ENGINEERING
TOMORROW

# **Annual Report** 2014
## Danfoss **accelerates growth**

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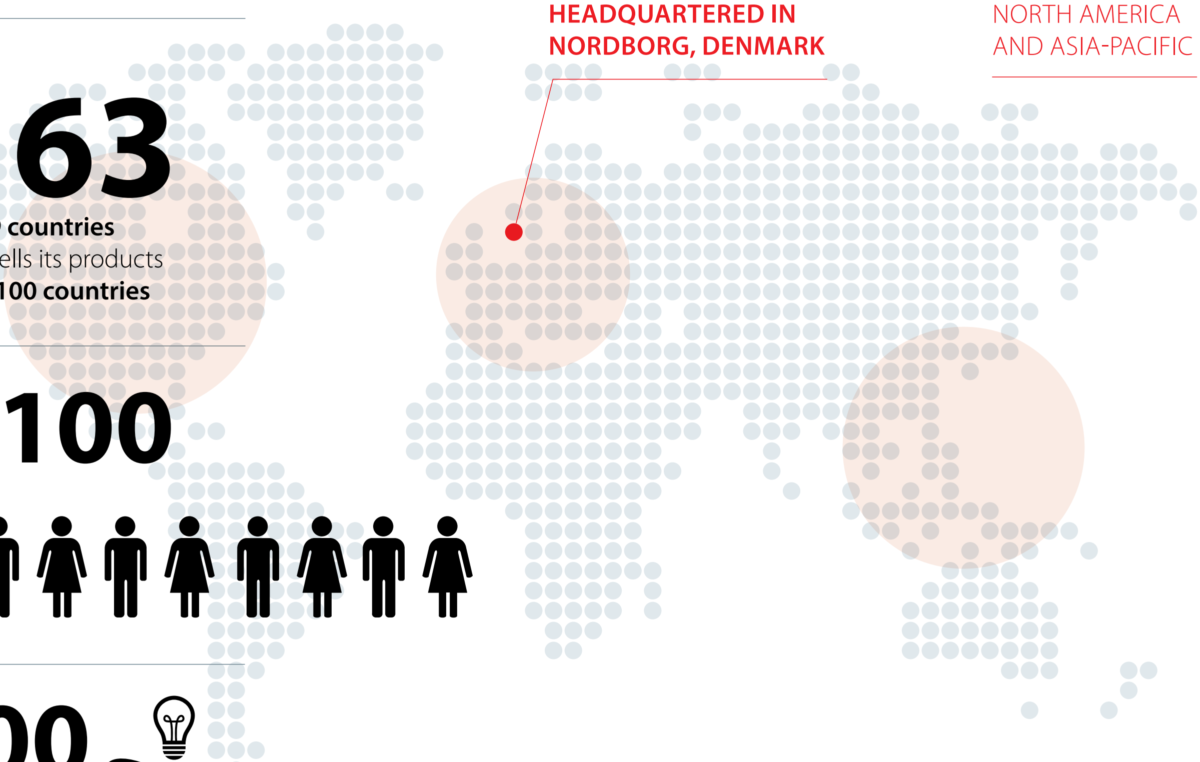
# Danfoss at **a glance**

Danfoss engineers technologies that enable the world of tomorrow to do more with less. We meet the growing need for infrastructure, food supply, energy efficiency and climate-friendly solutions.

## Key facts




**63**

factories in **19 countries** and Danfoss sells its products in more than **100 countries**

**24,100**

Employees

**1200**

Patent families

## Strong global position

Since the Core & Clear strategy was initiated in 2010, the Danfoss Group has significantly strengthened its global position. Financially, the Group stands on a robust foundation driven by continuous high profitability and strong free cash flow. By focusing on the core and targeted acquisitions, the Danfoss businesses are world leaders in the markets where we are active.

The four elements of the Group's strategy Core & Clear

- CORE AND CLEAR
- FREE AND AGILE
- CUSTOMER AND INNOVATION
- PASSION AND PERFORMANCE

# Danfoss Growth Themes

**INFRASTRUCTURE**
We help build the roads, buildings and energy systems for the world's growing cities and support progress for people, communities and businesses across the world.

**FOOD**
Our solutions meet the constant need for more and better food by improving agricultural productivity and keeping food fresh all the way to consumers with minimum waste.

**ENERGY**
No matter what we do, the goal is to optimize performance, increase efficiency and minimize waste. This means that our technologies enable our customers and society as a whole to get more from less.

**CLIMATE**
While meeting the global climate challenge, our products also contribute to human productivity and well-being indoors by optimizing heating, ventilation and air conditioning systems.

## Our Climate strategy: 3x25

**BY 2025**

**25%**
LESS $CO_2$ EMISSIONS

**25%**
MORE RENEWABLE ENERGY

## Our approach to sustainability

- Follow the UN Global Compact
- Guidelines, training and programs that govern our behavior
- Code of Conduct for suppliers and regular audits to verify compliance

# The Danfoss heritage

Danfoss has grown from a solo enterprise into a world leader, by having a clear focus on quality and innovative engineering right from the beginning

**1933** Danfoss was founded by Mads Clausen

**2014** Danfoss is a privately-held company and controlled by the Bitten and Mads Clausen Foundation.

# 2014 at **a glance**

In 2014, Danfoss maintained a strong momentum in its core business and delivered strong financial results. The year was characterized by continuing low, global growth conditions. However, the need for infrastructure, food supply, energy efficiency and climate-friendly solutions continued to be the strong drivers of the demand for Danfoss technologies.

