KENDRION

WE MAGNETISE THE WORLD

ANNUAL REPORT 2010

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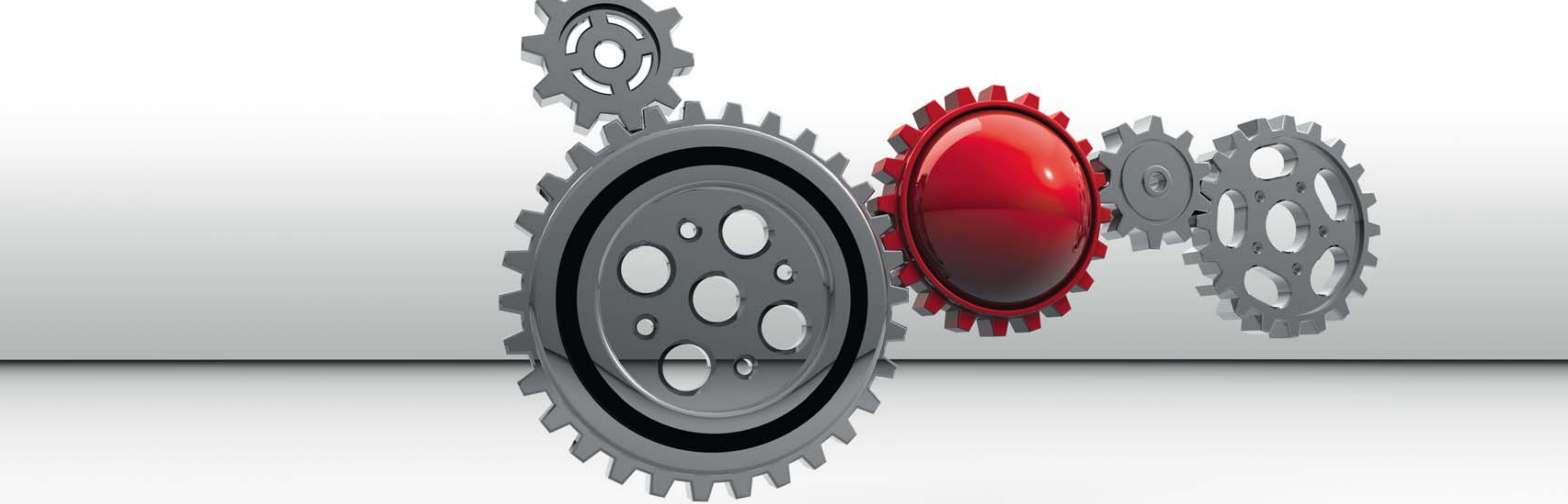
(www.kendrion.com) along with
other publications such as press
releases, presentations as well as
the Annual Review 2010.

Contents



Profile

KENDRION N.V., a solution provider, develops, manufactures and markets innovative high-quality electromagnetic systems and components for customers all over the world. Kendrion's operations are carried out by four business units focused on specific market segments, namely *Industrial Magnetic Systems*, *Industrial Drive Systems*, *Passenger Car Systems* and *Commercial Vehicle Systems*.

KENDRION has leading positions in a number of business-to-business niche markets. Germany is Kendrion's main market, although other countries are becoming increasingly important.

Kendrion's activities

KENDRION develops advanced electromagnetic solutions for industrial applications. These are used by customers all over the world in systems such as lifts, door-locking systems, industrial robots, medical equipment, electrical switchbox systems, diesel engines, air-conditioning installations, motor cooling systems and beverage dispensers. Kendrion's key customers include Bosch, Siemens, Daimler, Continental, Delphi, Evobus, Hyundai and Yutong.

Kendrion's shares are listed on NYSE Euronext's Amsterdam market.

Organisation

KENDRION

WE MAGNETISE THE WORLD

Industrial Magnetic Systems
Electromagnetic components tailored to the individual needs of advanced industries.

BINDER

Industrial Drive Systems
Electromagnetic brakes and clutches for the industrial drive technology.

BINDER

Passenger Car Systems
Project solutions for specific customer applications in the automotive and special vehicle industries.

BINDER

Commercial Vehicle Systems
Individual energy-saving systems for commercial vehicles and off-road applications.

LINNIG

Preface *To all our shareholders and other stakeholders,*

2010 developed in a completely different direction from 2009: 2010 was a very favourable year, in complete contrast to 2009 that was dominated by the global crisis.

At the end of 2009 we forecast that it would probably take several years to return to the level of the operations in 2008. However, the recovery took place at an unprecedented rate. Kendrion experienced an unparalleled upturn in 2010 following the extremely strong development of the German economy, due to the substantial impetuses the country's economy received from the rapid growth in exports to the Far East. This led to the recovery of the mechanical engineering sector that is of particular importance to Kendrion, as well as of the automotive industry. Kendrion's focus on environmental and energy-saving product development also paid off. These developments resulted in an approximately 49% growth of Kendrion's revenue in 2010 following the 27% decline in revenue in 2009. After the first quarter, in which the organisation needed to accelerate its response to the rapid growth in revenue, very good results were reported in the remaining quarters of 2010. These results were further enhanced by the streamlining of the company achieved by the measures implemented within the context of the 'Springtime' reorganisation Plan in 2009. The strong growth of revenue following the great improvement in economic conditions in turn led to the renewed growth of the number of employees from 1,100 to 1,300 during the year under review.

Once again, we are convinced that Kendrion's competitive position has improved even further in 2010. The company is now active in a large number of countries in Europe, the Far East and the Americas. Kendrion also took the first steps in India in 2010. Its technical competences were not impaired by the crisis and have since been enhanced even further. This, in combination with the powerful financial position and highly-developed innovative capacity, indicates that the company has emerged from the crisis in good condition. This is also evident from the well-filled order book at the beginning of 2011, and from the large number of interesting projects the business units are working on with a view to the future.

A number of issues received specific attention in 2010. One key issue, in particular during a period of expanding activities, was once again the management of the working capital required to achieve a highly-satisfying cash flow. The efforts in this area in part resulted in Kendrion's arrangement of an appealing finance package with three banks at the end of 2010. A great deal of attention was also devoted to the 'flexibility' theme in 2010. Since Kendrion expects a further increase in the economic volatility of the company's most important home markets it is necessary to maintain a flexible organisation and work with flexible employees and flexible suppliers.

Additional attention was devoted to the 'innovation' theme in 2010. Pursuant to Kendrion's Innovation Calendar, Dr. Wilhelm Binder Days were organised in October 2010 during which the business units presented a number of important energy-saving and safety innovations. Kendrion's many stakeholders greatly appreciated these events, which have enhanced the company's innovative image even further.

As a result of the global focus on electromagnetic applications that has been developed in recent years, Kendrion is now a leading international company in its niche markets that leverages its existing know-how, innovative capabilities and commercial strengths to offer solutions to its industrial customers, whereby the achievement of excellent returns remains one of the main objectives. Kendrion was, for the first time in the company's history, able to achieve EBITA of more than 10% in relation to revenue in 2010. During the year under review the company was further reinforced by the acquisition of the specialised Magneta company in Aerzen (Germany). Kendrion will endeavour to make further acquisitions in the coming years to enhance the existing operations. In addition to Germany, Kendrion will also focus on China and the USA, where the company is already active at a number of production locations. Moreover, the company forecasts further growth in these countries due to an increasing need for European technology in a number of Kendrion's familiar niche markets.

We are proud to be able to celebrate 100 years of electromagnetism at Kendrion in 2011. A number of activities will be organised to mark this milestone.

It will by now be self-explanatory that Kendrion has full confidence in the future, whereby it is gratifying to note that 2010 was much more favourable to the employees than the preceding crisis years.

We wish to take this opportunity to thank all employees, management and other stakeholders for their efforts, support and dedication, especially in a year in which a great deal was requested in achieving the unexpected growth. Our ambitions remain great, in part due to all the steps that we took in the past, and we hope that we will succeed in expanding our company even further in the coming years.

Piet Veenema, CEO

Kendrion at a glance Key figures

EUR million, unless otherwise stated	2010	2009
Net profit	16.6	4.0
Operations		
Revenue	221.9	149.2
Organic growth	42.9%	(27.0%)
Operating result before amortisation (EBITA) [1, 4]	24.2	5.1
Operating result before depreciation and amortisation (EBITDA) [1]	32.9	12.8
Net investments	8.9	5.9
Depreciation and amortisation	10.1	8.8
Financial position		
Total equity	114.5	96.1
Net interest-bearing debt	5.2	13.9
Share information		
Number of issued shares at year-end (x 1,000)	11,316	11,316
Net result per share (EUR)	1.47	0.37
Main key figures		
Solvency (total equity/balance sheet total)	64.7%	62.9%
Net interest-bearing debt/equity ratio (gearing)	0.05	0.14

	2010	2009
Main key figures on pro forma basis [1]		
Normalised net profit (EUR million)	14.8	1.0
Working capital in % of revenue [5]	11.7%	14.5%
Net interest-bearing debt/operating result before depreciation and amortisation (EBITDA) ratio	0.16	1.09
Operating result before amortisation (EBITA [4])/ net finance costs ratio	8.1	1.6
EBITA [4]/invested capital [2] (ROI)	18.7%	4.5%

	Target	Actual
Organic growth of continued operations	› 10% per year	42.9%
Return on Sales [4] (ROS)	› 10%	10.9%
Return on invested capital [2]	› 17.5%	18.7%
Solvency	not below 30%	64.7%
Ratio of interest-bearing debt and EBITDA	‹ 3.00	0.16
Free cash flow [3]	healthy free cash flow in relation to organic growth in % of net profit	105%
Dividend distribution	30% of net profit	40%

1 2009 EBITA and EBITDA excluding effect restructuring provision and costs related to the disposal of the Vink Group.

2 Total invested capital is property, plant and equipment, intangible assets and current assets less the current tax liabilities, trade payables and other payables.

3 Before cash flow relating to acquisitions and sale of operations.

4 EBITA excluding amortisation related to acquisitions (part of other intangible assets).

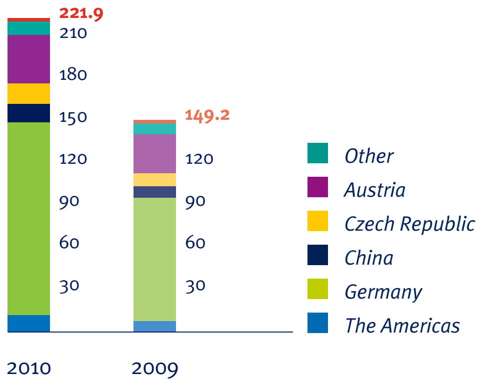
5 Excluding an earn-out liability at year-end 2010.

EUR million

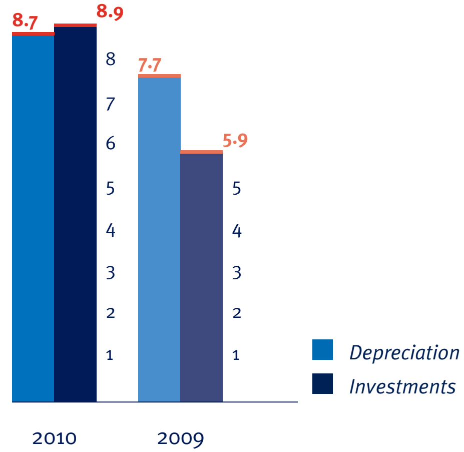
[1] *Excluding amortisation related to acquisitions (part of other intangible assets).*

[2] *Before cash flow relating to acquisitions and sale of operations.*

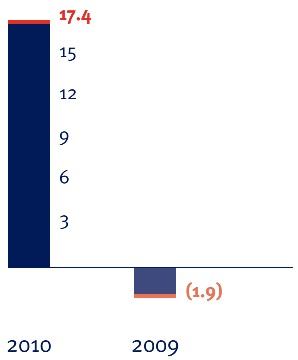
Revenue by region (based on the location of the operating companies)



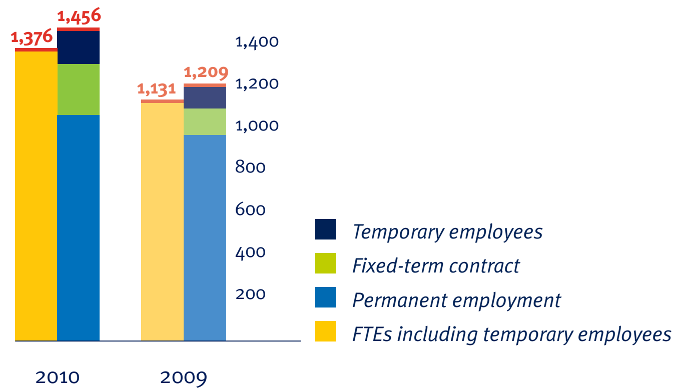
Depreciation and amortisation [1]/investments



Free cash flow [2]



Number of employees in FTEs and absolute numbers



Mission, strategy and financial objectives

Mission

Kendrion is committed to being a leading international company that uses its existing know-how, innovative capabilities and commercial strengths to provide solutions to the company's industrial and automotive customers. In doing so Kendrion intends to be a transparent, flexible and reliable company where entrepreneurial zeal is combined with clear profit targets. Kendrion seeks to further strengthen its position as a fast-growing high-tech company.

Strategy

Kendrion's policy is focused on the creation of sustainable added value and the achievement of appealing return on investment for the company as a whole. This is based on a powerful focus on a number of selected operations and on profitable growth achieved both organically and via acquisitions. Kendrion's objective is to evolve from a European player into a global player. Kendrion intends to achieve this objective by building up and expanding its leading market positions in selected niche markets in terms of both revenue and added value.

Kendrion utilises its existing know-how, innovative capacity and commercial strengths to offer solutions to a wide range of customers, whereby the company shall focus on the further expansion in the fields of applications for electromagnetic systems and components.

Kendrion is characterised by its transparency, flexibility and local entrepreneurship, whereby the company is driven by challenging but realistic targets. In addition, Kendrion intends to be and remain a company that appeals to its employees, customers and shareholders. Kendrion is aware of the importance of its social responsibility, and for this reason the social and environmental standards governing all processes are continually being made more stringent.

Kendrion's spearheads are:

- Niche market leadership in selected business-to-business markets;
- Organic growth in the current operations;
- Utilisation of synergy in and between the business units (locally but also internationally);
- Balanced spread of the operations;
- Targeted acquisitions;
- Enhancement of the innovative capacity.

Niche market leadership in selected business-to-business markets

Kendrion endeavours to achieve niche market leadership in selected business-to-business markets. Niche markets are small markets, whereby 'small' relates not so much to revenue or volume as to a limited number of suppliers in the sense of quality (technology and innovation). Kendrion intends to acquire a leading position in the niche markets that offer appealing margins and which are governed by relatively high barriers to entry (know-how, investments). Kendrion's products and services have the following features:

- The products and services are of an innovative and technical nature;
- Products and services are mostly customised;
- The contribution to costs may be 'minor', but is essential to the customer's finished products;
- The number of customers (and suppliers) is limited but there are long-term relationships;
- The market for a specific product or service offers the company an opportunity to hold a leading position in that market.

Organic growth in the current operations

Kendrion endeavours to achieve organic growth in its operations in terms of revenue, volume and result. This can be achieved by having powerful market positions, the further expansion of the company's high-grade engineering and test facilities, and the provision of excellent logistics concepts. Top priority is assigned to the provision of first-rate service. A special programme named 'Beat the Competition' has been conducted.

Utilisation of synergy in and between the business units

Kendrion's four market-focused business units operate in different markets. Kendrion endeavours to achieve optimum synergy in and between the business units by measures including joining forces in marketing and sales and exchanges of engineering know-how, purchasing and support services such as HR, Finance, and IT.

A balanced spread of the operations

Kendrion strives to achieve a balanced customer base in which no customer generates more than 5% of the entire company's revenue. Kendrion intends to safeguard stable results by avoiding a dependency on one geographical market. Kendrion endeavours to achieve a balanced geographical spread of its operations, whereby priority is assigned to covering the most relevant European markets. Nevertheless, the importance of countries in Eastern Europe and, especially, outside Europe shall continue to increase. Eastern Europe offers opportunities in terms of production locations and markets, as is illustrated by the operating companies in the Czech Republic and Romania. The Far East and the USA are also becoming more important. Kendrion is increasing its focus on these areas to achieve further growth, whereby the company is striving to create centres of excellence in each location.

Targeted acquisitions

Kendrion endeavours to acquire companies that enhance its leading positions (both in terms of its markets and the geographical spread of its operations). These acquisitions are pursued, in particular, for the industrial business units.

Enhancement of the innovative capacity
Globalisation and technological developments are increasing the competitive pressure. Kendrion is aware that the company will be unable to achieve and retain its planned growth and attractive market positions without permanent improvements to its operations and its knowledge of markets and customers. This will in turn require Unique Selling Points and innovation. Kendrion uses a multi-year Innovation Calendar that states fixed times at which the business units are encouraged to introduce innovations. This leads to annual presentations of Kendrion's most important innovations to its stakeholders. The first results of this process were the Dr. Wilhelm Binder Days that were organised in Amsterdam (the Netherlands) and Villingen (Germany) in October 2010. Kendrion also makes use of the services of an external Innovation Board for the provision of the necessary advice and support to the company. Kendrion strives to improve the company's Intellectual Property strategy and devotes continually increasing efforts to the development of knowledge management.

Financial objectives

- Annual organic growth in revenue of at least 10%;
- Growth of the company, including acquisitions, to revenue of about EUR 350 million within the next two years;
- Return on Sales (ROS) of more than 10%;
- Return on investment (ROI) inclusive of goodwill of more than 17.5%;
- Payment terms and stock levels of each operation in line with the market, taking account of local variations;
- A healthy free cash flow given the organic growth achieved;
- Solvency ratio not below 30%;
- Interest-bearing debt/EBITDA of lower than 3.0;
- Dividend distribution of 30% of the net profit, unless dictated otherwise by intended long-term investments and/or acquisitions and/or exceptional circumstances.

Important events

25 February 2010
Kendrion has reached an agreement with the owner of Magneta GmbH & Co. KG concerning the acquisition of this company as per 25 February 2010. The company is specialised in small electromagnetic brakes and clutches and is located in Aerzen (Germany).

4 and 7 October 2010
Dr. Wilhelm Binder Day – first Kendrion Innovation Event
Kendrion organised the first Dr. Wilhelm Binder Days in early October 2010. The events were attended by a total of approximately 350 guests and 500 Kendrion employees. A number of new innovative products in the field of energy efficiency and safety were displayed during the event. The participants in the Dr. Wilhelm Binder Days gave the event a very high rating.

8 December 2010
Kendrion has reached an agreement for a new credit facility totalling EUR 123.5 million, of which EUR 35 million will be allocated for working capital and general purposes, EUR 40 million for acquisitions and EUR 48.5 million for a bank guarantee in favour of the European Commission on account of the ongoing fine proceedings dating from late 2005 in connection with Fardem Packaging (a former subsidiary sold in 2003).
The credit facility is being provided by a consortium comprised of the current bank relationships ING Bank and Rabobank and as a new partner Deutsche Bank. The new credit agreement will go into effect in early January 2011 and will have a maturity of five years.

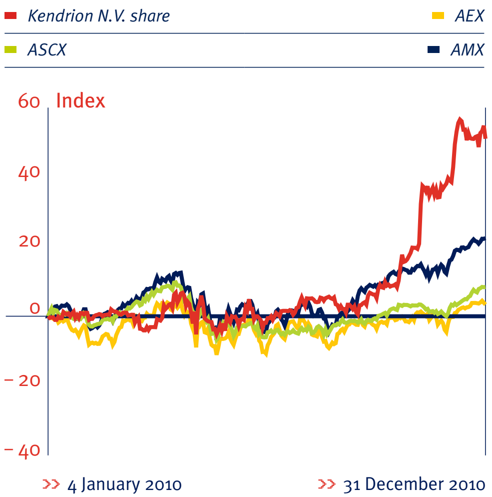
Information on Kendrion N.V. shares

Share capital

The authorised share capital amounts to EUR 80,000,000 and is comprised of 40,000,000 ordinary shares with a nominal value of EUR 2.00. On 31 December 2010, 11,316,374 shares had been issued. On the balance sheet date the company owned 59,115 shares that are required to cover the current share plans.

Kendrion's shares are listed on NYSE Euronext's Amsterdam market.

Movements in the share price from 4 January 2010 to 31 December 2010



Movements in the number of outstanding shares

	Ordinary shares entitled to dividend	Repurchased shares	Total number of issued shares
At 1 January 2010	11,267,886	48,488	11,316,374
Repurchased	25,000	25,000	
Delivered repurchased shares	14,373	14,373	
At 31 December 2010	11,257,259	59,115	11,316,374

Other information

In EUR, unless otherwise stated	2010	2009	2008
Number of shares x 1,000 at 31 December	11,316	11,316	10,288
Market capitalisation at 31 December, EUR million	164.1	105.8	74.1
Enterprise value (EV)	169.3	119.7	149.4
Highest share price in the financial year	15.10	10.30	18.17
Lowest share price in the financial year	8.82	6.59	5.80
Share price on 31 December	14.50	9.35	7.20
Average daily ordinary share volume	13,642	4,230	6,979
EBITDA multiple (over EV)	5.10	9.30 [1]	6.90
Result per share	1.47	0.37	1.25
Share price earnings ratio	9.93	26.71	5.76

[1] *Before Springtime.*

Major shareholders

Pursuant to the Netherlands Financial Supervision Act, Kendrion is aware, on the basis of the information in the registers of the Netherlands Authority for the Financial Markets (AFM), that the following shareholders possessed an interest of more than 5% on 31 December 2010:

Shareholder		Date of report
Parcom Capital (ING)	15.07%	1-10-2010
Dr. T. Tettamanti	8.48%	1-11-2006
Menor Investments B.V.	7.92%	7-1-2009
Aviva Plc	7.58%	1-11-2006
Darlin N.V.	5.09%	1-11-2006
Janivo Participaties II B.V.	5.09%	1-11-2006
Jan Plas S.A.	5.02%	2-4-2009
J.N.A. van Caldenborgh	5.00%	4-3-2010
Total	59.25%	

New NIB Ltd. has disclosed that its interest in Kendrion fell to 4.93% on 16 February 2010. Navitas has disclosed that its interest in Kendrion fell to 0.68% on 6 October 2010. More movements in the size of the interests of Kendrion's major shareholders occurred during the course of 2010. These changes fall within the disclosure thresholds as stipulated in the Financial Supervision Act and, consequently, do not need to be disclosed by the major shareholders.

Transactions between the company and legal persons holding at least 10% of the shares in the company as specified in best practice provision III.6.4 of the Netherlands Corporate Governance Code have not taken place.

Dividend

Kendrion's dividend policy takes account of both the interests of the shareholders and the expected further development of the company. Pursuant to this policy 30% of the net profit is distributed among the share-holders, subject to the proviso that the solvency ratio is retained at a level not below 30% and unless dictated otherwise by investments, acquisitions or exceptional circumstances.
In the medium to long-term Kendrion's reserve and dividend policies are also designed to enable the company, in part within the scope of the current strategy, to grow whilst retaining a healthy solvency ratio.

An extraordinary item concerns the current proceedings following the fine the European Commission imposed on Kendrion in 2005 for the alleged involvement of one of Kendrion's former subsidiaries in illegal price-fixing agreements, and the bank guarantees Kendrion issued to the European Commission in connection with this fine. This ensures that the company will retain its healthy position should the General Court (formerly named the Court of First Instance) unexpectedly rule against Kendrion. The General Court has invited Kendrion for an oral hearing to be held on 9 March 2011. Normally, a ruling may be expected eight to twelve months after the hearing, although this can occasionally take longer.

The Executive Board shall, in line with the dividend policy and with the approval of the Supervisory Board, submit a proposal to the shareholders for the payment of a dividend of 30% of the net profit of 2010. In addition, it will be proposed to pay an extra dividend of 10% of the net profit of 2010. The reasons for the proposal to pay this extra dividend are the very good results recorded in 2010, the absence of a dividend in 2009 and the low debt position. The total dividend is equivalent to an amount of EUR 6.6 million. The number of outstanding shares entitled to dividend at 31 December 2010 was 11,257,259 and, consequently, the dividend amounts to EUR 0.59 per ordinary share with a nominal value of EUR 2.00 each.

A proposal will be submitted to the shareholders during the General Meeting of Shareholders in April 2011 for the payment of the total dividend, at the shareholder's discretion, either fully in cash or fully in ordinary shares charged to the tax-exempt share premium reserve. The share dividend will be set on 12 May 2011, on the basis of the volume-weighted average price of all ordinary shares in Kendrion traded on 5, 6, 9, 10 and 11 May 2011, at a level whereby the value of the dividend in shares is virtually equal to the cash dividend.
The net profit for 2010 will be transferred to the other reserves.

Financial calendar

Monday 28 February 2011	Publication of the 2010 full-year figures
Monday 21 March 2011	Record date General Meeting of Shareholders
Monday 18 April 2011	General Meeting of Shareholders
Wednesday 20 April 2011	Ex-dividend date
Tuesday 26 April 2011	Dividend record date
Wednesday 27 April – Wednesday 11 May 2011, 3 pm	Dividend election period (stock or cash)
Tuesday 10 May 2011	Publication of the results for the first quarter of 2011
Thursday 12 May 2011	Determination stock dividend exchange ratio
Monday 16 May 2011	Cash dividend made payable and delivery stock dividend
Thursday 25 August 2011	Publication of the results for the first six months of 2011
Tuesday 8 November 2011	Publication of the results for the third quarter of 2011
Wednesday 29 February 2012	Publication of the 2011 full-year figures
Monday 16 April 2012	General Meeting of Shareholders

Voting by proxy

Shareholders can be represented by proxy at meetings of shareholders. At request a proxy can be granted to an independent third party. Shareholders who are unable to attend the General Meeting of Shareholders can request proxy forms from the company. These are issued free of charge and are also available on Kendrion's website. Shareholders may also grant a proxy electronically through e-voting (www.rbs.com/evoting).

Participation

A share plan for the top management of Kendrion was introduced in 2005. This plan provides for the issue of shares in Kendrion as payment in kind. After the General Meeting of Shareholders each year the number of shares to be awarded to the top management of Kendrion in that year is determined by the Supervisory Board on the basis of the Board's recommendations. 5,000 shares were awarded pursuant to this plan in 2010. The plan does not extend to the Board. In addition, the Business Unit Managers and a number of other officers are offered an opportunity to apply for the conversion of a maximum of half of their annual net cash bonus into shares. Kendrion doubles the number of shares after three years when officers are still employed by Kendrion and still possess the shares. Pursuant to this loyalty bonus plan a total of 2,064 shares were issued in 2010. A bonus scheme in shares was granted to the members of the Executive Board for 2010. More information about the shares issued to the members of the Executive Board is enclosed on pages 120 and 121. A comprehensive description of the bonus scheme for 2011 and onwards is included in the remuneration policy section on pages 54 and 55.

Regulations to prevent insider trading

Kendrion has implemented internal regulations to prevent insider trading. These regulations govern the Supervisory Board, Board, Innovation Board, Business Unit Managers and their Controllers, and a number of other employees. In addition, the Board and the Supervisory Board are governed by restrictions on trading in other listed companies. Kendrion has also designated a number of consultants affiliated with the company as insiders. Kendrion's Compliance Officer is entrusted with the supervision of compliance with the regulations.

Investor relations

Kendrion attaches great importance to appropriate communications with financial stakeholders and other interested parties such as investors, capital providers and analysts to provide them with a good insight into the developments at Kendrion. Price-sensitive information is disclosed in public announcements. Transparency should lead to healthy pricing, and must support sufficient liquidity.

Analysts

The following stock exchange analysts actively monitor the Kendrion share:

■ ABN AMRO Bank N.V.	René Verhoef
■ Rabo Securities N.V.	Frank Claassen
■ SNS Securities N.V.	Gert Steens
■ Theodoor Gilissen Bankiers N.V.	Tom Muller
■ The Idea Driven Equities Analyses company	Maarten Verbeek

More information about the Kendrion share is available from Kendrion's website, www.kendrion.com.

Members of the Supervisory Board

From left to right:
S.J. van Kesteren, Chairman of the Supervisory Board
R.L. de Bakker, Vice-Chairman
M.E.P. Sanders, member
H.J. Kayser, member

S.J. van Kesteren (69)
Mr Van Kesteren is the Chairman of the Supervisory Board. In 2005 the General Meeting of Shareholders appointed Mr Van Kesteren for a four-year term until 2009. In 2009 the General Meeting of Shareholders reappointed Mr Van Kesteren for a four-year term until 2013. He is member of the Remuneration Committee of Kendrion. Mr Van Kesteren is Chairman of the Supervisory Board of Koninklijke Nedschroef Holding B.V. Formerly he was Chairman of the Board of Draka Holding N.V. and member of the Advisory Board of ABN AMRO N.V.
Mr Van Kesteren is a Dutch national. He does not possess any shares in Kendrion.

R.L. de Bakker (60)
Mr De Bakker was appointed a member of the Supervisory Board during the Extraordinary General Meeting of Shareholders held in June 2005 for a two-year term until 2007. In 2007 Mr De Bakker was reappointed for a four-year term until 2011. A proposal to reappoint Mr De Bakker for a four-year term will be put on the agenda for the General Meeting of Shareholders in April 2011. He is Chairman of the Audit Committee of Kendrion.
Mr De Bakker is Chairman of the Supervisory Board of SPIE Nederland B.V. and member of the Supervisory Board of WCC B.V. He is also a member of the Board of a number of investment companies based in the Netherlands and a member of the Board of Tom-Tom Continuity Foundation, Chairman of the Supervisory Board of the Raamwerk Foundation, and Vice-Chairman of the Supervisory Board of the Laurens Foundation. He was formerly a member of the Executive Board and Chief Financial Officer of ASM International N.V. Mr De Bakker is a Dutch national. He does not possess any shares in Kendrion.

M.E.P. Sanders (57)
Ms Sanders was appointed a member of the Supervisory Board during the General Meeting of Shareholders held in April 2005 for a three-year term until 2008. In 2008 the General Meeting of Shareholders reappointed Ms Sanders for a four-year term until 2012. She is Chair of the Remuneration Committee of Kendrion.
Ms Sanders is Chair of the Supervisory Board of Solar Total Holding B.V. and Hoens Broadcast Facilities B.V. and Chair of the Advisory Board of Difrax Beheer B.V. and Kalff de Jager B.V. Ms Sanders is also member of the Advisory Board of De Hoge Dennen B.V. and member of the Board of Supervision of Altrecht N.V.
Ms Sanders is a Dutch national. She does not possess any shares in Kendrion.

H.J. Kayser (50)
Dr Kayser was appointed to the Supervisory Board during the Extraordinary General Meeting of Shareholders held in July 2009 for a four-year term scheduled to expire in 2013. He is a member of Kendrion's Audit Committee. Dr Kayser is CEO of 3W Power Holdings SA and AEG Power Solutions BV. He was formerly the CEO of Kuka AG. He held several (international) management positions with Siemens AG and McKinsey & Company during the period from 1989 to 2008.
Dr Kayser is a German national. He does not possess any shares in Kendrion.

Report of the Supervisory Board

Annual Report

We hereby present you the Annual Report for 2010 prepared by the Executive Board. The Annual Report includes the financial statements audited by KPMG Accountants N.V. The unqualified independent auditor's report is enclosed on pages 131 and 132 of this Report.

The Supervisory Board and the Board held extensive discussions on the Annual Report for 2010 and the preparation of the Report during meetings attended by the auditor. These discussions have convinced us that the Annual Report complies with the transparency requirements, and we are of the opinion that it constitutes a good basis for the accountability of the Supervisory Board for its supervision and advice during the year under review.

The Supervisory Board recommends that the General Meeting of Shareholders to be held on 18 April 2011 adopts these financial statements and discharges the Executive Board and Supervisory Board of responsibility in respect of their respective management and supervision.

Composition of the Supervisory Board

The Supervisory Board is comprised of four members. The membership of the Supervisory Board remained unchanged during the year under review. In accordance with the rotation schedule and after consideration a proposal to reappoint Mr De Bakker as a member of the Supervisory Board for a further four-year term shall be submitted to the General Meeting of Shareholders to be held on 18 April 2011.

All four members of the Supervisory Board comply with best practice provision III.3.4 of the Netherlands Corporate Governance Code (stipulating the maximum number of Supervisory Boards of Dutch listed companies of which an individual may be a member).

The Supervisory Board is of the opinion that it complies with the independence requirements stipulated by the Netherlands Corporate Governance Code.

The profile of the Supervisory Board includes a statement (in part in view of the diversity provisions of best practice provision III.3.1 of the Netherlands Corporate Governance Code) that endeavours shall be made to achieve a mixed composition in terms of age and experience and that preferably at least one woman shall be a member of the Supervisory Board. These endeavours have been achieved. The profile of the Supervisory Board is available on the website of the company.

Both the Supervisory Board and the Executive Board comply with the conflicts of interest rules laid down in the Netherlands Corporate Governance Code.
No transactions took place in the year under review in which conflicts of interest on the part of the members of the Executive Board or the Supervisory Board played a role.

The prevailing regulations and addendum governing the ownership of and transactions in the own company's securities and securities of other designated companies offer sufficient assurances.

Evaluations

In several meetings of the Supervisory Board, not attended by the Board, the performance of the Supervisory Board and its members, the performance of the Board and its members and an evaluation of the remuneration policy governing the Board were discussed.
These meetings also reviewed the require-

ments for the profile, composition and competence of the Supervisory Board. In 2010, the Supervisory Board started to work with a self-assessment questionnaire, to be filled out by each of its members. The performance of this form of evaluation was discussed in a meeting of the Supervisory Board which reviewed issues including the Board's opinion on the communication and the modus operandi between the two Boards. This revealed a few attention points which will be addressed in 2011, to be monitored by the Chairman of the Supervisory Board. These attention points include the more direct involvement of the Business Unit Managers and other senior staff in the discussions with the Supervisory Board. This will enable the members of the Supervisory Board to understand the drivers and current business ideas within the business units even better.

