakturering på over 1 mio. kr. skal overholde programmets forretnings-, kvalitets- og bæredygtighedsmæssige krav.

**Vi (SM)** vil også fortsat optimere produktions- og administrationssystemerne, blandt andet ved at sikre en mere smidig arbejdsgang fra ordre til faktura, samtidig med at **vi (SM)** styrker virksomhedens strategi og vækstsmål.

## UDNYTTELSE AF RESSOURCER

I det følgende rapporterer **vi (SM)** om **vores (SM)** mål for energi-, vand- og CO2-effektivitet samt andre resultater vedrørende udnyttelse af ressourcer.

Energi-, vand- og CO2-effektivitet

Energieffektivitet

Den realiserede forbedring i energieffektivitet i 2012 var 38% sammenlignet med 2005, hvilket opfyldte målet på 38%. Forbedringen skyldes gennemførelse af en lang række energispareprojekter med fokus på udskiftning af udstyr og optimering af energiudnyttelse. Energieffektiviteten blev forbedret med 4 %-point fra 34% i 2011, hvilket svarer til en energibesparelse på yderligere 250.000 GJ og en estimeret omkostningsbesparelse på **ca. (hedge)** 30 mio. kr. i 2012.

Vandeffektivitet

Forbedringen af vandeffektiviteten var 32% i 2012 sammenlignet med 2005, hvilket er lidt under målet på 33%. Det lykkedes **os (SM)** ikke at reducere vandforbruget yderligere på grund af omlægning til produkter, som kræver mere procesvand, samt forsinkelse af nogle vandspareprojekter. Alligevel steg vandeffektiviteten med 2 %-point fra 30% i 2011. Det betyder en vandbesparelse på **ca. (hedge)** 200.000 m<sup>3</sup> (og dermed en reduktion af det samlede vandforbrug til 6.446.000 m<sup>3</sup>) samt en omkostningsbesparelse på **ca. (hedge)** 2 mio. kr.

Med henblik på at opnå en væsentlig forbedring af **vores (SM)** vandeffektivitet og gøre fremskridt i retning af at nå **vores (SM)** mål på 40% i 2015 har **vi (SM)** iværksat flere vandspareprojekter med længere tilbagebetalingstid.

#### CO2-effektivitet

Novozymes forbedrede sin CO2-effektivitet med 55% i 2012 sammenlignet med 2005 og overgik dermed det langsigtede mål på 50% for 2015. Det gode resultat skyldes hovedsagelig den strategiske beslutning i 2011 om at øge indkøbet af CO2-neutral vindmølleenergi væsentligt. I Danmark køber **vi (SM)** nu al elektricitet fra vindmøller, hvilket udgør **omkring (hedge)** en tredjedel af **vores (SM)** samlede CO2-effektivitetsforbedring. **Vi (SM)** har også identificeret og gennemført energispareprojekter i hele organisationen og øremærket de samlede omkostningsbesparelser til indkøb af CO2-neutral energi.

#### Affald

Den registrerede mængde affald steg til 14.241 tons i 2012 fra 11.704 tons i 2011. Stigningen skyldes biomasse produceret på **vores (EM)** nye fabrik i Blair, Nebraska, USA, som ikke kunne spredes som gødning ligesom NovoGro®. Det medførte også et fald i andelen af genbrugt affald til **ca. (hedge)** 34% i 2012 fra **ca. (hedge)** 41% i 2011.

#### Transport og distribution

I 2012 blev CO2-udledningen fra transport af varer til kundens første leveringssted samt fra transport mellem produktionsstederne estimeret til 19.000 tons, en reduktion på **ca. (hedge)** 14% i forhold til 22.000 tons i 2011.

#### Dyreforsøg

Brugen af dyreforsøg blev øget med **ca. (hedge)** 10% fra 1.119 dyr i 2011 til 1.240 i 2012. Stigningen skyldes primært øget toksikologitestning i Enzyme Business.

#### Overholdelse af miljømyndighedskrav og naboklager

Novozymes bestræber sig på at overholde alle myndighedskrav og minimere antallet af klager. I 2012 registrerede **vi (SM)** på verdensplan 15 overskridelser af de fastsatte grænseværdier, sammenlignet med 21 i 2011.

I 2012 fik Novozymes 11 klager fra naboer, hvilket er en reduktion fra 18 i 2011. Klagerne kom **i de fleste tilfælde (hedge)** fra private borgere og var relateret til lugt- og støjgener fra nærliggende fabrikker.

Novozymes forsøger **altid (booster)** at undgå væsentlige spild, herunder spild af kemikalier til vand og jord. Der var ingen væsentlige spild i 2012.

Novozymes er involveret i en sag i USA, hvor der for en del år siden blev målt høje nitratniveauer i grundvandet omkring Novozymes' fabrik i Franklinton, North Carolina. I begyndelsen af 2008 blev der indsendt yderligere kontrolmålinger til myndighederne, som stadig er i gang med at gennemgå tallene og derfor endnu ikke har nået en konklusion.

#### INDVIRKNING PÅ KLIMAFORANDRINGER

Det er **vigtigt (AM)** for Novozymes at kunne positionere enzymteknologien som en del af løsningen på klimaproblemerne. Gennem kundernes anvendelse af **vores (SM)** produkter opnåede **vi (SM)** i 2012 en reduktion af CO2-udledning på **ca. (hedge)** 48 mio. tons, hvilket svarer til **omkring (hedge)** tre fjerdedele af Danmarks samlede årlige CO2-udledning. Dette var en stigning på 3 mio. tons sammenlignet med 2011 og oversteg **vores (SM)** mål på 47 mio. tons. Forbedringen skyldes delvis en stigning i salget af vaskemiddelenzymer.

For at måle **vores (SM)** påvirkning og forsyne kunderne med valide salgsargumenter arbejder Novozymes løbende på at udvikle forskerbædømte miljømæssige livscyklusvurderinger. I 2012 gennemførte **vi (SM)** vurderinger inden for tekstil- og akvakulturindustrien og udarbejdede en artikel med gennemgang af miljøvurderinger for industriens brug af enzymer inden for de

seneste 15 år. Endvidere har **vi (SM)** leveret CO2-data om udvalgte enzymer til kunder og partnere og rådgivet dem om, hvordan de kan ændre deres produktmiks ved at skifte til mere koncentrerede og mindre miljøbelastende produkter.

## MEDARBEJDERFORHOLD

I det følgende rapporterer **vi (SM)** om mål og resultater relateret til medarbejderne og arbejdspladsen.

### Personaleomsætning

I 2012 var målet for personaleomsætning på mellem 4% og 9%, hvilket afspejler den aktuelle beskæftigelsessituation og Novozymes' mål om at tiltrække og fastholde medarbejdere. Personaleomsætningen var 8,1%, så målet blev nået.

### Tilfredshed, motivation og Novozymes' værdier

Medarbejdernes tilfredshed og motivation, deres opfattelse af egne muligheder for udvikling og evnen til efterleve **vores (SM)** værdier er vigtige indikatorer for medarbejdernes velbefindende og **vores (SM)** evne til at tiltrække og fastholde dygtige medarbejdere. Hvert år har Novozymes' medarbejdere i hele verden mulighed for at give deres mening til kende via medarbejderundersøgelsen People's Opinion. I 2012 var den gennemsnitlige score for "Tilfredshed og motivation" 78, hvilket er rekordhøjt og overgår målet på 75. For virksomheder med base i Norden, som har en arbejdsstyrke på mindst 2.000 og medarbejdere ansat i mindst to lande uden for Norden, betragtes en medarbejdertilfredshedsscore på 75 og derover som "Top in Class" i en sammenlignende undersøgelse foretaget af **vores (SM)** leverandør Ennova.

Resultatet for "Muligheder for faglig og personlig udvikling" var 75 i 2012, hvilket oversteg målet på 74. For at styrke medarbejderudviklingen yderligere iværksatte Novozymes i 2012 nye ledelses- og talentudviklingsprogrammer, som vil blive gennemført i endnu højere grad i 2013. Med hensyn til **vores (SM)** nye værdisæt **viser (booster)** undersøgelsen, at medarbejderne har stor tillid til, at kolleger og ledere efterlever Novozymes' værdier, og **vores (SM)** mål på 80 blev mere end nået med en score på 83.

### Mangfoldighed og lige muligheder

Novozyymes' medarbejdere ansættes på baggrund af kompetencer, og stillingerne tilbydes uden forfordeling, udelukkelse eller præferencer. **Vi (SM)** har forpligtet **os (SM)** til at udvikle en mangfoldig arbejdsstyrke, der fremmer innovation og en rummelig arbejdskultur.

I 2012 havde **vi (SM)** fortsat fokus på at udnytte det fulde potentiale i **vores (SM)** globale gruppe af kandidater og efterfølgere til ledende stillinger. For at øge mangfoldigheden blandt **vores (SM)** ledere yderligere, så den i højere grad afspejler sammensætningen i **vores (SM)** rekrutteringsbase, har **vi (SM)** endvidere fastsat en række specifikke mål for køn og nationalitet for nye ledere, som rekrutteres i 2013. **Læs (EM)** mere om dette i afsnittet "Mål og forventninger".

### STORE FØDDER, LILLE FODAFTRYK

Med **vores (SM)** forpligtelse til bæredygtighed i hele værdikæden har **vi (SM)** minimeret det miljømæssige fodaftryk af både **vores (SM)** egen og **vores (SM)** kunders drift. Ved at anvende Novozymes' biologiske løsninger reducerede kunderne deres CO2-udledning med **ca. (hedge)** 48 mio. tons i 2012.

### Fokus på sikkerhed

Novozyymes bestræber sig på at tilbyde et sikkert arbejdsmiljø. Frekvensen af arbejdsulykker var historisk lav i 2012 med 3,0 pr. mio. arbejdstimer, langt under målet på under 4,0. **Desværre (AM)** var året mærket af en **tragisk (AM)** ulykke med dødelig udgang på et af **vores (EM)** produktionssteder i Danmark. Efter ulykken iværksatte **vi (SM)** straks en undersøgelse af årsagen og sørgede for krisehjælp til pårørende og kolleger.

En **tragisk (AM)** ulykke som denne kræver ekstra opmærksomhed på sikkerhed. Derfor har alle afdelinger identificeret processer og udstyr, som kan forårsage personskade, således at risikoen for fremtidige **tragiske (AM)** ulykker er så lav som overhovedet muligt. Derudover lancerede Novozymes en ny kampagne, "Stop and Think", som skal minde de ansatte om at tænke sig om en ekstra gang i potentielt risikable arbejdsituationer. Endelig har Novozymes hyret eksterne konsulenter, som skal gennemgå virksomhedens globale forholdsregler og resultater i forbindelse med arbejdsmiljø og udpege eventuelle områder med mulighed for forbedring.

### Sundhed, velbefindende og fravær

Novozyymes **ønsker (AM)** at hjælpe sine medarbejdere til at træffe sunde valg ved at tilbyde forhold, oplysninger og faciliteter på arbejdspladsen, som fremmer sund livsstil og muligheden for at øge velværet. Øget velbefindende og lavere fravær kommer

medarbejderne til gode, ikke kun ved at reducere ubehaget i forbindelse med sygdom, men også ved at begrænse unødigt stress og overarbejde for kollegerne. Dette kommer også virksomheden til gode, eftersom lavere fravær forbedrer arbejdsgangene og sparer omkostninger. Med en fraværsporcet på 1,9 i 2012 nåede **vi (SM)** målet for året på under 3%.

#### Overholdelse af menneskerettigheder og arbejdstagerrettigheder

I 2012 gennemførte Novozymes en evalueringsproces som del af et projekt med udgangspunkt i FN's Guiding Principles on Business and Human Rights. Resultatet af dette projekt har medført forbedringer i **vores (SM)** praksis som for eksempel **klarere (AM)** forankring af ansvar for Novozymes' minimumstandards for menneske- og arbejdstagerrettigheder i organisationen samt bedre forståelse for de regionale forskelle i opfattelsen af menneskerettigheder.

Desuden har **vi (SM)** ajourført **vores (SM)** forpligtelse med hensyn til menneskerettigheder, ligesom **vi (SM)** har inkorporeret denne i **vores (SM)** forretningsaktiviteter som for eksempel processer i forbindelse med fusioner og virksomhedsovertagelser. Disse forbedringer **bør (hedge)** kunne gøre **os (SM)** i stand til mere systematisk at påvise og forhindre risici med hensyn til menneskerettigheder på alle sites. I 2013 vil **vi (SM)** gennemføre intern undervisning i brugen af **vores (SM)** Ethics Hotline og derved sikre, at alle medarbejdere ved, hvordan de skal anmelde eventuelle overgreb på menneskerettighederne.

#### SOCIOØKONOMISK EFFEKT

I det følgende rapporterer **vi (SM)** om Novozymes' resultater for værdifordeling, herunder skattebidrag og samarbejde med leverandører. Afsnittet dækker også status for **vores (SM)** forretningsintegritetsprogram, **vores (SM)** projekt om fødevarer og energi i Mozambique samt **vores (SM)** Corporate Citizenship-program.

#### FORDELING AF GENERERET VÆRDI

I 2012 blev 88% af Novozymes' genererede værdi givet tilbage til samfundet gennem køb af varer og tjenesteydelser fra leverandører, lønninger og pensioner til **vores (SM)** 6.041 medarbejdere, skatter og afgifter til samfundet samt udbytte og finansielle omkostninger til **vores (SM)** kapitalleverandører. De resterende 12% forblev i Novozymes med det formål at udvikle virksomheden og sikre dens konkurrenceevne og fremtidige værdiskabelse til fordeling blandt de vigtigste interessenter.

#### Samlet skattebidrag

I 2012 var Novozymes' skattebidrag, herunder selskabsskat samt andre skatter og afgifter, på **ca. (hedge)** 875 mio. kr., svarende til 8% tilbagebetaling til samfundet (**se (EM)** diagrammet Fordeling af genereret værdi). Herudover opsamlede og tilbageholdt Novozymes udbytteskat og kildeskat på **ca. (hedge)** 975 mio. kr. I 2012 var **vores (SM)** samlede skattebidrag således **ca. (hedge)** 1.850 mio. kr., sammenlignet med **ca. (hedge)** 1.900 mio. kr. i 2011. Den overordnede skattestrategi og anvendte politik for interne afregningspriser har til formål at understøtte et positivt skattebidrag til samfundet og staten i de lande, hvor Novozymes har aktiviteter. **Se (EM)** også Novozymes' holdning til skat på [www.novozymes.com](http://www.novozymes.com).

#### Leverandører

Novozymes vurderer løbende risici og identificerer muligheder gennem virksomhedens program for ansvarligt indkøb, som blev indført i 2009. I 2012 var **vores (SM)** dækning på 93% af de samlede udgifter. **Vi (SM)** afsluttede 11 handlingsplaner for leverandører, som ikke levede op til kravene, enten gennem dialog eller ved at standse indkøb fra de pågældende leverandører.

Novozymes har sat et nyt mål om 100% opfyldelse af leverandørprogrammet for forretnings-, kvalitets- og bæredygtighedsmæssig præstation for leverandører, hvor **vores (SM)** årlige udgifter er over 1 mio. kr. **Se (EM)** afsnittet "Mål og forventninger". Større leverandører, som **vi (SM)** har regelmæssige transaktioner med, er nemmere at påvirke. **Vi (SM)** vil dog fortsat vurdere mindre leverandører og reducere relaterede risici.

I 2012 indførte Novozymes en udvidet version af sine leverandørkrav i leverandørkontrakter over hele verden. Gennem samarbejde med leverandørerne har **vi (SM)** designet ny emballage samt bidraget til sikrere håndtering af udvalgte produkter. Der blev identificeret mere miljøvenlige alternativer til råvarerne i **vores (SM)** enzymproduktion, for eksempel titanium. Endelig afholdt Novozymes en innovationsdag for leverandørerne med det formål at etablere et tættere samarbejde med strategiske leverandører. **Se (EM)** også **vores (SM)** redegørelse om fremskridt i henhold til FN's Global Compact på The Novozymes Report 2012 på [www.report.2012.novozymes.com](http://www.report.2012.novozymes.com) under "Supplementary".

#### Forretningsintegritet

**Vi (SM)** har fortsat **vores (SM)** dedikerede informations- og undervisningsindsats for at sikre, at forretningsintegritet **altid (booster)** har høj prioritet hos **vores (SM)** medarbejdere og forretningspartnere. På globalt plan har 79% af medarbejderne nu gennemført

undervisningen gennem e-læring, sammenlignet med 71% i 2011. **Vi (SM)** har også afholdt lokale seminarer på **vores (EM)** største sites i samarbejde med regionale finansafdelinger.

Efter opkøbet af EMD/Merck Crop BioScience i 2011 har en del af integrationsprocessen i 2012 været udarbejdelse af en spansk version af folderen Bestikkelse – nej tak! om forretningsintegritet for at sikre, at **vores (SM)** nye kolleger fra EMD/Merck Crop BioScience i Argentina samt **vores (SM)** forretningspartnere også forstår og opfylder **vores (SM)** seks principper. Folderen findes også på dansk, engelsk, kinesisk og portugisisk.

#### Fødevarer- og energiprojekt i Afrika

Novozymes har investeret i et projekt i Mozambique via et joint venture, CleanStar Mozambique (CSM). Formålet er at udvikle et bæredygtigt landbrug, der skal øge fødevarerproduktionen og levere råvarer til fremstilling af ethanol som erstatning for trækul til madlavning i byerne. CSM hjælper mindre landmænd i Sofala-provinsen med at indføre et miljøgenoprettende skovlandbrug, som skal producere en række forskellige landbrugsprodukter. I 2012 åbnede CSM sit første anlæg til fremstilling af madlavningsbrændstof i Sofala. Her omdannes nogle af landbrugsprodukterne til ethanolbaseret madlavningsbrændstof, som sælges lokalt.

Ved udgangen af 2012 havde CSM over 150 medarbejdere, involverede over 1.200 mindre landmænd og havde solgt over 3.000 komfurer, som bruger ethanolbaseret madlavningsbrændstof, til husholdninger i byerne. Projektet bidrager på mange måder til FN's 2015-mål. For eksempel er det med til at:

- Udrydde ekstrem fattigdom ved at løfte 1.200 landmænd og 150 medarbejdere og deres familier fra et eksistensminimum til at have en indtægt, de kan leve af (mål 1)
- Forbedre mødres sundhed (mål 5) og reducere børnedødeligheden (mål 4) i **ca. (hedge)** 3.000 hjem ved at mindske den indendørs forurening
- Sikre et bæredygtigt miljø (mål 7) ved at fremme et skift væk fra trækul, som bidrager til skovudryddelse

#### Corporate Citizenship-initiativer

I 2012 fortsatte **vi (SM)** udbredelsen af **vores (SM)** kendskab til naturvidenskab og miljømæssig ansvarlighed til lokalsamfundene gennem **vores (SM)** Corporate Citizenship-program, Citizymes. Dermed bidrager **vi (SM)** til en bedre grundskoleuddannelse i **vores (SM)** lokalsamfund (mål 2) og til et mere bæredygtigt miljø (mål 7). I 2012 nåede **vores (SM)** undervisning ud til **ca. (hedge)** 26.000 personer, sammenlignet med **ca. (hedge)** 9.800 i 2011, hvor projektet blev lanceret. Stigningen skyldes primært **vores (SM)** engagement i Saskatoon, Saskatchewan, med den canadiske organisation Agriculture in the Classroom, som har undervist **ca. (hedge)** 10.000 børn i plantevækst og fødevarerproduktion.

**Omkring (hedge)** en tredjedel af de personer, som **vi (SM)** er nået ud til, kom fra Latinamerika og Asien & Oceanien, hvor virksomheder i stigende grad forventes at yde en uddannelsesindsats, for eksempel ved at vise, hvordan teori kan omsættes til praksis.

Blandt de nye projekter kan nævnes Novozymes' partnerskab med Bangladesh University of Textiles om at undervise fremtidige ledere af tekstilfabrikker i bioteknologi og bæredygtighed som led i universitetets MBA-program. **Læs (EM)** mere om programmet, og **se (EM)** andre eksempler på **vores (SM)** Citizenship-projekter på [www.novozymes.com](http://www.novozymes.com).

#### Dokumentation af **vores (EM)** socioøkonomiske effekt

I 2012 udsendte Novozymes den første dokumentation af virksomhedens socioøkonomiske effekt. Den afdækkede den socioøkonomiske effekt i USA af at introducere kødproteineksrakt (MPE) som alternativ til natrium i forarbejdet kød. Resultaterne **viste (booster)**, at der er betydelige fordele for forbrugere og samfund, og at MPE **kan (hedge)** være en del af løsningen på problemet med amerikanernes alt for store indtag af salt (natrium). Med denne undersøgelse har Novozymes udviklet en ny metode til vurdering af virksomhedens socioøkonomiske effekt og dokumentation af salgsargumenter, som supplerer den eksisterende ekspertise inden for miljømæssige livscyklusvurderinger.

#### LEDERSKAB INDEN FOR BÆREDYGTIGHED

Her rapporterer **vi (SM)** om, hvordan **vores (SM)** præstationer inden for bæredygtighed benchmarkes, samt om **vores (SM)** præstationer i forhold til globale og regionale projekter.

Aktieanalytikere og ratingbureauer vurderer løbende virksomheder på bæredygtighedsområdet, og **vi (SM)** anvender de mest relevante vurderinger til at sammenligne Novozymes med tilsvarende virksomheder. **Vi (SM)** anvender især vurderingerne fra Dow

Jones Sustainability Indexes og den underliggende Sustainability Asset Management (SAM) som indikator for **vores (SM)** mål om at opnå SAM's Gold Class-vurdering i Sustainability Yearbook. På baggrund af **vores (SM)** præstation i 2011 opnåede **vi (SM)** Gold Class-vurdering i SAM's Sustainability Yearbook 2012, og målet blev dermed nået.

Endvidere fastholdt **vi (SM)** positionen som sektorleder inden for det bioteknologiske område i Dow Jones Sustainability Indexes på baggrund af **vores (SM)** præstation i 2012. **Vi (SM)** forbedrede **vores (SM)** position i Nordic Carbon Disclosure Leadership Index ved at gå fra nr. 10 i 2011 til nr. 5 i 2012 med en score på 94. Det skyldes dels betydelige investeringer i at nedsætte CO<sub>2</sub>-udledningen/energiforbruget på **vores (EM)** egne produktionsanlæg, dels at **vi (SM)** hjælper kunderne med yderligere at reducere deres CO<sub>2</sub>-udledning.

#### Globale og regionale projekter

I 2012 var Novozymes involveret i en række rådgivende aktiviteter, først og fremmest FN's bæredygtighedskonference (Rio+20). Med skarpt fokus på at levere praktisk forretningsinput og løsninger samt at gå i dialog med de interessenter, der ønskede det, var Novozymes i stand til at:

- Deltage aktivt i Business Action for Sustainable Development (BASD) og Rio+20 Business Day
- Lever input til politiske dokumenter som Det Internationale Handelskammers Green Economy Roadmap og WBCSD's Vision 2050 og Changing Pace-rapport
- Støtte FN Global Compacts arbejdsgruppe om Sustainable Energy for All, herunder SEFA-initiativet (Sustainable Energy for All)
- Øge informationen om og kendskabet til **vores (SM)** vision om en biobaseret økonomi

SEFA-initiativet, som blev lanceret af FN's generalsekretær, er særligt **interessant (AM)** for Novozymes. Målet er at realisere visionen om bæredygtig energi for alle i 2030, og både private og offentlige aktører samt NGO'er opfordres til at deltage. Det giver Novozymes en enestående mulighed for at positionere bioenergiteknologier som en del af løsningen, og derfor har Novozymes sat som mål, at biobrændstoffer skal inkluderes som en "high-impact opportunity" i SEFA-initiativet i 2015. **Se (EM)** også afsnittet "Mål og forventninger".

**Vi (SM)** øgede også **vores (SM)** engagement i lokale Global Compact-netværk i USA, Brasilien, Kina og Indien. Sammen med A.P. Møller - Mærsk, Novo Nordisk, Business for Social Responsibility (BSR) og FN's Global Compact bidrog **vi (SM)** til rapporten New Geographies of Corporate Sustainability, der har fokus på de lokale bæredygtighedsdagsordener i Kina, Brasilien og Indien. Projektet øgede **vores (SM)** viden om de regionale forskelle inden for bæredygtighed, som **vi (SM)** skal tage højde for i forbindelse med fremtidige aktiviteter.

#### Opfyldelse af rapporteringskrav om bæredygtighed

I henhold til § 99a i årsregnskabsloven er det obligatorisk for store virksomheder at rapportere om deres samfundsansvar. Som medlem af FN's Global Compact udarbejder Novozymes en redegørelse om fremskridt (Communication on Progress), som offentliggøres på The Novozymes Report 2012 på

[www.report2012.novozymes.com](http://www.report2012.novozymes.com) under "Supplementary". Sammen med den integrerede finansielle, miljømæssige og sociale rapportering opfylder **vores (SM)** redegørelse om fremskridt både kravet om rapportering om samfundsansvar og de avancerede rapporteringskriterier i Global Compact. Herudover rapporterer **vi (SM)** om **vores (SM)** bæredygtighedsaktiviteter og opdaterer årligt **vores (SM)** oversigt over væsentligheden af bæredygtighedstemaer på [www.novozymes.com](http://www.novozymes.com).

#### BIOBASERET ØKONOMI PÅ DEN GLOBALE SCENE

**Vi (EM)** er måske en forholdsvis lille virksomhed, men **vi (SM)** har store planer – **vi (SM)** **ønsker (AM)** at forandre verden sammen med **vores (SM)** kunder. **Vores (EM)** teknologi er nøglen til en økonomi baseret på vedvarende ressourcer. Novozymes arbejder ihærdigt på at opbygge en biobaseret økonomi, ikke kun gennem sine produkter og løsninger, men også ved at deltage i de politiske processer, som er med til at forme morgendagens verden.

Hvis det skal lykkes at udvikle den globale økonomi, skal statslige organer og private virksomheder kunne samarbejde om at fremme innovation og vækst. Derfor begynder regeringer at lytte til viden- og innovationsbaserede virksomheder som Novozymes. Novozymes udnytter muligheden til at skabe yderligere forandring ved at gå i dialog med politikerne og være fortalere for et biobaseret samfund, ved at dele sin bioteknologiske knowhow og ved at præsentere nyskabende løsninger.

Muligheder skabes

Som led i den globale indsats udvælger og deltager **vi (SM)** i globale fora og begivenheder såsom Rio+20 og B20- møder, hvor **vi (SM)** ikke alene kommer i kontakt med politikere og meningsdannere inden for industrien, men også møder kunder og partnere med henblik på at finde mulige synergieffekter.

**Vores (SM)** mål for 2012 var at have en positiv indvirkning på og drive nødvendige forandringer på følgende områder:

- Afskaffelse af tilskud til fossile brændstoffer

- Fri handel med bæredygtige løsninger
- Stabile priser på CO<sub>2</sub>
- Støtte til gennemførelse af CO<sub>2</sub>-besparende løsninger
- Private investeringer i grøn infrastruktur

FN's konference om bæredygtig udvikling (Rio+20-konferencen) i juni 2012 var den største begivenhed inden for bæredygtighed i de sidste 20 år. Over 55.000 mennesker fra 193 lande og mere end 1.500 virksomheder deltog og bidrog direkte til debatten. Novozymes var repræsenteret i alle dele af konferencen, hvis sluttafte fokuserede på en række nøgleområder, der både er afgørende for virksomhedens og den biobaserede økonomis fremtid. **Vi (SM)** præsenterede **vores (SM)** løsninger for stats- og regeringschefer, journalister og globale meningsdannere, ligesom **vi (SM)** talte med en lang række nuværende og potentielle kunder for at udforske mulighederne for fremtidige projekter.

Risikobegrænsning gennem lydhørhed

Ved at deltage i globale begivenheder som denne og ved at mødes med interessenter fra hele verden får Novozymes **vigtig (AM)** viden, som kan integreres i forretningen og de løsninger, **vi (SM)** tilbyder kunderne. Når **vi (SM)** lærer, hvordan politikere, meningsdannere og NGO'er opfatter **vores (SM)** industrier, er **vi (SM)** bedre i stand til at forstå værdikæden, forudse fremtidens behov og sikre **vores (SM)** forretning ved at udvikle nye løsninger, der opfylder markedets skiftende behov.

Den langsigtede forpligtelse

Det er en lang proces at påvirke politiske beslutninger, og **vi (SM)** erkender (**booster**), at det naturligt nok tager lang tid at opbygge politisk vilje til at etablere en biobaseret økonomi. I 2013 vil **vi (SM)** fortsat promovere løsninger og politikker, som fremmer bæredygtig vækst på langt sigt. **Vi (SM)** vil blandt andet arbejde for at sætte stærke dagsordener inden for bæredygtighed med særlig vægt på vedvarende energi over for den nye ledelse i Kina og den amerikanske regering. Et af **vores (SM)** langsigtede mål går ud på at få biobrændstoffer med som en "highimpact opportunity" på den globale dagsorden for FN's initiativ Sustainable Energy for All i 2015.

## NOVOZYMES-AKTIE

I løbet af 2012 udbetalte Novozymes over 1,4 mia. kr. til aktionærerne i form af udbytte og aktietilbagekøb. Aktiekursen havde et svært år og sluttede året med et fald på 10%.

Novozyymes' aktie er noteret på NASDAQ OMX København og indgår i indekset OMX Copenhagen 20 (OMXC20). Aktien handles under symbolet NZYM B og ISIN DK0060336014. Novozymes er registreret i Erhvervsstyrelsen med nr. 10 00 71 27.

## AKTIEKURSUDVIKLING

Novozyymes' aktiekurs faldt 10% i 2012. Til sammenligning steg OMXC20 27%, MSCI Pan Europe Index 13% og Dow Jones Sustainability World Index 12%.

I 2012 var den gennemsnitlige daglige omsætning i Novozymes' aktie 587.031 aktier eller 93 mio. kr. Aktien var dermed den syvende mest omsatte på NASDAQ OMX København, hvor den i 2011 var den niende mest omsatte. Ultimo var den samlede børsværdi af Novozymes' B-aktier 43,2 mia. kr., og den anslåede værdi af de unoterede A-aktier var 8,5 mia. kr.

I de seneste fem år har Novozymes' aktie givet et gennemsnitligt årligt afkast til aktionærerne på 7% (9% inklusive udbytte). Dette kan sammenlignes med et gennemsnitligt femårigt afkast eksklusive udbytte på 1% for OMXC20 og -5% for både MSCI Pan Europe Index og Dow Jones Sustainability World Index.

## AKTIELILBAGEKØBSPROGRAM INDLEDT OG AFSLUTTET I 2012

I 2011 blev det besluttet at indlede et aktietilbagekøbsprogram med tilbagekøb af aktier for op til 2 mia. kr. over en toårig periode begyndende i 2012. Tilbagekøbsprogrammet var betinget af, at der ikke blev foretaget større virksomhedsopkøb. Mellem 20. januar og 29. oktober 2012 tilbagekøbte Novozymes aktier til en samlet værdi af 831.847.334 kr. Tilbagekøbsprogrammet blev afsluttet med offentliggørelsen af det strategiske partnerskab med og opkøb af en ejerandel i Beta Renewables.

B-aktiekapitalen **forventes (hedge)** at blive reduceret med 10.600.000 kr. fra 542.512.800 kr. til 531.912.800 kr. ved annullering af en del af beholdningen af egne B-aktier. Aktieannulleringen er betinget af generalforsamlingens godkendelse den 28. februar 2013.

For at sikre, at annulleringen af aktier ikke får negativ indvirkning på omsætteligheden af Novozymes' aktie, er Novozymes' største aktionær, Novo A/S, indforstået med at holde sin relative beholdning af B-aktier på det nuværende niveau (25,5% af aktiekapitalen) efter Novozymes' annullering af aktier som følge af aktietilbagekøbsprogrammet.

## UDBYTTE

På generalforsamlingen vil **bestyrelsen (SM)** foreslå en udbyttebetaling på 2,2 kr. pr. aktie for regnskabsåret 2012. Det vil medføre en samlet udbyttebetaling på **ca. (hedge)** 687 mio. kr. , svarende til en udbyttesats på 34,1%. Novozymes har et mål om at øge udbyttesatsen til 35% over de kommende 1-2 år.

## AKTIEANALYTIKERE

Følgende selskaber dækker Novozymes-aktien:

## BÆREDYGTIGHEDSANERKENDELSER

Et **vigtigt (AM)** led i Novozymes' kommunikation med aktionærerne er at informere aktieanalytikere, ratingbureauer og kapitalforvaltere om virksomhedens resultater på bæredygtighedsområdet. Novozymes bestræber sig løbende på at forbedre både bæredygtighedsrapportering og -processer og værdsætter derfor dette samspil meget. I 2012 opnåede Novozymes blandt andet:

- At blive genbekræftet som medlem af Dow Jones Sustainability World Index og Dow Jones Sustainability STOXX Index, udnævnt til sektorleder for 11. gang og tildelt Gold Classbedømmelse for resultaterne i 2011 i SAM Sustainability Yearbook 2012
- At blive nr. 5 i Carbon Disclosure Projects Nordic Carbon Disclosure Leadership Index 2012 med en score på 94 ud af 100
- At blive blandt de tre førende i sundhedssektoren i Bloombergs Global Corporate Renewable Energy Index (CREX) 2012
- Igen at blive udnævnt til en af verdens 100 mest bæredygtige virksomheder af The Global 100 Most Sustainable Corporations in the World Project
- At blive genbekræftet som medlem af ET Global 300 Carbon Index
- At blive genbekræftet som medlem af FTSE4Good Index

## AKTIONÆRER

Novozymes' aktiekapital består af to typer aktier: A- og B-aktier. Begge har en nominel værdi af 2 kr. pr. aktie. Alle A-aktierne ejes af Novo A/S, og hver A-aktie har 10 gange så mange stemmerettigheder som en B-aktie.

Ultimo 2012 ejede Novo A/S 25,5% af den samlede aktiekapital og havde i kraft af sit ejerskab af A-aktierne og en del af B-aktierne (29.131.400 aktier) 70,1% af stemmerne. Novo A/S er 100% ejet af Novo Nordisk Fonden, hvorfor Novozymes indgår i Novo Nordisk Fondens koncernregnskab. Novo A/S har hjemsted i Hellerup.

Ultimo 2012 havde Novozymes **omkring (hedge)** 50.000 aktionærer, hvoraf 99% er private danske investorer. 20 institutionelle investorer, herunder Novo A/S, ejer **ca. (hedge)** 55% af B-aktierne. Udenlandske investorer ejer **ca. (hedge)** 70% af B-aktierne.

Novozymes ejer 4,7% af B-aktierne, svarende til 3,9% af aktiekapitalen.

Ud over Novo A/S ejer kun én aktionær, Baillie Gifford & Co., mere end 5% af Novozymes' aktiekapital pr. 31. december 2012.

## KONTAKT INVESTOR RELATIONS

Besøg **vores (SM)** investorsektion på [www.novozymes.com](http://www.novozymes.com), der indeholder IR-guidelines, præsentationer, værktøjer og downloads, koncernregnskabsmeddelelser og anden information for både private og institutionelle investorer.

Hvis **du (EM)** har spørgsmål til Investor Relations, kan **du (EM)** kontakte:

## VIRKSOMHEDSPROFIL

Novozymes er verdens førende inden for bioinnovation og fremstiller en lang række industrielle enzymer, mikroorganismer og biofarmaceutiske ingredienser. **Vores (SM)** biologiske løsninger hjælper kunderne med at få mere ud af mindre, samtidig med at de sparer energi og producerer mindre affald.



Befolkningstallet stiger, og det medfører et øget pres på naturens ressourcer. Derfor skal der innovation til, hvis **vi (EM)** fortsat vil kunne opfylde **vores (EM)** grundlæggende behov. Novozymes' løsninger er en del af svaret. De bruges i fremstilling af talrige produkter, hvor de forbedrer effektiviteten af industrielle processer ved at spare energi og råvarer samt mindske spild. Resultatet er, at **vores (SM)** kunder oplever højere kvalitet, lavere omkostninger og mindre miljøbelastning.

#### RETHINK TOMORROW

**Vi (SM)** bruger **vores (SM)** ekspertise inden for bioteknologi til at udvikle innovative løsninger, **ofte (hedge)** i samarbejde med kunderne. På globalt plan har Novozymes over 6.000 medarbejdere i seks verdensdele. Over 20% af Novozymes' globale arbejdsstyrke arbejder med forskning og udvikling, og 13-14% af salget investeres i forskning og udvikling rundt om i verden.

**Vores (SM)** løsninger er baseret på en unik bioteknologisk platform, der tilbyder industrier verden over et væld af muligheder. Mikrobielle teknikker, high-throughput-screening, proteinteknologi og gæringsteknologi er nogle af de redskaber, der danner grundlaget for **vores (SM)** forretning. Med udgangspunkt i **vores (SM)** teknologiske platform og store indsigt i industrien samarbejder **vi (SM)** med kunder om at skabe morgendagens industrielle, biologiske løsninger inden for en lang række områder. For at sikre ejerskabet af **vores (SM)** biologiske løsninger har **vi (SM)** p.t. 7.000 tildelte patenter og patentansøgninger, hvilket illustrerer de muligheder, der opstår, når natur og teknologi arbejder sammen.

#### INDBYGGET BÆREDYGTIGHED

Bæredygtighed er en integreret del af **vores (SM)** løsninger. **Vores (SM)** teknologi sætter **os (SM)** i stand til at tilbyde kunderne løsninger, der gør det muligt for dem at få mere ud af råvarer og energi. Det er blevet en konkurrencefordel for os, i takt med at flere og flere kunder selv bruger bæredygtighed som konkurrenceparameter.

For at understøtte **vores (SM)** ambition om at fremme bæredygtighed rundt om i verden arbejder **vi (SM)** tæt sammen med interessenter på tværs af hele værdikæden: leverandører, kunder og samfundet. Novozymes mindsker risici og udnytter leverandørernes styrke ved at kræve sikkerhed ved levering, kvalitet og effektivitet i forhold til bæredygtighed og innovation. **Vi (SM)** arbejder på at øge CO<sub>2</sub>-effektiviteten ved at forbedre produktionsprocesser. **Vi (SM)** hjælper også kunderne med at reducere deres CO<sub>2</sub>-udledning yderligere, når de bruger **vores (SM)** produkter. Alene i 2012 hjalp **vi (SM)** kunderne med at mindske CO<sub>2</sub>-udledningen med **ca. (hedge)** 48 mio. tons.

**Vi (SM)** forsøger at skabe den nødvendige balance mellem forretningsmæssig vækst, et renere miljø og bedre levevilkår. I kraft af **vores (SM)** engagement og tilslutning til internationale aftaler og universelle værdier er **vi (SM)** i stand til at identificere de problemer og udfordringer, som er relevante for **vores (SM)** interessenter og for **vores (SM)** virksomhed. Blandt andet har **vi (SM)** tilsluttet **os (SM)** FN's Global Compact, og **vi (SM)** støtter FN's Biodiversitetskonvention i bestræbelserne på at sætte en mere bæredygtig global dagsorden.

Det er **vigtigt (AM)** for **os (SM)** at være en gennemsigtig og ansvarlig virksomhed. **Vores (SM)** tværfunktionelle bæredygtighedsorganisation, der er ansvarlig for at fastsætte mål på bæredygtighedsområdet, afspejler **vores (SM)** værdikæde og bygger på dialogen med **vores (SM)** mange interessenter. **Læs (EM)** mere om **vores (SM)** langsigtede mål i "Langsigtede mål og strategi".

#### GENTÆNK (EM) MORGENDAGEN

En voksende verdensbefolkning med øgede krav om mad, vand, energi og andre ressourcer presser industrien til at blive dygtigere og producere mere med mindre. Novozymes støtter denne transformation ved at erstatte traditionelle kemikalier med enzymer og mikroorganismer og derved bidrage til at reducere mængden af vand, energi og råvarer i mange industriprocesser.

#### VERDENS FØRENDE INDEN FOR INDUSTRIELLE ENZYMER

**Vores (SM)** største forretningssegment, Enzyme Business, stod i 2012 for 91% af den samlede omsætning. BioBusiness, som udgjorde de resterende 9%, omfatter mikroorganismer og biofarmaceutiske ingredienser.

**Vi (SM)** arbejder løbende på at udvide **vores (SM)** markeder ved at lancere innovative løsninger på eksisterende markeder samt ved at udvikle helt nye anvendelsesmuligheder. Med en andel på 47% af det globale enzymmarked fastholdt Novozymes i 2012 sin position som verdens største og førende producent af industrielle enzymer. Det samlede salg var 11.234 mio. kr. og resultat af primær drift 2.745 mio. kr.

#### OVER 700 PRODUKTER OG 40 FORSKELLIGE SLUTBRUGERMARKEDER OVER HELE VERDEN

Novozymes' produkter sælges i hele verden og til en lang række industrier, herunder vaskemiddel-, bioenergi-, landbrugs-, føde- og drikkevare-, biofarma-, spildevands-, tekstil- og papirindustrien.

Vaskemiddelenzymer anvendes i vid udstrækning til tøj- og maskinopvask, og de udgør en stor del af Novozymes' salg. **Vores (SM)** løsninger forbedrer vaskemidlernes ydeevne gennem bedre pletfjernelse, skånsom vask og generelt øget vaskeevne. Enzymer kan erstatte petrokemiske ingredienser, og fordi de har en enestående katalytisk virkning, er enzymer særligt anvendelige i vaskemidler til vask ved lav temperatur og i koncentrerede produkter.

Et af Novozymes' primære fokusområder er enzymer til bioenergiindustrien, som kan omdanne stivelse (primært majs) og cellulose til forgærbare sukkerarter, der anvendes til fremstilling af ethanol. Biobrændstoffer er et **vigtigt (AM)** skridt på vejen mod at imødekomme den voksende efterspørgsel efter vedvarende energi.

Enzymer bruges også i stor udstrækning i føde- og drikkevarerindustrien til at forbedre kvaliteten af brød, øl, vin og andre produkter samt i foderindustrien til at forbedre fordøjeligheden og næringsværdien af dyrefoder.

Derudover leverer Novozymes en række mikroorganismer til industriel anvendelse inden for rengøring, spildevandsbehandling og landbrug, mens biofarmaforretningen har fokus på at forbedre medicinsk udstyr samt indgivelse og formulering af lægemidler ved hjælp af unikke rekombinante albumin- og hyaluronsyreteknologier.

## TOUCH THE WORLD

**Vores (SM)** vision, bærende forretningsidé, forpligtelse og værdier danner et sæt samlede retningslinjer, som **vi (SM)** kalder Touch the World.

- **Vores (SM)** vision: En fremtid, hvor **vores (SM)** biologiske løsninger skaber den nødvendige balance mellem forretningsmæssig vækst, et renere miljø og bedre levevilkår
- **Vores (SM)** bærende forretningsidé: Rethink Tomorrow
- **Vores (SM)** forpligtelse: Løbende forbedre **vores (SM)** finansielle, miljømæssige og sociale resultater for at drive verden mod bæredygtighed
- **Vores (SM)** værdier:
  - **Hav (EM)** modet til at gå forrest – fordi **du (EM)** skaber fremtiden
  - Vis og vind tillid – fordi intet er stærkere end gensidig tillid
  - **Gå (EM)** sammen for at skabe nyt – fordi verden er fuld af gode ideer
  - Frigør passion – fordi passion vækker drømme til live

## INNOVATION + MARKETING = EN STÆRK PIPELINE

At kunne oversætte kundernes behov til banebrydende, salgbare løsninger er afgørende for Novozymes' fastholdelse af sin stærke produktpipeline. For hele tiden at være et skridt foran konkurrenterne bruger **vi (SM)** nytænkning til at udvikle løsninger, der radikalt ændrer industriens måde at arbejde på og hjælper kunderne med at fremstille mere med mindre. **Vi (SM)** involverer også kunderne tidligt i idéudviklingsfasen, så **vi (SM)** kan levere kvalitetsprodukter, der opfylder markedets behov.

I Novozymes er **vi (SM)** klar over (**booster**), at verden er fuld af gode ideer, men de skal opdages, forbedres og realiseres på den rigtige måde. Derfor har **vi (SM)** en struktureret tilgang til at fremme innovationen i virksomheden, samtidig med at **vi (SM)** inddrager eksterne eksperter og kunder, så løsningerne bliver bedre, ekspertisen samles, og risiciene mindses.

Blandt en lang række interne værktøjer bruger **vi (SM)** onlinesoftware for at kunne arbejde optimalt sammen og sociale medier til at søge bredt efter ideer til løsninger på branchespecifikke problemer, for eksempel hvordan **man (EM)** erstatter et kemikalie med et enzym for at spare energi, vand og råvarer i et specifikt trin i tekstilfremstillingsprocessen.

Gode hjerner arbejder sammen

Kolleger på tværs af Novozymes brainstormer online, hvor de introducerer og kommenterer nye ideer og samler en prioriteret liste med løsninger, der afspejler, hvad der er behov for fra marketing og R&D. Et sådant forløb varer **typisk (hedge)** et par dage, hvorefter de højst prioriterede ideer defineres, og det vurderes, om Novozymes har kompetencerne til at udvikle dem. **Omkring (hedge)** 15-20% af ideerne går videre til næste trin, hvor det besluttet, om de skal udvikles som nye højprioritetsprojekter, **eventuelt (hedge)** sammen med relevante partnere, eller om de skal skrinlægges.

**Vi (SM)** samarbejder også på tværs af hele innovationsværdikæden for at maksimere potentialet og mindske risiciene ved **klart (AM)** at identificere behov og muligheder, der sætter **os (SM)** i stand til at tage skridtet fra idé til salgbart produkt.

For eksempel integrerer Novozymes' Shandong Innovation and Business Center, der åbnede i juni 2012, R&D, forretningsudvikling og dialog med interessenter. Her arbejder **vi (SM)** sammen med lokale interessenter for at kommercialisere de bedste udviklingsprojekter i forhold til behovene på det lokale marked. Centret, der ligger i Shandong-provinsen på Kinas dynamiske østkyst, udnytter provinsens industrielle biotekinfrastruktur, herunder universiteter og mikrobiologiske forskningsinstitutioner. Centret trækker også på provinsens position som kinesisk centrum for blandt andet fødevarerproduktion samt tekstil-, bryggeri- og læderindustri. Alle sammen områder, hvor **vi (SM)** kan tilbyde omkostningseffektive og bæredygtige løsninger.

Salgbare produkter

Radikal nytænkning handler om kreativitet og om at få den næste store idé, men den skal være både teknologisk mulig, praktisk realiserbar og opfylde et behov. Novozymes og virksomhedens partnere skal desuden have den nødvendige forskningskapacitet og marketingstruktur til at føre ideen ud i livet.

Et godt eksempel er Novozymes' forskningssamarbejde med Sea6 Energy, som har base i Chennai i Indien. Her er målet at omdanne kulhydrater fra tang til sukker, der kan forgæres og blive til brændstofethanol, finkemikalier, fødevareproteiner og gødning. Partnerskabet, der blev lanceret i januar 2012, er baseret på, at Novozymes udvikler de enzymer, der skal bruges til omdannelsesprocessen, mens Sea6 Energy bidrager med sin offshoreteknologi til dyrkning af tang. Begge partnere har skudt penge i projektet, og forskningssynergien styrker forretningspotentialet. Partnerskabet supplerer nemlig Novozymes' andre bestræbelser på at omdanne biomasse til brændstofethanol, og Sea6 Energy er en pioner, når det gælder forgæring af sukker udvundet af tang, så de kan bruges til at fremstille brændstof med minimal anvendelse af ferskvand. Resultatet er udvikling af et skalerbart, bæredygtigt alternativ til fossile brændstoffer og avanceret brændstofethanol, der ikke kræver gødning og ikke dyrkes på knappe landbrugsarealer.

Samarbejde med kunderne på et tidligt stadie

For at sikre, at der er et marked for nye produkter, og for at få fuldt udbytte af **vores (SM)** partnerskaber, er marketing og forretningsudvikling en integreret del af innovationsprocessen, og kunderne inddrages på et tidligt stadie i produktudviklingen. Det giver mulighed for en grundig undersøgelse af konceptet fra såvel teknisk som kommercielt perspektiv. Med andre ord kan **vi (SM)** hurtigt afgøre, om et foreslået produkt har den ønskede effekt, hvordan det påvirker miljøet, om det opfylder et kundebehov til en rimelig pris, og om der eksisterer konkurrerende teknologier.

Samarbejde på et tidligt stadie afdækker også, i hvilken grad kunden engagerer sig i projektet, og fremskynder kommercialiseringen af salgbare produkter. **Typisk (hedge)** kommer 6-8 produkter årligt på markedet ud af en pulje af væsentlige projekter.

**Vi (SM)** afprøver for tiden nye interne strukturer, der skal forbedre produktstrømmen i **vores (SM)** R&D-pipeline, så **vi (SM)** får mere brugbare løsninger, og som skal bidrage til at accelerere processen fra idéstadie til lancering. Successen af tiltagene måles ud fra nye produkters øgede kommercielle betydning samt løbende forbedring af den interne ressourcefordeling, så ressourcerne kanaliseres over i de projekter, der er mest relevante ud fra et markedssynspunkt.

## MÅL OG FORVENTNINGER

### NOVOZYMES' ÅRSRAPPORT 2012

#### FORVENTNINGER TIL 2013

##### Finansielle mål

- Salgsvækst på 4-7% i danske kroner
- Salgsvækst på 5-8% i lokal valuta
- Organisk salgsvækst på 5-8%
- Vækst i resultat af primær drift på 4-7%
- Overskudsgrad på **ca. (hedge)** 24%
- Vækst i årets resultat på 6-9%
- Investeringer på **ca. (hedge)** 1.100 mio. kr.
- Frie pengestrømme før opkøb på **ca. (hedge)** 1.650 mio. kr.
- Afkast af investeret kapital (ROIC) på **ca. (hedge)** 20%

##### Bæredygtighedsmål

- Sikre, at 95% af leverandørerne overholder **vores (SM)** leverandørprogram for forretnings-, kvalitets- og bæredygtighedsmæssig præstation
- Forbedre energieffektiviteten med 42% i forhold til 2005
- Forbedre CO<sub>2</sub>-effektiviteten med 50% i forhold til 2005
- Forbedre vandeffektiviteten med 35% i forhold til 2005
- Opnå en score på mindst 75 i "Tilfredshed og motivation" i medarbejderundersøgelsen
- Opnå en score på mindst 75 i "Muligheder for faglig og personlig udvikling" i medarbejderundersøgelsen
- Sikre, at mindst 30% af nyansatte ledere er kvinder
- Sikre, at mindst 55% af nyansatte ledere er af anden nationalitet end dansk
- Fastholde frekvensen af arbejdsulykker på under 3,0 pr. mio. arbejdstimer
- Fastholde medarbejderfraværet på under 3%
- Fastholde personaleomsætningen på over 4% og under 9%
- Opnå Gold Class-bedømmelse af SAM i Sustainability Yearbook 2014
- Muliggøre en reduktion i CO<sub>2</sub>-udledningen på 50 mio. tons gennem kundernes anvendelse af **vores (SM)** produkter
- Fastlægge og stå i spidsen for et biobrændstoftiltag under det FN-ledede initiativ SEFA (Sustainable Energy for All)

## FINANSIELLE FORVENTNINGER

2012 var et begivenhedsrigt år for Novozymes. Året var meget **tilfredsstillende (AM)** hvad angår rentabilitet og indtjeningsvækst, mens salgsvæksten **skuffede (AM)**, på trods af at den lå inden for det **forventede (AM)** spænd. For 2013 **forventer (hedge) vi (SM)** at kunne fastholde det nuværende rentabilitetsniveau, da **vi (SM)** har tillid til fortsat at kunne forbedre produktiviteten i hele forretningen. På salgssiden **forventer (hedge) vi**, at Novozymes' salgsvækst stiger i forhold til 2012, dog vil den stadig være under den langsigtede målsætning.

#### Forventninger til salget

Helårsforventningen til salgsvæksten både i lokal valuta og organisk er 5-8%. På basis af valutakurserne den 18. januar 2013 **forventes (hedge)** salgsvæksten i danske kroner at blive 4-7%. Salgsvæksten **forventes (hedge)** at stige hen over året.

Inden for Enzyme Business **forventer (hedge)** Novozymes, at alle fire forretningsområder vil bidrage til væksten i 2013. Vækstdriverne vil også i 2013 være vaskemiddel- og foderenzymer; sidstnævnte indgår i området foder- og andre tekniske enzymer.

Vaskemiddelenzymer **forventes (hedge)** at blive den største bidragyder til salgsvæksten for året som helhed, da de grundlæggende vækstdriverne inden for dette område **forventes (hedge)** at gøre sig gældende også i 2013. Derudover vil salget af enzymer til vaskemiddelindustrien blive understøttet af et øget salg til en vaskemiddelproducent, som stoppede sin resterende egenproduktion af enzymer i 2. halvdel af 2012.

Foderenzymer, som indgår i området foder- og andre tekniske enzymer, **forventes (hedge)** at drage fordel af den fortsatte globale lancering og stigende anvendelse af RONOZYME® ProAct samt en positiv udvikling i salget af fytaseenzymer.