TOTAL NET SALES / m DKK
**34,375**

SALES GROWTH IN LOCAL CURRENCY
**4%**

R&D SPENT / m DKK
**1,331**

FREE CASH FLOW (BEFORE M&A) / m DKK
**3,389**

OPERATING PROFIT / m DKK
**4,356**
excluding other income and expenses

EQUITY / m DKK
**13,242**

EQUITY RATIO
**36%**

## 2014 Expectations compared to results

**Net sales**
Net sales expected to show moderate growth in local currency terms

**4%**
Danfoss generated total net sales of DKK 34,375m equal to 4% growth in local currency

**Operating profit**
Operating profit (EBIT) expected to increase at least in line with net sales

**13%**
Operating profit (EBIT) excluding other operating income and expenses grew by 13% to reach DKK 4,356m.

## Financials in brief

The Group's total net sales reached a record level of DKK 34,375m against DKK 33,628m in 2013, while operating profit (EBIT) excluding other operating income and expenses grew by 13% to reach DKK 4,356m, making 2014 the strongest year in the history of Danfoss in terms of profitability. The free cash flow was maintained at a high level, however slightly below the record level of 2013.

The Climate & Energy business segment had sales growth of 4% in local currency, and operating profit (EBIT) was improved to DKK 2,878m from DKK 2,561m.

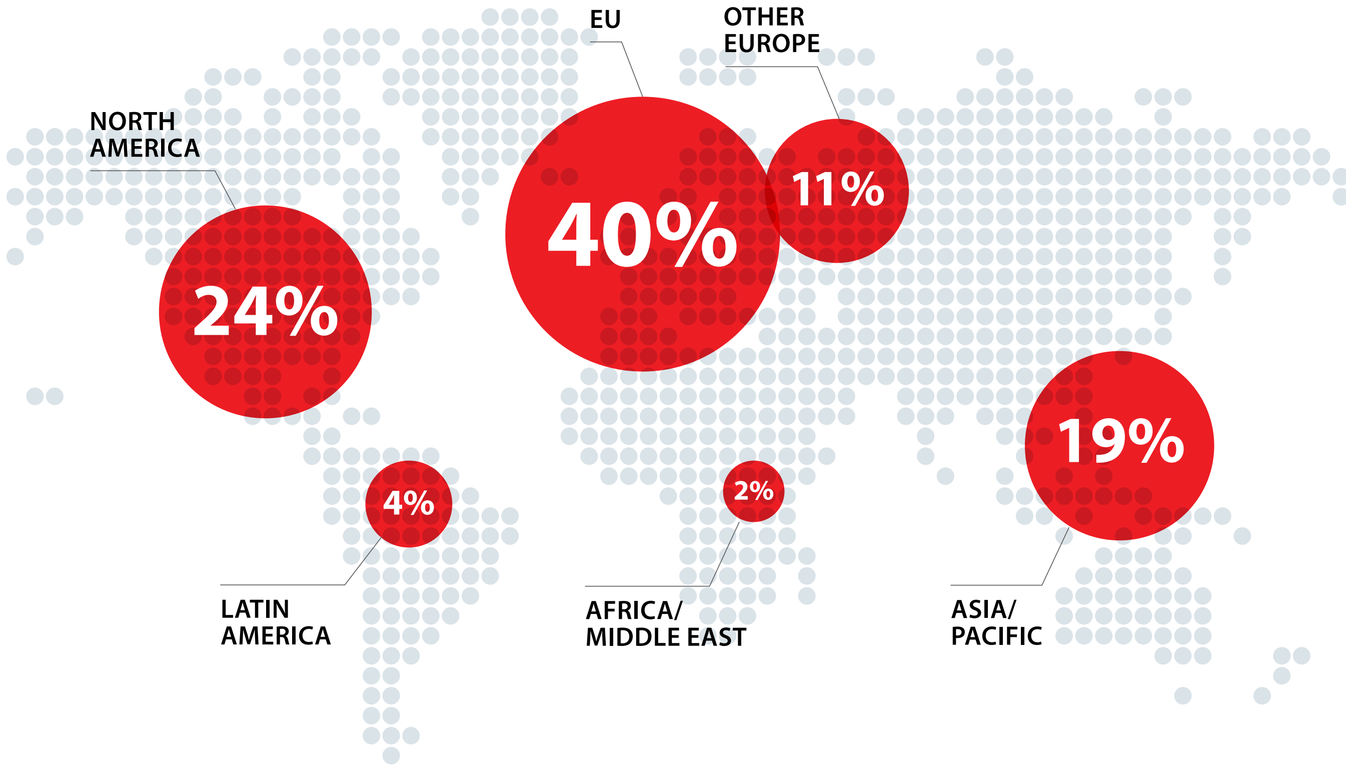
The Power Solutions business segment had sales growth of 5% in local currency, and operating profit (EBIT) improved to DKK 1,703m from DKK 1,593m.

## 2015 outlook in brief

Net sales including full-year impact of the acquisition of Vacon is expected to grow by 5-10%.

Underlying profitability is expected to slightly improve through the continuous operational improvements and the targeted strategic initiatives already launched. However, integration cost in the first year of Vacon ownership is expected to keep operating profit (EBIT) excluding other income and expenses on par with 2014.

# Sales distribution by region




## 2014 highlights

Danfoss entered the next phase of the Group strategy Core & Clear focusing on growing by taking market share – organically and through acquisitions.

Danfoss acquired the Finnish drives manufacturer Vacon. Combining the two companies has created a Nordic-based global leading player in the low voltage drives market.

Danfoss and the world's largest producer of solar inverters, German SMA Solar Technology AG (SMA), entered a strategic partnership.

Danfoss and Bosch Thermotechnik GmbH signed a contract to form a joint venture to develop and manufacture a new innovative and energy-efficient oil-free compressor technology.

A new campus in India was officially inaugurated. The new facilities will secure a strong foundation and support in the development and quest for accelerated growth in the region.

The Group issued a 7-year corporate Euro bond. This disposition further strengthened Danfoss's financial position by diversifying the Group's funding on several sources.