The Supervisory Board also held consultations with the external auditor, in part attended by the Board. In addition to these formal meetings, the Chairman of the Supervisory Board held regular informal discussions with the CEO, and the Chairman of the Audit Committee had informal discussions with the CFO.

The Audit Committee has reviewed the need for an internal auditor. The Supervisory Board recommends that the Board, in line with the Audit Committee's proposal, maintains the current situation. The Supervisory Board is of the opinion that the internal control procedures described in more detail on pages 29 and following of this Annual Report are adequate for Kendrion's needs.

Meetings

The Supervisory Board met with the Board on eight occasions. These meetings reviewed a number of permanent items on the agenda which included the company's strategy, the results of and developments within the market-focused business units and Kendrion as a whole, corporate governance, the independence of the auditor, the auditor's findings and recommendations, the business units' policy and business plans, the financing, fiscal position, risk management, PR, IR, the new ERP project HORIZON, as well as management development. A number of meetings were convened specifically to define the strategy in more detail, inclusive of the growth and acquisition policy.

With the exception of one meeting, all meetings were attended by all members of the Supervisory Board.

The Supervisory Board paid a working visit to the newly acquired company Magneta in Aerzen in Germany.

It has been a pleasure for the members of the Supervisory Board to attend the Dr. Wilhelm Binder Days in Amsterdam and Villingen and to have the opportunity to have informal contacts with shareholders, employees and other participants.

Committees

The Supervisory Board instituted two specific committees, an Audit Committee and a Remuneration Committee. Both Committees have been assigned the duty of making the preparations for the decision-making by the full Supervisory Board. The roles and responsibilities of the Committees are in accordance with the relevant provisions of the Netherlands Corporate Governance Code (best practice provisions III.5.4 and III.5.10). The regulations of both Committees have been published on Kendrion's website.

Audit Committee

In 2010 the Audit Committee was comprised of Mr De Bakker (Chairman and financial expert within the meaning of the Netherlands Corporate Governance Code) and Ms Sanders.

The Audit Committee held four meetings with the CFO during the year under review which discussed issues including the development in the results, the tax position, risk management, claims, treasury activities and insurance. The external auditors joined the meetings in which the yearly figures of 2009 and the half year figures of 2010 were discussed. The members of the Committee attended all meetings.

Remuneration Committee

In 2010 the Remuneration Committee was comprised of Mr Van Kesteren (Chairman) and Dr Kayser. The Netherlands Corporate Governance Code prescribes that the position of the Chairman of the Remuneration Committee shall not be fulfilled by the Chairman of the Supervisory Board. However, this provision has not been applied in view of the restricted size of Kendrion's Supervisory Board.

The Remuneration Committee held two meetings in 2010. The meetings were attended by the CEO. During the meetings the bonus systems were discussed and also the remuneration policy for the Board from 2010 onwards was evaluated and the to be expected outcome of the variable remuneration for 2010 was discussed. Both members of the Committee attended the meetings.

The Supervisory Board's internal evaluation has resulted in the Board's decision to change the membership of its committees. As from 2011, the members of the Audit Committee will be Mr De Bakker (Chairman) and Dr Kayser. The members of the Remuneration Committee will be

Ms Sanders (Chair) and Mr Van Kesteren. These changes bring the membership of the committees into line with the best practice provisions of the Netherlands Corporate Governance Code.

Highlights supervision

The financial results as well as working capital and other developments (including the associated press releases) were discussed in detail during the meetings held prior to the publication of the quarterly, half-year and annual figures. The company's external auditor attended the meeting in which the annual figures were discussed.

One meeting was devoted especially to examining and discussing the company's strategy on the mid-term, including the acquisition strategy. During this meeting the Supervisory Board also scrutinised the business unit's principles, risks and opportunities in greater detail. Intensive discussions have taken place about markets, acquisition targets and geographical focus. Furthermore, it was evaluated to which extent recent acquisitions have delivered what was expected at the moment the acquisitions were done.

The internal risk management and control systems received full attention.
More information is enclosed in the risk management section on pages 29 and following of this Annual Report. In one meeting, the overview of internal control issues of the auditor was discussed as well as the results, progress and further improvements of the internal tests of the financial reporting systems.
The Supervisory Board expressed its satisfaction with the fact that the management letter revealed only a limited number of relatively minor issues.

The Board and the Supervisory Board also discussed thoroughly the new financing arrangements for Kendrion, including the selection of ING Bank, Rabobank and Deutsche Bank, the financial covenants and other relevant terms and conditions.
The Supervisory Board is of the opinion that the new financing package creates the right level of flexibility required for Kendrion to execute its mid-term strategy.

The Supervisory Board closely monitors the developments relating to the fine imposed by the European Commission for the alleged infringement of Article 81, paragraph 1, of the EC Treaty by a former Kendrion subsidiary. Kendrion is invited for the oral hearing at the General Court on 9 March 2011. Normally, a ruling may be expected eight to twelve months after the hearing, although this can occasionally take longer.

The Supervisory Board was updated from time to time on the progress of the ERP Project HORIZON. In one of its meetings, the responsible Program Director was present to provide a status update.

The Supervisory Board recognises the importance of Kendrion's social responsibility and fully supports the further intensification of the focus on the company's social and environmental standards that govern its processes.
The progress report that was provided to the UN Global Compact Organisation was shared and discussed with the Supervisory Board. Reference is made to pages 24 and 25 where more information is provided on the CSR activities of Kendrion.

From time to time, the Supervisory Board is updated with the latest developments in relevant legislation and at such occasions required steps to be made by Kendrion are discussed.

Remuneration Executive Board

The Supervisory Board determined the remuneration for the individual members of the Executive Board in accordance with the remuneration policy approved by the General Meeting of Shareholders.
A specification of the remuneration for the Executive Board and the Supervisory Board is enclosed in the notes to the financial statements (pages 129 and 130).

The Supervisory Board has received confirmation from the auditor that the figures on which the 2010 bonus for the Executive Board is based are derived from the audited financial statements, and that the calculation of the bonus has been checked.

Remuneration policy

The remuneration policy is designed to offer remuneration that attracts managers qualified to manage an international company of the nature and character of Kendrion. The policy is also sufficiently challenging to motivate managers and, with good performance, retain them for the longer term. The composition of the remuneration package supports Kendrion's short and long-term objectives.

The package is of a performance-oriented design, whereby the results are used to determine a variable income, which is of a challenging level but not excessive.

The Supervisory Board adopted the remuneration package after taking account of the movement in results, movement in the share price and non-financial indicators also relevant to the long-term creation of company value. Consideration was also given to the influence of the total remuneration of the Executive Board on the overall remuneration rates within the company. The Supervisory Board has analysed the possible outcomes of the proposed variable remuneration components of the policy.

The Supervisory Board periodically benchmarks the remuneration package against information supplied by external experts to verify that it is in line with the company's objectives and the market.

A further explanation of the remuneration policy and a specification of actual remuneration is provided on pages 54, 55, 129 and 130, and can also be reviewed in the remuneration report as published on Kendrion's website.

Share plan

A share plan for the top management of Kendrion was introduced in 2005. This plan provides for the allocation of shares in Kendrion as payment in kind. After the General Meeting of Shareholders in each year the number of shares awarded to the senior management of Kendrion in that year is determined by the Supervisory Board on the basis of the Executive Board's recommendations. 5,000 shares were awarded pursuant to this plan in 2010. The plan does not extend to the Board.

In addition, the Business Unit Managers and a number of other officers are offered an opportunity to apply for the conversion of a maximum of half of their annual net cash bonus into shares. Kendrion doubles the number of shares after three years when officers are still employed by Kendrion and still possess the shares. Pursuant to this loyalty bonus plan a total of 2,064 shares were issued in 2010.

Profit appropriation

Kendrion recorded a net profit of EUR 16.6 million over 2010.

The Executive Board shall, in line with the dividend policy and with the approval of the Supervisory Board, submit a proposal to the shareholders for the payment of a dividend of 30% of the net profit of 2010. In addition, it will be proposed to pay an extra dividend of 10% of the net profit of 2010. The reasons for the proposal to pay this extra dividend are the very good results recorded in 2010, the absence of a dividend in 2009 and the low debt position. The total dividend is equivalent to an amount of EUR 0.59 per share entitled to dividend. A proposal will be submitted to the share-holders during the General Meeting of Shareholders in April 2011 for the payment of the total dividend, at the shareholder's discretion, either fully in cash or fully in ordinary shares charged to the tax-exempt share premium reserve. The net profit for 2010 will be transferred to the other reserves.

The members of the Supervisory Board have signed the financial statements to comply with their statutory obligation pursuant to Article 2:101, paragraph 2, of the Netherlands Civil Code.

The Supervisory Board thanks the Board and all Kendrion employees for their contribution and efforts in the year 2010.

Supervisory Board
S.J. van Kesteren, Chairman
R.L. de Bakker, Vice-Chairman
M.E.P. Sanders
H.J. Kayser

Zeist, 25 February 2011

Members of the Board

P. Veenema* **(55)**
Position: Chief Executive Officer
Nationality: Dutch
Joined Kendrion: 1993
Appointment to current position: 2003
Additional positions: member of the Supervisory Board of Helvoet Holding B.V.

E. Ris* **(52)**
Position: Chief Financial Officer
Nationality: Dutch
Joined Kendrion: 2001
Appointment to current position: 2004
New term: 2008-2012
Additional positions: member of the Board of Supervision of Zaans Medisch Centrum, Chairman of the Audit Committee of Zaans Medisch Centrum and member of the Supervisory Board of Dekker Holding Krabbendam B.V.

H. Freitag (60)
Position: Chief Operating Officer
Nationality: German
Joined Kendrion: 1978

* *Executive Board*

From left to right: **H. Freitag, P. Veenema, E. Ris**

Highlights

- Further expansion of a focused company with a clear profile;
- 49% increase in revenue due to the strongly expanding economy in Kendrion's most important markets;
- Growth in revenue recorded by all business units, resulting in Kendrion's achievement of EBITA of 10.9%, whereby the company benefited greatly from the cost reductions implemented within the scope of the Springtime Plan;
- Very good net profit of EUR 16.6 million which increased in successive quarters due to the growth in revenue and relatively low cost level;
- Powerful financial position, with a solvency ratio of almost 65% (equity EUR 114.5 million) and very low bank debts (EUR 5.2 million at the end of 2010);
- Excellent free cash flow of EUR 17.4 million, notwithstanding the substantial growth in revenue;
- At the end of 2010, a new and attractive financing package totalling EUR 123.5 million was arranged with Deutsche Bank, ING Bank and Rabobank for a period of five years;
- A great deal of attention for innovation, including activities such as the organisation of Dr. Wilhelm Binder Days in Amsterdam (the Netherlands) and Villingen (Germany);
- A great deal of attention for flexibility, as part of which the business units were requested to prepare for the increasing economic volatility of their most important home markets;
- Focus on the enhancement of the business units' market positions, including the development of further marketing plans within the context of the joint 'Beat the Competition' project;
- Further refinement of the company's strategy (the 'Summertime' Mid-term Plan), designed to achieve leading global positions in Kendrion's most important niche markets;
- Acquisition of the specialised Magneta company in Aerzen (Germany) to reinforce the Industrial Drive Systems business unit.

Organisational structure

Kendrion is a strongly focused company with one main objective: the development, manufacture and sales of innovative high-quality electromagnetic components and systems. The operations are organised into four market-focused business units:

- *Industrial Magnetic Systems:* electromagnetic components tailored to the individual needs of advanced industries;
- *Industrial Drive Systems:* electromagnetic brakes and clutches for the industrial drive technology;
- *Passenger Car Systems:* project solutions for specific customer applications in the automotive and special vehicle industries;
- *Commercial Vehicle Systems:* individual energy-saving systems for commercial vehicles and off-road applications.

Each business unit has a number of operating companies in various geographical locations. The organisation has implemented a decentralised structure to promote the company's decisiveness.

The individual business units have a shared strategy and the Business Unit Managers and the Managing Directors of the individual operating companies collaborate in a wide range of fields, such as engineering, project management, purchasing, production strategy, marketing and sales. The Board, supported by the Business Unit Managers – together the Executive Committee – takes all significant decisions concerning the strategy and direction of the electromagnetic operations as a whole including the allocation of resources to the individual operating companies. The Executive Committee that meets regularly reviews the financial and operational performance of the individual companies on the basis of the internal management information and identifies the prevalent best practices to be shared and implemented within Kendrion.

Kendrion strongly encourages motivated local entrepreneurship. Short lines of communication enable managers to respond rapidly and adequately to new developments at their customers or in local markets. Kendrion's Board performs a coordinating role in the development of the strategy, and is responsible for the acquisition policy.

A number of responsibilities are entrusted to Kendrion Group Services, such as financing and cash management, reporting and controlling, taxation, risk management, corporate communications and investor relations, facility management, insurance, IT, human resources management, legal affairs and corporate governance.

More information about the business units is enclosed on pages 42 and following of this Annual Report.

Targets and objectives

Continued focus on key issues

Kendrion will remember 2010 as the year that surpassed all expectations: after going through the deepest crisis Kendrion had ever encountered, in 2010 the company went on to achieve an equally unparalleled turnaround. The objectives Kendrion's Board had formulated for 2009 certainly continued to prove their worth in 2010. Kendrion's objectives in 2010 were:

- Alert response to market developments after the crisis;
- Increase in the flexibility of staff and costs;
- Strategic acquisitions in selected operations;
- Enhancement of innovative capacity;
- Further improvement of working capital management;
- Ongoing strengthening of risk management.

Kendrion can conclude that the specific steps taken to achieve these objectives have largely resulted in the required effects.

Alert response to market developments after the crisis

The company was able to adapt to the enormous increase of volumes, whereby Kendrion benefited from the decision made in 2009 to maintain the core (engineering skills) of the company's employees. The suppliers also needed to be managed to increase deliveries while maintaining quality levels. Kendrion has spent more time on the selection of the appropriate strategic suppliers for the longer term and has made changes to contracts to increase flexibility in the future.

Increase in the flexibility of staff and costs

In the last quarter of 2010, Kendrion also began to monitor more closely the flexibility in labour and costs in each business unit to enable the company to exhibit an even better response to the volatility of its most important niche markets in the future.

Strategic acquisitions in selected operations

Kendrion succeeded in acquiring Magneta in Aerzen (Germany) in February 2010, to further enhance the activities of the Industrial Drive Systems business unit. Many discussions were also held with industrial business companies in China and the USA to prepare for more rapid growth in these countries within the near future.

Enhancement of innovative capacity

Kendrion implemented an Innovation Calendar during the year that resulted in the organisation of the Dr. Wilhelm Binder Days in October 2010, which have increased the awareness of Kendrion's innovative capacity and enhanced the company's reputation as an innovative company. In September 2010, Commercial Vehicle Systems was presented the Company Award for the most innovative business unit in applying existing technologies in other market segments.

Further improvement of working capital management

A great deal of attention was once again devoted to the management of working capital in 2010. This resulted in an increase in the stock turnover rate and a decrease in the average collection period, which in turn led to a substantial free cash flow in 2010.

Ongoing strengthening of risk management

Kendrion's risk management programme is performing satisfactorily and was continued in 2010. More emphasis was placed on the risks associated with the planned implementation of a new ERP system. Kendrion is also working on the design of an adequate governance structure, one element of which is the contracting of the appropriate consultants. The focus will certainly be placed on this element of risk management in the coming years.

Over the course of 2010, all these activities resulted in the definition of four keywords that will govern Kendrion's operations in the coming years, namely flexibility, innovation, sustainability and globalisation.

Flexibility
The major lesson learned from the crisis was that flexibility in all areas and at all levels is essential to Kendrion's development and growth. For this reason Kendrion endeavours to integrate between 20-30% flexibility into the total cost structure (staff costs and other operating expenses) and makes continual assessments of all other opportunities and options available for achieving flexibility. The continual monitoring of flexibility will remain one of the major issues in 2011. The winners of the future will be the companies which adapt most to rapidly changing circumstances.

Innovation
Innovation involves more than simply requesting everyone to be innovative: innovation can be achieved by the creation of the appropriate conditions and scope for innovation, which starts with devoting innovation the attention it deserves. Kendrion has implemented an organisational structure designed to assure continual innovation within the Group. The Innovation Board, the Innovation Calendar, the Dr. Wilhelm Binder Days and the appointment of dedicated Innovation Managers at the Kendrion business units have promoted the adoption of an innovative attitude.

Sustainability
Sustainability is at the core of many of Kendrion's products and innovations. Kendrion and its staff, intrinsically motivated and making use of the specific expertise and experience available within the company, endeavour to contribute to the substantial reduction of emissions and fuel consumption. Kendrion is inspired by the objective of securing a sustainable and 'green' environment for the generations to come, whereby the company fully appreciates and assumes its responsibility for the achievement of this objective.

Globalisation
The world is Kendrion's marketplace. Kendrion will further strengthen its position by monitoring business opportunities, not only in the existing markets but also by placing an even greater focus on the emerging markets. At the start of 2011, Kendrion launched a greenfield operation in Pune, India. Kendrion plans to expand its strong European base and is following developments in other regions – in particular, China and the USA – very closely, to ensure that the Group can serve its customers close to their markets and make full use of new opportunities for growth.

Financial
In 2011, the financial targets Kendrion set the Group remain unchanged. As in 2010, the primary target is to achieve organic growth of 10%. In two years' time Kendrion's turnover is to grow to approximately EUR 350 million, in part driven by targeted acquisitions that will further improve the Group's market position.

>> Mid-term Plan

Measures implemented in the past enabled Kendrion to strengthen its position further in 2010. Kendrion has always devoted a great deal of attention to the Mid-term Plans. The Mid-term Plan 2010-2012, the 'In motion after Springtime' plan, focused on adaptation to the effects of the global crisis. The latest Mid-term Plan 2011-2013, the 'Summertime' plan, concentrates on the most important mid-term issues to be addressed if Kendrion is to strengthen the Group's position as a leading player in its niche markets. For this reason the internal focus is placed on issues including flexibility, innovation and knowledge management (including the development of an Intellectual Property strategy). The plan also defines the areas for growth as viewed from both activity and geographical perspectives. The Plan is, as is standard, based on targets for the coming years which are specified in consultation with the Business Unit Managers.

The operating companies use these targets to prepare their individual Mid-term Plans. The Business Unit Managers then use these individual plans to prepare an overall plan for their business unit. The Board processes the results to draw up Kendrion's Mid-term Plan and tests the plan against the targets specified by Kendrion's Board. This Mid-term Plan serves as a touchstone for the strategy pursued by the management at local and business unit level, as well as for their responsibilities. Kendrion can then determine, at an early stage, whether it meets – and, even more importantly, continues to meet – the company's targets. As a result, Kendrion can exhibit a prompt response to major changes in market conditions (as has been demonstrated in the past) and has an explicit specification of the approach to be adopted for further growth.

Corporate Social Responsibility

Corporate Social Responsibility (CSR)

CSR is high on Kendrion's agenda. CSR and sustainability are intrinsic, integral elements of Kendrion's local operations. For Kendrion, CSR means conducting business with consideration for climate effects and energy sources, with a feeling for people and the environment, and on the basis of a responsibility for the chain in which the company operates. This form of entrepreneurship pivots on the creation of multiple value – and consequently not just Profit, but also People and Planet. Kendrion intends to give shape to CSR in a practical and relevant manner.

Transparency and chain responsibility are important issues for Kendrion. Kendrion attaches great importance to good relationships with the group's customers, employees, suppliers, other business partners and the communities where Kendrion is active. Cooperation and consultations are essential if Kendrion is to fulfil its ambitions.

CSR also offers all Kendrion's business units opportunities to develop innovative products for new markets. Kendrion develops many specific electromagnets that are necessary for the appropriate performance of products that take account of climate effects, sources of energy, safety and the environment. A number of examples, including an innovative brake system for wind turbines, safety magnets for ski lifts, energy-saving variable transmission systems and designs for diesel engine oil pumps that lower fuel consumption, were shown to Kendrion's stakeholders during the Dr. Wilhelm Binder Days held in Amsterdam (the Netherlands) and Villingen (Germany) in October 2010.

Environment and quality

Kendrion endeavours to reduce waste and make efficient use of energy, and encourages the company's employees to make continual organisational and technical improvements to environmental procedures. During the design phase and technical planning Kendrion takes due account of the consequences for the environment. This relates not only to the reduction of harmful emissions and the achievement of a lower environmental impact, but also to the retention of the company's good reputation. As a company Kendrion bears a social responsibility that necessitates attention to environmental issues when assessing processes. Involvement, both now and in the future, is of great importance to the individual Kendrion companies and the enterprise as a whole. The quality, environmental management and safety systems are usually combined in one system that forms the basis for the implementation of many projects. Virtually all Kendrion's operating companies comply with the most stringent quality and safety requirements. Kendrion's environmental management systems comply with the ISO 14001 standard.

UN Global Compact

Kendrion joined the UN Global Compact in September 2009. The UN Global Compact is the world's largest network initiative that unites companies, UN organisations and civil society in support of ten principles encompassing human rights, labour, the environment and sound business practices. Kendrion endorses these principles and will issue periodic reports on the measures it has implemented in these areas. This is a further example of Kendrion's objective of being a company that all stakeholders can be proud of, in particular regarding the company's social and ethical principles and the manner in which these principles are implemented in everyday practice.

Kendrion filed its first progress report in September 2010. This report is available on Kendrion's website, under the 'CSR' section. The report provides a more detailed description of all Kendrion's CSR activities and the measures Kendrion has implemented recently. In addition, the report contains some examples of products developed by Kendrion's business units which were designed with due regard for climate effects, safety, sources of energy and the environment.

Code of Conduct

Kendrion has implemented a Code of Conduct in its organisation that applies to all Kendrion staff. The principles and best practices established in this Code reflect the main values that need to guide Kendrion's staff in the performance of their duties, and the actions they need to take in a variety of circumstances and situations. The core themes include market position, authorities, corporate social responsibility, accountability in general, and the obligation for due care regarding safety and health, the environment, and social interests. Kendrion promotes compliance with the Code of Conduct by continually bringing the Code to the attention of (new) managers and staff. The Code of Conduct was revised and presented to all employees early 2010, in part due to the company's accession to the UN Global Compact.

Whistleblower's Charter

The Whistleblower's Charter offers the Kendrion employees an opportunity to report irregularities or suspicions of irregularities to the management without jeopardising their (legal) position. In 2010 an ex-employee has reported irregularities. A full investigation was performed, no material irregularities were found and some weaknesses in internal control were solved. The Whistleblower's Charter has been updated early 2010 and presented to all employees.

2011 and beyond

Kendrion's CSR policy will be given further shape in 2011, in part by the appointment of a CSR working party. This working party, which will be chaired by a member of the Executive Committee, will be comprised of representatives from the various business units. A number of the main issues will be worked out in more detail in the form of specific policy and targets. A report on the policy and targets will be published at a later date. These issues include social policy, chain responsibility and energy, as well as the prevention of corruption, a sensitive issue in some of the countries in which Kendrion is active.

Human Resources

Personnel

Kendrion is a decentralised organisation comprised of four market-focused business units. Responsibilities are assigned as low as possible within the organisation, and local entrepreneurship is encouraged. Short lines of communication enable managers to respond rapidly and adequately to new developments at their customers or in local markets. This in turn results in high levels of creativity and involvement at the local companies, as well as ample challenges and feasibilities for the development of the local management. In so doing, local entrepreneurship offers flexibility and opportunities.

The situation in 2010 was completely different than in 2009. In 2009, Kendrion had to reduce its total number of employees as a result of the global economic crisis. Market conditions improved quarter on quarter in 2010. In addition to this economic growth, during the year there were new projects and product releases, especially in Kendrion's automotive activities, that further increased the company's revenue level. While high growth in the first quarter led to some inefficiencies at Kendrion's plants, the company succeeded in improving its output quite rapidly. Growth reached such a high level that Kendrion was required to hire numerous new employees throughout all parts of the organisation.

However, in view of past experiences, keeping costs, including personnel costs, flexible will remain extremely important in the years to come. Kendrion believes that there will be increased fluctuations in the worldwide economy in forthcoming years and that the related effects will be greater than in the past.

Kendrion's Human Resources (HR) policy is decentralised, and local management bears the responsibility for the local HR policy within the specified guidelines. A number of duties are coordinated at a central level. These duties primarily relate to the (senior) management, a group of about 40 managers.

New employees to be recruited by the company are selected on the basis of a number of core competences. The quality of the management is assured by internal and external training programmes, and solely highly trained managers are recruited.

Kendrion takes many initiatives to promote itself as an appealing employer in the region, such as publications in regional newspapers and magazines, as well as open days for schoolchildren, family days, and the provision of traineeships. Kendrion also organises fairly regular meetings for its retired employees.

Kendrion attaches importance to the creation of diversity in nationalities and cultures: this diversity promotes intercultural experience, which is highly compatible with the current internationalisation trend.

Bond with the employees

Kendrion's success is determined by the quality of both the company's organisation and employees. An explicit strategy and, on the basis of the strategy, feasible and challenging targets, open and honest labour relations and short lines of communication create a strong bond between Kendrion and its employees.

Kendrion's Board and the Business Unit Managers devote a great deal of attention to the communication of the strategy, the plans of action resulting from the strategy, and the details and progress of the plans. This ensures that the employees are provided with a clear insight into what is expected of them, and consequently are able to make an active contribution to the achievement of growth. Many operating companies have implemented career development and training programmes

designed to improve their staff's knowledge and skills. Employees receive guidance in forms such as annual performance appraisal interviews. Kendrion's corporate magazine 'Magnetised', for all staff, is published three times a year.
Kendrion has a good relationship with the works councils and the unions.

Number of employees

Kendrion has approximately 1,300 employees in seven European countries and China, Mexico, Brazil, India and the USA. People make Kendrion, and consequently Kendrion invests in the development of the knowledge and skills of its employees. Kendrion promotes inspirational exchanges of experience and collaboration between the various business units and operating companies.

Remuneration

Kendrion offers its employees good terms of employment that are in line with the market and are always assessed against local benchmarks. A bonus scheme has been implemented for the management that is based on the company's performance (operating result and free cash flow) and on individual long-term and short-term performance targets. Kendrion has implemented a share scheme for senior management.

Insight

Insight into the quality of the company's Human Resources (HR) is at least as important as insight into Kendrion's financial health, since figures and results are the product of human action. Kendrion obtains this insight with an HR audit developed by the company. Competences, knowledge and experience, as well as the manner in which Kendrion deploys its employees, contribute to the company's continuity and decisiveness. The HR audit, an element of the regular audits, is used to obtain insight in an operating company at a given point in time and to provide information about a number of HR indicators. The audit provides insight into both hard HR indicators and somewhat softer issues. The audit has been found to constitute a uniform and objective instrument that measures quality and which provides a clear insight into opportunities for developments in the HR field.
In addition, monthly HR key figures are reported for the entire company.
Understanding of the influence of the human factor on the organisation's performance results in an increasingly strategic HR policy, and offers scope for specific modification.

Awards

Kendrion also promotes innovation and improvement, and encourages the management and employees.
In September 2010 Company Awards were presented to the most innovative Kendrion company and the Kendrion business unit demonstrating the best adaptation to the economic circumstances. This time, Commercial Vehicle Systems won both awards.

Management development

Kendrion's ambition is to achieve niche market leadership in business-to-business markets by organic growth and strategic acquisitions, and consequently the quality of the management is both important to and characteristic of Kendrion. Good management is of essential importance to the future, and for this reason Kendrion assigns high priority to management development. The corporate management development programme is supported by the Kendrion Executive Programme, a customised, international modular teaching programme in which the company collaborates with the Rotterdam School of Management. The subjects covered by the programme are communication and leadership, sales and marketing, strategy, production and logistics, HR and project management. The programme also constitutes an important platform for exchanges of experience between the (senior) management, and for the further expansion of collaboration between the various operating companies.

Every year a group of non-financial managers follows a course in finance. This course, which is also customised, covers issues of importance to Kendrion, such as risk management, purchasing, production, sales, investments and planning and control. In addition, the various business units have implemented training programmes at all levels in the organisation. Kendrion's management development endeavours to find an appropriate equilibrium between the transfer of internal knowledge and the recruitment of external knowledge.

The economic crisis led to the company's decision to freeze the Kendrion Executive Programme and the financial training courses in 2009. In view of the improved economic conditions, Kendrion resumed the Kendrion Executive Programme in the second half of 2010. The financial training courses will be relaunched in 2011.

A professional organisation of the nature of Kendrion must ensure for continuity. Consequently, the company needs to devote continual attention to the question as to who is to be succeeded by who and when, and what is required to ensure that the succession is a success. Obviously, the converse is also the case: Kendrion wishes to help people fulfil their ambitions: people are the most important factor, and Kendrion intends to invest in their future. Kendrion will also need a group of managers with a well-developed vision of strategy and internationalisation in the future. Kendrion endeavours to retain high potential managers and interest them in filling vacant positions. The development of the managers is followed by means such as annual performance appraisal interviews where the managers' targets and duties are reviewed and the managers receive feedback on their performance. In addition, managers participate in an individual development assessment.

Social policy

Kendrion is and wishes to remain a conscientious and reputable company. Kendrion intends to be a versatile and flexible company for its employees, a company where pleasure in entrepreneurship is combined with clear result targets.

Kendrion's social policy is designed to enable the company to achieve its targets and offer its staff at all levels opportunities to develop and further themselves. Kendrion's HR policy endeavours to ensure that the composition of the company's personnel, including the lower and middle management, reflects the geographical spread of Kendrion's operations.

The importance Kendrion attaches to a good social policy is also demonstrated by the company's accession to the UN Global Compact that includes labour principles relating to the working conditions of employees.

Personnel: key figures	2010	2009
Total number of employees at 31 December	1,298	1,105
Number of women in permanent employment	413	378
Number of men in permanent employment	660	599
Number of employees with a fixed-term contract	225	128
Number of temporary employees	158	104
Number of permanent and temporary employees at 31 December (FTE)	1,376	1,131
Number of direct employees	716	571
Number of indirect employees	582	534
Average age of women	41.4	41.3
Average age of men	39.9	39.6
Average age of all employees	40.4	40.3
Average number of years' service	10.0	11.0
Average rate of absenteeism per employee (%)	2.5	3.7
Influx percentage (%)	31	6
Departure percentage (%)	19	22
Wage costs per FTE (EUR)	42,971	43,679
Training costs (as a % of wage costs)	1.00	0.39

Risks and risk management

Background

Kendrion promotes local entrepreneurship at its companies and, logically, offers scope to exercise the associated discretionary powers. Kendrion actively conveys the essential need to maintain a healthy equilibrium between entrepreneurial spirit and the extent to which risks are accepted. Adequate risk management is an integral element of good business practice. When risks are made visible Kendrion's managers can implement adequate measures in their everyday management that offer them optimum control of the risks. Kendrion's risk management is not intended to eliminate all risks entirely. Kendrion's objective is to adopt the approach to business risks required to minimise surprises.

Kendrion has a responsibility to put internal controls and procedures into place and test them to verify their adequate performance. The local management is expected to be fully aware of the operating risks and the necessity for internal control procedures. Kendrion has devoted structural attention to the optimisation of the risk management and control system since 2005 as part of the everyday decision-making. All companies are logically confronted with business risks during the pursuit of their operations. Kendrion's policy is focused on mitigating the risks or, when possible and prudent, hedging the risks without losing sight of the company's entrepreneurship.

The Board wishes to emphasise that risk management and control systems – no matter how professional they may be – can neither offer absolute guarantees that the company's objectives shall be achieved nor entirely prevent material errors, loss, fraud, or violations of laws or regulations.

Kendrion's approach to the company's risk management is laid down in the Enterprise Risk Management Framework as shown in the following illustration:

Kendrion Risk Management 2010

Enterprise Risk Management

Strategic & Business Risk Management
- Risk workshop
- Quarterly evaluation per business unit

Operational Risk Management
- Quality systems
- Safety & health environment
- Hedging against commodity price risk
- Monitoring & hedging financial risk
- Insurance
- IT governance
- Quarterly evaluation per business unit

Financial Reporting Risk Management
- Group Reporting Manual
- Monthly closing procedures
- Internal control procedures
- Audits (external & internal)
- Monthly review cycle with business unit management

Compliance & Regulatory
- Reporting & disclosures
- Legal counseling
- Internal audits
- Training

Planning & Control Cycle

Kendrion's Code of Conduct & Whistleblower's Charter

Kendrion's Control Framework (COSO)

Kendrion employs a structured risk management framework that reveals the various elements of risk management and the relationship between the elements. Kendrion's objective is to avoid duplication within separate systems whenever possible. Links are made, when this is worthwhile, between systems where they interact. The factors that underpin the quality of the management framework are integrity, business ethics and the staff's expertise, the management style and the manner in which authorities and responsibilities are delegated and monitored by the management, but also the deployment and development of the staff, and the manner in which the aforementioned factors are directed. The risk management process is based on the generally accepted COSO Enterprise Risk Management framework.

Control environment and financial reporting risk management in the year under review

Control environment

The Board is responsible for the control environment including internal risk management and control systems, and for the optimum management of the strategic, operational, financial and reporting risks confronting Kendrion. The internal risk management and control systems extend to issues including policy-making, processes, duties, influencing conduct and other aspects of the organisation that jointly provide for the achievement of targets and the prevention or timely identification of potentially material errors, loss, fraud, or infringement of legislation and regulations.