Væksten i salgsområdet føde- og drikkevareenzymer **forventes (hedge)** at blive øget, eftersom væksten vil vende tilbage for nogle af de større industrier som stivelse og bageri, og efterspørgslen efter enzymer til sunde fødevarekoncepter fortsat **forventes (hedge)** at stige.

Enzymsalget til bioenergiindustrien **forventes (hedge)** at vokse i 2013 i forhold til 2012. Salget i USA vil blive positivt påvirket af øget penetration af det nyligt lancerede produkt Novozymes Avantec®, som gør det muligt for producenter af majsbaseret ethanol at øge ethanoludbyttet af den samme mængde majs med op til 2,5%. Helårsforventningen til salget er baseret på, at den amerikanske bioethanolproduktion i 2013 vil ligge på nogenlunde samme niveau som i 2012.

Der **forventes (hedge)** tocifret organisk salgsvækst inden for BioBusiness med positivt bidrag fra både mikroorganisme- og biofarmaforretningsområdet.

Salget af mikroorganismer til BioAg-industrien **forventes (hedge)** at blive den største bidragyder til væksten som følge af at de nyligt offentliggjorte partnerskaber samt vækst i Nordamerika og på nye markeder i Europa og Asien. Opkøbet af Natural Industries, Inc. i november 2012 vil i 2013 bidrage svagt til salgsvæksten i både lokal valuta og i danske kroner. Der **forventes (hedge)** moderat vækst i de øvrige mikroorganismeindustrier.

Biofarmasalget **forventes (hedge)** at nyde gavn af øget salg af rekombinant albumin til en voksende kundebase, der blev etableret i 2012. Salget af hyaluronsyre **forventes (hedge)** også at vokse, i takt med at potentielle kunder afslutter produkttestfasen i 2013 og afgiver deres kommercielle ordrer.

#### Forventninger til indtjeningen

Resultat af primær drift **forventes (hedge)** at stige 4-7%.

Forventningen til overskudsgrad i 2013 er **ca. (hedge)** 24%.

Årets resultat **forventes (hedge)** at stige 6-9%.

**Ca. (hedge)** 75% af den forventede USD-eksponering for 2013 er afdækket på 5,61 DKK/USD mod 5,70 i 2012. **Ca. (hedge)** 42% af den forventede EUR-eksponering er afdækket på 7,41 DKK/EUR for 2013.

#### Forventninger til investeringer og pengestrømme

For 2013 **forventer (hedge)** Novozymes nettoinvesteringer på **ca. (hedge)** 1,1 mia. kr. Ud over omkostninger til vedligeholdelse af anlægsaktiver og investeringer i driftseffektivitet vil Novozymes investere i fremtidig salgsvækst, herunder udvidelse af forsknings- og udviklingsfaciliteter. Der vil også blive investeret i forbedring af energieffektiviteten, hvilket vil bidrage positivt til energibesparelser og opnåelse af målene for bæredygtighed.

Frie pengestrømme før opkøb **forventes (hedge)** at blive **ca. (hedge)** 1.650 mio. kr., primært som følge af højere resultat for året og lavere anlægsinvesteringer.

Afkast af investeret kapital **forventes (hedge)** at blive **ca. (hedge)** 20%.

#### MERE MED MINDRE

Novozymes' biologiske løsninger hjælper med at løse ubalancen mellem mere og mere knappe naturressourcer, øgede omkostninger og stigende menneskelige behov. **Vi (SM)** hjælper kunderne med at producere flere produkter af højere kvalitet med brug af mindre energi og færre råvarer. Det kan lade sig gøre at skabe en biobaseret økonomi, og med **vores (SM)** innovation hjælper **vi (SM)** verden godt på vej mod målet.

#### Valutakurser ultimo

Forventningerne er baseret på, at kurserne for selskabets vigtigste valutaer forbliver uændret året igennem i forhold til spotkurserne pr. 18. januar 2013.

Alt andet lige **forventes (hedge)** en 5% ændring i USD at påvirke resultat af primær drift med 60-80 mio. kr. på årsbasis.

#### Produktpipeline

Novozymes har en stærk pipeline for produktlanceringer og **forventer (hedge)** at lancere flere nye produkter i 2013 end i 2012. Disse produktlanceringer vil understøtte Novozymes' langsigtede vækst.

#### FORVENTNINGER TIL BÆREDYGTIGHED

Som det er tilfældet for **vores (SM)** langsigtede mål, afspejler **vores (SM)** forventninger til bæredygtighed hensynet til hele værdikæden og til **vores (SM)** vigtigste interessenter. Derfor adresserer **vores (SM)** forventninger følgende kategorier: leverandører, Novozymes, kunder og samfund. Selv om **vi (SM)** tager hele værdikæden i betragtning, er størstedelen af **vores (SM)** forventninger dog koncentreret om interne tiltag.

#### Bæredygtig forsyningskæde

I tråd med **vores (SM)** nye langsigtede mål om at opnå 100% tilslutning til **vores (SM)** leverandørprogram for forretnings-, kvalitets- og bæredygtighedsmæssig præstation i 2015 er **vores (SM)** mål for 2013 at sikre, at 95% af alle leverandører med en 12-måneders rullende fakturering på over 1 mio. kr. skal overholde kravene.

#### BÆREDYGTIGHED I HELE VÆRDIKÆDEN

**Vores (SM)** fokus på bæredygtighed i hele værdikæden har betydning for **vores (SM)** relationer med leverandører, kunder og samfundet som helhed. Herved er **vi (SM)** med til at forbedre levevilkår, miljø og den måde, **vi (SM)** selv driver forretning på.

#### Novozymes

Inden for Novozymes vedrører **vores (SM)** forventninger ressourceudnyttelse, udvikling af arbejdspladsen og lederskab inden for bæredygtighed.

#### Ressourceudnyttelse og effekt på klimaforandringer

**Vi (SM)** har valgt 2005 som basisår for **vores (SM)** effektivitetsmål i forhold til ressourcer. 2013-målene for forbedring af ressourceeffektiviteten er 42% for energi, 35% for vand og 50% for CO<sub>2</sub>. CO<sub>2</sub>-målet er baseret på udledning fra Novozymes' egne produktionsanlæg og fra energiforsyningselskaber.

#### Udvikling af arbejdspladsen

Novozymes arbejder på at sikre en arbejdsstyrke bestående af tilfredse og motiverede medarbejdere gennem fastsættelse af mål for medarbejdertilfredshed og motivation. I 2013 er målet en score på mindst 75 i **vores (SM)** medarbejderundersøgelse for både "Tilfredshed og motivation" og "Muligheder for faglig og personlig udvikling".

For yderligere at fremme en mangfoldig og rummelig arbejdsplads har **vi (SM)** sat nye mål for mangfoldighed på ledelsesniveau. Andelen på ledelsesniveau af kvinder og personer af anden nationalitet end dansk er p.t. lavere end i organisationen som helhed og ligger også **relativt (hedge)** konstant. Derfor er **vores (SM)** mål for 2013, at mindst 30% af alle nyansatte ledere skal være kvinder, og 55% skal være af anden nationalitet end dansk. Ledere defineres her som ansatte, som mindst tre medarbejdere refererer til.

Ud over disse mål **ønsker (AM) vi (SM)** at fastholde frekvensen af arbejdsulykker på under 3,0 pr. mio. arbejdstimer og fravær på under 3% i 2013. Målet for personaleomsætning er fastsat med en øvre og en nedre grænse og afspejler den aktuelle beskæftigelsessituation og Novozymes' mål om at tiltrække og fastholde medarbejdere. **Vi (SM) anser det for ønskværdigt (AM)**, at personaleomsætningen i 2013 ligger på over 4% og under 9%.

Lederskab inden for bæredygtighed

Novozymes **lægger stor vægt på (AM)** at måle indsatsen på bæredygtighedsområdet op mod sammenlignelige virksomheders. Dette afspejles i **vores (SM)** mål for 2013 om at opnå en Gold Classvurdering i SAM's Sustainability Yearbook 2014. Selv om **vi (SM)** har valgt Dow Jones Sustainability Indexes og SAM's vurdering som målestok, er en række alternative vurderinger lige så **værdifulde (AM)**.

Kunder

**Vi (SM) ønsker (AM)** at hjælpe kunderne med at få mere ud af verdens ressourcer og nedbringe deres produkters miljømæssige fodaftryk igennem hele deres livscyklus. **Vi (SM)** har derfor fastsat et mål om en reduktion af CO<sub>2</sub>-udledningen på 50 mio. tons gennem **vores (SM)** kunders anvendelse af **vores (SM)** produkter i 2013.

Samfund

Som et logisk led i **vores (SM)** bestræbelser på at styrke samfundets gradvise bevægelse i retning af bæredygtige løsninger og nå **vores (SM)** nye langsigtede mål har **vi (SM)** sat et mål for 2013 om at stå i spidsen for indførelsen af et biobrændstoftiltag under det FN-ledede initiativ SEFA (Sustainable Energy for All). Mere specifikt vil det kræve, at Novozymes tager en ledende rolle med henblik på at samle alle relevante parter med tiltag inden for biobrændstoffer under, hvad der er defineret som et initiativ under SEFA.

## LANGSIGTEDE MÅL OG STRATEGI

Novozymes' vision er en fremtid, hvor **vores (SM)** biologiske løsninger skaber den nødvendige balance mellem forretningsmæssig vækst, et renere miljø og bedre levevilkår.

**Vores (SM)** integrerede forretningstilgang afspejles i **vores (SM)** langsigtede mål. Ud over ambitionerne for salgsvækst og finansielt afkast **ønsker (AM) vi (SM)** at udnytte **vores (SM)** ressourcer så effektivt som muligt, reducere **vores (SM)** miljømæssige fodaftryk og fortsat være førende inden for bæredygtighed.

## LANGSIGTEDE MÅL

Pr. 21. januar 2013 har **vi (SM)** opdateret både **vores (SM)** langsigtede finansielle mål for de kommende fem år og **vores (SM)** mål for bæredygtighed. De finansielle mål har været uændrede siden 2009. Nu har et **klarere (AM)** billede af Novozymes' fremtidige vækstfaktorer og indtjening imidlertid givet anledning til en justering af de langsigtede finansielle mål. De nye mål, som er angivet herunder, **forudsætter (hedge)**, at Novozymes ikke foretager større opkøb.

**Vi (SM)** har også ændret **vores (SM)** langsigtede mål for bæredygtighed, så de afspejler Novozymes' engagement i hele værdikæden. De nye mål, som er integreret i **vores (SM)** forretningsstrategi og konkrete forretningsinitiativer, understreger **vores (SM)** involvering og samarbejde med forretningspartnere og andre interessenter.

**Læs (EM)** mere om de langsigtede finansielle mål og mål for bæredygtighed i afsnittet "Strategisk opdatering".

### FORRETNINGSSTRATEGI

**Vores (SM)** mål er at etablere nye, rentable forretningsområder og optimere udnyttelsen af **vores (SM)** egne og naturens ressourcer ved at drive innovation, udvide forretningsmuligheder og forbedre både **vores (SM)** egen og **vores (SM)** kunders produktivitet.

## NOVOZYMES' LANGSIGTEDE MÅL

Finansielle mål

- Gennemsnitlig organisk salgsvækst på over 10%
- Overskudsgrad på over 24%
- Afkast af investeret kapital (ROIC) på over 22%

Målet for den gennemsnitlige organiske salgsvækst **forventes (hedge)** at kunne nås fra 2015 og fremover efter en optrapning fra det nuværende niveau.

Målene er baseret på følgende **antagelser (hedge)**:

- Verdensøkonomien stabiliserer sig
- Biobrændstofmarkedet i USA bevæger sig i retning af E15
- Novozymes sælger enzymer til mindst 15 biomasseomdannende fabrikker senest i 2017 med optrapning i 2015-2016

Mål for bæredygtighed

- Sikre, at 100% af leverandørerne overholder Novozymes' leverandørprogram for forretnings-, kvalitets- og bæredygtighedsmæssig præstation i 2015
- Muliggøre en reduktion i CO<sub>2</sub>-udledningen på 75 mio. tons i 2015 gennem anvendelse af Novozymes' produkter
- Forbedre vandeffektiviteten med 40% i 2015 i forhold til 2005
- Forbedre energieffektiviteten med 50% i 2015 i forhold til 2005
- Forbedre CO<sub>2</sub>-effektiviteten med 50% i 2015 i forhold til 2005
- Øge energiforsyningen fra vedvarende og CO<sub>2</sub>-neutrale energikilder til 50% i 2020
- Blive anerkendt som verdensførende inden for bæredygtighed
- Blive en foretrukket arbejdsgiver på verdensplan, som tiltrækker talentfulde medarbejdere fra hele verden til en mangfoldig og rummelig arbejdsplads
- Stå i spidsen for medtagelse af biobrændstoffer som "high-impact opportunity" i FN's initiativ Sustainable Energy for All i 2015

#### **VIGTIG (AM) UDVIKLING INDEN FOR BIOENERGI**

Novozymes er verdens førende leverandør af enzyntechnologi til konventionelle biobrændstoffer. Gennem innovation og strategiske partnerskaber spiller **vi (SM)** også en afgørende rolle, når det gælder kommercialisering af avancerede biobrændstoffer, som fremstilles af restprodukter fra landbruget og andre affaldsprodukter. Produktionen af konventionelle biobrændstoffer i USA, som er Novozymes' største bioenergimarked, er steget voldsomt inden for de sidste 10 år og udgør nu 10% af landets benzinforbrug til transport. Væksten i den amerikanske bioenergiindustri er imidlertid fladet ud de sidste par år, da forhøjelsen af den øvre grænse for ethanolindholdet i benzin fra 10% til 15% kun langsomt vinder indpas på markedet. Desuden har udsving i majspriserne lagt pres på ethanolproducenternes indtjening og dermed givet bioinnovation en central rolle i forhold til at producere mere med mindre.

**Vores (SM)** seneste produkt, Novozymes Avantec®, som blev lanceret i oktober 2012, gør det nu muligt for producenterne at presse 2,5% mere ethanol ud af majs. En **typisk (hedge)** amerikansk ethanolfabrik bruger årligt **ca. (hedge)** 900.000 tons majs af foderkvalitet til at producere 100 mio. gallon (380 mio. liter) ethanol. Med Avantec kan fabrikken spare 22.500 tons majs og producere samme mængde ethanol. Hvis alle ethanolfabrikker i SA anvendte Avantec, **ville (hedge)** de tilsammen kunne spare 3 mio. tons majs svarende til en årlig bruttobesparelse på **ca. (hedge)** 5 mia. kr.

#### **Spændende (AM) udvikling inden for avancerede biobrændstoffer**

Med indvielsen af de første kommercielle produktionsanlæg i Kina og planlægning af flere fabrikker i Europa og USA i 2013 blev 2012 et **vigtigt (AM)** år for de avancerede biobrændstoffer. I oktober tog Novozymes endnu et **vigtigt (AM)** skridt i forhold til at fremme kommercialiseringen af avancerede biobrændstoffer ved at indgå et strategisk partnerskab med Beta Renewables, en førende leverandør af teknologi til biobrændstofproduktion. Formålet er i fællesskab at kunne garantere produktionsomkostninger og -processer.

Løsningen er enestående, idet den reducerer både de finansielle og de teknologiske risici ved kundernes projekter og hjælper med at sætte skub i masseproduktionen inden for denne industri. Novozymes **forventer (hedge)**, at Beta Renewables over de næste 3-5 år vil kunne vinde kontrakter på 15-25 nye fabrikker, hvilket vil øge Novozymes' årlige omsætning med op til 1 mia. kr. Disse første kommercielle anlæg er et **vigtigt (AM)** skridt i retning af at påvise, at markedet er levedygtigt.

Samtidig lancerede **vi (SM)** en ny enzymløsning, Novozymes Cellic® CTec3, som yderligere reducerer omkostningerne og øger udbyttet ved produktion af avancerede biobrændstoffer, så prisen for at producere en liter ethanol af biomasse er på niveau med prisen på konventionel ethanol og benzin.

Risikominimering i en politisk reguleret industri

I modsætning til de fleste andre industrier, som Novozymes er involveret i, er transportbrændstofindustrien strengt reguleret. Den amerikanske bioenergiindustri er reelt opstået som et politisk initiativ med det formål at udnytte nationale landbrugsressourcer til at øge energisikkerheden, reducere CO<sub>2</sub>-udledningen og støtte den økonomiske udvikling i landområderne. Disse tre faktorer gør sig gældende i hele verden, mens den politiske støtte varierer afhængigt af den regionale og geopolitiske udvikling.

I 2012 blev en række både nye og eksisterende reguleringstiltag på bioenergiområdet debatteret. Som følge af en omfattende tørke kom den amerikanske energilov Renewable Fuel Standard (RFS) under pres, da en række delstater anmodede den amerikanske miljøstyrelse, EPA, om at sænke iblandingskravet til indholdet af biobrændstof i benzin. Alle anmodninger blev dog afvist. **Vi (SM) forventer (hedge)**, at iblandingskravet vil blive udfordret igen i 2013, men har tillid til, at branchen fortsat vil bakke op om RFS og promovere de positive resultater, den har medført.

I Kina skete der fremskridt, idet den Nationale Udviklings- og Reformkommission annoncerede, at den senest i 2015 vil øge produktionen af bioenergi med 5 mio. tons om året. Det er en kraftig stigning i forhold til de 1,75 mio. tons, der blev fremstillet i 2011. Samtidig foreslog Europa-Kommissionen at begrænse de konventionelle biobrændstoffer til 5% og at give et større incitament til produktion af avancerede biobrændstoffer. Endelig brød den verdensomspændende debat om brugen af landbrugsressourcer til energiproduktion atter ud i lys lue, da de globale priser på landbrugsvarer endnu en gang viste store udsving i årets løb.

Novozymes arbejder aktivt på tværs af regioner og i tæt samarbejde med industripartnere, vigtige meningsdannere, NGO'er og mellemstatslige organisationer for at fremme en nuanceret offentlig debat og sikre, at politiske beslutninger baseres på videnskabelige data. Formålet er at sikre en langsigtet bæredygtig udvikling. **Vi (SM)** investerer også løbende i innovation for at fremme teknologien, minimere den politiske risiko og sikre kommerciel levedygtighed. Yderligere oplysninger om **vores (SM)** holdning til bioenergi kan ses på [www.novozymes.com](http://www.novozymes.com).

2012 – et glimt af fremtiden

Udviklingen i 2012 illustrerer det, som Novozymes er bedst til: at levere innovative løsninger, som øger både bæredygtigheden og levedygtigheden af kundernes forretninger. Novozymes beskæftiger **omkring (hedge)** 150 videnskabsfolk og forskere samt et særligt dedikeret forretningssteam, som udelukkende fokuserer på innovation inden for bioenergi. **Vi (SM) ved (booster)**, at bioenergiindustrien **altid (booster)** vil være politisk reguleret, hvilket skaber både muligheder og udfordringer. **Vi (SM)** vil fremover løbende forbedre **vores (SM)** enzymteknologi for at øge udbyttet i den konventionelle ethanolindustri, ligesom **vi (SM)** løbende vil reducere omkostningerne ved de avancerede biobrændstoffer og arbejde for at få biobrændstoffer med som "high-impact opportunity" på den globale dagsorden for FN's tiltag "Sustainable Energy for All" i 2015.

## STRATEGI

Novozymes er en business-to-business-virksomhed, der leverer biologiske løsninger. **Vi (SM)** konkurrerer på **vores (SM)** forståelse af kundernes forretningsmæssige behov og på **vores (SM)** evne til at skabe omkostningsbesparende og innovative biologiske løsninger på basis af **vores (SM)** indsigt. **Vores (SM)** mål er at drive verden mod bæredygtighed sammen med **vores (SM)** kunder ved at udnytte jordens ressourcer bedre med henblik på at dække behovet for fødevarer, foder, brændstoffer og andre forbrugsvarer. **Vores (SM)** forretning bygger på bioteknologi, enzymer og mikroorganismer, og det er **vores (SM)** mål at blive markedsførende alle de steder, hvor **vi (SM)** vælger at drive forretning. **Vi (SM)** arbejder ud fra princippet om den tredelte bundlinje og har derfor forpligtet **os (SM)** til løbende at forbedre **vores (SM)** finansielle, miljømæssige og sociale resultater.

**Vores (SM)** strategiske dagsorden har tre spor: at drive innovation, udvide forretningsmuligheder og forbedre produktivitet.

### Drive innovation

Som verdens førende udvikler og producent af industrielle enzymer driver **vi (SM)** industrien fremad ved at gentænke, hvordan og hvor enzymer kan anvendes. **Vi (SM) anser (AM)** bæredygtighed for at være en integreret del af **vores (SM)** forretning og en væsentlig drivkraft for styrkelse af langsigtede kunderelationer. **Vores (SM)** løsninger dækker behovet for at forbedre industrielle processer og produkter og gør det muligt for **vores (SM)** kunder at producere mere med mindre. **Vi (SM)** er dybt engageret i forskning og udvikling, som **vi (SM)** hvert år allokerer 13-14% af **vores (SM)** omsætning og over 20% af **vores (SM)** globale arbejdsstyrke til. **Vi (SM)** er også en af verdens mest aktive patentansøgere inden for **vores (SM)** område med p.t. 7.000 udstedte patenter og patentansøgninger. **Vores (SM)** innovation driver toplinjevæksten, som gør **os (SM)** i stand til både at øge forretningen på eksisterende markeder og komme ind på nye markeder.

### Udvide forretningsmuligheder

Novozymes har som mål at udnytte fundamentet i enzymteknologien til at udforske biologiske forretningsmuligheder, også inden for andre områder. Biologiske løsninger som mikroorganismer og andre proteiner end enzymer vil også kunne dække behovet for sikre og omkostningsbesparende løsninger, forbedre industriprocesser og reducere forbruget af råvarer, vand og energi. **Vi (SM)** er førende på en række områder, hvor **vi (SM)** har en konkurrencefordel som følge af **vores (SM)** teknologiske platform og organisationsmæssige kompetencer, og **vores (SM)** løsninger er til gavn for hele samfundet. **Vi (SM)** bestræber **os (SM)** på at omdanne muligheder til større forretningsområder, som kan understøtte **vores (SM)** langsigtede vækst og afkast.

### Forbedre produktivitet



Novozymes har som mål at levere vedvarende afkast af **vores (SM)** innovationsarbejde ved løbende at forbedre udnyttelsen af både **vores (SM)** egne og naturens ressourcer i hele virksomheden og specielt i **vores (SM)** produktionsprocesser. **Vi (SM)** anvender avancerede teknologier til at forbedre både effektiviteten i **vores (SM)** gæringsprocesser, de stammer, der producerer **vores (SM)** enzymer, og enzymerne ydeevne. Derved kan **vi (SM)** øge udbyttet af eksisterende anlæg og samtidig mindske **vores (SM)** forbrug af råvarer, vand og energi, hvilket resulterer i en fleksibel produktionsstruktur, der forbedrer overskudsgraden, afkastet og **vores (SM)** miljømæssige fodaftryk.

## STRATEGISK OPDATERING

Novozymes' strategi og finansielle mål har været uændrede siden 2009. **Direktionen og bestyrelsen (SM)** bekræfter, at Novozymes vil fortsætte strategien med at levere bæredygtig vækst gennem innovation, markedstilstedeværelse og driftseffektivitet. **Ledelsen (SM)** har imidlertid besluttet at opdatere de finansielle mål som følge af den forbedrede visibilitet for fremtidige salgs- og indtjeningsmuligheder.

Tidligere medtog Novozymes ikke fremtidigt salg af enzymer til omdannelse af biomasse i sine langsigtede mål. Nu er der imidlertid bedre visibilitet med hensyn til vækstmuligheder inden for dette nye område. Derudover er visibiliteten forbedret for adskillige projekter i pipelinen for salg af mikroorganismer til BioAg-industrien og løsninger til biofarmaindustrien. Hvad angår indtjeningen har **vi (SM)** i de sidste par år overgået **vores (SM)** hidtidige langsigtede mål for overskudsgrad, og **vi (SM)** **forventer (hedge)** at kunne fastholde det nuværende niveau.

## Salgsvækst

Novozymes **forventer (hedge)** vækst inden for alle industrier i den femårige periode med salg af vaskemiddelenzymer blandt de største vækstdrivere. Salget af enzymer til biomasseomdannelse og salget til biofarmaindustrien **forventes (hedge)** langsomt at geare op i 2013 og 2014 og bidrage væsentligt til salgsvæksten i 2015. Herved vil Novozymes kunne nå en gennemsnitlig organisk salgsvækst på over 10% i 2015 og fremover. Målet for salgsvækst er baseret på den **antagelse (hedge)**, at verdensøkonomien stabiliserer sig og ikke oplever større udsving.

## Omdannelse af biomasse

Novozymes' langsigtede mål **forudsætter (hedge)**, at selskabet sælger enzymer til mindst 15 biomasseomdannende fabrikker senest ved udgangen af 2017. De første fabrikker til produktion af cellulosebaseret ethanol bliver indviet i 2013-2014. Herefter **forventes (hedge)** det, at flere aktører vil påbegynde opførelse af fabrikker.

Novozymes samarbejder med Beta Renewables, som **forventes (hedge)** at skrive kontrakt på design og planlægning af 15-25 fabrikker til produktion af cellulosebaseret ethanol inden for de kommende 3-5 år. Da Novozymes er den foretrukne leverandør af enzymer til Beta Renewables, **forventes (hedge)** det, at disse kontrakter vil generere et enzymsalg for Novozymes, så snart de pågældende fabrikker går i drift cirka to år senere, og at disse kontrakter om 5-7 år vil bidrage med op til 1 mia. kr. årligt til Novozymes' enzymsalg.

Novozymes samarbejder desuden med andre partnere om udvikling af teknologi til produktion af cellulosebaseret ethanol og andre metoder til omdannelse af biomasse til forgærbare sukkerarter til produktion af biokemikalier og andre materialer. Disse partnerskaber **forventes (hedge)** også at medføre salg af enzymer hen imod slutningen af den femårige periode.

## Overskudsgrad

Novozymes' nye langsigtede mål for overskudsgrad er over 24%. Dette niveau **forventes (hedge)** at være opnåeligt, samtidig med at **vi (SM)** fastholder den ønskede fleksibilitet i forretningen med hensyn til at forfølge muligheder for langsigtet vækst.

## Afkast af investeret kapital (ROIC)

Det langsigtede mål for afkast af investeret kapital, inklusive goodwill, på over 22% er uændret. Målet er ambitiøst, men opnåeligt. Afkastet af investeret kapital er faldet gennem de seneste par år som følge af opkøb, men i takt med at investeringsniveauet nærmer sig normalen, og salget samtidig stiger, **forventer (hedge)** Novozymes at nå målet og fastholde et niveau på over 22%.

Novozymes **forventer (hedge)** fortsat at kunne opnå produktivitetsforbedringer inden for både Enzyme Business og BioBusiness. Dette er **vigtigt (AM)** for at kunne opveje stigende råvarepriser og nå målene for overskudsgrad og afkast af investeret kapital.

## Innovation

Novozymes' fremtidige succes afhænger af innovation, og selskabet vil derfor fortsat allokere 13-14% af salget til forskning og udvikling. Fokus vil **altid (booster)** ligge på at investere i projekter, der kan sikre fremtidig vækst for Novozymes og være til gavn for

kunderne. Novozymes foretager p.t. ændringer i interne strukturer med henblik på at forbedre produktflowet i forsknings- og udviklingspipelinen i retning af bedre kvalificerede løsninger og kortere gennemløbstid fra idé til marked. Måleenheden for denne indsats er øget kommerciel effekt af nye produkter.

#### Investeringer

I de seneste år har Novozymes foretaget **relativt (hedge)** store investeringer med henblik på at være gearet til fremtidig vækst inden for både Enzyme Business og BioBusiness. **Vi (SM) forventer (hedge)**, at et investeringsniveau på ikke over 8% set i forhold til salget vil være tilstrækkeligt til fremover at sikre en salgsvækst på 10%. Viser der sig vækstmuligheder, der kræver en forudgående investering, vil Novozymes tillade, at investeringerne stiger til over det fastsatte mål. Udvidelser af forsknings- og udviklingsfaciliteter er ikke inkluderet i 8%-målet.

#### Opkøb og partnerskaber

Novozymes er til stadighed interesseret i virksomheder og teknologier, der passer strategisk til selskabets overordnede målsætninger, og som kan fastholde balancen i porteføljen med hensyn til risiko, fremtidig værdiskabelse, markedsadgang og ressourceudnyttelse. Novozymes er **altid (booster)** på udkig efter nye muligheder og vil fortsat foretage opkøb og frasalg af aktiviteter, når det er nødvendigt for at sikre balance i porteføljen.

Strategiske partnerskaber er et væsentligt led i at nå ud til og servicere nye kunder. Novozymes vil fortsat søge efter forretningspartnere, som kan komplementere selskabets styrker og bringe dets teknologi på markedet.

#### Bæredygtighed

Bæredygtighed er en integreret del af Novozymes' forretning. Novozymes' teknologi gør kunderne i stand til at optimere udnyttelsen af råvarer og energi. Det er blevet en konkurrencefordel for os, i takt med at flere og flere kunder selv bruger bæredygtighed som konkurrenceparameter.

For at understøtte ambitionen om at fremme bæredygtighed rundt om i verden arbejder Novozymes tæt sammen med virksomheder på hele værdikæden: leverandører, kunder og samfundet. Novozymes mindsker risici og udnytter leverandørernes styrke ved at kræve sikkerhed ved levering, kvalitet og effektivitet i forhold til bæredygtighed og innovation. **Vi (SM)** arbejder på og investerer i at øge **vores (SM)** CO<sub>2</sub>-effektivitet ved at forbedre egne produktionsprocesser og ved at reducere kundernes CO<sub>2</sub>-udledning, når de bruger **vores (SM)** produkter. Novozymes er medlem af Dow Jones Sustainability World Index og Dow Jones Sustainability STOXX Index. En lang række eksterne interessenter har anerkendt Novozymes som en af verdens førende virksomheder inden for bæredygtighed.

Målene for bæredygtighed er blevet opdateret for at afspejle Novozymes' bæredygtighedsambitioner og aktiviteter i hele værdikæden og for at sikre den langsigtede udvikling af Novozymes som en international, rummelig og succesrig virksomhed.

#### TRE NYE BÆREDYGTIGHEDSMÅL

Novozymes' langsigtede mål fokuserer i stigende grad på den eksterne virkning af **vores (SM)** indsats på bæredygtighedsområdet. Derfor har **vi (SM)** tilføjet tre nye bæredygtigheds mål:

- **Vi (SM)** arbejder på, at alle leverandører skal overholde **vores (SM)** program for forretnings-, kvalitets- og bæredygtighedsmæssig præstation i 2015. Målet vil bidrage til at øge bæredygtighedseffekten af Novozymes' partnerskaber
- For yderligere at styrke **vores (SM)** position som en foretrukket arbejdsgiver har **vi (SM)** udvidet **vores (SM)** ansættelsesmål med det formål at trække på en global pulje af kandidater og derved sikre, at **vi (SM)** bliver en mere rummelig arbejdsgiver. En mangfoldig og balanceret arbejdsstyrke er af afgørende vigtighed for at fremme innovationsevner og indsigt i globale forhold
- **Vi (SM) ønsker (AM)**, at FN skal anerkende biobrændstoffer som et "high-impact opportunity"-område i sit initiativ Sustainable Energy for All (SEFA), der har som formål at gøre bæredygtig energi tilgængelig på verdensplan senest i 2030 gennem tiltag inden for alle samfundssektorer. Om initiativet bliver en succes afhænger af de mange nøgleaktørers engagement, så Novozymes og andre interessenter **må (EM)** samarbejde om at udbrede kendskabet til potentialet i biobrændstoffer

#### LEDELSE

## BESTYRELSE OG DIREKTION (SM)

**Bestyrelsen og direktionen (SM)** har forskellige kompetencer for at sikre den bedst mulige ledelse af virksomheden. Medlemmerne har bred international ledelseserfaring, solid ekspertise inden for bioteknologi og indgående kendskab til Novozymes' forretning.

### BESTYRELSEN (SM)

\* Disse bestyrelsesmedlemmer anses ikke for uafhængige i henhold til definitionen i de danske Anbefalinger for god selskabsledelse.

HENRIK GÜRTLER\*

Født 1953. Administrerende direktør, Novo A/S. Bestyrelsesformand siden 2000. Valgt for et år ad gangen.

Ledelseshverv

Formand: Københavns Lufthavne A/S

COWI Holding A/S

Medlem: Novo Nordisk A/S

Særlige kompetencer: Indgående kendskab til Novozymes' forretning samt ekspertise i at lede og arbejde i en international biotekvirksomhed

KURT ANKER NIELSEN\*

Født 1945. Bestyrelsesnæstformand siden 2000. Formand for Revisionskomiteen. Valgt for et år ad gangen.

Ledelseshverv

Formand: Dalhoff Larsen & Horneman A/S

Medlem: Novo Nordisk Fonden

Novo Nordisk A/S

Vestas Wind Systems A/S

Veloxis Pharmaceuticals A/S

Formand for revisionskomiteen: Vestas Wind Systems A/S

Veloxis Pharmaceuticals A/S

Medlem af revisionskomiteen: Novo Nordisk A/S

Særlige kompetencer: Ekspertise inden for kapitalmarkeder, økonomi og regnskab samt indgående kendskab til Novozymes' forretning

AGNETE RAASCHOU-NIELSEN

Født 1957. Bestyrelsesmedlem siden 2011. Medlem af Revisionskomiteen. Valgt for et år ad gangen.

Ledelseshverv

Formand: Brdr. Hartmann A/S

JØP Pension

Næstformand: Danske Invest

Medlem: Danske Invest Management A/S

Dalhoff Larsen & Horneman A/S

Arkil Holding A/S

Solar A/S

Schouw & Co. A/S

Energiteknologisk Udviklings- og Demonstrationsprogram (EUDP)

Medlem af revisionskomiteen: Dalhoff Larsen & Horneman A/S

Særlige kompetencer: Ekspertise inden for forretningsudvikling og opkøb, makroøkonomi og immaterialret

JØRGEN BUHL RASMUSSEN

Født 1955. Koncernchef, Carlsberg A/S. Bestyrelsesmedlem siden 2011. Valgt for et år ad gangen.

Ledelseshverv

Formand: JSC Baltika Breweries

Medlem: Carlsberg Breweries A/S

DI's udvalg for erhvervspolitik

Særlige kompetencer: Opkøb, international forretningsdrift og ledelse, navnlig inden for salg, marketing og branding

LENA OLIVING

Født 1956. Viceadministrerende direktør og COO, Saab AB (Sverige). Bestyrelsesmedlem siden 2011. Medlem af Revisionskomiteen. Valgt for et år ad gangen.

Ledelseshverv

Medlem: SJ AB

Medlem af revisionskomiteen: SJ AB

Særlige kompetencer: Ekspertise inden for finans og regnskab, bred erfaring med forsyningskæde, procesoptimering og produktion

MATHIAS UHLÉN

Født 1954. Professor, Kungliga Tekniska Högskolan, Stockholm, og DTU. Bestyrelsesmedlem siden 2007. Valgt for et år ad gangen.

Ledelseshverv

Formand: Atlas Antibodies AB

Antibodypedia AB

Næstformand: Affibody AB

Medlem: Swetree Technologies AB

Bure Equity AB

Særlige kompetencer: Bred erfaring med forskning og bioteknologi

LARS BO KØPPLER

Født 1962. Tekniker. Medarbejderrepræsentant. Bestyrelsesmedlem siden 2010. Valgt for fire år ad gangen.

SØREN HENRIK JEPSEN

Født 1947. Leder, Regulatory Affairs. Medarbejderrepræsentant. Bestyrelsesmedlem siden 2005. Valgt for fire år ad gangen.

ULLA MORIN

Født 1954. Laborant. Medarbejderrepræsentant. Bestyrelsesmedlem siden 2001. Valgt for fire år ad gangen.

Ledelseshverv

Medlem: Novo Nordisk Fonden

## **DIREKTIONEN (SM)**

STEEN RIISGAARD

Født 1951. Administrerende direktør.

Ledelseshverv

Formand: Verdensnaturfonden (WWF) i Danmark

ALK-Abelló A/S

Næstformand: Egmont International Holding A/S

Rockwool International A/S

Medlem: CAT Science Park A/S

Medlem af revisionskomiteen: ALK-Abelló A/S

BENNY D. LOFT

Født 1965. Koncerndirektør og CFO.

Ledelseshverv

Næstformand: Bygningsfonden Den Blå Planet

Medlem: DONG Energy A/S

Xellia Pharmaceuticals AS

Medlem af revisionskomiteen: DONG Energy A/S

PEDER HOLK NIELSEN

Født 1956. Koncerndirektør, Enzyme Business.

Ledelseshverv

Medlem: Hempel A/S

LEO Pharma A/S

Beta Renewables S.p.A.

Medlem af revisionskomiteen: Beta Renewables S.p.A.

PER FALHOLT

Født 1958. Koncerndirektør, Forskning & Udvikling.

Ledelseshverv

Formand: DTU

Medlem: DHI Group

ARTs Biologics A/S

THOMAS NAGY

Født 1963. Koncerndirektør, Stakeholder Relations og COS.

Ledelseshverv

Medlem: Danish-American Business Forum

American Chamber of Commerce i Danmark

THOMAS VIDEBÆK

Født 1960. Koncerndirektør, BioBusiness.

Ledelseshverv

Medlem: Evolva AG

NY LEDELSE

**BESTYRELSEN (SM)** I NOVOZYMES UDNÆVNER PEDER HOLK NIELSEN TIL NY ADMINISTRERENDE DIREKTØR PR. 1. APRIL 2013

**Bestyrelsen (SM)** i Novozymes har udnævnt Peder Holk Nielsen til ny administrerende direktør pr. 1. april 2013. Peder Holk Nielsen afløser den nuværende administrerende direktør, Steen Riisgaard, der efter 12 år som administrerende direktør og 33 år i Novo Industri/ Novo Nordisk fratræder sin stilling som planlagt.

Peder Holk Nielsen, 56, er i dag koncerndirektør med ansvar for Enzyme Business, en stilling han har haft siden 2007. Igennem sin karriere hos Novozymes og Novo Industri/ Novo Nordisk har Peder Holk Nielsen bestredet en række ledende stillinger indenfor forretningsudvikling, forskning, kvalitetssikring og salg og markedsføring. Peder Holk Nielsen har en kandidatgrad og en Ph.D. i kemi fra Danmarks Tekniske Universitet samt en HD i international forretningsledelse fra Copenhagen Business School.

Andrew Fordyce indtræder i **direktionen (SM)** pr. 1. april, 2013

Novozymes vil få en ny direktion den 1. april, 2013. Alle koncerndirektørerne fra den nuværende direktion vil fortsætte i den nye direktion, hvor Andrew Fordyce, 49, vil indtræde som nyt medlem. Andrew Fordyce er i dag Vice President, Sales and Customer Solutions. Siden sin start i virksomheden i 1993 har Andrew Fordyce haft en række stillinger indenfor salg, forskning og produktion i både Danmark, Schweiz og USA. Andrew Fordyce har en Ph.D. i kemi fra University of Texas, Austin.

Den 1. april, 2013 vil **direktionen (SM)** bestå af følgende medlemmer med nye ansvarsområder:

Administrerende direktør: Peder Holk Nielsen

Business Development: Koncerndirektør, Thomas Videbæk

Business Operations: Koncerndirektør, Andrew Fordyce

Supply Operations: Koncerndirektør, Thomas Nagy

Research & Development: Koncerndirektør og CSO, Per Falholt

Corporate Functions: Koncerndirektør og CFO, Benny D. Loft

## CORPORATE GOVERNANCE

**Bestyrelsen og direktionen (SM)** har opfyldt deres hovedansvarsområder og fik også i 2012 en positiv vurdering.

Novozymes forsøger til stadighed at sikre åbenhed og gennemsigtighed og at give interessenterne relevant indsigt i virksomheden og den måde, den ledes på. Til det formål er der over en årrække udviklet effektive ledelsessystemer, som løbende justeres, så de afspejler ændringer i lovkrav, ny forretningsudvikling og interessenternes forventninger. Struktureringen af Novozymes' Corporate Governance udgør en hjørnesten i ledelsessystemerne.

### BESTYRELSENS (SM) SAMMENSÆTNING OG ANSVARSOMRÅDER

Novozymes har i henhold til dansk lovgivning et tostrengt ledelsessystem, der består af en bestyrelse og en direktion uden personsammenfald. Ansvarsfordelingen mellem **bestyrelse og direktion (SM)** er **klart (AM)** fastlagt og beskrevet i **Bestyrelsens (SM)** forretningsorden og Retningslinjer for direktionen, der findes på [www.novozymes.com](http://www.novozymes.com).

I henhold til Novozymes' vedtægter skal der på den årlige generalforsamling vælges 4-8 bestyrelsesmedlemmer. **Bestyrelsen (SM)** har p.t. seks generalforsamlingsvalgte medlemmer, som vælges for et år ad gangen, og som ikke kan vælges eller genvælges, efter at de er fyldt 70. Kandidater indstilles på baggrund af en vurdering af blandt andet kompetencer, mangfoldighed, uafhængighed og, for eksisterende medlemmers vedkommende, tidligere indsats. Desuden sidder der i **bestyrelsen (SM)** tre medarbejderrepræsentanter, som vælges for fire år ad gangen.

**Bestyrelsen (SM)** står til regnskab over for virksomhedens aktionærer for den måde, virksomheden driver forretning på. **Bestyrelsen (SM)** skal derfor sammensættes således, at medlemmernes samlede kompetencer til enhver tid sætter den i stand til at inspirere, vejlede og føre tilsyn med virksomhedens udvikling og ansvarsfuldt tage hånd om og løse de udfordringer og problemer, virksomheden står over for.

De fornødne kompetencer er defineret i en kompetenceprofil, der angiver forskellige personlige egenskaber, færdigheder og erfaring. De enkelte bestyrelsesmedlemmers kompetencer er beskrevet i afsnittet "Bestyrelse og direktion".

**Bestyrelsens (SM)** hovedansvarsområder er:

- Sikring af den optimale ledelses- og organisationsstruktur
- Overvågning af den finansielle, sociale og miljømæssige præstation samt **direktionens (SM)** daglige ledelse af virksomheden
- Fastlæggelse af virksomhedens overordnede ledelse og strategiske udvikling

Opgaverne i denne forbindelse er vist i diagrammet Et år med **bestyrelsen (SM)**.

Der er etableret et formandskab i henhold til selskabets vedtægter og **bestyrelsens (SM)** forretningsorden. Det består af to medlemmer – formand Henrik Gürtler og næstformand Kurt Anker Nielsen – og skal bistå **bestyrelsen (SM)** i spørgsmål vedrørende aflønning og udnævnelse af medlemmer af **direktionen (SM)** samt føre tilsyn med **direktionens (SM)** daglige ledelse af virksomheden og rapportere tilbage til **bestyrelsen (SM)**. Formandskabet har også ansvaret for at planlægge og forberede bestyrelsesmøder, forberede materiale til indstilling af kandidater til **bestyrelsen (SM)** og komme med anbefalinger til aflønning af bestyrelsesmedlemmer.

Desuden har **bestyrelsen (SM)** nedsat en Revisionskomite. Nærmere oplysninger om Revisionskomiteen findes på [www.novozymes.com](http://www.novozymes.com).

## CHARTRE OG ANBEFALINGER

Ved fastlæggelsen af ledelsesprincipperne i Novozymes har **bestyrelsen (SM)** fulgt Anbefalinger for god selskabsledelse, som er en del af de oplysningsforpligtelser, der gælder for selskaber, som er noteret på NASDAQ OMX København. Anbefalingerne findes på [www.corporategovernance.dk](http://www.corporategovernance.dk). En detaljeret gennemgang af Novozymes' holdninger til de enkelte anbefalinger findes i den

lovpålagte Corporate Governance-rapportering i henhold til § 107b i årsregnskabsloven under "Corporate governance" på [www.novozymes.com](http://www.novozymes.com).

I henhold til anbefalingerne skal virksomheder redegøre for eventuel manglende efterlevelse af anbefalingerne. Novozymes efterlever 72 af de 79 anbefalinger. Undtagelserne er:

- Der er ikke nedsat en vederlagskomite eller en nomineringskomite. Disse ansvarsområder er omfattet af charteret for formandskabet (anb. 5.10.7 og 5.10.8)
- Vederlagsinformation for selskabets direktion gives på et samlet og ikke individuelt niveau. Novozymes er af den **opfattelse (AM)**, at information på individuelt niveau er fortrolig og privat og ikke øger informationsniveauet over for aktionærerne. **Vi (SM) anser (booster)** de givne oplysninger for at være tilstrækkelige til at bedømme **direktionens (SM)** vederlag. Der oplyses dog om den højeste gage – **se (EM)** note 4 i koncernregnskabet (anb. 6.2.3)
- Vederlagspolitikken for **direktionen (SM)** indeholder ikke en specifik klausul om tilbagebetaling af variable lønandele, der er udbetalt på grundlag af fejlbehæftede oplysninger, da Novozymes **anser (booster)** de danske lovregler for tilstrækkelige på dette område (anb. 6.1.8)
- Den nuværende direktion har ret til en fratrædelsesgodtgørelse på maksimalt tre års fast grundløn og pensionsbidrag, dvs. eksklusive variable lønandele. Dette maksimum overstiger p.t. ikke to års samlet vederlag. Novozymes har besluttet ikke at ændre de nuværende kontrakter, men ved indgåelse af fremtidige kontrakter vil den maksimale fratrædelsesgodtgørelse udgøre to års fast grundløn (anb. 6.1.9)
- Novozymes' bestyrelse forbeholder sig ret til i visse tilfælde at afvise overtagelsestilbud uden forelæggelse for aktionærerne. Dette skyldes de begrænsninger, som følger af Novo Nordisk Fondens vedtægter samt Novozymes' ejerstruktur (anb. 1.4.1 og 1.4.2)

**Vi (SM)** handler også i henhold til rammerne i Touch the World, hvor virksomhedens værdier og forpligtelser beskrives. **Vi (SM)** har desuden forpligtet **os (SM)** til at følge principperne i FN's Global Compact og FN's Biodiversitetskonvention.

#### **BESTYRELSENS (SM) SELVEVALUERING**

**Bestyrelsen (SM)** afholdt otte møder i 2012. Mødeprocenten var 95.

Som led i at sikre, at Novozymes til stadighed har velfungerende ledelsessystemer, foretager **bestyrelsen og direktionen (SM)** hvert år en vurdering af, hvorvidt hovedansvarsområderne er blevet opfyldt. Ligeledes bliver de to ledelsesorganers præstation og kvaliteten af deres indbyrdes samarbejde gennemgået og vurderet.

I 2012 blev evalueringen gennemført af en ekstern konsulent, og den var positiv. Der blev kun fundet få områder, som kan forbedres. Der var **generelt (hedge)** bred tilfredshed med planlægningen, indholdet og gennemførelsen af møder. Den **generelle opfattelse (hedge)** var, at indlæg og drøftelser på møderne var af høj kvalitet, og at **direktionen (SM)** har været meget lydhør over for **bestyrelsens (SM)** tilkendegivelser. **Bestyrelsen og direktionen (SM)** planlægger at skærpe fokus på risikoanalyse og planer for at mindske risici.

Revisionskomiteen afholdt fire møder i 2012. Alle medlemmer var til stede ved alle møder.

Revisionskomiteen udfører ligeledes en årlig evaluering af sin egen præstation, og de eksterne revisorer bliver også bedt om at vurdere, om komiteen har opfyldt kravene i Revisionskomiteens charter. Vurderingen af præstationen i 2012 var igen positiv og bekræftede, at chartret er opfyldt.

Hvert år vurderer Revisionskomiteen behovet for en intern revisionsfunktion i Novozymes. Baseret på den positive vurdering af selskabets interne kontrolmiljø og anbefaling af Revisionskomiteen har **bestyrelsen (SM)** besluttet, at en intern revisionsfunktion ikke er nødvendig.

#### **ANDRE OPLYSNINGER, SOM VEDRØRER BESTYRELSEN (SM)**

Til vedtagelse af forslag om ændring af vedtægterne kræves, at aktionærer repræsenterende mindst 2/3 af det samlede antal stemmer i selskabet er repræsenteret på generalforsamlingen, og at mindst 2/3 såvel af de afgivne stemmer som af den på generalforsamlingen repræsenterede stemmeberettigede aktiekapital stemmer for forslaget.

Generalforsamlingen har bemyndiget **bestyrelsen (SM)** til at lade selskabet løbende erhverve egne aktier i et omfang, således at den pålydende værdi af selskabets samlede beholdning af egne aktier ikke på noget tidspunkt overstiger 10% af selskabets



aktiekapital, jf. selskabslovens § 198. Købsprisen må ikke afvige med mere end 10% fra børskursen på NASDAQ OMX København på erhvervelsestidspunktet. Bemyndigelsen gælder indtil den 1. marts 2017.

Et af **bestyrelsens (SM)** ansvarsområder er at foretage en årlig vurdering og sikring af, at fastholdelsen af A- og B-aktiestrukturen er optimal. Det er fortsat **bestyrelsens (SM)** vurdering, at dette er den bedste måde at sikre Novozymes' langsigtede udvikling på til gavn for selskabets aktionærer og andre interessenter.

Novozyymes har indgået en række partnerskabsaftaler, der kan opsiges af den anden part i tilfælde af betydelige ændringer i Novozymes' ejerforhold eller kontrollen med virksomheden. Herudover indeholder enkelte af kontrakterne bestemmelser, der indskrænker Novozymes' licens til at anvende specifikke teknologier i sådanne situationer.

Novozyymes har indgået kontrakter, hvorunder ledende medarbejdere kan kræve godtgørelse i forbindelse med, at de opsiges deres stilling eller afskediges, eller hvis stillingen overflødiggøres som følge af overtagelse.

## RISIKOSTYRING

Novozyymes' ledelsessystemer har til formål at understøtte vækst- og udviklingsmuligheder. Samtidig skal de bidrage til at begrænse risici og sikre, at gældende love og regler på det miljømæssige, sociale og finansielle område bliver overholdt.

Risici kan **i nogen grad (hedge)** begrænses ved at sikre korrekt intern adfærd, men eftersom risici **ofte (hedge)** er relateret til eksterne faktorer, er processen i forhold til at identificere og styre risici integreret i Novozymes' ledelsessystemer på alle niveauer.

## IDENTIFIKATION AF RISICI OG MULIGHEDER

Novozyymes definerer risici som "begivenheder eller tendenser, der **kan (hedge)** forhindre virksomheden i at opnå de overordnede mål, herunder finansielle mål og bæredygtighedsmål, eller negativt påvirke **vores (SM)** omdømme eller **vores (SM)** fremtidige resultater". Novozymes søger at identificere risici så tidligt som muligt. Så snart de er identificeret, stræber **vi (SM)** efter så vidt muligt at begrænse dem, ligesom **vi (SM)** løbende overvåger risici.

Gennem hele værdikæden vurderer Novozymes nøje, hvad der sker i virksomhedens omgivelser med henblik på at identificere tendenser og udviklinger, der **kan (hedge)** påvirke koncernens forretning positivt eller negativt. Formålet er at sikre, at Novozymes er i stand til at reagere på forandringer i omgivelserne, enten ved at udnytte nye muligheder eller ved at håndtere risici i tide.

### MULIGHEDER OG RISICI I KIKKERTEN

Styring af risici er en løbende proces hos Novozymes. **Vi (SM)** ser både indad og udad for at få øje på forretningsmuligheder og risici og opnå maksimal effekt gennem en kombination af dybtgående undersøgelse, analyse, konstruktiv dialog, balanceret gennemgang af **vores (SM)** muligheder og rettidig respons.

## Involvering af interessenter

At involvere **vores (SM)** interessenter er en effektiv metode til at identificere risici, muligheder og nye tendenser og samtidig leve op til **vores (SM)** ambition om at være en åben og gennemsigtig virksomhed. **Vi (SM)** prioriterer **(AM)** forståelse og indfrielse af **vores (SM)** interessenteres forventninger højt.

Hvert år deltager **vi (SM)** i en lang række møder med **vores (SM)** interessenter, herunder investorer, politiske beslutningstagere, kunder, naboer og Ngo'er, for derigennem at få kendskab til relevante problemstillinger og tendenser, der **kan (hedge)** give **os (SM)** værdifuldt input til **vores (SM)** strategiske udvikling.

Den dialog, **vi (SM)** fører med interessenterne, giver **os (SM)** også mulighed for at fremme **vores (SM)** holdninger, løsninger osv. **Vi (SM)** ønsker **(AM)** at sikre, at dette sker på en respektfuld måde, så **vi (SM)** værner om **vores (SM)** omdømme. Derfor har **vi (SM)** udarbejdet en række principper for, hvordan **vi (SM)** kan bidrage til at påvirke **vores (SM)** interessenter på en etisk forsvarlig måde. **Vi (SM)** har for eksempel implementeret en ledelsesstandard, som definerer god forretningspraksis for **vores (SM)** samspil med myndigheder, beslutningstagere og politiske partier.