Danfoss introduced a bold new brand platform and visual identity to support the growth agenda: Engineering Tomorrow.

## Regional highlights

2014 was the year of a strong comeback for North America with a growth rate of 9% in local currency and a very positive impact on the Group's sales performance.

The Group continued its vigilant focus on the growth potential in India and saw growth in local currency of 10%.

Considering the difficult market conditions, Danfoss had a satisfactory year in Russia with sales close to the level of 2013.

In China, the year began with sales above 2013 level, but over the quarters the growth decreased, and China ended up just above 2013 level for the full year.

In total, 2014 was a year of mixed market conditions in the BRIC countries and the share of sales was at year end at 22% and at level with last year.

2014 was characterized by continued low growth in Europe. In contrast, Japan and Turkey had growth rates in local currency of 24 and 22% respectively.

**NORTH AMERICA 9%** GROWTH RATE
**INDIA 10%** GROWTH RATE
**JAPAN 24%** GROWTH RATE
**TURKEY 22%** GROWTH RATE

# Danfoss solutions make more out of less

**7%**
**lower energy consumption**

## **Record low energy consumption** in Zurich's tallest building

The Prime Tower in Zurich, Switzerland, sets new standards for low energy consumption. Thousands of state-of-the-art valves and efficient control of electrical motors installed in the refrigeration and heating system deliver cuts energy consumption by 7%, and make Prime Tower one of the most energy-efficient buildings in Europe.

# FINANCIAL HIGHLIGHTS

DKKm

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| **INCOME STATEMENT** | | | | | |
| Net sales | 31,550 | 33,904 | 34,007 | 33,628 | 34,375 |
| Operating profit before depreciation, amortization, impairment and other operating income and expenses | 5,209 | 5,327 | 5,454 | 5,549 | 6,079 |
| Operating profit before depreciation, amortization and impairment (EBITDA) | 5,067 | 5,941 | 5,750 | 5,304 | 5,661 |
| Operating profit excl. other operating income and expenses | 3,400 | 3,653 | 3,729 | 3,870 | 4,356 |
| Share of profit from associates and joint ventures after tax | 14 | 16 | -2 | 8 | -187 |
| Operating profit (EBIT) | 3,278 | 4,242 | 3,767 | 3,624 | 3,925 |
| Financial items, net | -334 | -1,024 | -421 | -369 | -449 |
| Profit before tax from continuing operations | 2,944 | 3,218 | 3,346 | 3,255 | 3,476 |
| Profit from discontinued operations | -829 | -931 | 0 | 0 | 0 |
| Net profit | 1,378 | 1,314 | 2,339 | 2,285 | 2,290 |
| **BALANCE SHEET** | | | | | |
| Total non-current assets | 18,703 | 17,422 | 17,038 | 16,052 | 25,822 |
| Total assets | 29,868 | 28,124 | 27,768 | 26,116 | 36,883 |
| Total shareholders' equity | 11,700 | 12,597 | 14,193 | 11,443 | 13,242 |
| Net interest-bearing debt | 6,675 | 4,634 | 2,691 | 4,116 | 11,439 |
| Net assets | 18,167 | 17,037 | 16,775 | 15,476 | 22,432 |
| **CASH FLOW STATEMENT** | | | | | |
| Cash flow from operating activities | 3,387 | 3,359 | 4,245 | 4,444 | 4,351 |
| Cash flow from investing activities | -741 | -209 | -1,321 | -917 | -10,576 |
| Acquisition of intangible assets and property, plant and equipment | -634 | -1,220 | -1,169 | -1,004 | -996 |
| Acquisition of subsidiaries and activities | -132 | 1,106 | -191 | 0 | -7,377 |
| Acquisition (-)/sale of other investments etc. | 25 | -95 | 39 | 87 | -2,203 |
| Free cash flow | 2,646 | 3,150 | 2,924 | 3,527 | -6,225 |
| Free cash flow before M&A | 2,792 | 2,078 | 3,019 | 3,513 | 3,389 |
| Cash flow from financing activities | -2,037 | -2,530 | -2,779 | -3,623 | 6,194 |
| **NUMBER OF EMPLOYEES** | | | | | |
| Number of employees | 23,392 | 23,430 | 23,092 | 22,463 | 24,117 |
| **FINANCIAL RATIOS** | | | | | |
| Organic net sales growth (%) | 25 | 10 | -2 | 1 | 4 |
| EBITDA margin excl. other operating income and expenses (%) | 16.5 | 15.7 | 16.0 | 16.5 | 17.7 |
| EBITDA margin (%) | 16.1 | 17.5 | 16.9 | 15.8 | 16.5 |
| EBIT margin excl. other operating income and expenses (%) | 10.8 | 10.8 | 11.0 | 11.5 | 12.7 |
| EBIT margin (%) | 10.4 | 12.5 | 11.1 | 10.8 | 11.4 |
| Return on invested capital (ROIC) after tax (%) | 8.8 | 17.5 | 15.2 | 15.9 | 13.2 |
| Return on invested capital (ROIC) (%) | 13.1 | 23.1 | 21.4 | 22.2 | 19.4 |
| Return on equity (%) | 12.3 | 9.0 | 17.8 | 18.2 | 18.4 |
| Equity ratio (%) | 39.2 | 44.8 | 51.1 | 43.8 | 35.9 |
| Leverage ratio (%) | 62.2 | 36.8 | 19.0 | 36.0 | 86.4 |
| Net interest bearing debt to EBITDA ratio | 1.3 | 0.8 | 0.5 | 0.8 | 2.0 |
| Dividend pay-out ratio (%) | 7.5 | 25.0 | 17.1 | 35.0 | 21.8 |
| Dividend ratio per share (%) | 10.0 | 31.5 | 39.2 | 78.3 | 48.9 |

In situations where the ratios have been defined according to "Recommendations & Key Figures 2010", as prepared by the Danish Association of Financial Analysts, the ratios are computed according to these definitions.