During the year under review the major elements and foundations of Kendrion's internal risk management and control systems were:

Code of Conduct

Kendrion has implemented a Code of Conduct in its organisation that applies to all Kendrion staff. The principles and best practices established in this Code reflect the main values that need to guide Kendrion's staff in the performance of their duties, and the actions they need to take in a variety of circumstances and situations. The core themes include market position, authorities, corporate social responsibility, accountability in general, and the obligation for due care regarding safety and health, the environment, and social interests. Kendrion promotes compliance with the Code of Conduct by continually bringing the Code to the attention of (new) managers and staff. The Code of Conduct was revised early in 2010, in part due to the company's accession to the UN Global Compact. The revised Code of Conduct has been presented to all employees within Kendrion.

Whistleblower's Charter

The Whistleblower's Charter offers the Kendrion employees an opportunity to report irregularities or suspicions of irregularities to the management without jeopardising their (legal) position. In 2010 an ex-employee has reported irregularities. A full investigation was performed, no material irregularities were found, some weaknesses in internal control were solved. The Whistleblower's Charter has been updated early 2010 and presented to all employees.

Regulations to prevent insider trading

Kendrion has implemented regulations to prevent insider trading which are designed to make a contribution to the prevention of employee infringement of the prevailing insider trading and market abuse regulations. These regulations include a prohibition on dealing in Kendrion's shares in the period prior to the publication of the quarterly, half-yearly and annual figures. More details about these regulations are disclosed on page 13.

Rules and Regulations and Letters of Representation

Kendrion employs Rules and Regulations and Letters of Representation. The Rules and Regulations constitute rules of behaviour governing all Kendrion Managing Directors. The Letters of Representation are submitted once a quarter, in a bottom-up procedure, to the Managing Directors of the operating companies and Controllers, and to the Business Unit Managers and their Controllers. Each officer is required to sign the letter to confirm to their managers that the information and financial information they have reported is correct and complete.

Group Reporting Manual

Kendrion has implemented a Group Reporting Manual governing all operating companies to provide for correct financial reporting. The Manual is continually updated. To this end the company has implemented measures including the formation of the Kendrion Group Reporting Committee, with representatives from the operating companies.

Planning and control cycle

Insight into Kendrion's performance is obtained from the monthly reports of the current figures submitted by all the operating companies. In the summer of each year Kendrion prepares a Mid-term Plan with a three-year planning horizon. This plan provides insight into the strategic course of the companies and business units. The Mid-term Plan is accompanied by a more detailed annual budget to provide a precise management tool. The budget is also used to reach short-term agreements with managers. A complete forecast prepared each quarter offers insight into financial expectations until the end of the year, and updates the budget. The Board and the Board's control and audit team devote a great deal of attention to the assessment and follow up of all report cycles. When necessary, special audits are conducted to review specific issues in more depth. Consultations on the progress, development of key performance indicators and variations from long-term targets are held at various levels in the organisation. Kendrion has implemented a capital expenditure procedure which makes use of standard investment request forms. Board approval is required for new projects with planned annual revenue in excess of EUR 1 million to test return on investment, payback period and cash flows. Board approval is also required for actual capital expenditure in excess of EUR 50,000.

Quarterly and monthly reports and meetings

Regular discussions in the monthly meetings between the Board and the Business Unit Managers and similar reviews within the business units address the internal risk management system. Each business unit submits a comprehensive written report at least once a quarter which provides details about the financial and operational situation and the status of any current claims and proceedings, where relevant. These reports include an estimate of the possible financial consequences of each of the claims.

Strategic and business risk management

The Executive Committee discussed specific strategic and business risks during the year under review. Quarterly meetings on this issue were held with and within the business units. In 2010, the main issues receiving attention were macroeconomic downturns (the flexibility of the operations), ERP implementation (due to the planned investment in a completely new ERP platform) and raw material price developments.

Operational risk management

Kendrion's companies make active use of quality systems designed to improve the processes. Virtually all companies have been awarded ISO certification, and possess the relevant safety certificates.

Financial reporting risk management

The Controllers' regular duties include the structured management of financial reporting risks. Pursuant to this duty the Controllers periodically monitor the organisation's implementation of and compliance with control measures, i.e. monitor the use of control measures as an integral element of the Group's operations. Kendrion has also implemented corporate guidelines that specify the monthly close procedures and the minimum controls to be performed. The internal control procedures of the largest companies are also reviewed in semi-annual internal audits conducted by teams of Kendrion N.V., Business Unit Controllers and contracted qualified auditors.

A structured approach to both financial reporting risks and strategic and operating risks is a standard component of risk management. Kendrion's organisation of risk management varies for each focal point and can rapidly be tightened as necessary.

Compliance & regulation

Kendrion must comply with the local legislation and regulations in all countries in which the company is active. The responsibility for compliance rests with the local management. Transactions and affairs that could be of influence on the legal structure of the Kendrion Group companies and material claims should be addressed at corporate level. Kendrion obtains advice from external legal experts to acquire timely information about the latest developments in the legislation and regulations, including the applicable stock exchange regulations. Kendrion has also arranged for liability insurance at corporate level to protect the companies and their Managing Directors from possible future claims. Internal audits conducted from time to time at the operating companies investigate issues including compliance with local legislation and regulations.

Kendrion's strategic and business risks identified and arising from the current financial risks are reviewed below. This review extends to a selection of the major risk factors, and is not exhaustive. The four most important risks are indicated by the 'top 4 risk' text at the beginning of the relevant paragraph.

Strategic risks

External

Adaptation to economic downturn (top 4 risk)

A lack of further adaptation to deteriorating economic conditions could be detrimental to Kendrion's financial results and the company's ability to achieve its strategic goals

Kendrion expects greater volatility in future economic development. In addition, the situation in the eurozone remains unstable at present. An economic decline could be detrimental to Kendrion's profitability. Kendrion has prioritised the maintenance of a flexible organisation to enable the company to 'breathe' with the economic tides. Flexibility not only relates to working with temporary personnel or with personnel with contracts of employment for a definite period and a focus on the reduction of variable operating expenses. It also includes the development of plans to enable personnel to switch between business units, make justifiable insourcing and outsourcing decisions, adjust supplier contracts, implement performance-dependent employee benefits, work with flexible hour contracts and make use of opportunities for the reduction of working hours in specific countries.
Kendrion has implemented a flexibility measurement system for each operating company and, consequently, for each business unit. The flexibility measurement focuses primarily on variable staff costs and variable or semi-variable other operating expenses. Specifically, it is a cost block Kendrion can use to reduce costs when revenue decreases. Variable staff costs include temporary employees and fixed-term contracts, while variable other operating expenses include transport and packaging costs, sales costs, etc. Additionally, working-time reduction in certain jurisdictions, such as Germany, offer cost compensations. Over the last six months of 2010, Kendrion's flexibility rate hovered between approximately 20-30%. The latter percentage includes governmental working-time reduction plans.

Kendrion will retain its focus on flexibility. Steps have been taken to further improve the quality of the periodic measurements. One of the factors limiting the company's maintenance of high levels of flexibility is Kendrion's current problems with the recruitment of good, qualified temporary staff in southern Germany due to the greatly improved economic conditions.

In addition to the increased focus on flexibility, Kendrion's objective is to decrease the company's dependency on the European and, more specifically, German market. Kendrion is of the opinion that a broader geographical spread in combination with a spread between customers and markets will reduce the company's vulnerability to regional economic or market downturns.

Sustainable market developments/ competition

Kendrion could become more dependent on one of its markets in which it operates

Kendrion is a technically-driven company with a leading position in the European market. The barriers to entry to specific markets are substantial due to the high levels of technological knowledge and investments that are required. Kendrion's competitors are often smaller family-owned companies focused on a specific segment. In 2010 approximately 39% of the revenue from electromagnetic components and systems was generated by the automotive market, a market characterised by competition and, consequently, pressure on prices. As a result, and notwithstanding the companies' good market positions, customers endeavour to pass this pricing pressure back up the supply chain. Kendrion has adopted a strategy stipulating that the company shall not become excessively dependent on a specific market or customer and has adjusted its investment and acquisition policy accordingly. Kendrion has a broad spread of customers in a wide range of market segments. Only one customer accounts for more than 5% of the total revenue of the company (9%).

Internal

Innovation

Kendrion might not be able to benefit from a changing market environment

Kendrion is an innovative player in the field of electromagnetic systems and products. The company carries out innovative projects in close consultation with its customers, an approach which Kendrion also perceives as contributing to the company's provision of added value. However, new technologies and innovations in the market environment could result in the imposition of changed requirements on Kendrion's products and operations. This would offer the company opportunities, but could also be accompanied by risks. Kendrion conducts an innovative policy that enables the company to approach opportunities in a balanced manner. Pursuant to this policy Kendrion has implemented measures including the institution of an Innovation Board in 2009. The Innovation Board is comprised of five external members from various disciplines and countries who each make a contribution to the company's innovative capacity together with a number of Kendrion staff. Kendrion has also installed an Innovation Calendar and appointed Innovation Managers at each business unit, both measures designed to maintain a continual focus on Kendrion's innovative creativity and conduct.

Project management (top 4 risk)

The lack of adequate project management could cause a loss of knowledge and reputation which could in turn be detrimental to Kendrion's productivity, customer contacts and results
Adequate project management is essential if new products are to enter the production phase with success, and the risks associated with inadequate project management can exert a significant effect on the results. Kendrion imposes stringent requirements on the finished product.

Customers request the company to develop products complying with specific functional requirements that can, on occasion, come close to the limits of the technologically achievable. Project teams and the requisite disciplines assess the feasibility, since an incorrect estimation of the technical feasibility can result in the (potential) customer's loss of confidence. Moreover, the available capacities are scarce and the successful completion of projects is of great importance. For this reason the company is also confronted with the risk that Kendrion's engineers succeed in developing a technologically acceptable solution, but that the customer nevertheless decides not to proceed with the approach. In order to avoid such circumstances, Kendrion is continually aiming for sole suppliership. Kendrion has a number of patents for its operations, although it is impossible to state with certainty that patents provide sufficient protection from third-party infringements. In general, the majority of the development costs are borne by the customer, either in instalments during the development phase or as part of the selling price per unit.
In addition to project management, this definition also extends to greenfield operations and acquisitions. The progress in the organisation at new locations and recent acquisitions is reported at a number of management levels, thereby ensuring continual attention and, where relevant, implementation of the necessary measures.

>> Operational risks

External

Commodity markets (top 4 risk)

An inability to access raw materials and/or increases in the cost of raw materials and energy could be detrimental to Kendrion's future results
Kendrion's results could suffer from the reduced availability of raw materials and fluctuations in the price of raw materials due, for example, to increasing or decreasing prices of fossil fuels. Steel and copper are Kendrion's most important raw materials. These raw materials are purchased from reputable suppliers. Kendrion has also adopted a multi-sourcing strategy for important materials and components, with procurement in several countries. The raw materials are purchased separately by each business unit, making use of differentiated requirements.
Raw materials are purchased in accordance with a group policy that is discussed regularly by the business units.
The purchases are coordinated. Kendrion limits the unavailability of raw materials by using adequate planning systems in the supply chain.
Self-evidently, Kendrion endeavours to minimise the effects of price fluctuations on the group's results. The degree to which this is feasible depends on contractual clauses and the market. In addition, a time lag is usual. Copper is an important raw material in this respect. When Kendrion cannot pass on price increases to customers, Kendrion either implements fixed purchase prices for a specific period and/or concludes corporate hedging transactions to limit the impact of price increases. Steel is Kendrion's number-one raw material, although a large proportion is in the form of purchased components. Kendrion concludes fixed price arrangements with suppliers for periods up to twelve months (the maximum period which is feasible).

Product liability

Product liability claims and/or product recalls could be detrimental to the company's reputation and results
Claims under product liability can be detrimental to Kendrion's operations and operating results due to the resultant damage to the company's reputation. Kendrion has taken out liability insurance at group level for its operating companies to reduce the financial risks arising from possible claims under product liability. The amount and scope of the cover are comparable to those of other companies in Kendrion's sectors: the cover is benchmarked once every few years, most recently in the year under review. Kendrion also aims to limit the group's liability exposure by employing up-to-date general terms and conditions and arranging for reviews of material or long-term contracts by external legal advisors.

Environmental liabilities

Kendrion's business is exposed to (reputational) risks of environmental liabilities
The nature of Kendrion's operations and business are such that they give cause to limited environmental risks. Most Kendrion companies have been awarded ISO 14001 certification. This certification also includes international environmental standards.

Internal

Information and communication technology systems (ICT) (top 4 risk)

Inadequate ICT systems (including the infrastructure) and/or implementation of new systems could have a major influence on the company's business processes and, consequently, the results
This risk has received significant management attention during the year under review due to the preparations for a replacement of the existing ERP applications within the next two years.

The major ICT risks include the risk of interruptions, loss of data and unauthorised access to data. ICT is of importance to Kendrion, both in terms of the risks and business support. Kendrion's Board and, in particular, the CFO bears the overall ICT responsibility. Kendrion has implemented a corporate ICT policy and strategy which extends to issues including:

- the arrangements for ICT decision-making and the decisions that can be made at each level (central or local);
- IT governance for system and data responsibility;
- the regulations governing the implementation of ICT systems;
- the arrangements for sourcing ICT products and services for the business units and their operating companies;
- the requirements to be met by the ICT organisation in serving the users as internal customers;
- the measures that need to be implemented to mitigate risks, such as access security (programmes, equipment backup and recovery, change management procedures, etc.).

The implementation of new software, servers and network systems can pose interruption risks that can in turn pose major consequential risks (loss of orders, customers, or the company's reputation, etc.). These implementations must be based on best practice guidelines and common procedures that include the following:

- an adequate governance structure throughout the entire project;
- thorough preparations;
- balanced selection of suppliers;
- milestone planning;
- audits for important go/no-go decisions;
- business cases.

Infrastructure – Most operating companies and Kendrion Group Services are supported by the ICT department in Villingen, Germany. This department coordinates the service level agreements with suppliers such as network providers, security, maintenance companies and suppliers of hardware. Kendrion works with highly skilled ICT staff and reputable external ICT suppliers. The servers are well protected against outsiders, fire and unauthorised access. Appropriate procedures have also been implemented for regular backups of the data. The infrastructure operates at a high availability level. Kendrion Magneta and Kendrion Tri-Tech (the USA) acquired by Kendrion were migrated to the central infrastructure and security measures in 2010. The Commercial Vehicle Systems operating companies in the USA and Germany will be migrated in 2011/2012. Centralisation of the smaller operations in China, Brazil and Mexico will be evaluated, whereby account will be taken of the risks, costs and investments.

Software application portfolio – Most operating companies use a standardised ERP system (operational since 2000), Microsoft operating systems (OS) and applications and software for specific applications such as project management. The software is stable and Kendrion has the knowledge required for user support. However, the current ERP application has reached the end of its lifecycle and does not meet Kendrion's future needs. Kendrion is preparing for the introduction of a new ERP system within the next two years. This will involve a substantial investment. ERP implementations are accompanied by high risks of business interruption and substantial budget overrides. Kendrion has implemented measures to minimise these risks by strict and high-level governance including adequate project management.

This includes:

- hiring a dedicated Program Director with a solid track record of successful ERP implementations;
- appointing Information Managers for each business unit;
- contracting Gartner for quality assurance;
- setting up a steering committee with the CFO as the member of the Board with overall ICT responsibility;
- including consultants in the process when required.

Business processes were mapped and improvements were identified during the year under review. At the beginning of 2011, Kendrion is engaged in the selection of a software vendor and system integrator. Kendrion forecasts the migration of current software/systems and performance of a pilot ERP implementation during the second half of 2011, followed by the roll-out of the new ERP platform at the beginning of 2012.

Financial risks

External

Treasury

A lack of insight into the treasury risks and a lack of appropriate agreements on the approach to risks of this nature can be detrimental to Kendrion's results

Kendrion has implemented a Treasury Policy. Pursuant to the management's policy significant sensitivities to currency and interest rate fluctuations can be hedged with currency derivatives.

Exchange rate risks – The majority of Kendrion's revenue, costs, assets and liabilities are denominated in euros. Revenue and costs are realised in the same currency whenever this is feasible and profitable. Kendrion monitors forecasted currency exposures and carries out quarterly evaluations of projects throughout their lifetime.

Group companies with significant sensitivities to currency and interest rate fluctuations must hedge these sensitivities with the central Treasury, which then makes arrangements for the derivatives by entering into back-to-back transactions with counterparties. Future transactions pursuant to existing projects are hedged with derivatives for a maximum of two years, whereby Kendrion makes use of forward exchange contracts or currency options. In addition, loans to Group companies in currencies other than the euro are hedged at a central level using currency swaps.

At balance sheet date Kendrion had not hedged any net investments in its subsidiaries outside the eurozone.

In principle significant acquisitions and local debts are financed in the local currency and as a result this financing constitutes a natural hedge against exchange rate risks.

Interest rate risks – The majority of the financing raised by the company is in the form of variable interest rate loans. These variable interest rates can fluctuate and reduce the results. In view of the low interest-bearing debt at the end of the year under review the impact of fluctuating market interest rates will be very limited. For this reason Kendrion had no hedge to cover interest rate sensitivity at 31 December 2010. If the interest-bearing debt increases due to the acquisition of companies with bank loans then a substantial proportion of the interest-bearing debt will be hedged.

Fluctuations in the level of interest rates can also affect the assets and liabilities of pension funds and result in higher pension costs and contributions. The majority of Kendrion's pension schemes are defined contribution pension schemes.

Although Kendrion hedges significant sensitivities to interest rate and currency fluctuations, some sensitivities will always remain.

Tax risks

The outcome of tax disputes, litigation, indemnification and guarantees, and regulatory action could be detrimental to the business and the results

Kendrion operates in 12 countries with companies that possess a high degree of autonomy. In most countries the responsibility for accurate tax returns has been assigned to the local management. Kendrion carries out an annual inventory at corporate level and in close collaboration with renowned international tax consultants to assess whether fiscal developments could have an effect on the company's subsidiaries.

Management of financial reporting risks in the year under review

Kendrion has adopted a structured approach to the management of financial reporting risks. The company perceives the structured management of financial reporting risks as one of the regular duties of the Controllers of the largest Kendrion companies. In principle, the control measures are integrated in the various company processes. The local Controllers supervise compliance. Kendrion has implemented guidelines for the Controllers that specify the monthly close procedures and the minimum controls to be performed. Kendrion has developed a special internal audit programme (KiC: Kendrion-in-Control) for an independent assessment of the effectiveness of the companies' control framework. Kendrion has to date opted for an audit programme with a scope of the companies that jointly account for approximately 80% of the value of the relevant reporting cycles. The reporting cycles Kendrion has implemented for its operating companies are revenue and accounts receivable, purchase and accounts payable, inventories, fixed assets, and human resources. The current audit programme set-up safeguards the independence of the internal auditors, since Controllers do not audit their own operating companies. The KiC testing also serves as a platform for management development and provides for the sharing of best practices between the various operating companies.

Results from and shortcomings revealed by the audit programme

In 2010, Kendrion audited companies to assess the quality of their financial reporting risk management systems. These internal audits covered over 80% of the value of the relevant reporting cycles. Companies where deficiencies were noted were revisited to verify that remedial measures had been implemented. The overall results from the audits carried out in 2010 were satisfactory, in view of the outcome of the internal audits conducted by Kendrion and the limited number of audit findings of the external local auditors communicated in the management letters and identified during the final audits. During the past year Kendrion devoted a great deal of attention to issues requiring improvement, i.e. the (further) segregation of duties in ICT and payment systems, the super users of ICT systems and proof of authorisation. Active support has been given to the adjustment of user authorisations and the definition and design of practical compensating controls. Segregation of duty deficiencies were detected in the ICT system of Kendrion Magneta, the company which was acquired in 2010. These deficiencies will be repaired, or the risks will be mitigated with compensating controls in the first quarter of 2011.

In view of the above, the Board is of the opinion that the design of the internal risk management and control systems provide a reasonable assurance that the financial reporting does not contain any errors of material importance and that, with due regard for the aforementioned shortcomings, the risk management and control systems performed adequately in the year under review.

Financial review

Highlights

Acquisition of Magneta GmbH & Co. KG, Aerzen (Germany)

On 25 February 2010, Kendrion acquired Magneta, a German company in Aerzen, near Hannover. The company, with about 40 employees who generated revenue of approximately EUR 9 million in 2009 and is highly profitable, is specialised in small electromagnetic brakes and clutches for use in applications including cash dispensers, transportation systems and in the automotive industry. In 2010, following the crisis, Kendrion Magneta succeeded in increasing revenue by 15% and achieving an improved operating result.

Financial results

In 2010 Kendrion generated net profit of EUR 16.6 million, including a one-time profit from taxes of EUR 1.8 million that was primarily due to recording a deferred tax asset in the Netherlands. This relates to the valuation of part of the Dutch tax losses carried forward following the pro-active restructuring of Kendrion's tax position in the Netherlands and in Germany. Consequently, normalised net profit for 2010 was EUR 14.8 million.

Kendrion benefited in full from the measures implemented in 2009 (the Springtime Plan), which resulted in a leaner organisation that has the key people on board and has enabled the company to record a much higher profit than before the crisis. In 2008, Kendrion recorded normalised net profit of EUR 8 million from revenue of EUR 204.2 million (4%). In 2010 the revenue of EUR 221.9 million generated a normalised net profit of EUR 14.8 million (6.7%).

Revenue

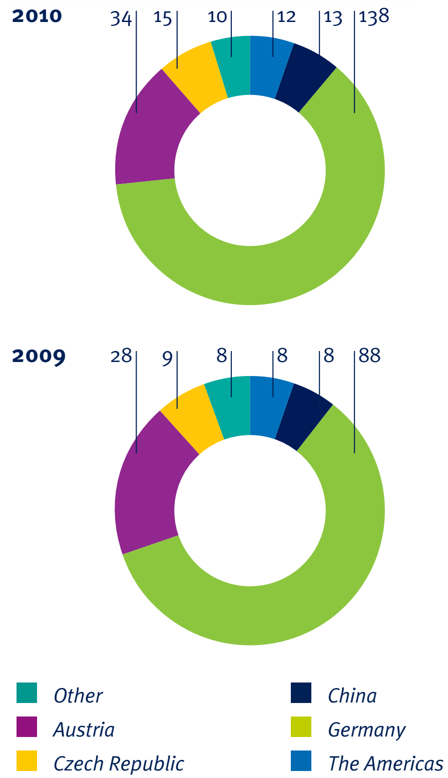
In 2010, revenue grew to almost EUR 222 million from EUR 149 million in the previous year, an increase of 49%. When Kendrion Magneta is not taken into account organic growth amounted to 43%. Kendrion exhibited very strong growth in the four quarters of 2010 as compared to the same periods in the previous year:

1st quarter:	34%
2nd quarter:	65%
3rd quarter:	51%
4th quarter:	46%

Kendrion's organic revenue in 2010 was EUR 9 million higher than in 2008 (4.4%). Although revenue until the second quarter of 2010 was still lower than in 2008, from the third quarter onwards Kendrion's revenue exceeded the 2008 levels. The effect of increased sales prices was negligible (lower than 1% of revenue) during the year under review; sales price reductions were also negligible (lower than 1% of revenue). In 2010, the effect of exchange rate translation differences was approximately EUR 3.1 million, equivalent to 1.4%. The translation effect on net profit was EUR 0.3 million.

The revenue by location of the operating companies can be specified as follows:

EUR million



The powerful growth in 2010 was largely driven by the demand for products from Kendrion's German customer base required by end-users in the Far East. Europe's internal markets have yet to return to pre-crisis levels.

Developments in each business unit
Industrial Magnetic Systems achieved organic growth of 24% in 2010, largely due to the strong recovery of the safety & locking markets. Revenues in the machine building and energy system segments recovered during the year, while segments such as the medical and beverage industry remained fairly stable during the crisis. The business unit invested in new projects for medical equipment and flow control which will begin to take effect in 2011/2012.

Industrial Drive Systems achieved organic growth of 43%. However, the business unit still has potential for further growth since the level of activity remains lower than before the crisis. The powerful growth following the crisis was due to the demand for permanent magnet brakes for servomotors. New projects such as the ski lift system have also supported growth. In addition, service business for the USA also increased.

Passenger Car Systems saw revenue grow strongly by 62%: all locations reported similar high growth percentages. This business unit's revenue is up 60% from the pre-crisis level due to growth in all product categories and, in particular, in new diesel projects. Kendrion has acquired very strong positions in technology of this form and expects further growth from additional projects in this area.

Commercial Vehicle Systems was able to increase revenue by 37%, largely due to increased demand in the Far East (China and Korea). The business unit has also succeeded in its endeavours to enter the US truck market and expand its technology to other markets. In addition, Kendrion has begun a greenfield operation in India for the truck market.

Added value
In 2010, added value amounted to EUR 114.4 million (51.4%) as compared to EUR 77.6 million in 2009 (51.7%). When the effect of changes in stock is not taken into account then added value decreased by two points. The increase and reduction in sales prices was negligible and had virtually no effect on added value. The 2% decrease was due to a number of factors, of which the most important were the outsourcing of coil winding from the former Austrian plant in 2010, increased material prices (below 1%), the changes to the product mix of some business units and inefficiency during the first half year due to rapidly increasing demand. Conversely, Kendrion was able to localise more supplies in emerging markets and improved prices with suppliers.

Staff costs and other operating expenses
Staff costs (including temporary employees) and other operating expenses in 2010 amounted to EUR 81.5 million, equivalent to 71.2% of added value, in comparison with EUR 67.8 million (normalised) in 2009, equivalent to 87.3% of added value. The increase compared to 2009 amounted to EUR 13.7 million; when Kendrion Magneta is excluded the increase was EUR 10.9 million (16.1%).

In 2009, staff costs were detrimentally influenced by the Springtime Plan whilst, conversely, some temporary cost measures (working hours reduction and a 10% salary decrease for 40 managers including the members of the Board and the Supervisory Board) reduced costs by EUR 1 million in 2009. Staff costs (normalised) increased from EUR 50 million in 2009 to EUR 62 million in 2010 (24%), including the ten months of the operations of the newly-acquired Magneta company; when this acquisition is excluded the increase was 20%. The increase was primarily due to hiring additional staff, salary increases and higher bonus liabilities. Staff costs expressed in terms of added value decreased from 65% in 2009 (normalised) to 54% in 2010. Average staff costs per FTE increased slightly to EUR 43,000.
Other operating expenses increased from EUR 17.5 million in 2009 (normalised) to EUR 19.5 million, an increase of 11%. This EUR 2 million increase is primarily due to variable expenses including transport costs, energy costs and the increase in sales promotion and travel & representation costs following the crisis year. Operating expenses expressed in terms of added value decreased from 22.6% to 17% in 2010.
Kendrion is focused strongly on the increase in the company's flexibility as monitored on the basis of systems such as quarterly measurements of the development of staff expenses and operating expenses, categorised in fixed, variable and semi-variable costs.

Net financing costs
Net financing costs amounted to EUR 3 million, including favourable exchange rate differences of EUR 0.2 million. The EUR 3.2 million interest expenses also included the bank guarantee fee relating to the EC fine, commitment fees on unused facilities, amortised bank and legal fees (transaction costs), interest on pension obligations and a number of smaller items. Average bank debt levels in 2010 amounted to EUR 22 million, excluding cash positions. Although this might appear to be high, the level is primarily due to the EUR 15 million

term loan from the bank syndicate agreed since the crisis. During the year under review net bank debt decreased and cash increased, although the latter generates almost no interest. The average interest charge was 6.25%. The relatively high average interest rate as compared to the low average market rates is due to Kendrion's interest swap of 3-month EURIBOR to a fixed rate of 4.2% for an amount of EUR 15 million. This swap contract expired on 31 December 2010.

Income tax
Recorded income tax expenses amounted to EUR 3.2 million, but were favourably influenced by a one-time gain of EUR 1.8 million in the fourth quarter. Normalised tax expense amounted to EUR 5 million, equivalent to 25% of profit before tax. Tax paid in 2010 amounted to EUR 0.8 million. This is low in comparison with the income tax expense and was largely due to the existing tax losses in Germany and Austria, as well as to the tax holidays for China.

Statement of financial position total, working capital and financial position
At 31 December 2010, the balance sheet total amounted to EUR 177 million, a growth of EUR 24 million. Goodwill and intangibles increased by a total EUR 9 million due to the acquisition of Magneta in February 2010. Working capital items increased by EUR 15 million due to the strong growth in revenue.

At 31 December 2010, working capital as a percentage of revenue was 11.7%, excluding an earn-out liability at year-end (31 December 2009: 14.5%) – a great improvement as compared to last year. This is particularly evident from the Days Inventory Outstanding as based on the fourth-quarter revenue, which decreased to 44 from 51 in the same period last year, while the Days Sales Outstanding decreased from 46 to 41.
The quality of the trade receivables portfolio remains, in analogy with the crisis year of 2009, at a high level. At year-end the provision amounted to EUR 0.3 million. Amounts › 60 days overdue are negligible (less than 1%).

At year-end 2010, the solvency ratio was 64.7% (year-end 2009: 62.9%), while net bank debts amounted to EUR 5.2 million. At year-end 2010, Kendrion complied with all terms of the bank covenants by an ample margin, as is shown below:

- Quarterly compliance levels:
  - Bank solvency › 27.5% (at 31 December 2010: 43.2%);
  - Debt cover ‹ 3.40 (at 31 December 2010: 0.77);
  - Quarterly interest cover › 2.40 (at 31 December 2010: 14.3);
- The bank solvency is calculated with shareholders' equity reduced with 75% of the EC bank guarantee exposure and with 50% of the recorded goodwill;
- The debt cover is calculated as net bank debt including 50% of the EC bank guarantee exposure over the 12-month operating result before depreciation and amortisation (EBITDA);
- The interest cover is calculated as the operating result in the quarter over the net finance costs before the amortisation of intangible assets.

In December 2010, Kendrion's subordinated loan receivable of EUR 0.6 million, arising from a company sold in 2003, was repaid in full.

In December 2010, Kendrion concluded a credit facility agreement with a new bank syndicate, which took effect in January 2011. The new financing arrangement has a term of five years, with a EUR 35 million revolving credit facility for working capital and general corporate purposes, a EUR 40 million revolving credit facility for acquisitions for three years with 2 one-year extension options and a EUR 48.5 million bank guarantee facility relating to the EC fine. The most important conditions are:

- Full flexibility in terms of acquisitions within Kendrion's strategy, dividend pay-out, equity issues and mezzanine finance;
- No pledges or other securities;
- The acquisition facility will be reduced by 12.5% semi-annually from 3.5 years after the date of the facility agreement unless the leverage ratio (net bank debt plus bank guarantee over EBITDA) is below 2.0;
- Interest cover compliance level of at least 4, based on EBITDA over finance charges including the fee for the EC bank guarantee (pro forma 31 December 2010: 17.3);
- Debt cover compliance level of a maximum of 2.5, based on net bank debt excluding the EC bank guarantee over EBITDA (pro forma 31 December 2010: 0.16);
- Solvency compliance is no longer required;
- Competitive interest ratchet.

Capital expenditure

In 2010, capital expenditure amounted to EUR 8.9 million at a depreciation level of EUR 8.7 million (excluding amortisation of intangibles arising from acquisitions). This expenditure comprised EUR 3 million on project investments including assembly lines for Passenger Car Systems, EUR 4 million on production equipment and tools and EUR 1.9 million on building and infrastructure reconstruction and ICT.

Free cash flow

In 2010, free cash flow before acquisitions was outstanding at EUR 17.4 million, exceeding net profit and achieved with limited growth in working capital whilst a 43% organic growth in revenue. All business units made a good contribution to the overall free cash flow.

Contingent liabilities

By the end of 2009 Kendrion disclosed that the Slovenian company Maravi d.o.o. claimed a breach of an existing supply contract by Kendrion Binder Magnete GmbH (Austria) relating to the purchase of the minimum number of products. This claim is void since the court ruled in Kendrion's favour at the end of 2010. The other disclosed contingent liabilities by the end of 2009 – the EC fine and the claim from Binder Magnete s.r.l. Italy – are still applicable. More information is given on pages 110 and 111 of the notes to the financial statements.

Directors' declaration

The Executive Board is responsible for the preparation of the financial statements and the annual report in accordance with the Dutch law and the International Financing Reporting Standards (IFRS). As prescribed in Article 5-25 C of paragraph 2 of the Financial Supervision Act, and with due regard for the above, the Executive Board declares, that to its knowledge (i) the financial statements give a true and fair view of the assets, liabilities, financial position and profit of Kendrion N.V. and the companies jointly included in the consolidation; (ii) the report of the Board gives a true and fair view of the situation at balance sheet date, the situation during the financial year at Kendrion N.V. and the companies affiliated with Kendrion whose figures are incorporated in the financial statements, and (iii) that the report of the Board describes the significant risks which Kendrion faces.

The members of the Executive Board have signed the financial statements to comply with their statutory obligation pursuant to Article 2:101, paragraph 2 of the Netherlands Civil Code and Article 5-25 C, paragraph 2, under C, of the Financial Supervision Act.

Developments in each business unit

Industrial Magnetic Systems

Norman Graf
Business Unit Manager
Industrial Magnetic Systems

Profile

The Industrial Magnetic Systems business unit develops and manufactures electromagnetic systems for industrial applications including mechanical engineering, energy distribution, process automation, doors and safety technology, medical equipment and the beverages industry. Both the group of customers and range of applications are extremely diverse. The business unit's products make use of the most advanced technology and comply with the most stringent reliability and precision requirements. The activities of Industrial Magnetic Systems are subdivided into two core competences:

- projects with customised products in large volumes;
- modified products and services.

The business unit's head office is in Donaueschingen (Germany) and the business unit has production facilities in Germany, Romania, the USA and China. In addition, the business unit has sales organisations in the UK and Switzerland. The other major European markets are covered by sales partners and distributors.

Objectives and strategy

Industrial Magnetic Systems continues to expand its position from a player on the European market to a global player in specific submarkets, whereby the business unit's objectives are to achieve powerful organic growth and excellent returns.