**Vores (SM)** Sustainability Development Board (SDB) er et eksempel på, hvordan **vi (SM)** systematisk anvender input fra **vores (SM)** interessenter. SDB består af direktører fra samtlige nøglefunktioner og har ansvaret for at udvikle **vores (SM)** strategi og mål for bæredygtig udvikling, så Novozymes hele tiden spiller en ledende rolle inden for bæredygtighed. For at kunne levere kvalificeret støtte til den strategiske beslutningstagning og forfølge en ambitiøs bæredygtighedsstrategi modtager SDB systematiske rapporter fra undersøgelser, der identificerer og vurderer tendenser, som **kan (hedge)** have væsentlig indflydelse på forretningen, og som er relevante for Novozymes' interessenter. På baggrund heraf udvælger SDB de hovedtendenser, der skal følges op på. Dette sker ud fra en vurdering af deres relevans og betydning for Novozymes' forretningsstrategier, både hvad angår muligheder og risici.

SDB rapporterer direkte til Novozymes' direktion, som vurderer og godkender bæredygtighedsmålene og -strategien før **bestyrelsens (SM)** godkendelse.

#### Risikovurderinger

Novozyymes udfører jævnligt risikovurderinger inden for forskellige dele af organisationen, **ofte (hedge)** i samarbejde med eksterne partnere, for eksempel forsikringsselskaber, så **vi (SM)** hele tiden har et opdateret, afbalanceret billede af de forretningsmæssige risici. **Vi (SM)** vurderer desuden **vores (EM)** produktionssteders sociale og miljømæssige påvirkning, som efterfølgende holdes op imod eksterne risikoanalyser og nye tendenser inden for bæredygtighedsrisikovurdering.

Som led i disse processer fastsætter **vi (SM)** mål for at forbedre præstationen inden for de vurderede områder. Hvis der påvises risici eller afdækkes manglende opfyldelse, sikrer systemerne, at der træffes yderlige forholdsregler ved at inkludere manglerne i **ledelsens (SM)** gennemgang på forskellige niveauer, alt efter hvor alvorlige de er.

#### Langsigtede scenarier

I forbindelse med strategiprocessen benytter **direktionen (SM)** langsigtede scenarier som led i en årlig evaluering af mulighederne og begrænsningerne for fremtidig vækst. Grundlaget for denne evaluering er rapporter om langsigtede scenarier for hvert forretningsområde. Scenarierne bruges også til at vurdere effekten af større beslutninger og til at vurdere den potentielle effekt af væsentlige risici. Eftersom disse scenarier anvendes som grundlag for strategiske beslutninger, suppleres rapporterne med udførlige beskrivelser, følsomhedsanalyser og risikobeskrivelser, og for ekspansionsprojekter og større investeringsforslag inkluderes et estimat af investeringens nutidsnettværdi.

En del af dette scenariearbejde omfatter identifikation af potentielle flaskehalse for fremtidig vækst, for eksempel behov for udvidelse af produktionskapacitet og adgang til ressourcer såsom vand. En del af disse scenarier, som præsenteres for direktionen, tager udgangspunkt i risici og muligheder, som er identificeret i risikostyringsprocessen.

#### RISIKOSTYRINGSPROCES

Ud over ovennævnte risikoidentifikationstiltag har Novozymes en formel proces til løbende kortlægning, vurdering og reduktion af risici. Alle forretningsenheder og direktører rapporterer systematisk nye risici og eventuelle ændringer i tidligere identificerede risici. Denne proces ledes af vicefinansdirektøren og sikrer **topledelsens (SM)** bevågenhed på risici samt involvering og ejerskab i hele organisationen.

De rapporterede risici samles og kortlægges på baggrund af sandsynlighed og mulige konsekvenser. Risici vurderes og klassificeres ud fra deres indvirkning på både økonomi og omdømme, da rapporteringen dækker såvel finansielle som ikke-finansielle risici.

Formålet med Novozymes' risikostyring er at sikre en proaktiv styring af de vigtigste risici, hvilket medfører, at der så vidt muligt gøres en aktiv indsats for at reducere både sandsynlighed og uønskede konsekvenser.

Hvert halvår rapporteres risici til Corporate Financial Planning & Analysis, som foretager en vurdering og udarbejder en liste over de **omkring (hedge)** 15 vigtigste risici. Disse rapporteres derefter til direktionen, og passende foranstaltninger for at mindske disse risici vedtages og implementeres. **Ca. (hedge)** 10 af de vigtigste risici set ud fra et økonomisk eller omdømmemæssigt perspektiv fremlægges også for og diskuteres med **bestyrelsen (SM)** to gange om året.

Den systematiske og analytiske tilgang til risikostyring giver Novozymes et **klarere (AM)** overblik over risici og et stærkere beslutningsgrundlag for såvel investering, ressourcer og nødvendige forholdsregler i forbindelse med koncernens risikoprofil.

#### Mindskelse af risici

Novozyymes mindsker risici på mange forskellige måder og på mange forskellige niveauer. Nogle risici kan mindskes gennem adfærd, andre gennem processer, procedurer eller specifikke handlinger.

#### Adfærd

Øverst i ledelsessystemet beskriver værdisættet Touch the World virksomhedens vision, bærende forretningsidé, forpligtelse og værdier. Touch the World er således et udtryk for Novozymes' forretningsfilosofi, ligesom det udstikker retningslinjerne for, hvordan **vi (SM)** driver virksomhed og handler socialt ansvarligt. Ved at overholde disse principper fremmer **vi (SM)** korrekt adfærd og mindsker risikoen for uredelighed. For at sikre, at Novozymes lever op til værdierne i Touch the World, gennemføres hvert år en undersøgelsesproces, som evaluerer hver forretningsenheds bestræbelser på at støtte og overholde principperne i Touch the World. Novozymes opfyldte sit mål for 2012 i forhold til at måle virksomhedens evne til at efterleve Touch the World i hele organisationen.

**Vores (SM)** principper om forretningsintegritet er et eksempel på, hvordan ønsket adfærd fremmes i organisationen gennem obligatorisk uddannelse. **Vi (SM)** arbejder også på at indføre disse principper uden for organisationen; **vi (SM)** informerer således **vores (SM)** leverandører, agenter m.fl. om principperne og opfordrer dem til at overholde dem. Systemer til at vurdere **vores (SM)** partners præstation i forhold til **vores (SM)** principper er implementeret, og **vi (SM)** måler **vores (SM)** fremskridt i forhold til **vores (SM)** langsigtede bæredygtighedsmål om 100% leverandøroverholdelse af **vores (SM)** leverandørprogram for forretnings-, kvalitets- og bæredygtighedsmæssig præstation.

**Vores (SM)** forretningsintegritetsprincipper kan ses på [www.novozymes.com](http://www.novozymes.com) under "Business integrity".

#### Procedurer

Risici kan også relatere sig til fejl i interne procedurer, som **kan (hedge)** føre til fejlinformation, fejlbehæftede produkter mv. Novozymes bestræber sig på at minimere disse proceduremæssige risici gennem omfattende brug af kvalitetsstyringssystemer og ISO-certificeringer. Disse systemer indbefatter generelle politikker og standarder samt omfattende krav til kontrol og handlinger, både når det gælder overordnede procedurer og specifikke krav i forhold til lokation, forretningsområde og funktion.

For at sikre, at kvalitetsstyringssystemerne bliver overholdt, gennemfører **vi (SM)** en lang række interne kvalitetsauditeringer. Resultatet kommunikeres til de relevante ledelsesniveauer.

#### Rettidig og korrekt rapportering

Novozymes **lægger stor vægt på (AM)** rettidig, gennemsigtig og korrekt rapportering, som udgør kernen i en troværdig virksomhed og er en væsentlig forudsætning for at kunne opretholde en ligeværdig dialog med interessenterne.

Novozymes' risikostyring og interne kontroller vedrørende regnskabsaflæggelsen er tilrettelagt

med henblik på:

- Aflæggelse af et internt regnskab, som giver mulighed for at måle, evaluere og følge op på Novozymes' resultater
- Aflæggelse af et eksternt regnskab, der er i overensstemmelse med International Financial Reporting Standards som godkendt af EU og andre yderligere oplysningskrav til årsrapporter for børsnoterede selskaber, og som giver et retvisende billede uden væsentlig fejlinformation

Novozymes' interne kontroller og risikostyringssystemer opdateres løbende og er udformet med henblik på at opdage og eliminere fejl og mangler i både regnskab og procedurer. Da der imidlertid **altid (booster) må (EM)** anses at være en indbygget risiko for uretmæssig brug af aktiver, uventede tab osv., kan de interne kontroller og risikostyringssystemer kun give **rimelig og ikke absolut sikkerhed (hedge)** for, at alle væsentlige fejl og mangler opdages og korrigeres.

De interne kontroller og risikostyringssystemer omfatter også de miljømæssige og sociale data, som medtages i Novozymes' Årsrapport.

En uddybende beskrivelse af Novozymes' risikostyring og interne kontroller vedrørende regnskabsaflæggelsesprocessen kan findes på [www.report2012.novozymes.com](http://www.report2012.novozymes.com)<sup>1</sup>, og denne udgør den lovpligtige Corporate Governance-rapportering, som er påkrævet i henhold til § 107b i årsregnskabsloven.

<sup>1</sup> <http://report2012.novozymes.com/Material/Statutory+report+on+corporate+governance+2012>

Regnskabsprocessen og de interne kontroller, der understøtter den, overvåges af Revisionskomiteen. Som et led i denne overvågning rapporteres alle tilfælde af besvigelser og sager, som har givet anledning til bekymring, til Revisionskomiteen, uanset om sagerne er rejst via whistleblower-systemet (Ethics Hotline) eller direkte af interne eller eksterne personer.

I 2012 blev der rapporteret 13 tilfælde af besvigelser mod fire i 2011. Samtlige 13 tilfælde førte til afskedigelse af de involverede medarbejdere, mens fem tilfælde blev politianmeldt. Alle tilfælde vedrørte tyveri eller uretmæssig brug af Novozymes aktiver.

#### Specifikke handlinger

Der vil **altid (booster)** være risici, som ikke kan undgås ved at gennemføre de **sædvanlige (AM)** foranstaltninger, men hvor indsatsen skal tilpasses og planlægges i forhold til størst mulig virkning. Der er **som regel (hedge)** tale om risici, der enten har en meget speciel karakter, som er betydelige i omfang eller **kan (hedge)** have store konsekvenser.

Nedenfor beskrives de primære risikofaktorer for Novozymes, og hvad der gøres for at mindske disse risici.

## RISIKOFAKTORER

Novozymes er udsat for en lang række risikofaktorer. **Vi (SM)** stræber efter så tidligt som muligt at identificere og begrænse enhver risiko, der **kan (hedge)** påvirke **vores (SM)** finansielle, miljømæssige eller sociale resultater.

I dette afsnit beskrives en række kritiske risici, der er identificeret i værdikæden, samt de tiltag, som Novozymes har sat i værk for at begrænse dem. Der er her tale om de væsentligste risici, som er forelagt **bestyrelsen (SM)**. Dog er udvalgte oplysninger udeladt af kommercielle eller konkurrencemæssige hensyn.

Nogle af de beskrevne risici vedrører muligheder, som i øjeblikket udforskes aktivt.

Hver risiko er tildelt en farvekode, der angiver Novozymes' vurdering af risikoen, efter at den er forsøgt begrænset:

.Høj risiko og store konsekvenser

.Lav risiko og store konsekvenser eller høj risiko og begrænsede konsekvenser

.Lav risiko og begrænsede konsekvenser

Finansielle risici er ikke inkluderet her, men beskrives i note 34 i koncernregnskabet.

## FORSYNINGS- OG LEVERANDØRRISICI

Energiforbrug og -priser.

Novozymes' produktion kræver **relativt (hedge)** store mængder energi, hvorfor udsving i energipriserne påvirker produktionsomkostningerne. Risikoen for en negativ effekt af stigende energipriser styres gennem løbende optimering af produktionsprocessen, blandt andet ved brug af genteknologi, samt ved delvis afdækning af energipriser for en fremtidig periode. På længere sigt opvejes denne risiko **ofte (hedge)** af den positive indflydelse på salget, når energipriserne stiger, da det så bliver økonomisk mere attraktivt for **vores (SM)** kunder at erstatte oliebaseerede ingredienser med enzymer og bruge energibesparende enzymer i deres produktion.

For yderligere at begrænse denne risiko har Novozymes sat et mål for forbedring af energieffektiviteten pr. kilo produkt med 50% i 2015 i forhold til 2005.

Råvareforbrug og -priser.

En væsentlig andel af Novozymes' råvarer kommer fra landbrugsprodukter, og udsving i prisen på disse råvarer påvirker derfor produktionsomkostningerne. Novozymes forsøger at mindske risikoen for en negativ påvirkning af omkostningerne ved at optimere produktionsprocessen ved brug af blandt andet genteknologi samt ved at sikre størst mulig fleksibilitet i brugen af råvarer. Råvarer købes i mange tilfælde på 12-måneders kontrakter, så risikoen for pludselige prishop mindskes.

Styring af leverandørkæden.

Novozymes **lægger vægt på (AM)** at integrere bæredygtighed og risikostyring i udvælgelsen og evalueringen af **vores (SM)** nøgleleverandører, da valget af de forkerte leverandører **kan (hedge)** indebære en risiko for at skade **vores (SM)** omdømme. **Vi (SM)** anvender derfor et avanceret styringssystem for leverandørpræstation, hvor bæredygtighed er et parameter, som evalueres på linje med kommercielle og kvalitetsmæssige aspekter. I stedet for udelukkende at bero på leverandørernes selvevaluering supplerer Novozymes' indkøbere med medieresearch, dialog og kritisk indsigt.

Systemet hjælper med at evaluere og sammenligne leverandørerne i forhold til risiko og muligheder, ligesom det giver overblik over den globale leverandørpulje. Systemet er desuden udformet, så det hjælper indkøbsfunktionen med at identificere de leverandører, som **typisk (hedge)** udgør den største risiko. Kritiske leverandører bliver bedt om at besvare yderligere spørgsmål, bliver auditeret, eller der bliver udarbejdet handlingsplaner for dem.

## INNOVATIONSRIISICI

Innovation.

Novozymes bestræber sig på at fastholde positionen som markedsleder ved løbende at lancere nye, forbedrede løsninger af høj kvalitet, som opfylder kundernes behov. **Vores (SM)** projekterede salg afhænger ikke af enkeltstående, store produktlanceringer, da **vi (SM)** hele tiden har flere nye produkter i pipelinen. Manglende innovation **kan (hedge)** imidlertid øge risikoen for, at

Novozymes' mål for salgsvækst påvirkes negativt. Dette stiller store krav til **vores (SM)** forsknings- og udviklingsfunktion, fordi der hele tiden skal være en lind strøm af nye produkter på vej. Novozymes anvender 13-14% af salget til forskning og udvikling for at sikre tilstrækkelige ressourcer til fremtidig innovation.

Patentstrategi.

**Vores (SM)** teknologi er **vores (SM)** forretningsgrundlag, og **vi (SM)** fører en aktiv patentstrategi, hvor nye opfindelser beskyttes så tidligt som muligt. Det forhindrer, at nye produkter, processer m.m. kopieres. Med 7.000 udstedte patenter eller patentansøgninger har Novozymes en omfattende patentportefølje, som **vi (SM)** aktivt værner om for at undgå og standse krænkelser fra konkurrenternes side. Samtidig holder **vi (SM)** hele tiden øje med konkurrenternes aktiviteter, så **vi (SM)** sikrer, at Novozymes' innovation ikke krænker eksisterende patenter. På den måde kan **vi (SM)** spare ressourcer og omkostninger til produktudvikling ved at gribe tidligt ind.

I 2012 arbejdede **vi (SM)** konstant på at sikre patentrettigheder i Kina, da **vi (SM)** har set en stigende risiko i forbindelse med håndhævelse af immaterielle rettigheder i det kinesiske retssystem.

## MARKEDSRISICI

Biobrændstoffer.

I modsætning til de fleste andre industrier, hvor Novozymes er aktiv, er transportbrændstofindustrien politisk reguleret, og salget til denne industri hænger nøje sammen med udviklingen i lovgivningen. I USA, som er **vores (SM)** største marked for biobrændstoffer, påvirkes **vores (SM)** salg for eksempel kraftigt af ændringer i grænserne for blandingsforholdet og/eller den amerikanske energilov Renewable Fuel Standard.

Den amerikanske biobrændstofindustri er reelt opstået som et politisk initiativ med det formål at udnytte lokale landbrugsressourcer til at øge energisikkerheden, reducere CO<sub>2</sub>-udledningen og støtte den økonomiske udvikling i landdistrikterne. De tre faktorer gør sig gældende i hele verden, mens den politiske støtte varierer afhængigt af den regionale og geopolitiske udvikling.

Salget til denne industri **kan (hedge)** også påvirkes af den igangværende debat om, hvorvidt det er bæredygtigt at anvende landbrugsressourcer til energiproduktion.

Novozymes arbejder aktivt på tværs af regioner og i tæt samarbejde med industripartnere, vigtige meningsdannere, NGO'er og mellemstatslige organisationer for at fremme en nuanceret offentlig debat og sikre, at politiske beslutninger baseres på videnskabelige data. Formålet er at sikre en langsigtet bæredygtig udvikling.

Kundekonzentration.

Salget til de fem største kunder udgør **ca. (hedge)** 28% af det samlede salg. Et mindre antal kunder står dermed for en stor del af Novozymes' omsætning, hvilket betyder, at **vi (EM)** bliver påvirket af udviklingen i disse kunders markedsforhold. For at mindske risikoen for udsving i salget har **vi (SM)** fokus på hele tiden at have mange nye produkter på vej, så **vi (SM)** kan støtte kundernes markedsudvikling. Novozymes har også et tæt samarbejde med de største kunder og opbygger langsigtede kunderelationer, som blandt andet omfatter fælles udviklingsprojekter og fælles produktionsplanlægning.

## ANDRE RISICI

Omdømme.

Novozymes' omdømme er en **vigtig (AM)** faktor i hele forretningen – fra kontakter og partnerskaber med kunder til forhold til myndigheder og rekruttering af nye medarbejdere. Novozymes forsøger at fastholde et godt omdømme gennem åbenhed og gennemsigtighed i **vores (SM)** kommunikation, både internt og eksternt. Herudover arbejder **vi (SM)** løbende på at reducere risikoen for, at der opstår situationer, som **kan (hedge)** skade Novozymes' omdømme. Gældende lovgivning skal til enhver tid overholdes, og Novozymes har forpligtet sig til at sikre en høj standard i alle aktiviteter og til at drive forretning på en ansvarlig måde. For eksempel underviser **vi (SM)** løbende alle medarbejdere i **vores (SM)** forretningsintegritetsprincipper.

Novozymes lægger stor vægt på **(AM)** at have en positiv indflydelse på det omkringliggende miljø. **Vi (SM)** forsøger derfor at drive forretning på en måde, så **vores (SM)** miljøpåvirkning udgør en del af løsningen på de aktuelle miljøproblemer. **Vores (SM)** mål for væsentlige reduktioner i såvel CO<sub>2</sub>-udledning som vand- og energiforbrug afspejler **vores (SM)** bestræbelser på at realisere denne ambition.

## Data- og IT-sikkerhed.

Den løbende udvikling af IT-teknologien og anvendelsen af elektroniske værktøjer medfører en øget risiko for udefra kommendes tyveri af data. I 2012 opgraderede Novozymes sin IT-sikkerhedsopsætning og indførte undervisningsprogrammer for medarbejderne, så de kender til potentielle trusler og den bedste måde at sikre fortrolig information på.

## Global organisation og skatteforhold.

Novozymes opererer på mange markeder via salgsselskaber og distributører, mens produktionen er begrænset til få lande. Dette medfører en række transaktioner mellem koncernens selskaber. Novozymes følger OECD's principper ved fastsættelsen af interne afregningspriser på disse transaktioner. Interne afregningspriser kan imidlertid være komplicerede og indebærer derfor en skatterisiko, ikke mindst fordi det område er udsat for politisk bedømmelse i hvert enkelt land. Novozymes indgår **ofte (hedge)** i dialog med skattemyndighederne for at reducere denne risiko og har indgået Advance Pricing Agreements (APA) med skattemyndighederne i de lande, hvor koncernen har sine mest omfattende interne transaktioner såsom USA og Kina. For Novozymes giver sådanne aftaler forudsigelighed i relation til beskatning og nedbringer risikoen for, at **vi (SM)** bliver involveret i den løbende debat om afregningspriser, der foregår flere steder i verden. En væsentlig del af koncernens interne transaktioner er dækket af APA-aftaler.

## REGNSKAB & DATA

### NOVOZYMES' ÅRSRAPPORT 2012

#### LEDELSESPÅTEGNING

**Bestyrelse og direktion (SM)** har dags dato behandlet og godkendt årsrapporten for regnskabsåret 1. januar – 31. december 2012 for Novozymes A/S.

Koncernregnskabet udarbejdes efter International Financial Reporting Standards som godkendt af EU, og årsregnskabet udarbejdes efter årsregnskabsloven. Herudover udarbejdes koncernregnskabet og årsregnskabet i overensstemmelse med yderligere danske oplysningskrav for børsnoterede selskaber. Ledelsesberetningen er også udarbejdet i overensstemmelse med danske oplysningskrav for børsnoterede selskaber.

Det er **vores (SM) opfattelse (hedge)**, at den valgte regnskabspraksis er **hensigtsmæssig (AM)**, og at koncernens interne kontroller, der er relevante for at udarbejde og aflægge årsrapporten, er tilstrækkelige. Koncernregnskabet og årsregnskabet giver efter **vores (SM) opfattelse (hedge)** et retvisende billede af koncernens og moderselskabets aktiver, passiver og finansielle stilling pr. 31. december 2012 samt af resultatet af koncernens og moderselskabets aktiviteter og koncernens pengestrømme for regnskabsåret 2012.

Ledelsesberetningen indeholder efter **vores (SM) opfattelse (hedge)** en retvisende redegørelse for udviklingen i koncernens og selskabets aktiviteter og økonomiske forhold, årets resultat og koncernens og selskabets finansielle stilling samt en beskrivelse af de væsentligste risici og usikkerhedsfaktorer, som koncernen og selskabet står over for.

Det er **vores (SM) opfattelse (hedge)**, at Novozymes A/S følger principperne i AA1000 AccountAbility, og at miljø- og sociale data er aflagt i overensstemmelse med anvendt regnskabspraksis.

Årsrapporten indstilles til generalforsamlingens godkendelse.

Bagsværd, den 21. januar 2013

Direktion

Steen Riisgaard Administrerende direktør

Benny D. Loft      Peder Holk Nielsen      Per Falholt      Thomas Nagy      Thomas Videbæk

Bestyrelse

Henrik Gürtler Formand      Kurt Anker Nielsen Næstformand      Agnete Raaschou-Nielsen

Jørgen Buhl Rasmussen      Lars Bo Køppler      Søren Henrik Jepsen      Lena Olving

Mathias Uhlén Ulla Morin

## LEDELSESBERETNING

### FINANSIELLE HOVED- OG NØGLETAL

Koncernomsætningen var DKK 6.652 millioner. EBITDA-marginen var 24,9%. Årets resultat var DKK 1.202 millioner. Frit cash flow DKK 1.151.

Den økonomiske udvikling for hele 2012 er en anelse bedre end **forventet (AM)**. Udviklingen er som forudsat negativt påvirket af effekten af den lagerombytning, der blev påbegyndt den 21. februar 2012.

- koncernen opnåede en omsætning på DKK 6.652 millioner i 2012 mod DKK 6.658 millioner i 2011:
  - Nord- og Sydamerika steg med 5,3% (et fald på 2,5% i lokal valuta)
  - Europa faldt med 3,1% (et fald på 5,0% i lokal valuta)
  - Asien og stillehavsområdet faldt med 10,4% (et fald på 17,5% i lokal valuta)
- bruttomarginen faldt til 66,6% i 2012 fra en bruttomargin på 73,0% i 2011
- EBITDA-marginen var 24,9% i 2012 mod 34,3% i 2011, og EBITDA faldt med 27,3% til DKK 1.658 millioner
- EBIT-marginen var 22,2% i 2012 mod 30,9% i 2011, og EBIT faldt med 28,3% til DKK 1.475 millioner
- årets resultat faldt med 41,0% til DKK 1.202 millioner i 2012 mod DKK 2.037 millioner i 2011. Korrigeret for regulering af earn-out-hensættelsen vedrørende PANDORA Jewelry Central Western Europe (CWE) faldt nettoresultatet for 2012 med 24,6% til DKK 1.151 millioner mod et korrigeret nettoresultat på DKK 1.526 millioner i 2011
- frit cash flow udgjorde i 2012 DKK 1.151 millioner mod DKK 1.670 millioner i 2011
- **bestyrelsen (SM)** foreslår, at der for regnskabsåret 2012 udbetales udbytte på DKK 5,50 pr. Aktie svarende til en udbytteprocent på 59% mod 35% i 2011
- PANDORA vil påbegynde et aktietilbagekøbsprogram på op til DKK 700 millioner, som planlægges gennemført i 2013 med det hovedformål at reducere selskabets aktiekapital på generalforsamlingen i 2014

### FORVENTNINGER TIL 2013

For 2013 **forventer (hedge)** PANDORA en omsætning på over DKK 7,2 milliarder og en EBITDA-margin på mere end 25%. PANDORA **forventer (hedge)** anlægsinvesteringer på **omkring (hedge)** DKK 300 millioner samt en effektiv skatteprocent på **ca. (hedge)** 19%. I 2013 **forventer (hedge)** PANDORA at åbne **ca. (hedge)** 150 konceptbutikker.

### BESTYRELSENS (SM) VURDERING AF KAPITALSTRUKTUREN

Som tidligere meddelt har **bestyrelsen (SM)** analyseret, hvad den mener, er den optimale kapitalstruktur for selskabet. Herunder er der truffet en beslutning om, hvordan overskydende kapital distribueres til aktionærerne. Resultatet af denne analyse er, at **bestyrelsen (SM)** foreslår, at selskabets udbyttepolitik ændres, og at der iværksættes et aktietilbagekøbsprogram.

**Bestyrelsen (SM)** har tidligere sigtet mod en gennemsnitlig udbytteprocent på **omkring (hedge)** 35% af årets resultat, defineret i overensstemmelse med IFRS (de internationale regnskabsstandarder). Fremadrettet er det **bestyrelsens (SM)** mål - med udgangspunkt i udbyttet for 2011 på DKK 5,50 pr. Aktie - at opretholde et stabilt og herefter stigende nominelt udbytte pr. Aktie.

Under hensyntagen til det ovenstående vil **bestyrelsen (SM)** herudover løbende træffe beslutning om, hvorvidt overskydende kapital skal distribueres via aktietilbagekøbsprogrammer eller som ekstraordinært udbytte med henblik på at opnå en optimal kapitalstruktur, som **bestyrelsen (SM)** på nuværende tidspunkt **anser (AM)** for at være en netto rentebærende gæld i forhold til EBITDA på 0-1x målt på 12-måneders løbende basis.

Denne politik og PANDORAs evne til at distribuere overskydende kapital til aktionærerne afhænger bl.a. Af, om der er tilstrækkelige frie reserver, selskabets finansielle stilling, resultat og kapitalbehov samt andre faktorer, som **bestyrelsen (SM)** anser for relevante.

### AKTIETILBAGEKØBSPROGRAM FOR 2013

PANDORAs bestyrelse har besluttet at iværksætte et tilbagekøbsprogram ("programmet") i 2013, hvor under selskabet **forventer (hedge)** at tilbagekøbe egne aktier for et beløb på op til DKK 700 millioner. I henhold til beslutning truffet på den ekstraordinære generalforsamling afholdt den 17. september 2010 er PANDORAs bestyrelse bemyndiget til at erhverve egne aktier på vegne af selskabet til en samlet nominel værdi på op til 10% af PANDORAs aktiekapital indtil 17. september 2015 ("bemyndigelsen").

Formålet med programmet er at nedsætte PANDORAs aktiekapital samt at opfylde forpligtelser i henhold til aktieoptionsprogrammer for selskabets medarbejdere. Programmet vil ophøre senest den 31. december 2013. **Bestyrelsen (SM)** agter på generalforsamlingen i 2014 at fremsætte forslag til PANDORAs aktionærer om, at PANDORAs aktiekapital reduceres med det antal aktier, der er købt under programmet.

PANDORA kan også bruge de aktier, der bliver købt under programmet, til at opfylde de forpligtelser, der måtte opstå i forbindelse med aktieoptionsprogrammer for selskabets medarbejdere. Nettoforpligtelsen pr.

31. december 2012, fratrukket beholdning af egne aktier (182.925), er på 925.198 aktier. Programmet implementeres i henhold til bestemmelserne i Europa-kommissionens forordning nr. 2273/2003 af 22. december 2003 ("safe harbour"), som beskytter børsnoterede selskaber mod overtrædelse af lovgivning om insiderhandel i forbindelse med aktietilbagekøb.

PANDORA har udpeget Nordea bank Danmark A/S ("Nordea") som lead manager for programmet. I henhold til særskilt aftale med selskabet vil Nordea tilbagekøbe aktier på vegne af PANDORA og træffe beslutninger om handel med PANDORAs aktier uafhængigt af og uden indflydelse fra PANDORA.

PANDORA har til enhver tid ret til at afslutte programmet. Hvis selskabet træffer beslutning om at afslutte programmet, skal PANDORA give meddelelse herom, og Nordea vil som følge heraf ikke længere være berettiget til at købe aktier på vegne af PANDORA.

Majoritetsaktionæren, Prometheus Invest ApS, har forpligtet sig til at deltage i programmet på et forholdsmæssigt grundlag med henblik på at sikre, at det nuværende free float ikke reduceres. Deltagelsen er planlagt sådan, at Prometheus Invest ApS på hver handelsdag vil sælge et antal PANDORA-aktier til den volumenvægtede gennemsnitskurs, som aktierne blev købt til under programmet i markedet på den pågældende handelsdag.

Programmet vil blive implementeret i henhold til bemyndigelsen inden for følgende rammer:

- den maksimale købesum for tilbagekøbte PANDORA-aktier i programmets løbetid er DKK 700 millioner
- programmet vil ophøre senest den 31. december 2013, og der vil blive købt maksimalt 12.831.400 PANDORA-aktier under programmet, som – på datoen for offentliggørelsen af denne årsrapport – sammen med selskabets beholdning af egne aktier på 182.925 aktier vil svare til 10% af aktierne udstedt i PANDORA
- det maksimale antal aktier, der skal købes pr. Handelsdag i markedet, vil svare til 25% af den gennemsnitlige daglige omsætning af aktier i selskabet, der er handlet på NASDAQ OMX Copenhagen i de foregående 20 handelsdage
- aktierne kan ikke købes til kurser, der er højere end de to følgende kurser:
  - a) Kursen på den seneste uafhængige handel
  - b) Kursen på det højeste uafhængige bud på NASDAQ OMX Copenhagen

Selskabet vil ugentligt udsende en meddelelse om de transaktioner, der foretages under programmet.

## VÆSENTLIGE BEGIVENHEDER I 2012

### Tiltag for at højne kvaliteten af forhandlernes lagre

PANDORA påbegyndte den 21. februar 2012 ekstraordinære, tidsbegrænsede globale tiltag til lagerbalancering med henblik på at forbedre kvaliteten af lagersammensætningen hos selskabets vigtigste forhandlere. Størstedelen af tiltagene blev afsluttet i 3. Kvartal 2012.

I 2012 returnerede forhandlerne udgåede produkter til PANDORA til en værdi på grossistniveau af DKK 609 millioner, og disse blev erstattet med nye produkter med en tilsvarende værdi, hvilket derved resulterede i en nuleffekt på omsætningen i 2012.

PANDORAs forhandlere har taget godt imod tiltaget til balancering af lagrene, og deltagelsesraten blandt forhandlerne har været høj i antal butikker såvel som i volumen. **Ca. (hedge)** to tredjedele af alle PANDORAs forhandlere deltog. For konceptbutikker og shop-in-shops var deltagelsesprocenten **ca. (hedge)** 80%.

For at kunne foretage en sammenligning med historiske tal, og i det omfang det var relevant, har PANDORA i løbet af 2012 givet supplerende tal i relation til lagerbalanceringstiltaget. De supplerende tal skal imidlertid behandles med forsigtighed, da de – hvis



de blot tillægges de rapporterede tal – ikke nødvendigvis giver et hverken repræsentativt eller retvisende billede. Dette skyldes ikke mindst periodeforskydningen mellem returneringer og den efterfølgende ombytning med nye varer, kvartalerne imellem.

Det har været **vigtigt (AM)** at gennemføre lagerbalanceringerne for at kunne forbedre forhandlernes lagre med hensyn til pris og kvalitet, og samtidig forbedre selskabets goodwill hos forhandlerne.

Modtagelsen af nye kollektioner lanceret i 2012

Ud over de ovenfor nævnte tiltag til balancering af lagrene tilpassede PANDORA i løbet af året prisstrukturen og produktsortimentet. De nye innovative produkter lanceret i 2012 til kommercielt rigtige priser, klarede sig godt, såvel hvad angik salget til forhandlerne som salget ud af butikkerne. Sammen med tilpasningen af prisstrukturen og resten af produktsortimentet, er PANDORAs produktsortiment atter konkurrencedygtigt og indeholder de rette kommercielle prispunkter.

Meddelelse fra Finanstilsynet

Finanstilsynet udstedte den 10. januar 2012 en påtale til PANDORA om, at selskabet burde have orienteret markedet på et tidligere tidspunkt end med selskabsmeddelelse nr. 30 af 2. august 2011, som anførte, at selskabet ikke kunne indfri sine tidligere udmeldte forventninger om en omsætningsvækst for helåret 2011 på 30%.

I henhold til dansk lovgivning har finanstilsynet nu overgivet sagen til politiet med henblik på videre efterforskning.

Som tidligere udmeldt er det fortsat PANDORAs **opfattelse (hedge)**, at:

- selskabet reagerede korrekt på en hurtig og **uventet (AM)** omsætningsnedgang ved at offentliggøre en rettidig og præcis selskabsmeddelelse, i hvilken selskabet, på baggrund af nye oplysninger og på grundlag af en analyse af ændringerne i markedssituationen i juli 2011, justerede sine helårsforventninger,
- selskabet **altid (booster)** fuldt ud har overholdt alle relevante regler og love for udstedere af aktier.

#### REGNSKABSBERETNING

##### OMSÆTNINGSUDVIKLING

Der er tale om en flad omsætningsudvikling fra DKK 6.658 millioner i 2011 til DKK 6.652 i 2012. Dette på trods af den negative effekt af de lagerbalanceringstiltag, der blev igangsat i februar 2012, og et væsentligt ændret produktmix.

Korrigeret for valutakurseffekter faldt omsætningen med 5,5%. Omsætningsudviklingen er påvirket af ændret produktmix effekt (-7,8 procentpoint), prisreduktioner (-4,0 procentpoint), ændret markedsmix (2,6 procentpoint) og øget volumen (3,7 procentpoint). Volumen er positivt påvirket af lagerbalanceringstiltagene.

Baseret på salget i konceptbutikker, som har været i drift i 12 måneder eller derofter, udviklede det direkte sammenlignelige salg ud af butikkerne sig positivt på PANDORAs fire store markeder i løbet af 2012. Dette skyldes efter PANDORAs **opfattelse (hedge)**, at de nye innovative produkter klarede sig godt, og at eksekveringen i butikkerne **generelt (hedge)** blev forbedret i 2012.

##### GEOGRAFISK FORDELING AF OMSÆTNINGEN

Den geografiske fordeling af omsætningen i 2012 udgjorde 49,8% for Nord- og Sydamerika mod 47,2% i 2011, 38,2% for Europa mod 39,4% i 2011 og 12,0% for Asien og stillehavsområdet mod 13,4% i 2011.

Som tidligere nævnt er tiltaget til balancering af lagrene hos PANDORAs forhandlere er nu afsluttet med succes.

PANDORA har implementeret flere initiativer for fremadrettet at reducere risikoen for opbygning af for store lagre af langsomt omsættelige varer hos forhandlerne. Hyppigere og mindre kollektioner vil minimere risikoen for opbygning af for store lagre hos forhandlerne. Derudover vil selskabets evne til tættere at følge udviklingen og overvåge dag-til-dag salget på produktniveau ud af konceptbutikkerne øge kendskabet til dårligt sælgende produkter på et tidligere tidspunkt og dermed give mulighed for at sikre en bedre balance mellem salg ind til og salg ud af butikkerne, hvilket yderligere vil mindske risikoen for opbygning af for store lagre.

Fremadrettet vil PANDORA benytte to primære fremgangsmåder til at adressere lagre af udgåede varer hos forhandlerne. For det første vil PANDORA to gange årligt sælge udgåede varer i butikkerne på udsalg samt sælge produkterne via online og offline outlet-

kanaler. For det andet vil PANDORA tage varer retur fra forhandlerne og løbende foretage hensættelser til returneringsforpligtelser på markeder, hvor returnering af produkter fra kunderne er almindeligt forekommende.

Disse muligheder anvendes på forskellige måder i de forskellige geografiske regioner.

I Nord- og Sydamerika tager PANDORA varer tilbage fra forhandlerne, og annoncerer aktivt, startende i Q4 2012, til forhandlerne når produkter udgår. Andre regioner benytter **generelt (hedge)** udsalgskampagner eller udsalg via outletkanaler.

Baseret på erfaringerne fra annoncering af returneringspolitikker overfor forhandlerne i forbindelse med lagerbalanceringen i 2012, samt det faktum at PANDORA nu aktivt kommunikerer til forhandlerne når produkter udgår, har PANDORA besluttet at hensætte DKK 416 millioner til returneringsforpligtelser i 2012 mod DKK 225 millioner i 2011 (**se (EM)** note 21), hvilket påvirker bruttomarginen med et tilsvarende beløb. Omsætningseffekten af hensættelsen svarer til 9% af koncernomsætningen i 2012 mod 5% i 2011.

#### NORD - OG SYDAMERIKA

Omsætningen for Nord- og Sydamerika steg med 5,3% til DKK 3.312 millioner i 2012 mod DKK 3.144 millioner i 2011. Korrigeret for valutakurseffekter faldt den underliggende omsætning med 2,5% i forhold til 2011.

Omsætningen i USA, der udgør 38,8% af den samlede koncernomsætning, steg med 1,7% i 2012 mod 0,8% i 2011.

PANDORA oplevede en positiv udvikling i det direkte sammenlignelige salg ud af konceptbutikkerne i USA i hele 2012.

Omsætningen for øvrige Nord- og Sydamerika steg med 20,8% og med 11,4% korrigeret for valutakurseffekter og udgjorde i 2012 11,0% af den samlede koncernomsætning. Med en stigning på 28,4% i forhold til året før, var Canada det største enkeltmarked i øvrige Nord- og Sydamerika.

I 2012 steg antallet af brandede butikker i Nord- og Sydamerika med 224 til i alt 1.572 mod 1.348 i 2011.

Brandede butikker udgjorde 48,5% af det samlede antal butikker mod 44,7% ved udgangen af 2011.

#### EUROPA

Omsætningen i Europa, der udgør 38,2% af den samlede koncernomsætning, faldt med 3,1% (svarende til et fald på 5,0% i lokal valuta) til DKK 2.542 millioner i 2012 mod DKK 2.623 millioner i 2011. Udviklingen har været drevet af en nedgang især i Storbritannien og Tyskland samt hos eksterne distributører i Grækenland, Spanien, Portugal og Irland, delvist opvejet af vækst i Italien, Rusland og Frankrig, omend fra et lavt niveau.

Storbritannien, der er PANDORAs største enkeltmarked i Europa, tegnede sig for 13,1% af koncernomsætningen i 2012 mod 14,3% i 2011. Omsætningen i Storbritannien faldt med 8,6% (et fald på 15,3% målt i lokal valuta) som følge af forhandlerens reduktion af lagre.

For helåret 2012 steg det direkte sammenlignelige salg ud af konceptbutikkerne i Storbritannien en anelse i forhold til 2011, hvilket **indikerer (hedge)**, at slutkunderne tog godt imod ændringen i produktmixet med lavere prispunkter.

Tyskland, der er PANDORAs næststørste marked i Europa, tegnede sig for 7,1% af koncernomsætningen i 2012 mod 9,6% i 2011. Omsætningen i Tyskland faldt med 26,5% i 2012 i forhold til 2011. PANDORA fortsatte i 2012 arbejdet med at reducere distributionsnetværket i Tyskland ved at lukke et betydeligt antal ikke optimalt placerede butikker, særligt i kategorien sølv- og hvid-forhandlere.

Der er lukket mere end 522 primært ikke-brandede forhandlere, svarende til 32,0% af det samlede antal butikker ved udgangen af 2011. Ved udgangen af 2012 udgjorde de brandede butikker 48,8% af det samlede netværk i Tyskland mod 28,2% i 2011.

Det direkte sammenlignelige salg ud af konceptbutikkerne i Tyskland var positivt i tre ud af fire kvartaler i 2012. Selvom der er implementeret mange tiltag i Tyskland, og salg ud af konceptbutikkerne er forbedret, vil effekten heraf, som tidligere annonceret, først med tiden kunne ses på PANDORAs omsætning.

I kategorien "øvrige Europa" steg omsætningen med 16,4% i 2012 i forhold til 2011, primært på baggrund af betydelig vækst i Italien, Rusland og Frankrig. PANDORAs eksterne distributørmarkeder såsom Grækenland, Spanien, Portugal og Irland var i 2012 fortsat negativt påvirket af vanskelige makroøkonomiske forhold, og fortsatte derfor med at nedbringe lagrene med henblik på at optimere de lokale varebeholdninger.

I Europa reduceredes distributionsnetværket med 459 butikker til i alt 6.506 ved udgangen af 2012. Udviklingen i antallet af brandede butikker fortsatte i positiv retning, og brandede butikker udgjorde 37,0% af det samlede antal butikker mod 27,0% ved udgangen af 2011.

#### ASIEN OG STILLEHAVSOMRÅDET

Omsætningen i Asien og stillehavsområdet, der udgør 12,0% af den samlede koncernomsætning, faldt med 10,4% til DKK 798 millioner i 2012 mod DKK 891 millioner i 2011. Korrigeret for valutakurseffekter faldt den underliggende omsætning i regionen med 17,5% i forhold til året før.

Australien har en omsætning svarende til 9,3% af den samlede koncernomsætning. I Australien oplevede selskabet en ændring i trends i løbet af 2012. PANDORA lukkede 138 primært sølv- og hvid-forhandlere i 2012 og havde som ventet og tidligere annonceret i alt 415 butikker ved udgangen af 2012. Dette kombineret med den positive effekt af de nye produktlanceringer påvirkede udviklingen i Australien positivt i 4. Kvartal 2012, både hvad angår salget til forhandlerne samt salget ud af konceptbutikkerne, som steg i forhold til 4. Kvartal 2011.

I kategorien øvrige Asien og stillehavsområdet, som udgør 2,7% af den samlede koncernomsætning, faldt omsætningen i 2012 med 23,4% i forhold til 2011.

PANDORA har opsagt samarbejdet med den tidligere japanske distributør, Vérité Co. Ltd., og har samtidig indgået en ny aftale med Bluebell Japan Limited.

Opsigelsen af samarbejdet med Vérité Co. Ltd. vil i første omgang medføre lukning af butikker i Japan i en overgangsperiode. Opsigelsen har tillige foranlediget at PANDORA har foretaget en hensættelse til tilbagekøb af lager fra Vérité Co. Ltd. Til en værdi af DKK 38 millioner, med en tilsvarende negativ indvirkning på omsætningen for øvrige Asien og stillehavsområdet i 2012.

Korrigeret for denne effekt faldt omsætningen for øvrige Asien og stillehavsområdet med 7,2% i 2012 i forhold til 2011, hvilket hovedsageligt skyldtes færre butiksåbninger og et **generelt (hedge)** lavere salg ind til kunder i 2012 i forhold til 2011.

I Asien og stillehavsområdet reduceredes distributionsnetværket med 124 butikker til i alt 626 i 2012, hovedsageligt drevet af lukningen af ikke-brandede butikker i Australien. Brandede butikker fortsatte den positive udvikling og udgjorde 75,6% af det samlede antal butikker mod 59,1% ved udgangen af 2011.

#### PANDORA SALGSKANALER

Direkte distribution udgjorde 96,9% af omsætningen i 2012 mod 95,1% i 2011. Omsætningen i 2012 har været drevet af udviklingen i konceptbutikkerne, som udgjorde 58% af det brandede salg i 2012 mod 49,4% i 2011. Det brandede salg udgjorde 81,0% af det samlede direkte salg mod 77,0% i 2011. Udviklingen har primært fundet sted i øvrige Nord- og Sydamerika (Canada) og øvrige Europa (primært Italien, Rusland og Frankrig). Antallet af brandede butikker steg med 705, mens antallet af forhandlere faldt med 358 til 10.374 i 2012.

#### PRODUKTUDBUD

Lagerbalanceringen har påvirket omsætningsfordelingen på produktkategorier. Især kategorierne ringe og andre smykker har været betydeligt påvirket af returnerede produkter, hvilket omvendt har haft en positiv effekt på kategorierne charms og charms-armbånd i sterlingsølv og guld. De to kategorier charms og charms-armbånd i sterlingsølv og guld udgjorde 87,3% af den samlede omsætning i 2012 i forhold til 81,5% i 2011. Omsætningen fra de to kategorier var henholdsvis DKK 4.958 millioner og DKK 846 millioner, svarende til en stigning på 7,0% fra 2011 til 2012. Ringe udgjorde 6,4% af den samlede omsætning mod 6,0% i 2011. Ringe steg med 6,5% til DKK 427 millioner mod DKK 401 millioner i 2011. Øvrige smykker faldt med 49,4%.

I 2012 faldt den gennemsnitlige salgspris pr. Enhed til DKK 129 mod DKK 134 i 2011, hvilket primært skyldtes lavere prispunkter på nye produktlanceringer og generelle prisreduktioner i 2012, som delvist opvejedes af positive valutakurseffekter.

## BRUTTORESULTAT OG BRUTTOMARGIN

Bruttoresultatet udgjorde DKK 4.429 millioner i 2012 mod DKK 4.860 millioner i 2011, hvilket resulterede i en bruttomargin på 66,6% i 2012 mod 73,0% i 2011.

Sammenlignet med 2011 var 2012 negativt påvirket af stigende råvarepriser (-6,7 procentpoint), prisændringer (-1,1 procentpoint), produkt- og markedsmix (1,5 procentpoint) og valutakurser (-0,1 procentpoint). Produkt- og markedsmix omfatter en negativ indvirkning på bruttomarginen på **ca. (hedge)** 1 procentpoint på grund af bortfald af fritagelsen for betaling af visse typer af told på varer produceret i Thailand i henhold til "U.S. Generalized System of Preferences Program".

Det er selskabets politik at afdække henholdsvis 100%, 80%, 60% og 40% af det forventede forbrug af guld og sølv i de efterfølgende fire kvartaler. Den samlede virkning af tidsforskydningseffekten på varebeholdningen og PANDORAs løbende 12-måneders afdækning betyder, at selskabet i stor udstrækning er afdækket i 2013.

Hvis der ses bort fra PANDORAs afdækning og tidsforskydningseffekten fra lagerbeholdningen, **ville (hedge)** den underliggende bruttomargin have været **ca. (hedge)** 67,0% baseret på de gennemsnitlige markedspriser for guld (1.672 USD/oz) og sølv (31,36 USD/oz) i 2012. Under de samme forudsætninger **ville (hedge)** en ændring på 10% af de kvartalsmæssige gennemsnitspriser på guld og sølv have påvirket bruttomarginen med **ca. (hedge)** +/- 2-3 procentpoint.

Den gennemsnitlige faktiske pris for guld og sølv var i 2012 henholdsvis 1.614 USD/oz og 33,85 USD/oz. Selskabets afdækkede priser for de kommende fire kvartaler er 1.677 USD/oz, 1.646 USD/oz, 1.753 USD/oz og 1.730 USD/oz for guld og 33,16 USD/oz, 30,78 USD/oz, 32,64 USD/oz og 31,94 USD/oz for sølv.

## DISTRIBUTIONSOMKOSTNINGER

Distributionsomkostningerne steg til DKK 2.084 millioner i 2012 fra DKK 2.053 millioner i 2011, svarende til 31,3% af omsætningen i 2012 mod 30,8% i 2011.

Salgs- og distributionsomkostningerne steg til DKK 1.261 millioner i 2012 fra DKK 1.080 millioner i 2011, svarende til 19,0% af omsætningen i 2012 mod 16,2% i 2011. Denne stigning skyldtes hovedsagligt en stigning i antallet af PANDORA-ejede konceptbutikker og shop-in-shops i 2012 (i alt 167) i forhold til 2011 (i alt 136) samt etablering på nye markeder.

Markedsføringsomkostningerne udgjorde i 2012 12,3% af omsætningen i forhold til 14,6% i 2011. Markedsføringsomkostningerne faldt til DKK 823 millioner i 2012 fra DKK 973 millioner i 2011.

## ADMINISTRATIONSOMKOSTNINGER

Administrationsomkostningerne udgjorde DKK 870 millioner i 2012 mod DKK 749 millioner i 2011, svarende til 13,1% af omsætningen mod 11,3% i 2011. Stigningen i administrationsomkostninger skyldtes hovedsageligt en stigning i antal medarbejdere på nye markeder og på hovedkontoret.

## OMKOSTNINGSPROCENTER

Omkostningsprocenterne for 2012 er påvirket af den negative omsætningseffekt fra lagerbalanceringsstiltagene. Derudover var salgs- og distributionsomkostninger i 2011 negativt påvirket med DKK 92 millioner vedrørende afskrivning af erhvervede distributionsrettigheder i PANDORA CWE.

EBITDA for 2012 faldt med 27,3% til DKK 1.658 millioner mod 2.281 millioner i 2011, svarende til en EBITDA-margin på 24,9% mod 34,3% i 2011.

Fordelt på regioner udgjorde EBITDA-marginerne for 2012 før allokering af centrale omkostninger 42,7% i Nord- og Sydamerika mod 51,5% i 2011, 23,4% i Europa mod 34,8% i 2011 og 23,9% i Asien og stillehavsområdet mod 36,5% i 2011. Ikke fordelte omkostninger faldt til 8,2% i 2012 fra 8,7% i 2011.

EBITDA for 2012 faldt med 9,4 procentpoint. **Generelt (hedge)** var EBITDA positivt påvirket af valutakurseffekter med 2,9 procentpoint, men negativt påvirket af stigende råvarepriser (-6,7 procentpoint), højere omkostningsprocenter (-3,0 procentpoint), produkt- og markedsmix (-2,6 procentpoint). Produkt- og markedsmixet omfatter en negativ indvirkning på bruttomarginen på **ca. (hedge)** 1 procentpoint på grund af bortfald af fritagelsen for betaling af visse typer af told på varer produceret i Thailand i henhold til "U.S. Generalized System of Preferences Program".

EBITDA-marginerne i alle regioner var betydeligt påvirket af den lavere bruttomargin i 2012. EBITDA-marginen for Nord- og Sydamerika var 8,8 procentpoint lavere end for 2011, hvilket blandt andet kan henføres til ovennævnte bortfald af fritagelse for betaling af visse typer af told på varer produceret i Thailand i henhold til "U.S. Generalized System of Preferences Program". Den faldende margin i Europa skyldtes opbygning af direkte distribution på det italienske og franske marked. Endvidere var den faldende EBITDA-margin i Asien og stillehavsområdet påvirket af hensættelsen til returnering af lagervarer i Japan, hvilket kun delvist opvejedes af en stigning i omsætningen i Australien.

## EBIT

EBIT for 2012 faldt til DKK 1.475 millioner fra DKK 2.058 millioner i 2011, svarende til et fald på 28,3% i forhold til 2011, hvilket resulterede i en EBIT-margin på 22,2% i 2012 mod 30,9% i 2011.

## FINANSIELLE INDTÆGTER OG OMKOSTNINGER (NETTO)

Finansielle indtægter og omkostninger udgjorde netto DKK 4 millioner i 2012 mod 311 millioner i 2011. Sammenlignet med året før blev tab på valutakurseffekter reduceret med DKK 188 millioner. 2011 var negativt påvirket af den kraftige styrkelse af USD. De finansielle indtægter var i 2012 positivt påvirket med DKK 51 millioner (2011: DKK 511 millioner) fra regulering af earn-out hensættelsen til PANDORA CWE på baggrund af ændrede forventninger. Mens det italienske marked udviklede sig positivt i forhold til forventningerne, levede det tyske marked, på trods af positive tendenser, ikke helt op til forventningerne. Som følge af denne regulering indeholder balancen ikke længere en earn-out hensættelse vedrørende PANDORA CWE.

## SELSKABSSKAT

Selskabsskat udgjorde DKK 277 millioner i 2012 mod DKK 332 millioner i 2011, hvilket svarer til en effektiv skatteprocent på 18,7% for 2012 mod 14,0% for 2011. Korrigeret for regulering af CWE earn-out hensættelsen udgjorde den effektive skatteprocent 19,4% i 2012 mod 17,9% i 2011.

## Periodens resultat

Resultatet for 2012 faldt med 41,0% til DKK 1.202 millioner mod DKK 2.037 millioner i 2011.