# Danfoss **accelerates growth**

A strong and eventful 2014 has further strengthened Danfoss' global position, and we are well underway with initiatives to accelerate profitable growth.

This Annual Report shows how Danfoss has become more agile, competitive and is in a robust financial position. Danfoss saw several remarkable highlights in 2014. At the same time, 2014 was financially very strong, with the global need for infrastructure, food supply, energy efficiency and climate-friendly solutions continuing to drive demand for Danfoss technologies. Through our strategic initiatives, we continued strengthening the already solid foundation of the core businesses, and our results were at a continued high level.

**Continuing the strong results**
Danfoss obtained increasingly strong financial results during 2011, 2012 and 2013 – and 2014 was no exception. As expected, the global economy was characterized by low visibility and low growth. Despite the challenging conditions, the Group maintained momentum, and we are pleased to see that we fully met our expectations. We saw high growth rates in North America and India, while the developments in China and Europe were more modest. Despite the difficult conditions in Russia, we managed to continue to deliver satisfactory performance in the region. In local currency, the Group's total net sales grew by 4%. Operating profit (EBIT) before other income and expenses increased by 13%, making 2014 the strongest year ever. Meanwhile, with DKK 3,389m the free cash flow before M&A remained at a high level.

**Continuous improvements are part of our DNA**
Our strong results obtained in spite of low, global economic growth can be ascribed to our persistent strategic focus on improving quality, reliability and innovation. Under our strategy Core & Clear, we have made a systematic effort over the past five years to get the basics right and delivering ongoing improvements has become part of our DNA. Once again, in 2014 we increased productivity, we further improved product quality, and our ability to make on-time deliveries according to customer requests was also further improved. The fact that we have created a world-class production and supply chain is best documented through the improved customer satisfaction rates seen over the past few years.

**Danfoss aims to grow faster**
We will continue to focus on strengthening the platform created during the first phase of Core & Clear: Get the Basics Right. But, on the basis of the strong financial position and improved supply chain, we also want to make Danfoss grow even faster. Consequently, we launched the next phase of Core & Clear in 2014: Get Going. The objective is clear: accelerating profitable growth. Several milestones have already been set on the journey towards growth. Innovation is one of our growth drivers. Therefore, in 2014 we continued to invest above industry average in research and development. We have strengthened our organization and production capacity in regions having

" Once again, in 2014 we increased productivity, we further improved product quality, and our ability to make on-time deliveries according to customer requests was also further improved."

**The Danfoss Executive Committee; Niels B. Christiansen, Danfoss President & CEO, Kim Fausing, Executive Vice President & COO, and Jesper V. Christensen, Executive Vice President & CFO.**

major growth potential, and as of 2015 we have reorganized into four new business segments. These organizational changes aim to better utilize high potential growth pockets around the world and accelerate growth in the core businesses. Another milestone in the implementation of Get Going was the launch of our new brand platform: Engineering Tomorrow. Engineering Tomorrow is a strong and unique brand which unites all of the Danfoss businesses and allows us to stand out in the market and strengthen our position further.

**Strengthening our core businesses**

Our strategic target is to achieve a strong leading position in the markets where we play. Throughout 2014, we worked to meet this ambition. With the partnership with German SMA Solar Technology AG, we joined forces with the world's largest company within solar inverters. The year's most significant highlight was without a doubt the acquisition of the Finnish drives manufacturer Vacon, made at the year-end. The Vacon and Danfoss drives businesses complement each other to a large extent and, combined, the two units already make up one of the world's largest drives manufacturers, and through sound profitability and investments in growth opportunities, we aspire to further improve our market position.

**Optimistic view on 2015**

It is people that drive great results. The dedicated effort of 24,100 colleagues, who succeeded in building strong relationships and loyalty among customers, suppliers and partners was the key to the strong performance and results we obtained in 2014. We are well underway accelerating growth. This is why we take an optimistic approach to 2015, although visibility remains low in regards to the development of the global economic environment due to among other factors the expected continued difficult market conditions and currency devaluation in Russia. However, we are convinced that we will maintain the positive development through ongoing improvement of our business, an intensified focus on how to serve our customers in the best possible way, and carefully selected investments in growth opportunities. Combined: our customers, partners and employees will all benefit from our initiatives.

"The dedicated effort of 24,100 colleagues, who succeeded in building strong relationships and loyalty among customers, suppliers and partners was the key to the strong performance and results we obtained in 2014. We are well underway accelerating growth. This is why we take an optimistic approach to 2015."

On behalf of the Danfoss Executive Committee,

Niels B. Christiansen

# Entering the next phase: **Get Going**

Danfoss has entered the next phase of the Group strategy Core & Clear and the focus is on growing by taking market share – organically and through acquisitions.

Having conducted a successful implementation of the first phase of the Group strategy, Get the Basics Right, Danfoss started the next phase in 2014: Get Going.

Niels B. Christiansen, Danfoss CEO & President, says:

**"We have spent several years thoroughly getting the basics right. Now we are in a financially strong position and we have become much more agile. At the same time we have developed a world-class scalable and flexible supply chain. Consequently, we have entered the next phase of the strategy."**

**Continuing the basics**

Since 2010, Core & Clear has formed the basis for initiatives to push boundaries on results and reputation in Danfoss. The past few years have seen a positive impact of the dedicated implementation. Product quality is the best in class and further improving, and Danfoss has strengthened its leading positions, increased investments in innovation, improved customer focus, reduced complexity and improved productivity annually by double-digits. Meanwhile, satisfaction among customers and employees has gone up.

**"Get the Basics Right has become part of our DNA. Get the Basics Right is the platform of our growth journey, and we will continue to harvest the full potential of improving the basics, while focusing on making Danfoss grow faster,"** says Niels B. Christiansen.