Industrial Magnetic Systems develops new project activities in its markets by means of relationships with customers operating on a global scale or possessing powerful positions in local submarkets. In addition, Industrial Magnetic Systems' project activities have enabled the business unit to expand its operations to the provision of modified products and services. These operations offer less risky opportunities to generate revenue, certainly in more difficult economic times. During the coming years the business unit will focus on selected key markets where the most important developments are foreseen in the global industry.

Developments in 2010

Industrial Magnetic Systems observed the continuous recovery of its key markets from early 2010 onwards. The recovery started with significant growth rates in the same market segments in which the greatest decreases had taken place in 2009. These segments included both the locking and safety industry and the automation industry. Other sectors, including machine building, exhibited clear uncertainty during the first half of 2010 and an overall recovery has only been seen in these segments since the second half of 2010. The market base stabilised month by month and market by market and reached a strong and stable growth level for the business unit's overall business in the third quarter.

The strong economic recovery was supported by intensified engineering and sales activities. Industrial Magnetic Systems has been able to acquire several new projects with new customers. The consequent development of innovation technology and market know-how further develops and underlines the leading position in the selected key niche markets.

The business unit made successful steps in increasing its international footprint. The initial projects are being realised in co-operation with the plant in the USA. The excellent technology leverage enables Industrial Magnetic Systems to enter into new niche markets such as the pharmaceutical industry.

Following the closure of the plants in Spain and Austria as part of the Springtime Plan in 2009, the main focus of the plants has been on increasing the efficiency of the production plants and building up a network of suppliers and partners in order to strengthen overall flexibility. The plant in Donaueschingen (Germany) was divided into two independent production areas, one for project business and one for the application and service business. The processes have now been optimised according to the related customers' specific needs and requirements. Industrial Magnetic Systems furthermore launched production operations in Romania for its labour-intensive activities. The first products are now already being assembled at this location and the activities will be intensified in 2011.

>> Market and market position

Industrial Magnetic Systems' main market continues to be Germany with its advanced market-leading mechanical engineering and automation industries. The USA, China, France and Italy are the other most important countries for the business unit. Additional attention was devoted in the year under review to the market developments of Sweden, the UK and Spain.

The business unit focuses on niche markets that feature excellent growth figures and that are gaining importance for the future. These markets include the energy, medical & pharma, transportation and safety industries.

Industrial Magnetic Systems' Chinese operation focuses on customer and product applications that require a high level of technical know-how, product quality and reliability. The business unit concentrates less attention on the low-cost segment of the market.

The beverage industry is the most important market segment for the business unit's US operating company, which is the clear market leader in this segment. Expansion into other niche markets is currently being implemented or prepared.

>> Outlook for 2011

When the economy remains stable Industrial Magnetic Systems expects satisfactory organic growth in the year ahead. The main focus in terms of regions will be on Germany, France and Italy in Europe as well as the USA and China. Kendrion's subsidiaries in Germany, the USA and China are working hand in hand to ensure the delivery of the right products to customers at the right time and place on all three continents.

The new projects mark significant strides forward in the energy, medical & pharma and process automation industries. Industrial Magnetic Systems will consequently continue to focus on its defined niche markets and to strengthen its technical leadership through the next generation of innovation.

Developments in each business unit

Industrial Drive Systems

Michael Bernhard
Business Unit Manager
Industrial Drive Systems

Profile

The Industrial Drive Systems business unit develops and manufactures electromagnetic brakes and clutches for industrial drive systems that accelerate, retard, position, hold and secure movable drive components and loads. The primary applications for the business unit's products are robotics and process-automation technology, machine construction and production machines, machine control and lift technology. The business unit's head office and production location are located at Villingen (Germany) and it also has a sales organisation in Bradford (UK) as well as a production location in Aerzen (Germany). The other major European markets are covered by sales partners and distributors.

Objectives and strategy

Industrial Drive Systems has further enhanced its position as a European market leader in permanent magnet brake technology. The business unit's objectives are to achieve powerful organic growth and excellent returns. Industrial Drive Systems develops new project activities in its markets by means of relationships with customers operating on a global scale or possessing powerful positions in local submarkets. In addition, the business unit is also expanding its operations in the field of services on the basis of project activities.

During the coming years the business unit will focus on two key markets, namely process automation and the generation of sustainable energy, the markets where the most important developments are foreseen in the global industry.

Developments in 2010

The moderate start to the year in January and February made it difficult for Industrial Drive Systems to make plans for 2010 as a whole. However, following the extremely favourable developments from March onwards the forecast for 2010 was exceeded by an ample margin.
The ski lift magnet and wind power projects have, in particular, contributed significantly to this development. The year under review has furthermore been influenced by positive development of the business unit's most important customers in the OEM business. The acquisition of Magneta in Aerzen (Germany) made it possible for the business unit to raise its revenue significantly. It also was able to realise a good level of profit. The Industrial Drive Systems business unit, particularly the range of smaller and specific electromagnetic clutches and brake systems, will benefit from this acquisition in the future. The business unit was also able to reduce its production costs and parts per million (ppm) rate by improving lean manufacturing and ensuring an increased focus on quality. These factors led to an outstanding operating result.

Market and market position

Germany, with its advanced market-leading mechanical engineering and automation industries, remains Industrial Drive Systems' major market. The business unit is the European market leader in permanent magnet spring brakes.
Additional attention has been devoted to the enhancement of the spring-applied brake operations, whereby Kendrion intends to play the role of problem-solver for specific customer needs and questions and, in so doing, distinguish the company from the market for standard products. Industrial Drive Systems is still a small niche player in the USA and China. Nevertheless, the business unit has succeeded in achieving remarkable growth figures in Asia during the past two years. Kendrion expects that this achievement can be repeated in the coming years.

The increasing use of technology for the generation of sustainable energy, a global trend, opens an attractive new segment of the market to the business unit. Industrial Drive Systems possesses the technology required to develop suitable products for this segment. A number of new projects have now been initiated and Kendrion benefited from the initial results of these developments in 2010.

Outlook for 2011

Industrial Drive Systems will focus in 2011 on expanding its customer base in global markets, particularly in the USA and China. The business unit will furthermore aim to gain market share with a new product line in the spring brakes product range in order to further expand its market leadership in the range of permanent magnet brakes.

The sales team will fundamentally be repositioned to focus on market segments. The transportation and medical sectors are two examples of sectors that are of key importance to Industrial Drive Systems. Another objective will be to further expand the leading position in the traditional OEM business. The business unit plans to undertake a number of activities in the area of marketing, including participating in the Hannover Messe Motion, Drive and Automation trade fair and the SPS/IPC/DRIVES trade fair in Nuremberg (Germany) and several other international exhibitions. The one hundredth anniversary of Binder Magnete will be highlighted at both the Hannover Messe and the SPS/IPC/DRIVES.

The business unit's production operations will be further modernised in the 'lean manufacturing' and 'quality' line and substantial investments will be made in the Villingen (Germany) site in particular.

A newly formed innovation team will focus on ensuring the success of future products by laying a foundation for products and market requirements for the years ahead.

Industrial Drive Systems forecasts another strong business year in 2011 with attractive growth and strong results in the global markets.

Developments in each business unit

Passenger Car Systems

Bernd Gundelsweiler
Business Unit Manager
Passenger Car Systems

Profile

The Passenger Car Systems business unit develops and manufactures electromagnetic components for applications in the automotive industry. The business unit is globally renowned as a competent development and engineering partner and has production facilities in Germany, Austria, the Czech Republic, Romania and China. All products are developed and designed in accordance with the customer's specific needs, whereby great emphasis is placed on performance and reliability. Kendrion has been awarded ISO/TS 16949 certification, and supports environmentally-conscious working methods in accordance with ISO 14001.

Objectives and strategy

Passenger Car Systems is continually expanding its market position by obtaining new customer orders that relate to new projects or to further applications that expand the current portfolio. The business unit's objectives are to achieve acceptable organic growth with satisfactory returns and cash flow.
The business unit's operations are conducted on the basis of an explicit strategy which addresses niche markets by offering them innovative technological solutions in the fields of switching solenoids (on/off or proportional), braking systems and advanced valve technology (common rail). In addition, the business unit also develops and manufactures electromagnetic components for hydraulic systems. The highly reliable production processes are in part carried out in clean-room conditions, and are virtually entirely or partly automated, depending on the annual production volume. Passenger Car Systems complies with stringent quality standards through the use of end-of-line control units for complete systems or individual functions.

Developments in 2010

Early 2010 was characterised by empty stocks and reduced capacities worldwide. Global markets, especially China, then picked up at an incredibly rapid pace and tremendous effort had to be put into ensuring the delivery of single parts from suppliers to meet the high demands of the fully operational production lines. All of Passenger Car Systems' plants benefited from their highly flexible production units and were able to fulfil the customers' demand. Flexibility across all functions and optimum capacity planning resulted in record numbers of produced units month by month. Revenue at the end of 2010 had already grown substantially compared to 2008, strongly driven by the new projects acquired in the recent years.

The business unit's product portfolio corresponds exactly with the current market trends of motor management, downsizing, switchable units, fuel efficiency and CO_2 reduction. In addition to the fully operational production lines, the market also picked up with a high number of new requests for quotations (RFQs) and a fully booked R&D department. New product and application development will enlarge the current portfolio for future business.

The decisive measures being taken as a result of the 2009 Springtime Plan to restructure the complete business unit and to transform the Austrian plant in Eibiswald into a 100% automotive unit were successfully concluded. The balanced support functions and the implemented cost control resulted in strong revenue growth.

Market and market position

The international automotive market can be divided into three regions, Europe, the USA and Asia. The business unit's largest market is Europe and, within that market, Germany. From a global perspective the business unit's major customers are Daimler, Continental, Delphi Europe, INA, Automotive Lighting and ZF Lemförder. Customers can rely on Passenger Car Systems as a development partner, with active project teams, in-depth technical knowledge and access to development, test and production facilities. This will be of particular importance to the US market in the coming years.

Further growth in the worldwide electromagnetic component market is expected due to new applications in environmental protection, aggregates that can be switched on/off and common rail technology that minimises emissions. New hybrid and electric cars create new market segments that are favourable to Passenger Car Systems.

Outlook for 2011

Passenger Car Systems will expand its electromagnetic portfolio with strong organic growth in production and new developed units/applications on a global base. The business unit's flexible workforce model and ability to be the most adaptive in the market are clearly geared towards optimally serving its customers worldwide. The alignment of the plants and production will create further business opportunities. As a customer-orientated organisation with a strong focus on corporate social responsibility, Passenger Car Systems is committed to achieving market and innovation leadership in electromagnetic niche technologies.

Developments in each business unit

Uwe Spörl
Business Unit Manager
Commercial Vehicle Systems

Commercial Vehicle Systems

Profile

Commercial Vehicle Systems develops and manufactures components and complete cooling systems for buses, trucks and special vehicles. Products include fan clutches for engine cooling, compressor clutches for vehicle air-conditioning, vibration dampers for crankshaft applications, fan clutches with angle gear for cooling, pneumatic and hydraulic clutches, brakes and belt tensioners.

The business unit's customers include all major OEMs in the global bus market and all first-line suppliers of air-conditioning systems, as well as manufacturers of refuse collection vehicles, agricultural vehicles, railway vehicles, and specialised vehicles such as piste bullies for the preparation of ski pistes.

Commercial Vehicle Systems has its head office (including production, R&D, sales and accounting) in Markdorf (Germany), and has additional production, R&D and sales departments in Atlanta (USA), Mexico City (Mexico), São Paulo (Brazil) and Nanjing (China). Commercial Vehicle Systems has a global network of partners for distribution and service.

The business unit's products help to reduce the fuel consumption of commercial vehicles and consequently contribute to lower vehicle emissions. Thanks to this contribution, the business unit has seen steady operational growth in recent years. The goal of the business unit's corporate philosophy is to provide answers for customers' technical issues by helping them to reduce fuel consumption using solutions based on electromagnetic components.

Objectives and strategy

Commercial Vehicle Systems' steady growth over the past ten years has been built on the business unit's objectives of supplying customers all over the world and doing business with every OEM in Asia, the USA and Europe.
The business unit's objective is to evolve from a local niche player into a global company and to play a critical role in the achievement of Kendrion's ambition to set the standards for quality and speed in R&D. The targets specify excellent organic growth and returns.

Developments in 2010

Following the crisis year 2009, the Commercial Vehicle Systems business unit's activities recovered very well and quickly. Turnover rose by approximately 40% in comparison to the previous year. The business unit achieved especially good results in the USA, Asia and Brazil with double-digit growth in new applications and projects. Commercial Vehicle Systems furthermore succeeded in increasing its volume in the after-sales business with acceptable margins. In 2010, Kendrion also entered the US truck market with a new range of engine cooling products.

This upward trend is striking because the most important sectors for the business unit, namely trucks and buses, have not yet returned to pre-crisis levels of activity. Bus production in Germany was even 10% lower than the weak volume realised in 2009.
Commercial Vehicle Systems presented the latest developments at a number of trade shows including Busworld in Shanghai, the IAA Nutzfahrzeuge in Hannover and shows in the USA, India, Australia and Mexico.

Market and market position

There are three regions in the international market for components for engine-cooling systems and air-conditioning: Europe, the Americas and Asia. Kendrion Linnig is the European market leader in compressor and fan clutches. The company faces technical competition in the engine-cooling segment from companies offering solutions not based on electromagnetic components. But as the requirements on engine cooling and emission reductions become increasingly stringent, Kendrion is increasingly convinced that the company is in the right position to expand its share of the market.
Although Commercial Vehicle Systems is still a niche player in the USA and South America, the business unit has implemented ambitious objectives that will enable it to achieve steady growth. The situation in Asia is also conducive to growth, and Kendrion is working on new projects with a large number of new customers in that region.

Outlook for 2011

The current outlook points to continuing positive market perspectives and trends for the Commercial Vehicle Systems business unit in 2011. This expectation is founded on the business unit's continuing focus on the recovering truck market and new projects. Commercial Vehicle Systems recently started a new facility in Pune, India. The positive outlook is further supported by new projects in Russia and a project for Genset applications. The BRIC states and new projects for new EURO 6 emission standards are expected to be key drivers of growth. China and India furthermore forecast to generate significant growth in the year ahead.

Commercial Vehicle Systems is scheduled to participate in trade shows in China, the USA, Mexico and Germany.

The product portfolio will also be expanded in 2011 to include fans for the business unit's clutches and cooling systems with a view to becoming increasingly a system tier-1 supplier.

Corporate governance

Every year Kendrion states the outlines of the company's corporate governance structure in the Annual Report, and submits all substantial changes to the structure to the General Meeting of Shareholders for discussion. Information about corporate governance and the rules and regulations is available at Kendrion's website (www.kendrion.com), under 'Corporate Governance'. This section and the 'Information on Kendrion N.V. shares' section incorporate the information referred to in Article 1 of the Decree of 5 April 2006 for the implementation of Article 10 of the EU Takeover Directive. In addition, the information contained in this section in combination with the information about the management and control systems for the financial reporting contained in the risk management section can be regarded as the Corporate Governance Statement prescribed by the Decree establishing further instructions concerning the content of the annual report (*'Besluit tot vaststelling van nadere voorschriften omtrent de inhoud van het jaarverslag'*) as amended in December 2009. This Corporate Governance Statement has also been published on the company's website.

Kendrion is characterised by a transparent and efficient corporate governance structure that lays down the relationship between the shareholders, Supervisory Board and Executive Board. Kendrion monitors corporate governance developments closely to ensure that any necessary changes to the structure can be implemented in good time.

The Executive Board will submit, with the approval of the Supervisory Board, a proposal to amend the Articles of Association to the General Meeting of Shareholders to be held on 18 April 2011. In amending the Articles of Association Kendrion will implement amongst others the new legislation for the implementation of the EU Directive on the exercise of shareholder rights as well as for management and supervision.

Corporate governance structure

Kendrion N.V. is a public limited liability company under Netherlands law, with its registered offices in Zeist, the Netherlands. The company's authorised share capital is divided into 40,000,000 ordinary shares with a nominal value of EUR 2.00. At year-end 2010 11,316,374 ordinary shares had been issued, of which 59,115 shares are held by the company. These 'own' shares have been purchased for the variable remuneration package for the members of the Board and the share plan for the senior management. Kendrion's shares are listed on NYSE Euronext's Amsterdam market. Kendrion N.V. does not have a Works Council.

Articles of Association

A resolution to amend the Articles of Association can be passed by the General Meeting of Shareholders solely on the proposal of the Executive Board as approved by the Supervisory Board. Resolutions of this nature can be passed by an absolute majority of the votes cast at the General Meeting of Shareholders. Amendments to the Articles of Association are also governed by a number of procedural regulations specified in more detail in the company's Articles of Association.

The company's Articles of Association include what is referred to as a 'creeping control' provision that is similar to the statutory provisions. A shareholder acquiring 20% of the shares or votes is under the obligation to disclose this to the company with immediate effect. Shareholders governed by compulsory disclosure may cast a number of votes at a General Meeting of Shareholders of at most the number disclosed to the company on the day before the day of the publication of the notice convening the relevant meeting. In the absence of a disclosure the number of votes that can be cast is limited to a maximum of the disclosure limit. The Executive Board can grant exemption from the voting right limit. A shareholder acquiring more than 30% of the shares or votes is under the obligation to make an immediate bid for the other issued shares. The bid must be submitted in accordance with the then prevailing statutory regulations. The Executive Board can issue a notice suspending the meeting and voting rights from the time a party is under the obligation to make a bid until the time the party declares the bid unconditional (or is not required to do so because fewer than 66 2/3% of the voting rights have been tendered).

General Meeting of Shareholders

According to new legislation, a notice convening a General Meeting of Shareholders shall be issued on behalf of the Executive Board or the Supervisory Board by no later than the 42nd day prior to the day of the meeting. Parties who have the right to vote and attend the meeting and who are registered as such in a designated (sub)register on the 28th day prior to the day of the meeting ('*registratiedatum*') will be entitled to attend the meeting and vote, irrespective of the identity of the entitled party with respect to those shares at the time of the meeting. This will be included in the proposal to amend the company's Articles of Association.

Votes representing shares can be cast at the General Meeting of Shareholders either personally or by proxy. No restrictions are imposed on these proxies, which can be granted electronically or in writing to the company, or to independent third parties. Pursuant to the proposed amendment of the Articles of Association the Executive Board will be entitled to determine that shareholders may also vote by letter prior to the meeting. Each share grants an entitlement to one vote. All resolutions adopted by the General Meeting of Shareholders are passed by an absolute majority of the votes cast, unless the law or the Articles of Association prescribe a larger majority. The shareholders possess the rights conferred by Kendrion's Articles of Association and by law.

Shareholders individually or jointly representing at least 1% of the issued share capital (or individually or jointly representing at least EUR 50 million of the issued share capital) are entitled to submit a request to the Executive Board or Supervisory Board for the inclusion of items on the agenda of the General Meeting of Shareholders. A request of this nature shall be granted provided that the motivated request is submitted in writing to the CEO or the Chairman of the Supervisory Board at least 60 days before the date of the General Meeting of Shareholders. Resolutions relating to items placed on the agenda in this manner can be passed by an absolute majority of the votes cast that represents at least one third of the issued share capital. In the event that an absolute majority supports the resolution but this majority does not represent one third of the issued share capital then in a new meeting to be convened the resolution can be passed by an absolute majority of the votes independent of the represented issued share capital (unless the law prescribes a larger majority or a quorum).

Unless indicated otherwise, there are no restrictions on the transfer of shares, the exercising of voting rights or the term for exercising those rights, and there are no special controlling rights attached to shares.

Shareholders representing 73% of the total issued share capital attended or were represented at the regular General Meeting of Shareholders held in the year under review on 7 April 2010.

Board

Kendrion is managed by a Board comprised of three members, of whom two are Executive Directors, and is supervised by the Supervisory Board. The Executive Board possesses the powers that the law or the Articles of Association have not assigned to the Supervisory Board or the General Meeting of Shareholders.

The Executive Board has adopted regulations governing the Executive Board's procedures and decision-making. These regulations have been approved by the Supervisory Board. The members of the Executive Board are appointed by the General Meeting of Shareholders on the recommendation of the Supervisory Board. Each member of the Executive Board can be dismissed by the General Meeting of Shareholders at any time. The General Meeting of Shareholders can pass a resolution for dismissal on the proposal of the Supervisory Board by an absolute majority of the votes cast. The General Meeting of Shareholders can pass a resolution for dismissal other than on the proposal of the Supervisory Board solely by an absolute majority of the votes cast that represents at least one third of the issued share capital.

The Board is supplemented by an Executive Committee, which is not mandated under the Articles of Association, comprised of the Board and the Business Unit Managers. The Executive Committee is a consultative body and the Board always has the deciding vote.

Important resolutions of the Executive Board require the approval of the Supervisory Board. The resolutions governed by this stipulation are specified in Kendrion's Articles of Association.

The Executive Board has the authority, with the approval of the Supervisory Board, to decide to issue shares in the period until 7 October 2011. This authority relates to a maximum of 10% of the issued share capital at the time of issue.
In addition, the Executive Board has the authority to arrange for the company to acquire shares in its capital. This authority relates to a maximum of 10% of the issued share capital, and runs until 7 October 2011. Each year, the Executive Board places a request to be granted the authority for the issue and purchase of shares referred to above on the agenda of the General Meeting of Shareholders.

Supervisory Board

The Supervisory Board's duty is to supervise the management of the Executive Board and the general developments within the company and its affiliated companies, and to advise the Executive Board. Meetings of the Supervisory Board are usually attended by the Board.

The Supervisory Board currently has four members. The members of the Supervisory Board are appointed by the General Meeting of Shareholders on the recommendation of the Supervisory Board. The Supervisory Board has adopted regulations and a profile of the Supervisory Board. The Supervisory Board elects a Chairman from amongst its members. The members of the Supervisory Board step down by rotation pursuant to a schedule adopted by the Supervisory Board. Members of the Supervisory Board who step down can be reappointed.

These reappointments take account of the manner in which the candidate performed his or her duties as a member of the Supervisory Board.
Each member of the Supervisory Board can be dismissed by the General Meeting of Shareholders at any time in a resolution passed by an absolute majority of the votes cast. Resolutions for dismissal not on the proposal of the Supervisory Board are passed solely by an absolute majority of the votes cast that represents at least one third of the issued share capital.

The Supervisory Board has established two Committees, an Audit Committee and a Remuneration Committee.
The Committees are responsible for making the preparations for the decision-making by the Supervisory Board. Their roles and responsibilities are in accordance with the relevant provisions of the Netherlands Corporate Governance Code. The regulations for both Committees have been adopted by the Supervisory Board. The regulations have been published on Kendrion's website.

Code of Conduct and the Whistleblower's Charter

The Code of Conduct and the Whistleblower's Charter are available for inspection on the website.
The Whistleblower's Charter offers the Kendrion employees an opportunity to report irregularities or suspicions of irregularities to the management without jeopardising their legal position. The Code of Conduct and the Whistleblower's Charter were both updated in 2010.

Corporate governance structure in light of the Netherlands Corporate Governance Code

The provisions of the Netherlands Corporate Governance Code as amended on 10 December 2008 are applicable to Kendrion. The Netherlands Corporate Governance Code is available at www.commissiecorporategovenance.nl. Kendrion has applied virtually all the principles and best practice provisions – to the extent that they are applicable – laid down in the Code.

The company reserves, however, the right, both now and in the future, not to apply the occasional best practice provision, whereby the company shall always comply with the principle formulated in the Netherlands Corporate Governance Code that the company shall explain why it has not applied the best practice provision in question. For example, the company will not be able to breach existing agreements at will. It should be noted that the Netherlands Corporate Governance Code also states that agreements of this nature should be respected. The provisions of the Netherlands Corporate Governance Code that have not been applied are listed below.

II.1.1 *A Management Board member is appointed for a maximum period of four years.* This provision is not in line with the contractual situation of the current CEO. Kendrion respects this contractual situation.

II.2. *Remuneration of the Executive Board.* Kendrion has applied or will apply virtually all best practice provisions. The precise criteria for the variable remuneration are not disclosed, since the company is of the opinion that the disclosure of the (relevant) performance criteria is undesirable from the perspective of the competitive and market positioning of the company. In addition, the publication of the performance criteria is at variance with the management of external expectations, such with the knowledge that there is a simultaneous internal need for incentives for the members of the Executive Board in the form of challenging targets.

II.2.8 *The maximum remuneration in the event of dismissal is one year's salary.* This provision is not in line with the contractual situation of the current CEO (currently over two years based on the years of service). Kendrion respects this contractual situation.

III.5.11 *The Remuneration Committee may not be chaired by the Chairman of the Supervisory Board or by a Supervisory Board member who is a member of the management board of another listed company.* In 2010 Kendrion had not applied this best practice provision in view of the limited size of the Supervisory Board; the Chairman of the Supervisory Board was also the Chairman of the Remuneration Committee. As of 2011, Kendrion will be in compliance.

IV.3.1 *All investor relations meetings shall be announced in advance, and provisions shall be made for all shareholders to follow these meetings in real time.* Kendrion announces all press conferences and analyst meetings in advance. Kendrion is of the opinion that webcasting these meetings is not necessary. Unannounced meetings with individual analysts are also held. No price-sensitive information is disclosed during these meetings.

Agreements in the meaning of Article 1.j. of the Decree of 5 April 2006 for the implementation of Article 10 of the EU Takeover Directive (change of control)

Kendrion has a new credit facility at its disposal which has been concluded with a consortium of banks. An explanation of this facility is enclosed on pages 95 and 96 of the financial statements. The credit facility incorporates what is referred to as a 'change of control' provision. Once a party acquires more than half the company's issued share capital or voting rights then the company is governed by a repayment commitment. As a rule the company does not conclude new agreements: these are concluded by the operating companies. Agreements concluded, for example, with leasing companies can also incorporate change of control provisions.

Remuneration policy

General
Kendrion's current remuneration policy was discussed by and adopted at the General Meeting of Shareholders in 2010.
The remuneration report, which is published on the company's website, explains the policy for the remuneration of the Executive Board and the Supervisory Board. The remuneration report also provides information about the remuneration that was actually paid over 2010.
Information about the remuneration received by the individual members of the Executive Board and the Supervisory Board is also enclosed in the financial statements (pages 129 and 130).

The policy for the remuneration of the members of the Executive Board is based on the allocation of remuneration of an amount and structure such that qualified and expert executives can be recruited.
The policy is also challenging to such an extent that it motivates the members of the Executive Board and, when they exhibit an appropriate performance, ensures they can be retained in the longer term.
The composition of the remuneration package promotes the achievement of Kendrion's short and long-term objectives.
Pursuant to the Netherlands Corporate Governance Code, the Supervisory Board possesses discretionary powers for the downward or upward adjustment of the total remuneration should the variable remuneration system result in unreasonable and inequitable remuneration. In addition, when so requested by the Supervisory Board, the variable component of the remuneration adopted in the past two years must be repaid in part or in full should it transpire that this was unjustifiably awarded on the basis of incorrect financial information.
The Supervisory Board periodically tests the package to verify that it is in line with the company's objectives and the market on the basis of information supplied by external experts.

The current remuneration policy provides for a fixed component and a variable component, as well as a pension scheme and a number of fringe benefits.

Fixed remuneration
The fixed remuneration is in line with the aforementioned policy. During the year under review the fixed component was adjusted solely pursuant to the indexation provision of the remuneration policy.

Variable remuneration
The variable remuneration is intended to promote the Executive Board members' attention to the growth of the company and the value of the share. The variable remuneration is appropriate in relation to the fixed remuneration. The Supervisory Board determines the variable remuneration for the individual members of the Executive Board on the basis of their performance and results as compared to the agreed performance criteria.

Variable remuneration up to 2009
In view of the economic conditions it was decided, with the approval of the General Meeting of Shareholders held in 2009, that the bonus for 2009 would be paid solely in the form of shares. The CEO was granted 2,750 shares and the CFO 1,800 shares.
These shares must be held for a minimum of five years, unless the officer's contract of employment is terminated earlier.
The shares were allocated immediately after the General Meeting of Shareholders held in April 2010.

Variable remuneration from 2010
The General Meeting of Shareholders held in April 2010 decided that a variable bonus for the Executive Board members shall be awarded in 2010 and the following years that promotes the achievement of Kendrion's short and long-term objectives.
The annual variable remuneration for an at-target performance will amount to 40% of the gross fixed remuneration of the CEO and 35% of the gross fixed remuneration of the CFO, with a maximum of 50% of the gross fixed remuneration. 70% of the bonus will be comprised of financial performance criteria (net profit, ROI, free cash flow and relative Total Shareholders Return (the movement in Kendrion's TSR compared to the AScX) and 30% will be comprised of individual (non-financial) performance criteria. The four financial performance criteria are weighted approximately equally.
The component of the bonus relating to the relative TSR is set to zero when the relative TSR is less than zero.

One third of the amount to be determined by the Supervisory Board shall be paid in cash. Two thirds of the bonus shall be comprised of a conditional award of shares (the vesting scheme). The award of the shares becomes unconditional after three years (including the relevant year in which the performance is assessed) if the CEO and CFO are still in office and the Supervisory Board is of the opinion that there are no exceptional circumstances that would render the unconditional award unreasonable. The award of the shares is definitively withdrawn in the event that the relevant member of the Executive Board leaves Kendrion as a 'bad leaver' during the three-year vesting period. The Supervisory Board possesses discretionary powers to refrain from the full issue of the shares in the event that the relevant member of the Executive Board leaves the company as a 'good leaver' in the vesting period (for example, on retirement or in the event of an occupational disability) when the full issue of the shares would be unreasonable under the circumstances.

Once the award of the shares has become unconditional after the expiry of the vesting period they must be retained for a minimum of two years (the holding period) unless the relevant member of the Executive Board terminates his/her term of office or the term of office is terminated during this period.

The aforementioned financial and individual performance criteria are determined for each full year prior to the beginning of the relevant financial year. The precise criteria are not disclosed, since the company is of the opinion that the disclosure of the (relevant) performance criteria is undesirable from the perspective of the competitive and market positioning of the company. In addition, the publication of the performance criteria is at variance with the management of external expectations, such with the knowledge that there is a simultaneous internal need for incentives for the members of the Executive Board in the form of challenging targets.

Although this is an annual scheme it nevertheless possesses the long-term nature required by the Netherlands Corporate Governance Code by virtue of the inclusion of the vesting and holding regulations.

The Supervisory Board has drawn up the scenario analyses prescribed by the Netherlands Corporate Governance Code.

Kendrion has drawn up this proposed scheme with the intention of introducing a simple and transparent remuneration package. This is also one of the objectives of the Netherlands Corporate Governance Code.

Pensions

Pursuant to the policy, the company bears the cost of the contributions for the old-age pension of the members of the Executive Board to a maximum of 20% of the pension base. The pensionable age is 65. No schemes have been agreed for the (voluntary) early retirement of the members of the Executive Board.

Sundry

The company does not grant loans, advances or guarantees to the members of the Executive Board.
No exceptional remuneration was paid to the members or former members of the Executive Board in the year under review.

Remuneration of the Supervisory Board

The remuneration received by the members of the Supervisory Board is comprised of a fixed remuneration that is independent of the results, whereby a distinction is made between the remuneration received by the Chairman and the other members of the Supervisory Board. Pursuant to this distinction the remuneration received by the Chairman is about one third higher than the remuneration received by the other members. The members of the Supervisory Board receive an additional limited fixed remuneration for their membership of the Audit Committee or Remuneration Committee. The remuneration received by the members of the Supervisory Board was set by the Extraordinary Meeting of Shareholders held in 2009, and has not been adjusted subsequently.

Severance pay

The contract of employment with the current CEO grants the officer entitlement to severance pay equal to the compensation for involuntary dismissal in the event that the contract of employment is terminated after a change of control.
The provision in the current CFO’s contract of employment entitles the officer to severance pay comprised of one year’s salary following a change of control.

Prospects

2010 was an excellent year for Kendrion: the economic conditions improved virtually month after month and all Kendrion's business units were able to benefit greatly from this improvement. Kendrion also began 2011 with a well-filled order book, and a weakening of the economy in Kendrion's most important markets is not expected in the coming period. Nevertheless it is striking to note that uncertainty remains large, as is manifested by the continual reports about the problems in the southern countries of Europe and Ireland and their consequences for the entire eurozone. Opinions differ about the developments in China, an important country for Kendrion, as a result of which the only forecasts that would appear to be reliable at this point are short-term forecasts.

Kendrion has, due to the steps taken in the past years, emerged from the crisis in a stronger position. This is demonstrated by the developments that took place in 2010: the company's strong financial position, competitive position and innovative capabilities lay the foundations for further growth in the future, whereby all business units are working on new strategic opportunities for the coming years.

For 2011, Kendrion forecasts further growth as compared to 2010 provided that the economic conditions remain unchanged. This growth shall, in particular, be achieved by a further increase in current revenue due to projects initiated in 2010 and before. For example, the Passenger Car Systems business unit forecasts further growth in the diesel engine segment and, in the longer term, also perceives opportunities for electromagnetic valves in the gasoline engine segment. This latter is also of interest for the further penetration of the US market. The Industrial Magnetic Systems and Industrial Drive Systems business units forecast further growth due, in particular, to the continued increase in German exports to the Far East and to a number of new projects in the existing niche markets.
The Commercial Vehicle Systems business unit forecasts further growth due to a continued increase in global sales in the bus and truck market, driven by developments including the new activities in India.

Investments in 2011 will outpace depreciation by a considerable margin, with the major portion from this margin in the new ERP project.

Kendrion continues to endeavour to strengthen its existing market positions by means of acquisitions. The related emphasis will remain on the most important market, Germany, although during the year under review Kendrion also made great efforts to achieve further growth in the USA and China in the coming years. Market research is also being carried out in a number of countries where Kendrion has a plant (such as Brazil and India) to review the longer-term growth opportunities these countries offer to all business units.