Korrigeret for regulering af CWE earn-out hensættelsen faldt nettoresultatet for 2012 med 25% til DKK 1.151 millioner mod et korrigeret nettoresultat på DKK 1.526 millioner i 2011.

## LIKVIDITET OG KAPITALBEREDSKAB

Der blev i 2012 genereret et frit cash flow på DKK 1.151 millioner i 2012 mod DKK 1.670 millioner i 2011, svarende til en cash conversion i procent på 95,8% mod 82,0% i 2011. Reduktionen af frit cash flow på DKK 520 millioner var påvirket af den lavere EBITDA for året og positivt påvirket af nedbringelsen af varelagre.

Nettoarbejdskapitalen (defineret som varebeholdninger og tilgodehavender med fradrag af hensatte forpligtelser, leverandørgæld, skyldige selskabsskatter og anden gæld reguleret for afledte finansielle instrumenter) udgjorde ved udgangen af 2012 DKK 1.277 millioner mod DKK 1.327 millioner i 2011, svarende til 19,2% af omsætningen fra de foregående 12 måneder mod 19,9% ved udgangen af 2011. Udviklingen i nettoarbejdskapitalen skyldes hovedsagligt lavere varebeholdninger. Korrigeret for værdien af sikringskontrakter udgjorde nettoarbejdskapitalen 18,5% af omsætningen sammenlignet med 16,2% i 2011.

Nettoarbejdskapital relateret til driften (defineret som varebeholdninger og tilgodehavender fra salg og tjenesteydelser med fradrag af leverandørgæld) ultimo 2012 var 30,7% af de seneste 12 måneders omsætning mod 33,4% i 2011.

Varebeholdninger faldt betydeligt med 18,1% til DKK 1.318 millioner i 2012 mod DKK 1.609 millioner i 2011. Varebeholdningerne faldt til trods for stigende guld- og sølvpriser (en gennemsnitlig stigning på **ca. (hedge)** 20% i guld og sterlingsølv), hvilket skyldtes forbedret lagerstyring og omsmeltnings af udgåede varer som følge af lagerbalanceringsstiltagene i 2012.

Tilgodehavender fra salg og tjenesteydelser steg til DKK 940 millioner i 2012 (14,1% af de foregående 12 måneders omsætning) fra DKK 900 millioner i 2011 (13,5% af de foregående 12 måneders omsætning). Tilgodehavender fra salg og tjenesteydelser var påvirket af en øget omsætning i 4. Kvartal 2012 i forhold til 4. Kvartal 2011. I 2012 investerede PANDORA i alt DKK 276 millioner i materielle og immaterielle aktiver mod DKK 269 millioner i 2011, svarende til 4,2% af omsætningen i 2012 mod 4,0% af omsætningen i 2011.

Den samlede rentebærende gæld udgjorde DKK 158 millioner ved udgangen af 2012 mod DKK 385 millioner ved udgangen af 2011.

Likvide beholdninger og kortfristede indeståender udgjorde DKK 341 millioner ved udgangen af 2012 mod DKK 176 millioner ved udgangen af 2011. Nettorentebærende gæld udgjorde ved udgangen af 2012 DKK -183 millioner svarende til -0,1 ltm EBITDA mod DKK 209 millioner ved udgangen af 2011 svarende til 0,1 ltm EBITDA.

Risikostyring og interne kontroller

Risikostyring

**Bestyrelsen (SM)** vurderer løbende de overordnede risici og de specifikke risici, der er forbundet med PANDORAs aktiviteter og drift, og søger at sikre, at disse risici styres proaktivt og effektivt. Der er etableret interne kontrolsystemer, herunder en whistleblower-funktion, som gennemgås regelmæssigt af **bestyrelsen (SM)** for at sikre, at disse systemer er **passende (AM)** og tilstrækkelige.

PANDORA samarbejder med forskellige interessenter på verdensplan. Desuden er der visse transaktioner og kontrakter, der er meget komplekse. PANDORA **anerkender (AM)** de dermed forbundne risici og gør brug af juridiske rådgivere med henblik på at minimere disse risici.

De væsentlige eksisterende risici fremgår nedenfor:

Brand og omdømme

PANDORAs evne til at opnå sine fremtidige mål afhænger af selskabets brand og omdømme. Brandstrategien er at tiltrække, engagere og fastholde slutkunderne i selskabets brandede kanaler og påvirke det direkte salg i brandbutikker under selskabets egen kontrol samt gennem digitale medier.

PANDORA har siden 2010 fokuseret på at opbygge kendskabet til brandet på alle markeder og positionere brandet som et "Affordable Luxury" smykke-brand gennem tv, trykte og udendørs reklamer, brochurer, digitale medier og forhandlere. Selskabet har især styrket de digitale medier via selskabets hjemmeside, e-handel, PANDORA Club og aktiviteter gennem sociale medier. Implementeringen af digitale medier har medført en øget lokal digital tilstedeværelse i hele verden og har skabt muligheder i lokale markeder samt styrket PANDORAs egne mediekkanaler.

Med henblik på at beskytte værdien af PANDORA-brandet, og som følge af karakteren af PANDORAs produkter og fremstillingsprocesser, har PANDORA som led i selskabets CSR-strategi valgt at tilslutte sig FN's Global Compact. Hvis selskabet ikke driver virksomhed i henhold til gældende love og regler, eller opfattes af offentligheden som en part, der ikke overholder visse arbejdsretlige normer, herunder anvender urimelige arbejdsmetoder, **kan (hedge)** det få alvorlig negativ indvirkning på selskabets omdømme og virksomhed. Det er derfor afgørende, at ikke alene PANDORA, men også selskabets leverandører og underleverandører overholder normerne for CSR enten direkte eller indirekte. **Se (EM)** afsnittet om samfundsansvar på side 23.

Udsving i råvarepriser

PANDORA fremstiller håndlavede smykker af primært sterlingsølv og guld, som udgør en væsentlig del af produktionsomkostningerne. En stigning i priserne på sterlingsølv og guld, som ikke kan overføres til selskabets kunder, **kan (hedge)** have væsentlig negativ indvirkning på PANDORAs forretning og resultat, da PANDORA **bør (EM)** forblive i "Affordable Luxury"-segmentet. Som følge af at fritids- og underholdningsprodukter konkurrerer med smykker om kundernes forbrug af luksusprægede varer, vil f.eks. en stigning i sølv- og guldpriser svække smykkeindustrien i forhold til andre industrier.

I henhold til PANDORAs finanspolitik skal eksponeringen herimod være begrænset. PANDORA anvender finansielle instrumenter til afdækning af selskabets eksponering både i guld og sølv. Disse instrumenter afdækker mellem 40% og 100% af eksponeringen fra 1 til 12 måneder fremadrettet med en sikringsrate, som falder i takt med restløbetiden. Guld- og sølvpriserne steg betydeligt i 2010 og 2011. Som følge af den samlede effekt af PANDORAs afdækningspolitik og den tidsmæssige forskydning i forhold til PANDORAs varebeholdninger blev de stigende markedspriser i 2010 først indregnet i koncernens vareforbrug i 2011.

Tilsvarende blev yderligere høje markedspriser i 2011 først indregnet i koncernens vareforbrug i 2012, og råvarepriserne i koncernens vareforbrug var derfor højere i 2012 end i 2011. Disse prisstigninger har haft en negativ indvirkning på PANDORAs bruttomargin i 2012 sammenlignet med 2011.

## Finansielle risici

Der henvises til note 19 for oplysninger om finansielle risici.

## Globale økonomiske forhold

En yderligere økonomisk nedgang og usikre økonomiske udsigter for et eller flere geografiske markeder **kan (hedge)** få en negativ indvirkning på forbrugernes indkøbsvaner. PANDORAs øgede geografiske udbredelse sammen med vækst fra nye markeder og regioner mindsker dog afhængigheden af enkeltmarkeder.

## Produktudvikling

Det er afgørende for PANDORAs evne til at nå sine fremtidige mål, at selskabet er i stand til at udvikle produkter, som afspejler markedstendenserne og slutkundernes præferencer. Selskabets nye produkter skal være i tråd med kundernes opfattelse af PANDORA-brandet for at være vellykket.

## Koncentrationen af produktionsanlæg i Thailand

Koncentrationen af produktionsanlæg i Thailand betyder, at PANDORAs drift afhænger af, om råvarer kan importeres til Thailand, at produktionen ikke afbrydes og at produkter kan eksporteres fra Thailand. Afbrydelser **kan (hedge)** blandt andet være forårsaget af den politiske situation eller naturkatastrofer.

Thailand har fra tid til anden været ramt af en kraftig monsunregn, med alvorlig oversvømmelse i Bangkok som følge. PANDORAs fabrikker ligger i et industrikvarter for smykkeproduktion i Gemopolis uden for Bangkok. Dette område er **generelt (hedge)** godt drænet og beskyttet mod oversvømmelser. Selskabet har implementeret en nødplan med henblik på at undgå oversvømmelse, og til dato har der ikke været nogen væsentlige afbrydelser.

PANDORA i Thailand etablerede i 2012 en Business Continuity Management funktion, som har til opgave at overvåge faktorer, der **kan (hedge)** påvirke PANDORAs drift.

Med henblik på at sikre kontinuitet i produktionen er PANDORA Production's kontinuitetsplan for produktionsanlægget blevet afprøvet med **tilfredsstillende (AM)** resultat.

Tidligere har politisk uro i Thailand medført nogle få dages midlertidig afbrydelse i forsyningskæden, dog uden at påvirke forretningen. Thailands politiske situation var stabil i 2012. PANDORA vurderer løbende fordele og risici ved at koncentrere produktionen i Thailand, selvom selskabet ikke har oplevet væsentlige afbrydelser i de mere end 20 år, hvor produktionen har fundet sted i Thailand.

## Skattemæssige risici

Der henvises til note 1 for oplysninger om skattemæssige risici.

## INTERNE KONTROLLER OG RISIKOSTYRING I FORBINDELSE MED REGNSKABSAFLÆGGELSESPROCESSEN

Formålet med PANDORAs interne kontroller og risikostyringssystemer i forbindelse med regnskabsaflæggelsesprocessen er at sikre, at både de interne og eksterne regnskaber aflægges i henhold til IFRS som vedtaget af EU og yderligere danske oplysningskrav for årsrapporter for børsnoterede selskaber, samt at regnskaberne giver et retvisende billede uden væsentlig fejlinformation. Selvom de interne kontrol- og risikostyringssystemer er til for at sikre, at væsentlige fejl eller uregelmæssigheder identificeres og rettes, kan der ikke gives fuld **sikkerhed (hedge)** for, at alle fejl opdages og rettes.

De interne kontrol- og risikostyringssystemer udvikles løbende og omfatter:

- kontrolmiljø
- risikovurdering
- kontrolaktiviteter
- information og kommunikation
- overvågning

## Kontrolmiljø

**Bestyrelsen (SM)** har oprettet et revisionsudvalg, som hjælper **bestyrelsen (SM)** med at overvåge regnskabsaflæggelsesprocessen og effektiviteten i PANDORAs interne kontrol- og risikostyringssystemer.

**Direktionen (SM)** er ansvarlig for at opretholde kontroller og et effektivt risikostyringssystem, og har taget de nødvendige skridt, for at håndtere de identificerede risici i forbindelse med regnskabsaflæggelsen.

Sammensætningen af **bestyrelsen (SM)**, revisionsudvalget og **direktionen (SM)** sikrer, at der **altid (booster)** er relevante kompetencer i selskabet til varetagelse af interne kontroller og risikostyring i forbindelse med regnskabsaflæggelsesprocessen.

#### Risikovurdering

**Bestyrelsen og direktionen (SM)** vurderer løbende risici, herunder risici i forbindelse med regnskabsaflæggelsen.

Revisionsudvalget gennemgår højrisikoområderne én gang i kvartalet, herunder:

- Væsentlige regnskabsmæssige skøn
- Væsentlige ændringer i regnskabsprincipper

Revisionsudvalget overvåger en gennemgang af de interne kontroller mindst én gang om året for at vurdere, om de er effektive i forhold til de risici, der identificeres i regnskabsaflæggelsesprocessen.

#### Kontrolaktiviteter

PANDORA's globale Finance Management Forum mødes en gang i kvartalet. Dette er samtidig forum for fastlæggelse af strategi for optimering af koncernens finansfunktion.

Kontrolfunktionerne i økonomifunktionen, som rapporterer til koncernens CFO, er ansvarlige for at kontrollere regnskabsrapporteringen fra moderselskabet og datterselskaberne. Økonomifunktionens kompetencer vurderes løbende for at sikre et **passende (AM)** og **tilfredsstillende (AM)** kontrolmiljø.

Koncernen har defineret et internt kontrolsystem, som identificerer væsentlige processer, iboende risici og kontrolprocedurer med henblik på at sikre regnskabsprocesserne.

#### Information og kommunikation

PANDORA etablerede i 2012 et fælles ERP-system for alle enheder bortset fra USA og Canada. Dette system gør det muligt at opnå stor gennemsigtighed på det finansielle område og udgør samtidig grundlaget for at øge såvel datakvalitet som rapporteringshastighed.

PANDORA afholder konferencer for økonomicheferne for at drøfte den seneste udvikling i væsentlige regnskabsforhold samt "best practice" vedrørende interne kontroller.

#### Overvågning

Datterselskabernes regnskabsaflæggelse kontrolleres løbende, og der er fastlagt procedurer for kontrol og test af disse aflæggelser. Procedurene etableres ligeledes for at sikre, at eventuelle fejl kommunikerer til og rettes af de selskaber, der aflægger regnskab.

Revisionsudvalget overvåger de interne kontrolsystemer for at sikre, at eventuelle svagheder elimineres og at eventuelle fejl i regnskaberne, som identificeres og rapporteres af revisorerne, rettes, herunder at der gennemføres kontroller eller procedurer for at forhindre sådanne fejl.

#### Revision

Selskabets eksterne revisorer vælges for et år ad gangen på den ordinære generalforsamling efter indstilling fra revisionsudvalget. Før denne indstilling vurderer **bestyrelsen (SM)** i samråd med **direktionen (SM)** revisorerne uafhængighed og kompetencer og andre forhold i relation til disse.

Rammerne for revisorerne pligter, herunder deres honorar, revisionsydelser og andre ydelser, aftales årligt mellem **bestyrelsen (SM)** og revisorerne efter anbefaling fra revisionsudvalget.

#### Videnkapital



På grund af værdien af PANDORAs brand og de særlige produkter og fremstillingsprocesser er det yderst **vigtigt (AM)** at udvikle og sikre selskabets videnkapital, herunder især de menneskelige ressourcer og immaterielle rettigheder.

#### Human resources

Det er PANDORAs **opfattelse (hedge)**, at mennesker er et **vigtigt (AM)** aktiv. PANDORAs fælles værdisæt er baseret på de normer og den adfærd, der er etableret gennem selskabets **næsten (hedge)** 30-årige historie i det tidligere familieejede og -drevne selskab, samt **værdifulde (AM)** bidrag fra tidligere selvstændige distributører, som nu er en del af selskabet, og nye medarbejdere på nye markeder. PANDORAs tre kerneværdier – pride, passion og performance – og den måde, hvorpå disse værdier udledes og fortolkes i alle selskabets handlinger, bidrager til at sikre en stærk og ensartet virksomhedskultur i alle PANDORAs virksomheder rundt omkring i verden.

Det er PANDORAs **opfattelse (hedge)**, at medarbejderudvikling er en væsentlig faktor i selskabets udvikling. For at sikre fremtidig vækst i PANDORA er det **vigtigt (AM)**, at selskabet løbende udvikler sine medarbejdere og således gør dem i stand til at klare de fremtidige udfordringer. PANDORA har derfor indført en række uddannelsesprogrammer.

I 2012 deltog 23 Vice Presidents på tværs af koncernen i et globalt program bestående af fire moduler, hvoraf det ene blev udviklet og gennemført i samarbejde med Harvard Business School. Modulerne uddanner deltagerne i såvel ledelse som forretningsforståelse. Selskabet udpegede i 2012 nye direktører for Nordamerika og Australien, og de blev begge identificeret og forfremmet internt fra denne gruppe af deltagere.

På lokalmarkederne gennemførtes lederuddannelse for det næste niveau af ledere med det formål at understøtte PANDORAs forretning. I lederuddannelsen indgår f. Eks. Personlig effektivitet, uddelegering og ledelse af andre som vigtige elementer.

**Omkring (hedge)** 80 ledere på verdensplan deltog i dette program i løbet af 2012.

På PANDORAs produktionsenhed i Thailand er der, udover en omfattende håndværksmæssig, teknisk og ledelsesmæssig uddannelse, åbnet et bibliotek og e-læringscenter, hvortil alle medarbejdere har adgang i overensstemmelse med PANDORAs tre kerneværdier. Derudover har PANDORA Production styrket og forbedret den organisatoriske åbenhed og engagement gennem regelmæssige såkaldte "radarmøder" med deltagelse af mere end 4.000 medarbejdere fra alle afdelinger og på individuel basis gennemført et 360-graders udviklingsprogram for ledergruppen.

#### Immaterielle rettigheder og politikker

PANDORAs immaterielle rettigheder anses for at være centrale for PANDORAs værdiskabelse, konkurrenceevne, handlefrihed og forretningsudvikling. De er derfor beskyttet på alle tænkelige måder, herunder ved et omfattende globalt overvågnings-, registrerings- og kontrolprogram. De immaterielle rettigheder udgøres hovedsageligt af varemærker, copyright og patenter og er yderligere styrket af forretningshemmeligheder, karakteristiske produkt designs, procedurer for fortrolighed og konkurrenceregulering. Det er ikke tilladt for distributører, forhandlere eller andre at registrere eller anvende PANDORAs immaterielle rettigheder uden forudgående aftale. PANDORAs håndhævelse og forsvar af disse rettigheder styrkes yderligere gennem implementeringen af en nul-tolerance-politik overfor krænkelse af PANDORAs immaterielle rettigheder på internettet, overfor kopiprodukter og af PANDORAs varemærker generelt.

#### Varemærker

PANDORA har registreret og ansøgt om en række ord- og figurmærker i forskellige jurisdiktioner rundt om i verden, herunder i EU, USA, Australien, Asien og Kina. Varemærkerne er registreret i forskellige internationale vare- og tjenesteydelsesklasser, primært international klasse 14, som omfatter smykker og ure.

Varemærkeporteføljen omfatter blandt andet EU-registreringer af "PANDORA" og logo "PANDORA med et kronet o" i forskellige internationale klasser, som anses for at være relevante for salg og markedsføring af PANDORAs produkter, herunder de internationale klasser for smykker, lædervarer og tøj. PANDORA styrkede ligeledes sine immaterielle rettigheder i Kina i 2011, og den latinske udgave af PANDORA varemærket blev registreret i klasse 14 i Kina.

#### Patenter

PANDORAs internationale patentfamilier omfatter patentrettigheder i forbindelse med charms-armbåndets funktionalitet. Der er udstedt patenter med virkning for EU's medlemsstater, USA, Australien, New Zealand, Sydafrika, Kina, Schweiz og Norge. **Generelt (hedge)** beskytter patenterne en smykkeked, dvs. en halskæde eller et armbånd, hvorpå der er monteret et stopled, en såkaldt "stopper". En aftagelig holder, en såkaldt "keeper" (f.eks. et charms klemmeled) er fastgjort til stopperen og udgør en komponent, som er større end kæden og derfor skaber afstand mellem de forskellige charms i halskæden eller armbåndet. Formålet er at

forhindre, at de bevægelige charms klumper sig sammen i den ene side af kæden. I USA udløber selskabets patent i 2023 og i andre jurisdiktioner i 2024.

## Samfundsansvar

Dette afsnit indeholder PANDORAs lovpligtige rapport om samfundsansvar for regnskabsåret 2012 i henhold til årsregnskabsloven § 99a.

PANDORAs CSR udvalg består af repræsentanter for **direktionen (SM)** og relevante, strategiske forretningsenheder. CSR udvalg er ansvarlig for at definere PANDORAs CSR strategi med henblik på fortsat at styrke ansvarlig forretningspraksis i hele koncernen. I 2012 lancerede PANDORA CSR politikker indenfor virksomhedsetik, menneskerettigheder, sundhed og sikkerhed, miljø samt ansvarlig leverandørstyring.

Hvert enkelt marked er ansvarligt for at integrere politikkerne i den daglige drift. Hertil har Group CSR udarbejdet en række vejledninger og værktøjer, som skal understøtte de lokale ledelser med at løse CSR relaterede opgaver. Politikkerne, vejledningerne og værktøjerne udgør tilsammen "PANDORA Ethics", og har direkte reference til PANDORAs kerneværdier defineret i "PANDORA Life".

Elementerne i "PANDORA Ethics" er i overensstemmelse med de ti principper i FN's Global Compact og i "the Responsible Jewellery Council's (RJC) Code of Practices", som definerer ansvarlig forretningsetik i smykkeindustrien.

Derudover arbejder PANDORA konsekvent på at sikre at politikken for menneskerettigheder og indsats herfor er i overensstemmelse med FN's "Guiding Principles on Business and Human Rights".

## Implementering af PANDORA Ethics

Den 1. Februar 2012 lancerede PANDORA en implementerings- og oplysningskampagne for "PANDORA Ethics" på tværs af hele PANDORA. Kampagnen sigtede mod at nå ud til alle medarbejdere i koncernen og er implementeret gennem:

- Et generisk træningsmodul som er implementeret i hele organisationen
- Skræddersyede træningsmoduler til strategiske forretningsenheder og udvalgte markeder
- Oplysningskampagner via intranet, video, foldere og plakater
- Uddelegering af ansvar til **ledelsen (SM)** på alle markeder
- Integrering af CSR i eksisterende introprogrammer
- PANDORAs compliance værktøj, i henhold til hvilket markederne skal rapportere om status på overholdelse af 100 CSR indikatorer

Kampagnen kulminerede i august 2012, da PANDORA blev certificeret i henhold til RJC's "code of practices", som er det mest ambitiøse CSR initiativ indenfor smykkeindustrien. PANDORA opnåede certificeringen på baggrund af en række anmeldte og uanmeldte kontrolbesøg gennemført af uafhængige auditører på hovedkontoret i Danmark, fabrikken i Thailand, samt regionale kontorer og butikker globalt.

PANDORAs CSR politikker, retningslinjer og værktøjer varierer på tværs af værdikæden, som omfatter indkøb af materialer, smykkeproduktion og salg af PANDORA smykker.

## Indkøb af materialer

I 2012 har PANDORA fortsat implementering af et "Four Step CSR Supplier Program", som sigter mod at kategorisere, træne og auditere PANDORAs leverandører samt følge op på deres indsats for at leve op til PANDORAs leverandørstandarder. På baggrund af de gode erfaringer opnået med programmet, har PANDORAs indkøbsafdelinger i Danmark og Thailand besluttet at gennemføre uafhængige kontrolbesøg af alle strategiske leverandører inden udgangen af 2013. PANDORA Production Thailand initierede i 2012 et projekt, som sigter mod at integrere leverandøraudits udført af PANDORAs egne medarbejdere indenfor følgende parametre: kvalitet, levering, omkostninger og CSR. PANDORA er **overbevist om (booster)**, at de gode erfaringer, der er opnået med integrerede ledelsessystemer i PANDORA Production Thailand og kontrolbesøg, vil inspirere leverandørerne til at udvikle sig indenfor alle fire områder.

## Smykkeproduktion

PANDORA sætter en ære i at drive en effektiv og ansvarlig smykkeproduktion på PANDORAs fabrikker i Bangkok, Thailand. Der fokuseres på at styrke og systematisere produktionen med henblik på at minimere miljøpåvirkning, samtidig med at der anlægges en "Total Reward" tilgang til hr og organisatorisk udvikling. I 2012 koncentrerede PANDORA sine miljøtiltag omkring udvikling af en miljøstrategi, forbedring af medarbejdernes miljøbevidsthed samt måling og synliggørelse af PANDORAs fremskridt på miljøområdet ved løbende at offentliggøre resultaterne internt. "Total Reward" tilgangen afspejler de fire hovedelementer, som repræsenterer værdien af at arbejde i PANDORA Production Thailand: **rimelige (AM)** lønforhold, attraktive personalegoder, kompetenceudvikling med **klart (AM)** definerede karrieremuligheder samt et sikkert, respektfuldt, kreativt og positivt arbejdsmiljø.

Ledelsessystemerne hos PANDORA Production Thailand blev i 2012 revideret af uafhængige auditører, valideret og certificeret i henhold til fire vigtige standarder for ansvarlig forretningsetik:

- The Responsible Jewellery Council's: "Principles and Code of Practices"
- ISO 14001: Miljøledelse
- OHSAS 18001: Arbejdsmiljøledelse
- C-TPAT: US Customs-Trade Partnership Against Terrorism

Mere end 4.000 medarbejdere arbejder på PANDORAs fabrikker, hvoraf mange ikke har direkte adgang til intranet. Implementering af CSR tiltag og oplysningskampagner gennemføres her gennem PANDORAs interne radio- og tv kanaler. Ligeledes er et nyåbnet bibliotek og e-læringscenter et væsentligt led i oplysning og uddannelse, ligesom det giver alle medarbejdere adgang til moderne it faciliteter i et stimulerende læringsmiljø.

#### Salg af PANDORA smykker

I 2010 og 2011 fokuserede PANDORA overvejende på CSR initiativer inden for indkøb og produktion. I 2012 har PANDORA i højere grad inkluderet salgsleddet, det sidste led i værdikæden. Således er alle salgskontorer blevet trænet i PANDORA Ethics politikker og retningslinjer for ansvarlig adfærd. Ligeledes er der udviklet moduler, som er integreret i selskabets e-læringsmoduler målrettet butikspersonale. Som led i RJC certificeringsprocessen blev 40% af de regionale salgskontorer auditeret af uafhængige konsulenter, og under disse kontrolbesøg blev der ikke identificeret nævneværdige afvigelser fra RJC standarderne. Kontrolbesøg og mystery shopping i PANDORA-ejede butikker **viste (booster)** de samme positive resultater. PANDORA er **overbevist om (booster)**, at baggrunden for disse positive resultater er den veltilrettelagte implementering af PANDORA Ethics, herunder den omfattende oplysningskampagne.

PANDORA's 45 interne trænere samt selskabets omfattende e-læringsystem gør det muligt for PANDORA at udvikle kompetencerne hos såvel PANDORAs egne medarbejdere som hos de **ca. (hedge)** 30.000 eksterne salgsmedarbejdere, der sælger PANDORA smykker på verdensplan. I løbet af 2012 blev der gennemført mere end 105.000 e-learning-moduler globalt. I 2012 intensiverede PANDORA bestræbelserne på at uddanne selskabets kunder i de unikke karakteristika, der kendetegner PANDORAs ægte smykker, og opfordre dem til at bidrage med at forhindre krænkelse af PANDORAs immaterielle rettigheder og derigennem værne om PANDORAs brand og produkt.

#### God selskabsledelse

Målet for god selskabsledelse og kommunikation er at sikre gennemsigtighed, ansvarlighed og at PANDORA opfylder sine forpligtelser overfor aktionærer, kunder, forbrugere, medarbejdere, myndigheder og andre vigtige interessenter så godt som muligt for således at maksimere den langsigtede værdiskabelse.

PANDORA kan henvise til selskabets hjemmeside <http://investor.PANDORA.net/governancestatement.cfm> for en gennemgang af selskabets lovpligtige rapport om god selskabsledelse for regnskabsåret 2012, i henhold til årsregnskabslovens §107b.

PANDORA har til hensigt til enhver tid at udøve god selskabsledelse samt at vurdere sine procedurer i henhold til de anbefalinger, der er udstedt af komiteen for god selskabsledelse. Som børsnoteret selskab er PANDORA omfattet af de, af NASDAQ OMX Copenhagen fastlagte oplysningskrav, som har føjet anbefalingerne til "regler for udstedere af aktier".

I henhold til anbefalingerne skal selskabet forklare eventuelle tilfælde, hvor anbefalingerne ikke følges. PANDORA har valgt at fravige anbefalingerne vedrørende **ledelsens (SM)** vederlag på følgende områder, idet selskabet **ønsker (AM)** at tilskynde til fælles og vedvarende, langsigtede mål for **ledelsen (SM)** og aktionærerne i overensstemmelse med selskabets strategi:

- formanden for **bestyrelsen (SM)** er berettiget til at modtage yderligere en engangsbonus i aktier for et beløb på DKK 6,5 millioner, i det omfang visse resultatmål for EBITDA (på justeret grundlag) defineret i selskabets forretningsplan nås for regnskabsårene 2013, 2014 eller 2015 (anbefaling nr. 6.1.6)

- PANDORA har etableret en aktieordning, i henhold til hvilken formanden og andre medlemmer af **bestyrelsen (SM)** hver især skal eje et mindsteantal aktier svarende til størrelsen af deres respektive første årlige bruttohonorar (anbefaling nr. 6.1.6)
- vederlagspolitikken for **ledelsen (SM)** indeholder ingen særlig klausul angående tilbagebetaling af variable dele af vederlagspakken på baggrund af forkerte oplysninger, idet PANDORA **anser (booster)** reglerne i den danske lovgivning for tilstrækkelige i sådanne tilfælde (anbefaling nr. 6.1.8)

### Bestyrelse og direktion (SM)

Den nuværende praksis i Danmark er, at beføjelserne fordeles mellem **bestyrelsen og direktionen (SM)**, og at der eksisterer en uafhængighed mellem disse to organer. **Bestyrelsen (SM)** vælges af generalforsamlingen for et år ad gangen. **Direktionen (SM)** udpeges af **bestyrelsen (SM)**. **Direktionen (SM)** varetager selskabets daglige ledelse, mens **bestyrelsen (SM)** fører tilsyn med **direktionens (SM)** arbejde og er ansvarlig for den generelle strategiske ledelse.

**Bestyrelsens (SM)** hovedopgaver er at sikre, at PANDORA har et stærkt ledelsesteam, en passende organisationsstruktur, effektive forretningsgange, optimal kapitalstruktur, gennemsigtig bogføringspraksis og ansvarlig kapitalstyring.

**Bestyrelsens (SM)** sammensætning skal sikre, at **bestyrelsen (SM)** til enhver tid har de nødvendige kompetencer til at overvåge selskabets udvikling og behørigt håndtere de konkrete muligheder og udfordringer, som PANDORA har og står over for. **Bestyrelsen og direktionen (SM)** udarbejder selskabets overordnede strategier og fører tilsyn med, at selskabet har de nødvendige kompetencer og ressourcer til at opnå den størst mulige sandsynlighed for, at PANDORA når sine mål. Desuden overvåger **bestyrelsen (SM)** den økonomiske udvikling og de dertil hørende planlægnings- og rapporteringssystemer.

### Bestyrelsens (SM) virke i 2012

**Bestyrelsen (SM)** holdt 12 ordinære bestyrelsesmøder i løbet af året med en samlet mødeprocent på 91,6%. I 2012 beskæftigede **bestyrelsen (SM)** sig særligt med eksekveringen af den vedtagne 18-måneders turnaround plan, gennemførelse af omfattende tiltag til balancering af lagre ude på markederne, tilpasningen af pris- og produktarkitekturen, forbedring af like-for-like-salget i konceptbutikkerne, fastlæggelse af den for selskabet optimale kapitalstruktur og udbyttepolitik samt introduktion af to nye bestyrelsesmedlemmer og ny CEO.

### Bestyrelsesudvalg

**Bestyrelsen (SM)** har etableret et revisionsudvalg, et vederlagsudvalg og et nomineringsudvalg, hvoraf størstedelen af medlemmerne er uafhængige bestyrelsesmedlemmer som defineret i anbefalingerne udstedt af komiteen for god selskabsledelse. **Bestyrelsen (SM)** udpeger udvalgsmedlemmer og udvalgsformanden. Udvalgenes vedtægter og aktiviteter offentliggøres på selskabets hjemmeside.

### Revisionsudvalget

De nuværende medlemmer af revisionsudvalget er Anders Boyer-Søgaard (formand), Andrea Alvey og Nikolaj Vejlsgaard. Revisionsudvalget gennemgår og vurderer selskabets regnskabsaflæggelses- og revisionsprocedurer samt interne kontrolsystemer og tager stilling til, om disse kontrolprocedurer er tilstrækkelige. Det er revisionsudvalgets opgave konkret at føre tilsyn med følgende områder:

- Regnskabsaflæggelsesproceduren
- Interne kontrol- og risikostyringssystemer
- Ekstern revision

Revisionsudvalget holdt seks møder i 2012 med en mødeprocent på 100%. Hovedaktiviteterne i 2012 var:

- møder med **ledelsen (SM)** og eksterne revisorer for at gennemgå den reviderede årsrapport
- møder med **ledelsen (SM)** for at gennemgå delårsrapporterne, de vigtigste regnskabsprincipper og væsentlige regnskabsmæssige skøn
- stillingtagen til om selskabets interne kontroller og risikostyringssystemer er tilstrækkelige og effektive
- gennemgang af selskabets væsentligste finansielle risici
- vurdering af behovet for intern revision
- anbefalinger til valget af eksterne revisorer samt godkendelse af honorar til eksterne revisorer
- revisionsudvalgets årlige selvevaluering

### Vederlagsudvalget

De nuværende medlemmer af vederlagsudvalget er Allan Leighton (formand), Marcello V. Bottoli, Torben Ballegaard Sørensen, Christian Frigast Og Ronica Wang.

Vederlagsudvalgets væsentligste opgaver er:

- at udarbejde anbefalinger til **bestyrelsen (SM)** om vederlagspolitikken for **bestyrelsen (SM)** og de 15 øverste direktører, herunder direktionen, hvad angår faste og variable dele af vederlagspakken
- at fremsætte forslag til **bestyrelsen (SM)** til dennes og de ledende medarbejders samlede individuelle vederlagspakke
- at sikre, at oplysningerne om vederlag i årsrapporten er korrekte, nøjagtige og tilstrækkelige

Vederlagsudvalget holdt tre møder i 2012 med en mødeprocent på 82%. Hovedaktiviteten var den årlige gennemgang af vederlagspolitikken og vejledningen for incitamentsaflønning samt godkendelse af selskabets samlede lønregulering. Som et led i denne gennemgang foretog udvalget en sammenligning af det samlede vederlag til selskabets ledende medarbejdere i forhold til nationale og international tendenser.

#### Nomineringsudvalget

De nuværende medlemmer af nomineringsudvalget er allan leighton (formand), Christian frigast og ronica Wang.

Nomineringsudvalget bistår **bestyrelsen (SM)** med at opfylde sit ansvar i forbindelse med f.eks.:

- beskrivelse af de kvalifikationer, der kræves af medlemmer af **bestyrelsen (SM)** samt **direktionen (SM)**
- nominering af kandidater til **bestyrelsens (SM)** godkendelse i forbindelse med besættelse af ledige poster i **bestyrelsen og direktionen (SM)**
- **bestyrelsens (SM)** selvevaluering
- vurdering af **direktionens (SM)** præstation og samarbejdet mellem **bestyrelse og direktion (SM)**
- afløserplanlægning for den øverste ledelse nomineringsudvalget holdt to møder i 2012 med en mødeprocent på 100%. Udvalgets hovedaktivitet i 2012 var den årlige bestyrelsesevaluering samt søgning, valg og uddannelse af nye bestyrelsesmedlemmer.

#### Vederlagspolitik

PANDORAs vederlagspolitik gælder for **bestyrelsen og direktionen (SM)** og skal godkendes af generalforsamlingen. Den dækker den faste såvel som den incitamentsbaserede aflønning og har til formål at tiltrække, fastholde og motivere medlemmerne af **bestyrelsen og direktionen (SM)**.

#### Bestyrelsens (SM) vederlag

Hvert bestyrelsesmedlem modtager et fast årligt honorar. Basishonoraret er ens for alle bestyrelsesmedlemmer, bortset fra formanden. Næstformanden modtager 1,5 gange basishonoraret. Der er nedsat en række udvalg, og medlemmerne af hvert udvalg modtager et fast honorar for deres bidrag. Formanden for udvalget modtager 1,5 gange dette honorar. Bestyrelsesformanden modtager ikke honorar for udvalgsarbejde.

#### Direktionens (SM) vederlag

**Direktionens (SM)** vederlagspakke består af en fast basisløn, en kortsigtet kontant bonus, en langsigtet aktiebaseret incitamentsordning samt andre goder. Formålet med den kortsigtede kontante bonus er at fremme præstationen og sikre, at medlemmerne af **direktionen (SM)** belønnes for deres individuelle bidrag til selskabets succes på en rimelig og ansvarlig måde. Den kortsigtede kontante bonus kan maksimalt resultere i en ekstraudbetaling på 50% af den årlige basisløn for direktionen. Målene for det kortsigtede kontante bonusprogram fastlægges af vederlagsudvalget og godkendes af **bestyrelsen (SM)**. Formålet med det langsigtede incitamentsprogram er at fremme **direktionens (SM)** samlede præstation og sikre overensstemmelse mellem **direktionens (SM)** interesser og selskabets aktionærers langsigtede interesser. Der udbetales ikke fratrædelsesgodtgørelse i tilfælde af opsigelse i forbindelse med forsætlig pligtforsømmelse eller grov uagtsomhed.

#### Bestyrelsens (SM) selvevaluering

**Bestyrelsen (SM)** foretager en gang om året en selvevaluering for løbende at forbedre sin præstation og samarbejdet med direktionen. Formanden, som også er formand for nomineringsudvalget, styrer vurderingsforløbet. Vurderingen udføres en gang årligt ved, at hvert enkelt bestyrelsesmedlem udfylder et spørgeskema efterfulgt af en individuel samtale med formanden. Når svarene er samlet ind, fremlægges resultatet på det efterfølgende bestyrelsesmøde, og de områder, der skal forbedres i det kommende år, identificeres.

Blandt de emner, der behandles i selvevalueringen, er **bestyrelsens (SM)** sammensætning, nomineringsprocessen samt **bestyrelsens (SM)** kompetencer. Derudover afdækkes, hvordan **bestyrelsen (SM)** fungerer, atmosfæren, samarbejdet med direktionen, **bestyrelsens (SM)** involvering i finansielle forhold og kontrol, de individuelle bidrag og udvalgsarbejdet.

Hovedkonklusionerne af selvevalueringen var: **bestyrelsen (SM)** er velfungerende, er som helhed fagligt velkvalificeret til at understøtte PANDORAs forretning og der er ”god (AM) kemi” og respekt mellem bestyrelsesmedlemmerne. De konklusioner, der er draget af vurderingen, har også resulteret i en yderligere styrkelse af proceduren for afløserplanlægning samt en yderligere strukturering af arbejdet i nominerings- og vederlagsudvalget. Formanden foretager en gang om året en formel vurdering af direktionen.

#### Bestyrelse

Allan Leslie Leighton, født 1953, er britisk statsborger og bor p.t. i London i Storbritannien. Allan har fulgt ”Advanced Management Program” på Harvard University. Han har en æresgrad fra Cranfield University og et æresstipendium fra University of Lancashire. Allan er p.t. Formand for Pace LLC, Office Ltd. Og Music Maqqie.co.uk, formand for **bestyrelsen (SM)** i Matalan Ltd., eksternt bestyrelsesmedlem for Bighams Ltd. Og protektor for ”Breast Cancer Care”. Allan har været formand for **bestyrelsen (SM)** i PANDORA A/S siden august 2010 og er desuden formand for **bestyrelsens (SM)** vederlagsudvalg og nomineringsudvalg. Han anses for at være uafhængigt bestyrelsesmedlem.

Allans særlige kompetencer, som er vigtige for hans bestyrelseshverv i PANDORA A/S, er hans store erfaring inden for generel ledelse og økonomistyring i børsnoterede selskaber, globale forsyningskæder og indkøb, salg til forbrugere og markedsføring inden for detailhandel samt global ”cross-platform” branding.

Marcello Vittorio Bottoli, født 1962, er italiensk statsborger og bor p.t. i Surlej-Silvaplana i Schweiz. Marcello har en doktorgrad i business administration fra Bocconi University i Milano i Italien. Han er p.t. Formand for **bestyrelsen (SM)** i Pharmafortune S.A., eksternt bestyrelsesmedlem for international Flavour & Fragrances Inc., true religion Apparel, Inc. Og Blushington LCC. Han er desuden operating partner for advent international, som er en global private equity-virksomhed. Marcello har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden august 2010 og er desuden medlem af **bestyrelsens (SM)** vederlagsudvalg. Marcello anses ikke for at være uafhængigt bestyrelsesmedlem, da han i en periode var konstitueret administrerende direktør for PANDORA A/S.

Marcellos særlige kompetencer, som er vigtige for hans bestyrelseshverv i PANDORA A/S, er hans store erfaring inden for generel ledelse i børsnoterede selskaber, salg til forbrugere og markedsføring inden for detailhandel, global ”cross-platform” branding og ”affordable goods”-sektoren.

Torben Ballegaard Sørensen, født 1951, er dansk statsborger og bor p.t. i Højbjerg i Danmark. Torben har en cand.merc. fra Handelshøjskolen i Århus (nu Business and Social Sciences, Aarhus Universitet) og er adjungeret professor på institut for ledelse, Aarhus Universitet. Torben er p.t. administrerende direktør for Investeringselskabet af 1. juli 2008 ApS. Han er desuden formand for bestyrelsen i AS3 Companies A/S, CAT Forsknings- og Teknologipark A/S, Realfiction A/S og Tajco Group A/S. Torben er medlem af bestyrelsen i fonden CAT, Fonden Invest Zealand, Egmont Fonden, Egmont International Holding A/S, Ejendomsselskabet Vognmagergade 11 ApS, Ejendomsselskabet Gothersgade 55 ApS, Lego A/S, Systematic A/S og AB Electrolux. Torben har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden marts 2008 og er desuden medlem af **bestyrelsens (SM)** vederlagsudvalg. Han anses for at være uafhængigt bestyrelsesmedlem.

Torbens særlige kompetencer, som er vigtige for hans bestyrelseshverv i PANDORA A/S, er hans store erfaring inden for generel ledelse og økonomistyring i børsnoterede selskaber, salg til forbrugere og markedsføring inden for detailhandel samt global ”cross-platform” branding.

Andrea Dawn Alvey, født 1967, er amerikansk statsborger og bor p.t. i Raleigh i North Carolina, USA. Andrea har en bachelorgrad i Business Economics/Statistics fra Southern Connecticut State University. Andrea er præsident for Kitabco Investments, Inc. Og regional developer for Peak Franchising. Andrea har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden august 2010 og er desuden medlem af **bestyrelsens (SM)** revisionsudvalg. Hun anses for at være uafhængigt bestyrelsesmedlem.

Andreas særlige kompetencer, som er vigtige for hendes bestyrelseshverv i PANDORA A/S, er hendes store erfaring inden for generel ledelse og økonomistyring i børsnoterede selskaber, globale forsyningskæder og indkøb samt salg til forbrugere og markedsføring inden for detailhandel.

Povl Christian Lütken Frigast, født 1951, er dansk statsborger og bor p.t. i Klampenborg i Danmark. Christian har en kandidatgrad i statskundskab og økonomi fra Københavns Universitet. Han er p.t. managing partner i Axcel Management A/S og administrerende direktør i Axcel Industriinvestor A/S, CCTC Invest A/S, Axcel II Management A/S, Axcel II A/S, Axcel III KS Invest ApS, Axcel Management A/S, MP-AX I Invest ApS, MP-AX II Invest ApS og MNGT1 ApS. Desuden er Christian p.t. formand for bestyrelsen i AX

Cimbria Invest ApS, Prometheus Invest ApS, Axcel Prometheus NewCo 4 ApS, AX NO Invest ApS, Junckers Holding A/S, AX MITA Invest ApS og AX Investment Invest ApS. Han er desuden næstformand for bestyrelsen i Royal Scandinavia A/S, DVCA Danish Venture Capital og Private Equity Association. Han er endvidere medlem af bestyrelsen i Axcel Management A/S og Royal Scandinavia Invest A/S. Christian har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden august 2010 og er desuden medlem af **bestyrelsens (SM)** vederlagsudvalg og nomineringsudvalg. Han anses ikke for at være uafhængigt bestyrelsesmedlem på grund af stillingen som managing partner i Axcel.

Christians særlige kompetencer, som er vigtige for hans bestyrelseshverv i PANDORA A/S, er hans store erfaring inden for generel ledelse og økonomistyring i børsnoterede selskaber, salg til forbrugere og markedsføring inden for detailhandel samt "affordable goods"-sektoren.

Nikolaj Vejlsgaard, født 1971, er dansk statsborger og bor p.t. i Vedbæk i Danmark. Nikolaj er uddannet cand. Merc. i erhvervsøkonomi fra Copenhagen Business School. Nikolaj er p.t. Partner i Axcel management A/S og administrerende direktør i Prometheus Invest ApS, Royal Scandinavia Invest A/S, Waldorf & Statler ApS, AXIII MPH Invest ApS, UIM Holding ApS og tre datterselskaber. Desuden er han p.t. Formand for bestyrelsen i IP Gruppen Holding ApS og IP development A/S og næstformand for bestyrelsen i f. Junckers industrier A/S. Nikolaj er endvidere medlem af bestyrelsen i Axcel Prometheus NewCo 4 ApS, Royal Scandinavia Invest A/S, Royal Scandinavia A/S, ERA Biler ApS, ERA A/S, ERA Ejendomme A/S, IP Online A/S, IP Administration A/S, Prometheus Invest ApS, Royal Scandinavia II ApS, mngt2 ApS, MNGT Komplementar ApS, AXIII MP Holding ApS, Junckers Holding A/S og Axcel-Junckers Invest A/S. Nikolaj har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden marts 2008 og er desuden medlem af **bestyrelsens (SM)** revisionsudvalg. Han anses ikke for at være uafhængigt bestyrelsesmedlem på grund af stillingen som partner i Axcel.

Nicolajs særlige kompetencer, som er vigtige for hans bestyrelseshverv i PANDORA A/S, er hans store erfaring inden for generel ledelse og økonomistyring i børsnoterede selskaber, salg til forbrugere og markedsføring inden for samt "affordable goods"-sektoren.

Anders Boyer-Søgaard, født 1970, er dansk statsborger og bor p.t. i Charlottenlund i Danmark. Anders blev uddannet cand.merc. i finansiering og regnskab fra Copenhagen Business School i 1997. Anders er p.t. Chief Financial Officer for GN Store Nord A/S. Anders har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden marts 2012 og er desuden formand for **bestyrelsens (SM)** revisionsudvalg. Han anses for at være uafhængigt bestyrelsesmedlem hvad angår **bestyrelsens (SM)** sammensætning.

Anders' særlige kompetencer, som er vigtige for hans bestyrelseshverv i PANDORA A/S, er hans store erfaring inden for generel ledelse og økonomistyring i børsnoterede selskaber samt globale forsyningskæder og produktion.

Ronica Wang, født 1962, er statsborger i Hongkong og bor p.t. i Asien, hvor hun tilbringer det meste af sin tid i Kina. Ronica har en MBA fra Wharton Business School, University of Pennsylvania, og en bachelorgrad i Applied Science and Engineering (Industrial Engineering) fra the University of Toronto. Hun har desuden studeret multinational ledelse på the London Business School. Ronica er p.t. administrerende direktør i The InnoGrowth Group, Ltd., som hun var med til at stifte i 2007. Ronica har været medlem af **bestyrelsen (SM)** i PANDORA A/S siden marts 2012 og er desuden medlem af **bestyrelsens (SM)** vederlagsudvalg og nomineringsudvalg. Hun anses for at være uafhængigt bestyrelsesmedlem.

Ronicas særlige kompetencer, som er vigtige for hendes bestyrelseshverv i PANDORA A/S, er hendes store internationale erfaring inden for generel ledelse i børsnoterede selskaber, salg til forbrugere og markedsføring inden for detailhandel, global "cross-platform" branding samt "affordable goods"-sektoren.

## Ledelse

Bjørn Gulden (født 1965)

President, Chief Executive Officer

Formand for **Direktionen (SM)**

Andre bestyrelsesposter og hverv:

- Expert AS – Norge (BM)
- Ekornes AS – Norge (BM)
- Tchibo GmbH – Tyskland (BM)

Henrik Holmark (født 1965)

Executive Vice President, Chief Financial Officer

Medlem af **Direktionen (SM)**

Sten Daugaard (født 1957)

Executive Vice President, Chief Development Officer

Medlem af **Direktionen (SM)**

Thomas Ryge Mikkelsen (født 1972)

Executive Vice President, Chief Merchant

Andre bestyrelsesposter og hverv:

- Prokura P/S (BM)

(BM) bestyrelsesmedlem

#### Aktionærinformation

#### AKTIONÆRINFORMATION

PANDORA er noteret på NASDAQ OMX Copenhagen i Danmark. PANDORA blev inkluderet i OMXC20-indekset i forbindelse med den halvårslige revision af indekset i juni 2012 og indgår også i indekset over de 20 mest omsatte aktier i den efterfølgende periode fra december 2012 til juni 2013.

#### OMSÆTNING

Den laveste slutkurs i 2012 var på DKK 52 den 17. juli 2012, mens den højeste slutkurs var på DKK 131 den 17. december 2012. Der blev handlet mere end 134 millioner PANDORA-aktier i 2012 med en gennemsnitlig omsætning på **ca. (hedge)** 540.000 aktier pr. dag.

#### UDBYTTE

Det er **bestyrelsens (SM)** mål at opretholde et stabilt og herefter stigende nominelt udbytte pr. Aktie med et udbytte for 2011 på DKK 5,50 pr. Aktie som udgangspunkt. PANDORA-aktien handles eksklusive udbytte dagen efter generalforsamlingen den 20. Marts 2013. Der vil automatisk blive udbetalt udbytte via VP Securities den 26. marts 2013.

#### AKTIONÆRER

Pr. 31. december 2012 var PANDORAs største aktionær Prometheus Invest ApS, CVR-nr. 28 48 30 23, som ejede 65.704.750 aktier à nom. DKK 1 i PANDORA A/S, svarende til 50,49% af aktiekapitalen og det tilsvarende antal stemmer. Andre større aktionærer omfatter institutionelle aktionærer primært i Danmark, USA og Storbritannien. Selskabet har også et betydeligt antal private aktionærer i Danmark. **Omtrent (hedge)** 50% af aktierne i fri handel ejes af aktionærer uden for Danmark.

#### INVESTOR RELATIONS

**Direktionen (SM)** er ansvarlig for, at der findes en Investor Relations (IR) funktion, hvis chef er ansvarlig for, at PANDORA overholder sin investor relations-politik. IR er organiseret som en separat enhed og refererer direkte til Executive Vice President



and Chief Financial Officer. Formålet med Selskabets Investor Relations-aktiviteter er at sikre, at aktiemarkedet rettidigt får relevante, nøjagtige oplysninger som grundlag for regelmæssig handel med og en rimelig kursfastsættelse af aktien. PANDORA **ønsker (AM)** at sikre, at aktiemarkedet opfatter Selskabet som et synligt, tilgængeligt og professionelt selskab, samt at PANDORA anses for at være blandt de bedste i forhold til sammenlignelige selskaber. Dette vil blive opnået ved, at Selskabet overholder regler og love for selskaber noteret på NASDAQ OMX Copenhagen, samt ved at overholde PANDORAs interne politikker.

PANDORA vil bestræbe sig på at bibeholde et højt og ensartet informationsniveau fra Selskabet og på at sikre, at oplysningerne kanaliseres tilbage fra aktiemarkedet til **direktionen og bestyrelsen (SM)**. Derudover vil PANDORA løbende sikre kendskab og tillid til Selskabets vision, strategi, politikker og beslutninger på kapitalmarkedet.

#### Talsmænd

Følgende funktioner har beføjelser til at kommunikere med investeringssamfundet (herunder analytikere, børsmæglere, privatpersoner og institutionelle investorer), medmindre andet er aftalt:

- Bestyrelsesformanden
- **Direktionen (SM)**
- Investor relations

#### Selskabsmeddelelse

Offentliggørelse af koncernmeddelelser finder sted i overensstemmelse med dansk lovgivning. Oplysninger opslås på PANDORAs hjemmeside umiddelbart efter offentliggørelsen. Lovpligtige koncernmeddelelser og regnskaber foreligger på engelsk og dansk. Alle andre informationer foreligger kun på engelsk. Med henblik på at sikre hurtig adgang til koncernmeddelelser og pressemeddelelser opfordrer PANDORA alle interesserede parter til at tilmelde sig e-mail-advisering på selskabets hjemmeside under investor.

#### Møder

Der afholdes regelmæssigt møder med interesserede investorer og analytikere i både store og små grupper samt individuelt. Ved sådanne møder drøftes PANDORAs forhold, mens insideroplysninger **aldrig (booster)** afsløres.

Hvis PANDORA bliver bedt om at gennemse en analytikers udkast til en rapport, vil selskabet begrænse sin gennemgang og sine kommentarer til:

- kun at rette historiske, faktuelle oplysninger
- pointere oplysninger, som er offentligt tilgængelige
- give oplysninger, som PANDORA anser for at være utvetydigt uvæsentlige
- **generelt (hedge)** drøfte faktorer, som **kan (hedge)** påvirke de underliggende forudsætninger for fremtidige prognoser

#### Tavshedsperiode

PANDORA kommenterer ikke på spørgsmål om regnskabsmæssige resultater eller forventninger i en periode på fire uger før den planlagte offentliggørelse af delårsrapporter.