**Get Going is about profitable growth**

Today, Danfoss is in a strong global position within technologies and solutions which accommodate the increasing demand for food supply, modern infrastructure, efficient energy utilization and climate-friendly solutions. Targeted investments in growth – organically and through acquisitions – are set to further enhance the current position.

**"We will accelerate growth and grow faster than the market. To achieve this ambition, we will make sound investments in growth opportunities. We will take the same thorough and systematic approach to accelerating growth, as we have taken in improving the basics. There will be no 'quick fixes', but a long haul,"** says Niels B. Christiansen.

Part of the growth will be generated by introducing new technologies and products. Consequently, the Group continues to make significant investments in innovation to differentiate the products and application portfolio from those of the competitors. Moreover, Danfoss dedicates resources to geographical areas with extensive growth potential, and increases investments in branding and marketing activities. The customers will also be directly affected by the Get Going initiatives.

In the words of Niels B. Christiansen:

**"Our focus on customers has become and will become even more explicit in this new phase of the strategy, where we will invest more in development of solutions to enhance the customers' experience of interacting with Danfoss and continue to earn their loyalty."**

Finally, focused acquisitions which are set to strengthen Danfoss' core businesses are also part of the initiatives to accelerate growth.

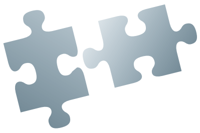
**"Our strong financial position enables us to acquire companies to strengthen our core businesses. Considering the continued global, low growth environment, acquisitions are simply another way of taking market share and strengthening our global position,"** says Niels B. Christiansen.

**NIELS B. CHRISTIANSEN**
Danfoss President & CEO

# 2014 Core & Clear **highlights**

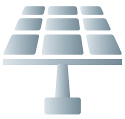
**LAUNCHING THE ENGINEERING TOMORROW BRAND**
**"We are introducing a bold new brand platform and visual identity to support our growth agenda. The aim is to update and sharpen our position in the market,"** says Mette Refshauge, head of Danfoss Corporate Communication & Reputation.

Read more on page 20 and 21



**THE ACQUISITION OF VACON**
**"With this acquisition, we create a new drives business with a market leading position in the low voltage variable speed drives market,"** says Danfoss President and CEO Niels B. Christiansen.

Read more on page 18 and 19



**STRONG ALLIANCE IN SOLAR**
In May, Danfoss entered into a strategic partnership with German SMA Solar Technology AG (SMA), who is a world leader within the market for solar inverters. The alliance enables significant scale synergies on procurement for both companies.

Read more on page 39

**DANFOSS PROMISES QUALITY, RELIABILITY AND INNOVATION**
**"Our commitment to quality and being a reliable and innovative business partner is nothing new, but we have as a part of our strategic focus invested significantly to keep us at the forefront of the development as we continue to create solutions that set the global engineering standard",** says Danfoss Executive Vice President and COO Kim Fausing.

Read more on page 32 and 33

**CONTINUING STRONG FINANCIAL PERFORMANCE**
**"We maintained a momentum in the core businesses and delivered strong results with the highest sales and earnings in the history of Danfoss",** says Danfoss Executive Vice President and CFO Jesper V. Christensen.

Read more on page 37 to 45

# About the Core & Clear strategy

## THE FOUR CORE ELEMENTS

**CORE & CLEAR PORTFOLIO**
means having strong leading positions globally in the core businesses being positioned as number one or two in the markets

**FREE & AGILE**
means ensuring the Group's ability to rapidly adapt to market developments and having a flexible and competitive supply chain

**CUSTOMER & INNOVATION**
means providing value to customers by delivering on our promise of quality, reliability and innovation based on customer needs

**PASSION & PERFORMANCE**
means building capabilities and engagement to drive strong performance and execute on the Danfoss strategy

## THE PHASES OF CORE & CLEAR EXPLAINED

**GET GOING**

**GET THE BASICS RIGHT**

2010 | 2014 | 2017

Get the Basics Right provides a strong and scalable foundation for all activities in Danfoss. The drivers are:

**CORE & CLEAR PORTFOLIO**
- Core businesses positioned as number one or two in the markets where Danfoss is present
- Adjacent businesses with significant revenue and clear differentiation from competitors
- Strong globalization of the portfolio and focus on organic growth

**FREE & AGILE**
- A world-class supply chain giving Danfoss competitive advantages and flexibility
- A strong focus on generating cash flow and handle market fluctuations profitably

**CUSTOMER & INNOVATION**
- Danfoss offering its customers a distinctive, measureable and sustainable value proposition
- A dedicated focus on what matters most to the customers: quality and delivery
- Innovation from the core

**PASSION & PERFORMANCE**
- A systematic development of employees and leaders to create high level of engagement
- Global coverage of Danfoss Business System ensuring alignment with common processes and tools
- Our strong performance orientation, KPIs and quarterly follow ups

Get Going is about accelerating profitable growth by taking market share. The drivers are:

**CORE & CLEAR PORTFOLIO**
- Building leading positions via acquisitions strengthening the core businesses and invest in new growth businesses

**CUSTOMER & INNOVATION**
- 'Engineering Tomorrow' as one strong brand, sharpening the Group's identity and improving impact in sales and marketing activities
- Investing in the best opportunities that have the potential to accelerate growth: infrastructure, food, energy and climate. This also includes making the most of geographical opportunities
- Innovate to differentiate utilizing our deep understanding of customer applications combined with developing and sourcing of new technology and modular approach
- Earning customer loyalty by becoming easier to do business with

**PASSION & PERFORMANCE**
- Driving passion and performance through leadership, diversity and winning teams
- Focusing on our employer brand, linking to Engineering Tomorrow to attract the best talent
- Building leadership and talent pipelines through systematic talent management

# **Milestones** in the Core & Clear **journey**

Danfoss developed the Group strategy Core & Clear to push boundaries on results and reputation, thereby expanding its world-leading position.