Although Kendrion refrains from issuing specific forecasts for profit performance in 2011, it will be self-evident that the company looks to the coming year with full confidence and is banking on further improvement in revenue and profit.

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Consolidated statement of financial position at 31 December

Note	EUR million	2010	2009
	Assets		
	Non-current assets		
1	Property, plant and equipment	46.5	45.3
2	Intangible assets	50.1	41.4
3	Other investments, including derivatives	0.0	0.6
4	Deferred tax assets	12.8	13.3
	Total non-current assets	109.4	100.6
	Current assets		
5	Inventories	28.2	22.4
	Current tax assets	0.3	0.3
6	Trade and other receivables	30.2	24.8
7	Cash and cash equivalents	9.0	4.7
	Total current assets	67.7	52.2
	Total assets	177.1	152.8

Note	EUR million	2010	2009
	Equity and liabilities		
8, 9	**Equity**		
	Share capital	22.6	22.6
	Share premium	68.4	68.4
	Reserves	6.8	1.0
	Retained earnings	16.5	3.9
	Total equity attributable to equity holders of the company	114.3	95.9
	Minority interest	0.2	0.2
	Total equity	114.5	96.1
	Liabilities		
10	Loans and borrowings	2.5	13.6
11	Employee benefits	7.0	6.5
	Government grants received in advance	0.3	–
13	Provisions	2.7	2.6
4	Deferred tax liabilities	3.4	3.2
	Total non-current liabilities	15.9	25.9
7	Bank overdraft	1.7	3.7
10	Loans and borrowings	10.0	1.3
	Current tax liabilities	2.0	0.3
14	Trade and other payables	33.0	25.5
	Total current liabilities	46.7	30.8
	Total liabilities	62.6	56.7
	Total equity and liabilities	177.1	152.8

Consolidated statement of comprehensive income

Note	EUR million	2010	2009
	Revenue	221.9	149.2
22	Other operating income	0.8	1.0
		222.7	150.2
	Changes in inventories of finished goods and work in progress	(2.4)	4.4
	Raw materials and subcontracted work[1]	110.7	68.2
23	Staff costs[1]	62.0	55.5
	Depreciation and amortisation	10.1	8.8
	Impairment of other investments	–	0.9
16, 24	Other operating expenses[1]	19.5	17.4
	Results before net finance costs	**22.8**	**(5.0)**
	Finance income	0.4	0.2
	Finance expense	(3.4)	(3.6)
25	**Net finance costs**	**(3.0)**	**(3.4)**
	Profit before income tax	**19.8**	**(8.4)**
26, 27	Income tax expense	(3.2)	(1.5)
	Profit from continuing operations	**16.6**	**(9.9)**
20	Result on sale of discontinued operations (net of income tax)	–	13.9
	Profit for the period	**16.6**	**4.0**
	Attributable to:		
	Equity holders of the company	16.5	3.9
	Minority interest	0.1	0.1
	Profit for the period	**16.6**	**4.0**

Note	EUR million	2010	2009
	Other comprehensive income		
	Foreign currency translation differences for foreign operations	1.1	(0.5)
	Net change in fair value of cash flow hedges, net of tax	0.9	0.2
	Other	–	–
	Other comprehensive income for the period, net of income tax	2.0	(0.3)
	Total comprehensive income for the period	**18.6**	**3.7**
	Total comprehensive income attributable to:		
	Equity holders of the Company	18.5	3.6
	Minority interest	0.1	0.1
	Total comprehensive income for the period	**18.6**	**3.7**
9	Basic earnings per share (EUR)	1.47	0.37
9	Diluted earnings per share (EUR)	1.47	0.37

[1] *Allocation of temporary personnel and other personnel costs under Staff costs (2009 re-allocated).*

Consolidated statement of changes in equity

EUR million	Share capital	Share premium	Translation reserve	Hedge reserve	Reserve for own shares	Other reserves	Retained earnings	Total	Minority interest	Total equity
Balance at 1 January 2009	20.6	71.3	1.0	(1.1)	(0.3)	(11.0)	12.8	93.3	0.2	93.5
Total comprehensive income for the period										
Profit or loss	–	–	–	–	–	–	3.9	3.9	0.1	4.0
Other comprehensive income										
Foreign currency translation differences for foreign operations	–	–	(0.5)	–	–	–	–	(0.5)	–	(0.5)
Net change in fair value of cash flow hedges, net of tax	–	–	–	0.2	–	–	–	0.2	–	0.2
Total other comprehensive income	–	–	(0.5)	0.2	–	–	–	(0.3)	–	(0.3)
Total comprehensive income for the period	–	–	(0.5)	0.2	–	–	3.9	3.6	0.1	3.7
Transactions with owners, recorded directly in equity										
Contributions by and distributions to owners										
Issue of ordinary shares	2.0	7.1	–	–	–	–	–	9.1	–	9.1
Own shares acquired	–	–	–	–	(0.1)	–	–	(0.1)	–	(0.1)
Dividends to equity holders		(10.0)	–	–	–	–	–	(10.0)	–	(10.0)
Total contributions by and distributions to owners	–	–	–	–	–	12.8	(12.8)	–	(0.1)	(0.1)
Changes in ownership interests in subsidiaries that do not result in a loss of control										
Balance at 31 December 2009	22.6	68.4	0.5	(0.9)	(0.4)	1.8	3.9	95.9	0.2	96.1

Consolidated statement of changes in equity (continued)

EUR million	Share capital	Share premium	Translation reserve	Hedge reserve	Reserve for own shares	Other reserves	Retained earnings	Total	Minority interest	Total equity
Balance at 1 January 2010	22.6	68.4	0.5	(0.9)	(0.4)	1.8	3.9	95.9	0.2	96.1
Total comprehensive income for the period										
Profit or loss	–	–	–	–	–	–	16.5	16.5	0.1	16.6
Other comprehensive income										
Foreign currency translation differences for foreign operations	–	–	1.1	–	–	–	–	1.1	–	1.1
Net change in fair value of cash flow hedges, net of tax	–	–		0.9	–	–	–	0.9	–	0.9
Total other comprehensive income	–	–	1.1	0.9	–	–	–	2.0	–	2.0
Total comprehensive income for the period	–	–	1.1	0.9	–	–	16.5	18.5	0.1	18.6
Transactions with owners, recorded directly in equity										
Contributions by and distributions to owners										
Issue of ordinary shares	–	–	–	–	–	–	–	–	–	–
Own shares acquired	–	–	–	–	(0.1)	–	–	(0.1)	–	(0.1)
Dividends to equity holders	–	–	–	–	–	–	–	–	–	–
Total contributions by and distributions to owners	–	–	–	–	–	3.9	(3.9)	–	(0.1)	(0.1)
Changes in ownership interests in subsidiaries that do not result in a loss of control										
Balance at 31 December 2010	22.6	68.4	1.6	0.0	(0.5)	5.7	16.5	114.3	0.2	114.5

Consolidated statement of cash flows

Note	EUR million	2010	2009
	Cash flows from operating activities		
	Profit for the period	16.6	4.0
	Adjustments for:		
	Net finance costs	3.0	3.4
	Income tax expense	3.2	1.5
	Result on discontinued operations	–	(13.9)
	Depreciation of property, plant and equipment	8.4	7.3
	Amortisation of intangible assets	1.7	1.5
	Impairment of financial fixed assets	–	0.9
	Reversal of impairment of property, plant and equipment	(0.2)	–
		32.7	4.7
	Change in trade and other receivables	(4.6)	(0.8)
	Change in inventories	(4.3)	7.8
	Change in trade and other payables	4.3	(3.5)
	Change in provisions	0.6	(0.2)
		28.7	8.0
	Interest paid	(2.4)	(3.4)
	Interest received	0.2	0.2
	Tax paid	(0.8)	(0.9)
	Net cash flows from operating activities	**25.7**	**3.9**
	Cash flows from investing activities		
20	Disposal of subsidiary, net of cash disposed of	–	77.1
21	Acquisition of subsidiary, net of cash received (2009: earn-out payment)	(8.2)	(1.7)
	Investments in property, plant and equipment	(13.2)	(13.9)
	Disinvestments of property, plant and equipment	4.6	8.0
	Investments in intangible fixed assets	(0.3)	(0.1)

Note	EUR million	2010	2009
	Disinvestments of intangible fixed assets	–	0.1
	(Dis)investments of other investments	0.6	0.1
	Net cash from investing activities	**(16.5)**	**69.6**
	Free cash flow	**9.2**	**73.5**
	Cash flows from financing activities		
	Proceeds from borrowings (non current)		
	Repayment of borrowings (non current)	(11.8)	(7.0)
	Proceeds borrowings (current)	–	–
	Repayment of borrowings (current)	8.8	(50.5)
	Dividends paid	–	(10.0)
	Change in shares held in own Company	(0.1)	(0.1)
	Proceeds from issue of share capital	–	9.1
	Net cash from financing activities	**(3.1)**	**(58.5)**
	Cash flow of discontinued operations		
	Net cash from operating activities of discontinued operations	–	(6.6)
	Net cash from investing activities of discontinued operations	–	(1.1)
	Net cash from financing activities of discontinued operations	–	3.4
	Total cash flow of discontinued operations	**–**	**(4.3)**
	Change in cash and cash equivalents	6.1	10.7
	Cash and cash equivalents at 1 January	1.0	(9.6)
	Effect of exchange rate fluctuations on cash held	0.2	(0.1)
7	Cash and cash equivalents at 31 December	7.3	1.0

Notes to the consolidated financial statements

Significant accounting policies

The Company is domiciled in the Netherlands. The Company's registered office is Utrechtseweg 33, 3704 HA Zeist. The consolidated financial statements of the Company for the year ended 31 December 2010 comprise the Company and its subsidiaries (together also referred to as the 'Group'). The Group is involved in the design, manufacture and sale of high-quality electromagnetic systems and components.

(a) Statement of compliance

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations of the standards adopted by the International Accounting Standards Board (IASB) and endorsed by the European Union (hereinafter referred to as EU-IFRS) at per 31 December 2010.

The Company financial statements are part of the 2010 financial statements of Kendrion N.V. With regard to the company income statement of Kendrion N.V., the Company has made use of the option provided by Section 402 of Book 2 of the Netherlands Civil Code.

The consolidated financial statements were authorised for issue by the Executive Board on 25 February 2011.

(b) Basis of measurement

The financial statements are presented in millions of euros, the euro also being the Group's functional currency.

The financial statements have been prepared on a historical cost basis except that:

- derivative financial instruments are stated at fair value;
- liabilities arising from cash-settled share-based payments arrangements are stated at fair value;
- the defined benefit liability is recognised as the net total of the plan assets, plus unrecognised past service costs and unrecognised actuarial losses, less unrecognised actuarial gains and the present value of the defined benefit obligation;
- the contingent consideration is stated at fair value.

The methods used to measure the fair values are discussed further in note u.

The preparation of the financial statements in conformity with EU-IFRS requires the Executive Board to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses.

The estimates and associated assumptions are based on historical experience and various other factors that are considered reasonable in the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods. Changes in estimation methods and the impact thereof are outlined in the notes to the relevant item.

Judgements made by the Executive Board in the application of EU-IFRS that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are included in the following notes:

- note 2 – measurement of the recoverable amount of cash-generating units containing goodwill
- note 4 – utilisation of tax losses
- note 11 – measurement of defined benefit obligations
- note 13 – provisions
- note 15 – valuation of financial instruments
- note 18 – contingent liabilities
- note 21 – business combinations

(c) Changes in accounting policies

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and by the Group entities.

(i) Accounting for business combinations

From 1 January 2010 the Group has applied IFRS 3 – *Business Combinations (2008)* in accounting for business combinations. The change in accounting policy has been applied prospectively and has had no material impact on the earnings per share.

Business combinations are accounted for using the acquisition method at the acquisition date, which is the date on which control is transferred to the Group. Control has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, the Group takes into consideration potential voting rights that currently are exercisable.

(ii) Acquisitions on or after 1 January 2010

For acquisitions on or after 1 January 2010, the Group measures goodwill at the acquisition date as:

- the fair value of the consideration transferred; plus
- the recognised amount of any non-controlling interests in the acquiree; plus if the business combination is achieved in stages, the fair value of the existing equity interest in the acquiree; less
- the net recognised amount (generally fair value) of the identifiable assets acquired and liabilities assumed.

When the excess is negative, a bargain purchase gain is recognised immediately in profit or loss.

The consideration transferred does not include amounts related to the settlement of pre-existing relationships. Such amounts are generally recognised in profit or loss.

Costs related to the acquisition, other than those associated with the issue of debt or equity securities, that the Group incurs in connection with a business combination are expensed as incurred.

Any contingent consideration payable is recognised at fair value at the acquisition date. If the contingent consideration is classified as equity, it is not remeasured and settlement is accounted for within equity. Otherwise, subsequent changes to the fair value of the contingent consideration are recognised in profit or loss.

When share-based payment awards (replacement awards) are required to be exchanged for awards held by the acquiree's employees (acquiree's awards) and relate to past services, then all or a portion of the amount of the acquirer's replacement awards is included in measuring the consideration transferred in the business combination. This determination is based on the market-based value of the replacement awards compared with the market-based value of the acquiree's awards and the extent to which the replacement awards relate to past and/or future service.

(iii) **Acquisitions between 1 January 2004 and 1 January 2010**

For acquisitions between 1 January 2004 and 1 January 2010, goodwill represents the excess of the cost of the acquisition over the Group's interest in the recognised amount (generally fair value) of the identifiable assets, liabilities and contingent liabilities of the acquiree. When the excess was negative, a bargain purchase gain was recognised immediately in profit or loss. Transaction costs, other than those associated with the issue of debt or equity securities, that the Group incurred in connection with business combinations were capitalised as part of the cost of the acquisition.

(iv) **Acquisitions prior to 1 January 2004 (date of transition to IFRS)**

As part of its transition to IFRS the Group elected to restate only those business combinations that occurred on or after 1 January 2003. In respect of acquisitions prior to 1 January 2003, goodwill represents the amount recognised under the Group's previous accounting framework, Dutch GAAP.

(d) Basis of consolidation

(i) **Subsidiaries**

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights, that are currently exercisable or convertible, are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The shares of third parties in shareholders' equity and results are stated separately. The accounting policies of subsidiaries have been changed, where necessary, to align them with the policies adopted by the Company.

(ii) **Composition of the Group**

2010

The Company reached an agreement with the owner of Magneta GmbH & Co. KG concerning the acquisition of this company as per 25 February 2010.

2009

On 12 February 2009 the sale of the Vink Group to Edmundson Distribution Limited was completed.

(iii) **Transactions eliminated on consolidation**

Intragroup balances and transactions, as well as any unrealised gains and losses or income and expenses arising from intragroup transactions, are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with equity-accounted entities are eliminated against the investment to the extent of the Group's interest in the investee. Unrealised losses are eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

(e) >> Foreign currency

(i) **Foreign currency transactions**

Transactions expressed in non-euro zone currencies are translated into euros at exchange rates at the date of the transaction. Monetary assets and liabilities denominated in non-euro zone currencies at the reporting date are translated into euros at the exchange rate at that date. Non-monetary assets and liabilities denominated in currencies that are measured at historical cost are translated at the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in the non-euro zone currencies that are measured at fair value and are translated in euros against the exchange rates which were valid at the dates that the fair values were set. Currency differences arising on translation are recognised in the statement of comprehensive income, except loans considered to be part of the net investment, or qualifying cash flow hedges which are recognised directly in the translation reserve in equity.

(ii) **Foreign operation**

The assets and liabilities of non-euro zone operations, including goodwill and fair value adjustments arising on the moment of acquisition, are translated into euros at exchange rates at the reporting date. The income and expenses of non-euro zone operations are translated into euros at rates approximating the exchange rates at the date of the transaction. Foreign currency differences are recognised directly in the translation reserve.

On the partial or complete sale of a foreign operation the related amount is transferred from the translation reserve to the profit or loss.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a non-euro zone operation, of which the settlement is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a non-euro zone operation and are recognised directly in equity in the translation reserve.

(f) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are measured at cost or assumed cost less accumulated depreciation and accumulated impairment losses (see accounting policy j). The cost includes expenditure that is directly attributable to the acquisition of the asset. The cost of self-constructed assets includes the cost of materials, direct labour, the initial estimate, where relevant, of the costs of dismantling and removing the items and reinstating the site on which they are located, and a reasonable proportion of production overheads.

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

Leases under which the Group assumes substantially all the risks and rewards of ownership are classified as finance leases. Owner-occupied property acquired by way of finance lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at inception of the lease, less accumulated depreciation (see below) and impairment losses (see accounting policy j).

(iii) Subsequent costs

The cost of replacing part of an item of property, plant and equipment is recognised in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Group and its cost can be measured reliably. The carrying amount of the replaced part is derecognised. The costs of the day-to-day servicing of property, plant and equipment are recognised as a charge in the statement of comprehensive income as incurred.

(iv) Depreciation

Depreciation is charged to the profit or loss on a straight-line basis over the estimated useful life of each component of property, plant and equipment. Land is not depreciated.

Depreciation methods, useful lives and residual values are reviewed annually.

(v) Recognition of transaction results

Gains and losses on the disposal of property, plant and equipment are accounted for in other operating income/other expenses in comprehensive income.

(g) Intangible assets

(i) Goodwill

Goodwill that arises upon acquisition of subsidiaries is included in intangible assets. For the measurement of goodwill at initial recognition see note c.

Goodwill is carried at cost less any accumulated impairment losses. Goodwill is allocated to cash-generating units and is not amortised but is tested annually for impairment (see note j).

Negative goodwill arising on an acquisition is recognised directly in the profit or loss.

(ii) Research and development

Expenditure on research activities undertaken with the prospect of gaining new scientific or technical knowledge and understanding is recognised in the profit or loss as incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset. The expenditure capitalised includes the cost of materials, direct labour, overhead costs that are directly attributable to preparing the asset for its intended use, and capitalised borrowing costs. Other development expenditure is recognised in profit or loss as incurred.

Capitalised development expenditure is measured at cost less accumulated amortisation and accumulated impairment losses.

(iii) Other intangible assets

Other intangible assets, that are acquired by the Group and have finite useful lives, are stated at cost less accumulated amortisation (see below) and accumulated impairment losses (see note j). Based on the purchase price allocation of acquisitions, intangible assets are recognised which are part of the other intangible assets and relate to, amongst others, valued customer relations, trade names and technologies.

(iv) Subsequent expenditure

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits, embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

(v) Amortisation

Amortisation is recognised in the profit or loss on a straight-line basis over the estimated useful lives of the intangible assets unless such lives are indefinite. Goodwill and other intangible assets with an indefinite useful life are systematically tested for impairment at each reporting date. Other intangible assets are amortised from the date they are available for use.

(h) Financial instruments and other investments

(i) Financial instruments

Non-derivative financial instruments

Non-derivative financial instruments comprise trade and other receivables, recognised interest bearing loans and borrowings, trade and other payables, cash and cash equivalents, and other non-derivative financial instruments, recognised on the date they are originated.

Non-derivative financial instruments are recognised initially at fair value, less any directly attributable transaction costs. Subsequent to initial recognition non-derivative financial instruments are measured as described below.

Trade and other receivables
Trade and other receivables are carried at amortised cost, less impairment losses (see note j).

Recognised interest-bearing loans and borrowings
After initial recognition, interest-bearing loans and borrowings are carried at amortised cost with any difference between the initial carrying amount and the redemption amount, based on the effective interest method taken to the profit or loss over the term of the loans.

Trade and other payables
Trade and other payables are carried at amortised cost.

Cash and cash equivalents
Cash and cash equivalents comprise cash and bank balances and other call deposits payable on demand. Bank overdrafts that are repayable on demand, and form an integral part of the Group's cash management, are included as a component of cash and cash equivalents in the statement of cash flows and are measured at face value.

Other non-derivative financial instruments
Other non-derivative financial instruments are measured at amortised cost using the effective interest method, less any impairment losses. These concern subordinated loans granted to third parties.

Derivative financial instruments, including hedge accounting

The Group holds derivative financial instruments to hedge its foreign currency rate exposures. At 31 December 2010 no interest rate hedge derivatives existed.

Derivatives are initially measured at fair value, with attributable transaction costs recognised in the statement of comprehensive income when incurred. Subsequent to initial recognition, derivatives are carried at fair value. Any changes are taken to the profit or loss, unless the instruments are designated as cash flow hedges.

Embedded derivatives are separated from the host contract and accounted for separately. If the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative, would meet the definition of a derivative, and the combined instrument is not measured at fair value in the profit or loss. One embedded derivative has been identified and separated from the host contract. Changes in the fair value of separated embedded derivatives are recognised immediately in the profit or loss.

Changes in the fair value of a derivative hedging instrument, designated as a cash flow hedge, are recognised in other comprehensive income and presented in the hedging reserve in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes are recognised immediately in the comprehensive income.

On initial designation of the derivative as the hedging instrument designated as a cash flow hedge, the Group formally documents the relationship between the hedging instrument, the hedged item and the hedged risk, including the risk management objective and strategy in undertaking the hedge transaction, together with the methods that are used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in achieving offsetting of the changes in the cash flows for the respective hedged items attributable to the hedged risk, and whether the actual results of each hedge are with a range of 80–125%. For a cash flow hedge of a forecasted transaction, the Group establishes that the hedged transactions are highly probable to occur and present an exposure to variations in cash flows that could ultimately affect the profit or loss.

If the hedging instrument no longer meets the criteria for a cash flow hedge, expires or is sold, then hedge accounting is discontinued prospectively. The cumulative result previously included in equity is recognised in the profit or loss unless it is expected that the original hedged transaction will still take place.

(i) >> Inventories

Inventories are measured at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and the estimated costs to sell.

The cost of inventories of the Group is based on the weighted average cost, and includes expenditure incurred in acquiring the inventories and bringing them to their current location and condition. The cost of inventories includes an appropriate share of overheads based on normal operating capacity.

(j) Impairment

(i) Financial assets

A financial asset is assessed at each reporting date to determine whether there is any objective evidence that it is impaired. A financial asset is considered to be impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

An impairment loss in respect of a financial asset measured at amortised cost, is calculated as the difference between its carrying amount, and the present value of the estimated future cash flows discounted at the original effective interest rate.

Significant financial assets are tested for impairment on an individual basis. The remaining financial assets are assessed collectively in groups that share similar credit risk characteristics.

All impairment losses are recognised as a charge in the profit or loss.

An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. For financial assets measured at amortised cost, the reversal is recognised in the profit or loss.

(ii) Non-financial assets

The carrying amounts of the Group's non-financial assets, inventories and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill and intangible assets that have indefinite lives or that are not yet available for use, the recoverable amount is estimated at each reporting date.

The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the 'cash-generating unit'). For the purpose of impairment testing, the goodwill acquired in a business combination is allocated to cash-generating units that are expected to benefit from the synergies of the combination.

An impairment loss is recognised if the carrying amount of an asset or its cash-generating unit exceeds its estimated recoverable amount. Impairment losses are recognised in the profit or loss. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to the units and then to reduce the carrying amount of the other assets in the unit (group of units) on a pro rata basis.

(iii) **Reversal of impairment losses**

An impairment in respect of a receivable carried at amortised cost is reversed, if the subsequent increase in the recoverable amount can be related objectively to an event occurring after the impairment loss was recognised. Impairment losses in respect of goodwill are not reversed. Impairment losses in respect of other assets are reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. Reversals of impairment losses are recognised in the profit or loss.

(iv) **Calculation of recoverable amount**

The recoverable amount of the Group's receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed on initial recognition of these financial assets). Receivables with a short remaining term are not discounted. The recoverable amount of other assets is the greater of their net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs.

(k) >> Share capital

(i) **Ordinary shares**

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of ordinary shares are recognised as a deduction from equity, net of any tax effect.

(ii) **Repurchase, disposal and reissue of share capital (treasury shares)**

When own shares recognised as equity are repurchased, the amount of the consideration paid, including directly attributable costs and net of any tax effects, is recognised as a deduction from equity. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are sold or reissued subsequently, the amount received is recognised as an increase in equity, and the resulting surplus or deficit on the transaction is transferred to or from other reserves.

(iii) **Dividends**

The holders of ordinary shares are entitled to receive dividends as determined from time to time by the General Meeting of Shareholders.

The Executive Board has the authority to decide, with the approval of the Supervisory Board, what portion of the profit will be allocated to the reserves. If applicable the declared but not yet paid dividends are recognised as a liability.

(l) Employee benefits

(i) Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognised as an employee benefit expense in the statement of comprehensive income when they are due. Prepaid contributions are recognised as an asset to the extent that cash refund or a reduction in future payments will occur.

(ii) Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. The Group's net obligation in respect of defined benefit pension plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. Any unrecognised past service costs and the fair value of any plan assets are deducted. The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of the Group's obligations and that are denominated in the same currency in which the benefits are expected to be paid.

The calculation is performed annually by a qualified actuary using the projected unit credit method. When the calculation results in a benefit to the Group, the recognised asset is limited to the total of any unrecognised past service costs and the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. An economic benefit is available to the Group if it is realisable during the life of the plan, or on settlement of the plan liabilities.

Actuarial results gains and losses arising from defined benefit plans in excess of the so called 'corridor' (10% of the higher of the defined benefit oblgations or the fair value of the pension fund assets) are amortised over the remaining average term of service.

(iii) Other long-term service benefits

The Group's net obligation in respect of long-term service benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods. The obligation is calculated using the projected unit credit method, discounted to its present value and net of the fair value of any related assets. The discount rate is the yield at the financial position date on AA-credit rated bonds that have maturity dates approximating the terms of the Group's obligations. Any actuarial gains and losses are recognised in the comprehensive income in the period in which they arise.

(iv) **Incentive programme (Share plan)**

The grant-date fair value of share-based payment awards granted to employees and the Board, is recognised as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognised as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognised as an expense is based on the number of awards that meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with the non vesting conditions, the grant-date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

(m) Provisions

A provision is recognised in the financial position when the Group has a legal or constructive obligation as a result of a past event and it is probable that settlement of the obligation will involve an outflow of funds.

If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

The unwinding of the discount is recognised as finance cost.

(n) Revenue

(i) **Goods sold and services rendered**

Revenue from the sale of goods is recognised in the profit or loss when the significant risks and rewards of ownership have been transferred to the customer. No revenues are recognised if there are significant uncertainties about the collectability of the consideration due, the associated costs on the possible return of goods and also when there is no continuing management involvement with the goods, and the amount of revenue cannot be measured reliably. The transfer of risks and rewards varies depending on the terms of the individual sales contract.

(ii) **Government grants**

Unconditional government grants are recognised in the profit or loss as operating income when they become receivable.

Other government grants are recognised in the statement of financial position initially as deferred income when there is reasonable assurance that they will be received and that the Group will comply with the conditions attaching to them. Grants that compensate the Group for expenses incurred are recognised as revenue in the profit or loss in the same periods in which the expenses are incurred. Grants for the cost of an asset that compensate the Group are recognised in the profit or loss as other operating income over the useful life of the asset.

(o) Expenses

(i) **Operating lease payments**

Payments made under operating leases are recognised in the statement of comprehensive income on a straight-line basis over the term of the lease.

(ii) **Finance lease payments**

Minimum lease payments are apportioned between the finance expense and the reduction in the outstanding liability. The finance expense is allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(iii) **Net finance costs**

Finance income comprises interest income on funds invested, and financial assets held to maturity. Interest income is recognised as it accrues in the profit or loss, using the effective interest method.

Finance expenses comprise interest expense on borrowings, commitment fees, accrued interest on provisions, interest on pension liabilities, impairment losses recognised on financial assets and losses on interest rate hedge instruments to the extend they are recognised in the profit or loss. All borrowing costs are recognised in the profit or loss using the effective interest method.

Realised and unrealised foreign currency gains and losses on monetary assets and liabilities, including changes in fair value of currency hedge instruments that are not qualified as cash flow hedges are reported on a net basis.

(p) Income tax

Income tax for the year comprises current and deferred tax. Income tax is recognised in the profit or loss unless it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax, payable or receivable, on the taxable income for the year, using applicable tax rates enacted or substantially enacted at the financial position date, and any adjustment to tax calculated in respect of previous years.

Deferred tax is recognised using the balance sheet method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for the following temporary differences:

- the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit;
- relating to investments in subsidiaries and jointly controlled entities to the extent that it is probable that they will not reverse in the foreseeable future;
- arising on the initial recognition of goodwill.

Deferred tax is measured at the tax rates that are expected to be applied to the temporary differences when they reverse, based on the laws that have been enacted or substantially enacted at the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax assets and liabilities, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which the asset can be applied. Deferred tax assets are reduced where it is no longer probable that the related tax benefit will be realised.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend is recognised.

(q) » Discontinued operations

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations that has been disposed of or is held for sale, or is a subsidiary acquired exclusively with a view to resale. Classification as a discontinued operation occurs upon disposal or when the operation meets the criteria to be classified as held for sale, if earlier. When an operation is classified as a discontinued operation, the comparative statement of comprehensive income is restated as if the operation had been discontinued from the start of the comparative period.

(r) » Earnings per share

The Company presents basic and diluted earnings per share data for its ordinary shares. Basic earnings per share is calculated by dividing the profit or loss attributable to ordinary shareholders of the Company by the weighted average number of ordinary shares outstanding during the reporting period. Diluted earnings per share is determined by adjusting comprehensive income attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding for the effects of all dilative potential ordinary shares.

(s) » Segment reporting

The Group continues to determine and present operating segments based on the information that is provided internally to the Board, the Group's chief operating decision-maker. This is in conformity with IFRS 8-Operating segments.

Based on the criteria of IFRS 8, in essence the individual operating companies of Kendrion are the operating segments of the Group. An operating segment is a component of the Group that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the Group's other components. The operating segment's operating results are reviewed regularly by the Board to make decisions about resources to be allocated to the segment and assess its performance, and for which separate financial information is available.

Based on the aggregation criteria of IFRS 8, however, these operating segments have been aggregated into one single reportable operating segment on the consolidated level of Kendrion as a Group. In accordance with IFRS 8, the Company discloses general and entity-wide disclosures, including information about geographical areas and major customers of the Group as a whole.

(t) New standards and interpretations

A number of new standards, amendments to standards and interpretations are effective for the year ended 31 December 2010, and, where relevant, have been applied in the preparation of these consolidated financial statements.

The standards or interpretations published by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC), which are in effect for the year ended 31 December 2010, and may be relevant and may have an impact on the financial statements, are as follows:

- **IAS 38:** Intangible assets. The amendments clarify that an intangible asset that is separable only together with a related contract, identifiable asset or liability is recognised separately from goodwill together with the related item and complementary intangible assets with similar useful lives may be recognised as a single asset. This amendment also describes valuation techniques commonly used by entities when measuring the fair value of intangible assets acquired in a business combination for which no active market exists. The financial statements were not impacted by this amendment.

- **IAS 39:** Financial instruments: Recognition and measurement. The amendments to IAS 39 clarify how the principles that determine whether hedged risks, or portions of cash flows are eligible for designation should be applied in particular situations. This amendment became effective in 2010 and have not affected the financial statements.

- **IAS 27:** Consolidated and separate financial statements. The amendments to IAS 27 reflect the changes to the accounting for non-controlling interest. The amendments deal primary with the accounting for changes in ownership interests in subsidiaries after control is obtained, the accounting for the loss of control of subsidiaries and the allocation of comprehensive income to controlling and non-controlling interests in a subsidiary. This amendment has not affected these financial statements.

- **IFRS 2:** Share-based payments. The amendments clarify that business combinations, as defined in IFRS 3, are outside the scope of IFRS 2, notwithstanding that they may be outside the scope of IFRS 3. The financial statements were not impacted by this amendment.

- **IFRS 3:** Business combinations. This standard has influenced the accounting policies related to business combinations and changed ownership interests and are explained in note c.

- **IFRS 5:** Non-current assets held for sale and discontinued operations. The amendments to IFRS 5 clarify the classification of assets and liabilities held for sale and the disclosures for discontinued operations. The financial statements were not impacted by this amendment.

- **IFRIC 17:** Distributions of non-cash assets to owners. This provides guidance in respect of distributions of non-cash assets to owners by focusing on the measurement of the dividend payable. This IFRIC has not affected the financial statements.

- **IFRIC 9** Reassessment of embedded derivatives. The IASB amended the scope of IFRIC 9 so that embedded derivatives in contracts acquired in business combinations as defined in IFRS 3 (2008), joint venture formations and common control transactions remain outside the scope of IFRIC 9. The financial statements were not impacted by this amendment.

- **IFRIC 16** Hedges of a net investment in a foreign operation. The amendments remove the restriction that prevented a hedging instrument from being held by a foreign operation that itself is being hedged. The financial statements were not impacted by this amendment.

- **IFRS 8** Operating segments. The amendments clarify that segment information with respect to total assets is required only if such information is regularly reported to the chief operating decision maker. The financial statements were not impacted by this amendment.

- **IAS 1** Presentation of financial statements. The amendments clarify that the classification of the liability component of a convertible instrument as current or non-current is not affected by terms that could, at the option of the holder of the instrument, result in settlement of the liability by the issue of equity instruments. The financial statements were not impacted by this amendment.

- **IAS 7** Statement of cash flows. The amendments clarify that only expenditures that result in the recognition of an asset can be classified as a cash flow from investing activities. This amendment did not affect the statement of cash flows.

- **IAS 17** Leases. The IASB deleted guidance stating that a lease of land with an indefinite economic life normally is classified as an operating lease, unless at the end of the lease term, title is expected to pass to the lessee. The amendments clarify that when a lease includes both the land and building elements, an entity should determine the classification of each element based on paragraphs 7 – 13 of IAS 17, taking account of the fact that land normally has an indefinite economic life. The financial statements were not impacted by this amendment.

