PERFORMANCE MATERIALS

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KEY FIGURES

€ million	2014	2013	Change in %
Total revenues	2,060.5	1,644.4	25.3
Sales	2,059.6	1,642.1	25.4
Operating result (EBIT)	611.5	653.3	– 6.4
Margin (% of sales)	29.7	39.8	
EBITDA	803.6	765.8	4.9
Margin (% of sales)	39.0	46.6	
EBITDA pre one-time items	894.8	779.7	14.8
Margin (% of sales)	43.4	47.5	
Business free cash flow	699.6	787.8	– 11.2

Development of sales and results of operations

In 2014, sales of the Performance Materials division grew by 25.4 % to € 2,060 million (2013: € 1,642 million). Both solid organic growth of 4.1 % as well as acquisition-related sales increases of 22.8 % or € 375 million contributed to this increase. Adverse foreign exchange effects lowered sales by –1.5 %. Organic growth was delivered by all the existing business units, namely Liquid Crystals, Pigments & Cosmetics and Advanced Technologies, with Liquid Crystals making the largest absolute contribution to sales growth. The acquisition-related sales growth was due to the first-time consolidation of AZ as of May 2, 2014, the integration of which has been completed.

The Liquid Crystals business unit again maintained its market leadership position in liquid crystal materials in 2014. The two leading technologies (PS-VA and IPS) registered strong organic sales growth thanks to continued demand for high-quality (e.g. ultra high-definition) and large-size televisions. This growth was also bolstered by sales volume developments of the new UB-FFS technology, which is mainly used in smartphones and tablet PCs. Higher sales volumes were partly offset by the customary price declines for liquid crystals.

The Pigments & Cosmetics business unit achieved slight organic sales growth in 2014. Xirallic® pigments, which are primarily used in automotive coatings, as well as technical functional materials were the main drivers. Including negative currency effects, sales of the Pigments & Cosmetics business unit reached the year-earlier level.

Thanks to higher demand for OLED displays, the Advanced Technologies business unit made a good contribution to the organic growth of the division.

The development of sales in the individual quarters in comparison with 2013 as well as the respective organic growth rates are presented in the following overview:

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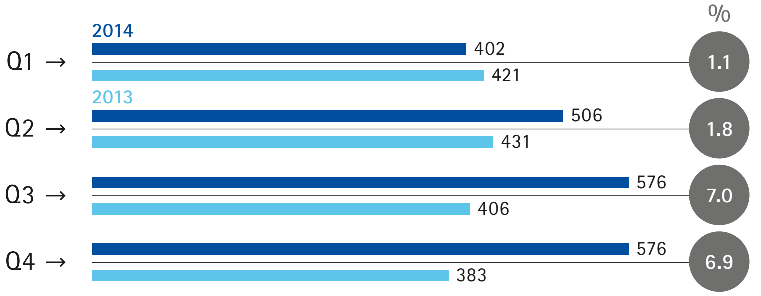
SALES AND ORGANIC GROWTH BY QUARTER[1]

€ million / organic growth in %



[1] Quarterly breakdown unaudited.

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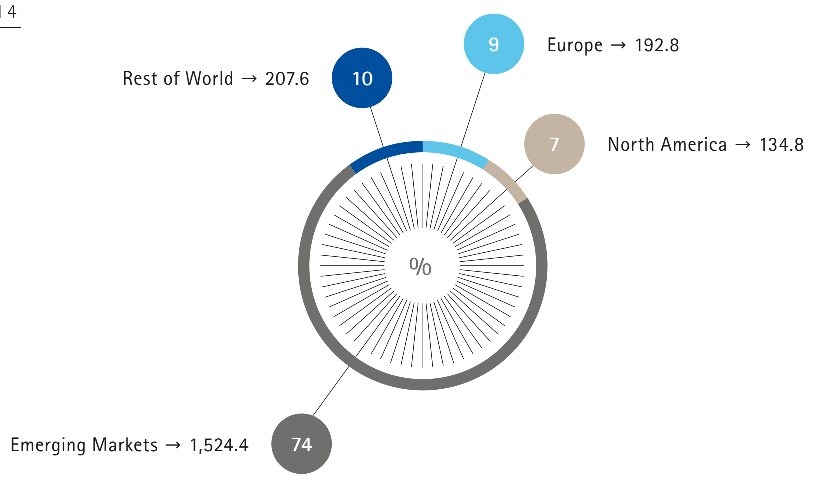
SALES BY REGION – 2014

€ million / % of divisional sales



Accounting for 74 % of sales (2013: 75 %), the Emerging Markets region again generated the vast majority of the division's sales. This is due to the concentration of liquid crystal customers as well as high-tech materials from the new AZ business unit in Asia. The division achieved organic sales growth of 4.4 % in this region. Sales in the Emerging Markets region rose by 19.8 % due to the acquisition of AZ. Taking negative foreign exchange effects of – 0.9 % into account, sales in this region rose to a total of € 1,524 million (2013: € 1,237 million).