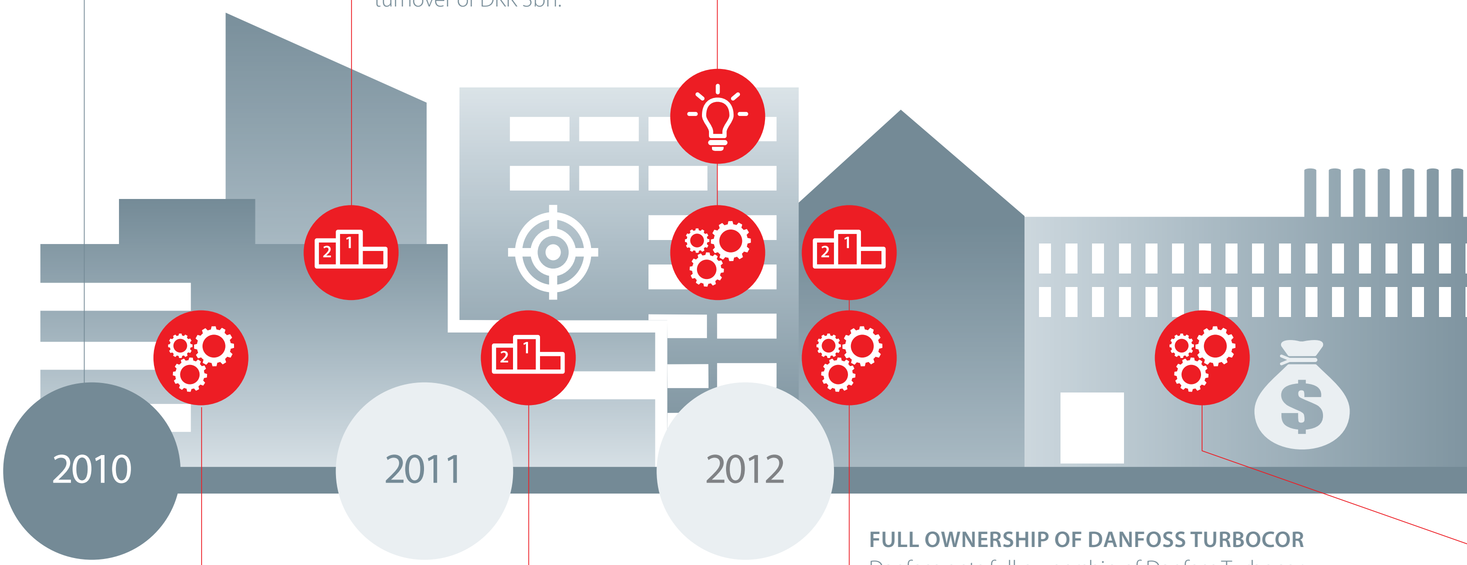
**HERE IS A COLLECTION OF SOME OF THE MILESTONES IN THE FIRST FIVE YEARS OF CORE & CLEAR**

**LAUNCH OF CORE & CLEAR**
The strategy was launched to strengthen the Group's results and reputation. For the first period of the strategy, focus was solely on 'Get the Basics Right'.

**IDENTIFYING AND REFOCUSING ON THE CORE BUSINESSES**
To focus entirely on the core, Danfoss has divested non-core businesses. The first business to be sold was Danfoss Household Compressors, with an annual turnover of DKK 3bn.

**SYSTEMATIC CUSTOMER INVOLVEMENT**
The Group introduced new processes for the systematic involvement of customers from the early stages of product development. The aim is to ensure that Danfoss keeps a sharp focus on customers and their needs.

**BUILDING A WORLD-CLASS SUPPLY CHAIN**
In order to make Danfoss more agile and strengthen the core businesses, the development of a world-class production and supply chain was initiated. This includes productivity improvement, focus on procurement with strong global category management and building even stronger quality management capabilities.




**FULL OWNERSHIP OF DANFOSS TURBOCOR**
Danfoss gets full ownership of Danfoss Turbocor Compressors, and the innovative, variable speed, oil-free compressor technology with outstanding energy efficiency performance.

**CORE BUSINESS PORTFOLIO IN PLACE**
With the divestitures of Danfoss Water Controls and Danfoss Geared Motors in 2011, Danfoss achieved a key target of the strategy by having carried out the most significant adjustments in the business portfolio.

**ONE COMPANY – ONE WAY**
Danfoss Business System, a center of best practice, is a key lever in driving global coverage of aligned work processes, tools and core business capabilities.

**SIGNIFICANT COMPLEXITY REDUCTION**
The reduced complexity of the business carried out since the launch of Core & Clear becomes visible and thereby increases transparency. The number of part numbers is reduced. Complexity on the supplier side is also reduced while purchasing is concentrated with fewer, but larger, suppliers.

### HIGH INVESTMENTS IN INNOVATION

In 2013, Danfoss introduced a record number of products to the market. Relative to its size, with around 4% of annual sales, Danfoss allocates above industry average resources to innovation.

### INCREASING CUSTOMER LOYALTY

2013 was the third straight year of rising customer loyalty, bearing witness to the effect of greater customer focus under Core & Clear.

### FULL OWNERSHIP OF SAUER-DANFOSS

Danfoss acquires the remaining share of Sauer-Danfoss Inc. and gets full ownership. Sauer-Danfoss is renamed Danfoss Power Solutions.

