

**TRENDREPORT 2010**

**"DAX Annual Reports for 2009"**

**- Observations and Trends -**

**9th HGB Summer Lounge, 7 June 2010**

Hamburg, 7 June 2010 - Anyone who thought the switch had been flicked on the crisis on 15 September 2008 and that things couldn't get any worse has been badly deceived, since things have got worse and nobody knows when this dynamic chain reaction will end. One thing is certain: the business world has been derailed, Europe is broke and no longer what it used to be.

What happens in the economy and on the financial markets in times of crisis is inevitably also reflected in the annual report. Yet how much room do rating agencies and short-trading financial jugglers leave for issues such as sustainability, values and corporate social responsibility? With this in mind, we took a more precise look at the latest reports. How are German businesses communicating at the moment? Is there a trend towards greater transparency and openness? Moreover: have the language and vision changed?

**What doesn't kill us makes us stronger**

What first struck us as astonishing was that we were unable to detect any signs of resignation or pessimism in the reports. On the contrary: the current economic situation is regarded as an extreme challenge and burden, but also as an opportunity: to tackle issues, adjust the strategy, give credible answers and make the business viable in future. This is definitely the essence of the reports.

But how is the crisis manifested in the report? It is largely played out on a solely textual level, as with the hope for recovery. It barely has any effect on the style of design and layout. The foreword and management report are pervaded by the sometimes dramatic impacts of the crisis. Against this background, businesses rely on credibility, integrity, information and content. With the use of clear and precise language.

Almost all companies reach the following conclusion: we are in the best position for the future because we have coped well with the crisis year of 2009. The CEO's letter repeatedly includes the comment "Our business model has proved itself in the crisis". "Our business model is durable".

However, several CEOs fail to address missed targets or results, or to make a comparison between forecasts and achieved targets. In contrast, the **Lufthansa** report contains a table, which concisely compares the target statements with achieved objectives for 2009. The **GfK** example reads: "lower turnover, lower profit, lower dividends". The Chairman specifies concrete objectives for the 2010 financial year. The management report even presents, in the form of graphs, internal and external growth, as well as the development of margins per segment.

### **On dealing with the crisis**

The **VW** example states: "We have not only held our ground and coped with the crisis significantly better than many of our competitors. We have also implemented important strategic measures. Our business model is strong and resilient. Especially in the crisis." At its competitor **BMW**, this is how things sound: "In a crisis you can only hope that it will pass quickly or react quickly and consistently. We will be one of the winners in this crisis because we have learned the right lessons from it". The report therefore also radiates belief in the future, optimism and vitality.

The Chairman of **adidas** puts it like this: "Such challenges spur us on to our top performance and we have reacted quickly. We take a fair share of new optimism from the challenges of 2009." In any case this is highlighted by a large number of companies: you don't argue, but believe in the future and the recovery. Drive and viability for the future pervade the reports, alongside crisis-related issues. Or, with a little help from the Swiss writer Max Frisch: "Crisis can be a productive state. It only has not to give you a flavour of disaster."

In the **Pfeiffer Vacuum** example: the Chairman, right at the start of his foreword, addresses what he considers most important: secure jobs for employees and a lucrative return on shareholder's capital. The core statement: safely through stormy times. The foreword conveys the company's strategy in a way that is full of optimism and confidence. "All in all we can talk of a successful financial year despite a dramatic economic crisis. We have strengthened our market position." And the management report states: "In the most severe economic crisis since the foundation of the Federal Republic, Pfeiffer Vacuum achieved results which most other companies fail to achieve even in periods of economic boom." Crisis is a different story.

The **BB Biotech** report is possibly the only one which fails to mention the crisis even once. Instead, it proudly describes achievements and strategic measures in the financial year. But the crisis has almost passed **MorphoSys** by as well: as shown by the visual appearance of the report. The strong financial results are already referred to in the foreword. "Despite the very demanding economic situation, MorphoSys has continued to develop, in almost every respect, into a stronger and more mature company." The crisis is therefore of secondary importance in the annual reports of companies with positive trends or a crisis-proof business model.

The situation is quite different at solar manufacturer **Q-Cells**, which admits, with brutal honesty: "The crisis has hit Q-Cells hard. 2009 was a year of upheaval, which has made us aware of our weaknesses in a very painful way." How the company has responded strategically is shown by an intelligent and fact-oriented image section of almost 30 pages. The year of transformation and change is described very openly and coherently. The situation is similar at **Deutsche Post DHL**: where the crisis is already a central factor in the chairman's foreword. The management report is also a "crisis report": anti-crisis measures, as well as the prospects for successful crisis management are consistently addressed.

### **It is all a matter of the right strategy**

The following observation is interesting, from BMW to Metro: essentially a great deal of importance is attached to not just seeing the current business strategy as a response to the crisis, but to having started with foresight long before the first visible signs of the crisis: "Before the outbreak of the crisis we had already set the right course and were therefore well-prepared for the crisis", is **Henkel's** view. And as **Metro** puts it: "our future program is not a reaction to the crisis, but a component of the long-term strategy." Some reports have a chapter on a more or less comprehensive strategy, which frequently also has an extremely programmatic title.

Some examples:

- HPO (High Performance Organisation) = Linde
- Future Safeguards = HHLA
- Climb 2011 = Lufthansa
- Agenda 2015 = Fraport
- Goal 10 = Fresenius Medical Care
- BISS = GfK
- Challenge 09-12 = Lanxess

- Shape 2010 = Metro Group

In many reports the strategy and, above all, statements on future viability are seen as the central theme running through the report. Generally accepted statements on strategy are largely made in the management report in relation to group management or value-based business management. It is notable that companies with a clearly defined strategy manage to describe objectives in detail on two pages (e.g. Deutsche Post, Fraport, Fresenius Medical Care, Lanxess), while other companies produce a lot of air over several pages.