#### Telefonkonference

Ved offentliggørelsen af regnskaber og andre større nyheder afholder PANDORA telefonkonferencer eller videotransmissioner, som kan følges direkte på selskabets hjemmeside sammen med tilhørende præsentationer.

#### Eksterne konferencer og præsentationer

Taler og præsentationer fra konferencer, road shows, investormøder og lignende vil være tilgængelige på hjemmesiden samtidig med, at de finder sted, eller så hurtigt som muligt derefter. Det vil også være muligt at følge de planlagte aktiviteter og begivenheder via finanskalenderen, som føres online.

#### Kapitalmarkedsdage og lignende begivenheder

PANDORA afholder kapitalmarkedsdage og lignende begivenheder efter behov. Alle taler og præsentationer er tilgængelige samtidig med, at begivenheden finder sted, eller så hurtigt som muligt derefter.

## Udtalelser om forventninger til fremtiden

Årsrapporten indeholder udtalelser om forventninger til fremtiden. Sådanne udtalelser er underlagt risici og usikkerheder, da en række faktorer, hvoraf mange ligger uden for A.P. Møller-Mærsk A/S kontrol, **kan (hedge)** føre til, at den faktiske udvikling og det faktiske resultat adskiller sig markant fra forventningerne i Årsrapporten.

## Ledelsesberetning

(tal for 2011 i parentes)

Gruppen leverede et resultat på USD 4,0 mia. (USD 3,4 mia.), hvilket var lidt højere end den senest udmeldte forventning af 9. november 2012 på **ca. (hedge)** USD 3,7 mia. Afkastet af den investerede kapital (rOIC) var 8,8% (8,3%).

Resultatet var positivt påvirket af forliget i en algerisk skattesag i første kvartal på USD 899 mio. kombineret med forøgede containermængder samt højere rater og lavere enhedsomkostninger for Maersk Line. Resultatet var negativt påvirket af et fald i Maersk Oils produktionsandel samt nedskrivninger på netto USD 405 mio., hvoraf Maersk Tankers tegnede sig for USD 268 mio. i tredje kvartal. Salgsavancer var USD 636 mio. (USD 890 mio.) med salget af to FPSO'ere, Maersk LNG og Maersk Equipment Service som de største transaktioner. Omsætningen viste et beskedent fald til USD 59,0 mia. (USD 60,2 mia.).

Pengestrøm fra driftsaktiviteter var USD 7,6 mia. (USD 7,3 mia.), mens pengestrøm vedrørende anlægsinvesteringer var netto USD 6,3 mia. (USD 9,8 mia.), efter modregning af avance ved afhændelse USD 3,4 mia. (USD 1,7 mia.). Gruppens frie pengestrøm var positiv med USD 1,3 mia. (negativ med USD 2,5 mia.).

Den rentebærende nettogæld steg med USD 339 mio. til USD 15,7 mia. (USD 15,3 mia.). Egenkapitalen udgjorde USD 39,3 mia. (USD 36,2 mia.), positivt påvirket af årets resultat på USD 4,0 mia. Der blev udbetalt udbytte på USD 945 mio. (USD 924 mio.).

## Sammenfatning for Gruppen for 2012

Med en egenkapitalandel på 52,9% (51,4%) og en likviditetsreserve på USD 13,6 mia. (USD 11,3 mia.) er Gruppen velforberedt og **besluttet (AM)** på at føre sine langsigtede vækstambitioner ud i livet og handle på de muligheder, der opstår i markederne inden for kerneforretningerne, uanset de fortsatte begrænsninger på finansmarkederne. Maersk Line leverede et overskud på USD 461 mio. (tab på USD 553 mio.), og ROIC var 2,4% (negativ med 3,1%). Resultatet var positivt påvirket af forøgede containermængder samt højere rater og lavere enhedsomkostninger. De gennemsnitlige fragtrater var med 2.881 USD/FFE (2.828 USD/FFE) 1,9% højere, og containermængderne steg med 5% til 8,5 mio. FFE (8,1 mio. FFE). Brændstofforbruget pr. FFE blev reduceret med 11%, og antallet af medarbejdere på hovedkontoret blev reduceret betydeligt.

Maersk Line annoncerede og gennemførte betydelige generelle ratestigninger for de fleste ruter understøttet af aktive kapacitetstilpasninger i form af slow steaming, skrotning, oplægning og aflyste afgange. Den totale flådekapacitet blev forøget med 4% til 2,6 mio. TEU (2,5 mio. TEU). Kapacitetsøgningen i egen flåde blev delvist opvejet ved tilbagelevering af chartrede skibe. Maersk Line fastholdt sin markedsandel i 2012 som helhed. Pengestrøm fra driftsaktiviteter var USD 1,8 mia. (USD 899 mio.), og pengestrøm vedrørende anlægsinvesteringer var USD 3,6 mia. (USD 3,2 mia.). Maersk Oil leverede et overskud på USD 2,4 mia. (USD 2,1 mia.), og ROIC var 36,6% (37,2%). Resultatet var positivt påvirket af engangsskatteindtægt på USD 899 mio. fra forliget i en algerisk skattesag samt en avance på USD 91 mio. fra et delvist salg af andele i Brasilien. Dette blev delvist opvejet af en nedgang på 23% i Gruppens andel af olie- og gasproduktionen til 257.000 boepd (333.000 boepd), som hovedsageligt skyldes lavere produktionsandel i Qatar og Danmark.

Udviklingen i porteføljen omfattede modning af de vigtige projekter Chissonga i Angola og Johan Sverdrup i Norge, en aftale om yderligere udvikling af Al Shaheen feltet i Qatar samt start af Dunga fase II produktionen i Kasakhstan. Efterforskningsudgifter var USD 1,1 mia. (USD 1,1 mia.). Pengestrøm fra driftsaktiviteter var USD 3,9 mia. (USD 4,3 mia.), og pengestrøm vedrørende anlægsinvesteringer var USD 2,0 mia. (USD 3,8 mia.).

APM Terminals leverede et overskud på USD 723 mio. (USD 648 mio.), og ROIC var 13,6% (13,1%).

Resultatet var positivt påvirket af avancer fra salg før skat på USD 123 mio. (USD 28 mio.). Antallet af håndterede containere steg med 6% til 35,4 mio. TEU (33,5 mio. TEU) påvirket af tilgange af terminaler til porteføljen, hvilket var bedre end markedets vækst på 4%.

De væsentligste ændringer i porteføljen var købet af en fællesledet 37,5% andel i Global Ports Investments PLC, Rusland, samt overtagelse af driften i Gøteborg, Sverige. Der blev indgået aftaler om nye terminalprojekter i Lazaro Cardenas, Mexico, og Ningbo, Kina. Pengestrøm fra driftsaktiviteter var USD 975 mio. (USD 912 mio.), og pengestrøm vedrørende anlægsinvesteringer var USD 1,4 mia. (USD 688 mio.).

Maersk Drilling leverede et overskud på USD 359 mio. (USD 488 mio.), og ROIC var 8,3% (12,5%). Resultatet var negativt påvirket af en forsinket opstart samt værftsophold for to enheder. Maersk Drilling indgik i 2012 tre nye større kontrakter og har nu indgået aftale for fem ud af syv nybygninger til levering i 2013-2015. Kontraktbeholdningen steg til USD 7,0 mia. (USD 4,9 mia.), og den etårige kontraktsdækning var ved udgangen af 2012 98% (98% ved udgangen af 2011). Den gennemsnitlige operationelle opetid var 92,1% (95,6%). Pengestrøm fra driftsaktiviteter var USD 651 mio. (USD 825 mio.), og pengestrøm vedrørende anlægsinvesteringer var USD 589 mio. (USD 600 mio.).

Maersk Supply Service leverede et overskud på USD 132 mio. (USD 243 mio.), og ROIC var 6,1% (11,2%), negativt påvirket af generel overkapacitet i de fleste markedssegmenter med undtagelse af beredskabs- og redningssegmentet.

Maersk Tankers fik et tab på USD 312 mio. (tab på USD 153 mio.), og ROIC var negativ med 8,3% (negativ med 4,3%). Resultatet var negativt påvirket af en nedskrivning på USD 268 mio. Maersk Tankers solgte Small Northwest Europe segmentet og har indgået en aftale om at afhænde Handygas segmentet. Handygas transaktionen vil finde sted i 2013. Salgene svarer til 14% af flåden målt i forhold til investeret kapital. Damco leverede et overskud på USD 55 mio. (USD 63 mio.), og ROIC var 13,5% (24,4%). Damco øgede sit serviceudbud inden for luftfragt betydeligt ved købet i 2011 af NTS International Transport Services i Kina. I oktober 2012 købte Damco speditørselskabet Pacific Network Global Logistics, for at styrke sin position i Oceanien.

SVITZER leverede et overskud på USD 9 mio. (USD 102 mio.) efter nedskrivning af goodwill på USD 102 mio. relateret til Adsteam-aktiviteterne, der blev erhvervet i 2007. ROIC var 0,6% (6,4%). Dansk Supermarked Gruppen leverede et overskud på DKK 1,3 mia. (DKK 5,4 mia. inklusive avancen fra salget af Netto, UK), og ROIC var 8,2% (35,1%). Gruppen åbnede 71 nye butikker og lukkede 55 butikker, heraf 37 Tøj & Sko butikker.

Maersk FPSOs og Maersk LNG leverede et overskud på USD 336 mio. (USD 10 mio.), og ROIC var 33,9% (0,4%), positivt påvirket af avancer fra salg på USD 245 mio.

#### AKTIEKURS OG UDBYTTE

I løbet af 2012 steg aktiekursen på Maersk B-aktien med 12,3% til DKK 42.600. **Bestyrelsen (SM)** foreslår, at der udbetales udbytte på DKK 1.200 pr. aktie à DKK 1.000, svarende til en udbytteprocent på 2,8% baseret på B-aktiens lukkekurs pr. 31. december 2012.

#### KVARTALSTAL

Kvartalstal for Gruppen for 2010-2012 er tilgængelige på <http://investor.maersk.com/da/financials.cfm>

#### Forventninger til 2013

Gruppen **forventer (hedge)** et resultat for 2013, som er lavere end 2012-resultatet (USD 4,0 mia.). Resultatet **forventes (hedge)** at blive på samme niveau som i 2012 (USD 2,9 mia.) eksklusive nedskrivninger, avancer fra salg og indtægten fra forliget i en algerisk skattesag.

Pengestrøm vedrørende anlægsinvesteringer **forventes (hedge)** at blive noget højere end i 2012 (USD 6,3 mia.), mens pengestrøm fra driftsaktiviteter **forventes (hedge)** at være stabil.

Maersk Line **forventer (hedge)** et bedre resultat end i 2012 (USD 461 mio.) primært baseret på yderligere reducerede enhedsomkostninger. Den globale efterspørgsel på søfragt af containere **forventes (hedge)** at stige med 4-5% i 2013, lavere på Asien-Europa ruterne, men understøttet af stigning i import til vækstøkonomierne.

Maersk Oil **forventer (hedge)** et betydeligt lavere resultat end i 2012 (USD 2,4 mia.), som omfattede en engangsskatteindtægt på USD 899 mio. fra forliget i en algerisk skattesag. Resultatet **forventes (hedge)** at blive under resultatet for 2012 (USD 1,5 mia.) eksklusiv effekten af skattemæssige engangspåvirkninger, nedskrivninger og avancer fra salg. Maersk Oil **forventer (hedge)** en produktionsandel på 240.000-250.000 boepd, lavere i første halvår end i andet halvår 2013 til en gennemsnitlig oliepris på USD 105 pr. tønde. Den lavere produktionsandel skyldes især en naturlig nedgang og en mindre ejerandel i Danmark, der udlignes af opstart af El Merk og Gryphon felterne. Efterforskningsudgifter ventes at blive over USD 1,0 mia.

APM Terminals **forventer (hedge)** et bedre resultat end i 2012 (USD 723 mio.) samt en vækst, der ligger over markedets, understøttet af containermængder fra nye terminaler samt forbedringer af produktiviteten i eksisterende faciliteter.

Maersk Drilling har **næsten (hedge)** fuld kontraktsdækning i 2013 og **forventer (hedge)** et bedre resultat end i 2012 (USD 359 mio.).

Det samlede resultat for alle andre aktiviteter **forventes (hedge)** at blive højere end 2012, eksklusive salgsavancer og nedskrivninger.

Der er betydelig usikkerhed knyttet til forventningerne til 2013, ikke mindst som følge af udviklingen i verdensøkonomien. Gruppens forventede resultat afhænger af en række faktorer. Baseret på det forventede indtjeningsniveau, og alt andet lige er følsomhed for de fire **vigtigste (AM)** faktorer estimeret i nedenstående tabel.

#### Virksomhedsprofil

A.P. Møller - Mærsk Gruppen er repræsenteret globalt i mere end 130 lande med **omkring (hedge)** 121.000 ansatte og hovedsæde i København. Ud over at være et af verdens største rederier, er Gruppen involveret i en lang række aktiviteter inden for energi, transport, offshore og detailhandel.

#### FREMMER VERDENS CONTAINERBÅRNE HANDEL

Maersk Line transporterer **omkring (hedge)** 14% af al søfragt af containere og kan sammen med APM Terminals og Damco levere infrastruktur for global handel.

#### BIDRAGER TIL AT IMØDEKOMME VERDENS EFTERSPØRGSEL PÅ ENERGI

Gruppen er beskæftiget med olie- og gasproduktion, efterforsknings- og offshore boreaktiviteter, FPSO'er samt transport af råolie og produkter.

Gruppens væsentligste forretningsenheder vises i den grafiske oversigt. En mere omfattende liste af virksomheder er tilgængelig på: <http://investor.maersk.com/da/financials.cfm?Year=2012>

#### MAERSK CONTAINER INDUSTRY

Producerer tørcontainere, kølecontainere og kølemaskiner

##### 1. MAERSK LINE

En flåde på **omtrent (hedge)** 600 skibe og et antal containere, der svarer til mere end 4,0 mio. TEU (20 fods containere)

##### 2. MAERSK OIL

Gennemsnitlig andel af olie- og gasproduktion var 257.000 tønner olieækvivalenter pr. dag i 2012

##### 3. APM TERMINALS

Driver et globalt netværk af terminaler m.v. i 68 lande

##### SVITZER

Er en global markedsleder inden for bugser- og bjærgningsaktiviteter m.v. med en flåde **tæt på (hedge)** 500 skibe

1. Maersk Line er Gruppens største forretningsenhed målt på omsætning og det førende containershippingselskab i verden. Maersk Line bliver konsekvent anerkendt som det mest pålidelige containershippingselskab.

2. Maersk Oil er et internationalt olie og gasselskab, som udsprang af de første aktiviteter i Nordsøen for 50 år siden og nu har aktiviteter i store dele af verden. Maersk Oil har specialiseret sig i at omdanne marginale og udfordrende oliefelter til kommercielle succeser.

3. APM terminals' kernekompetencer er udvikling, konstruktion og drift af havne og såkaldte inland services. Virksomheden har et globalt netværk på 62 havne i 40 lande samt drift af indenlandske faciliteter på over 160 steder i 47 lande.

4. Maersk Drilling er en ledende global operatør af højteknologiske borerigge. Maersk Drilling udfører boreoperationer til havs i de væsentligste markeder for nogle af de største olieselskaber med en af verdens yngste og mest avancerede rigflåder.

Damco

Har kontorer i mere end 90 lande og håndterer 2,7 mio. TEU af søfragt og supply chain management volumen samt mere end 210.000 tons luftfragt årligt

Dansk Supermarked Gruppen

Ejer 18 Bilka supermarkeder, 89 Føtex supermarkeder, 2 Salling stormagasiner og 1.210 Netto discountbutikker i Danmark, Tyskland, Polen og Sverige

Danske Bank

A.P. Møller Mærsk ejer 20% i en af de største banker i Norden

Maersk Supply Service

En flåde på mere end 50 skibe, som leverer services over hele verden til offshoreindustrien samt andre industrier

Maersk tankers

Ejer og driver en flåde på 162 råolie og produkttankerskibe samt gasskibe. Maersk Tankers' flåde er en af de største, mest moderne og mest alsidige, uafhængige flåder i verden

#### 4. Maersk Drilling

Selskabet er med 16 jack-up og flydende rigge specialist i at operere i områder med hårdt vejr og på store vanddybder

Maersk FPSOs

ejer og opererer fire flydende olie og gas produktions- og opbevaringsenheder (FPSO'er), som udlejes til nogle af verdens største olieselskaber

At bygge på Gruppens styrke

Det er Gruppens fortsatte **ønske (AM)** at bygge et førsteklasses konglomerat. Dette skal opnås gennem en disciplineret allokering af kapital på tværs af Gruppens forretningsområder, aktiv porteføljestyling, en **klar (AM)** finansieringsstrategi, en førsteklasses forretningsmæssig udførelse, teknologisk innovation samt udvikling af de menneskelige ressourcer.

#### Strategisk retning

Gruppen vil fortsat fokusere sine investeringer i de fire kernevækstforretninger, Maersk Line, Maersk Oil, APM Terminals og Maersk Drilling. Investeringer i opportunistic core, Maersk Supply Service, Maersk Tankers, Damco og SVITZER, fortsætter ud fra en vurdering af forretningsmulighederne i hvert enkelt tilfælde. De strategiske investeringer, Dansk Supermarked Gruppen og Danske Bank, vil overvejende vokse gennem egne pengestrømme og egne ressourcer. Værdiforvaltede aktiver vil fortsat blive udviklet med henblik på værdimaksimering.

Det er Gruppens mål at opnå et afkast af den investerede kapital (ROIC) på over 10% med et overskud på mindst USD 1,0 mia. fra hver af de fire kernevækstforretninger og gradvis at levere en øget værdi for dermed at fortsætte den historiske udvikling med et stigende udbytte pr. aktie understøttet af den underliggende vækst i indtjeningen.

Den overordnede prioritering af aktiv porteføljestyling vil fortsætte. Porteføljen af forretningsområder og aktiver vurderes i den årlige review proces. Den nuværende stærke position i vækstmarkeder vil forblive et fokusområde, da Gruppen er i en **god (AM)** position til at bidrage til udviklingen i vækstlande og kapitalisere på væksten.

#### KAPITALALLOKERING

I dag er 70% af Gruppens kapital investeret i de fire kernevækstforretninger. Ved at afsætte mere end 90% af Gruppens planlagte anlægsinvesteringer til de fire kernevækstforretninger vil deres andel af den investerede kapital nå 75% af Gruppens investerede kapital i 2017. Størrelsen af Gruppens totale investerede kapital ventes at vokse 30-40% i den samme periode som følge af et højt investeringsniveau.

Gruppen vil også fortsat opbygge vindervirksomheder og styrke sine mindre kerneforretningers respektive konkurrencemæssige positioner. Der vil være en opportunistisk tilgang, hvis deres respektive markeder åbner for muligheder, der er værd at forfølge.

Allokeringen af kapital og Gruppens årlige review proces af strategien er en fuldt integreret proces. Strategier, herunder detaljerede investeringsplaner for de kommende år, udarbejdes for hver enkelt forretningsenhed.

De samlede investeringskrav på tværs af forretningsområder prioriteres derefter med henblik på optimering af Gruppens portefølje og i overensstemmelse med den finansielle politik. Vurderingsparametre omfatter, hvor attraktiv industrien er, prognoser for det finansielle afkast, den forretningsmæssige eksekvering samt de overordnede strategiske planer. Den deraf følgende plan udgør investeringsrammen for hver enkelt forretningsenhed. Planlagte porteføljustyringer indgår i planen.

I overensstemmelse med investeringsstrategien, som er rettet mod mere lønsomme og mindre volatile forretningsområder, vil Maersk Lines andel af Gruppens investerede kapital **sandsynligvis (hedge)** opleve et forholdsmæssigt fald fra 38% i dag til et niveau på 25-30%, mens Maersk Oil, APM Terminals og Maersk Drillings samlede andel af den investerede kapital vil opleve en forholdsmæssig stigning fra 32% til et niveau på 45-50% over de kommende 4-5 år.

#### PORTEFØLJESTYRING

Den overordnede prioritering af aktiv porteføljestyring vil fortsætte. For at sikre den mest optimale forretningsportefølje vurderer Gruppen løbende sammensætningen af aktiver. I forbindelse med optimeringen deltager Gruppen i både strategiske og opportunistiske køb og salg af virksomheder såvel som af individuelle aktiver.

Gruppen har i de seneste fem år solgt virksomheder og aktiver for mere end USD 10,4 mia. med fortjenester før skat på USD 4,4 mia.

Gruppen har i 2012 annonceret og gennemført en række salg og investeringer i de forskellige segmenter. Gruppens **vigtigste (AM)** erhvervelser/investeringer i 2012 var:

- Købet af en fællesledet 37,5% andel i Global Ports Investments PLC i Rusland
- Deltagelse med et pro rata bidrag på USD 250 mio. til Danske Banks kapitaludvidelse på DKK 7,15 mia. (USD 1,2 mia.) i oktober 2012
- Købet af 100% af aktierne i Skandia Container Terminal AB, Gøteborg, Sverige.

Årets salg af aktiviteter udgjorde i alt USD 3,4 mia. i frigjort pengestrøm, primært:

- Maersk LNG A/S (seks helejede og to delejede skibe)
- FPSO Maersk Peregrino
- Små produkttankskibe i Nordvest-Europa (13 skibe)
- Indenlandske serviceaktiviteter, Maersk Equipment Service Company, Inc.

Derudover har Maersk Tankers indgået aftale om salg af sit Handygas segment (11 skibe). Salget **forventes (hedge)** afsluttet i 2013.

Optimering af porteføljen vil fortsætte i de næste år for at styrke Gruppens strategiske fokus, men også for at drage fordel af de muligheder, der **kan (hedge)** vise sig i de forskellige industrier, som Gruppen opererer i.

#### FINANSIERINGSSTRATEGI

For at understøtte vækst, sikre likviditet og afbalancere risiko i forhold til afkast har Gruppen udviklet en finansieringsstrategi, der tager højde herfor. Hovedelementerne er, at:

- Sikre en langsigtet forpligtelse til at understøtte forretningsstrategien
- Fortsat opnå finansiering fra forskelligartede kilder for at sikre adgang til finansiering i volatile tider
- Understøtte en tilstrækkelig likviditetsreserve for til enhver tid at have finansiell fleksibilitet
- Bevare en konservativ kapitalstruktur og finansieringsprofil, der passer til en stærk "investment-grade" virksomhed i hele konjunkturforløbet.

Gruppen rejste mere end USD 5 mia. i ny finansiering i 2012 for at understøtte investeringer på netto USD 6,3 mia. (USD 9,8 mia.), samt afdrag på gældsporteføljen med USD 2,1 mia. (USD 3,6 mia.), og tilbagebetaling på trækingsfaciliteter netto USD 2,0 mia. (trækning netto USD 1,9 mia.). Med en pengestrøm fra driftsaktiviteter på USD 7,6 mia. (USD 7,3 mia.) for året og en udbyttebetaling på USD 945 mio. (USD 924 mio.) var Gruppens likviditetsreserve USD 13,6 mia. (USD 11,3 mia.) pr. 31. december 2012.

Diversificering af finansieringskilderne forbliver en strategisk prioritet for Gruppen. Gruppen er i 2012 fortsat med at udstede virksomhedsobligationer under Euro Medium Term Note programmet, der giver fleksibel adgang til obligationsmarkederne, svarende til USD 1,9 mia. fra NOK-, EUR- og SEK-markederne. Pr. 31. december 2012 udgjorde udestående obligationer i alt USD 4,7 mia. (USD 2,5 mia.) svarende til 24% (13%) af den rentebærende gæld.

Den rentebærende gæld udgjorde USD 19,6 mia. (USD 19,1 mia.) pr. 31. december 2012. Gruppens rentebærende nettogæld udgjorde USD 15,7 mia. (USD 15,3 mia.). Den rentebærende nettogæld steg svagt med USD 339 mio. i 2012 som følge af investeringer, delvist udlignet af en stærk udvikling i pengestrømmen fra driftsaktiviteter samt frasalg for USD 3,4 mia. Den gennemsnitlige finansieringsomkostning var 4,6% (5,0%).

Pr. 31. december 2012 var den gennemsnitlige restløbetid for Gruppens udestående lån **ca. (hedge)** fem år (**ca. (hedge)** fem år), og Gruppen har begrænsede refinansieringsbehov de næste to år.

Gruppens gearing (rentebærende nettogæld/EBITDA) er fortsat inden for det historiske interval (0,5-2,0).

#### Kapitalberedskab

Pr. 31. december 2012 udgjorde likviditetsreserven, defineret som likvide beholdninger og værdipapirer USD 2,6 mia. (USD 2,7 mia.) og uudnyttede kommitterede trækingsrettigheder USD 11,0 mia. (USD 8,6 mia.), i alt USD 13,6 mia. (USD 11,3 mia.). Hertil kommer en række trækingsrettigheder tilknyttet Gruppens daglige likviditetsstyring, samt finansieringsforpligtelser i forbindelse med nybygningsprogrammet på USD 3,0 mia.

Gruppen **ønsker (AM)** at bevare en konservativ kapitalstruktur og finansieringsprofil, der passer til en stærk "investment-grade" virksomhed i hele konjunkturforløbet. Som følge af udsving i betalingsprofilen på investeringer samt mulige udsving i Gruppens pengestrømme **må (EM)** der **forventes (hedge)** udsving i den finansielle profil. Baseret på størrelsen af de tilsagte lånefaciliteter, inklusive lån til finansiering af specifikke aktiver, løbetiden på lånefaciliteterne og kapitalforpligtelserne, anses Gruppens finansielle beredskab for at være **tilfredsstillende (AM)**.

#### EN FØRSTEKLASSES FORRETNINGSFØRELSE

Strategien bliver til handling med en førsteklasses forretningsførelse.

Gruppens forretningsmæssige resultater evalueres via kvartalsvis benchmarking af centrale finansielle og driftsmæssige nøgletal i forhold til de vigtigste konkurrenter.

Disse benchmarks bruges til at sætte konkrete mål, at opbygge en incitamentsstruktur samt fastsætte individuelle KPI'er i hele Gruppen.

Det er Gruppens ambition, at alle kerneforretninger opnår en placering i øvre kvartil inden for deres forretningsområder, og at der er defineret aktiviteter til at sikre fremskridt i den retning.

Der er mange niveauer og elementer i en præstationsmåling, hvoraf hovedparten defineres inden for hver enkelt forretningsenhed.

#### Maersk Line

I de kommende fem år er det Maersk Lines ambition at løfte det finansielle resultat fra en over middel placering i dag til en klar placering i øverste kvartil og at levere et afkast, der ligger over kapitalomkostningerne. Dette skal opnås gennem en kombination af yderligere stordriftsfordele samtidig med fortsat at bevare den nuværende markedsposition som det mest pålidelige rederi i branchen. Maersk Line skal vokse sammen med markedet finansieret af egne pengestrømme.

#### Maersk Oil

Det er Maersk Oils ambition at øge forretningen med **næsten (hedge)** 50% og dermed opnå en produktionsandel på 400.000 boepd ved udgangen af 2020, hvilket indebærer betydelige investeringer i de kommende år. Maersk Oils afkast af investeret kapital vil falde i forhold til afkastet på **ca. (hedge)** 30% i perioden 2010-2012, men et tocifret afkast **forventes (hedge)** fastholdt i ekspansionsfasen. Der vil fortsat være fokus på at opbygge en stærk, gennemsigtig organisation i de kommende år.

#### APM Terminals

I de kommende fem år vil APM Terminals fortsat have fokus på stærke forretningsmæssige resultater og sigte mod at opnå mindst 50% af omsætningen fra tredjepartskunder. Endvidere vil APM Terminals fortsat søge at investere i attraktive terminaler på vækstmarkeder samtidig med, at driften af eksisterende faciliteter forbedres. APM Terminals' finansielle ambition er at bidrage med USD 1,0 mia. til Gruppens resultat ved udgangen af 2016.

#### Maersk Drilling

Maersk Drillings finansielle ambition er at bidrage med USD 1,0 mia. til Gruppens resultat ved udgangen af 2018. Dette skal opnås ved at sikre forretningsmæssig drift og sikkerhed i verdensklasse samtidig med opbygning af en rigflåde af en tilstrækkelig størrelse til at blive den foretrukne partner for de vigtigste kunder. Maersk Drillings mål for de næste fem år er at udvide flåden til 30 high-end rigge til boring fortrinsvis i barske miljøer og på dybt vand.

Strategisk fokus	
<b>Maersk Line</b> <ul style="list-style-type: none"> <li>○ Placering i øverste kvartil</li> <li>○ EBIT margin 5% over sammenlignelige i branchen</li> <li>○ Vokse med markedet finansieret af egne pengestrømme</li> <li>○ Levere stabile afkast over kapitalomkostninger</li> <li>○ Få betaling for ydet merværdi.</li> </ul>	<b>APM Terminals</b> <ul style="list-style-type: none"> <li>○ Bedste havneoperatør i verden</li> <li>○ Stærkt varemærke; mindst 50% omsætning fra tredjepartskunder</li> <li>○ Flere attraktive terminaler i vækstmarkeder</li> <li>○ Årligt overskud (NOPAT) &gt; USD 1,0 mia. i 2016</li> </ul>
<b>Maersk Oil</b> <ul style="list-style-type: none"> <li>○ Produktionsandel i 2020 &gt; 400.000 boepd</li> <li>○ Tocifret afkast</li> <li>○ Opbygning af reserver til 10 års produktion</li> <li>○ Stærk gennemsigtig organisation.</li> </ul>	<b>Maersk Drilling</b> <ul style="list-style-type: none"> <li>○ Placering i øverste kvartil</li> <li>○ 30 højtydende rigge fortrinsvis til barske miljøer og på dybt vand</li> <li>○ Årligt overskud (NOPAT) &gt; USD 1,0 mia. i 2018</li> </ul>

For at opbygge værdi på tværs af Gruppen er de **vigtigste (AM)** prioriteter for opportunistic core og de strategiske investeringer følgende:

- Maersk Supply Service – Bygge på en førerposition
- Maersk Tankers – Beskytte værdier under lavkonjunktur
- Damco – Lønsum vækst
- SVITZER – Øge dækningsbidrag og investere i lønsomme kontrakter
- Dansk Supermarked Gruppen – Tilbage til vækst og øget indtjening.

#### TEKNOLOGISK INNOVATION

For at sikre avancerede teknologiske løsninger investerer Gruppen inden for alle forretningsområder. Innovation er fokuseret på, at:

- Levere bedre service
- Beskytte medarbejderne
- Minimere den miljømæssige påvirkning
- Skabe nye forretningsmuligheder
- Sikre omkostningseffektivitet.

Teknologisk innovation udføres af teknologiafdelinger i Gruppens forretningsenheder i tæt samarbejde med producenter, skibsværfter, leverandører, universiteter og forskningsinstitutter. Nedenfor følger eksempler fra Gruppens fire kerneforretningsområder.

#### Skibsfart

Forbedring af skibseffektivitet: ECO Retrofit Teknologiprogram En bred vifte af opgraderingstiltag, der er skræddersyet individuelle skibstyper. Eksemplerne omfatter:

- Montering af forbedrede bulbstævne for at reducere brændstofforbruget
- Installation af udstødsgaskedler på hjælpemotorer
- Udnyttelse af varmen fra udstødsgassen fra hjælpemotorer.



Projektet **forventes (hedge)** at bidrage med en nettoomkostningsbesparelse på USD 20 mio. i 2013.

Olie

Raketvidenskab (TriGen) giver nyt liv til modne oliefelter

Med en raketmotor kan gas af lav kvalitet omdannes til ren energi, rent vand og CO<sub>2</sub>. Denne CO<sub>2</sub> kan anvendes til at udvinde mere olie fra modne felter.

Motoren:

- Forbrænder gas af lav kvalitet, som ellers ikke kunne udnyttes
- Omdanner genereret varme til elektricitet
- Udskiller rent vand som biprodukt; en **værdifuld (AM)** ressource i tørre områder
- Udvinde CO<sub>2</sub>, som kan blive pumpet ind i modne oliefelter for at forbedre udvinding af olie. Al CO<sub>2</sub> udvundet på denne måde er isoleret i oliereservoiret.

Potentialet for TriGen-teknologien er meget stort på grund af den stigende efterspørgsel efter energi og olie. TriGen vil både kunne generere en større olieproduktion fra eksisterende modne oliefelter ved at øge indvindingsgraden og ved at gøre ikke-kommercielle gasfelter rentable.

Terminaler

Næste automatiseringsspring: Løftautomatiserede, styrede køretøjer

Den nye terminal i Rotterdam Maasvlakte II vil have:

- De største og mest avancerede kajkraner i verden. De vil være de første, der fjernstyres fra et centralt kontrolrum, hvilket giver en mere effektiv kran-drift og større kranhastighed
- De første Løftautomatiserede, styrede køretøjer, som forbedrer driftseffektiviteten i havnen. De vil anvende batteriteknologi til driften, hvilket reducerer udledningen fra køretøjerne til nul
- En specialfremstillet softwarepakke vil styre alt det automatiserede udstyr i terminalen. Dette optimerer brugen af udstyr.

Automatisering af terminaler vil forøge produktiviteten med 25-30% sammenlignet med konventionelle terminaler og vil samtidig reducere behovet for land til at håndtere den samme mængde containere.

Boring

Innovation inden for læring: Højt avanceret simulatoranlæg overgår alle kendte standarder I 2012 byggede Maersk Drilling sammen med Maersk Training Centre det mest avancerede boresimulatoranlæg inden for boreindustrien, som vil muliggøre:

- Mere træning i hold. Et forbedret samspil mellem mandskabsmedlemmer på riggene medvirker til at forhindre uheld
- Opstilling af mere realistiske scenarier. Det er muligt at simulere de ekstreme brøndsituationer, som mandskaberne skal kunne håndtere i virkeligheden.

De nye faciliteter hos Maersk Training Centre i Svendborg vil blive anvendt til at træne mange af de 3.000 nye medarbejdere, som Maersk Drilling skal ansætte i de kommende år.

## HUMAN RESOURCES

Human Resources arbejder tæt sammen med forretningsenhederne for at sikre, at Gruppen har en engageret og motiveret arbejdsstyrke, og at der er en tydelig sammenhæng mellem resultater og belønning. Gruppens største HR-udfordringer er at sikre et tilstrækkeligt antal højt kvalificerede og veluddannede medarbejdere til at håndtere den planlagte vækst.

Resultatorienteret ledelse og engagement

Medarbejdernes engagement er højt prioriteret af Gruppen, da engagerede medarbejdere præsterer godt og er med til at skabe et godt og positivt arbejdsklima. Den årlige medarbejderundersøgelse havde en svarprocent på 91 i 2012, den højeste til dato, og det **viser (booster)**, hvor stor betydning medarbejderne tillægger undersøgelsen.

## Lederudvikling

Gruppen investerer i udviklingen af fremtidige ledere til forretningsenhederne.

Ledelsescentret Rolighed, nord for København, åbnede i slutningen af 2011. Rolighed er blevet stedet, hvor ledere og globale talenter fra forskellige steder og forretningsenheder mødes for at udvikle og dele deres erfaringer og kompetencer samt interagere med erfarne ledere. På Rolighed afholdes der ledelsestemamøder og lederudviklingsprogrammer, og eksperter holder foredrag om den nyeste tænkning. Sådanne interaktioner er platformen for den fortsatte udvikling af Gruppens ledere og forretningsenheder.

## Mangfoldighed og inklusion

Gruppen havde fortsat fokus på mangfoldighed og inklusion i 2012 og støttede ledere i deres ledelse af forskellige teams samt gennemførte initiativer til fremskyndelse af karrieremulighederne for kvinder samt talenter på vækstmarkeder.

Globalt var Gruppens repræsentation af kvinder i toplederstillinger 5% (4%) på vicedirektørniveau, 10% (9%) på seniorlederniveau og 20% (21%) på mellemlederniveau (eksklusiv Dansk Supermarked Gruppen og de fleste joint venture selskaber). Gruppens fortsatte ambition om at udvide på vækstmarkeder afspejles også af indsatsen for at styrke rekruttering og andre HR-aktiviteter, der skal sikre et solidt grundlag for en længerevarende tilstedeværelse på disse markeder. I 2012 blev Gruppen nomineret til virksomhedsprisen for mangfoldighed i arbejdslivet af det danske Institut for Menneskerettigheder og til europæiske priser for mangfoldighed i kategorien Årets Virksomhed. Det er ambitionen at blive anerkendt på verdensplan som en inkluderende arbejdsgiver, der omfatter og løfter mange former for mangfoldighed, og som har konstant fokus på yderligere forbedringer på dette område.

## Databaseret beslutningstagen

I 2012 blev der indført et nyt globalt HR-system til afløsning af **ca. (hedge)** 90 forskellige HR/IT-løsninger i hele Gruppen. HR-systemet understøtter HR-administrationen og omfatter vidtgående selvbetjeningsfunktionaliteter for medarbejdere og ledere.

## Forretningsenhedernes største prioriteter

Gruppens HR-afdeling arbejder tæt sammen med forretningsenhedernes HR-afdelinger. De fire kerneforretninger har hver deres prioriterede områder og fokusområder til understøttelse af deres respektive strategier.

## Maersk Line

### *Enkelthed, fokus og teamwork*

For at understøtte strategien om omkostningsminimering har HR fokus på at motivere organisationens medarbejdere for strategien og relaterede afgørende kampe ("Must Win Battles"), herunder de tre kulturforstærkende faktorer, der anses for at være afgørende for succes: enkelthed, fokus og teamwork.

Det andet prioriterede område er at drive forbedringer af den resultatorienterede ledelse og kultur for at sikre, at Maersk Line kan levere bedre resultater til Gruppen.

HR vil understøtte fokusområderne ved at stille globale data og udviklingsplaner for talentstyring, udpegning af efterfølgere og mangfoldighed til rådighed.

## Maersk Oil

### *Tiltrække og fastholde talenter*

Efterspørgslen på erfarne og talentfulde olie- og gasfolk bliver til stadighed større. Industrien står over for udfordringer som følge af nye porteføljer med komplekse og talrige projekter.

Maersk Oil skal til stadighed tiltrække og fastholde talenter for at opretholde en stærk og velafbalanceret tilgang af medarbejdere.

Maersk Oil **ønsker (AM)** at sikre, at juniormedarbejdere, der er rekrutteret til et af industriens mest attraktive uddannelsesprogrammer, kan nyde godt af coaching og mentorfunktionen fra de mere erfarne medarbejdere.

En hurtig udvikling er et fokusområde for de yngre generationer og for virksomheden. Maersk Oil sikrer, at mulighed for yderligere læring er til rådighed.

Ligeledes fokuserer Maersk Oil på at tiltrække erfarne medarbejdere til at supplere arbejdsstyrken.

Senest har Maersk Oils lederteam fornyet sit fokus på fordelingen af arbejdsstyrken for at sikre, at ressourcer allokeres til projekter med den højeste værdiskabelse.

Formålet er endvidere at følge væksthastigheden og efterspørgslen efter medarbejdere. Prioriteringen afgøres af de globale tekniske funktionsafdelinger i tæt samarbejde med organisationerne i de enkelte lande.

#### APM Terminals

##### *Sikre operationer*

Sikkerhed er en forudsætning for, at APM Terminals kan drive sin forretning. For yderligere at understrege og sætte nyt fokus på sikkerhedskulturen er en erfaren leder med omfattende indsigt i alle dele af forretningen udpeget som intern sikkerhedsaktivist. Dette har betydet, at medarbejdere har haft større fokus på sikkerhed i 2012. APM Terminals er førende inden for industrien med en stærk og kontinuerlig vækst, der betyder, at APM Terminals kan tiltrække gode medarbejdere, men også at konkurrenter ønsker at ansætte medarbejdere fra APM Terminals.

De forbedrede resultater af medarbejderundersøgelsen, som indirekte måler kvaliteten af APM Terminals' lederskab, arbejdsstyrkens produktivitet og sandsynligheden for at fastholde medarbejderne, placerede APM Terminals i den øverste kvartil i 2012 efter benchmarking mod en række globale virksomheder.

For yderligere at understøtte den vægt, der lægges på betydningen af ledelse, er alle ledelses- og tilsynsniveauer nu dækket af en række uddannelsesprogrammer for lederudvikling.

I erkendelse af den betydning, aflønning har på motivation for den langsigtede præstation, blev der i 2012 indført en incitamentsplan for APM Terminals' terminalledere, som har til formål at fastholde dem.

#### Maersk Drilling

##### *Rekruttering og integrering af 3.000 nye medarbejdere*

Vækststrategien medfører, at der skal ansættes og integreres 3.000 nye medarbejdere frem mod 2018. De første 1.300 ansættes mellem 2013 og 2015. Rekruttering udgør en betydelig udfordring som følge af mangel på kvalificeret arbejdskraft til den generelle vækst i boreindustrien.

For at sikre en bæredygtig forøgelse af arbejdsstyrken har Maersk Drilling iværksat adskillige initiativer, som eksempelvis optagelse af flere medarbejdere på talent-programmer for at udvikle flere kompetencer, en forbedret proces for at tillære kompetencer og integrere medarbejdere hurtigt, og et uddannelsesprogram for boreoperatører for at udvikle alsidige kompetencer.

Der gennemføres individuel uddannelse og teamuddannelse gennem et struktureret uddannelsesprogram, som omfatter brugen af verdens mest avancerede offshore boresimulator. For at opnå en sikker og effektiv drift af nye rigge i overensstemmelse med processer, systemer og værdier vil teams på de nye enheder bestå af en kombination af erfarne medarbejdere og nyansatte for således at muliggøre en effektiv integrering af de nye medarbejdere.

#### BÆREDYGTIGHED

Gruppen er aktiv inden for brancher, som er **essentielle (AM)** for global økonomisk vækst og udvikling: handel, energi og infrastruktur. Kombineret med Gruppens vækst og perspektiver på nye vækstmarkeder er der udfordringer og muligheder inden for bæredygtighed for alle Gruppens aktiviteter.

Gruppens bæredygtighedsstrategi fokuserer på en integrering af bæredygtig praksis i alle aktiviteter for alle forretningsenheder. Til understøttelse af denne strategi er der fastsat mål for hvert af de bæredygtighedsområder, der er blevet identificeret som de mest væsentlige for Gruppen. Et bæredygtighedsråd overvåger, at Gruppens standarder overholdes, og at bæredygtighed integreres i alle forretningsenheder. Rådet rapporterer til direktionen, som har det overordnede ansvar for bæredygtighed.

#### Sikkerhed

Medarbejdernes sikkerhed har højeste prioritet, og Gruppen overvåger løbende udviklingen og opfordrer til forbedringer. Antallet af dødsulykker i forbindelse med driften steg i 2012. Dette er **uacceptabelt (AM)**, og Gruppen er af den klare **overbevisning (booster)**, at enhver dødsulykke kan undgås. Stigningen i dødsulykker i 2012 bekræfter beslutningen om at øge fokus på processikkerhed og risikostyring.

#### CO2-udledninger

Gruppen har opnået en forbedring på 8% i CO<sub>2</sub>-effektivitet siden 2010, primært drevet af betydelige forbedringer inden for containerbranchen. Både de relative og de absolutte CO<sub>2</sub>-udledninger faldt i 2012. Den forbedrede effektivitet i skibsfart påvirker Gruppens CO<sub>2</sub>-resultater væsentligt, da mere end 80% af udledningerne stammer fra Maersk Line. Der blev også opnået CO<sub>2</sub>-reduktioner i olieproduktionen, hvor Maersk Oil har reduceret CO<sub>2</sub> udledninger fra afbrændinger fra produktionsfaciliteter med 86% siden 2007. I 2012 forhøjede Gruppen målet for relativ CO<sub>2</sub>-reduktion fra 10% til 20% fra 2010 til 2020.

#### Korruption

Korruption påvirker negativt samfund, hvori Gruppen opererer, ligesom den globale økonomiske udvikling påvirkes. Som følge af Gruppens aktiviteter globale natur har Gruppen mulighed for at støtte globale forbedringer på dette område. Et internt træningsprogram for korruptionsbekæmpelse er gennemført i hele Gruppen. Siden 2010 er flere end 25.000 medarbejdere blevet undervist i korruptionsbekæmpelse. Gruppen er også involveret i industriens bestræbelser for at eliminere de såkaldte "smørepenge" inden for skibsfart, spedition og olieindustrien.

#### Menneskerettigheder

Som for den overordnede strategi om bæredygtighed har Gruppen en langsigtet plan om integrering af menneskerettigheder i de eksisterende systemer. I 2012 kortlagde Gruppen risici og mangler i forbindelse med menneskerettigheder, idet Gruppen afholdt 11 workshops. Overordnet adresseres størstedelen af Gruppens menneskerettighedsområder gennem programmer for ansvarligt indkøb, globale arbejdsprincipper, korruptionsbekæmpelse og sikkerhed.

#### Ansvarligt indkøb

Muligheden for at styre risici i leverandørkæden har siden lanceringen i 2011 af programmet for ansvarligt indkøb taget et skridt fremad. Gruppen har henvendt sig til 1.985 eksterne leverandører (svarende til 32% af Gruppens totale eksterne omkostninger) og har bedømt 178 leverandører (7%). Af de bedømte eksterne leverandører har Gruppen revideret de 23, og de overordnede problemer, der blev identificeret, vedrører arbejdstider, overtidsbetaling og gennemsigtighed vedrørende underleverandører. Ti leverandører har underskrevet formelle forbedringsplaner, der skal imødegå de identificerede problemer, mens Gruppen er i dialog med andre om at implementere forbedringsplaner, hvor dette er nødvendigt i fremtiden.

#### Større gennemsigtighed og opbygning af tillid

Gruppens bæredygtighedsrapport (Sustainability Report) for 2012 giver detaljerede oplysninger om Gruppens resultater inden for bæredygtighed. Den er samtidig Gruppens Fremskridtsrapport, som krævet af FN's Global Compact. Rapporten er udarbejdet i overensstemmelse med kravene i den danske årsregnskabslov om rapportering af virksomheders samfundsansvar. Rapporten kan ses på: [http://www.maersk.com/Sustainability/Documents/Maersk\\_Sustainability\\_Report\\_2012.pdf](http://www.maersk.com/Sustainability/Documents/Maersk_Sustainability_Report_2012.pdf)

#### Gruppens forretningsområder

Gruppens investerede kapital var på USD 55 mia. ved udgangen af 2012, og det årlige afkast af den investerede kapital (rOIC) udgjorde 8,8%. Det er gruppens ambition at opnå en rOIC > 10%.

#### SVITZER Sohar Oman

Som leverandør af havnebugsering og eskortering har SVITZER i Sohar en aktiv rolle i et af verdens største udbygningsprojekter for industrihavne. Med fem til seks bugseringer dagligt er SVITZER travlt beskæftiget med at medvirke til eksporten af stål og aluminium. Den håndterede fragtmængde i havnen er steget fra 4 mio. tons i 2007 til 44 mio. tons i 2012.

#### Maersk Line

Maersk Line forbedrede sit resultat i 2012 med USD 1,0 mia. og leverede et overskud på USD 461 mio. til trods for at året startede med globale fragtrater på uholdbare niveauer og de hidtil højeste brændstofpriser. Fra andet halvår 2011 til andet halvår 2012 steg resultatet med USD 1,7 mia. Det forbedrede resultat skyldtes et detaljeret program til forbedring af lønsomheden med stort fokus på omkostningsreduktioner, opkrævning af tillægsafgifter og ratestigninger, der blev muliggjort gennem aktiv kapacitetstilpasning.

- Overskud på USD 461 mio. (tab på USD 553 mio.)
- ROIC var 2,4% (negativ med 3,1%)
- Pengestrøm fra driftsaktiviteter var USD 1,8 mia. (USD 899 mio.)
- Pengestrøm vedrørende anlægsinvesteringer var USD 3,6 mia. (USD 3,2 mia.)
- Den gennemsnitlige fragtrate steg med 1,9% til 2.881 USD/FFE (2.828 USD/FFE)

- Aktiv kapacitetstilpasning gennem oplægning, slow steaming og aflyste afgang
- Enhedsomkostninger faldt med 1,7% til 3.054 USD/FFE (3.108 USD/FFE)
- Betydelig reduktion i antal medarbejdere på hovedkontoret blev gennemført i juni 2012
- Containermængder steg med 5% til 8,5 mio. FFE (8,1 mio. FFE).

#### MARKEDSUDVIKLING

I 2012 steg efterspørgslen på det globale marked for containertransport med **anslået (hedge)** 2% i forhold til 2011. Stigningen i efterspørgslen svækkedes i løbet af året fra 5% i første kvartal til blot 0-1% i tredje og fjerde kvartal i forhold til samme perioder i 2011. Overordnet set var den europæiske import svag, og efterspørgslen på containertransport på den vestgående Asien-Europa rute faldt 7-9% i tredje og fjerde kvartal i forhold til året før.

Denne udvikling afspejlede den svage europæiske økonomi og i særdeleshed gældskrisen i Middelhavslændene. Importen til USA aftog ligeledes, og efterspørgslen steg kun i mindre grad i tredje kvartal. For hele 2012 faldt mængderne på Asien-Europa ruterne med **næsten (hedge)** 2%, mens de på Transpacific ruten steg med 2%. Til trods for at efterspørgslen kun steg lidt, og der blev leveret et betydeligt antal nye containerskibe, var balancen mellem udbud og efterspørgsel stabil. Den nominelle stigning i kapacitet som følge af levering af nye skibe var 8,1% i 2012, men gennem slow steaming, skrotning, oplægning og aflyste sejlads blev det industrien at skabe balance mellem stigningen i den effektive kapacitet og den samlede efterspørgselsstigning på vestgående ruter.

Som følge af priskrigen i andet halvår 2011 startede de globale containerfragtrater på et meget lavt niveau i 2012. Især Asien-Europa ruten var hårdt ramt med spot-rater på **omkring (hedge)** USD 700-750 pr. TEU i januar 2012. Disse rateniveauer lå betydeligt under driftsomkostningerne, og med brændstofpriser, der kulminerede med den hidtil højeste pris på over USD 700 pr. ton i marts 2012, oplevede industrien betydelige tab i første kvartal 2012. Det lykkedes industrien at opnå en generel ratestigning (GRI) på de fleste ruter. Specielt stigningen på USD 750 pr. TEU på Asien-Europa ruten med virkning fra 1. marts 2012 banede vejen for generelle ratestigninger på andre hovedruter som f.eks. Afrika og Latinamerika.

Til trods for fokus på generelle ratestigninger oplevede markedet et konstant nedadgående pres på raterne i andet halvår 2012 på grund af den faldende vækst i efterspørgslen i tredje og fjerde kvartal.

#### INITIATIVER I 2012

De meget lave fragtrater i første kvartal bevirkede, at Maersk Line startede året med tab på **omkring (hedge)** USD 8 mio. pr. dag og et tab på USD 599 mio. for første kvartal 2012. En strategi til forbedring af lønsomheden blev iværksat for at gøre Maersk Line lønsom igen, og en samlet gennemgang af hovedkontorets aktiviteter førte til en betydelig reduktion i antal medarbejdere på hovedkontoret i juni 2012. Strategien fokuserede på at opnå generelle ratestigninger, at opkræve tillægsafgifter, at tilpasse netværket af skibe for at understøtte de generelle ratestigninger og endelig at reducere de samlede omkostninger.

#### FINANSIELLE RESULTATER

Overskuddet var på USD 461 mio. i forhold til et tab på USD 553 mio. i 2011. Forbedringen skyldtes højere fragtrater og driftsomkostningseffektivisering, hovedsageligt på grund af optimering af rutenetværket. Resultatet forbedrede ROIC fra negativ 3,1% i 2011 til positiv 2,4% i 2012, men stadig lavere end de vægtede gennemsnitlige kapitalomkostninger.

Pengestrøm fra driftsaktiviteter var med USD 1,8 mia. betydeligt større end i 2011, som følge af forbedret lønsomhed delvist opvejet af forøget driftskapital.

Omsætningen steg med 8% til USD 27,1 mia., positivt påvirket af en stigning i mængder på 5% til 8,5 mio. FFE og en stigning i de gennemsnitlige fragtrater på 1,9% til 2.881 USD/FFE. Maersk Line fastholdt markedsandelen for året under ét. Den gennemsnitlige fragtrate, eksklusive BAF, steg med 4,6% til 2.274 USD/FFE i forhold til 2011, understøttet af en aktiv kapacitetstilpasning over hele året i form af oplægning, slow steaming og aflyste sejlads.

På de vigtigste Asien-Europa ruter faldt de vestgående mængder med 2%, mens de østgående mængder steg med 16% til en overordnet vækst på 3% i forhold til 2011.

De gennemsnitlige fragtrater for Asien-Europa ruterne steg med 6%, henholdsvis 10% for de vestgående ruter og 2% for de østgående ruter.

Ruterne Intra-Asien, Latinamerika og Vest- og Centralasien oplevede en kraftig vækst i containermængder på henholdsvis 19%, 10% og 7%. For Afrika ruterne medførte fokus på indtjening, at tabsgivende fragt blev reduceret, men samtidig blev de totale mængder også reduceret. Asien-Europa, Afrika og Intra-Asien ruterne oplevede den største vækst i rateniveau.