The Rest of World region, which is dominated by Japan, recorded organic sales growth of 10.4 %. The acquisition of AZ contributed 31.9 % of this increase. Including a foreign exchange impact of – 8.9 %, which largely stemmed from the Japanese yen, sales in this region reached € 208 million (2013: € 156 million). The share of sales attributable to the Rest of World region thus remained unchanged at 10 %.

The division achieved sales of € 193 million in Europe (2013: € 164 million). The rise in sales was almost solely attributable to the first-time consolidation of AZ. The European share of divisional sales in 2014 was 9 % (2013: 10 %).

In North America, sales grew by 57.5 % to € 135 million (2013: € 86 million). This was driven by the acquisition-related sales increase of 61.4 %. Organic sales declined by – 4.3 % due to weaker demand from the cosmetic industry for products from the Pigments & Cosmetics business unit. Consequently, the region contributed 7 % to divisional sales in 2014 (2013: 5 %).

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SALES COMPONENTS BY REGION – 2014

€ million / change in %	Sales	Organic growth	Exchange rate effects	Acquisitions / divestments	Total change
Europe	192.8	0.4	0.1	16.9	17.4
North America	134.8	– 4.3	0.4	61.4	57.5
Emerging Markets	1,524.4	4.4	– 0.9	19.8	23.3
Rest of World	207.6	10.4	– 8.9	31.9	33.4
Performance Materials	**2,059.6**	**4.1**	**–1.5**	**22.8**	**25.4**

The results of operations developed as follows:

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RESULTS OF OPERATIONS

	2014		2013		Change	
	€ million	in %	€ million	in %	€ million	in %
Sales	**2,059.6**	**100.0**	**1,642.1**	**100.0**	**417.5**	**25.4**
Royalty, license and commission income	0.9	0.0	2.3	0.1	–1.4	–63.1
Total revenues	**2,060.5**	**100.0**	**1,644.4**	**100.1**	**416.1**	**25.3**
Cost of sales[1]	–983.2	–47.7	–617.1	–37.6	–366.1	59.3
(of which: amortization of intangible assets)[1]	*(–46.4)*		*(–1.2)*		*(–45.2)*	*(–)*
Gross profit[1]	**1,077.3**	**52.3**	**1,027.3**	**62.6**	**50.0**	**4.9**
Marketing and selling expenses[1]	–177.8	–8.6	–151.6	–9.2	–26.2	17.3
(of which: amortization of intangible assets)[1]	*(–11.7)*		*(–11.1)*		*(–0.6)*	*(6.0)*
Royalty, license and commission expenses	–1.1	–0.1	–1.3	–0.1	0.2	–13.4
Administration expenses	–56.1	–2.7	–27.8	–1.7	–28.3	101.4
Research and development costs[1]	–170.6	–8.3	–145.4	–8.9	–25.2	17.4
(of which: amortization of intangible assets)[1]	*(–2.8)*		*(–2.3)*		*(–0.5)*	*(22.6)*
Other operating expenses and income	–60.2	–2.9	–47.9	–2.9	–12.3	25.9
Operating result (EBIT)	**611.5**	**29.7**	**653.3**	**39.8**	**–41.8**	**–6.4**
Depreciation/Amortization/Reversals of impairments	192.1	9.3	112.5	6.9	79.6	70.9
(of which: one-time items)	*(–)*		*(–3.7)*		*(3.7)*	*(–)*
EBITDA	**803.6**	**39.0**	**765.8**	**46.6**	**37.8**	**4.9**
Restructuring costs	6.0		11.1		–5.1	–46.1
Integration costs/IT costs	12.2		2.8		9.4	–
Gains/losses on the divestment of businesses	4.6		–		4.6	–
Acquisition-related one-time items	68.4		–		68.4	–
Other one-time items	–		–		–	–
EBITDA pre one-time items	**894.8**	**43.4**	**779.7**	**47.5**	**115.1**	**14.8**

[1] The disclosure of amortization of intangible assets (excluding software) has been changed. See "Accounting and measurement principles" in the Notes to the Group accounts.