- **IAS 36** Impairment of assets. The amendments clarify that the largest unit to which goodwill should be allocated is the operating segment level as defined in IFRS 8 before applying the aggregation criteria of IFRS 8. The amendments apply prospectively.
The financial statements were not impacted by this amendment.

- **IAS 39** Financial instruments: Recognition and measurement. The amendments provide additional guidance on determining whether loan prepayment penalties result in an embedded derivative that needs to be separated. The financial statements were not impacted by this amendment.

- **IAS 39** Financial instruments: the amendments clarify that the scope exemption in IAS 39 paragraph 2(g) is restricted to forward contracts, i.e. not options, between an acquirer and a selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date within a reasonable period normally necessary to obtain any required approvals and to complete the transaction; and clarify that the gains or losses on a cash flow hedge should be reclassified from other comprehensive income to comprehensive income during the period that the hedged forecast cash flows impact the profit or loss. The financial statements were not impacted by this amendment.

- **IFRS 2** Share-based payment – group cash-settled share-based payment transactions. The IASB amended IFRS 2 to require an entity receiving goods or services (receiving entity) in either an equity-settled or a cash-settled share-based payment transaction to account for the transaction in its separate or individual financial statements. This principle even applies if another group entity or shareholder settles the transaction (settling entity) and the receiving entity has no obligation to settle the payment. The financial statements were not impacted by this amendment.

The standards or interpretations published by the International Accounting Standards Board (IASB) and the International Financial Reporting Interpretations Committee (IFRIC) which are not yet in effect at 31 December 2010 and may be relevant, and may have an impact on the financial statements, are as follows:

- **IAS 1** (EU-endorsed). The amendment clarifies that disaggregation of changes in each component of equity arising from transactions recognised in other comprehensive income also is required to be presented, but may be presented either in the statement of changes in equity or in the notes. This amendment applies to financial years started on or after 1 January 2011. The company will review the effects after this expansion.

- **IAS 24:** Related party disclosures (EU-endorsed). The amendment to IAS 24 clarifies the definition of a related party and provides a partial exemption from the disclosure requirements for government-related entities. The revised standard is effective as from 1 January 2011. The amendment is not expected to have influence on the Group's financial statements.

- **IAS 32:** Financial instruments: presentation – classification of rights issues (EU-endorsed). The amendment allows rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency to be classified as equity instruments provided the entity offers the rights, options or warrants pro rata to all existing owners of the same class of its own non-derivative equity instruments. The revised standard is effective as from 1 February 2010. The amendment is not expected to have influence on the Group's financial statements.

- **IFRS 3:** Business combinations (EU-endorsed). The amendment clarifies and expands the current guidance with respect to IFRS 3. The amendment is effective as from 1 July 2010. The Group does not expect a material impact on the presented figures.

- **IFRS 7:** Financial instruments: disclosures (not yet EU-endorsed). The amendment add an explicit statement that qualitative disclosure should be made in the contact of the quantitative disclosures to better enable users to evaluate an entity's exposure to risk arising from financial instruments. This amendment applies to financial years started on or after 1 January 2011.

- **IFRS 9:** Financial instruments (not yet EU-endorsed). The first chapters of a new standard on accounting for financial instruments which will replace IAS 39 Financial instruments: recognition and measurement. This standard will become effective as from 2013, with earlier adoption permitted, including for 2010. IFRS 9 introduces new requirements for classifying and measuring financial assets. This standard encompassed an overall change of accounting principles.

- **IFRIC 14:** Minimum funding requirements (EU-endorsed). An amendment to IFRIC 14 on minimum funding requirements corrects an unintended consequence of the originally issued interpretation. The amendment is effective as from 1 January 2011, with earlier application permitted.

- **IFRIC 19:** Extinguishing financial liabilities with equity instruments (EU endorsed). This interpretation provides guidance on the accounting for debt for equity swaps. The interpretation is effective as from 1 July 2010.

(u) Fair values

(i) Measurement of fair value

Several of the Group's accounting policies, as well as the information supply by the Group, require the fair value of both financial and non-financial assets and liabilities to be determined. For valuation and information supply, the fair value is measured using the following methods. Where applicable, more detailed information on the basis of the fair value measurement is disclosed in the specific notes on the asset or liability in question. The principal methods and assumptions used in estimating the fair value of financial instruments included in the summary are given below.

(ii) Property, plant and equipment

The fair value of property, plant and equipment recognised as a result of a business combination, is based on market value. The market value of property is the estimated amount for which the property in question could be exchanged on the valuation date between a buyer and seller in an arm's length transaction, in which both parties have acted knowledgeably, prudently and without compulsion. The market value of other items of property, plant and equipment is based on the quoted market prices of comparable assets and goods.

(iii) Intangible assets

The fair value of patents and trademarks acquired as part of a business combination is measured on the basis of the discounted estimated royalties, which have been avoided through ownership of the patent or trademark. The fair value of customer relationships acquired in a business combination is based on the excess earnings method over multiple periods, valuating the asset in question by deducting a real return on all other assets which in total create the related cash flows. The fair value of other intangible assets is based on the expected discounted value of the cash flows from the use and ultimate sale of the assets.

(iv) Financial lease liabilities

The fair value is estimated on the basis of the present value of future cash flows, discounted at the interest rate for lease contracts of a similar kind. The estimated fair value reflects movements in interest rates.

(v) **Inventories**

The fair value of inventories acquired as part of a business combination is determined on the basis of the estimated selling price as part of the normal business operations, less the estimated costs of completion and the selling costs, plus a reasonable profit margin which reflects the completion and sales effort.

(vi) **Trade and other receivables/trade and other payables**

The face value of receivables and liabilities falling due within one year is regarded as a reflection of their fair value. The fair value of all other receivables and liabilities is measured on the basis of present value. The discount factor is based on the risk free interest rate of the same duration of the receivable and/or payable, plus a credit mark up reflecting the credit worthiness of the Group.

(vii) **Interest-bearing loans**

The fair value is calculated on the basis of the present value of future repayments of principal and interest at the prevailing market rate of interest, augmented by a credit mark-up reflecting the credit worthiness of the Group.

(viii) **Derivatives**

The fair value of forward exchange contracts is based on the present value of the contractual cash flows for the remaining term based on a risk-free interest rate.

(ix) **Non-derivative financial liabilities**

The fair value of non-derivative financial liabilities is determined for information supply and is based on the present value of future repayments of principal and interest, discounted at a risk-free rate and a margin based on the credit worthiness of the Group on the reporting date.

(v) >> Financial risk management

The Group has exposure to the following risks from its use of financial instruments:

- credit risk;
- liquidity risk;
- market risk.

This section provides general information about the Group's exposure to each of the above risks in the course of its normal business operations, the Group's objectives, policies and processes for measuring and managing risk, and the Group's management of capital. Further quantitative disclosures are concluded in the financial instrument section in these consolidated financial statements.

The Board bears the ultimate responsibility for the organisation and control of the Group's risk management framework. The Group's risk policy is designed to identify and analyse the risks confronting the Group, implement appropriate risk limits and control measures, and monitor the risks and compliance with the limits. The risk management policy and systems are evaluated at regular intervals and, when necessary, adapted to accommodate changes in market conditions and the Group's operations.

The Company's Supervisory Board supervises compliance with the Group's risk management policy and procedures.

For a more detailed description of risk management and the position of financial risk management in the Group's framework, we refer to the Annual Report.

(i) **Credit risk**

Credit risk is the risk of financial loss to the Group in the event that a client or counterparty to a financial instrument fails to meet its contractual obligations. Credit risks arise primarily from accounts receivable, derivative transactions concluded with banks and cash positions and deposits held with banks. The Group continually monitors the credit risk within the Group. The Group does not require collateral for trade and other receivables and financial assets.

The credit policy includes an assessment of the creditworthiness of every new major client before offering payment and delivery terms. This assessment includes external credit ratings or reports if they are available. The creditworthiness of major clients is actively monitored on an ongoing basis.

The Group recognises impairment provisions of an amount equal to the estimated losses on trade and other receivables and other investments. The main component of this provision comprises specific provisions for losses on individual accounts of material significance.

(ii) **Credit risk concentration**

The Group's most significant customer, a German-based buying entity of an international automotive group, accounted for 8% of the trade and other receivables at 31 December 2010. In 2009 the largest customer accounted for 10% (excluding a non-recurring invoice) of total receivables. The geographical credit risk from the Group's direct customers is largely concentrated in Germany. However, as the Group's most important customers in the various segments of the German market are multinational or global players this reduces the Group's dependency on the German market.

(iii) **Investments and financial instruments**

The Group currently does not invest in debt securities. Cash positions and exposure to the financial instruments of financial counterparties are monitored actively. The Group's main financial counterparties are well-established banks with good creditworthiness. The cash in bank accounts at other than the core relationship banks is maintained at the minimum level required for the operations of the Group's companies.

(iv) **Liquidity risk**

The liquidity risk is the risk that the Group is unable to meet its financial obligations at the required time. Liquidity risk management is based on the maintenance of sufficient liquidity in the form of unused (uncommitted) credit facilities or cash to meet present and future financial obligations in normal and difficult circumstances.

A summary of the credit lines available to the Group is enclosed in note 10 of these consolidated financial statements. The Group had approximately EUR 40 million available within its existing credit facility on the financial position date.

(v) **Market risk**

The market risk is the risk of the deterioration of the Group's income due to movements in market prices, such as exchange rates and interest rates. The management of market risk exposure is intended to keep the market risk position within acceptable limits.

Derivatives are used to manage specific market risks. These transactions are usually carried out within the treasury framework adopted by the Board. Where necessary, the Group uses hedge accounting to manage volatility in the statement of comprehensive income.

(vi) **Interest rate risk**

Pursuant to the Group's policy, between 50-85% of the exposure to changes on borrowings is maintained on a fixed rate basis, taking into account any assets with exposure to changes in interest rates and expected short term free cash flow. The policy is implemented by making use of derivative financial instruments such as interest rate swaps and interest rate options. Considering the low net debt position at the date of these financial statements, no interest rate hedges were outstanding.

(vii) **Currency risk**

The Group is exposed to exchange rate risks on sales, purchases, equity positions and loans expressed in currencies other than the euro. The Group companies are primarily financed in their own currency. The majority of the revenues and costs of the Group companies are realised in the eurozone. Approximately 85% of the cost base and 85% of the revenue is realised in euros. Sales outside the eurozone are partly produced locally and partly exported. Most of these exports are expressed in euros.

The Group’s activities in the Czech Republic result in the most significant currency exposure, since the majority of revenue is generated in euros and part of the costs are realised in Czech krones. Pursuant to the Group's policy this currency exposure is hedged to a level of at least 70% for the next four quarters and at least 35% for the next four quarters thereafter. Exchange rate risks are hedged with derivatives.

The Group also actively hedges intercompany loans in foreign currency with forward, swaps or back-to-back external loans in the same foreign currency.

Pursuant to the Group's policy for other monetary assets and liabilities denominated in foreign currency, net exposure is maintained at an acceptable level by buying or selling foreign currencies at spot rates as required to correct short-term imbalances.

The Group's policy stipulates that, in principle, equity investments and other translation exposures are not hedged.

(viii) Other price risks

Copper constitutes the Group's main direct exposure to raw material price risks, since copper wire is an important component of electromagnets. Pursuant to the Group's policy, the sensitivity to copper prices is actively reduced both by concluding fixed-price purchase contracts with copper suppliers and by including raw material clauses in sales contracts. As the occasion arises the Group can also conclude derivative financial instrument contracts with financial counterparties to hedge the copper risk. No financial derivative contracts for raw materials were outstanding at the balance sheet date.

The Group is mainly indirectly exposed to raw material price risks relating to oil and steel, primarily as part of the purchase prices of machined components. This exposure is monitored and, when feasible, reduced by means of raw material clauses with customers and by concluding fixed-price agreements with suppliers.

(ix) Capital management

The Executive Board's policy is designed to maintain a strong capital gearing to retain the confidence of investors, creditors and the markets and to safeguard the future development of the business activities. The Executive Board monitors the return on equity, which the Group defines as the net operating result divided by shareholders' equity, excluding minority interests. The Executive Board also monitors the level of dividend distributed to ordinary shareholders.

The Executive Board seeks to strike a balance between a higher return that would be achievable with a higher level of borrowed capital and the benefits and security of sound capital gearing.

No changes were made to the Group's capital management system during the reporting period.

Neither the Company nor its subsidiaries are subject to any externally imposed capital requirements beyond those stipulated by law, other than the covenants with the banks as explained in note 10.

1 ## Property, plant and equipment

EUR million	Land and buildings	Plant and equipment	Other fixed assets	Under construction	Total
Cost					
Balance at 1 January 2009	30.8	39.6	21.6	12.1	104.1
Acquired, other	0.5	10.0	2.2	1.2	13.9
Disposals	(0.2)	(0.0)	(0.3)	(7.8)	(8.3)
Currency translation differences	0.0	0.0	0.0	0.0	0.0
Balance at 31 December 2009	31.1	49.6	23.5	5.5	109.7
Balance at 1 January 2010	31.1	49.6	23.5	5.5	109.7
Acquired through business combinations	0.0	0.3	0.2	–	0.4
Acquired, other	0.6	8.4	2.8	1.4	13.2
Disposals	–	(1.1)	(0.4)	(3.9)	(5.3)
Currency translation differences	0.0	0.4	0.0	0.0	0.4
Balance at 31 December 2010	31.7	57.6	26.1	3.0	118.4
Depreciation and impairment losses					
Balance at 1 January 2009	14.6	26.9	15.9	–	57.4
Depreciation for the year	1.0	4.3	2.0	–	7.3
Disposals	(0.1)	(0.0)	(0.2)	–	(0.3)
Balance at 31 December 2009	15.5	31.2	17.7	–	64.4
Balance at 1 January 2010	15.5	31.2	17.7	–	64.4
Depreciation for the year	1.0	5.2	2.2	–	8.4
Reversal of impairment	–	(0.2)	–	–	(0.2)
Disposals	–	(0.4)	(0.3)	–	(0.7)
Balance at 31 December 2010	16.5	35.7	19.6	–	71.9
Carrying amounts					
At 1 January 2009	16.2	12.7	5.7	12.1	46.7
At 31 December 2009	15.6	18.4	5.8	5.5	45.3
At 1 January 2010	15.6	18.4	5.8	5.5	45.3
At 31 December 2010	15.2	21.8	6.5	3.0	46.5

Translation differences are calculated on the carrying amount and reflected in the related item in the cost.

The estimated useful life is as follows:

Buildings	10 – 30 years
Plant and equipment	5 – 10 years
Other fixed assets	3 – 7 years

2 Intangible assets

EUR million	Goodwill	Software	Other	Total
Cost				
Balance at 1 January 2009	34.2	2.2	9.3	45.7
Acquired, other	–	0.1	0.0	0.1
Disposals	–	(0.5)	–	(0.5)
Currency translation differences	(0.2)	0.0	(0.0)	(0.2)
Other	(0.2)	–	–	(0.2)
Balance at 31 December 2009	33.8	1.8	9.3	44.9
Balance at 1 January 2010	33.8	1.8	9.3	44.9
Acquired through business combinations	7.1	–	2.4	9.5
Acquired, other	–	0.3	–	0.3
Disposals	–	0.0	–	0.0
Currency translation differences	0.4	0.0	0.2	0.6
Balance at 31 December 2010	41.3	2.1	11.9	55.3
Amortisation and impairment losses				
Balance at 1 January 2009	–	1.3	1.1	2.4
Amortisation for the year	–	0.4	1.1	1.5
Disposals	–	(0.4)	–	(0.4)
Effect of movements in exchange rates	–	0.0	–	0.0
Balance at 31 December 2009	–	1.3	2.2	3.5
Balance at 1 January 2010	–	1.3	2.2	3.5
Amortisation for the year	–	0.3	1.4	1.7
Disposals	–	(0.0)	–	(0.0)
Balance at 31 December 2010	–	1.6	3.6	5.2

EUR million	Goodwill	Software	Other	Total
Carrying amounts				
At 1 January 2009	34.2	0.9	8.2	43.3
At 31 December 2009	33.8	0.5	7.1	41.4
At 1 January 2010	33.8	0.5	7.1	41.4
At 31 December 2010	41.3	0.5	8.2	50.1

Depreciation, amortisation and impairment loss

Depreciation, amortisation and impairment losses are recognised in the following items in the statement of comprehensive income:

EUR million	2010	2009
Depreciation and amortisation of intangible assets and property, plant and equipment	10.1	8.8

The estimated useful life of software is between three and five years. The estimated life of other intangible assets is approximately between eight and ten years. Goodwill has an indefinite estimated useful life. The Group is preparing for the introduction of a new ERP system. Per 31 December 2010 EUR 0.3 million costs related to this project were recognised on the statement of financial position under intangibles and EUR 0.1 million was expensed in the statement of comprehensive income.

Impairment testing for cash-generating units containing goodwill

EUR million	2010	2009
Kendrion Linnig Group	27.6	27.6
Kendrion Tri-Tech LLC	6.6	6.2
Kendrion Magneta GmbH	7.1	–
	41.3	33.8

Key assumptions and method of quantification

The Group recognises its intangible assets in accordance with IAS 38 and IFRS 3. In accordance with IAS 36, the Group has performed an impairment test on the capitalised goodwill in Germany and the US. The test was carried out by discounting future cash flows to be generated from the continuing use of the cost-generating unit to which the goodwill applies and on the assumption of an indefinite life.
The cash flows for the next three years were based on the relevant Mid-term Plans and budgets drawn up by the local management. For the subsequent years the residual value was calculated on the basis of the results in the last year of relevant forecasts and whereby a moderate growth rate of 2% was taken into account to reflect inflation. The forecasts took no account of tax considerations, i.e. were based on pre-tax cash flow. The discount rate (WACC) was also pre-tax. In accordance with IAS 36.44, expansion investments were excluded from the calculations.

The expected growth in cash flows as a result of these expansion investments was also excluded.

The Group has not processed any impairment of goodwill in this accounting period.

Key assumptions used in the calculation of recoverable amounts are discount rates, terminal value growth rates and EBIT growth. Assumptions are based on past experience and external sources.

These assumptions are as follows:

Discounted cash flow projections

	Discount rate		Terminal value growth rate		Assumed EBIT growth	
	2010	2009	2010	2009	2010	2009
Kendrion Linnig Group	9.7%	14.0%	2.0%	0.0%	6.71%	18.22%
Kendrion Tri-Tech LLC	9.0%	13.9%	2.0%	0.0%	14.97%	107.9%
Kendrion Magneta GmbH	10.1%	–	2.0%	–	4.92%	–

Discount rate

In determining the pre tax discount rate, first the post tax average costs of capital were calculated for all cash generating units containing goodwill. The post tax rate is based on a debt leveraging compared to the market value of equity of 10%. The debt leveraging was derived from a peer group benchmark analysis. The cost of equity is based on a market risk premium of 5%, a risk-free interest rate of approximately 3%, and a beta factor (sensitivity to the overall stock market) of 1.00. The cost of debt is based on a risk-free rate of 3%, a credit margin of 2% and the local corporate income tax rates. All the post tax average cost of capital rates of the three cash generating units containing goodwill approximated 7.5%, which rate was used for calculating the after tax cash flows. Based on an iterative process the pre tax discount rates mentioned in the table above were derived for discounting the post tax cash flows.

Compared to last year the discount rates have decreased. The decrease was caused by the credit margin reduction, a lower debt gearing and not taking into account a small company risk premium, which was included last year.

Terminal value growth rate

All cash-generating units with goodwill have five years of cash flows included in their discounted cash flow models. A conservative long-term growth rate into perpetuity has been determined on the basis of a target rate of 2% price inflation in Europe and the US.

EBIT growth

Forecasted EBIT is expressed at the compound annual growth rates in the initial five years of the cash flow models employed for impairment testing and is based on the three-year Mid-term Plans, drawn up locally in a bottom-up forecasting process and the 2% growth rate mentioned above.

Sensitivity to changes in assumptions

The recoverable amounts of all cash-generating units with goodwill exceed the carrying amounts. Management has carried out an analysis of sensitivity to changes in assumptions. When other variables were kept unchanged, management established that a 10% reduction in EBIT levels from the 2010 level and no growth into perpetuity would not lead to impairment. The same analysis was carried out for the discount rate. A 2.5% point increase in the pre-tax average cost of capital as compared to the rates mentioned above would not lead to impairment in any of the cash-generating units with goodwill. Refering to note s, in which the Group explains that the single reportable operating segments are aggregated into one single reportable operating segment of Kendrion as a Group, the Group chooses not to report on recoverable amounts on reporting entities.

3 >> Other investments, derivatives

Other investments in 2009 included a subordinated vendor loan (held to maturity financial asset) of EUR 0.6 million, which was repaid in full in 2010.

4 >> Deferred tax assets and liabilities

The Group has recognised deferred tax assets for tax loss carry-forwards in Germany, The Netherlands and Austria in the financial position.

Germany

Final assessments have been submitted for the German intermediate holding up to and including 2009, and for the German operating companies up to and including 2009. As from 2005, these years are still open for potential tax audits with the exception of Kendrion Magneta GmbH which has been audited up to and including 2008. At 31 December 2010 the tax loss carry-forwards amounted to about EUR 19 million ('Gewerbesteuer') and EUR 48 million ('Körperschaftsteuer'). These are recognised in full, resulting in deferred tax assets of EUR 9.8 million.

The Netherlands

Final assessments have been submitted up to and including 2008. The years 2005 up to 2008 are still open for potential tax audits.
At 31 December 2010 the tax loss carry-forwards amounted to EUR 35 million. These are recognised in part, resulting in deferred tax assets of EUR 1.3 million.

The main element of the tax loss carry-forwards originates from 2008, after the final settlement of the Dutch tax return for 2007, in which a large tax loss incurred on the sale of Automotive Metals was recognised by the Dutch tax authorities.

Austria

Final assessments have been submitted up to and including 2009. The years 2006 to 2009 are currently being audited by the Austrian tax authorities. At 31 December 2010, the tax loss carry-forwards amounted to EUR 2 million. These are recognised in full, resulting in deferred tax assets of EUR 0.5 million.

Deferred tax assets and liabilities included in the financial position

The deferred tax assets and liabilities can be specified as follows:

EUR million	Assets		Liabilities		Net	
	2010	2009	2010	2009	2010	2009
Property, plant and equipment	0.2	0.0	0.9	0.7	(0.7)	(0.7)
Intangible assets	0.1	0.0	2.3	1.8	(2.2)	(1.8)
Inventories	0.0	0.0	0.1	0.1	(0.1)	(0.1)
Employee benefits	0.2	0.2	–	0.1	0.2	0.1
Provisions	0.2	0.3	0.1	(0.1)	0.1	0.4
Other items	0.5	0.1	0.0	0.6	0.5	(0.5)
Tax value of recognised loss carry-forwards	11.6	12.7	–	–	11.6	12.7
Deferred tax assets/liabilities	12.8	13.3	3.4	3.2	9.4	10.1

The deferred tax assets relate to a large extent to recognised tax loss carry-forwards.

The deferred tax liabilities relate almost entirely to temporary differences between the carrying amount and tax base of property, plant and equipment and intangible assets. These are of a relatively long term, mostly over five years.

Movements in temporary differences during the financial year

Net, EUR million	2010					2009		
	At 1 January	Effect acquisitions	EUR	Recognised in income	At 31 December	At 1 January	Recognised in income	At 31 December
Property, plant and equipment	(0.7)	–	(0.7)	0.0	(0.7)	(0.3)	(0.4)	(0.7)
Intangible assets	(1.8)	(0.5)	(2.3)	0.1	(2.2)	(1.8)	(0.0)	(1.8)
Inventories	(0.1)	–	(0.1)	(0.0)	(0.1)	(0.2)	0.1	(0.1)
Employee benefits	0.1	–	0.1	0.1	0.2	–	0.1	0.1
Provisions	0.4	–	0.4	(0.3)	0.1	(0.3)	0.7	0.4
Other items	(0.5)	0.5	–	0.5	0.5	(0.6)	0.1	(0.5)
Tax value of loss carry-forwards used	12.7	–	12.7	(1.1)	11.6	14.7	(2.0)	12.7
	10.1	–	10.1	(0.7)	9.4	11.5	(1.4)	10.1

In 2010, the net amount from the movement in deferred tax assets and liabilities, presented as tax in the profit or loss, is EUR – 0.7 million (2009: EUR – 1.4 million). In 2010 a deferred tax asset was recognised as a consequence of gains and losses of designated cash flow hedged, deferred in the hedging reserve in other incomprehensive income amounting to EUR 0.0 million (2009: EUR 0.3 million).
No deferred tax assets are recognised related to other items that are recognised directly in the other comprehensive income.

Unrecognised deferred tax assets
At 31 December 2010, the Group had not valued tax losses of approximately EUR 29 million (2009: EUR 30 million) primarily originating in the Netherlands. Tax losses in the Netherlands can be carried forward for a period of nine years. The majority of the current unrecognised losses will expire in 2016.

5 Inventories

EUR million	2010	2009
Raw materials, consumables, technical materials and packing materials	12.6	10.2
Work in progress	7.7	5.9
Finished goods	7.4	5.0
Goods for resale	0.5	1.3
	28.2	22.4

The inventories are presented after accounting for a provision for obsolescence amounting to EUR 4.0 million (2009: EUR 3.6 million). In 2010 the amount of the write down to net realisable value of the inventories was EUR 0.5 million (2009: EUR 0.3 million).

6 Trade and other receivables

EUR million	2010	2009
Trade receivables	26.4	20.5
Other taxes and social security	1.1	0.6
Other receivables	1.0	0.7
Derivatives used for hedging	0.1	–
Prepayments	1.6	3.0
	30.2	24.8

The credit and currency risks associated with trade and other receivables are disclosed in note 15 and the financial risk management paragraph in note v.

7 >> Cash and cash equivalents

EUR million	2010	2009
Bank balances	9.0	4.7
Bank overdrafts	(1.7)	(3.7)
Cash and cash equivalents in the statement of cash flows	7.3	1.0

The bank balances are freely available. The interest-rate risk for the Group and a sensitivity analysis for financial assets and liabilities are disclosed in notes 15 and v.

8 >> Capital and reserves

Capital and share premium

	Ordinary shares entitled to dividend		Repurchased shares		Total number of issued shares	
	2010	2009	2010	2009	2010	2009
At 1 January	11,267,886	10,272,392	48,488	15,232	11,316,374	10,287,624
Repurchased	25,000	45,000	25,000	45,000	–	–
Delivered repurchased shares	14,373	11,744	14,373	11,744	–	–
Issued	–	1,028,750	–	–	–	1,028,750
At 31 December	11,257,259	11,267,886	59,115	48,488	11,316,374	11,316,374

Issuance of ordinary shares

In 2010 no new shares were issued. During 2010, the Company delivered 14,373 shares to the Board and senior management as part of its share plan and remuneration packages. The Company purchased 25,000 of the Company's shares in 2010 (2009: 45,000 shares). These will cover future deliveries under the Company's share plan and remuneration packages.

Ordinary shares

The authorised share capital consists of:

EUR million	2010	2009
40,000,000 ordinary shares of EUR 2.00	80.0	80.0

Issued share capital

Balance at 1 January 2010: 11,316,374 ordinary shares (2009: 10,287,624)	22.6	20.6
Balance at 31 December 2010: 11,316,374 ordinary shares (2009: 11,316,374)	22.6	22.6

Share premium

EUR million	2010	2009
Balance at 1 January	68.4	71.3
Dividend payment	–	(10.0)
Share premium on issued shares	–	7.1
Balance at 31 December	68.4	68.4

Translation reserve

The translation reserve comprises all foreign currency differences arising from the translation of the financial statements of associates in the non-euro zone. Gains and losses relating to the translation risk are recognised in equity. The build-up of the cumulative figure commenced on 1 January 2004.

Hedge reserve

The hedge reserve comprises the effective portion of the cumulative net movement in the fair value of cash flow hedging instruments relating to hedged transactions that have not yet occurred.

The net movement was EUR 0.9 million (2009: EUR 0.2 million). The realisation of hedged transactions amounted to EUR 0.9 million, which was recycled to the profit or loss (2009: EUR 0.8 million). The hedge reserve increased with EUR 0.0 million due to valuation (2009: EUR – 0.6 million). There was no hedge ineffectiveness in 2010 (2009: EUR 0.0 million).

Reserve for own shares (treasury shares)

The reserve for the Company's own shares comprises the cost of the Company shares held by the Company for the share plan and the remuneration packages for the Board and senior management. At 31 December 2010, the Company held 59,115 of the Company's shares (2009: 48,488).
See also note 28.

Other reserves

Other reserves are all the reserves other than those shown separately and comprise primarily of the accumulated, undistributed profits from previous financial years.

Retained earnings

In 2010, the result for 2009 was fully transfered in other reserves. Retained earnings in the 2010 financial statements consequently consist solely of the result for 2010.

Restrictions
Certain subsidiaries are restricted, either by law or by the provisions of their Articles of Association, in the extent to which they may distribute equity. These restrictions amounted to EUR 4.7 million at 31 December 2010 (2009: EUR 2.7 million).

Minority interests
The Company has one non 100%-subsidiary that is fully consolidated: Kendrion Binder Magnete Vertriebsgesellschaft mbH (Austria). For the interest that is not held by the Company, an amount is included in equity and results.

9 Earnings per share

Basic earnings per share
The calculation of the basic earnings per share at 31 December 2010 is based on the profit of EUR 16.5 million (2009: EUR 3.9 million) attributable to the holders of ordinary shares and the weighted average number of shares outstanding during the year 2010: 11,258,000 (2009: 10,554,000).

EUR million	2010	2009
Net profit attributable to ordinary shareholders	16.5	3.9

Weighted average number of ordinary shares

In thousands of shares	2010	2009
Ordinary shares outstanding at 1 January	11,268	10,272
Effect of own shares repurchased	11	33
Effect of shares issued in September 2009	–	1,029
Ordinary shares outstanding at 31 December	11,257	11,268
Weighted average number of ordinary shares	11,258	10,554
Basic earnings per share (EUR)	1.47	0.35
Basic earnings per share (EUR), based on weighted average	1.47	0.37

Diluted earnings per share
The calculation of the diluted earnings per share at 31 December 2010 is based on the profit of EUR 16.5 million (2009: EUR 3.9 million) attributable to the holders of ordinary shares and the weighted average number of shares in issue during the year: 11,258,000 (2009:10,554,000).

EUR million	2010	2009
Net profit attributable to ordinary shareholders	16.5	3.9
Effect of dilution	–	–
Net profit attributable to ordinary shareholders (diluted)	16.5	3.9

Weighted average numbers of ordinary shares (diluted)

In thousands of shares	2010	2009
Weighted average numbers of ordinary shares at 31 December	11,258	10,554
Weighted average numbers of ordinary shares at 31 December (diluted)	11,258	10,554
Basic earnings per share (EUR), based on weighted average	1.47	0.37

10 Loans and borrowings

These notes contain information on the contractual provisions of the Group's interest-bearing loans and borrowings, which are carried at amortised cost price. For further information on the interest rate, currency and liquidity risks borne by the Group, see notes 15 and v.

EUR million	2010	2009
Non-current liabilities		
Secured bank loans	0.0	13.2
Financial lease liabilities	0.1	0.1
Other loans	2.4	0.3
	2.5	13.6

EUR million	2010	2009
Current liabilities		
Interest-bearing debts to credit institutions	10.0	1.3
	10.0	1.3

Financing conditions

At 31 December 2010, the Group had the following credit lines available:

- A EUR 85.6 million Facility Agreement, with a syndicate of three banks, consisting of:
  - A EUR 35 million committed revolving credit facility, with a commitment running until 16 November 2011;
  - A EUR 10 million term loan facility, with a commitment running until 16 November 2011;
  - A EUR 40.6 million guarantee facility. This facility was provided In connection with the fine imposed by the European Commission, against which the Group has appealed;
- EUR 3.0 million other facilities, including a EUR 2.1 million loan in Austria.

At 31 December 2010, the total unutilised amount of the facilities was approximately EUR 40 million.

On 8 December 2010, the Group reached an agreement with a new syndicate of three banks consisting of Deutsche Bank, ING Bank and Rabobank, for a refinancing package of a total of EUR 123.5 million and with a maturity of five years. This refinancing package took effect in January 2011 and has replaced the EUR 85.6 million facility agreement referred to above.

Banking syndicate credit facility

Pursuant to the terms of the credit facility contract with the banking consortium still valid in 2010, the Group has agreed to a number of financial covenants relating to interest-bearing debt/EBITDA (debt cover), solvency ratio and interest coverage. These covenants are tested by treating an increasing proportion of the EU bank guarantee (in connection with the EU fine), including accrued interest, as interest-bearing debt in the calculation of the debt cover (50% at 31 December 2010) and deducting this amount from equity in calculating the solvency ratio (75% at 31 December 2010). In addition, among others 50% of goodwill is deducted from equity in calculating the solvency ratio. The required covenants are tested each quarter. All covenant ratios were satisfied at year-end 2010.

The refinancing package referred to above also includes an interest-bearing debt / EBITDA and an interest coverage covenant that will be tested once a quarter on a 12-month rolling basis. The new facility agreement does not include a solvency covenant.

Security provided

The Group has provided security for the consortium facility in the form of pledges of shares of a number of individual Group Companies and pledges of intercompany loans granted to certain Group Companies. The Group has provided security for the subsidised ERP (European Restructuring Programme) loan in Austria referred to above in the form of a pledge on specific machinery in Austria for which the loan was received.

On the finalisation of the refinancing package referred to above, in January 2011, the share pledges and pledges on intercompany receivables are released and have not been replaced by new pledges.

Interest-rate sensitivity

The interest payable on the Group's interest-bearing borrowings is mainly at rates fixed for three months or shorter periods. Reference is made to notes 15 and v for further details.