Den samlede omkostning pr. FFE faldt med 1,7% til 3.054 USD/FFE, hovedsageligt som følge af et lavere brændstofforbrug pr. FFE og lavere driftsomkostninger. Maersk Line anvendte fortsat super slow steaming for at reducere udledning af CO<sub>2</sub> og mindske brændstofomkostningerne. Brændstofprisen var 7% højere i 2012, men de samlede brændstofomkostninger faldt med 1% til USD 6,7 mia. i forhold til 2011.

Pålideligheden af Daily Maersks service har i gennemsnit været over 98% siden introduktionen i 2011. For så vidt angår samlet pålidelighed er Maersk Line stadig det mest pålidelige rederi med en forventet pålidelighed for 2012 på 91%. Daily Maersk er blevet godt modtaget af kunderne, og den samlede kundetilfredshed er høj.

Maersk Lines flådekapacitet blev forøget med 4% til en samlet kapacitet på 2,6 mio. TEU. Flåden bestod af 270 ejede containerskibe og 326 chartrede skibe ved udgangen af 2012. Egen flådekapacitet blev forøget med 6%, idet 17 nybyggede skibe med en samlet kapacitet på 100.000 TEU blev leveret.

Skibene er designet til Afrika og Latinamerika ruterne - to vigtige vækstmarkeder for Gruppen. Ud over fokus på reduktion af omkostninger og udledning af drivhusgasser er skibene attraktive på grund af deres øgede kapacitet til kølecontainere. Derudover blev den eksisterende flådekapacitet øget med leveringen af to multi purpose skibe på i alt 36.000 DWT, mens et skib på 750 TEU blev solgt.

11 skibe fik forøget kapaciteten med 1.400 TEU pr. skib hovedsageligt som følge af forhøjelse af broen. Den chartrede flåde blev reduceret med 65 skibe svarende til en kapacitetsreduktion på 1% til en kapacitet på i alt 1,1 mio. TEU i forhold til 2011 i forbindelse med optimeringen af netværket. Til gengæld steg behovet for mere tonnage til at gennemføre yderligere slow steaming. Herudover ejede Gruppen fem og chartrede seks multi purpose skibe. 25 skibe på i alt 395.100 TEU er i ordre til levering i 2013-2015. De første fem af 20 Triple-E containerskibe til Asien-Europa ruten vil blive leveret i 2013.

#### STRATEGISK FOKUS

Den globale vækst i containerefterspørgsel **forventes (hedge)** fortsat at ligge på et beskedent niveau på 4-5% i 2013. Særligt udsigterne for Asien-Europa ruten er dystre, og den vestgående efterspørgsel **forventes (hedge)** at forblive uændret. Udfordringerne med hensyn til efterspørgsel er forbundet med leveringen af en betydelig mængde ny tonnage svarende til en kapacitetsstigning på 11% eller 1,8 mio. TEU. Uden væsentlige kapacitetstilpasninger **forventes (hedge)** markedet for containerskibsfart derfor at opleve et fortsat nedadgående pres på fragtraterne i 2013.

Maersk Line har defineret fem vigtige fokusområder for 2013. Initiativet til omlægning af kølecontainerraten vil fokusere på at genoprette lønsomheden inden for kølespedition gennem en global rateomlægning. Rate- og kontraktinitiativet vil fokusere på at fastholde raterne på et bæredygtigt niveau. Netværksomkostningsinitiativet vil fokusere på at opbygge et mere rentabelt netværk af skibe, mens det samlede enhedsomkostningsinitiativ sigter mod at opnå markedets lavest mulige omkostning. Endelig vil mængde- og markedsandelsinitiativet fokusere på at fastholde Maersk Lines globale position.

#### SIKKERHED

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,76 pr. mio. arbejdstimer sammenlignet med 0,63 pr. mio. arbejdstimer i 2011.

#### Maersk Oil

Maersk Oil gjorde fortsat fremskridt med porteføljen af udbygningsprojekter, inklusive produktionsstart af Dunga Fase II i Kasakhstan og yderligere modning af Chissonga i Angola og Johan Sverdrup i Norge, begge med planlagt produktionsstart i 2017-18. Derudover udgør aftalen om yderligere udbygning af Al Shaheen feltet i Qatar en milepæl.

- Overskud på USD 2,4 mia. (USD 2,1 mia.), positivt påvirket af en engangsskatteindtægt på USD 899 mio. i Algeriet, samt en avance på USD 91 mio. fra et delvist salg af andele i Brasilien
- ROIC var 36,6% (37,2%)
- Pengestrøm fra driftsaktiviteter var USD 3,9 mia. (USD 4,3 mia.)
- Produktionsandelen faldt med 23% til 257.000 boepd (333.000 boepd)
- Den gennemsnitlige oliepris var 1% højere med USD 112 pr. tønde (USD 111 pr. tønde)
- Efterforskningsudgifter var USD 1,1 mia. (USD 1,1 mia.).

#### INITIATIVER I 2012

Maersk Oil har efterforsknings- og produktionsaktiviteter i 11 lande og en produktionsandel på **ca. (hedge)** 257.000 tønder olieækvivalenter pr. dag (boepd) fra seks lande. Maersk Oil modner olie- og gasressourcer via et stort efterforskningsprogram samt gennemførelse af en række udbygningsprojekter.

På A.P. Møller – Mærsk kapitalmarkedsdag den 9. oktober 2012 offentliggjorde Maersk Oil oplysninger om reserver og ressourcer og løftede sløret for planerne om at øge produktionen med **næsten (hedge)** 50% frem til 2020 til en daglig produktionsandel på 400.000 boepd. Mere information fra kapitalmarkedsdagen kan findes på:  
<http://investor.maersk.com/da/events.cfm?altevent=otherevents>

Ved udgangen af 2011 havde Maersk Oil reserver og ressourcer på 1,38 mia. tønder olieækvivalenter, inklusive reserver (1P) på 443 mio. tønder olieækvivalenter. Reserverne og ressourcerne er estimeret i overensstemmelse med internationale standarder (Society of Petroleum Engineers' Petroleum Resources Management System), og reserverne er revideret af uafhængig tredjepart. Tallene for reserver og ressourcer opdateres årligt, og tallene for udgangen af 2012 oplyses sammen med delårsrapporten for første kvartal 2013.

## PRODUKTION

Den gennemsnitlige daglige andel af olie- og gasproduktion var i 2012 på 257.000 boepd, på niveau med de tidligere meddelte forventninger på 258.000 boepd; 23% lavere end i 2011 (333.000 boepd).

I Qatar var produktionsandelen 103.000 boepd (157.000 boepd); 34% lavere end i 2011 som følge af aftalen om produktionsdeling og en lavere andel til dækning af omkostninger, mens bruttoproduktionen fra feltet var uændret i niveau på 300.000 boepd.

Produktionsandelen i Danmark var 91.000 boepd (113.000 boepd); 19% lavere end i 2011 hovedsagelig som følge af Nordsøfondens indtræden (Den Danske Nordsøfond ejet af den danske stat) som partner med en 20% andel i DUC (Dansk Undergrunds Consortium) den 8. juli 2012. Denne ændring har ingen indvirkning på Gruppens nettoresultat, da den danske stats deltagelse erstatter en 20% overskudsandel, der er betalt, siden aftalen blev indgået i 2003. Endvidere påvirkede det naturlige fald i modne danske felter produktionen negativt.

Produktionsandelen i Storbritannien (UK) på 28.000 boepd var på samme niveau som i 2011 (27.000 boepd). Gryphon FPSOen, som blev beskadiget under en storm i starten af 2011, **forventes (hedge)** at være tilbage i produktion i første kvartal 2013.

I Algeriet var produktionsandelen på 27.000 boepd marginalt højere i forhold til 2011 (25.000 boepd), positivt påvirket af forbedrede kontraktvilkår med det algeriske nationale olieselskab som følge af forliget i skattesagen i første kvartal 2012, men opvejet af den naturlige modning af felterne.

Produktionsandelen i Kasakhstan og Brasilien var på henholdsvis 3.000 boepd (3.000 boepd) og 5.000 boepd (8.000 boepd).

## UDBYGNING

Maersk Oil har en forskelligartet projektportefølje og en projektleveringsplan på plads for at kunne nå produktionsmålet på 400.000 boepd i 2020. Fem større projekter er blevet godkendt af myndighederne, og gennemførelsen går fremad mod produktionsstart i 2014.

I Algeriet fortsætter udbygningen af El Merk feltet, og den første olie **forventes (hedge)** i første kvartal af 2013.

I Angola fortsætter arbejdet med udbygningsplanen for Chissonga fundet i Blok 16, og boring af den fjerde vurderingsbrønd blev gennemført i slutningen af 2012. Udbygningen vil **sandsynligvis (hedge)** omfatte en selvstændig FPSO med **forventet (hedge)** produktionsstart i 2017-18.

I Kurdistan-området i Irak blev den anden vurderingsbrønd succesfuldt færdiggjort på Swara Tika fundet, og yderligere indledende udbygningsaktiviteter er planlagt til 2013. Maersk Oil øgede sin ejerandel i HKN Energy fra 20% til 30% (svarende til en 22,5% andel af Sarsang produktionsaftalen).

I Kasakhstan kom den første Dunga Fase II brønd i drift i december 2012 som planlagt, og i løbet af de næste tre år vil der blive boret yderligere 197 brønde, som vil blive sat i produktion.

I Norge er tre vurderingsbrønde færdigboret i Avaldsnesdelen af det betydelige Johan Sverdrup fund. En midlertidig aftale mellem de involverede licenshavere er på plads, og fortsatte vurderingsaktiviteter ventes at føre til valg af koncept ved udgangen af 2013 og produktionsstart i 2018. Zidane-2 brønden fandt et højtryksgasreservoir, og en vurdering af det samlede kommercielle grundlag for Zidane 1 og 2 fundene er igang. For at understøtte udbygningen af Zidane og andre fremtidige fund i det centrale Norge er der investeret i en andel af en planlagt gasrørledning.

I Qatar er der aftalt en ny feltudbygningsplan for 2012 med Qatar Petroleum, herunder yderligere investeringer på USD 1,5 mia., der bl.a. dækker 51 nye brønde, med det formål at optimere udvindingen og opretholde et stabilt produktionsniveau på 300.000 boepd fra Al Shaheen feltet.

I Storbritannien fortsætter udbygningsprojektet for Golden Eagle med planlagt produktionsstart i 2014. Maersk Oil købte den resterende 30% ejerandel i de Maersk Oil opererede Dumbarton og Lochranza felter samt FPSO'en Global Producer III. Med købet ejer Maersk Oil nu 100% af begge felter og FPSO'en.

I USA går udbygningen af dybtvandsfeltet Jack i Den Mexicanske Golf i USA fremad mod **forventet (hedge)** produktionsstart i 2014. Der er planlagt yderligere vurderingsboringer for Buckskin fundet i 2013.

## EFTERFORSKNING

Succesfuld efterforskning er afgørende for Maersk Oils målsætning om at øge den daglige produktionsandel med 50% til 400.000 boepd i 2020. Den nuværende produktionsprofil afspejler, at Maersk Oil er i en indhentningsfase, med hensyn til opbygning af reserver. Efterforskningsaktiviteterne er blevet optrappet, og der er gjort en række betydningsfulde fund i de seneste par år. Nye projekter modnes kontinuerligt gennem den globale portefølje, og ved at fokusere på produktive bassiner med en kendt geologi og risici har Maersk Oil været i stand til at tilføje nye ressourcer til konkurrencedygtige omkostninger.

Maersk Oil færdiggjorde 23 efterforsknings- eller vurderingsbrønde i forhold til 14 i 2011.

I Angola blev Caporolo fundet gjort i Blok 16, og der er planlagt yderligere boringer for at vurdere fundets kommercielle potentiale, der ligger ved siden af Chissonga fundet. Efterforsknings- og vurderingsboringer i Blok 16 fortsætter i begyndelsen af 2013. Der er også planlagt yderligere efterforsknings- og vurderingsboringer i Blok 8 og 23, men timingen afhænger af tilgængeligheden af rigge, hvilket i stadig større grad er blevet en udfordring som følge af det overophedede marked for borerigge i Vestafrika.

I Brasilien deltog Maersk Oil i boringen af fire efterforsknings- og vurderingsbrønde, og flere brønde er planlagt i 2013. I Blok BM-C-37 og BM-C-38 realiserede Maersk Oil værdi ved at sælge en andel på 20% samt operatørskabet til samarbejdspartneren til gengæld for en afståelsessum og total omkostningsdækning i op til seks brønde.

I Grønland blev indsamlingen af 3D seismiske data vellykket afsluttet i Baffin Bay, og Maersk Oil deltog i et kerneprøveudtagningsprogram på lavt vand.

I Kurdistan-området i Irak fortsætter den høje efterforskningsaktivitet i Sarsang blokken, og ved årets afslutning var boringen af to efterforskningsprospekter i gang.

I Kasakhstan blev boringen af tre efterforskningsbrønde afsluttet med lovende resultater, hvilket muliggjorde modningen af Dunga Fase III, som kan bringe bruttoproduktionen op på et niveau på 30.000 boepd.

I Norge afgav Maersk Oil bud i to efterforskningsbudrunder med **forventet (hedge)** tildeling i midten af 2013. T-Rex boringen fandt ikke kulbrinter i kommercielle mængder, og blev derfor forladt. Boring af Albert efterforskningsbrønden blev påbegyndt i december.

I Storbritannien blev boringen af syv efterforsknings- og vurderingsbrønde afsluttet, herunder vurderingsbrønde i Culzean, Ockley og Jackdaw. Maersk Oil fik tildelt ni nye licenser i den 27. budrunde i Storbritannien, samt mulighed for tildeling af yderligere tre licenser i 2013, som afventer resultatet af de igangværende miljømæssige vurderinger.

I USA udbygger Maersk Oil fortsat sin projektportefølje og blev tildelt syv nye blokke i budrunden om Den Mexicanske Golf i USA. Boring af Oceanographer projektet er planlagt til 2013.

## FINANSIELLE RESULTATER

Maersk Oils overskud i 2012 var USD 2,4 mia. (USD 2,1 mia.), og ROIC var 36,6% (37,2%). Resultatet var positivt påvirket af engangsskatteindtægten på USD 899 mio. fra forliget i en algerisk skattesag, en indtægt på USD 91 mio. fra et delvist salg af andele i Brasilien og en høj gennemsnitlig oliepris på USD 112 pr. tønde (USD 111 pr. tønde). Dette blev delvist opvejet af den **forventede (AM)** nedgang i andelen af olie- og gasproduktion til 257.000 boepd (333.000 boepd), som hovedsageligt skyldtes en lavere produktionsandel i Qatar og en lavere produktion i Danmark.

Gryphon FPSO'en har været ude af drift siden starten af 2011. Produktionstab og skaderne er dog delvist dækket af gældende forsikringspolicer, og i 2012 er der modtaget en kompensation på USD 407 mio. Det skal bemærkes, at forhandlinger om det endelige forsikringsprovenu fra forsikringsselskaberne stadig er i gang.

Pengestrøm fra driftsaktiviteter var USD 3,9 mia. (USD 4,3 mia.), og pengestrøm vedrørende anlægsinvesteringer var USD 2,0 mia. (USD 3,8 mia. påvirket af købet af SK Energy i Brasilien på USD 2,4 mia.). Efterforskningsaktiviteten var fortsat høj med færdiggørelse af 23 (14) efterforsknings- og vurderingsbrønde, som medførte efterforskningsudgifter på USD 1,1 mia. (USD 1,1 mia.).



## STRATEGISK FOKUS

Med de nuværende udbygningsplaner og et fortsat højt efterforskningsniveau træder Maersk Oil ind i en periode med planlagte årlige anlægsudgifter til udbygning af porteføljen på USD 3-5 mia., sammenlignet med USD 1-3 mia. i de seneste år for at udbygge porteføljen. Efterforskningsudgifter ventes at blive over USD 1,0 mia. pr. år.

## SIKKERHED

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,75 pr. mio. arbejdstimer sammenlignet med 0,91 pr. mio. arbejdstimer i 2011.

Maersk Oil fortsætter bestræbelserne på fuldstændigt at eliminere ulykker, og den forbedrede arbejdsulykkefrekvens er et resultat af denne indsats.

## APM Terminals

APM Terminals leverede en stigning i overskuddet og en ROIC på 13,6% (13,1%). Ekspansionen fortsatte på højvækstmarkeder, især med købet af en fællesledet 37,5% andel i Global Ports Investments PLC, en portefølje bestående af meget attraktive havneaktiver i rusland og tilstødende lande. Den forøgede tilstedeværelse i højvækstområder giver nye muligheder, men øger også den geopolitiske eksponering.

- Overskud på USD 723 mio. (USD 648 mio.), påvirket af en salgsavance før skat på USD 123 mio. (USD 28 mio.)
- ROIC var 13,6% (13,1%). Eksklusiv effekten af ændring i porteføljen og engangspåvirkninger var den underliggende ROIC 12,5% (12,4%)
- Pengestrøm fra driftsaktiviteter var USD 975 mio. (USD 912 mio.)
- Antallet af håndterede containere steg med 6% til 35,4 mio. TEU (33,5 mio. TEU), hvilket var over markedsvæksten på 4%, påvirket af tilgange af terminaler til porteføljen
- Der blev indgået aftaler om nye terminalprojekter i Lazaro Cardenas, Mexico, og Ningbo, Kina, og et nyt indenlandsk projekt blev indgået i Mombasa, Kenya
- APM Terminals overtog driften i Gøteborg, Sverige, og terminalen i Wilhelmshaven, Tyskland, åbnede.

## MARKEDSUDVIKLING

Det globale marked for containerterminaler steg med 4% målt i TEU i 2012. Væksten var højere i første halvdel af 2012 end i anden halvdel. Især aftog mængderne på ruten fra Asien til Europa i andet halvår, hvilket påvirkede havnemængderne i både Asien og Europa.

APM Terminals oplevede fornyet interesse fra rederier, der ønskede at sikre sig adgang til moderne container-terminaler med kranspecifikationer og en driftskapacitet, der matcher fremtidige markedsbegreb.

## INITIATIVER I 2012

Anvendelsen af større skibe og et større fokus fra kunderne på værdien af at have den hurtigst mulige ekspeditionstid i havn fik APM Terminals til at lancere et Global Transformation program for at løfte de driftsmæssige resultater. Formålet med projektet er at forbedre produktiviteten med 15%. Antal kranløft pr. time blev forbedret med 8% på tværs af terminalporteføljen i 2012.

APM Terminals fortsatte arbejdet med at udvikle attraktive kommercielle løsninger med henblik på at skabe værdi for kunderne i langsigtede partnerskaber. Containermængder fra tredjepartskunder udgjorde i 2012 48% (46%) af de samlede mængder.

I første halvdel af 2012 blev driften i nogle terminaler i Nordafrika, Europa og Mellemøsten negativt påvirket af politisk uro eller arbejdsmarkedsforhold. Driften var nogenlunde jævn i anden halvdel af 2012, og der var kun en mindre driftsforstyrrelse i Los Angeles i december.

I slutningen af oktober ramte orkanen Sandy USA's østkyst og lukkede havnene i New York og i New Jersey inklusive APM Terminals' facilitet i Port Elizabeth. Driften var påvirket i mere end en uge i hele havnen, men APM Terminals formåede at være den første terminal i området, der genoptog driften efter orkanen.

## PORTEFØLJE

I 2012 annoncerede APM Terminals følgende tiltag, der havde indvirkning på porteføljen:

- Den 28. november købte APM Terminals en fællesledet 37,5% andel i det børsnoterede selskab Global Ports. Global Ports er den førende operatør af containerterminaler i Rusland og Baltikum. Andelens værdi var **ca. (hedge)** USD 900 mio. Som følge heraf øgedes APM Terminals' globale netværk med tre containerterminaler i Rusland, to containerterminaler i Finland og en større olie- og olieproduktterminal i Estland.
- APM Terminals overtog driften af Skandia Container Terminal i Gøteborg, Sverige, pr. 4. januar 2012. Terminalen er Skandinaviens største containerterminal, og der håndteres årligt **ca. (hedge)** 0,8 mio. TEU.
- En 32-årig koncessionskontrakt blev indgået med havnemyndighederne i Lazaro Cardenas (APILAC), Mexico, om design, finansiering, konstruktion, drift og vedligeholdelse af en ny, specialiseret containerterminal i havnen. APM Terminals vil investere over USD 900 mio. i det nye dybtvandsprojekt, der har en kapacitet på 4,1 mio. TEU.
- Containerterminal Wilhelmshaven (CTW) åbnede den 21. september 2012. APM Terminals ejer en 30% andel i Tysklands eneste dybtvandsterminal. CTW har en kapacitet på 2,7 mio. TEU.
- Terminalen Brasil Terminal Portuario (BTP) i Santos, Brasilien, modtog kraner og andet **vigtigt (AM)** udstyr i færdiggørelsesfasen. Joint venture samarbejdet vil resultere i en 2,2 mio. TEU facilitet med 15 meter dybgang til større skibe fra de latinamerikanske ruter. Driftstarten er lidt forsinket og **forventes (hedge)** nu i første halvår af 2013. APM Terminals ejer en 50% andel af BTP.
- Gruppen indgik en samarbejdsaftale med henblik på at øge Meishan terminalfaciliteten i Ningbo, Kina, med det formål at opnå en ejerandel på 25% i udbygningen af tre nye kajpladser i terminalen.
- APM Terminals købte en 50% andel i et indenlandsk containerdepot i Mombasa, Kenya. APM Terminals vil få driftsansvaret for depotet.
- APM Terminals afhændede halvdelen af sin 50% andel i Xiamen terminalen i Kina med en avance efter skat på USD 20 mio.
- Maersk Equipment Service Company Inc., USA, blev solgt i marts 2012 med en avance efter skat på USD 46 mio.
- APM Terminals' tilbud på at overtage driften af alle Port of Virginia faciliteter i Hampton Roads, USA, på en langsigtet koncessionsaftale med Virginia Port Authority (VPA) blev mødt med konkurrerende bud fra den nuværende operatør Virginia International Terminals (VIT) samt fra infrastrukturinvesteringsselskaberne i to finansierings- og investeringsselskaber. Alle bud vurderes i øjeblikket af VPA.

## FINANSIELLE RESULTATER

APM Terminals leverede et overskud på USD 723 mio. (USD 648 mio.), og ROIC var 13,6% (13,1%). Eksklusiv effekten af ændring i porteføljen var den underliggende ROIC 12,5% (12,4%).

APM Terminals følger aktivt en investeringsstrategi med fokus på vækstmarkeder. 38 ud af i alt 62 containerterminaler er placeret i disse markeder, som bidrager med 78% af EBITDA.

Antallet af containere, som APM Terminals håndterede (målt som antal kranløft justeret for APM Terminals' ejerandel) steg med 6% i forhold til 2011, påvirket af tilgang til porteføljen og derfor bedre end markedets vækst på 4%.

APM Terminals' containermængder blev negativt påvirket af den globale økonomiske opbremsning og især af faldet i mængder på Asien-Europa ruten i anden halvdel af 2012. En positiv udvikling i Afrika og Latinamerika kompenserede i stor udstrækning for dette.

Omsætningen steg med 2% i forhold til 2011, hvilket var lavere end væksten i mængder, hovedsageligt som følge af salget af Maersk Equipment Service Company i første kvartal, som påvirkede omsætningen uden at have en indvirkning på mængderne. Takstmyndighederne for større havne (TAMP) i Indien reducerede taksterne med 44% på Gateway Terminals India i Mumbai, hvilket påvirkede omsætningen negativt med USD 46 mio.

EBITDA-marginen steg til 22,9% (22,6%).

Avancer før skat på USD 123 mio. blev primært opnået ved salg af halvdelen af 50% andelen i Xiamen, Kina, og Maersk Equipment Service Company.

## STRATEGISK FOKUS

Markedsvæksten i 2013 **forventes (hedge)** at blive på 4-5%. APM Terminals **forventer (hedge)** en vækst i mængder, der ligger over markedets, understøttet af nye tilføjelser til porteføljen og forskellige initiativer til forbedring af produktiviteten.

APM Terminals har en målsætning om at blive den førende operatør af containerterminaler og indenlandske services i verden senest i 2016. APM Terminals vil opnå denne position ved at servicere de globale rederier og fragtselskaber i langsigtede

partnerskaber gennem en sikker og solid drift samt ved at forvalte porteføljen aktivt og udvikle havneinfrastruktur og indenlandske faciliteter på højvækstmarkeder.

APM Terminals' finansielle midtvejsmål (2016) er en portefølje på 65-70 terminaler, en omsætning på USD 6,0 mia., en ROIC på 13% og et resultat på USD 1,0 mia.

#### SIKKERHED

Frekvensen af arbejdsulykker (LTIF) for 2012 var 2,41 pr. mio. arbejdstimer sammenlignet med 3,86 pr. mio. arbejdstimer i 2011.

APM Terminals har fortsat fokus på at undgå ulykker og fremme sikkerhedskulturen gennem kampagnen "Safety Activist", ved at eliminere højrisikosituationer gennem en systematisk adskillelse af mennesker og maskiner samt ved at udføre forskellige sikkerhedsforbedringer på faciliteterne.

#### Maersk Drilling

Med en høj kontraktsdækning og en ordrebog på syv rigge til levering i 2013-2015 er Maersk Drilling godt på vej til at opfylde sin strategiske målsætning om at levere et overskud på USD 1,0 mia. senest i 2018. Det samlede resultat for 2012 var dog negativt påvirket af opstartsproblemer på to borerigge.

- Overskud på USD 359 mio. (USD 488 mio.)
- ROIC var 8,3% (12,5%)
- Pengestrøm fra driftsaktiviteter var USD 651 mio. (USD 825 mio.)
- Kontraktsdækning på 98% for 2013 og 76% for 2014
- Den operationelle opetid var i gennemsnit 92,1% (95,6%).

#### MARKEDSUDVIKLING

Olieprisen var i 2012 fortsat gunstig for olieselskabernes fortsatte forøgelse af investeringerne i efterforskning og udvikling.

Det norske marked for jack-up rigge var fortsat solidt med fuld kapacitetsudnyttelse hele året. Markedet **forventes (hedge)** at være stærkt i de kommende år, og der er for nuværende ikke ledige jack-up rigge før i andet kvartal 2014. Olie- og gasselskaberne viser derfor allerede nu interesse for at købe rigkapacitet ud over 2014. Markedet for internationale premium jack-up rigge (uden for Norge) har en betydeligt højere kapacitetsudnyttelse og højere dagsrater end for ældre jack-up rigge, hvilket skyldes bedre sikkerhed og effektivitet for operatørerne.

Markedet for rigge til ultradybt vand (7.500 ft+) var kendetegnet ved fuld kapacitetsudnyttelse i 2012, og rateniveauet var det samme som før krisen på **omkring (hedge)** USD 600.000 pr. dag med enkelte forskelle fra region til region og land til land, der skyldes forskelle i driftsomkostningsniveau og skatter.

På trods af ordrebogen for nybygninger **forventes (hedge)** markedet for rigge til ultradybt vand fortsat at være stærkt, og antallet af rigge, der er tilgængelige i 2013, er begrænset. Operatører sikrer sig derfor allerede nu rigkapacitet til ultradybt vand til start i 2014.

Olieforsyningen fra dybtvandsfelter er nødvendig for at skabe balance i forhold til efterspørgslen på olie, og for at kunne levere den nødvendige produktion af dybtvandsolie er det **vigtigt (AM)** med betydelige efterforsknings- og udviklingsboringer i de kommende år. Den stigende efterspørgsel kommer primært fra hovedvækstområderne Vestafrika og Den Mexicanske Golf i USA, hvorimod der er usikkerhed om efterspørgslen i Brasilien. Nylige fund i andre nye dybtvandsområder, som eksempelvis Østafrika, vil også bidrage til den fremtidige vækst.

#### INITIATIVER I 2012

Med undtagelse af en enkelt jack-up rig var alle Maersk Drillings 16 jack-up rigge og flydende rigge, de ti boreprammer i Venezuela og den af Maersk Drilling drevne semi-submersible-rig (ejet af tredjepart) på kontrakt i hele 2012.

Maersk Drillings operationelle opetid var i gennemsnit 92,1% i 2012 (95,6%). For de flydende rigge var den operationelle opetid i gennemsnit 85,1% (92,4%), og for jack-up rigge var den i gennemsnit 95,3% (97,0%). Den operationelle opetid var negativt påvirket af opstartsvanskeligheder for en jack-up rig og en flydende rig.

Der var seks ophold på værft for planlagt eftersyn og opgradering i 2012. Værftopholdene blev afsluttet til tiden og uden budgetoverskridelser.

#### Maersk Training centre

Simulatoren er i stand til virtuelt at gengive de højtydende rigge i Maersk Drillings flåde og omfatter Svendborg alt udstyr og alle styresystemer, der er specifikke for riggene. Det betyder, at mandskabet kan træne Danmark specifikt i de samme omgivelser, som de vil opleve om bord på riggen.

#### INDGÅEDE KONTRAKTER I 2012

- Nybygget ultra harsh jack-up rig til drift i Norge, USD 620 mio. Kontraktperioden er fire år med start medio 2015 efter levering fra værftet og mobilisering til Norge.
- En option på en ultra dybtvands semi-submersible rig i Den Mexicanske Golf i USA. Optionens løbetid er to år med start den 4. november 2013, når den faste kontrakt udløber, USD 370 mio.
- En to-årig kontrakt for en ultra harsh jack-up rig, USD 280 mio. Kontrakten **forventes (hedge)** at begynde i april 2014 i direkte fortsættelse af den nuværende kontrakt.
- Den første af en serie på fire identiske ultra dybtvands boreskibe, der er under konstruktion, USD 610 mio. Kontraktperioden er tre år med **forventet (hedge)** start ultimo 2013 efter levering og mobilisering til Den Mexicanske Golf i USA. Den skønnede kontraktværdi omfatter mobilisering, men er eksklusive omkostningsstigninger og resultatbetinget bonus.
- Det andet boreskib i serien, USD 694 mio. Kontraktperioden er tre år plus en to-årig option med **forventet (hedge)** start i andet kvartal 2014 efter mobilisering til Den Mexicanske Golf i USA.

Ved udgangen af 2012 var Maersk Drillings kontraktsdækning 98% for 2013, 76% for 2014, 51% for 2015 og 41% for 2016. Den samlede omsætning på den fremtidige kontraktsdækning for Maersk Drilling var ved udgangen af 2012 USD 7,0 mia. (USD 4,9 mia.).

#### Flåde og nybygningsprogram

Maersk Drilling ejer og driver i dag seks ultra harsh jack-up rigge i Norge, tre ultra dybtvands semi-submersible rigge i Den Mexicanske Golf i USA, Angola og Egypten, og seks internationale premium jack-up rigge i Sydøstasien, Vestafrrika og Nordsøen. Endvidere ejer og driver Maersk Drilling en midwater semi-submersible rig i Det Kaspiske Hav og opererer en semi-submersible rig på vegne af dens kinesiske ejere.

Maersk Drilling ejer og driver ti borepramme i Venezuela, som i 2012 genererede en omsætning på USD 194 mio. (USD 178 mio.).

Maersk Drilling deltager i 50/50% joint venture Egyptian Drilling Company, som ejer og driver 64 landrigge og fire jack-up rigge. Joint venture genererede i 2012 en samlet omsætning på USD 424 mio. (USD 447 mio.).

Maersk Drilling har i dag syv rigge under konstruktion. Ordrebogen omfatter tre ultra harsh jack-up rigge, hvoraf de første to leveres i 2014 og den tredje i 2015. Derudover indeholder ordrebogen fire ultra dybtvands boreskibe, hvoraf den ene skal leveres i slutningen af 2013 og de øvrige i 2014. Nybygningsprogrammet forløber planmæssigt.

Der er allerede indgået kontrakt på fem ud af de syv nybyggede rigge, der giver en kontraktbeholdning på i alt 17 rigår med en **forventet (hedge)** omsætning på **ca. (hedge)** USD 2,9 mia.

#### FINANSIELLE RESULTATER

Overskuddet for 2012 på USD 359 mio. (USD 488 mio.) var negativt påvirket af mere end USD 125 mio. som følge af forsinket start på nye kontrakter for to rigge på grund af opstartsproblemer, men positivt påvirket af tilbageførsel af nedskrivninger på USD 24 mio.

Pengestrøm fra driftsaktiviteter var USD 651 mio. (USD 825 mio.) efter en mindre stigning i driftskapitalen på USD 25 mio. (USD 52 mio.).

Efter pengestrøm til investeringer på USD 589 mio. (USD 600 mio.) udgjorde den frie pengestrøm USD 62 mio. (USD 225 mio.).

#### STRATEGISK FOKUS

Fokusområderne for vækst er Norge, hvor Maersk Drilling skal løfte den markedsledende position på markedet for ultra harsh jack-up rigge, og dybtvandsområderne i Den Mexicanske Golf i USA og Vestafrrika, hvor Maersk Drillings mål er at opbygge en stærk position.

Med fuld kontraktsdækning for 2013 har Maersk Drilling en høj grad af gennemsigthed på indtjeningen. De væsentligste risici knytter sig til driftsresultaterne, prisinflation og levering af nybygninger, samt overholdelse af tidsfrister og budget for værftsophold

for eksisterende rigge. På længere sigt vil Maersk Drilling være eksponeret i tilfælde af lavere oliepriser, som vil påvirke olieselskabernes investeringer i efterforskning og udvikling negativt. Som følge af den betydelige vækst og de mange nye rigge, der tages i drift i 2013-2015, **forventer (hedge)** Maersk Drilling yderligere omkostninger i forbindelse med uddannelse og opstart, som vil påvirke resultaterne i 2013, 2014 og 2015 negativt. Efter levering fra værft påløber der driftsomkostninger for riggene, der ikke har fuld omsætning før kontraktstart. Det kan dreje sig om en periode på to-tre måneder per rig afhængig af driftsstedet.

#### SIKKERHED

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,53 pr. mio. arbejdstimer sammenlignet med 0,21 pr. mio. arbejdstimer i 2011. Stigningen i LTIF er ikke **tilfredsstillende (AM)**, og selvom sikkerheden stadig er forholdsvis høj, er der gennemført en række initiativer for at forbedre sikkerheden.

#### Maersk Supply Service

- Overskud på USD 132 mio. (USD 243 mio.)
- ROIC var 6,1% (11,2%)
- Pengestrøm fra driftsaktiviteter var USD 305 mio. (USD 375 mio.).

Resultatet var negativt påvirket af en generel overskudskapacitet i de fleste segmenter på markedet med undtagelse af segmentet for udryknings- og redningsskibe. Stigningen i pengestrøm vedrørende anlægsinvesteringer skyldtes investering i canadiske nybygninger og modifikation af en række eksisterende skibe.

Maersk Supply Service havde en **rimelig (AM)** kontraktsdækning ved starten af 2012 med fortsat fokus på brug af spotflåden på vigtige strategiske markeder, som f.eks. Vest- og Østafrika, Brasilien, Australien og Canada, hvor der blev indgået en række nye kontrakter og kontraktforlængelser.

For ankerhåndteringsskibene faldt nybygningsaktiviteten i markedet, og der blev kun placeret ganske få nye ordrer, hvorimod den betydelige ordrebog for platform forsyningsskibe fortsat øgedes. En række subsea supportskibe blev bestilt som en fremadrettet investering i årets løb.

ESVAGT blev en del af Maersk Supply Service's segment pr. 1. januar 2012. Inden for udryknings- og redningsskibe havde ESVAGT en høj kapacitetsudnyttelse i 2012, og omsætningen og resultatet var de hidtil største.

ESVAGT tog levering af tre skibe i 2012. Alle gik direkte på langtidskontrakter (løbetid på fem og ti år), to i Norge og én i Danmark. Nybygningerne er ESVAGT's mest avancerede skibe til dato og bringer flåden op på 35 skibe.

To ankerhåndteringsskibe er i ordre med optioner på op til fire yderligere skibe. Skibene bygges til det canadiske marked og optimeres til driften på stedet med reduceret udledning og brændstofforbrug. Et skib er solgt, og Maersk Supply Services flåde består nu af 65 skibe.

Kontraktsdækningen for 2013 er 57% og for 2014 29% eksklusive optioner.

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,74 pr. mio. arbejdstimer sammenlignet med 0,75 pr. mio. arbejdstimer i 2011.

#### Maersk Tankers

- Tab på USD 312 mio. (tab på USD 153 mio.)
- ROIC var negativ med 8,3% (negativ med 4,3%)
- Pengestrøm fra driftsaktiviteter var USD 142 mio. (USD 95 mio.)
- Nedskrivninger på USD 268 mio.
- Salg af Small Northwest Europe og Handygas segmenterne
- Time charter flåden blev reduceret med 25 skibe.

Overskudskapacitet og en lav stigning i efterspørgsel var fortsat bestemmende for uligevægten i markedet i de fleste segmenter. Som følge af markedsvilkårene justerede Maersk Tankers i løbet af året udsigterne på mellemlangt sigt og foretog nedskrivninger på USD 268 mio. inden for segmenterne supertankere til transport af råolie (VLCC), produkt handy-tankers og små produkttankskibe. Værdiansættelsen af skibe er stadig behæftet med betydelig usikkerhed.

En betydelig VLCC tonnage bliver tilført markedet i 2013, og stigningen i efterspørgsel **forventes (hedge)** at være uændret. Generel overkapacitet og en svag stigning i efterspørgsel påvirkede produkttankskibssegmentet negativt i 2012. Forventningerne til 2013 er uændrede med en relativ uændret udvikling i efterspørgsel og udbud.

I gassegmentet **forventes (hedge)** indtjeningen at komme under pres som følge af et stigende udbud af skibe i 2013.

Maersk Tankers har startet flere initiativer for at forbedre profitabiliteten, heriblandt et projekt med initiativer til kommercielle forbedringer og omkostningsreduktioner. Betydelige besparelser blev opnået i 2012, hvor initiativer inden for brændstofområdet bidrog mest med en reduktion på 7% svarende til USD 48 mio.

Maersk Tankers solgte Small Northwest Europe segmentet som led i strategien om at optimere, fokusere på færre segmenter og frigøre kapital til nye investeringer.

Disse investeringer vil omfatte en **mulig (hedge)** opgradering af VLCC'ere, som vil medføre effektivitetsfordele og en positiv indvirkning på miljøet som følge af reduktion i brændstofforbruget. Maersk Tankers har også reduceret time charter flåden betydeligt.

Maersk Tankers indgik aftale om salg af Handygas segmentet. Transaktionen vil finde sted i 2013.

Udover ovennævnte initiativer har Maersk Tankers besluttet kold oplægning af to VLCC skibe.

I 2012 tog Maersk Tankers levering af syv skibe (fem VLCC'ere og to produkttankskibe), solgte ti produkttankskibe og har ikke yderligere nybygninger i ordre.

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,89 pr. mio. arbejdstimer sammenlignet med 1,12 pr. mio. arbejdstimer i 2011.

#### Damco

- Overskud på USD 55 mio. (USD 63 mio.), positivt påvirket af avance fra salg før skat på USD 19 mio.
- ROIC var 13,5% (24,4%)
- Pengestrøm fra driftsaktiviteter var negativ med USD 97 mio. (positiv med USD 93 mio.).

Damco noterede en betydelig vækst i 2012, delvist på grund af påvirkning fra opkøb. Derudover voksede alle produktmængder hurtigere end markedet, og nettoomsætningen steg med 18,9% til USD 3,3 mia.

Damco fragtede 6% flere søfragtmængder i forhold til 2011. Luftfragtmængden blev **næsten (hedge)** fordoblet og steg med 91% i forhold til året før. Væksten i luftfragtmængder skyldtes delvist helårseffekten af købet af NTS i august 2011 (en kinesisk baseret speditør) og delvist den stærke vækst i udvalgte fokusindustrier. Supply Chain Management mængder steg på ny og sluttede 5% over sidste års niveau.

De forringede markedsvilkår samt etableringsomkostninger i forbindelse med nye forretninger medførte et nedadgående pres på Damcos lønsomhedsmargin og havde en negativ indvirkning på Damcos resultat i 2012. Pengestrøm fra driftsaktiviteter var negativ med USD 97 mio. (positiv med USD 93 mio.) på grund af stigning i driftskapital.

Damco oplyste tidligt i 2012 om en omstrukturering af sine europæiske operationer, som blev opdelt i øst og vest. I oktober købte Damco speditørfirmaet Pacific Network Global Logistics og styrkede derved sin position i Oceanien betydeligt. I september oplyste Damco, at det globale hovedkontor flytter fra København til Haag i Holland. Flytningen **forventes (hedge)** gennemført i første kvartal 2013.

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,51 pr. mio. arbejdstimer sammenlignet med 0,81 pr. mio. arbejdstimer i 2011.

#### SVITZER

- Overskud på USD 9 mio. (USD 102 mio.), negativt påvirket af nedskrivninger på USD 109 mio.
- EBITDA-margin på 29% (27%)
- ROIC var 0,6% (6,4%)
- Pengestrøm fra driftsaktiviteter var USD 257 mio. (USD 131 mio.).

Havnebugseringsaktiviteten var **stort set (hedge)** uændret i forhold til året før. Stærk vækst i aktiviteten i Australien (7%) blev udlignet af faldende aktivitet i Europa (-3%). Terminalbugseringsaktiviteterne udviklede sig som **forventet (AM)**. SVITZER **sikrede (booster)** befragtning af nyligt leverede skibe på nye terminalbugseringskontrakter og forlængede en række eksisterende kontrakter. Inden for bjærgning var aktiviteten svag i store dele af året men med en vis stigning i sidste kvartal.

Omsætningen steg med 2,7%, og EBITDA-marginen steg til 29% (27%) drevet af forskellige initiativer til en bedre styring af omsætning og omkostninger.

Markedet for bugsering har været svagt i Storbritannien i en længere periode, og med udsigt til et fortsat svagt marked blev der foretaget en nedskrivning af goodwill.

I alt blev nedskrevet USD 102 mio. i fjerde kvartal, som vedrørte Adsteam aktiviteterne, der blev købt i 2007. Derudover blev resultatet negativt påvirket af hensættelser til tab (USD 5 mio.), et skattekrav fra salget i 2007 af mandskabsbådsaktiviteter (USD 5 mio.) og nedskrivning på havbugseringsdivisionen (USD 7 mio.).

Pengestrøm fra driftsaktiviteter var USD 257 mio. (USD 131 mio.), som følge af forbedrede driftsresultater og betydelige modtagne betalinger inden for bjærgning.

I september 2012 lancerede SVITZER en ny strategi, der sammen med en ny organisatorisk struktur skal forbedre afkastet af havnebugseringsaktiviteter samt øge andelen af bugseringer på langtidskontrakter og forbedre sikkerhedsstandarden.

Frekvensen af arbejdsulykker (LTIF) for 2012 var 1,46 pr. mio. arbejdstimer sammenlignet med 0,78 pr. mio. arbejdstimer i 2011.

#### Dansk Supermarked Gruppen

- Omsætning på DKK 55,6 mia. (DKK 55,2 mia.)
- Overskud på DKK 1,3 mia. (DKK 5,4 mia. inklusive avancen fra salget af Netto, UK)
- ROIC var 8,2% (35,1%)
- Pengestrøm fra driftsaktiviteter var DKK 2,3 mia. (DKK 2,3 mia.)
- 71 nye butikker åbnede
- Køb af den resterende 25% andel af Netto, Tyskland
- Tøj & Sko kæden lukkede
- To tabsgivende Føtex butikker lukkede.

#### MARKEDET FOR DETAILHANDEL

Det danske detailmarked for dagligvarer steg med 2,3% i 2012. Markedet var præget af et fortsat skift fra supermarkeder til discountbutikker som følge af den fortsatte økonomiske opbremsning, åbning af flere discountbutikker i forhold til supermarkeder og en ny lukkelov, der tillader udvidede åbningstider inklusive åbning på søndage.

På kort sigt **forventes (hedge)** discountsegmentet fortsat at stige, især som følge af de udvidede åbningstider. På langt sigt **forventes (hedge)** discountbutikker at vokse mere end supermarkeder, men ikke i samme takt som i tidligere år.

Dansk Supermarked øgede sin markedsandel i Danmark til 34,0% (33,6%). Stigningen skete hovedsageligt i andet halvår af 2012. Dansk Supermarkeds markedsandel steg ligeledes i Polen og blev fastholdt i Tyskland og i Sverige.

Det danske non-food marked var stadig under pres primært som følge af det økonomiske klima sammen med den stigende betydning af onlinehandel, som også er afspejlet i onlinebutikkerne, [www.bilka.dk](http://www.bilka.dk) og [www.salling.dk](http://www.salling.dk), som begge oplevede en fortsat stærk vækst i 2012. Der var dog overordnet set et fald på non-food området.

#### INITIATIVER I 2012

Dansk Supermarked påbegyndte i 2012 en større omlægning for i de kommende år at sikre positionen som det foretrukne valg for kunder i alle koncepter. Hver uge håndterer Dansk Supermarked **ca. (hedge)** ni mio. transaktioner, og målet er løbende at forbedre kundens indkøbsoplevelse.

En række omkostningsreducerende projekter er igangsat for at finansiere omlægningen. Især er der forhandlet bedre priser med leverandørerne, og en række funktioner er blevet omorganiseret eller reduceret for at få en slankere og mere smidig organisation.

I de kommende år vil de strategiske prioriteter inkludere kundeindsigt, udvikling og opdatering af de forskellige kæder, fortsat udvidelse af Netto International, produktkategori-optimering, konkurrencedygtige priser, fortsat effektiv drift og udvikling af medarbejdere.

Som en del af Dansk Supermarkeds internationale vækststrategi blev de sidste 25% af ejerandelen af Netto, Tyskland (OHG Netto Supermarkt GmbH & Co.) købt med virkning fra december 2012, og Dansk Supermarked ejer nu selskabet 100%.

#### FINANSIELLE RESULTATER

Omsætningen for 2012 var DKK 55,6 mia., en stigning på DKK 2,1 mia. i forhold til 2011 justeret for salget af Netto Foodstores Limited, Storbritannien. I alt blev der åbnet 71 nye butikker, hvoraf 48 var uden for Danmark. Fordelt på landene blev der i alt lukket 55 butikker.

Resultatet var negativt påvirket af nedskrivninger på DKK 221 mio. (DKK 67 mio.), der hovedsagelig skyldtes lukkede butikker, herunder to føtex butikker og 37 Tøj & Sko butikker. Resultatet var yderligere negativt påvirket af et markant fald i resultatet for Netto, Sverige, delvist som følge af indførelse af et nyt ERP-system, samt af renovering af Salling, Ålborg.

Pengestrøm vedrørende anlægsinvesteringer var DKK 2,1 mia. (positiv med DKK 3,4 mia.). Når der ses bort fra pengestrøm fra salget af Netto, UK, udgjorde pengestrøm vedrørende anlægsinvesteringer i 2011 til sammenligning DKK 2,9 mia. Faldet på DKK 818 mio. skyldtes hovedsageligt færre investeringer i nye butikker samt flytning og renovering af eksisterende butikker.

Forventningen til 2013 er en samlet omsætningsvækst på 4-6% sammen med en forbedret lønsomhed.

#### SIKKERHED

Frekvensen af arbejdsulykker (LTIF) for 2012 var 13,46 pr. mio. arbejdstimer sammenlignet med 13,95 pr. mio. arbejdstimer i 2011.

#### Maersk FPSOs og Maersk LNG

- Overskud på USD 336 mio. (USD 10 mio.), heraf USD 245 mio. fra salgsavancer
- ROIC var 33,9% (0,4%)
- Salg af Maersk LNG gennemført med en avance på USD 80 mio.
- Salg af FPSO Maersk Peregrino gennemført med en avance på USD 163 mio.
- Den frie pengestrøm var USD 2,7 mia. (USD 254 mio.).

#### MARKEDSUDVIKLING

I de sidste tre år har FPSO markedet oplevet en stigning i salg af aktiver blandt operatørerne. Det finansielle afkast på de fleste FPSO kontrakter svarer ikke til de forbundne risici og omkostninger. Det har tvunget de mindre operatører til at forlade markedet, og det har skabt færre, men større spillere inden for tilbudsgivning i dag. Maersk FPSOs har også frasolgt aktiver, når de rette muligheder og de rette købere har vist sig.

Ved udgangen af 2012 bestod Maersk FPSOs' flåde af fire enheder, der opererer i Nordsøen og Congo på langtidskontrakter, som løber i op til ni år. To af enhederne, FPSO North Sea Producer og FGSO NKossa II, er joint ventures, hvor Maersk FPSOs ejer henholdsvis 50% og 51%.

#### INITIATIVER I 2012

Efter salget af FPSO Maersk Ngujima-Yin i december 2011 blev der indgået en aftale den 31. juli 2012 om salg af FPSO Maersk Peregrino til en pris af USD 1,2 mia. Salgsaktiviteterne gav en samlet regnskabsmæssig avance på USD 245 mio. i 2012 og en pengestrøm på USD 2,6 mia. I Gruppens konsoliderede tal blev yderligere en avance på USD 53 mio. indregnet for Maersk Peregrino transaktionen.

Maersk FPSOs indgik i tredje kvartal 2012 en ny kontrakt for FPSO North Sea Producer med en positiv finansiell indvirkning fra 1. januar 2012.

Boreforberedelser på Volve feltet i den norske del af Nordsøen er genoptaget i 2012, og det er besluttet at overføre Volve produktionsmodulet og driftsselskabet fra Maersk FPSOs til Maersk Drilling pr. 1. januar 2013. Der blev endvidere indgået aftale om at iværksætte en proces med henblik på en overdragelse af ejerskabet af FPSO Maersk Curlew til tredjepart.

#### FINANSIELLE RESULTATER

Resultatet for Maersk FPSOs og Maersk LNG var USD 336 mio. (USD 10 mio.) positivt påvirket af salgsavancer fra salget af Maersk LNG og FPSO Maersk Peregrino. Den fortsatte nedlukning af FPSO Maersk Curlew påvirkede resultatet negativt.

#### SIKKERHED

Frekvensen af arbejdsulykker (LTIF) for 2012 var 0,00 pr. mio. arbejdstimer sammenlignet med 0,53 pr. mio. arbejdstimer i 2011.

#### Maersk Container Industry



Maersk Container Industry (MCI) oplevede en stor efterspørgsel på kølecontainere og kølemaskiner i den første del af 2012 som et resultat af grundliggende gode markedsfaktorer. I den sidste del af 2012 faldt efterspørgslen påvirket af et forsøg fra rederier på at drive fragtraterne i vejret ved at reducere kapaciteten. De grundliggende markedsfaktorer **synes (hedge)** imidlertid intakte som et resultat af den underliggende vækst i varer, der transporteres på køl, og omlægningen af last fra traditionelle bulklastskibe til kølecontainere.

I løbet af året producerede MCI kølecontainer nr. 300.000 og kølemaskine nr. 125.000. Produktionen af Star Cool kølemaskinen begyndte i 2005, og for første gang solgte MCI på et år flere kølemaskiner end kølecontainere.

Omsætningen var USD 1,1 mia. (USD 1,2 mia.), og resultatet var USD 60 mio. (USD 69 mio.). ROIC var 27,7% (33,1%). Opførelsen af den nye kølefabrik i Chile forløber planmæssigt og **forventes (hedge)** at være driftsklar i slutningen af 2013. Frekvensen af arbejdsulykker (LTIF) for 2012 var 1,47 pr. mio. arbejdstimer sammenlignet med 1,45 pr. mio. arbejdstimer i 2011.

#### Danske Bank

Gruppen ejer 20% af aktierne i Danske Bank, den største danske bank, som har afdelinger i en række lande, herunder Danmark, Sverige, Finland, Norge, Irland og Nordirland. Bankens resultat var DKK 4,7 mia. (DKK 1,7 mia.), hvoraf 20%, svarende til DKK 952 mio. (DKK 343 mio.), er medtaget i Gruppens resultat.

Gruppen deltog med et pro rata bidrag til Danske Banks kapitaludvidelse på DKK 7,15 mia. (USD 1,2 mia.) i oktober 2012.

#### Ro/Ro og relaterede aktiviteter

Ro/Ro og relaterede aktiviteter består af Gruppens ejerandele i DFDS og Höegh Autoliners m.v. Resultatet var USD 55 mio. (USD 34 mio.), og ROIC var 7,7% (5,3%).

#### Ikke allokerede aktiviteter

Ikke allokerede aktiviteter omfatter omsætning og omkostninger m.v., samt finansielle poster, herunder renteindtægter og -omkostninger samt rente- og valutakursregulering af lån m.v., der ikke kan henføres til rapporteringspligtige segmenter. Endvidere indgår på nettobasis køb af brændstof og smøreolie på vegne af Gruppens selskaber samt ikke segmenthenførte oliesikringsaktiviteter.

Aktivitet med køb af brændstof har udvist en mindre stigning i forhold til sidste år. De finansielle poster udviste et negativt resultat på USD 755 mio. (negativ med USD 855 mio.). De to **vigtigste (AM)** bidragsydere til denne positive udvikling var lavere nettorenteudgifter (inklusive hedging og værdiregulering) hovedsageligt fra korte investeringer, samt valutareguleringer.