### GET GOING PHASE LAUNCHED

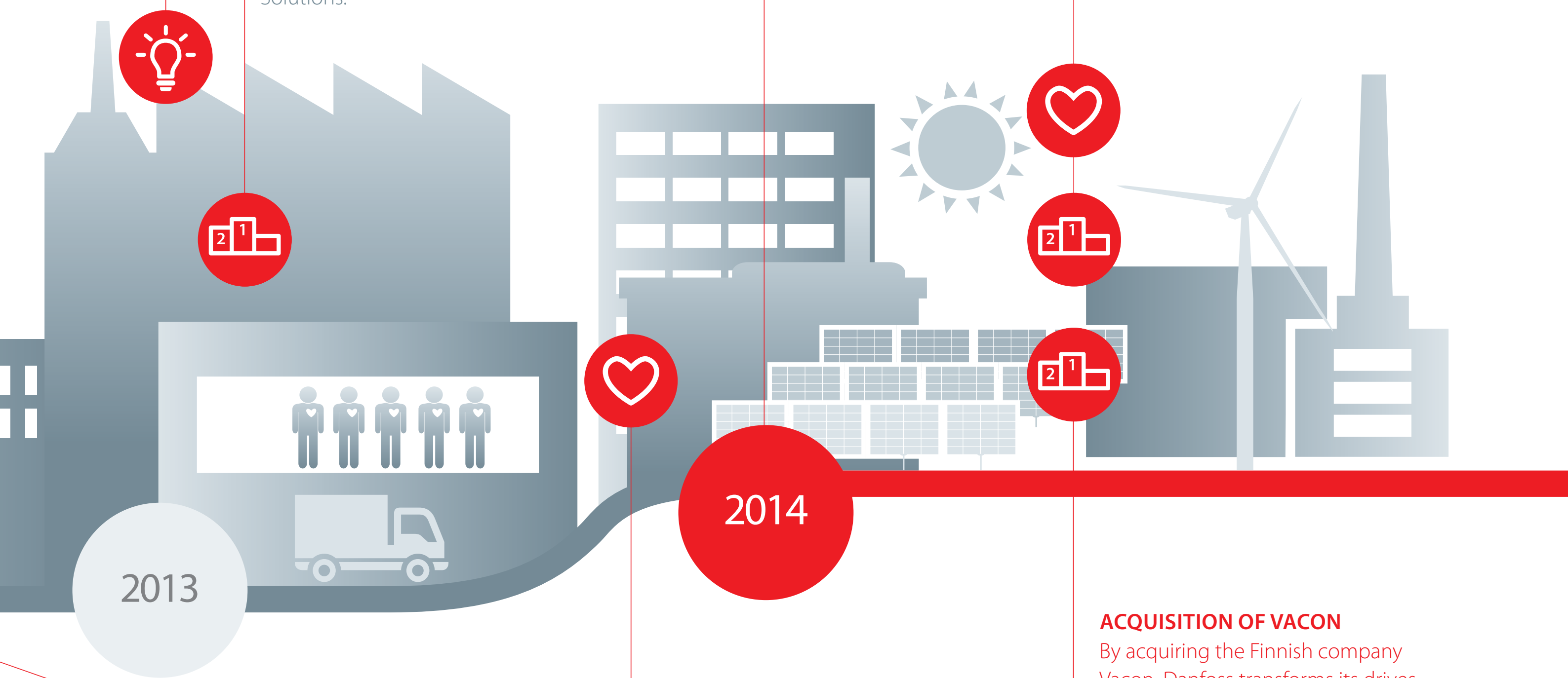
After four years of Get the Basics Right, the Get Going phase of the Core & Clear strategy is launched, adding a strong focus on accelerating profitable growth to the continuous improvement of the basics.

### NEW BRAND CONCEPT: ENGINEERING TOMORROW

As part of the growth initiatives, the concept 'Engineering Tomorrow' is launched, uniting the Danfoss business under a new strong brand platform.

### ALLIANCE WITH SMA

Danfoss enters a strategic partnership with SMA Solar Technology AG by acquiring 20% of the shares of the German world leader in solar inverters.




### STRENGTHENED FINANCIAL POSITION

The focus on improving profitability and generating a high free cash flow pays off. In 2012, the debt level reaches the desired level of 0 to 2 x EBITDA, and Danfoss' financial position is significantly strengthened.

### GLOBAL SERVICES GLOBALLY

Solid efficiency gains and improved process quality through Global Services rolled-out in all sales entities and factories globally, covering all general administration processes, finance, real estate and logistics.