Finance lease liabilities

The finance lease liabilities are payable as follows:

EUR million	2010			2009		
	Minimum lease	Interest	Principal	Minimum lease	Interest	Principal
‹ 1 year	0.0	0.0	0.0	0.1	–	0.1
1 – 5 years	0.1	–	0.1	–	–	–
› 5 years	–	–	–	–	–	–
	0.1	0.0	0.1	0.1	–	0.1

The finance lease liabilities relate to machinery. According to the provisions of the lease contracts, no conditional lease payments are due.

11 Employee benefits

EUR million	2010	2009
Present value of unfunded obligations	3.5	3.1
Present value of funded obligations	5.5	4.4
Fair value of plan assets	(3.6)	(2.4)
Present value of net obligations	5.4	5.1
Unrecognised actuarial gains and losses	(0.3)	(0.4)
Recognised liability for defined-benefit obligations (see below)	5.1	4.7
Liability for long-service leave and anniversaries	1.9	1.8
Total employee benefits	7.0	6.5
Employee benefits classified as liabilities	(7.0)	(6.5)
Total employee benefits	(7.0)	(6.5)

Movements in net liability for defined benefit obligations recognised in the statement of financial position

EUR million	2010	2009
Recognised net liability for defined-benefit obligations at 1 January	4.7	5.3
Expense recognised in the income statement	0.4	0.7
Benefits paid by the plan	(0.3)	(1.5)
Other movements (including currency differences, actuarial results and employer contributions paid)	0.2	0.2
Acquired through business combinations	0.1	–
Recognised net liability for defined-benefit obligations at 31 December	5.1	4.7

Movement in plan assets

EUR million	2010	2009
Fair value of plan assets at 1 January	(2.4)	(5.3)
Contributions paid employer	(0.2)	(0.1)
Contributions paid participants	(0.2)	(0.1)
Payments made	0.0	0.0
Expected return on plan assets	(0.2)	0.0
Other movements	(0.6)	3.1
Fair value of plan assets at 31 December	(3.6)	(2.4)

Expense recognised in the consolidated statement of comprehensive income regarding defined benefit arrangements

EUR million	2010	2009
Current service costs	0.3	0.2
Interest on obligation	0.2	0.4
Settlement (gain)/loss recognised	0.1	0.2
Expected return on plan assets	(0.2)	(0.1)
	0.4	0.7
Effective return on plan assets	0.3	0.0

The cost related to the defined benefit pension arrangements are processed in the following line items of the statement of comprehensive income:

EUR million	2010	2009
Interest expense	0.2	0.4
Staff costs[1]	0.2	0.3
	0.4	0.7

There were no actuarial gains or losses processed directly in equity.

[1] *In 2009 all pension related costs were processed in staff costs.*

Principal actuarial assumptions (expressed as weighted averages)

	2010	2009
Discount rate at 31 December	4.1%	4.9%
Expected return on plan assets at 31 December	4.0%	4.4%
Future salary increases	1.0%	2.3%
Future pension increases	0.2%	2.0%

Historical information

EUR million	2010	2009	2008	2007	2006
Net liability for defined-benefit obligations	9.0	7.5	12.0	11.2	11.8
Fair value of plan assets	3.6	2.4	5.3	5.4	6.0
Deficit in plan	5.4	5.1	6.7	5.8	5.8

Actuarial calculations of employee benefits have not been materially influenced by amendments based on historical experience and by variable assumptions.

Composition plan assets

EUR million	2010	2009
Bonds	2.0	1.2
Equity	1.0	0.7
Real estate	0.4	0.3
Government loans	0.1	0.1
Other	0.1	0.1
Total	3.6	2.4

Liabilities arising from employee benefits

The pension plans consist of both defined contribution plans and defined benefit plans. In the case of defined contribution plans, the contribution is charged to the year to which it relates. With defined benefit plans, benefit obligations are calculated using the projected unit credit method. Actuarial gains and losses falling outside the so-called 'corridor' (10% of the higher of the benefit obligations and fair value of the plan assets) are amortised over the remaining average years of service. Calculations are made by qualified actuaries. The pension liability shown on the financial position is the present value of the defined benefit obligation at the financial position date minus the fair value of the plan assets at the financial position date plus or minus unallocated actuarial gains and losses. The discount rate used to calculate the defined benefit obligation is based on the yield on AA-rated corporate bonds in Europe.

The greater part of the defined benefit obligation at year-end 2010 relates to pension arrangements in Germany, Austria and Switzerland. The organisation administers the plan in-house and is fully liable for the benefit obligations. A portion is reinsured.

Liabilities arising from employee benefits also include liabilities relating to long-service leave, termination of employment and service anniversaries.

12 Share-based payments

At 31 December 2010, the Group had the following share-based payment arrangements.

Loyalty bonus (equity settled)

The Group introduced a share incentive programme in 2010, which entitles key management personnel to purchase shares in the Company for an amount equal to a maximum 50% of their net cash bonus. Employees who retain these shares for three years and remain in service for three years become entitled to a number of shares equal to the number of shares purchased by the employee.

Terms & conditions share programme (loyalty bonus)

Grant date	Number of instruments	Vesting conditions
Shares granted to key management in 2010	2,064	3 years service
Total shares	2,064	

Share plan for the Executive Board (equity settled)

Details of the remuneration of the Executive Board are provided in note 28.

Awarded shares

Every year, the Company awards a number of shares in the Company to certain key employees. There are no vesting conditions attached to these shares.

13 Provisions

EUR million	2010	2009
Balance at 1 January	2.6	2.6
Provisions made during the period	0.1	0.3
Provisions used during the period	–	(0.1)
Provisions released during the period	(0.0)	(0.2)
Balance at 31 December	2.7	2.6
Non-current part	2.7	2.6
	2.7	2.6

This item includes a provision of EUR 2.6 million (including accrued interest) relating to the fine imposed by the European Commission. The Company lodged an appeal against the fine in 2006. The Company is invited for an oral hearing at the General Court in Luxembourg on 9 March 2011. Normally, a ruling may be expected eight to twelve months after the hearing, although this can occasionally take longer (see note 18).

14 Trade and other payables

EUR million	2010	2009
Trade payables	18.9	14.7
Other taxes and social security contributions	1.2	1.3
Derivatives used for hedging	–	0.5
Non-trade payables and accrued expenses	12.9	9.0
	33.0	25.5

15 ## Financial instruments

Credit risk

The carrying amount of the financial assets represents the maximum credit risk. The maximum credit risk on the reporting date was as follows:

EUR million	Carrying amount	
	2010	2009
Cash and cash equivalents	9.0	4.7
Interest rate swap contracts	–	–
Currency forward contracts	0.1	–
Issued loans	–	0.6
Other long term investments	–	–
Trade and other receivables	30.1	24.8
Total	39.2	30.1

Impairment losses

Aged analysis of the trade and other receivables

	2010		2009	
	Gross	Provision	Gross	Provision
Within the term of payment	26.9	–	19.8	–
0 – 30 days due	3.1	–	3.9	–
31 – 60 days due	0.3	(0.1)	0.7	–
› 60 days due	0.2	(0.2)	0.8	(0.4)
Total trade and other receivables	30.5	(0.3)	25.2	(0.4)

The provision for trade receivables is used to absorb impairment losses, unless the Group is certain that collection of the amount owed is impossible, in which case the amount is treated as a bad debt and written off against the financial asset in question.

At 31 December 2010 the provision for impairment losses on trade and other receivables relates to several customer invoices that the Group believes to be non-collectible, in whole or in part. Based on historic payment behaviour and information currently known, the Group believes that invoices not due and invoices up to 30 days overdue at 31 December 2010 are collectible. Besides the identified impairment losses at year end, the Group has written off EUR 0.0 million in 2010 (EUR 0.1 million in 2009).

The contractual terms of the financial obligations, including the estimated interest payments and repayment obligations, are set out below.

31 December 2010 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Non-derivative financial liabilities							
Bank loans	10.0	(10.0)	(10.0)	–	–	–	–
Finance lease liabilities	0.1	(0.1)	–	–	(0.1)	–	–
Bank overdrafts	1.7	(1.7)	(1.7)	–	–	–	–
Other loans and borrowings	2.4	(2.8)	(0.3)	(0.6)	(0.6)	(1.3)	–
Trade and other payables	33.0	(33.0)	(33.0)	–	–	–	–
Derivative financial liabilities							
Interest rate swap contracts	–	–	–	–	–	–	–
Forward exchange contracts	–	–	–	–	–	–	–
Total	47.2	(47.6)	(45.0)	(0.6)	(0.7)	(1.3)	–

31 December 2009 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	› 5 years
Non-derivative financial liabilities							
Bank loans	14.5	(15.4)	(0.3)	(1.5)	(13.6)	–	–
Finance lease liabilities	0.1	(0.1)	(0.0)	(0.0)	(0.0)	(0.1)	–
Bank overdrafts	3.7	(3.7)	(3.7)	–	–	–	–
Other loans and borrowings	0.3	(0.3)	(0.0)	(0.0)	(0.3)	–	–
Trade and other payables	25.5	(25.5)	(25.5)	–	–	–	–
Derivative financial liabilities							
Interest rate swap contracts	0.5	(0.5)	(0.3)	(0.2)	–	–	–
Forward exchange contracts	–	–	0.1	(0.1)	–	–	–
Total	44.6	(45.5)	(29.7)	(1.8)	(13.9)	(0.1)	–

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

Within the scope of the Group's risk management the Group has hedged the currency risks with derivatives, whereby the hedges have been designated as cash flow hedges. The following table lists the value of these derivatives at financial position date, and when the derivatives will influence the profit or loss and cash flows.

Cash flow hedges (in cash flows statement)

The following table indicates the periods in which the cash flows associated with derivatives that are cash flow hedges are expected to occur.

2010 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	–	–	–	–	–	–	–
Forward exchange contracts							
Assets	0.0	0.0	0.0	–	–	–	–
Liabilities	–	–	–	–	–	–	–
Total	0.0	0.0	0.0	–	–	–	–

2009 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	(0.5)	(0.5)	(0.3)	(0.2)	–	–	–
Forward exchange contracts							
Assets	–	–	–	–	–	–	–
Liabilities	0.0	0.0	0.1	(0.1)	–	–	–
Total	(0.5)	(0.5)	(0.2)	(0.3)	–	–	–

Cash flow hedges (in statement of comprehensive income)

The following table indicates the periods in which the cash flows associated with derivatives that are cash flow hedges are expected to impact comprehensive income.

2010 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	–	–	–	–	–	–	–
Forward exchange contracts	–	–	–	–	–	–	–
Assets	0.0	0.0	0.0	–	–	–	–
Liabilities	–	–	–	–	–	–	–
Total	0.0	0.0	0.0	–	–	–	–

2009 EUR million	Carrying amount	Contractual cash flows	0 – 6 months	6 – 12 months	1 – 2 years	2 – 5 years	5 years
Interest rate swap contracts							
Assets	–	–	–	–	–	–	–
Liabilities	(0.5)	(0.5)	(0.3)	(0.2)	–	–	–
Forward exchange contracts							
Assets	–	–	–	–	–	–	–
Liabilities	0.0	0.0	(0.2)	(0.2)	(0.3)	–	–
Total	(0.5)	(0.5)	(0.5)	(0.4)	(0.3)	–	–

Interest-rate risk

Part of the Group’s loans is governed by a floating interest rate (usually 3-month EURIBOR). In view of the relatively low net debt position and the Group’s ability to generate free cash flow the management is of the opinion that the exposure to interest rate risk is very low. For this reason no interest rate hedges existed at balance sheet date.

The following table shows the interest rates prevailing at the financial position date for interest-bearing financial assets and liabilities.

				2010		2009	
	Currency	Nominal interest	Year of redemption	Fair value	Carrying amount	Fair value	Carrying amount
Senior bank loans	EUR	EURIBOR + 3.25%	2011	10.0	10.0	14.5	14.5
ERP Fund Loan	EUR	1.75%	2014	2.0	2.1	–	–
Bank overdrafts	Various	EURIBOR + 3.25%	2011	1.7	1.7	3.7	3.7
Finance lease liabilities	USD	6.5-8.0%	2012	0.1	0.1	0.1	0.1
Other debts	EUR	2.50%	2012	0.3	0.3	0.3	0.3
Total interest-bearing debt				14.1	14.2	18.6	18.6

Sensitivity analysis interest

Financial assets and liabilities with a fixed interest rate are not recognised at fair value by processing the value changes in the statement of comprehensive income. For this reason a movement in interest rates across the yield curve at 1 January 2011 would not have had a material influence on the 2010 result.

Due to the low net debt position, a 1% point increase in the interest rate across the yield curve as from 1 January 2011 will not result in a material increase in the interest expenses in 2011 (less than EUR 0.1 million).

Exchange rate risk

The aggregate fair value of the outstanding forward exchange rate contracts concluded to hedge anticipated transactions was EUR 0.1 million at 31 December 2010 (2009: close to zero).

A 10% point appreciation of the currencies listed below against the euro would increase shareholders' equity at 31 December 2010 and the result for 2010 by the amounts shown in the following table. The same analysis was performed at 31 December 2009. A 10% point depreciation of the listed currencies against the euro would have had the opposite effect.

The same test was done for the profit or loss, where the sensitivities for a 10% appreciation or depreciation on 31 December 2010 would have had an impact as is shown below.

31 December 2010	Equity	Result
US dollar	0.3	0.0
Czech krone	0.4	(0.1)
Swiss franc	0.2	(0.1)
Chinese yuan	0.4	0.0

31 December 2009	Equity	Result
US dollar	0.3	0.0
Czech krone	0.8	0.0
Swiss franc	0.2	0.0
Chinese yuan	0.2	0.0

Principal exchange rates during the reporting period were as follows:

Applicable currency rates

Value of EUR	At 31 December 2010	At 31 December 2009	Average over 2010
Pound sterling	0.8607	0.8881	0.8578
Swiss franc	1.2504	1.4836	1.3748
Czech krone	25.0608	26.4732	25.3421
Chinese yuan	8.8220	9.8350	8.9779
US dollar	1.3362	1.4406	1.3271
Mexican peso	16.5475	18.9222	16.8432
Brazilian real	2.2177	2.5113	2.3319
Romanian ley	4.2620	4.2363	4.2168

Fair values of financial instruments

The following table shows the fair values and carrying amounts of the financial instruments.

EUR million	2010		2009	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets carried at amortised costs				
Loans and receivables (including current tax assets)	30.4	30.4	25.1	25.1
Cash and cash equivalents	9.0	9.0	4.7	4.7
Held to maturity investments	–	–	0.6	0.6
Other long term receivables	–	–	–	–
	39.4	39.4	30.4	30.4
Assets carried at fair value				
Forward exchange contracts	0.1	0.1	–	–
Liabilities carried at amortised costs				
Secured bank loans	(12.4)	(12.3)	(14.5)	(14.5)
Other debts	–	–	(0.3)	(0.3)
Finance lease liabilities	(0.1)	(0.1)	(0.1)	(0.1)
Bank overdraft	(1.7)	(1.7)	(3.7)	(3.7)
Trade and other payables (including current tax liabilities)	(35.0)	(35.0)	(25.3)	(25.3)
	(49.2)	(49.1)	(43.9)	(43.9)
Liabilities carried at fair value				
Interest derivatives	–	–	(0.5)	(0.5)
Forward exchange contracts	–	–	–	–
	–	–	(0.5)	(0.5)

The Group has no available-for-sale financial assets and all liabilities at fair value were designated as such upon initial recognition. The loans and receivables consist of the trade and other receivables, including the current tax assets in the statement of financial position. The held-to-maturity investments and other long-term receivables are included in the other investments, including derivatives in the statement of financial position. The interest derivatives and forward exchange contracts are included in the trade and other payables in the statement of financial position.

Interest rate used in measuring fair value

The interest rate used for discounting estimated cash flows, where applicable, is based on the swap curve at 31 December 2010, augmented by the prevailing credit mark-up, and is as follows:

	2010	2009
Derivatives	3.00%	4.55%
Leases	3.50%	5.25%

Fair value hierarchy

The table below analyses financial instruments carried at fair value, by valuation method. The different levels have been defined as follows:

level 1 quoted prices (unadjusted in active markets for identical assets or liabilities);

level 2 inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices);

level 3 inputs for the asset or liability that are not based on observable market data (unobservable inputs).

	Level 1	Level 2	Level 3	Total
31 December 2010				
Forward exchange contracts used for hedging	–	0.1	–	0.1
Contingent considerations	–	–	(2.2)	(2.2)
Total	–	0.1	(2.2)	(2.1)
31 December 2009				
Forward exchange contracts used for hedging	–	(0.5)	–	(0.5)
Total	–	(0.5)	–	(0.5)

The following table shows a reconciliation from the beginning to the ending balances for fair value measurements in Level 3 of the fair value hierarchy:

	Contingent consideration
31 December 2010	
Balance at 1 January	–
Arising from business combinations	2.2
Change in fair value of contingent consideration	–
Balance at 31 December	2.2

Level 3 fair value measurements are sensitive to professional judgments and assumptions. No sensitivity analysis is performed as the only level 3 fair value measurement relates to the contingent consideration (earn out) arising from business combination. This contingent consideration has been settled in January 2011 for the carrying amount.

16 Operating lease agreements

Lease contracts in which the Group acts as lessee

The sums payable on non-redeemable operating lease and rental contracts are as follows:

EUR million	2010	2009
‹ 1 year	2.5	2.4
1 – 5 years	4.1	4.2
› 5 years	3.2	3.4
	9.8	10.0

In the 2010 financial year a charge of EUR 0.8 million was recognised in consolidated statement of comprehensive income in respect of operating leases (2009: EUR 0.8 million) based on continuing activities. The operating lease contracts are mostly related to buildings.

17 Capital commitments

During the year ended 31 December 2010, the Group signed purchase contracts for property, plant and equipment totalling EUR 0.3 million (2009: EUR 0.7 million).

18 Contingent liabilities

Lawsuits at 31 December 2010

On 30 November 2005, the European Commission imposed a fine on the Company amounting to EUR 34 million for the alleged infringement of competition law by the Company's former subsidiary, Fardem Packaging B.V. The facts and circumstances then known and the legal counsel taken at the time resulted in the Company's decision to form a provision of EUR 2.3 million at 31 December 2005 for the fine imposed on Fardem and other entities. The Company has also issued a guarantee to the purchaser of Fardem for an equal amount. The Company lodged an appeal against this fine in 2006. The amount payable in relation to the fine and the provision accrue annually with an interest percentage of 3.56%. The total amount has accrued to EUR 40.5 million per 31 December 2010. The Company has been invited to an oral hearing at the General Court in Luxembourg to be held on 9 March 2011. Normally a ruling may be expected eight to twelve months after the hearing, although this can occasionally take longer.

Kendrion Binder Magnete GmbH (Germany) was summoned to appear before the court of Milan, Italy, by the Italian Binder Magnete s.r.l. company, not a member of the Kendrion Group, in connection with Kendrion Binder Magnete GmbH's termination of the distribution contract between the parties. Binder Magnete s.r.l. claims compensation of EUR 1,250,000. Kendrion has filed a counterclaim. The facts and circumstances currently known and the legal counsel that was taken resulted in the decision to form a provision of EUR 90,000. Witnesses were heard in 2009 and 2010. The court's ruling is not expected before the third quarter of 2012.

The Group has divested a number of divisions and companies during the past few years. The customary representations and warranties for transactions of this nature are included in the Share or Asset Purchase Agreements. As is customary for transactions of this nature, the Group also issues representations and warrants for potential (tax) claims in from periods prior to the various divestment dates.

19 >> Operating segments

The Group, in accordance with IFRS 8, has enclosed general and entity-wide disclosures in these consolidated financial statements.

Geographical segments based on physical location of the Group operating companies

The revenue and non-current assets per geographic area are specified below.

EUR million	America (North & South)		Germany		China	
	2010	2009	2010	2009	2010	2009
Revenue from transactions with third parties	11.9	7.5	137.8	88.1	13.0	8.4
Non-current assets	9.2	8.3	74.8	64.6	1.2	1.2
Deferred tax assets	0.1	0.1	10.7	12.3	0.0	0.0
Pensions	0.0	0.0	4.1	3.9	0.0	0.0

EUR million	Czech Republic		Austria		Other European countries		Consolidated	
	2010	2009	2010	2009	2010	2009	2010	2009
Revenue from transactions with third parties	14.7	9.2	34.5	28.0	10.0	8.0	221.9	149.2
Non-current assets	2.6	2.4	8.2	9.5	0.6	0.6	96.6	86.7
Deferred tax assets	0.0	0.1	0.6	0.8	1.4	0.0	12.8	13.3
Pensions	0.0	0.0	0.7	0.6	0.2	0.2	5.1	4.7

Sales segmented by customer location

EUR million	2010	2009
Germany	133.5	93.4
USA / Canada	12.4	8.2
Other EU countries	50.9	23.6
Other countries	25.1	24.0
Total	221.9	149.2

Major customers

The Group has one customer, which accounts for 9% of total revenue.

20 >> Discontinued operations

The Group did not have discontinued operations in 2010.

On 12 February 2009 the sale of the Vink Group to Edmundson Distribution Limited was completed. The group of assets and liabilities of the Vink Group to be divested were classified as held for sale until the moment of actual disposal at 12 February 2009. The sales value of the transaction was around EUR 86 million, and the sales proceeds from the transaction amounted to approximately EUR 79 million (excluding costs of disposal). In 2009, following the realisation of the transaction, the Group recorded a result from its discontinued operations amounting to EUR 15.6 million. When the net loss incurred from 1 January 2009 to 12 February 2009 is taken into account the result amounted to EUR 13.9 million. The book profit recorded in 2009 was higher due to the impairment loss of EUR 5.0 million taken in 2008. The Group recorded EUR 1.0 million disposal costs under the operating expenses of continued operations.

* *Effective moment of disposal 12-2-2009.*

Discontinued operations

EUR million	2010	2009*
Revenue (from transactions with third parties)		28.3
Other operating income	–	0.2
Expenses	–	(29.5)
Depreciation	–	(0.3)
Impairment loss	–	–
	–	
Results from operating activities before finance costs	–	(1.3)
Net finance costs	–	(0.5)
Results from operating activities, net of net finance costs	–	1.8
Income tax expense	–	0.1
Results from operating activities, net of income tax	–	(1.7)
Book profit on sale of shares of discontinued operations	–	15.6
Income tax expense on sale of shares of discontinued operations	–	–
Earnings (loss) for the year	–	13.9
Basic earnings (loss) per share (EUR)	–	1.23
Diluted earnings (loss) per share (EUR)	–	1.23

Effects of the disposals of individual assets and liabilities of Kendrion

EUR million	2010	2009*
Property, plant and equipment		14.2
Intangible assets	–	8.2
Other investments, including derivatives	–	1.2
Deferred tax assets	–	4.9
Inventories	–	38.2
Current tax assets	–	0.4
Trade and other receivables	–	43.7
Cash and cash equivalent	–	6.6
Total non-current liabilities	–	(9.6)
Current tax liabilities	–	(1.1)
Trade and other payables	–	(47.6)
Net assets and liabilities	–	59.1
	–	
Payment received in cash	–	86.0
Cash disposed of	–	(6.6)
Payment received in cash, net of cash disposed of	–	79.4

* *Effective moment of disposal 12-2-2009.*

21 Business combinations

2010

On 25 February 2010, the Company reached an agreement with the owner of Magneta GmbH & Co. KG on the acquisition of 100% of the interest in the company. Magneta is located in Aerzen (Germany) and is specialised in small electromagnetic brakes and clutches. These are amongst others applied in cash dispensers, transportation systems and in the automotive industry.

Kendrion Magneta is a real niche player fitting in the Group's overall strategy and will be an important expansion driver for the engineering know-how, product range and client base of the Industrial Drive Systems business unit. The Group furthermore expects to profit from various synergy effects such as the combined use of sales channels and the exchange of product knowledge and technical know-how.

During the ten months prior to 31 December 2010, Kendrion Magneta contributed revenue of EUR 8.8 million and a net profit of EUR 0.5 million to the Group's results. The management estimates that if the acquisition had taken place on 1 January 2010, the consolidated revenue would have been EUR 223.4 million and the consolidated net profit for the year would have been EUR 16.8 million. When management determined these amounts it was assumed that the fair value adjustments, as determined provisionally, arising on the date of acquisition would have been identical to those on acquisition on 1 January 2010.

The following summarises the major classes of consideration that have been transferred and the recognised amounts of assets acquired and liabilities assumed at the acquisition date.

Contingent consideration

The Company agreed to pay the selling shareholder an additional consideration dependent on the extent to which the acquired company's operating result exceeded a predetermined threshold in 2010. At acquisition date the discounted value of the consideration was valued at EUR 2.2 million. The carrying amount of the accrued contingent consideration at 31 December 2010 also amounted to EUR 2.2 million. In January 2011, the contingent liability was settled with the former shareholder at an amount of EUR 2.2 million.

Consideration transferred (EUR million)

Cash	8.3
Contingent consideration	2.2
	10.5

Identifiable assets acquired and liabilities assumed

(EUR million)	Book value before acquisition	Fair value adjustments	Recognised at acquisition
Property, plant and equipment	0.4	0.0	0.4
Intangible assets	–	2.4	2.4
Deferred tax assets	–	0.5	0.5
Inventories	1.1	–	1.1
Trade and other receivables	0.9	–	0.9
Cash and cash equivalents	0.1	–	0.1
Employee benefits	(0.3)	–	(0.3)
Deferred tax liabilities	–	(0.5)	(0.5)
Contingent liabilities	–	(2.2)	(2.2)
Trade and other payables	(1.2)	–	(1.2)
Total identifiable net assets	1.0	0.2	1.2

No contingent liabilities were assumed. The trade receivables comprise contractual amounts due of EUR 0.9 million, all of which was expected to be collectible at the acquisition date.

Goodwill

Goodwill was recognised as a result of the acquisition as follows:

EUR million	
Total consideration transferred	8.3
Contingent consideration (earn out)	2.2
Fair value of identifiable net assets	(3.4)
Goodwill	7.1

The goodwill is attributable to the technical skills of the Kendrion Magneta employees and the synergies expected to be achieved from integrating the company into the Group's Industrial Drive Systems business unit. The goodwill is fully deductible for tax purposes and is amortised over a period of 15 years for tax purposes.

Acquisition related costs

The Group incurred acquisition related costs of EUR 0.3 million related to legal fees and due diligence costs. The costs have been included in the other expenses in the consolidated statement of comprehensive income in 2010 (EUR 0.2 million) and 2009 (EUR 0.1 million).

2009

There were no acquisitions in 2009. However some earn out payments were done, related to SKA GmbH & Co KG (part of the former Automotive Metals division) and Kendrion Tri-Tech LLC.

22 » Other operating income

EUR million	2010	2009
Release of unused provisions	0.2	0.1
Net gain on disposal of property, plant and equipment	0.1	0.3
Other	0.5	0.6
	0.8	1.0

23 Staff costs

EUR million	2010	2009
Wages and salaries	49.5	46.0
Social security charge	6.5	6.1
Temporary personnel	4.5	1.3
Contributions to defined contribution plans	0.3	0.2
Expenses related to defined benefit plans	0.2	0.7
Increase in liability for long-service leave	0.1	0.5
Other costs of personnel	0.9	0.7
	62.0	55.5
Total number of employees and temporary workers at 31 December (FTE)	1,376	1,131

Allocation of temporary personnel and other personnel costs under Staff costs, instead of Other operating expenses (2009 re-allocated).

24 Other operating expenses

EUR million	2010	2009
Lease expenses	0.8	0.8
Increase in provision for doubtful debts	(0.1)	0.2
Premises costs	3.8	3.6
Maintenance expenses	2.3	1.8
Transport expenses	1.6	1.0
Consultancy expenses	2.7	2.6
Sales and promotion expenses	1.0	0.7
Car, travel and representation costs	2.2	1.9
Expenses of disposal Distribution Services	–	1.0
Other	5.2	3.8
	19.5	17.4

Research & Development expenses totalled EUR 10.6 million in the year under review. These expenses are presented in the consolidated statement of comprehensive income on the lines staff costs and other operating expenses. The Company has revised its definition of Research & Development expenses to reflect integral staff costs and testing activities. The comparable Research & Development expenses for 2009 amount to EUR 8.2 million (2009 Annual Report: EUR 3.2 million).

25 Net finance costs

EUR million	2010	2009
Interest income	0.2	0.2
Net exchange gain	0.2	–
Finance income	0.4	0.2
Interest expenses	(3.2)	(3.6)
Interest expenses related to employee benefits	(0.2)	–
Net exchange loss	–	0.0
Finance expense	(3.4)	(3.6)
Net financing costs	(3.0)	(3.4)

26 Income tax

Recognised in the consolidated statement of comprehensive income

EUR million	2010	2009
Current tax charge on year under review	(3.2)	(1.5)
Total corporation tax expenses in the income statement	(3.2)	(1.5)

27 Reconciliation with the effective tax rate

	Reconciliation with tax rate		Reconciliation with effective rate EUR million	
	2010	2009	2010	2009
Profit before income tax			19,8	(8,4)
Income tax expense at local corporation tax rate	25.5%	25.5%	5.1	(2.1)
Effect of tax rates in foreign jurisdictions	1.9%	0.5%	0.4	0.0
Tax holiday in foreign jurisdiction	(1.6)%	0.8%	(0.3)	(0.1)
Reduction in tax rate	2.6%	–	0.5	–
Change in unrecognised temporary differences	(2.1)%	(7.1)%	(0.4)	0.6
Current year losses for which no deferred tax effect was recognised	0.1%	–	0.0	–
Recognition of previously unrecognised tax losses	(9.7)%[1]	(9.6)%	(2.0)	0.8
Write down of deferred tax assets[2]		(32.8)%	–	2.8
Other movements	0.7%	4.8%	0.1	(0.5)
Under/over (–) provision in previous years	(1.0)%	0.0%	(0.2)	–
	16.4%	(17.9)%	3.2	1.5

[1] *Mainly due to recognition of carry forward tax losses in the Netherlands.*

[2] *Mainly due to disposal of Distribution Services.*

28 Related parties

Identity of related parties

A related-party relationship exists between the Company and its subsidiaries, their managers and executives. The Company has a number of agreements with its subsidiaries relating to the charging of central costs to and from the business units, including management, development, information technology and marketing costs, as well as agreements in respect of Group financing. Internal supplies also take place within the business units. Intercompany transactions are effected at arm's length market prices. As all subsidiaries are fully consolidated and reflected in these financial statements, the amounts of these transaction are not further specified. For a list of the principal subsidiaries and associates please refer to page 133.

Transactions with managers in key positions

The remuneration of the Board is as follows:

EUR thousand	2010	2009
Total remuneration	1,278.0	1,463.0
Pension and other expense	168.0	162.0

The total remuneration is included in staff costs (see note n).

The incentive plan, introduced in 2008, rewards the members of the Executive Board with a non-recurrent cash bonus when sufficient focus in the Group's activities is introduced within a period of a maximum of three years, what is referred to as the 'focus bonus'. With an at-target performance the bonus amounted to 75% of the gross fixed remuneration. The required focus was introduced on the sale of Vink in early 2009.
The Supervisory Board set the focus bonus on the basis of at-target performance. It has been decided that this remuneration will be converted into a deferred pay-out scheme in which the members of the Executive Board will receive shares three years after the determination and without further conditions being attached. The number of shares determined on the basis of the net bonus and the relevant closing share price amounted to 17,269 for the CEO and 12,886 for the CFO. The shares will be issued in 2012.

The bonus for 2009 was solely in the form of shares. With an at-target performance this bonus in shares amounted to 40% (CEO) and 35% (CFO) of the gross fixed remuneration, with a maximum of 50% of the gross fixed remuneration. The shares must be held for a minimum of five years unless the contract of employment is terminated earlier. The performance is in part assessed on the basis of the realisation of long-term shareholder value (the movement in the Group's TSR compared to the AScX) and in part on the basis of the Executive Board's performance during the 2009 financial year. The targets have been realised for 37.5%. The number of shares have been determined immediately after the General Meeting of Shareholders held on 7 April 2010, based on the net bonus and the prevailing share price on that date. The number of shares so allocated amounted to 2,750 for the CEO and 1,800 for the CFO. The holding period ends in 2015.

The General Meeting of Shareholders held in April 2010 decided that a variable bonus for the members of the Executive Board shall be awarded in 2010 and the following years to promote the achievement of the Group's short and long-term objectives. The annual variable remuneration for an at-target performance will amount to 40% of the gross fixed remuneration of the CEO and 35% of the gross fixed remuneration of the CFO, with a maximum of 50% of the gross fixed remuneration in case of above at-target performance. 70% of the bonus will be comprised of financial performance criteria (net profit, ROI, free cash flow and relative Total Shareholders Return (the movement in the Group's TSR compared to the AScX)) and 30% will be comprised of individual (non-financial) performance criteria. The four financial performance criteria are weighted more or less equally. The part of the bonus that relates to the relative TSR will be zero in case the relative TSR is less than zero.

One third of the amount to be determined by the Supervisory Board shall be paid in cash. Two thirds of the bonus shall be comprised of a conditional award of shares (the vesting scheme). The award of the shares becomes unconditional after three years (including the relevant year in which the performance is assessed) when the CEO and CFO are still in office and the Supervisory Board is of the opinion that there are no exceptional circumstances that would render the unconditional award unreasonable. The award of the shares is definitively withdrawn in the event that the relevant member of the Executive Board leaves the Group as a 'bad leaver' during the three-year vesting period. The Supervisory Board possesses discretionary powers to refrain from the full issue of the shares in the event that the relevant member of the Executive Board leaves the Company as a 'good leaver' in the vesting period (for example, on retirement or in the event of an occupational disability) when the full issue of the shares would be unreasonable under the circumstances.

Once the award of the shares has become unconditional after the expiry of the vesting period they must be retained for a minimum of two years (the holding period) unless the relevant member of the Executive Board terminates his/her term of office or the term of office is terminated during this period.