The development of the results of operations was significantly influenced by the inclusion of AZ. In particular, the sharp increase in cost of sales in 2014 related mainly to the first-time consolidation of AZ. The inventories from the acquisition were stepped up to fair values on the date of first-time consolidation. In 2014, the step-up of € 45 million was included as an expense in cost of sales. In addition, cost of sales rose due to the amortization of intangible assets in connection with the AZ purchase price allocation. As a consequence of these one-time expenses, the consolidated contribution of AZ to divisional gross profit was low in 2014. The gross margin of Performance Materials fell accordingly to 52.3 % (2013: 62.6 %). The decrease in the operating result (EBIT) to € 611 million was due among other things to the described AZ inventory revaluation, which was recognized as an expense as well as additional one-time expenses in connection with the acquisition of AZ. During the determination of EBITDA pre one-time items, these one-time effects from the inventory revaluation were added back. EBITDA pre one-time items thus includes the adjusted earnings contribution from AZ. Along with the very successful business performance of Liquid Crystals, EBITDA pre one-time items thus rose in 2014 by 14.8 % to € 895 million. The EBITDA margin pre one-time items fell to 43.4 % (2013: 47.5 %), reflecting in particular the lower margin of the AZ business.

The development of EBITDA pre one-time items in the individual quarters in comparison with 2013 is presented in the following overview:

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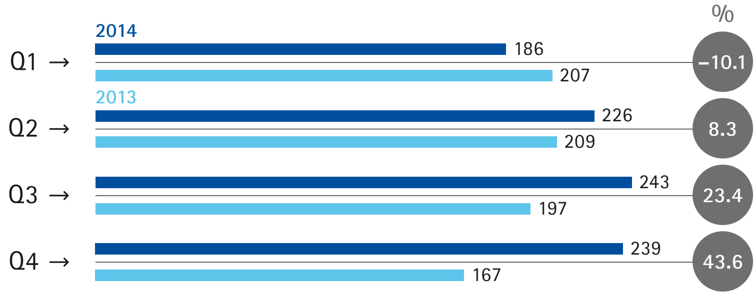
EBITDA PRE ONE-TIME ITEMS AND CHANGE BY QUARTER[1]

€ million / change in %



[1] Quarterly breakdown unaudited.

Development of business free cash flow

In 2014, the Performance Materials division generated business free cash flow of € 700 million (2013: € 788 million). The sharp increase in trade accounts receivable as well as inventories was related to the acquisition of AZ, among other things. This first-time consolidation effect was offset by the adjustment amounting to € 145 million. Higher capital spending in 2014 also lowered cash flow. Consequently, the improvement in EBITDA pre one-time items could not offset the higher level of cash outflows overall.

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BUSINESS FREE CASH FLOW

€ million	2014	2013	Change in %
EBITDA pre one-time items	894.8	779.7	14.8
Investments in property, plant and equipment, software as well as advance payments of intangible assets	−97.6	−71.7	36.1
Changes in inventories	−98.8	37.2	–
Changes in trade accounts receivable	−143.4	42.6	–
Adjustments first-time consolidation of AZ Electronic Materials	144.6	–	–
Business free cash flow	**699.6**	**787.8**	**−11.2**

The development of business free cash flow in the individual quarters in comparison with 2013 is presented in the following overview:

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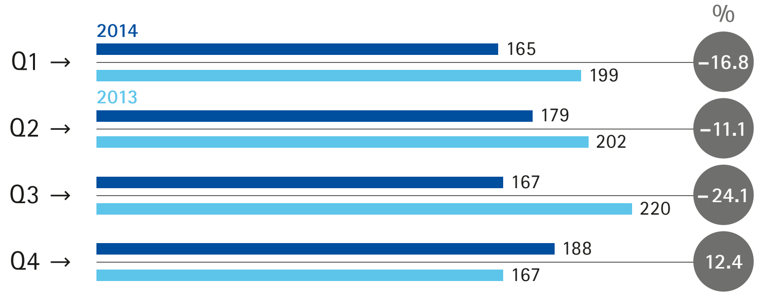
BUSINESS FREE CASH FLOW AND CHANGE BY QUARTER[1]

€ million / change in %



[1] Quarterly breakdown unaudited.