#### A.P. Møller - Mærsk Gruppen

##### Regnskabsberetning

A.P. Møller – Mærsk Gruppens resultat forbedredes med DKK 5,3 mia. til DKK 23,4 mia. (DKK 18,1 mia.), og egenkapitalen udgjorde DKK 222,5 mia. (DKK 207,9 mia.).

#### RESULTATOPGØRELSEN

Omsætningen steg med 6% til DKK 342,1 mia. (DKK 322,5 mia.). Målt i USD faldt omsætningen med 2% til 59,0 mia. (USD 60,2 mia.) positivt påvirket af højere oliepris og containermængder og negativt af lavere containerfragtrater og lavere andel af olieproduktion.

Driftsomkostninger steg med DKK 26,3 mia. til DKK 271,9 mia. (DKK 245,6 mia.) primært som følge af øgede containermængder og højere bunkerpriser.

Af- og nedskrivninger steg med DKK 2,1 mia. til DKK 31,0 mia. (DKK 28,9 mia.). Gruppen foretog nedskrivninger med netto DKK 2,3 mia. (DKK 1,7 mia.) hovedsageligt vedrørende Maersk Tankers og SVITZER.

Avance ved salg af anlægsaktiver faldt til DKK 3,7 mia. (DKK 4,8 mia.). I 2012 relateres avancen primært til salg af FPSO'en Maersk Peregrino, LNG aktiviteterne og et delvist salg af olieaktiviteter i Brasilien, hvorimod avancen i 2011 primært var relateret til salget af Netto Food-stores Limited, UK.

Andelen af resultatet i associerede virksomheder steg med DKK 0,6 mia. til DKK 1,3 mia. (DKK 0,7 mia.) som følge af et bedre resultat i Danske Bank og Höegh Auto-liners.

Finansielle poster blev reduceret til en nettoudgift på DKK 4,4 mia. (DKK 4,6 mia.). De væsentligste årsager til denne positive udvikling var lavere nettorenteudgifter inklusive sikring samt positiv værdiregulering hovedsageligt fra korte investeringer såvel som fra valutareguleringer.

#### SKAT

Gruppens selskaber beskattes efter forskellige systemer afhængig af hjemsted og aktivitet. For visse af Gruppens aktiviteter gælder særlige skatteforhold.

Skibsfartsaktiviteterne er som hovedregel omfattet af et tonnagebaseret eller lignende skattesystem, hvor opgørelsen af den skattepligtige indkomst inkluderer et beløb beregnet med udgangspunkt i flådens tonnage. Herudover betales i visse lande fragtskatter, der primært beregnes på basis af bruttofragtindtægter i de pågældende lande.

Olie- og gasaktiviteterne er i de fleste lande underlagt en særlig beskatning, der **oftest (hedge)** er betydeligt højere end den normale selskabsskat. For den danske del af Nordsøen modtog den danske stat i perioden 1. januar til 8. juli desuden 20% af resultatet før skat opgjort efter skattemæssige regler. Denne overskudsandel klassificeres regnskabsmæssigt som skat. I andre lande modtager staten, foruden skat, en del af olieproduktionen. Disse statsandele udeholdes fra omsætningen og indgår således ikke som skat.

Gruppens samlede skatter i 2012 var DKK 19,1 mia. (DKK 32,4 mia.). Faldet skyldtes primært et forlig i en algerisk skattesag, som medførte en engangsindtægt på DKK 5,2 mia. Af de samlede skatter udgjorde betalbar dansk skat DKK 9,3 mia. i 2012 (DKK 11,0 mia.), hvoraf DKK 6,1 mia. var særlig kulbrinteskate og overskudsandel til den danske stat (DKK 7,7 mia.), og DKK 3,2 mia. var selskabsskat vedrørende olieaktiviteterne (DKK 3,3 mia.). Skattebetaling vedrørende skibsfartsaktiviteter udgjorde DKK 57 mio. (DKK 56 mio.).

#### TOTALINDKOMST

Årets totalindkomst blev positiv med DKK 21,7 mia. (DKK 19,9 mia.) og består af årets resultat DKK 23,4 mia. (DKK 18,1 mia.) og anden totalindkomst med en nettoomkostning på DKK 1,7 mia. (nettoindtægt på DKK 1,8 mia.). I anden totalindkomst indgår væsentligst valutakursregulering ved omregning fra funktionel valuta til præsentrationsvaluta, dagsværdiregulering af visse værdipapirer, regulering vedrørende sikring af pengestrømme samt aktuariemæssige gevinster og tab.

#### BALANCEN

De samlede aktiver udgjorde pr. 31. december 2012 DKK 420,7 mia. (DKK 404,7 mia.). Immaterielle aktiver steg til DKK 34,2 mia. (DKK 28,8 mia.) primært som følge af tilkøbte terminalrettigheder.

Materielle aktiver DKK 261,4 mia. (DKK 254,8 mia.) blev i 2012 netto øget med DKK 6,6 mia., hvoraf årets investeringer udgjorde DKK 47,0 mia. (DKK 43,2 mia.). Årets afskrivninger var DKK 26,7 mia. (DKK 25,7 mia.), og årets nedskrivninger udgjorde netto DKK 1,7 mia. (DKK 1,4 mia.). Der fragik DKK 8,8 mia. (DKK 10,0 mia.) hovedsageligt vedrørende oliefaciliteterne i Danmark på grund af den statsejede Nordsøfunds indtræden som partner i DUC (Dansk Undergrunds Consortium) og salget af FPSO Maersk Peregrino. Valutakursreguleringer udgjorde et fald på DKK 3,2 mia. (DKK 5,0 mia.) grundet udviklingen i USD over for DKK.

Kapitalandele i associerede virksomheder udgjorde DKK 35,5 mia. (DKK 32,5 mia.), heraf Danske Bank DKK 27,7 mia. (DKK 25,2 mia.).

Afledte finansielle instrumenter udgjorde pr. 31. december 2012 en nettoforpligtelse på DKK 135 mio. (DKK 3,3 mia.). Den formindskede forpligtelse skyldes primært stigende NOK og DKK.

De samlede likvide midler, bestående af en handelsbeholdning af værdipapirer samt likvide beholdninger, udgjorde pr. 31. december 2012 DKK 15,2 mia. (DKK 15,2 mia.). Aktiver bestemt til salg udgjorde netto DKK 3,0 mia. (DKK 8,7 mia.) og bestod af aktiver, der **forventes (hedge)** solgt i 2013, heriblandt 11 handygas skibe.

Egenkapitalen udgjorde DKK 222,5 mia. (DKK 207,9 mia.). I stigningen indgik årets totalindkomst med DKK 21,7 mia. (DKK 19,9 mia.), og udbytte fragik med DKK 5,5 mia. (DKK 4,9 mia.).

Udskudt skatteforpligtelse udgjorde pr. 31. december 2012 DKK 7,9 mia. (DKK 6,0 mia.), og indregnet udskudt skatteaktiv udgjorde DKK 3,8 mia. (DKK 4,9 mia.). I tillæg hertil var der udskudte skatteaktiver for DKK 4,0 mia. (DKK 4,0 mia.), som ikke var indregnet, jf. note 13 til det konsoliderede regnskab.

#### RETSTVISTER M.V.

Gruppen er part i et antal retstvister. Herudover er Gruppen part i et antal skattesager, hvilke i enkelte tilfælde involverer betydelige beløb og er behæftede med en vis usikkerhed.

#### PENSIONER M.V.

Den aktuarmæssige nettoforpligtelse i ydelsesbaserede ordninger indregnet i regnskabet pr. 31. december 2012 udgør DKK 2,5 mia. (DKK 2,5 mia.). Udviklingen i de aktuarmæssige forudsætninger og pensionsordninger har medført et aktuarmæssigt tab på DKK 253 mio. (tab på DKK 844 mio.), som indgår i anden totalindkomst. Gruppen betalte i 2012 DKK 584 mio. (DKK 558 mio.) til ydelsesbaserede pensionsordninger.

#### PENGESTRØM

Pengestrøm fra driftsaktiviteter DKK 44,2 mia. (DKK 38,9 mia.) var positivt påvirket af lavere skattebetalinger, som blev delvist modsvaret af lavere indtjening før afskrivninger. Pengestrøm vedrørende anlægsinvesteringer var DKK 36,6 mia. (DKK 52,3 mia.). Faldet skyldtes hovedsageligt salget af FPSO Maersk Peregrino, LNG aktiviteterne samt et delvist salg af olieaktiviteter i Brasilien, som blev delvist modregnet af investeringer i skibe, olierettigheder samt kapitalforhøjelsen i Danske Bank.

#### OPERATIONELLE LEASINGFORPLIGTELSE

Nutidsværdien af operationelle leasingforpligtelser udgjorde pr. 31. december 2012 DKK 63,4 mia. (DKK 66,8 mia.) ved brug af en tilbagediskonteringsrente på 6% (6%). Beløbet opdeles i følgende hovedposter:

- Maersk Line og Maersk Tankers DKK 31,9 mia. (DKK 39,2 mia.) hovedsagelig vedrørende indchartrede skibe
- APM Terminals DKK 24,6 mia. (DKK 21,5 mia.) hovedsagelig vedrørende fremtidige koncessionsafgifter for havnefaciliteter
- Andre forpligtelser DKK 6,9 mia. (DKK 6,1 mia.).

**Ca. (hedge)** halvdelen af certepartiydelserne i Maersk Line og en tredjedel af certepartiydelserne Maersk Tankers skønnes relateret til operationelle omkostninger i forbindelse med drift af aktiverne. Brugen af chartrede skibe reducerer risikoen i forbindelse med udsving i efterspørgslen. Den gennemsnitlige restløbetid for de indchartrede skibe var 2,4 år (2,7 år) for Maersk Line og 4,3 år (4,2 år) for Maersk Tankers.

I APM Terminals vedrører størstedelen af forpligtelserne fremtidige koncessionsafgifter for havnefaciliteter, hvoraf de fleste koncessionsaftaler løber længere end 20 år.

#### INVESTERINGSPROGRAM

Forpligtelser vedrørende køb af materielle aktiver udgjorde i alt DKK 78,1 mia. (DKK 84,9 mia.) pr. 31. december 2012 og vedrører hovedsagelig Maersk Line DKK 19,2 mia. (DKK 30,0 mia.), Maersk Drilling DKK 19,2 mia.

(DKK 17,4 mia.), Maersk Oil DKK 19,3 mia. (DKK 16,5 mia.) og APM Terminals DKK 18,3 mia. (DKK 16,3 mia.).

I alt omfatter ordrebogen 25 containerskibe, 7 breenheder og 12 andre skibe ved udgangen af året.

Forpligtelserne finansieres af en kombination af Gruppens fremtidige pengestrøm fra operationelle aktiviteter, lån til finansiering af specifikke aktiver og kommitterede lånefaciliteter.

#### REGNSKAB FOR MODERSELSKABET

Moderselskabets aktiviteter omfatter de globale containerfarter i Maersk Line, dele af offshore og anden skibsfart samt olie- og gasaktiviteterne i den danske sektor af Nordsøen. Herudover besiddes aktier i dattervirksomheder og i associerede virksomheder.

I moderselskabets regnskab værdiansættes aktier i dattervirksomheder og i associerede virksomheder til kostpris jf. note 1 med fradrag af nedskrivninger, og i resultatopgørelsen indgår udbytter fra dattervirksomheder og associerede virksomheder som indtægt.

Årets resultat var DKK 8,4 mia. (DKK 10,5 mia.), primært grundet lavere udbytter fra dattervirksomheder og associerede virksomheder samt forøgede finansielle udgifter, mens skat var lavere som følge af lavere resultat før skat.

Pengestrøm fra driftsaktiviteter var DKK 17,1 mia. (DKK 17,4 mia.). Væsentligste ændringer var fald i modtagne udbytter, delvist modsvaret af fald i betalte skatter.

Samlede aktiver pr. 31. december 2012 udgjorde DKK 278,5 mia. (DKK 262,8 mia) og egenkapitalen DKK 116,5 mia. (DKK 113,3 mia.).

#### A.P. Møller - Mærsk Gruppen

##### Aktionærforhold

I 2012 afholdt Gruppen sin første kapitalmarkedsdag. Med deltagelse af mere end 300 analytikere og investorer var det den største deltagelse på en kapitalmarkedsdag i Danmark.

#### AKTIEKURSUDVIKLING

Den samlede markedsværdi for A.P. Møller - Mærsk A/S' aktier var ved udgangen af 2012 DKK 180,4 mia.

Den 20. februar 2012 lukkede B-aktien på den højeste pris i 2012 på DKK 48.040 (for én DKK 1.000-aktie), og den 4. juni 2012 lukkede den på den laveste pris på DKK 35.220. Ved udgangen af 2012 var prisen DKK 42.600, hvilket svarer til en stigning på 12,3% i forhold til slutningen af 2011. Det samlede afkast af B-aktien til aktionærerne var 15,5% i 2012.

#### AKTIEKAPITAL

A.P. Møller - Mærsk A/S blev børsnoteret i 1982. Aktierne er noteret på NASDAQ OMX Copenhagen og er inddelt i to klasser: A-aktier med stemmeret og B-aktier uden stemmeret. Én A-aktie à DKK 1.000 giver to stemmer. Den 31. december 2012 bestod den

samlede aktiekapital på DKK 4.395,6 mio. af 4.395.600 aktier, ligeligt fordelt på A- og B-aktier. Der er ingen indskrænkninger i aktiernes omsættelighed.

#### EJERFORHOLD

A.P. Møller - Mærsk A/S havde mere end 75.000 private og institutionelle aktionærer ved udgangen af 2012. 41,22% af aktiekapitalen, svarende til 50,6% af stemmerne, ejes af A.P. Møller og Hustru Chastine Mc-Kinney Møllers Fond til almene Formaal. Derudover kontrollerer den stiftende familie yderligere 25,9% af stemmerne gennem forskellige fonde og privat ejerskab. Den frit flydende del af aktierne udgør 42% af aktiekapitalen.

I tillæg til den store fondsejede del har A.P. Møller - Mærsk A/S et fundament af internationale aktionærer. Ifølge en analyse af aktionærstrukturen, der blev udført i december 2012, er fordelingen af de frit flydende aktier følgende:

- 60% fra Danmark fordelt på:
  - 43% private og øvrige investorer
  - 17% institutionelle investorer
- 18% fra Nordamerika
- 8% fra Storbritannien
- 11% fra resten af Europa
- 3% fra resten af verden.

#### EGNE AKTIER

Gruppens beholdning af egne aktier udgør 0,7% af aktiekapitalen og besiddes blandt andet til dækning af det revolverende optionsprogram, jf. note 17 i det konsoliderede regnskab. **Bestyrelsen (SM)** kan i henhold til generalforsamlingens bemyndigelse i perioden frem til den 3. april 2016 lade Selskabet erhverve egne aktier inden for en samlet pålydende værdi af i alt 10% af Selskabets aktiekapital, jf. Selskabslovens § 198. Købsprisen må ikke afvige mere end 10% fra den på erhvervelsestidspunktet noterede kurs på NASDAQ OMX Copenhagen.

#### UDBYTTE

**Bestyrelsen (SM)** foreslår, at der udbetales udbytte til aktionærerne på DKK 1.200 pr. aktie à DKK 1.000 – i alt DKK 5.275 mio. (DKK 1.000 pr. aktie à DKK 1.000 – i alt DKK 4.396 mio.). Den foreslåede udbyttebetaling svarer til en udbytteprocent på 2,8% (2,6%) baseret på Mærsk B-aktiens lukkekurs pr. 31. december 2012. Udbetaling **forventes (hedge)** at finde sted 17. april 2013. Gruppen har til hensigt at fortsætte den historiske tendens til at øge det nominelle udbytte pr. aktie på baggrund af den underliggende indtjeningsstyrke.

#### FINANSKALENDER 2013

11. april: Ordinær generalforsamling

17. maj: Delårsrapport 1. kvartal

16. august: Delårsrapport 2. kvartal

13. november: Delårsrapport 3. kvartal

#### ORDINÆR GENERALFORSAMLING

Den ordinære generalforsamling afholdes i Svendborg den 11. april 2013.

#### INVESTOR RELATIONS

A.P. Møller - Mærsk A/S fortsætter udviklingen af virksomhedens informationsniveau og sikrer en konsistent, regelmæssig og relevant strøm af informationer om Gruppens aktiviteter, forretningsmæssige mål, strategier og resultater. Gruppens første kapitalmarkedsdag blev afholdt i oktober 2012.

For at sikre en løbende og åben dialog med investorer og analytikere afholder **ledelsen (SM)** i forbindelse med års- og delårsrapporter telekonferencer samt besøg hos investorer i Europa og USA. Investorer og analytikere har desuden mulighed for at kontakte Investor Relations afdelingen.

#### ANALYTIKERE OG INVESTOR WEBSITE

A.P. Møller - Mærsk A/S dækkes af **omkring (hedge)** 31 analytikere, herunder internationale investeringsbanker, der regelmæssigt udarbejder analyserapporter. En liste over analytikere, der dækker selskabet, kan ses på [http:// investor.maersk.com/da/index.cfm](http://investor.maersk.com/da/index.cfm). På hjemmesiden kan interesserede også finde oplysning om Selskabets aktiviteter, herunder årsrapporter, kalenderoversigt, investorpræsentationer, aktieinformation, corporate governance, oblogationsprogrammer, kontaklinformation m.v.

#### A.P. Møller - Mærsk Gruppen Risikostyring

Gruppen er udsat for en række forskellige risici på grund af dens globale tilstedeværelse og forskelligartede forretninger. Dette kræver en differentieret tilgang til risici, hvor de negative risici vurderes nøje og vejes op mod det positive potentiale, og hvor risici vurderes ud fra et porteføljeperspektiv.

#### RISIKOSTYRINGSPROCES

Styringen af Gruppens risici er forankret i en Enterprise Risk Management model, hvor de væsentligste risici og styring heraf konsolideres halvårligt i en oversigt. Oversigten gennemgås med Gruppens bestyrelse og daglige ledelse.

#### Strategiske risici

##### *Ulige vægt mellem udbud og efterspørgsel for Maersk Line*

Gruppens resultat er eksponeret over for svingninger i fragtrater for især Maersk Line primært grundet de strukturelle problemer, der eksisterer mellem udbud og efterspørgsel. For at afbøde effekten af disse risici differentierer Maersk Line sine produkter fra konkurrenterne for at opbygge kundeloyalitet og for at sikre rater og mængder. I perioder med for meget ledig tonnage er slow steaming, aflysning af afgang og ophugning af fartøjer blandt de tiltag, Maersk Line benytter sig af.

##### *Olie produktion*

Gruppens forventede fremtidige olieproduktion er stærkt afhængig af eksisterende produktion, fremgang i igangværende og planlagte udviklingsprojekter af olieletter og forlængelse af eksisterende licenser og kontrakter. En **klar (AM)** projektmodningsproces er blevet vedtaget. Yderligere fokuseres der på rekruttering af medarbejdere, samarbejde med interessenter og afvikling af ikke-kommercielle fund.

##### *Politiske risici*

Gruppens globale tilstedeværelse eksponerer både aktiver og indtjening over for geopolitiske begivenheder. Politiske handlinger som f.eks. handelsbarrierer, nye skatter, valutabegrænsninger, eksproprieringer m.v. **kan (hedge)** påvirke Gruppens resultat og pengestrøm. De **vigtigste (AM)** midler til at styre disse risici omfatter samarbejde med politiske organer og myndigheder, lokale partnerskaber, overvågning af lovforslag, virksomhedens sociale ansvar og spredning af geografiske risici.

#### Finansielle risici

##### *Likviditet*

Gruppen skal have tilstrækkelige, tilgængelige likvide beholdninger for at kunne finansiere sine drifts- og investeringsprogrammer og servicere sin gæld. Gruppen har en finansiell politik og overvåger nøje prognoser om pengestrømme, finansielle nøgletal og likviditetsreserver. Derudover bestræber Gruppen sig på at sikre finansiering, inden den binder sig til investeringer, ligesom den forsøger at sprede finansieringskilder gennem virksomhedsobligationer og private placeringer.

##### *Kreditrisiko*

Gruppen har eksponering mod finansielle og kommercielle modparter, men har ingen særlig koncentration af kunder eller leverandører. Gruppen minimerer kreditrisikoen ved at foretage en grundig finansiell vurdering af alle større kunder og finansielle institutioner, afkræve tilstrækkelig sikkerhedsstillelse fra kommercielle modparter, og sætte kreditbegrænsninger for finansielle institutioner og vigtige kommercielle modparter.

##### *Valutakurser*

Gruppens indkomst fra shipping- og olierelaterede aktiviteter er primært denomineret i USD, mens de tilsvarende udgifter er i både USD og en række andre valutaer.

Gruppen har valutasikringsprogrammer for at mindske risikoen fra valutaudsving.

#### Oliepris

Gruppen har væsentlige indtægter fra salg af olie og gas og har væsentlige omkostninger til brændstof. Begge poster er meget følsomme over for udsving i olieprisen (henholdsvis råoliepris og brændstofpris). Gruppen søger at overføre brændstofomkostninger til kunderne gennem BAF (Bunker Adjustment Factor). Nettoolieprisen overvåges nøje og styres på koncernniveau.

#### Operationelle risici

##### Større sikkerhedshændelser

Kontrol af risikoen for større sikkerhedshændelser er en integreret del af Gruppens forretninger, især i olieog offshore-segmenterne. Gruppen forsøger at mindske disse risici gennem uddannelse, sikkerhedssystemer til risikostyring, certificering og klassificering af udstyr og procedurer, kvalitetssikring og processer til vidensdeling på tværs af Gruppen. Når aktiviteter udføres i partnerskaber eller joint ventures, hvor Gruppen ikke har fuld kontrol over aktiviteterne, forsøger Gruppen at beskytte sine interesser og værdier gennem samarbejde og aktionæroverenskomster m.v.

##### Større miljøhændelser

Kontrol af risiko for større miljøhændelser er en integreret del af Gruppens forretninger, især i olie-, offshore- og tanksegmenterne. Gruppen forsøger at mindske denne risiko gennem uddannelse, sikkerhedssystemer til risikostyring, procedurer for olieudslip, medlemskab af beredskabsorganisationer for flere brancher, politik om dobbeltskrog og ved at have en begrænset egenkapitalandel i virksomheder i højrisikoområder. Hvis aktiviteter udføres i partnerskaber eller joint ventures, og Gruppen ikke har fuld kontrol over aktiviteterne, forsøger Gruppen konstant at beskytte sine interesser og værdier gennem samarbejde og aktionæroverenskomster m.v.

##### Krig, terrorisme eller piratangreb

Da Gruppen driver virksomhed globalt, er der risiko for, at den udsættes for krig, terrorisme eller piratangreb. De **vigtigste (AM)** forholdsregler er katastrofe- og beredskabsplaner, sikkerhedsforanstaltninger på kontorer, skibe og installationer, bevæbnede vagter på skibe, rejseplanlægning og -overvågning samt efterretninger.

#### Informationsrisici

Gruppens globale tilstedeværelse, størrelse og kompleksitet gør det nødvendigt at have de rigtige oplysninger på det rigtige tidspunkt, sikre beskyttede oplysningers integritet og forhindre, at fortrolige oplysninger videregives.

Dette sikres gennem sikkerhedspolitik for oplysninger, it-styring, tekniske kontrolforanstaltninger, brugeruddannelse og kampagner vedrørende informationssikkerhed og beredskabsplaner for fortsat drift.

#### Procedurer og kontroller

Kontinuerlig styrkelse af forretningsenhedernes konkurrenceevne, herunder kundefokus og omkostningsstyring, er af væsentlig betydning for Gruppens resultat og udvikling. I APM Terminals og Maersk Oil drives en del af forretningen gennem partnerskaber og joint ventures, hvor Gruppen ikke har fuld kontrol over alle aktiviteterne. Gennem samarbejdsaftaler og aktionæroverenskomster m.v. med blandt andet statslige samarbejdspartnere søges det så vidt muligt sikret, at Gruppen til stadighed kan beskytte varige interesser og værdier samt påvirke gennemførelse af tiltag til styrkelse af Gruppens konkurrenceevne og resultater.

#### Compliance risici

##### Menneskerettigheder

Det er en prioritet for Gruppen at overholde de globale menneskerettighedsstandarder i forbindelse med de nye forventninger og standarder, der er defineret af OECD for multinationale virksomheder. Gruppen har implementeret et program for ansvarligt indkøb, samt programmer for håndtering af sundhed og sikkerhed og for globale arbejdsprincipper, der skal minimere risikoen for manglende overholdelse.

#### Skat

Gruppen er underlagt en lang række forskellige skattelovgivninger i 130 lande, og der er risiko for uventede skatteudgifter på grund af usikkerhed i fortolkningen af lokale skatteregler eller manglende overholdelse heraf. Denne risiko minimeres ved at have implementeret specifikke skattepolitikker, samt vedligeholde en skatterisiko-database, og Gruppens centrale skattefunktion modtager regelmæssigt rapporter fra forretningsenhedernes og landeafdelingernes skatteafdelinger. I de væsentligste områder overvåger specialiserede skattemedarbejdere ændringer i skattelovgivning og reglerne for at sikre, at de bliver overholdt. I andre områder bliver Gruppen vejledt af eksterne rådgivere.

#### Antikorruption, konkurrence og eksportregulering

Manglende overholdelse af gældende lovgivning om antikorruption-, konkurrence- og eksportregulering **kan (hedge)** have en væsentlig negativ indvirkning på Gruppens finansielle resultater og omdømme. For at minimere denne risiko har Gruppen indført obligatorisk uddannelse i compliance, specifikke compliancepolitikker og -procedurer, et whistleblowersystem, en "hospitality book" til rapportering af gaver samt compliancerevision og -øvelser.

#### Nye risici

Gruppen har besluttet at yderligere undersøge og vurdere den potentielle indvirkning af følgende nye risici:

- Konsekvenser af fremkomsten af skiferolie/gas og dens indvirkning på Gruppens forretninger, især Maersk Oil, Maersk Drilling og Maersk Tankers
- Konsekvenser af nye, ændrede handelsmønstre og forbrugeradfærd og betydningen heraf for Maersk Line.

#### Forsikring

Gruppen forsikrer aktiver og forpligtelser på tværs af Gruppens forretningsportefølje i overensstemmelse med lovkrav og branche procedurer. Forsikringsgrænser og -beløb er baseret på de maksimalt påregnelige tab under hensyntagen til mulighed og pris.

Siden januar 2012 har Gruppen drevet sit eget interne forsikringsselskab, Maersk Insurance A/S. Maersk Insurance A/S gør det muligt for Gruppen at selvforsikre risici inden for parametre, der er fastlagt af Gruppens bestyrelse, og således at optimere Gruppens omkostninger til forsikringsegnede risici.

Maersk Insurance A/S forsikrer risici på tværs af Gruppens forretningsportefølje, fra skibe, olie- og gasinstallationer, borerigge til havne og terminaler.

#### A.P. Møller - Mærsk Gruppen God selskabsledelse

God selskabsledelse er et emne, som A.P. Møller - Mærsk A/S' bestyrelse løbende behandler med udgangspunkt i Selskabets aktiviteter, ydre rammer, historie og behov m.v.

#### ANBEFALINGER FOR GOD SELSKABSLEDELSE

Som dansk børsnoteret selskab skal A.P. Møller - Mærsk A/S overholde "Anbefalinger for god selskabsledelse" implementeret af NASDAQ OMX Copenhagen i "Regler for udstedere af aktier" samt Årsregnskabslovens § 107b.

**Bestyrelsen (SM)** i A.P. Møller - Mærsk A/S har udarbejdet en redegørelse om virksomhedsledelse for regnskabsåret 2012. Redegørelsen kan læses og downloades på: <http://investor.maersk.com/da/governancestatement.cfm>

Redegørelsen omfatter en gennemgang af, hvordan Selskabet forholder sig til hver enkelt anbefaling i "Anbefalinger for god selskabsledelse" og en beskrivelse af Selskabets ledelsesstruktur og af hovedelementerne i Gruppens interne kontrol- og risikostyringssystemer i forbindelse med Gruppens regnskabsaflæggelse.

#### LEDELSESSTRUKTUR

A.P. Møller - Mærsk A/S har en todelt ledelsesstruktur bestående af en bestyrelse og en direktion, hvilket er illustreret nedenfor. **Bestyrelsen (SM)** fastlægger de overordnede forretningsmæssige og ledelsesmæssige principper for Gruppen og drager omsorg for Gruppens forsvarlige organisation. Herudover beslutter **bestyrelsen (SM)** strategien og risikopolitikker samt overvåger arbejdet i Selskabet, dets resultater og direktion. **Direktionen (SM)** varetager den daglige ledelse.



I august 2012 besluttede **bestyrelsen (SM)**, at Firmaet A.P. Møller skulle fratræde som direktion pr. 1. januar 2013, og fra samme dato blev de nuværende medlemmer af Executive Board, Nils Smedegaard Andersen, Kim Fejfer, Claus V. Hemmingsen, Søren Skou, Jakob Thomsen og Trond Westlie registreret som direktion i A.P. Møller - Mærsk A/S. Indtil 1. januar 2013 bestod **direktionen (SM)** i A.P. Møller - Mærsk A/S af Firmaet A.P. Møller, et dansk interessentskab. Yderligere oplysninger fremgår af ovennævnte redegørelse.

A.P. Møller - Mærsk A/S

Ledelseshverv

Bestyrelsen:

Michael Pram Rasmussen Formand (f. 1955)

Indtrådt i bestyrelsen i 1999. Senest genvalgt i 2011. Valgperioden udløber i 2013. Tidligere Adm. direktør for Topdanmark A/S. Øvrige ledelseshverv m.v.: Coloplast A/S (formand); Topdanmark A/S (formand) og et datterselskab; Semler Holding A/S (formand) og et datterselskab; JPMorgan Chase International Council; Museumsfonden af 7. december 1966; Louisiana – Fonden. Anses som ikke uafhængig.

Niels Jacobsen Næstformand (f. 1957)

Indtrådt i bestyrelsen i 2007. Senest genvalgt i 2011. Valgperioden udløber i 2013. Adm. direktør for William Demant Holding A/S. Ledelseshverv i William Demant Gruppen: Formand for 44 datterselskaber; William Demant Invest A/S (Adm. direktør); Össur hf. (formand); HIMPP A/S (formand); HIMSA A/S (formand); HIMSA II A/S; Sennheiser Communications A/S. Øvrige ledelseshverv m.v.: LEGO A/S (formand); KIRKBI A/S (næstformand); Thomas B. Thriges Fond (formand). Anses som uafhængig.

Ane Mærsk Mc-Kinney Ugglå Næstformand (f. 1948) Indtrådt i bestyrelsen i 1991. Senest genvalgt i 2012. Valgperioden udløber i 2014.

Øvrige ledelseshverv m.v.: A.P. Møller og Hustru Chastine Mc-Kinney Møllers Fond til almene Formaal (formand); Maersk Broker A/S (formand); Maersk Broker K/S (formand); Estemco A/S (formand). Anses som ikke uafhængig.

Sir John Bond (f. 1941)

Indtrådt i bestyrelsen i 2008. Senest genvalgt i 2012. Valgperioden udløber i 2014. Tidligere formand for HSBC Holdings Plc. Øvrige ledelseshverv m.v.: Xstrata plc (formand); Shui On Land Limited; International Advisory Board of Mitsubishi Corporation; China Development Forum; International Business Leaders' Advisory Council to the Mayor of Shanghai; Kohlberg Kravis Roberts & Co. Asia Limited (formand); Endowment Board of Qatar Foundation; Advisory Director, Northern Trust Corporation; International Advisory Council Tsinghua University School of Economics & Management; International Advisory Council Chinese Banking Regulatory Commission; International Advisory Council Central Bank of the U.A.E. Anses som uafhængig.

Arne Karlsson (f. 1958)

Indtrådt i bestyrelsen i 2010. Senest genvalgt i 2012. Valgperioden udløber i 2014. Tidligere Adm. direktør for Ratos AB. Øvrige ledelseshverv m.v.: Bonnier Holding (formand) og et datterselskab; Ratos (formand); SNS (Center for Business and Policy Studies) (formand); Einar Mattsson; Ecolan; Swedish Securities Council. Anses som uafhængig.

Jan Leschly (f. 1940)

Indtrådt i bestyrelsen i 2000. Senest genvalgt i 2012. Valgperioden udløber i 2014. Formand og ledende partner for Care Capital LLC. Tidligere Adm. direktør for SmithKline Pharmaceuticals. Øvrige ledelseshverv m.v.: American Express Company; Vaxart Pharmaceuticals; Adjungeret professor ved CBS (Handelshøjskolen) i København. Anses som ikke uafhængig.

Leise Mærsk Mc-Kinney Møller (f. 1941)

Indtrådt i bestyrelsen i 1993. Senest genvalgt i 2011. Valgperioden udløber i 2013. Øvrige ledelseshverv m.v.: A.P. Møller og Hustru Chastine Mc-Kinney Møllers Fond til almene Formaal; Bramsløkke Landbrug A/S (formand); L. Møller Shipping ApS. Anses som ikke uafhængig.

Lars Pallesen (f. 1947)

Indtrådt i bestyrelsen i 2008. Senest genvalgt i 2012. Valgperioden udløber i 2014. Tidligere rektor, Danmarks Tekniske Universitet (DTU).

Øvrige ledelseshverv m.v.: Mogens Balslevs Fond (formand); Metricorr ApS (formand); Frederiksberg Gymnasium (formand); Technische Universität Münchens Institute for Advanced Study; Korean Advanced Institute of Science and Technology President's Advisory Council.

Anses som uafhængig.

John Axel Poulsen (f. 1946)

Indtrådt i bestyrelsen i 2008. Senest genvalgt i 2012. Valgperioden udløber i 2014. Kaptajn (medarbejder).

Ingen andre ledelseshverv m.v.

Anses som ikke uafhængig.

Erik Rasmussen (f. 1955)

Indtrådt i bestyrelsen i 2010. Senest genvalgt i 2012. Valgperioden udløber i 2014. Senior maskiningeniør (medarbejder).

Ingen andre ledelseshverv m.v.

Anses som ikke uafhængig.

Robert Routs (f. 1946)

Indtrådt i bestyrelsen i 2010. Senest genvalgt i 2012. Valgperioden udløber i 2014. Tidligere Adm. direktør for Royal Dutch Shell plc.

Øvrige ledelseshverv m.v.: Aegon NV (formand); KPN NV; DSM NV (formand); ATCO Group; AECOM. Anses som uafhængig.

Jan Tøpholm (f. 1946)

Indtrådt i bestyrelsen i 2001. Senest genvalgt i 2011. Valgperioden udløber i 2013. Adm. direktør i Widex A/S.

Øvrige ledelseshverv m.v.: Syv datterselskaber til Widex A/S; T & W Holding A/S og et datterselskab (formand); Widex Holding A/S (formand); AM Denmark A/S (formand); GSA Invest ApS (formand) og to datterselskaber.

Anses som uafhængig.

Direktionen:

Nils Smedegaard Andersen

Administrerende direktør (f. 1958)

Medlem af Executive Board siden 2007.

Øvrige ledelseshverv m.v.: F. Salling Holding A/S (formand); F. Salling Invest A/S (formand); Dansk Supermarked A/S (formand); Industria De Diseño Textil S.A. (Inditex); Danske Banks Rådgivende Repræsentantskab; DI's Erhvervspolitiske Udvalg; European Round Table of Industrialists; EU-Russia Industrialist's Round Table.

Kim Fejfer (f. 1965)

Medlem af Executive Board siden 2011.

Øvrige ledelseshverv m.v.: Global Ports Investments PLC (næstformand).

Claus V. Hemmingsen (f. 1962)

Medlem af Executive Board siden 2007.

Øvrige ledelseshverv m.v.: DFDS A/S (næstformand); Egyptian Drilling Company; International Association of Drilling Contractors (IADC); Danmarks Rederiforening (næstformand); Denmark Hong Kong Trade Association (formand); Danish Chinese Business Forum; EU-Hong Kong Business Co-operation Committee.

Søren Skou (f. 1964)

Medlem af Executive Board siden 2007.

Øvrige ledelseshverv m.v.: S. Skou Invest ApS.

Jakob Thomasen

(f. 1962)

Medlem af Executive Board siden 2009.

Øvrige ledelseshverv m.v.: Bestyrelsesmedlem i Dansk Arbejdsgiverforening.

Trond Westlie

(f. 1961)

Medlem af Executive Board siden 2010.

Øvrige ledelseshverv m.v.: Dansk Supermarked A/S (næstformand); F. Salling Holding A/S; Danske Bank A/S; Danmarks Skibskredit A/S; Subsea 7 Ltd.; Pepita AS; Shama A/S; Tønsberg Delikatesse AS.

## OM CHR. HANSEN

Chr. Hansen er en global biosciencevirksomhed, som udvikler naturlige ingredienser til fødevarer- og kosttilskudsbranchen, den farmaceutiske industri og landbrugssektoren. Chr. Hansen udvikler, producerer og sælger kulturer, enzymer, probiotika og naturlige farver, og alle løsninger er baseret på stærke forsknings og udviklingskompetencer kombineret med betydelige investeringer i teknologi.

## OMSÆTNING

Omsætningen i regnskabsåret 2011/12 var EUR 699 mio. Virksomheden er markedsførende inden for alle sine divisioner – Cultures & Enzymes, Health & Nutrition og Natural Colors – og har mere end 2.450 engagerede medarbejdere i 30 lande med hovedproduktionssteder i Danmark, Frankrig, USA og Tyskland. Chr. Hansen blev grundlagt i 1874 og er børsnoteret på NASDAQ OMX Copenhagen.

## KERNEKOMPETENCER

Chr. Hansens viden om bioscience og dens anvendelsesområder inden for kulturer og enzymer samt avancerede applikationsekspertise inden for naturlige farver er virksomhedens kernekompetencer og udgør det tekniske grundlag for produkterne. Chr. Hansen har opbygget sine markedspositioner ved hjælp af omfattende ekspertise, målrettet innovation, optimale forsyningskæder og langvarige kunderelationer. Chr. Hansens salgs-, marketing- og innovationsorganisationer yder en koordineret indsats og bidrager i tæt samarbejde med kunderne til at fremtidssikre produkter og processer.

## CULTURES & ENZYMES DIVISION

Cultures & Enzymes Division fremstiller kulturer, enzymer og probiotika til fødevarerbranchen generelt og især til mejeribranchen. Chr. Hansens ingredienser er med til at definere udseendet, smagen, næringsværdien og de sundhedsmæssige fordele samt produkt levetiden ved en lang række fødevarer. Udvikling af nye og forbedrede fødevarer sker i samarbejde med kunderne, mens Chr. Hansens innovative løsninger bidrager til at optimere kundernes produktion ved at forbedre udbyttet og sikre kvaliteten.

## HEALTH & NUTRITION DIVISION

Health & Nutrition Division fremstiller produkter til kosttilskuds-, håndkøbsmedicin-, modermælkserstatnings- og dyrefoderbranchen. Kerneproduktet er probiotiske kulturer med dokumenteret sundhedseffekt. Chr. Hansen opbygger på grundlag af egen forskning og i samarbejde med førende internationale forskere ny viden om probiotiske kulturers effekt på mennesker og dyr.

## NATURAL COLORS DIVISION

Natural Colors Division fremstiller løsninger inden for naturlige farver til fødevarerbranchen, især segmenterne drikkevarer, konfekture, is, mejeriprodukter, frugtblandinger og færdigretter. De naturlige farver udvindes fra en lang række naturlige kilder som bær, rødder og frø, og Chr. Hansen behersker mange indkapslingsteknikker, som er med til at stabilisere udseendet af farver til forskellige fødevarerapplikationer.

## HOVEDTAL 2011/12

- Omsætningen var EUR 699 mio., hvilket er en stigning på 10% sammenlignet med 2010/11
- Den organiske vækst var 8% (11% justeret for ændrede salgspriser som følge af ændringer i råvarepriserne på karmin)
- EBIT blev EUR 185 mio., hvilket er en stigning på 16% sammenlignet med 2010/11
- EBIT-marginen udgjorde 26,5% i forhold til 25,0% i 2010/11
- Selskabsskat udgjorde EUR 41 mio., svarende til en effektiv skatteprocent på 24% sammenlignet med 23% i 2010/11
- Årets resultat blev EUR 131 mio. (EUR 129 mio. ekskl. minoritetsinteresser) sammenlignet med EUR 119 mio. i 2010/11 (EUR 117 mio. ekskl. minoritetsinteresser)
- Årets resultat af fortsættende aktiviteter pr. aktie, udvandet, EUR 0,95, hvilket er en stigning på 14% i forhold til 2010/11
- Anlægsinvesteringerne udgjorde EUR 64 mio., svarende til 9,1% af omsætningen
- Forsknings- og udviklingsudgifterne udgjorde EUR 47 mio., svarende til 6,7% af omsætningen
- Nedskrivning på EUR 4 mio. relateret til klinisk studie på immunsystemet

- Nettodriftskapitalen var EUR 99 mio., svarende til 14,1% af omsætningen sammenlignet med EUR 98 mio. eller 15,3% af omsætningen pr. 31. august 2011
- De frie pengestrømme udgjorde EUR 113 mio., hvilket er en stigning på 8% i forhold til 2010/11 ekskl. frasolgte aktiviteter
- Den nettorentebærende gæld blev EUR 364 mio., svarende til 1,5x EBITDA sammenlignet med 1,7x EBITDA pr. 31. august 2011
- Pr. 31. august 2012 var i alt 2.348.789 aktier med en samlet transaktionsværdi på EUR 52 mio. blevet tilbagekøbt i henhold til aktietilbagekøbsprogrammet. Programmet blev afsluttet den 19. oktober 2012. Der blev i alt tilbagekøbt 3.534.244 aktier med en samlet transaktionsværdi på EUR 80 mio.
- For regnskabsåret 2011/12 foreslås et udbytte på EUR 0,39 (DKK 2,90) pr. aktie, svarende til EUR 52 mio. Udbyttet svarer til 40% af årets resultat.

## DISCLAIMER

### Udtalelser om fremtiden

Årsrapporten indeholder udtalelser om fremtiden. Sådanne udtalelser er forbundet med risiko og usikkerhed, da mange faktorer, hvoraf mange ligger uden for Chr. Hansen Holding A/S' kontrol, **kan (hedge)** betyde, at den faktiske udvikling og de faktiske resultater **kan (hedge)** adskille sig væsentligt fra forventningerne i årsrapporten.

## FORVENTNINGER

### FORVENTNINGER TIL 2012/13

#### Organisk omsætningsvækst

Den organiske vækst **forventes (hedge)** fortsat at blive drevet af stigende efterspørgsel efter sunde fødevarer og kosttilskud, konvertering fra bulk-starter produktion til industrielle kulturer og fra syntetiske til naturlige farver, efterspørgsel efter værdiskabende løsninger og fortsat innovation. Probiotiske kulturer til fermenterede mælkeprodukter **forventes (hedge)** fortsat at være under pres i EU. Der **forventes (hedge)** en organisk vækst på 7-9%.

Efter et fald i 2011/12 har råvarepriserne på den naturlige farve karmin stabiliseret sig, og den gennemsnitlige salgspris på karmin **forventes (hedge)** at være lavere end sidste år. Især i 1. kvartal **forventes (hedge)** salgspriserne at være noget lavere end i samme periode sidste år.

Hvis **man (EM)** ser bort fra den påvirkning, som ændringerne i råvarepriserne på karmin har på salgspriserne, **forventes (hedge)** den organiske vækst at være 8-10%.

Den organiske vækst i Cultures & Enzymes Division **forventes (hedge)** fortsat at være solid, men lavere end den stærke organiske vækst i 2011/12.

Health & Nutrition Division **forventes (hedge)** at opnå en organisk vækst på samme niveau som sidste år. Den organiske vækst **forventes (hedge)** dog at være svingende i årets løb på grund af timingen af ordrer.

Hvis **man (EM)** ser bort fra den påvirkning, som ændringerne i råvarepriserne på karmin har på salgspriserne, **forventes (hedge)** den organiske vækst i Natural Colors Division at være højere end sidste år som følge af den fortsatte konvertering til naturlige farver.

I Natural Colors Division **forventes (hedge)** den organiske vækst i 1. kvartal at blive negativt påvirket af timingen af ordrer og et stærkt 1. kvartal sidste år.

#### EBIT-margin

EBIT-marginen før særlige poster og nedskrivninger **forventes (hedge)** at være højere end sidste år som følge af Chr. Hansens skalérbare forretningsmodel.

#### Pengestrømme

Som følge af større investeringer i kapacitetsudvidelse **forventes (hedge)** anlægsinvesteringerne i procent af omsætningen at være højere end sidste år. De frie pengestrømme før virksomhedsopkøb og -salg **forventes (hedge)** at være på samme niveau som i 2011/12.

## LANGSIGTEDE FINANSIELLE AMBITIONER (3-5 ÅR)

Der **forventes (hedge)** en årlig organisk omsætningsvækst på 8-10%. EBIT-marginen før særlige poster **forventes (hedge)** at stige over de kommende 3-5 år, **forudsat (hedge)** at forretningssammensætningen forbliver uændret. De frie pengestrømme **forventes (hedge)** at stige over de kommende 3-5 år.

Chr. Hansen vil fortsat fokusere på innovation og forbedring af klinisk dokumentation, og forsknings- og udviklingsomkostningerne i procent af omsætningen **forventes (hedge)** at være på samme niveau som i 2011/12.

Forventningerne til 2012/13 og de langsigtede finansielle ambitioner er følsomme over for større ændringer i den globale økonomi, herunder dollarkursen og råvarepriser på naturlige farver, som **kan (hedge)** påvirke virksomhedens forventede resultat.

## REGNSKABSBERETNING

### OMSÆTNING

Omsætningen udgjorde EUR 699 mio., hvilket er en stigning på 10% i forhold til sidste år. Den organiske vækst på 8% blev negativt påvirket med 3 procentpoint af ændrede salgspriser som følge af ændringer i råvarepriserne på karmin.

Cultures & Enzymes Division tegnede sig for 60%, hvilket er uændret i forhold til sidste år, mens Natural Colors Division stod for 25% af omsætningen sammenlignet med 26% i 2010/11. Health & Nutrition Division stod for 15% af omsætningen sammenlignet med 14% sidste år.

### BRUTTORESULTAT

Bruttoresultatet steg med 16% til EUR 360 mio. i forhold til 2010/11. Bruttomarginen steg med tre procentpoint til 51.5%, primært drevet af effekten af lavere råvarepriser på karmin, positive valutakurseffekter og stordriftsfordele.

### OMKOSTNINGER

Omkostningerne udgjorde i alt EUR 175 mio. i forhold til EUR 150 mio. i 2010/11, svarende til en stigning på 17%.

Forsknings- og udviklingsomkostninger, inklusive afskrivninger og nedskrivninger udgjorde EUR 36 mio. Aktiverede udviklingsomkostninger udgjorde EUR 19 mio., hvilket er en stigning på EUR 3 mio. i forhold til 2010/11. Stigningen skyldtes kliniske studier til dokumentation af probiotiske sundhedsanprisninger. Et klinisk studie relateret til immunsystemet blev afsluttet i september 2012. De foreløbige analyser **indikerede (hedge)** positive effekter, men studiet har ikke kunnet genbekræfte de positive resultater fra det første immunstudie. Derfor vurderer Chr. Hansen, at de data, der er tilgængelige, er utilstrækkelige til at få godkendt en sundhedsanprisning af sundhedsmyndighederne i EU, hvilket resulterede i en nedskrivning af aktiverede udviklingsomkostninger med EUR 4 mio. Yderligere nedskrivninger vedrørte øvrige immaterielle aktiver.

De samlede forsknings- og udviklingsomkostninger beløb sig til EUR 47 mio., svarende til 6,7% af den samlede omsætning sammenlignet med 6,6% i 2010/11.

Salgs- og markedsføringsomkostningerne steg med 14% til EUR 90 mio. og udgjorde 12,8% af omsætningen i forhold til 12,4% i 2010/11. Administrationsomkostningerne steg med 12% til EUR 52 mio. og udgjorde 7,4% af omsætningen i forhold til 7,3% i 2010/11.

### RESULTAT AF PRIMÆR DRIFT (EBIT)

EBIT blev EUR 185 mio. sammenlignet med EUR 159 mio. i 2010/11. EBIT-marginen udgjorde 26,5%, hvilket er en stigning fra 25,0% sidste år, primært som følge af stordriftsfordele samt positive effekter af lavere karmin priser og udvikling i valutakurser. EBIT-marginen blev påvirket negativt af nedskrivning af aktiverede udviklingsomkostninger.

### FINANSIELLE POSTER OG SKAT

Netto finansielle omkostninger udgjorde EUR 13 mio. sammenlignet med EUR 11 mio. i 2010/11. Nettorenteomkostningerne faldt fra EUR 14 mio. i 2010/11 til EUR 11 mio. Renter på EUR 2 mio. blev kapitaliseret som låneomkostninger indeholdt i kostprisen på kvalificerende aktiver, dvs. aktiver, som det har taget mere end 12 måneder at færdiggøre. I 2010/11 var de kapitaliserede rentekomkostninger nul. I 2011/12 var nettoeffekt af valutakursreguleringer nul sammenlignet med positive valutakursreguleringer på EUR 5 mio. i 2010/11.

Skat udgjorde EUR 41 mio. sammenlignet med EUR 34 mio. i 2010/11, svarende til en effektiv skatteprocent på 24% sammenlignet med 23% sidste år.

## ÅRETS RESULTAT

Årets resultat steg til EUR 131 mio. fra EUR 119 mio. i 2010/11 som følge af et bedre resultat af primær drift.

## AKTIVER

Pr. 31. august 2012 udgjorde de samlede aktiver EUR 1.343 mio. mod EUR 1.353 mio. sidste år.

De samlede anlægsaktiver steg med EUR 27 mio. til EUR 1.083 mio. Stigningen skyldes aktivering af udviklingsomkostninger og investeringer i ny pakke- og frysetørringskapacitet samt etablering af produktionsfaciliteter til den nye naturlige farve Ultra Stable Red™.

De samlede aktiver udgjorde EUR 260 mio. i forhold til EUR 297 mio. sidste år. Varebeholdningerne steg med EUR 5 mio., mens tilgodehavender fra salg steg med EUR 1 mio. De likvide beholdninger faldt med EUR 58 mio. til EUR 61 mio.

Pr. 31. august 2012 udgjorde nettodriftskapitalen EUR 99 mio., svarende til 14,1% af omsætningen i forhold til EUR 98 mio. eller 15,1% af omsætningen pr. 31. august 2011.

## EGENKAPITAL

Pr. 31. august 2012 udgjorde den samlede egenkapital ekskl. minoritetsinteresser EUR 655 mio. i forhold til EUR 641 mio. pr. 31. august 2011.

Der blev i 2011/12 udbetalt et udbytte på EUR 65 mio. for regnskabsåret 2010/11.

## NETTOGÆLD

Pr. 31. august 2012 udgjorde den nettorentebærende gæld EUR 364 mio., svarende til 1,5x EBITDA i forhold til 1,7x EBITDA pr. 31. august 2011. Justeret for et foreslået udbytte på EUR 52 mio. og inkluderet effekten af tilbagekøbte aktier i forbindelse med aktietilbagekøbs programmet i perioden efter 31. august 2012 på EUR 28 mio. **ville (hedge)** den nettorentebærende gæld have været 1.9x EBITDA.

Ultimo året var **ca. (hedge)** 62% af gælden sikret med fast rente. Den samlede gæld har en gennemsnitlig løbetid på 2,9 år sammenlignet med 4,2 pr. 31. august 2011.

## AFKAST AF INVESTERET KAPITAL, EKSKL. GOODWILL (ROIC)

Afkastet af den investerede kapital (ekskl. goodwill og justeret for frasalg) udgjorde 34,1% sammenlignet med 30,0% i 2010/11. Stigningen skyldes forbedrede afkast i alle tre divisioner.

## PENGESTRØMME

Pengestrømme fra driftsaktivitet udgjorde EUR 176 mio. sammenlignet med EUR 150 mio. i 2010/11. Stigningen skyldes et højere resultat af primær drift og mindre negative ændringer i nettodriftskapitalen, der delvist blev udlignet af en stigning i betalte skatter, som samlet beløb sig til EUR 43 mio. i forhold til EUR 21 mio. i 2010/11.

Pengestrømme fra investeringsaktivitet udgjorde EUR 63 mio. sammenlignet med EUR 26 mio. i 2010/11, hvor sidstnævnte var lavere grundet et provenu på EUR 19 mio. fra salget af Functional Blends-aktiviteterne. De største investeringer i 2011/12 omfattede en udvidelse af pakke- og frysetørringskapaciteten til kulturer, kliniske studier og etablering af produktionsfaciliteter til den naturlige farve Ultra Stable Red™. De samlede aktiverede udviklingsomkostninger udgjorde EUR 19 mio. i forhold til EUR 16 mio. sidste år. Anlægsinvesteringerne udgjorde 9,1% af omsætningen mod 7,1% sidste år.

Frie pengestrømme udgjorde EUR 113 mio. i 2011/12 sammenlignet med EUR 125 mio. eller EUR 105 mio. ekskl. frasolgte aktiviteter sidste år.