The Supervisory Board has decided that, on the basis of the performance and relevant criteria, both the CEO and the CFO shall receive the maximum bonus of 50% of their respective fixed remuneration. The CEO's bonus amounts to EUR 182,500 of which EUR 29,200 shall be paid in cash. EUR 58,400 is awarded conditionally in shares on the basis of the closing share price on 18 april 2011. The CFO's bonus amounts to EUR 137,500 of which EUR 22,000 shall be paid in cash. EUR 44,000 is awarded conditionally in shares on the basis of the closing share price on 18 april 2011. The vesting period ends in 2013 and the holding period ends in 2015.

Pensions
The Executive Board participates in the defined contribution plan of the Company in 2010. The contribution was EUR 64,600 for the CEO and EUR 59,000 for the CFO.

Some of the Group's operating companies have insured part of their defined benefit pension obligations. This relates to the Group companies in Germany (EUR 0.4 million) and Switzerland (EUR 3.2 million). In Germany the plan assets are insured with two companies: 80% is insured with HDI Gerling Lebensversicherungen AG and the remaining 20% is insured with Allianz Lebensversicherungen AG. The legal carrier of the pension plan in Switzerland Is the multi-employer pension fund ASGA Pensionkasse in St Gallen. No expenses have been recognised in 2010 within the context of any necessary write downs of the aforementioned parties' plan assets. All three companies are regarded as financially strong, creditworthy parties.

Transactions with shareholders
There were no transactions with shareholders. One of the Company's shareholders Parcom Capital is part of ING Bank N.V., which is also one of the banks that arranged the existing and new facility agreement of the Group referred to in note 10.

29 >> Accounting estimates and judgements by management

The Board discussed the selection and disclosure of the critical accounting policies for financial reporting and estimates as well as the application of these policies and estimates with the Supervisory Board.

In preparing the financial statements, the management is required under IFRS to make various judgements, estimates and assumptions which affect the implementation of policy and the amounts disclosed in relation to assets, liabilities, income and expenses. The estimates and assumptions are based on experience and factors deemed reasonable in the circumstances. Estimates and assumptions are constantly reappraised.
Changes in the accounting estimates used are reflected in the period in which the estimate is changed if the change affects only that period or in the period in which the estimate is changed and in future periods if the change affects both the reporting period and future periods.

Estimated impairment of goodwill
The Group tests annually whether the goodwill is subject to any impairment, in conformity with the accounting policy disclosed in note j. The impairment model applied is the discounted cash flow method (value determination on the basis of the discounted value of the expected cash flows) applying a weighted average cost of capital (pre-tax WACC) of around 10%. The use of estimates is essential for making this calculation. The explicit prognoses period contains five planning years. As of year six the residual value is calculated based on the last explicit prognoses year (year five). No further growth in earnings is considered, with the exception of an inflation adjustment. The first three years of the explicit prognoses period are based on cash flow projections derived from the bottom-up generated Mid-term Plan (available per company and approved by the Board). The last two years are based on experience or target data for the Group under review. The pre-tax WACC is consistent with external sources of information, past experience and internal assessment of the used assumptions.

Pensions
Since the pension arrangements involve long-term obligations and uncertainties, it is necessary to make assumptions in order to estimate the amount that the Group needs to invest to fund its pension obligations. Actuaries calculate the obligation for defined benefit plans partly on the basis of information provided by the Board, such as future pay rises, the return on plan assets, mortality tables and the probable extent to which pension scheme members will leave the scheme because they have reached retirement age, become incapacitated or left the Group.

30 >> Post-balance sheet events

Other than the finalisation of the new financing package with a syndicate of three banks explained in note 10 there are no post-balance sheet events.

Company balance sheet at 31 December
(before profit appropriation)

Note	EUR million	2010	2009
	Non-current assets		
	Property, plant and equipment	0.1	0.1
	Intangible assets	0.0	0.1
1.3	Financial assets	138.3	117.0
	Total non-current assets	138.4	117.2
	Current assets		
1.4	Receivables	0.6	1.5
	Cash and cash equivalents	0.9	0.0
	Total current assets	1.5	1.5
	Total assets	139.9	118.7
1.5	**Equity**		
	Share capital	22.6	22.6
	Share premium	68.4	68.4
	Reserves	6.8	1.0
	Retained earnings	16.5	3.9
	Total equity	114.3	95.9
1.6	**Provisions**	2.6	2.5
1.7	**Loans and borrowings (current)**	23.0	20.3
	Total equity and liabilities	139.9	118.7

Company income statement

Note	EUR million	2010	2009
1.11	Share in results of Group companies after tax	17.7	5.4
	Other results after tax	(1.2)	(1.5)
	Net profit	16.5	3.9

Notes to the company financial statements

1 Notes to the company financial statements

1.1 General

The Company financial statements are part of the 2010 financial statements of the Group. With regard to the Company statement of comprehensive income of the Group, the Company has made use of the option provided by Section 402 of Book 2 of the Netherlands Civil Code.

1.2 Principles of valuation of assets and liabilities and determination of results

In selecting the principles of valuation of assets and liabilities and determination of results employed in the company financial statements, the Group has made use of the option provided by Section 362, subsection 8, of Book 2 of the Netherlands Civil Code. Consequently, the principles of valuation of assets and liabilities and determination of results (the 'accounting policies') employed in the company financial statements of the Group are identical to those employed in the consolidated EU-IFRS financial statements. Interests in entities in which the Group has significant influence are measured using the equity method. The consolidated EU-IFRS financial statements have been prepared in accordance with the standards adopted by the International Accounting Standards Board as endorsed for use in the European Union (hereinafter referred to as 'EU-IFRS'). These policies are discussed in notes a – o.
The share in the results of Group Companies relates to the Company's share in the results of those companies. Results on transactions whereby assets and liabilities have been transferred between the Company and its subsidiaries and between subsidiaries have not been recognised to the extent they can be considered unrealised.

1.3 Financial fixed assets

EUR million	Interest in Group Companies	Loans to Group Companies	Deferred tax	Total 2010	Total 2009
Carrying amount at 1 January	111.6	5.4	–	117.0	129.0
Results of Group companies	17.7	–	–	17.7	5.4
Movements in loans and borrowings	–	0.2	–	0.2	(15.4)
Movements in deferred tax assets	–	–	1.3	1.3	(2.1)
Other movements	2.1	–	–	2.1	(0.2)
Carrying amount at 31 December	131.4	5.6	1.3	138.3	117.0

The main part of the loans to Group Companies has a duration of over one year.

The investments in the principal subsidiaries and associates are disclosed on page 133 of the Annual Report.

1.4 **Receivables**

EUR million	2010	2009
Receivables from Group companies	0.3	0.9
Prepayments and accrued income	0.3	0.6
	0.6	1.5

1.5 **Equity**

EUR million	Share capital	Share premium	Translation reserve	Hedge reserve	Reserve for own shares	Statutory reserve for participations	Other reserves	Retained earnings	Total 2010	Total 2009
Balance at 1 January	22.6	68.4	0.0	(0.9)	(0.4)	2.7	(0.4)	3.9	95.9	93.3
Appropriation of retained earnings	–	–	–	–	–	–	3.9	(3.9)	–	–
Dividend payment	–	–	–	–	–	–	–	–	–	(10.0)
Repurchased own shares	–	–	–	–	(0.1)	–	–	–	(0.1)	(0.1)
Issue of ordinary shares	–	–	–	–	–	–	–	–	–	9.1
Other	–	–	0.0	0.9	–	2.0	(0.9)	–	2.0	(0.3)
Total recognised income and expenses	–	–	–	–	–	–	–	16.5	16.5	3.9
Balance at 31 December	22.6	68.4	0.0	0.0	(0.5)	4.7	2.6	16.5	114.3	95.9

1.5.1 **Share capital**

The authorised capital of the Company amounts to EUR 80 million, divided into 40 million ordinary shares of EUR 2.00, of which 11,316,374 ordinary shares have been issued.

1.5.2 **Share premium**

The share premium represents revenue from shares issued at more than their nominal value (issued above par). The issued and paid share capital, including share premium, is fiscally acknowledged capital.

1.5.3 **Translation reserve**

This statutory reserve comprises exchange differences resulting from the conversion of foreign currencies (including loans to foreign entities). On the sale of a Group Company, the accumulated translation differences relating to it are transferred to the company income statement accounted for in the transaction result.

1.5.4 **Hedge reserve**

The hedge reserve comprises the effective share of the cumulative net movement in the fair value of cash-flow hedging instruments relating to hedged transactions that have not yet been executed.

1.5.5 **Reserve for own shares**

The reserve for the Company's own shares comprises the cost of the Company shares which are held by the Company for the share plan and remuneration packages for the Board and senior management. At 31 December 2010, the Company held 59,115 of its own shares (2009: 48,488).

1.5.6 **Statutory reserve for participations**

This reserve represents the undistributed profits of subsidiaries the free distribution of which the Company cannot procure. The statutory reserve for participations arises as a result of participations being valued by the equity method and is shown as the share in the undistributed results of the subsidiaries since they were first valued using the equity method. The amount of any dividend – from these subsidiaries – to which there is an entitlement on adoption of the financial statements is deducted from this reserve.

1.5.7 **Other reserves**

Other reserves are all the reserves other than those shown separately and comprise primarily the cumulative, undistributed profits from previous financial years.

1.5.8 **Retained earnings**

In 2010, the full result for 2009 was included in other reserves. Retained earnings consequently consist solely of the result for 2010.

1.6 Provisions

EUR million	2010	2009
Other provisions	2.6	2.5
	2.6	2.5

The provisions include a provision of EUR 2.6 million (2009: EUR 2.5 million) relating to the fine imposed by the European Commission.

1.7 Loans and borrowings (current)

EUR million	2010	2009
Debts to credit institutions	0.1	0.0
Debts to suppliers and trade payables	0.2	0.3
Debts to Group companies	21.9	18.7
Other debts	0.8	1.3
	23.0	20.3

1.8 **Financial instruments**

See note 15 to the consolidated financial statements for details on financial instruments.

1.9 **Staff costs**

EUR million	2010	2009
Wages and salaries	1.7	1.7
Social security charge	0.1	0.1
Pension costs	0.2	0.1
	2.0	1.9
Total number of employees and temporary workers at 31 December (FTE)	10	10

The Company has only defined contribution plans for its employees. The Group had 10 employees (FTE) at year-end 2010 (2009: 10).

1.10 **Commitments not appearing on the balance sheet**

1.10.1 Joint and several liability and guarantees

The Company and its Group Companies have issued guarantees mainly in the context of the financing by financial institutions, and shares have also been pledged in certain cases. The Company has issued declarations of joint and several liabilities, as referred to in Section 403 of Book 2 of the Netherlands Civil Code, for:

- Combattant Holding B.V., Zeist
- Kendrion Finance B.V., Zeist

A EUR 40.6 million bank guarantee has been issued to the European Commission. This guarantee is valid until 14 March 2011. As part of the Group's Facility Agreement, the consortium of banks that issued the guarantee have undertaken to extend the guarantee on the maturity date by one year and to increase the amount by the accrued interest. The guarantee relates to the fine of EUR 34 million (excluding accrued interest) imposed by the European Commission at the end of 2005 in connection with alleged price-fixing by a former subsidiary (see also section 18 of the notes to the consolidated financial statements).

Following the refinancing agreed on 8 December with a new banking syndicate, which took effect in January 2011, the guarantee to the European Commission has been renewed for a period of five years. The amount has increased to EUR 47.3 million, to take into account the interest.

1.10.2 Fiscal unity

The Company and its Dutch subsidiaries form a fiscal unity for corporation tax purposes; according to the standard terms, each of the companies is jointly and severally liable for corporation tax payable by all the members of the fiscal unity.

1.11 Share in results of Group Companies

This relates to the Company's share in the results of its associates, of which EUR 17.7 million (2009: EUR 5.4 million) relates to Group Companies.

Fees to the auditor

With reference to Section 2:382a of the Netherlands Civil Code, the following fees have been charged by KPMG to the Company, its subsidiaries and other consolidated entities:

EUR thousand	2010			2009		
	KPMG Accountants NV	Other KPMG member firms and affiliates	Total KPMG	KPMG Accountants NV	Other KPMG member firms and affiliates	Total KPMG
Audit of financial statements	79.0	171.0	250.0	91.0	199.0	290.0
Other assurance services	7.0	7.0	14.0	11.0	24.0	35.0
Tax advisory services	–	4.0	4.0	–	10.0	10.0
Other non-audit services	12.0	–	12.0	–	103.0	103.0
Total	98.0	182.0	280.0	102.0	336.0	438.0

1.12 Remuneration of and share ownership by the Executive Board and Supervisory Board

Remuneration of the Executive Board

The remuneration of current Executive Board members charged to Group and Company Companies, including pension expenses as referred to in Section 383, subsection 1, of Book 2 of the Netherlands Civil Code, amounted to EUR 1,108,000 (2009: EUR 1,288,500). This remuneration is specified as follows:

EUR thousand	2010			2009		
	P. Veenema	E. Ris	Total	P. Veenema	E. Ris	Total
Fixed remuneration[1]	365.0	275.0	640.0	326.2	243.9	570.1
Variable remuneration:						
– focus bonus	–	–	–	264.0	197.0	461.0
– current	182.5	137.5	320.0	54.4	35.6	90.0
– non-current	–	–	–	13.9	7.0	20.9
Total remuneration	547.5	412.5	960.0	658.5	483.5	1,142.0
Pension and other expenses	77.7	70.3	148.0	79.1	67.4	146.5
	625.2	482.8	1,108.0	737.6	550.9	1,288.5

[1] *Fixed remuneration 2009 is inclusive 10% voluntarily reduction.*

The 2010 current variable remuneration will be granted directly after the General Meeting of Shareholders on 18 April 2011. The amount after income tax will be paid in cash for 1/3 and will be covered conditionally for 2/3 in shares against the prevailing closing share price of 18 April 2011.

Remuneration of the Supervisory Board

The total remuneration of current and former Supervisory Board members in 2010 amounts to EUR 130,000 (2009: EUR 98,000). This remuneration is specified as follows:

[1] *Fixed remuneration 2009 is inclusive 10% voluntarily reduction.*

EUR thousand	2010	2009[1]
Current Supervisory Board members:		
S.J. van Kesteren	40	34
R.L. de Bakker	30	25
M.E.P. Sanders	30	25
H.J. Kayser	30	14
	130	98

No loans, advances or related guarantees have been given to the current Board or Supervisory Board members.

Share ownership by the Executive Board and the Supervisory Board

		31 December 2010	31 December 2009
Executive Board	P. Veenema	14,171	10,717
	E. Ris	8,973	6,820
Supervisory Board		–	–

Zeist, 25 February 2011

Executive Board	*Supervisory Board*
P. Veenema	S.J. van Kesteren
E. Ris	R.L. de Bakker
	M.E.P. Sanders
	H.J. Kayser

To: The General Meeting of Shareholders of Kendrion N.V.

Independent auditor's report

Report on the financial statements

We have audited the accompanying financial statements 2010 of Kendrion N.V., Zeist. The financial statements include the consolidated financial statements and the company financial statements. The consolidated financial statements comprise the consolidated statement of financial position as at 31 December 2010, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising a summary of the significant accounting policies and other explanatory information. The company financial statements comprise the company balance sheet as at 31 December 2010, the company income statement for the year then ended and the notes, comprising a summary of the accounting policies and other explanatory information.

Management's responsibility

Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code, and for the preparation of the Report of the Board in accordance with Part 9 of Book 2 of the Netherlands Civil Code. Furthermore, management is responsible for such internal control as it determines is necessary to enable the preparation of the financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with Dutch law, including the Dutch Standards on Auditing. This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error.

In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion with respect to the consolidated financial statements

In our opinion, the consolidated financial statements give a true and fair view of the financial position of Kendrion N.V. as at 31 December 2010 and of its result and its cash flows for the year then ended in accordance with International Financial Reporting Standards as adopted by the European Union and with Part 9 of Book 2 of the Netherlands Civil Code.

Opinion with respect to the company financial statements

In our opinion, the company financial statements give a true and fair view of the financial position of Kendrion N.V. as at 31 December 2010 and of its result for the year then ended in accordance with Part 9 of Book 2 of the Netherlands Civil Code.

Report on other legal and regulatory requirements

Pursuant to the legal requirements under Section 2:393 sub 5 at e and f of the Netherlands Civil Code, we have no deficiencies to report as a result of our examination whether the Report of the Board, to the extent we can assess, has been prepared in accordance with Part 9 of Book 2 of this Code, and if the information as required under Section 2:392 sub 1 at b - h has been annexed. Further, we report that the Report of the Board, to the extent we can assess, is consistent with the financial statements as required by Section 2:391 sub 4 of the Netherlands Civil Code.

Utrecht, 25 February 2011

KPMG ACCOUNTANTS N.V.
J.P. Faber RA

Profit appropriation

The Executive Board proposes, with approval of the Supervisory Board to the shareholders for the payment of a dividend of 40% of the net profit of 2010. A proposal will be submitted to the shareholders during the General Meeting of Shareholders in April 2011 for the payment of the total dividend, at the shareholder's discretion, either fully in cash of fully in ordinary shares charged to the tax-exempt share premium reserve.

Appropriation of net profit

EUR million	
Net profit	16.5

The Executive Board has decided, with the approval of the Supervisory Board, that the net profit of EUR 16.5 million will be added to the other reserves.

Post-balance sheet events

Other than the finalisation of the new refinancing package explained in note 10, there are no post balance sheet events.

Principal subsidiaries

At 31 December 2010

[1] *Fully consolidated. The minority interest is shown separately on the consolidated statement of financial position and the consolidated statement of comprehensive income.*

Industrial Magnetic Systems (Norman Graf)

Kendrion Magnettechnik GmbH, Donaueschingen, Germany	Norman Graf
Kendrion Magnettechnik GmbH, Engelswies, Germany	Klaus Strefling
Kendrion Binder Magnetic (Suzhou) Co. Ltd, Suzhou, P.R. China	Jürgen Weisshaar
Kendrion Tri-Tech LLC, Mishawaka, Indiana, US	Brad Price
Kendrion Binder Magnet AG, Hausen am Albis, Switzerland	Edgar Bruhin
Kendrion Binder Magnete Vertriebsgesellschaft mbH, Linz, Austria (51%)[1]	Erich Holzinger

Industrial Drive Systems (Michael Bernhard)

Kendrion Binder Magnete GmbH, Villingen-Schwenningen, Germany	Michael Bernhard
Kendrion Binder Magnete (UK) Ltd, Bradford, United Kingdom	Peter McShane
Kendrion Binder Magnetic (Suzhou) Co. Ltd, Suzhou, P.R. China	Jürgen Weisshaar
Kendrion Tri-Tech LLC, Mishawaka, Indiana, US	Brad Price
Kendrion Magneta GmbH, Aerzen, Germany	Laurent Lebas

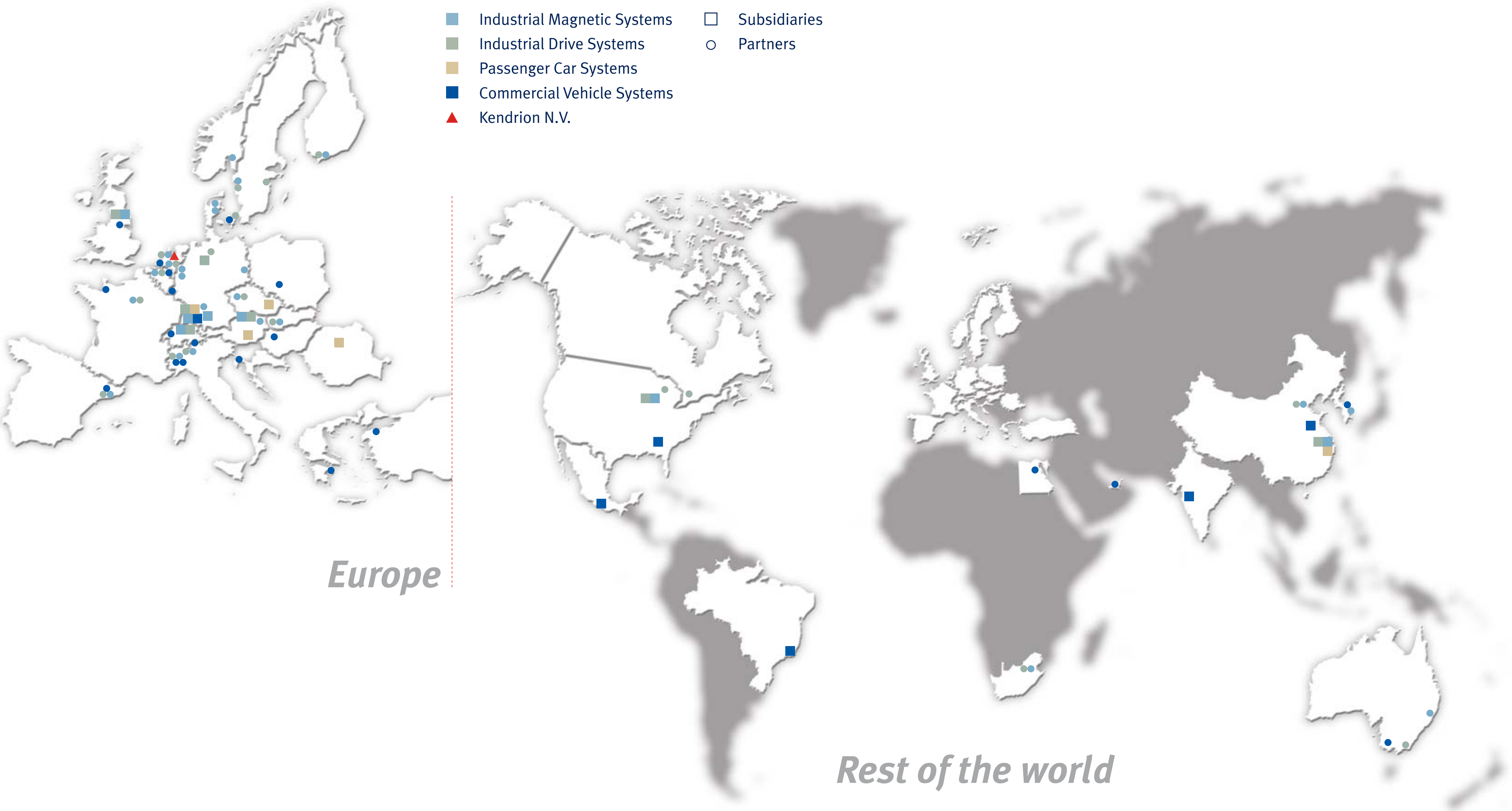
Passenger Car Systems (Bernd Gundelsweiler)

Kendrion Binder Magnete GmbH, Villingen-Schwenningen, Germany	Bernd Gundelsweiler
Kendrion Binder Magnete GmbH, Eibiswald, Austria	Martin Kollmann
Kendrion Binder Magnety s.r.o, Prostejov, Czech Republic	Jiři Hýbl
Kendrion Binder Magnetic (Suzhou) Co. Ltd, Suzhou, P.R. China	Jürgen Weisshaar
Kendrion Binder Magnete s.r.l., Rădăuţi, Romania	Artur Daneliuc

Commercial Vehicle Systems (Uwe Spörl)

Kendrion LINNIG GmbH, Markdorf, Germany	Uwe Spörl
Linnig Brasil Acoplamentos Ltda., Louveira, Brazil	Klaus Mertens
Linnig Corporation, Tucker, US	Jürgen Häberle
Linnig de México, S.A. de C.V., Mexicaltzingo, Mexico	Alexander Glaser
Linnig Drive Tech. (Nanjing) Co. Ltd., Nanjing, P.R. China	Liangchen Lu

A complete list of all subsidiaries and associates can be obtained from the Chamber of Commerce in Utrecht (number 30113646) and from the offices of the Company.


Industrial Magnetic Systems
Industrial Drive Systems
Passenger Car Systems
Commercial Vehicle Systems
Kendrion N.V.
Subsidiaries
Partners
Europe
Rest of the world

Five-year summary

[1] The reader should be aware that the Group went through a lot of changes since 2006; divestments took place including results on disposals, which does not give a clear insight in comparability between the years.

[2] Relates to inventories, receivables minus non interest bearing debts.

[3] 2009 EBITA and EBITDA excluding effect restructuring provision and costs related to the disposal of the Vink Group. EBITA excluding amortisation related to acquisitions.

[4] 2008 including Distribution Services.

[5] For 2008 including net interest bearing debt Vink in assets and liabilities as held for sale.

[6] Before cash flow acquisitions and disposals.

[7] Total invested capital is property, plant and equipment, intangible assets and current assets less the current tax liabilities, trade payables and other payables.

EUR million	2010	2009	2008	2007	2006
Kendrion N.V. consolidated [1]					
Income statement conform financial statements					
Revenue	221.9	149.2	207.4	501.0	568.5
Organic growth	42.9%	(27.0)%	3.6%	7.0%	5.6%
Operating result (EBIT)	22.8	(5.0)	11.0	21.8	25.1
Operating result before amortisation (EBITA) [3]	24.2	(3.9)	12.0	21.8	25.1
Depreciation and amortisation	10.1	8.8	8.3	10.1	13.5
Operating result before depreciation and amortisation (EBITDA)	32.9	3.8	19.3	31.9	38.6
Profit for the period	16.6	4.0	12.9	3.7	14.3
Balance sheet per 31 December conform statement of financial position					
Total assets	177.1	152.8	280.5	303.1	291.5
Total equity	114.5	96.1	93.5	88.8	83.8
Net interest-bearing debt [5]	5.2	13.9	75.3	85.2	87.5
Working capital [2]	26.0	21.7	22.4	63.2	75.8
Invested capital [7]	129.3	113.1	177.4	174.5	167.2
Cash flow conform financial statements					
Net cash from operating activities	25.6	3.9	21.3	23.8	13.1
Net investments	8.9	5.9	13.5	16.2	11.5
Free cash flow [6]	17.4	(1.9)	3.7	7.6	1.6
Ratios – pro forma					
Solvency	64.7%	62.9%	33.3%	29.3%	28.7%
Net interest-bearing debt [5] / EBITDA [3, 4] (debt cover)	0.2	1.1	2.4	2.2	2.3
Net interest-bearing debt [5] / equity (gearing)	0.1	0.1	0.8	1.0	1.0
EBITA [3] / net finance costs (interest cover) [4]	8.1	1.6	3.2	3.8	4.1
Working capital [2] in % of revenue	11.7%	14.5%	11.6%	11.8%	13.3%
Market capitalisation (in millions) at 31 December	164.1	105.8	74.1	185.2	196.3
Net interest-bearing debt at 31 December [5]	5.2	13.9	75.3	85.2	87.5
Theoretic value of the organisation (Enterprise Value)	169.3	119.7	149.4	270.4	283.8
Number of employees per 31 December (FTE) [4]	1,218	1,027	2,414	2,493	2,749

Glossary

Code of Conduct A set of behavioural rules and standards which broadly reflects the values that should guide all employees, for example in relation to doing business responsibly, safety, health and the environment.

Compliance Officer The Kendrion employee who is charged with supervising compliance with the regulations to prevent insider trading.

Corporate governance The management of the business, the supervision of that management, the rendering of account thereon and the way in which stakeholders can influence decisions.

COSO Enterprise Risk Management Framework Risk management framework based on the system proposed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) (see www.coso.org).

Creeping control provision Clause in the law and the Articles of Association of the Company which stipulates that if a shareholder: (i) acquires 20% of the shares or votes, that shareholder must notify the Company thereof immediately; (ii) acquires 30% of the shares or votes, that shareholder is obliged to table a bid immediately for the remaining shares.

Defined benefit plan A pension scheme where the employee is promised a pension the level of which depends on their age, salary and years of service.
The commitment carried in the financial is the cash value of the projected pension benefits on the financial position date, less the fair market value of fund investments.

Defined contribution plan Pension scheme where the employer pays agreed contributions to a fund or insurance company and no obligation arises for the employer to pay supplementary contributions in the event of a shortfall in the fund or insurance company.

Derivatives Derivative financial products which do not represent a direct cash value; they include options, forward exchange contracts and swap contracts.

ERP system Enterprise Resource Planning: an ICT system which supports all the business processes within an organisation, such as purchasing, sales and accounting, with data being exchanged between departments.

Fair value The current value. For assets or liabilities for which there is an active market, this is generally the market value.

Greenfield operation The start-up of a new activity, usually in a new location, which is not based on an acquisition. In reality this is organic growth.

Hedging The covering of financial risks, usually relating to (undesirable) movements in market interest rates, exchange rates and raw material prices.

IFRS International Financial Reporting Standards, also referred to as IAS (International Accounting Standards).
With effect from 2005, all listed companies in the European Union must comply with these accounting rules.

Interest rate swap Derivative financial product whereby an agreement is reached with a counterparty (bank) to exchange specific interest payments on a predetermined underlying amount during a predetermined period. A variable interest rate (e.g. three-month EURIBOR) is usually swapped for a fixed interest rate.

Mid-term Plan A plan for the medium term (three years) which is drawn up by the Group annually to facilitate the management and control of its organisation in the short to medium term.

Natural hedge Natural hedges arise where financial risks are neutralised without the use of derivative financial products, for example where currency risks relating to income in dollars are hedged by simultaneous dollar expenditure.

Normalisation Figures from which exceptional effects have been eliminated in order to improve comparability and transparency.

Number of employees (FTEs) Number of employees stated in full-time equivalents.

Organic (sales) growth Growth in revenue after eliminating the effects of acquisitions and disposal of activities.

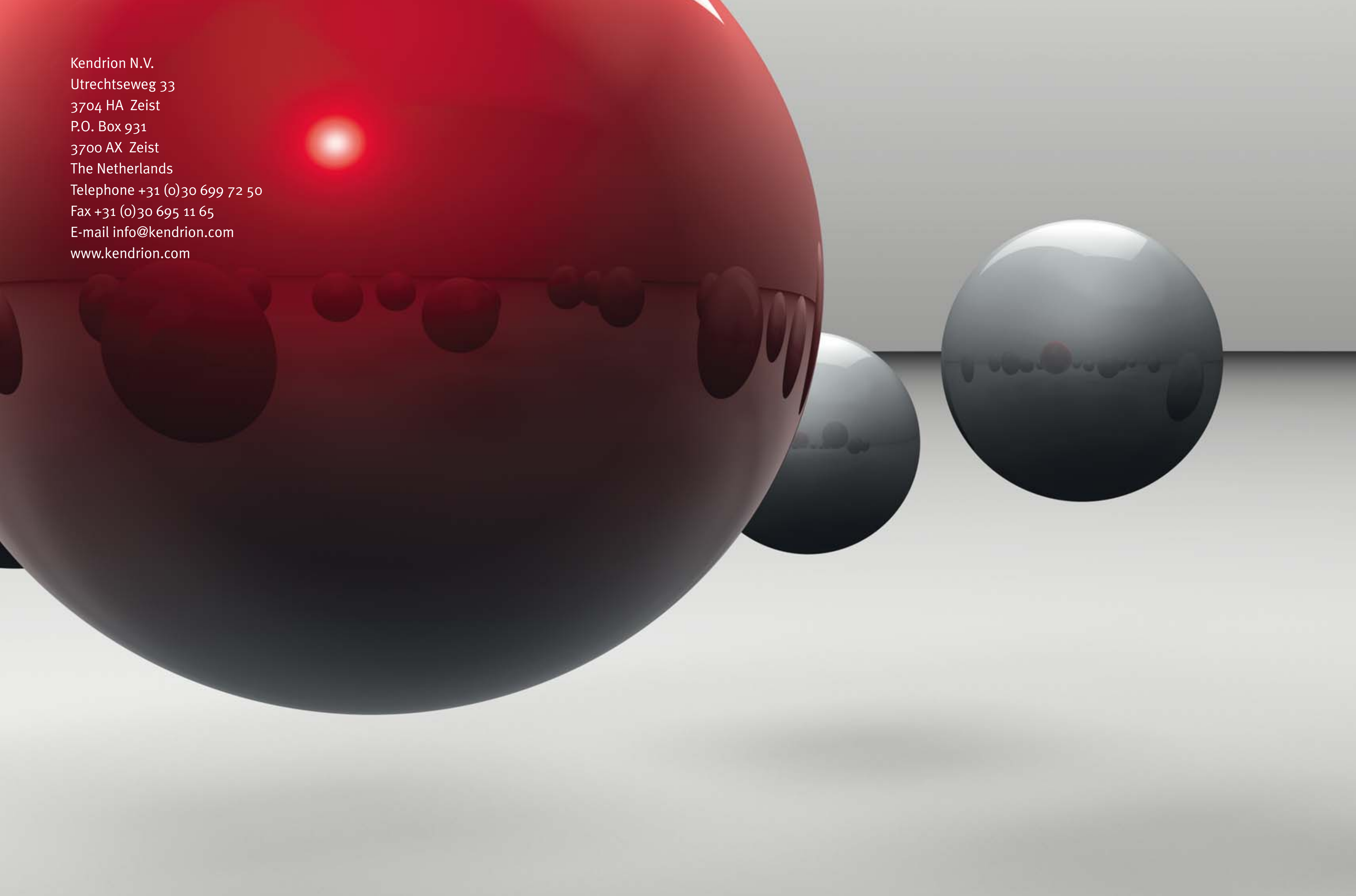
Return on investment (ROI) The result before amortisation of intangibles related to acquisitions, interest and tax as a percentage of the average invested capital.

Return on sales (ROS) The result before amortisation of intangables related to acquisitions interest and tax as a percentage of revenue.

Solvency ratio The ratio of total equity to the financial position total.

Translation risk Translation risk: a change in the value of an asset or liability of a subsidiary as a result of movements in the (non-euro) exchange rate.

TSR Total shareholders return.



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