### **What belongs together, grows together**

**Sustainability** and **responsibility** are much more strongly integrated in the annual report than in the past. These have become matters of substance. Based on this, an increasing number of market players insist on companies meeting this requirement. Anyone who has already come to terms with this task can collect plus points on this important issue for shareholders and stakeholders.

**BASF** is well ahead in this respect. The company publishes an integrated report, which documents the economic, ecological and social performances of the company. This links financial and sustainability reporting in one publication. How and in what way value is created for BASF and for society is consistently communicated. Value-based orientation and responsibility are central components of the business strategy. This subject pervades the entire report: from the Chairman's foreword, the chapter on "Strategy and Values", through to the management report. An extremely large amount of space is devoted to the subject and it is treated very systematically and credibly, statements are corroborated with concrete examples, facts and figures. In this respect we could describe it as an exemplary „responsibility report“.

**Henkel** too presents superbly integrated financial and sustainability reporting, with separate annual report and sustainability report publications, but presented as a single unit in a box-set. The close connection, in terms of content, between both works is enhanced by reader-friendly reference techniques and Internet links. Sustainable and responsible economic management and trading is part of the business strategy and regarded as a factor of success and an innovation driver. Virtually all product innovations must therefore contribute to the sustainable development of the business.

The situation appears similar at **VW**: an innovation is only really good, as far as the car-maker is concerned, if it generates technological progress, serves the well-being of mankind, and can be

implemented in harmony with the environment. Man, the environment and technology define corporate thinking and action.

But the **Deutsche Post DHL** report also shows that corporate success and sustainable and responsible economic management belong together. The message: respect for the values and needs of employees and customers is virtually a precondition for corporate success. In a 25-page story section, **Fraport** reports on how growth and social responsibility are mutually dependent. And **Lanxess** commits itself to acting responsibly in a 20-page chapter on CSR..

In addition to financial performance indicators, non-financial performance indicators are treated in much greater detail than previously in a large number of reports. **VW** reveals this as follows: While the most important financial performance indicators are described in the chapter on the financial, cash flows and income position, the report section "value-increasing factors" addresses the non-financial performance indicators, which provide information about the efficiency of the company's value driver. Corporate success is defined by employees, VW's contribution to environmental protection and the assumption of social responsibility. This can be gleaned from the more than 22 pages in this chapter, which is given more significance by the vivid graphics.

Fresenius **Medical Care AG** also presents almost 30 pages in the management report with regard to non-financial performance indicators, such as F&E, acquisition and logistics, production, quality, environment and employees. Reporting on value-based business management is often a component of the management report. However, hardly any target parameters are set and no target-actual comparison is made.

### **From tendency to trend**

The fact that **responsible-minded business management** and **sustainable economic management**, as well as the impacts of the crisis, are the dominant factor in the latest annual reports points to the fact that the companies have had a fundamental rethink. The reason is obvious, as we also discovered with a survey among IR and communications experts: shareholders are no longer solely focused on short-term business success, but are increasingly paying attention to the appearance of the economic, ecological and social performances of the company, and how they contribute to long-term business success. Long-term thinking and sustainable principles are the answer to a fatal short-term focus. Anyone who still makes mistakes in this area in future will be punished on the financial markets.

**Siemens** puts it: "One lesson from the crisis is that the sustainability of action can't be displaced by short-term calculations. Where sustainability is lost, there is also a lack of a sense of responsibility, trust is destroyed and economic damage is produced." The point cannot be made any better. Siemens deals with this matter in detail: how can we be sustainable and operate profitably at the same time? The company report is therefore extensively devoted to values, behavioural principles, and corporate responsibility. The understanding of sustainability and the subject of responsible added value creation are plausibly explained. Siemens sees sustainability as a competitive opportunity.

### **No future without sustainability**

Sustainability and responsibility are now valued even more highly by the company, as making a contribution to stabilising and securing future viability. We assume that this **tendency** will develop into a **trend** towards integrated reporting, i.e. the consolidation of business and sustainability reporting. The formation of an "International Integrated Reporting Committee" on the EU level is seen as the first indication of this. The goal: an internationally recognised and more practicable standard is to be established for integrated reporting by 2020.

The challenge for the next few years will therefore be to make the internal reporting systems fit for this task. But the most important question here is: if "integrated reporting" conforms to target groups in any way, won't the matter lose sustainability and thereby possibly even importance and interested parties? In any case: the concept of linking the sustainability report and annual report with one another is completely sensible. Finally, there are already a large number of overlaps between the two reports in terms of content. For example, sustainability reports, in addition to the ecological and social components, were also intended to cover economic considerations. Conversely, annual reports are required to shed light on non-financial performance indicators.

### **What does the future hold?**

Hardly any concrete target values are indicated for the new financial year. Statements with regard to future development are only described and hardly ever supported by concrete figures.

- **Henkel** expects better sales development than for the relevant markets.
- **Linke** intends to exceed the 2009 values in respect of group turnover and results in the 2010 financial year.

- **Lufthansa:** our goal is to regain reasonable operating margins.

Benchmarks for exemplary reporting:

- **adidas:** management predicts and quantifies the target figures. In one table it starts with "Prospects for 2009", "Results for 2010", "Objectives for 2010".
- **Deutsche Post DHL:** concrete results forecast and overview starts with "2009: What we have achieved", "2010: What we want to achieve."
- **Fresenius Medical Care:** Goals for 2009-2011

The analyses of economic forecasters are given priority in respect of economic prospects. Hardly any management dares to say "WE expect..." General uncertainty reigns. The independence of future business development from economic trends is repeatedly highlighted. But essentially it is true that the ability and willingness to make predictions is lower at times of crisis.