## GLOBAL SALES

Chr. Hansens rentable vækst bygger på en kunde- og branchefokuserede strategi samt en stærk global salgsorganisation. **Ca. (hedge)** 670 medarbejdere eller 28% af samtlige medarbejdere arbejder med salg og marketing.

Chr. Hansen **ønsker (AM)** at udvikle langvarige strategiske leverandørrelationer til en bredt sammensat kundebase. I 2011/12 tegnede de 25 største kunder sig for **ca. (hedge)** 31% af omsætningen, hvilket var uændret i forhold til sidste år.

Salgs- og markedsføringsomkostningerne steg med 14% til EUR 90 mio. i forhold til EUR 79 mio. sidste år og udgjorde 12,8% af omsætningen i forhold til 12,4% sidste år.

#### OMSÆTNING FORDELT PÅ REGIONER

**Vores (SM)** salgsaktiviteter er opdelt i fire regioner: Europa, Nordamerika, Sydamerika og Asien/Stillehavsområdet, Mellemøsten og Afrika (APMEA).

##### Europa

(46% af den samlede omsætning i 2011/12 sammenlignet med 51% i 2010/11)

Organisk vækst var 1% i 2011/2012 (4% justeret for ændrede salgspriser som følge af ændringer i råvarepriserne på karmin), mens omsætningen målt i EUR var uændret. Salget af kulturer til fermenterede mælkeprodukter bidrog med en **god (AM)** organisk vækst. Salget af probiotiske kulturer faldt som følge af den

fortsatte usikkerhed om adgangen til at anvende sundhedsanprisninger på fødevarerprodukter i EU og bidrog dermed negativt til den organiske vækst. Enzymer oplevede solid vækst. Omsætningen af naturlige farver faldt, som følge af lavere karminpriser og – mængder. Faldet blev delvist opvejet af fortsat konvertering til naturlige farver i andre farvetyper.

##### Nordamerika

(24% af den samlede omsætning i 2011/12 sammenlignet med 21% i 2010/11)

Omsætningen steg med 24% med en organisk vækst på 17% (17% justeret for ændrede salgspriser som følge af ændringer i råvarepriserne på karmin). Lanceringen af bio protective-kulturer bidrog til den kraftige vækst i kulturer til fermenteret mælk.

Kulturer til ost, human health- og animal health-produkter leverede også stærk vækst. Konverteringen til naturlige farver steg fortsat i Nordamerika, hvor den organiske vækst var drevet af annatto-baserede produkter.

##### Sydamerika

(13% af den samlede omsætning i 2011/12 sammenlignet med 12% i 2010/11)

Omsætningen steg med 18%, svarende til en organisk vækst på 22% (26% justeret for ændrede salgspriser som følge af ændringer i råvarepriserne på karmin). Trods den negative effekt af lavere karminpriser fortsatte den stærke organiske vækst i naturlige farver i regionen hjulpet af større kontrakter i 2011/12. Cultures & Enzymes Division opnåede også en stærk vækst.

##### Asien/Stillehavsområdet, Mellemøsten og Afrika (APMEA)

(17% af den samlede omsætning i 2011/12 sammenlignet med 16% i 2010/11)

Omsætningen steg med 16%, svarende til en organisk vækst på 10% (12% justeret for ændrede salgspriser som følge af ændringer i råvarepriserne på karmin). Regionen opnåede **god (AM)** vækst i alle divisioner.

#### CULTURES & ENZYMES DIVISION

(60% af omsætningen)

Cultures & Enzymes Division udvikler, producerer og sælger kulturer, enzymer og probiotika til fødevarerbranchen generelt og mejeribranchen i særdeleshed. Chr. Hansens ingredienser er med til at definere udseendet, smagen, næringsværdien, de sundhedsmæssige fordele og produktlevetiden for en lang række fødevarer. Derudover hjælper Chr. Hansen også med at optimere kundernes produktionsprocesser samt at øge udbyttet og forbedre kvaliteten.

#### GENERELLE TENDENSER

Chr. Hansen er godt rustet til at drage fordel af tre globale megatendenser: Den globale vækst i industrifødevarerproduktionen, øget fokus på sundhed og velvære samt efterspørgsel fra forbrugerne på de nye markeder. Forbrugerne efterspørger større

funktionalitet i de føde- og drikkevarer, de indtager, og mere avancerede egenskaber med hensyn til f.eks. smag, konsistens og sundhedsmæssige fordele.

Det globale forbrug af fermenterede mælkeprodukter og ost fortsatte med at vokse. Væksten drives af stigningen i efterspørgslen efter sunde fødevarer – ikke mindst i udviklingslandene.

Konverteringen fra egen bulk starterproduktion til industrielle kulturer, der fremstilles ved hjælp af DVS-teknologi, fortsatte i 2011/12., Mejerikulturer og enzymer til fremstilling af ost og fermenteret mælk, der hjælper kunderne med at forbedre udbyttet, lancere nye produkter og forbedre holdbarheden, oplevede fortsat vækst.

Probiotiske kulturer til fermenterede mælkeprodukter har været negativt påvirket af den fortsatte usikkerhed om EU-processen i forbindelse med godkendelse af sundhedsanprisninger igennem de sidste to år (**læs (EM)** mere under Forskning & Udvikling).

#### Innovation

I Cultures & Enzymes Division ligger hovedvægten på udvikling af innovative kundeløsninger gennem nye eller forbedrede fødevarekulturer og enzymer til mejeribranchen samt til kød- og vinprodukter.

Nye innovative løsninger udvikles **ofte (hedge)** i samarbejde med kunderne. Der er i 2011/12 lanceret en række nye produkter (**læs (EM)** mere under Forskning & Udvikling).

#### OMSÆTNING

Omsætningen i Cultures & Enzymes Division steg med 11% til EUR 420 mio. i 2011/12, svarende til en organisk omsætningsvækst på 10%. Divisionens organiske vækst blev primært drevet af øget salg af kulturer til fermenterede mælkeprodukter og ost, som i alt tegnede sig for mere end 50% af divisionens samlede omsætning. Fortsat konvertering og produktinnovation bidrog til væksten. Især bidrog lanceringen af nye bio protective-kulturer positivt til væksten.

Den organiske vækst blev negativt påvirket af en tilbagegang i salget af probiotiske kulturer i Europa, der især skyldes usikkerhed om adgangen til at anvende sundhedsanprisninger på fødevarer i EU. Nedgangen i salget af probiotiske kulturer i Europa såvel som en mindre nedgang i Nordamerika blev mere end udlignet af den gode vækst i APMEA og Sydamerika. Det samlede salg af probiotiske kulturer for perioden var en anelse over samme periode sidste år. Probiotiske kulturer tegnede sig for **ca. (hedge)** 20% af omsætningen.

Enzymer, der udgjorde **ca. (hedge)** 20% af omsætningen, opnåede en solid organisk vækst i forhold til sidste år.

Kød- og vinkulturer udgjorde mindre end 10% af omsætningen. Kødkulturer opnåede kraftig vækst, mens vinkulturer leverede **god (AM)** vækst.

#### EBIT

EBIT var EUR 120 mio. i 2011/12 eller 8% højere end sidste år. EBIT-marginen for 2011/12 var 28,5% mod 29,4% sidste år. Nedgangen var drevet af nedskrivninger på EUR 2 mio. der var relateret til kliniske studier af immunsystemet, mens stordriftsfordele blev udlignet af en stigning i transportomkostninger og omkostninger til outsourcing af frysetørring.

#### AFKAST AF GENNEMSNITLIG INVESTERET KAPITAL EKSKL. GOODWILL (ROIC)

Afkastet af den investerede kapital (ekskl. goodwill) var 31,8% i 2011/12 sammenlignet med 29,7% i 2010/11. Investeret kapital (ekskl. goodwill) var uændret sammenlignet med sidste år.

#### HEALTH & NUTRITION DIVISION

(15% af omsætningen)

Health & Nutrition Division udvikler, producerer og sælger produkter til kosttilskuds-, håndkøbsmedicin-, modernælkserstatnings- og dyrefoderbranchen. Kerneproduktet er probiotiske kulturer med dokumenteret sundhedseffekt. **Vi (SM)** opbygger på grundlag af egen forskning og i samarbejde med førende internationale forskere ny viden om og dokumentation for effekten af probiotiske kulturer på mennesker og dyr.

#### GENERELLE TENDENSER

Human health



De generelle markedsvilkår for probiotiske kosttilskud til mennesker var fortsat gunstige i 2011/12, men som følge af en koncentreret kundebase afhænger salget af, at de største kunder fører specialkampagner.

I de sidste par år er reglerne for probiotika inden for området Human Health & Nutrition blevet skærpet med hensyn til kvaliteten af produktdokumentation for sundhedsmæssige fordele – især inden for EU. Chr. Hansen investerer løbende i at opnå klinisk dokumentation for de sundhedsmæssige fordele ved probiotiske stammer for at fastholde kunderne og tiltrække nye, og som den førende aktør på markedet har Chr. Hansen nogle af de bedst dokumenterede stammer i sin produktportefølje (**læs (EM)** mere under Forskning & Udvikling).

#### Animal health

Stærk fokus på forbedring af sundheden og reduktion af dødeligheden i husdyrbesætninger for at øge produktionen er med til at fremme indførelsen af flere probiotiske foderkoncepter på verdensplan. Både markedet for probiotiske koncepter i dyrefoder og markedet for ensileringsmidler oplevede vækst i 2011/12.

#### Innovation

**Vi (SM)** har udviklet teknologiplatforme i verdensklasse – fra stammescreening til udvikling og produktformulering – som alle lever op til de farmaceutiske standarder og har til formål at dokumentere virkningen og sikkerheden af **vores (SM)** probiotiske produkter samt at identificere nye probiotiske stammer. Der er i 2011/12 lanceret en række nye produkter (**læs (EM)** mere under Forskning & Udvikling).

#### OMSÆTNING

Omsætningen i Health & Nutrition Division steg med 18% til EUR 107 mio. i 2011/12, svarende til en organisk omsætningsvækst på 13%.

Human health-produkter, der tegner sig for **omkring (hedge)** 60% af omsætningen i divisionen, oplevede solid vækst drevet af nye kundeprojekter.

Animal health-produkter, der tegnede sig for **ca. (hedge)** 40% af omsætningen i divisionen, leverede kraftig vækst. Markedsandelen for probiotiske kulturer til Direct Fed Microbials steg inden for segmenterne fjerkræ, svin og køer, mens ensileringsmidler opnåede stærk vækst trods tørken i USA.

#### EBIT

EBIT var EUR 38 mio. i 2011/12 i forhold til EUR 30 mio. sidste år, svarende til en stigning på 24%. EBIT-marginen steg til 35,0% fra 33,4% i 2010/11. Forbedringen var drevet af skalérbarhedseffekter fra det øgede salg, produktivitetsforbedringer og positive valutakurseffekter. En nedskrivning på EUR 3 mio. var primært relateret til kliniske studier af immunsystemet, hvilket havde en negativ effekt på marginen.

#### AFKAST AF GENNEMSNITLIG INVESTERET KAPITAL EKSKL. GOODWILL (ROIC)

Afkastet af den investerede kapital (ekskl. goodwill) var 39,1% i 2011/12 mod 33,6% sidste år. Den investerede kapital (ekskl. goodwill) steg med EUR 10 mio. eller 11% i forhold til 2010/11, primært som følge af investeringer i ny frysetørningskapacitet og kliniske studier af probiotiske kulturer.

#### NATURAL COLORS DIVISION

(25% af omsætningen)

#### NATURAL COLORS DIVISION

Natural Colors Division udvikler, producerer og sælger løsninger inden for naturlige farver til fødevarebranchen, især segmenterne drikkevarer, konfekturer, is, mejeriprodukter, frugtblandinger og færdigretter. Farverne udvindes fra en lang række naturlige kilder som bær, rødder og frø, og Chr. Hansen behersker mange indkapslingsteknikker, som er med til at stabilisere udseendet af farver til forskellige fødevareapplikationer.

#### GENERELLE TENDENSER

##### Konvertering

Der var **god (AM)** vækst i markedet for naturlige farver til føde- og drikkevarer i 2011/12 efter en meget stærk udvikling i 2010/11. Myndighedernes krav til mærkning af visse syntetiske farver samt øget efterspørgsel i befolkningen efter naturlige produkter medførte en fortsat konvertering fra syntetiske farver til naturlige farver i 2011/12. Konverteringen skete især i Sydamerika, Europa og Asien, mens Nordamerika oplevede en lidt svagere tendens. Konverteringen skete især i de hurtigt ekspanderende, globale fødevarevirksomheder inden for drikkevarer og konfektur. Med sin stærke markedsposition og store udbud af produktløsninger var Chr. Hansen godt rustet til at drage fordel af denne tendens, og salgsmængderne steg mere end 10% i 2011/12.

#### Indkøb

Efter at der i det meste af 2010/11 var mangel på råvarer til karmin, steg udbuddet i 2011/12 i takt med øget råvareproduktion. Dette medførte et fald i priserne til en gennemsnitspris på **ca. (hedge)** USD 30/kg mod en gennemsnitspris på USD 100/kg i 2010/11. Som følge af den stærke konverteringsrate til naturlige farver i 2011/12 er indkøbet af visse andre råvarer end karmin kommet under øget pres, hvilket har medført højere priser på disse råvarer.

#### Innovation

Chr. Hansens forskning og udvikling fokuserer på at introducere nye pigmenter fra frugt, grøntsager, rødder og frø, som **kan (hedge)** tilføre nye egenskaber og øget værdi til **vores (SM)** kunders applikationer, og på at introducere nye produkter og produktionsprocesser, der kan sætte nye industristandarder for naturlighed og funktionalitet. Der blev i 2011/12 lanceret en række nye produkter (**læs (EM)** mere under Forskning & Udvikling).

#### OMSÆTNING

Omsætningen i Natural Colors Division steg med 3% til EUR 172 mio. i 2011/12, svarende til en organisk omsætningsvækst på 2% (12% justeret for ændrede salgspriser som følge af ændringer i råvarepriserne på karmin). Der var kraftig vækst i **næsten (hedge)** alle produktområder bortset fra karmin, der oplevede et markant fald i salgspriserne og mindre mængder. Divisionens organiske vækst blev drevet af den fortsatte konverteringstendens, hvor syntetiske farver udskiftes med naturlige farver, kombineret med **vores (SM)** tilstedeværelse hos markedsledende kunder. Konverteringen til naturlige farver fortsatte i alle regioner, dog mest markant i Sydamerika og Europa.

#### EBIT

EBIT var EUR 28 mio. i 2011/12 i Natural Colors Division, hvilket er en stigning på EUR 10 mio. eller 58% i forhold til sidste år. EBITmarginen for 2011/12 var 16,1% sammenlignet med 10,5% sidste år. Forbedringen af EBITmarginen skyldes en forbedret margin på karmin, der især var drevet af ændrede salgspriser som følge af ændringer i råvarepriserne samt skalérbarhedseffekten af de større salgsmængder.

#### AFKAST AF GENNEMSITLIG INVESTERET KAPITAL EKSKL. GOODWILL (ROIC)

Afkastet af den investerede kapital (ekskl. goodwill) var 40,5% sammenlignet med 27,6% sidste år. Den investerede kapital (ekskl. goodwill) steg med EUR 6 mio. eller 8% i forhold til 2010/11, primært som følge af investeringer i produktionsfaciliteter til den naturlige farve Ultra Stable Red™.

#### FORSKNING & UDVIKLING

##### INNOVATION

Chr. Hansen brugte 6,7% af omsætningen på forskning og udvikling (F&U) i 2011/12, og mere end 300 medarbejdere var beskæftiget inden for F&U og tekniske applikationsaktiviteter, hvilket gør innovation til en hjørnesten i virksomheden. Chr. Hansen fortsætter med at investere betydeligt i dette område for at udvikle nye produkter og koncepter, der giver kunderne mulighed for at blive mere omkostningseffektive eller lancere nye innovative produkter, samt for yderligere at forbedre **vores (SM)** kliniske dokumentation af sundhedsanprisninger af probiotiske kulturer.

##### Bioscience-plattform

Størstedelen af Chr. Hansens produktinnovation stammer fra stærke bioscience-baserede teknologiplatforme, som bygger på omfattende videnskabelig indsigt og kompetence. Chr. Hansen har en af verdens største kommercielle samlinger af bakteriestammer med mere end 10.000 mælkesyrebakteriestammer. På grundlag af denne samling screenes, udvælges og forbedres bakteriekulturer, så de opfylder bestemte krav til slutproduktet, uanset om det drejer sig om fødevarer, kosttilskud eller foder.

**Vi (SM)** hjælper kunderne lokalt

Chr. Hansen har 19 applikations- og udviklingscentre rundt om i verden, som muliggør udvikling af nye produkter i tæt samarbejde med kunderne med henblik på at dække deres behov lokalt. Disse centre tilbyder også målrettet teknisk service.

#### Samarbejde

Chr. Hansen samarbejder aktivt med forskere og virksomheder om innovative projekter inden for **vores (SM)** ekspertiseområder. Samarbejde **kan (hedge)** indgås i alle faser af et projekt – fra fælles forskning i de tidlige udviklingsfaser til licensaftaler om fuldt udviklede produkter. I 2011/12 indgik Chr. Hansen bl.a. en samarbejdsaftale med Amino UP Chemical Co., Ltd. (Japan) om udvikling af kosttilskud, der kombinerer probiotiske kulturer med naturlige plantebaserede ingredienser.

#### Ny innovation

En række nye produkter blev introduceret i 2011/12, herunder produkter, der hjælper kunderne med at forbedre udbyttet, lancere nye innovative produkter, konvertere til DVSkulturer og reducere affald. Det fortsatte fokus på investering i forskning og udvikling giver Chr. Hansen en bred platform, der sikrer fremtidig vækst.

Lanceringen af nye produkter omfatter:

#### Cultures & Enzymes Division

- L. casei 431® Juice-probiotika til afkølet frugtjuice
- DVS® SafeIT™-kultur med bakteriofag modstandsdygtighed til oste af fetatypen, der forbedrer smag, konsistens og holdbarhed
- Fresco® 3000-kulturer, der øger udbyttet af hytteost
- OpenITM PS-60-kultur til hurtig og kontrolleret øjeformation (formation af huller) i schweiziske oste
- Nye YoFlex® og probiotiske nu-trish® yoghurtkulturer, herunder kulturer til fedtfattige produkter og græsk yoghurt
- FreshQ® bio protective-kulturer

#### Health & Nutrition Division

- Probiotisk tyggetablet, der kombinerer Lactobacillus L. casei 431® med C-vitamin
- Probiotisk pulver-”stick” med Lactobacillus rhamnosus LGG® og oral rehydreringsløsning

#### Natural Colors Division

- I-Colors™-sortiment af naturlige farver til pulverlæskedrikke
- Ny FruitMax®-sortiment af farvende fødevarer til forskellige konfekturanvendelsesområder
- Ultra Stable Red™ anthocyaninløsning til naturlig farvning af røde drikkevarer

Produkter udviklet inden for de seneste tre år tegnede sig for 14% af omsætningen i 2011/12 mod 15% i 2010/11.

#### IP-RETTIGHEDER

En stærk og beskyttet teknologiplatform er afgørende for Chr. Hansen. For at kunne understøtte en vedvarende og rentabel vækst i virksomheden sikres viden og teknologiplatforme gennem patenter. Både nye og eksisterende produkter søges beskyttet gennem strategiske varemærkeansøgninger. I 2011/12 blev der indsendt 25 varemærkeansøgninger.

#### EFSA – SUNDHEDSANPRISNINGER

Chr. Hansen har fermenteret mælkesyrebakterier i mere end 100 år og har leveret klinisk dokumenterede probiotiske kulturer til fødevarer-, kosttilskuds- og modernælkserstatningsbranchen samt landbrugssektoren siden 1980'erne. Regeringer og myndigheder, ikke mindst Den Europæiske Fødevarer sikkerhedsmyndighed (EFSA) i EU, er imidlertid i gang med at indføre strengere regler for dokumentation af sundhedsanprisninger af fødevarerrelaterede produkter.

EFSA, fik i 2007 mandat af EU-Kommissionen til at iværksætte en proces til vurdering af, om sundhedsanprisninger på fødevarer er videnskabeligt korrekte. I henhold til EU-Kommissionens forordning om ernærings- og sundhedsanprisninger kan anprisninger foretages i henhold til enten artikel 13.1 eller 13.5. For så vidt angår probiotiske produkter er anprisninger i henhold til artikel 13.1 generiske og omfatter alle anprisninger fra før 2008. Anprisninger i henhold til artikel 13.5 er derimod specifikt relateret til en bestemt bakteriestamme baseret på nye videnskabelige beviser. Der kan anmodes om beskyttelse af ejendomsretlige data for anprisninger i henhold til artikel 13.5.

Anprisninger i henhold til artikel 13.1

I maj 2012 godkendte EU-Parlamentet listen over tilladte sundhedsanprisninger i henhold til artikel 13.1. Som følge heraf udløber overgangsperioden for afviste sundhedsanprisninger af fødevarer i henhold til artikel 13.1 den 14. december 2012, hvorefter disse sundhedsanprisninger ikke længere kan anvendes. Ingen sundhedsanprisninger af probiotiske kulturer er blevet godkendt i henhold til artikel 13.1.

#### Anprisninger i henhold til artikel 13.5

Processen har vist, at godkendelse af sundhedsanprisninger af probiotiske skal ske i henhold til artikel 13.5. I 2010 indledte Chr. Hansen et klinisk studieprogram. Programmet har til formål at styrke dokumentationen af de positive effekter af to af de vigtigste probiotiske stammer på immunsystemet og mave-tarm funktionen. I tillæg til disse studier indgår Chr. Hansen i en række partnerskaber med udvalgte kommercielle partnere og universiteter om kliniske forsøg.

#### Immunsystemet

Det første studie på immunsystemet blev afsluttet succesfuldt - og resultaterne offentliggjort - i september 2011. På baggrund af de positive resultater iværksatte Chr. Hansen et nyt immunstudie, hvilket delvist blev offentliggjort i september 2012. De foreløbige analyser **indikerer (hedge)** positive effekter af den probiotiske stamme, men studiet har ikke kunnet genbekræfte de positive resultater fra det første immunstudie. Chr. Hansen vurderer, at de data, der p.t. er tilgængelige, er utilstrækkelige til at få godkendt en sundhedsanprisning af sundhedsmyndighederne i EU. Dette understreger udfordringerne i at generere den dokumentation, der kræves af EU's myndighed for fødevarer (EFSA), for at de kan godkende de positive effekter af kosttilskud – at dokumentere sundhedsfremmende virkninger hos en **generelt (hedge)** rask population. Chr. Hansen vil nu vurdere mulighederne for at bestemme de næste aktiviteter på immunområdet.

#### Mave-tarm funktionen

Kliniske studier, der bygger på validerede spørgeskemaer, og som undersøger effekterne af probiotiske stammer på mave-tarm funktionen, fortsætter som planlagt. De første resultater **forventes (hedge) omkring (hedge)** årsskiftet 2012/13.

#### CORPORATE SOCIAL RESPONSIBILITY

##### CSR-AMBITIONER for 2019/20

Chr. Hansen fokuserer på strategiske CSRprojekter, der understøtter udviklingen af **vores (SM)** forretning. **Vores (SM)** CSR-komité, der er forankret i **topledelsen (SM)**, sætter den overordnede kurs for politikker, strategier og mål, som implementeres via globale og lokale ledelsessystemer baseret på internationalt anerkendte standarder som FSSC 22000 og ISO 14001.

Chr. Hansen **ønsker (AM)** i samarbejde med kunder, leverandører og andre interessenter at løse CSR-relaterede spørgsmål. Samarbejdet har **ofte (hedge)** til formål at øge udbyttet, forbedre næringsværdien, optimere forsyningskæden og opfylde kundernes forventninger om sikre produkter, sundhedsfordele samt naturlig og **god (AM)** smag kombineret med lavt fedtindhold mv., der alt sammen er i overensstemmelse med Chr. Hansens vision om at forbedre fødevarer og sundhed i hele værdikæden.

Med henblik på at fremme integrationen af CSR i forretningen har Chr. Hansen opsat **klare (AM)** mål for 2019/20 inden for følgende områder: produksikkerhed og -kvalitet, medarbejderudvikling og -velfærd, bæredygtigt indkøb, samfundsengagement, ressourceeffektivitet, forureningsforebyggelse samt afbødning af og tilpasning til klimaændringer.

Principperne i FN's Global Compact er fortsat centrale i Chr. Hansens CSR-indsats, og virksomhedens politikker, mål og handlinger er i overensstemmelse med de 10 principper i FN's Global Compact.

Chr. Hansen arbejder på at udvikle organisationen ved at sætte fokus på mangfoldighed med henblik på at skabe den størst mulige talentpool til rekruttering. CSRstrategien og ambitionerne for 2020 er blevet opdateret med mål for mangfoldighed og inklusion. Resultaterne måles primært i forhold til mål for køn, nationalitet og alder på tværs af organisationen, også på ledelsesniveau.

#### PRODUKTSIKKERHED OG -KVALITET

Høj produksikkerhed og dermed forbrugersikkerhed er en hjørnesteen i Chr. Hansen som leverandør til fødevarer- og dyrefoderbranchen samt den farmaceutiske industri. Overholdelse af reglerne og de strengeste standarder har været udgangspunktet for ISO 22000- certificeringsarbejdet i Chr. Hansen. Foreløbig er 12 produktionssteder blevet FSSC 22000- certificeret, og det er **vores (SM)** mål, at alle produktionssteder skal være certificeret inden udgangen af 2013.

Ved udgangen af 2011/12 blev **vores (SM)** mål for produksikkerhed revideret for at optimere forholdet mellem værdiskabelse og risikostyring. Fremadrettede mål for "firsttime-right" og revisionsresultater i forbindelse med produksikkerhed blev prioriteret højere end tidligere bagudrettet måling af f.eks. antal tilbagekaldelser.

## MEDARBEJDERUDVIKLING

Det er afgørende for Chr. Hansens fremtidige udvikling at skabe lederpotentialer. I 2011/12 gennemførte en gruppe ledere med stort potentiale fra seks lande de første to af tre moduler i et omfattende lederudviklingsprogram, "High Flying", der er udviklet specielt til Chr. Hansen.

Det samlede antal kursusdage pr. medarbejder pr. år er nu 3,1, hvilket er en stigning på 21% i forhold til 2010/11. I de kommende år vil **vi (SM)** fortsat fokusere på uddannelse og udvikling.

I 2011/12 blev 870 medarbejdere, der er i regelmæssig kontakt med leverandører, kunder, myndigheder og andre interessenter, uddannet i konkurrenceret samt bekæmpelse af korruption via en e-learning-plattform.

### Medarbejdertilfredshed

Der gennemføres medarbejdertilfredshedsundersøgelser hvert andet år. Målingerne for 2011/12 lå fortsat på et højt niveau, selvom der blev sporet en mindre tilbagegang i forhold til den rekordhøje måling i 2009/2010. Den generelle tilfredshed og motivation faldt marginalt med 1,1 point til indeks 74,9. Målingen er **tilfredsstillende (AM)**, da et indeks på over 75 betragtes som meget godt. Sammenlignet med et benchmark i branchen på 65 klarer Chr. Hansen sig vældig godt. Resultaterne af undersøgelse anvendes på tværs af organisationen til opfølgingsmøder mv.

### Arbejdsmiljø

I 2011/12 blev frekvensen af ulykker med fravær pr. 1 mio. arbejdstimer (LTI – tabt arbejdstid som følge af arbejdsskader) forbedret fra 12 i 2010/11 til 10. Ingen af ulykkerne var alvorlige, men da selv en ulykke er en for meget, er et omfattende sikkerhedsprogram baseret på erfaringer fra produktionsanlægget i USA blevet indført på hovedproduktionsstederne. Programmet fokuserer på sikker adfærd, øget bevidsthed, kommunikation og på at tage ansvar.

## BÆREDYGTIGT INDKØB

Med den kraftigt stigende efterspørgsel efter naturlige farver er der sat større fokus på at sikre bæredygtige indkøb af råvarer som bær, grøntsager og frugt fra landmænd og pigmentleverandører. Der er nedsat en styregruppe, som er forankret i **topledelsen (SM)**, til løbende at overvåge udviklingen i leverandørstyringssystemet og sikre, at eventuelle problemer bliver løst i samarbejde med kunder og leverandører.

## RESSOURCEEFFEKTIVITET, FORURENINGSFOREBYGGELSE OG AFBØDNING AF KLIMAÆNDRINGER

Energiforbruget og CO<sub>2</sub>-udledningen blev forbedret i forhold til 2010/11. Ressourceudnyttelsen steg med 9% for energiforbrug pr. produceret enhed, mens CO<sub>2</sub>-udledningen blev reduceret med 9% pr. produceret enhed.

Ressourceudnyttelsen for vand faldt med 9% pr. produceret enhed i forhold til sidste år, fordi anvendelsen af genbrugsvand i produktionen af kulturer faldt på grund af tekniske problemer. Chr. Hansen har et mål om, at stigningen i vand- og energiforbruget kun må være halvt så stort som stigningen i produktionsmængden.

I 2011/12 blev der lanceret adskillige produkter, der potentielt **kan (hedge)** hjælpe kunderne med at reducere miljøpåvirkningen fra deres virksomhed, herunder produkter, der kan reducere affaldsgenereringen som følge af fordærv af fødevarer hos detailhandlere eller reducere ressourceforbruget hos kunderne. Internt **forventes (hedge)** det, at større fokus på flere produkttransporter med skib i stedet for fly vil reducere CO<sub>2</sub>-udledningen yderligere i fremtiden, samtidig med at et nyt emballagekoncept til kulturer **forventes (hedge)** at føre til mere genanvendelse.

Ledelsesberetningen omfatter ikke en fuldstændig redegørelse for samfundsansvar, idet der henvises til særskilt rapport om bæredygtighed, som udgør Chr. Hansens rapportering om fremdrift til FN's Global Compact, og opfylder kravene til rapportering i den danske Årsregnskabslov om samfundsansvar. Rapporten kan ses på <http://annualreport1112.chr-hansen.com>.

## AKTIONÆROPLYSNINGER

Chr. Hansen Holding A/S er børsnoteret på NASDAQ OMX Copenhagen og bestræber sig på at skabe et langsigtet afkast til aktionærerne gennem øgede aktiekurser og øget udbytte.

### Kursudvikling og handelsvolumen

Chr. Hansen Holding A/S' aktiekurs udviklede sig positivt i 2011/12. Aktiekursen var primo regnskabsåret DKK 118,3 mens aktiekursen ultimo august 2012 var DKK 176,8 svarende til en stigning på 49%. Den gennemsnitlige daglige omsætning var DKK 52

mio. Chr. Hansen Holding A/S indgår i en række aktieindekser, herunder C20-indekset på NASDAQ OMX Copenhagen (siden december 2010), der består af de 20 mest handlede aktier på børsen. C20-indekset steg med 36% i regnskabsåret 2011/12.

#### Udbyttepolitik og kapitalstruktur

**Bestyrelsen (SM)** vurderer løbende Chr. Hansens kapitalstruktur for at fastslå, om den stadig er i overensstemmelse med aktionærernes interesser. **Bestyrelsen (SM)** søger at fastholde en gearing, der er i overensstemmelse med en solid "investment grade" kreditvurdering mens overskydende kapital returneres til aktionærerne, enten gennem ordinære og ekstraordinære udbyttebetalinger eller gennem aktietilbagekøbsprogrammer.

Chr. Hansen Holding A/S' udbyttepolitik er en udbytteprocent på 30-50% af årets resultat. Forslag til udbytte sker på baggrund af **bestyrelsens (SM)** vurdering af forretningsudvikling, vækststrategi, finansieringsbehov mv., og der er ingen **sikkerhed (hedge)** for, at der vil blive foreslået eller udloddet udbytte i et givet år.

#### Aktietilbagekøbsprogram

Et aktietilbagekøbsprogram (struktureret i henhold til EU-Kommissionens Forordning nr. 2273/2003 af 22. december 2003 (Safe Harbor-forordningen)) på op til EUR 80 mio. blev etableret den 19. april 2012 med det formål at tilpasse kapitalstrukturen via udlodning af overskydende kapital til aktionærerne.

I perioden 19. april til 31. august 2012 er i alt 2.348.789 aktier blevet tilbagekøbt i henhold til programmet med en samlet transaktionsværdi på EUR 52 mio. Programmet blev afsluttet den 19. oktober 2012. Der blev i alt tilbagekøbt 3.534.244 aktier med en samlet transaktionsværdi på EUR 80 mio.

**Bestyrelsen (SM) forventer (hedge)** på generalforsamlingen den 27. november 2012 at fremlægge forslag til aktionærerne om nedsættelse af aktiekapitalen med det antal aktier, der er tilbagekøbt, nominelt EUR 35.342.440 mio.

#### Udbytte

**Bestyrelsen (SM)** foreslår, at der på generalforsamlingen godkendes et udbytte på EUR 0,39 (DKK 2,90) pr. aktie for regnskabsåret 2011/12, svarende til en udbyttebetaling på EUR 52 mio. Udbyttebetalingen svarer til 40% af årets resultat.

Med de nævnte initiativer er det **bestyrelsens (SM) opfattelse (hedge)**, at selskabets kapital- og aktiestruktur er i overensstemmelse med aktionærernes interesser. Kapitalstrukturen vurderes løbende for at fastslå, om den stadig er i overensstemmelse med aktionærernes interesser.

#### Aktionærer og aktiekapital

Chr. Hansen Holding A/S havde ved udgangen af august 2012 **ca. (hedge)** 18.000 institutionelle og private aktionærer. Novo A/S ejede mere end 25% af aktiekapitalen, mens Chr. Hansen Holding A/S ejede 3,8%, dels som led i aktietilbagekøbsprogrammet, dels for at opfylde visse forpligtelser til at levere aktier i henhold til incitamentsprogrammer for **ledelsen (SM)**. Den resterende aktiekapital ejes primært af institutionelle investorer fra Danmark, Storbritannien og USA. **Ca. (hedge)** 75% af aktiekapitalen i "free float" ejes af internationale investorer. Private investorer ejer **ca. (hedge)** 10%.

Den eneste aktivitet i det børsnoterede selskab Chr. Hansen Holding A/S er overordnet, central administration af aktiebeholdninger i virksomheder i Chr. Hansen Koncernen.

#### Analytikerdækning

Firmaet dækkes aktuelt af mere end 15 analytikere, herunder store internationale investeringsbanker. Der findes en liste over de analytikere, der dækker Chr. Hansen, på <http://investor.chrhansen.com/analysts.cfm>

#### Investor Relations-politik og -aktiviteter

Chr. Hansen Holding A/S søger at sikre, at kapitalmarkederne har adgang til relevante, præcise og rettidige oplysninger, som kan danne grundlag for løbende handel med og fair prisfastsættelse af virksomhedens aktier.

Formålet med at videregive disse oplysninger er at sikre, at Chr. Hansen opfattes som en synlig, tilgængelig, pålidelig og professionel virksomhed blandt investorerne, og at virksomheden anses for at høre til blandt de bedste i denne henseende sammenlignet med tilsvarende virksomheder.

Dette skal opnås samtidig med, at **vi (SM)** overholder reglerne og lovgivningen for børsnoterede virksomheder på NASDAQ OMX Copenhagen og i overensstemmelse med Chr. Hansens kommunikationspolitik.

Chr. Hansen sigter efter at fastholde et højt og ensartet informationsniveau over for investorerne og forsøger at sikre, at nødvendig information fra investorerne videregives til **direktionen og bestyrelsen (SM)**.

I 2011/12 afholdt Chr. Hansen mere end 250 møder med investorer og analytikere, herunder roadshows i København, London, New York, Boston, Paris, Frankfurt, Stockholm, Genève, Zürich, Oslo, Helsinki, Amsterdam og Wien, og deltog i en række konferencer, der blev afholdt af forskellige mæglere.

## KONTAKT

Investor Relations-afdelingen har ansvaret for den daglige kontakt med analytikere og investorer.

Chef for Investor Relations

Senior Director

Anders Mohr Christensen

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## HJEMMESIDE

**Vores (SM)** hjemmeside indeholder både historiske og aktuelle oplysninger om virksomheden, herunder selskabsmeddelelser, investorpræsentationer, telekonferencer, finanskalender, årsrapporter mv.: <http://investor.chr-hansen.com>

## ORDINÆR GENERALFORSAMLING

Den ordinære generalforsamling afholdes tirsdag den 27. november 2012 kl. 16.00 på Chr. Hansens hovedkontor, Bøge Allé 10-12, 2970 Hørsholm.

## CORPORATE GOVERNANCE

God selskabsledelse er den måde en virksomhed ledes på og kontrolleres gennem ejerskab, ledelsesstruktur, incitamentsprogrammer og selskabslove mv. Chr. Hansen Holding A/S' bestyrelse **ønsker (AM)** at følge "Anbefalinger for god Selskabsledelse" som implementeret af NASDAQ OMX København i Regler for udstedere af aktier den 16. august 2011 og har i alle henseender levet op til anbefalingerne i 2011/12.

Da Chr. Hansen Holding A/S er børsnoteret på NASDAQ OMX København, og i overensstemmelse med § 107b i Årsregnskabsloven, skal **bestyrelsen (SM)** for Chr. Hansen Holding A/S udarbejde en redegørelse for selskabsledelsen i regnskabsåret 2011/12. Redegørelsen indgår i ledelsesberetningen og kan læses og downloades på <http://investor.chrhansen.com/governancestatement.cfm>.

Redegørelsen indeholder en beskrivelse af Chr. Hansens tilgang til de udstedte "Anbefalinger for god Selskabsledelse" og en beskrivelse af ledelsesstrukturen og hovedelementerne i **vores (SM)** interne kontrol- og risikostyringssystemer i forbindelse med virksomhedens regnskabsaflæggelse.

## LEDELSESSTRUKTUR

Som dansk virksomhed har Chr. Hansen Holding A/S en ledelsesstruktur bestående af en bestyrelse og en daglig ledelse som vist herunder. Yderligere oplysninger findes i ovennævnte redegørelse om selskabsledelse.

## RISIKOSTYRING

Risikostyring er en integreret del af det at drive virksomhed i Chr. Hansen. Chr. Hansen har i 2011/12 implementeret en ny global risikostyringsproces i organisationen, hvor risici identificeres, overvåges og rapporteres til **direktionen og bestyrelsen (SM)**. Formålet med denne proces, som involverer linjeledelsen, er at identificere risici så tidligt som muligt og give **ledelsen (SM)** mulighed for proaktivt at tilpasse virksomhedsprocesser og -kontroller med henblik på at imødegå, styre og mindske disse risici.

Væsentlige risici vurderes på grundlag af mulige sikkerhedsmæssige, forretningsmæssige og økonomiske konsekvenser og sandsynligheden for, at risikoen indtræffer. Der etableres en **klar (AM)** rolle- og ansvarsfordeling i forhold til væsentlige risici, ligesom der identificeres, prioriteres og igangsættes initiativer til at mindske risici.

De væsentligste identificerede risici beskrives nedenfor, herunder de foranstaltninger, der er truffet for at mindske risiciene. Risiciene er ikke opstillet i prioriteret rækkefølge. Oversigten over risici omfatter dog ikke alle de risici, som kan tænkes at påvirke Chr. Hansen. Risici, som Chr. Hansen ikke er bekendt med, eller risici, som i øjeblikket ikke anses for væsentlige, vil i sidste instans kunne påvirke Chr. Hansens forretninger betydeligt.

## STRATEGISKE RISICI

### Produktsikkerhed

Størstedelen af Chr. Hansens produkter sælges til fødevarerindustrien og life sciencevirksomheder. De fleste af **vores (SM)** produkter indgår i kundernes slutprodukter, der forbruges som fødevarer, drikkevarer eller kosttilskud.

Derfor skal produktsikkerheden være helt i top. Chr. Hansens kunder kræver og forventer kvalitetsprodukter, og hvis kunderne, forbrugerne eller myndighederne sætter spørgsmålstegn ved produktsikkerheden, udgør det en alvorlig strategisk risiko for virksomheden.

For at sikre den bedst mulige produktsikkerhed gennemfører Chr. Hansen omfattende kvalitetssikring i alle led af værdikæden – fra indkøb af råvarer til levering af de færdige produkter til kunderne. Chr. Hansen vurderer også risiciene hos kunderne i applikationsfasen og ved slutbrugernes anvendelse af produkterne.

Chr. Hansens produktionsstyringssystem er baseret på en risikovurderingsmodel og er certificeret i henhold til internationale standarder som ISO 9001 og ISO 22000. Alle **vores (SM)** produkter indkøbes i overensstemmelse med ISO 22000, og alle produktionssteder med undtagelse af to er FSSC 22000-certificeret.

### Sundhedsanprisninger

Hos Chr. Hansen mener vi, at **vi (SM)** har nogle af de bedst dokumenterede probiotiske stammer på markedet. Regeringer og institutioner, ikke mindst Den Europæiske Fødevarer-sikkerhedsmyndighed (EFSA), er imidlertid i gang med at indføre strengere regler for dokumentation af sundhedsanprisninger af fødevarerrelaterede produkter.

Chr. Hansen arbejder omhyggeligt på at optimere dokumentationen af sundhedsanprisninger for **vores (SM)** probiotiske produkter. Chr. Hansen har den kritiske masse, der skal til for at sikre tilstrækkelig dokumentation for alle **vores (SM)** produkter, og **vores (SM)** arbejde med denne dokumentation vil gøre det muligt at fastholde **vores (SM)** førende position og konkurrenceevne på disse markeder. Yderligere oplysninger om Chr. Hansens kliniske studier findes under "Forskning og udvikling".

## OPERATIONELLE RISICI

### Produktion

Chr. Hansen har fem hovedproduktionssteder i Danmark (2), Frankrig, Tyskland og USA. Disse produktionssteder udgør kernen i **vores (SM)** forretning, og hvert produktionssted overvåger nøje sikkerheden og opfyldelsen af deres mål for at styre alle potentielle risici. Ved at samle hovedproduktionen på få produktionssteder sikres optimering af kapaciteten og dermed reduceres produktionsomkostningerne. For at mindske risikoen for produktionsnedbrud eller -fejl gennemfører Chr. Hansen regelmæssigt sikkerhedstjek for at sikre, at der udføres forebyggende vedligeholdelse og udskiftninger. Chr. Hansen arbejder desuden løbende på at opbygge overskudskapacitet til nøgleprocesser og vedligeholdelse af et sikkerhedslager af produkter.

### Retssager

Chr. Hansen er fra tid til anden part i retssager, som opstår i forbindelse med den almindelige forretningsgang, og Chr. Hansen var pr. 31. august 2012 sagsøgt i flere diacetylrelaterede retssager om påstået personskaade som følge af udsættelse for diacetyldampe. Chr. Hansen mener ikke, at diacetylsagerne vil få væsentlig negativ indvirkning på den finansielle stilling eller driftsresultat, da Chr. Hansen på produktionstidspunktet havde en forsikring, der dækker tab på diacetylsager mod virksomheden for produkter, der indeholder diacetyl. Det er en forudsætning for forsikringen, at kravene er baseret på samme ansvarspådragende handling. Chr. Hansen mener, at forsikringen er tilstrækkelig til at dække eventuelle tab som følge af sager mod selskabet, som vedrører udsættelse for diacetyl.

### Menneskelig kapital (human capital)



Det er **vigtigt (AM)** for Chr. Hansen at tiltrække og fastholde de bedste medarbejdere og nye talenter for at opnå de bedste resultater. Viden er afgørende for Chr. Hansens forretning, og der er stærk fokus på løbende at udvide videnbasen ved aktivt at udvikle medarbejdernes kernekompetencer. Hos Chr. Hansen er der ansat en lang række eksperter og forskere, og udvikling af deres kvalifikationer og viden er en **vigtig (AM)** del af opbygningen af Chr. Hansens globale kompetencer. Det er dog også **vigtigt (AM)** at integrere disse højt kvalificerede medarbejdere i de daglige aktiviteter og hjælpe dem med at blive bedre til at omsætte deres ekspertise til værdi for virksomheden.

#### Arbejdsmiljø

Chr. Hansen **ønsker (AM)** løbende at forbedre både det fysiske og psykiske arbejdsmiljø, så medarbejderne både føler sig sikre og har et sikkert arbejdsmiljø. Arbejdet med at reducere arbejdsmiljørisici, implementere forebyggende tiltag og skabe et godt fysisk og psykisk arbejdsmiljø foregår via officielle arbejdsmiljøpolitikker. Arbejdsmiljøet bliver løbende overvåget af arbejdsmiljøorganisationen, som består af repræsentanter fra forskellige funktioner på tværs af koncernen. Der gennemføres desuden uddannelsesforløb for at øge bevidstheden om arbejdsmiljø i organisationen.

#### Skat og transfer pricing

Chr. Hansen er en global virksomhed, som opererer i mange lande med forskellige skatteregler. Det er virksomhedens hensigt **altid (booster)** at opfylde sine skattemæssige forpligtelser i alle de lande, der drives virksomhed i. Chr. Hansen arbejder løbende på at sætte fokus på skatterisici i organisationen og har **klart (AM)** definerede roller og ansvarsområder i linjeledelsen, i de lokale økonomiafdelinger og i koncernens skatteafdeling.

Der opstår dog fra tid til anden sager om beskatning og interne afregningspriser, og transaktioner på tværs af grænserne har i stigende grad de lokale skattemyndigheders bevågenhed. Der er tilknyttet lokale skatterådgivere til at sikre opfyldelse af lokale skattemyndigheders krav, og koncernens skatteafdeling er involveret for at sikre, at koncernens skattepolitik, som er godkendt af **bestyrelsen (SM)**, overholdes. Koncernen bestræber sig desuden på at have en positiv dialog med de lokale skattemyndigheder for at forebygge uoverensstemmelser. Yderligere oplysninger om skatteforhold findes i note 9 i koncernregnskabet.

#### FINANSIELLE RISICI

Som international virksomhed er Chr. Hansen eksponeret mod en række finansielle risici som valutakurs- og renteudsving, finansiering og likviditet, kredit og modparts risici "credit and counter party risk". Yderligere oplysninger vedrørende disse risici findes i note 24 i koncernregnskabet.

#### BESTYRELSE

Ole Andersen

Professionelt bestyrelsesmedlem

Født 1956. Uafhængigt bestyrelsesmedlem

Formand for bestyrelsen siden 2010. Genvalgt 2011, valgperiode udløber 2012 Formand for vederlags- og nomineringsudvalgene

Medlem af revisionsudvalget

Andre Ledelseshverv:

Bestyrelsesformand: Danske Bank A/S, ISS A/S og et koncernselskab & Bang & Olufsen A/S og et koncernselskab

Medlem: NASDAQ OMX Nordic's nomineringsudvalg Adm. direktør: OGA Holding ApS og to koncernselskaber

Senior rådgiver: EQT Partners

Kompetenceprofil:

Ledelseserfaring med store finansielle og internationale virksomheder. Stor erfaring med bestyrelsesarbejde – også i børsnoterede selskaber. Finansiell og regnskabsmæssig ekspertise.

Frédéric Stévenin

Partner hos PAI partners

Født 1966

Næstformand

Medlem af bestyrelsen siden 2005 (formand indtil marts 2010). Genvalgt 2011, valgperiode udløber 2012 Medlem af vederlags- og nomineringsudvalgene

Andre Ledelseshverv:

Bestyrelsesformand: Cerba European Lab og medlem af tre koncernselskaber, Kaufman & Broad og medlem af to koncernselskaber.

Bestyrelsesmedlem: United Biscuits og to koncernselskaber, PAI partners SAS, PAI partners UK Ltd.

Adm. direktør: Alta Rocca Investissements, G.A.V.U. Gestion Sprl, Saint-Pey Holding

Kompetenceprofil:

Faglig erfaring med investeringer i store internationale virksomheder. Finansiell og regnskabsmæssig ekspertise. Stor erfaring med bestyrelsesarbejde – også i børsnoterede selskaber.

Henrik Poulsen

Adm. direktør for DONG Energy A/S

Født 1967. Uafhængigt bestyrelsesmedlem

Medlem af bestyrelsen siden marts 2010. Genvælt 2011, valgperiode udløber 2012 Formand for revisionsudvalget

Andre Ledelseshverv:

Bestyrelsesmedlem: Falck A/S og to koncernselskaber, Danske Banks Repræsentantskab

Rådgiver: EQT Partners

Kompetenceprofil:

Ledelseserfaring fra "Fast Moving Consumer Goods" og telekommunikationsindustrien – især med koncernomstrukturering, innovation, procesforbedringer, salg og markedsføring.

Gaëlle d'Engremont

Principal i PAI partners

Født 1975

Medlem af bestyrelsen siden 2009. Genvælt 2010, valgperiode udløber 2012 Medlem af revisionsudvalget

Andre Ledelseshverv:

Bestyrelsesmedlem: United Biscuits Topco Limited, Perstorp Holding AB

Kompetenceprofil:

Faglig erfaring med investeringer i mellemstore til store internationale virksomheder. Finansiell og regnskabsmæssig ekspertise.

Mark A. Wilson

Adm. direktør for Fonterra Brand's Asien, Afrika og Mellemøstens aktiviteter i Fonterra Co-Operative Group Limited Født 1952.

Uafhængigt bestyrelsesmedlem

Medlem af bestyrelsen siden 2010, valgperiode udløber 2011 Medlem af vederlags- og nomineringsudvalgene

Andre Ledelseshverv:

Medlem af Fonterra's Management Committee Bestyrelsesmedlem: Fonterra Co-Operative Group Limited og otte datterselskaber

Kompetenceprofil:

International administrerende direktør med mere end 36 års erfaring fra ledelse af "Fast Moving Consumer Goods" & Service/B2B industrier i Asien, Sydamerika, U.K., irske & internationale markeder.

Didier Debrosse

Adm. direktør for Heineken International, Western Europe Region, Holland Født 1956. Uafhængigt bestyrelsesmedlem

Medlem af bestyrelsen siden 2011, valgperiode udløber 2012

Andre Ledelseshverv:

Medlem af Heineken N.V. Executive Committee og bestyrelsesmedlem i ni koncernselskaber Kompetenceprofil:

Stor faglig erfaring med salg og marketing i "Fast Moving Consumer Goods (Food & Beverage)" og ledelseserfaring med store internationale selskaber

Jørgen O. Nielsen

Director, People Operations, Chr. Hansen

Født 1948

Medarbejderrepræsentant

Medlem af bestyrelsen siden august 2010, valgperiode udløber 2014

Svend Laulund

Manager, External Affairs, Chr. Hansen Født 1954

Medarbejderrepræsentant

Medlem af bestyrelsen siden 2006. Genvælt 2010, valgperiode udløber 2014

Martin G. Seidel

Business Analyst, Chr. Hansen

Født 1971

Medarbejderrepræsentant

Medlem af bestyrelsen siden 2006. Genvælt 2010, valgperiode udløber 2014

DIREKTION

Lars Frederiksen

Adm, direktør  
 Født 1958  
 Uddannelse:  
 Cand.merc. i økonomi og virksomhedsledelse  
 Ansat hos Chr. Hansen siden 1980  
 Andre Ledelseshverv:  
 Bestyrelsesmedlem: Hedorf Holding A/S & Hedorf Fonden  
 Tilknytning til investeringsfirma:  
 Digevej Invest ApS.

Klaus Pedersen  
 Økonomidirektør  
 Født 1967  
 Uddannelse:  
 Cand.merc i regnskab og virksomhedsledelse, Handelshøjskolen i Århus  
 Ansat hos Chr. Hansen siden 2011  
 Andre Ledelseshverv:  
 Bestyrelsesformand: Faroese Telecom & KP Consult ApS.

Henrik Dalbøge  
 Koncerndirektør, Health & Nutrition Division  
 Født 1956  
 Uddannelse:  
 Cand.scient. i molekylær biologi Lic.scient., Ph.d. i bioteknologi  
 Ansat hos Chr. Hansen siden 2006.

Knud Vindfeldt  
 Koncerndirektør, Cultures & Enzymes Division  
 Født 1963  
 Uddannelse:  
 Kandidat i mejerividenskab, Bachelor i International Business  
 Ansat hos Chr. Hansen siden 1991.

Carsten Hellmann  
 Koncerndirektør, Global Sales  
 Født 1964  
 Uddannelse:  
 Bachelor i Business Administration M.Sc. Information Management INSEAD, International Business Program  
 Ansat hos Chr. Hansen siden 2006  
 Andre Ledelseshverv:  
 Bestyrelsesformand: Pro-Meduc Group A/S

Carsten Bennike  
 Koncerndirektør, Natural Colors Division  
 Født 1964  
 Uddannelse:  
 Cand.merc. Business Administration, CBS, 1996  
 Executive MBA. London Business School, 2005  
 Ansat hos Chr. Hansen siden 2011  
 Andre Ledelseshverv:  
 Bestyrelsesmedlem: K/S Gosport  
 Adm. Direktør: TO BE Holding ApS  
 Jesper Allentoft  
 Koncerndirektør, Stakeholder Relations  
 Født 1955  
 Uddannelse:  
 Cand. Psych, Københavns Universitet  
 Ansat hos Chr. Hansen siden 2006.