### ALL-TIME HIGH EMPLOYEE ENGAGEMENT

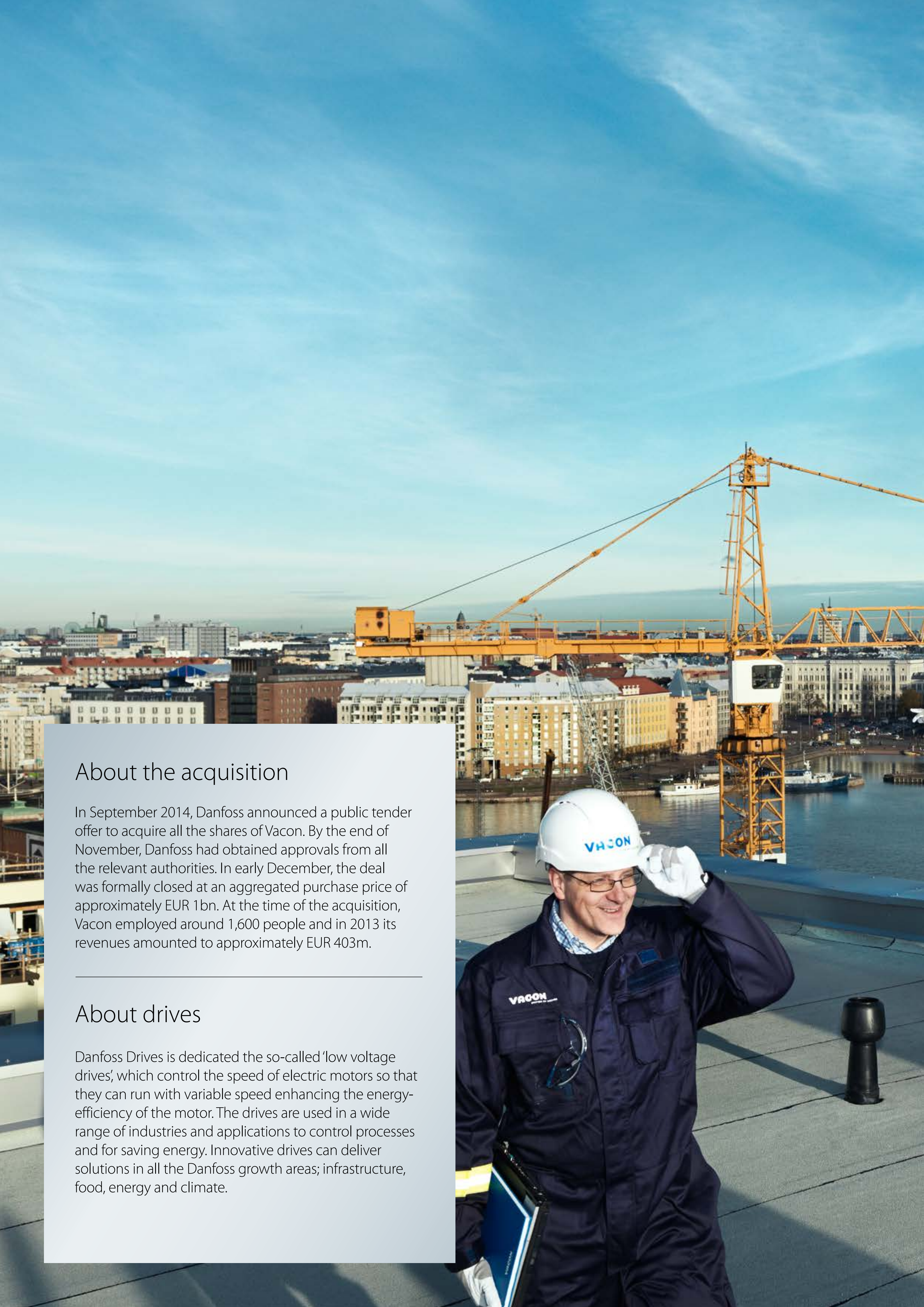
In the 2013 Employee Perception Study, employee engagement reached an all-time high of 78 out of 100. In 2009, the score was 73. Also, the measuring of performance management has gone up with an increased share of leaders rated 'excellent' by employees.

### ACQUISITION OF VACON

By acquiring the Finnish company Vacon, Danfoss transforms its drives business into a world leader in its field.

### FOUR STRONG SEGMENTS TO SUPPORT ACCELERATED GROWTH

To support the growth agenda, the Danfoss organization is restructured into four segments: Danfoss Power Solutions, Danfoss Cooling, Danfoss Drives and Danfoss Heating (effective as of January 2015).




## About the acquisition

In September 2014, Danfoss announced a public tender offer to acquire all the shares of Vacon. By the end of November, Danfoss had obtained approvals from all the relevant authorities. In early December, the deal was formally closed at an aggregated purchase price of approximately EUR 1bn. At the time of the acquisition, Vacon employed around 1,600 people and in 2013 its revenues amounted to approximately EUR 403m.

## About drives

Danfoss Drives is dedicated the so-called 'low voltage drives', which control the speed of electric motors so that they can run with variable speed enhancing the energy-efficiency of the motor. The drives are used in a wide range of industries and applications to control processes and for saving energy. Innovative drives can deliver solutions in all the Danfoss growth areas; infrastructure, food, energy and climate.

# Creating a **stronger** drives business

In 2014, Danfoss acquired the Finnish drives manufacturer Vacon. Danfoss and Vacon have complementary product and market portfolio and are a perfect match. Combining the two companies has created a Nordic-based global leading player.

The global drives manufacturer Vacon becoming part of the Danfoss Group was the single most significant event in 2014. The combination of Vacon and Danfoss has created one of the world's leading players in the drives market, which contains a substantial future growth potential.

**"The potential of drives is huge. Less than 20% of motors are controlled by drives today, and we see variable speed drives as a core technology and solution in many future applications in order to live up to new energy efficient standards,"** says Niels B. Christiansen.

He continues:
**"As a very strong and innovative player, Vacon was a perfect match for our strategic ambition of ensuring a long-term growth trajectory. Our new Drives segment can invest further in both innovation and in the sales force and gain scale, which is a key success factor in the drives business."**

Danfoss has formed a dedicated business segment called Danfoss Drives with Vesa Laisi, former CEO of Vacon, as President.

**"We want our core businesses to be number one or two in the markets where we operate. With this acquisition, we create a new drives business with a leading market position,"** says Niels B. Christiansen.

**NIELS B. CHRISTIANSEN**
Danfoss President & CEO

# Accelerating growth under a new strong brand

## A new brand platform makes Danfoss stand out in the industry and supports the strategic growth agenda

As part of entering the next phase of the Core & Clear journey, Get Going, Danfoss' new brand concept 'Engineering Tomorrow´ was launched in the second half-year of 2014. The brand concept unites all Danfoss businesses under one strong brand platform.

**"We have introduced a bold new brand platform and visual identity to support our growth agenda. The aim is to update and sharpen our position in the market while building on the strong foundation we have,"** says Mette Refshauge, head of Danfoss Corporate Communication & Reputation.

This updated brand platform is the result of a detailed process that builds on input from hundreds of internal and thousands of external stakeholders across the globe.

Mette Refshauge explains:
**"We know that we are in a low growth environment with a growth agenda. We also know that we have untapped potential when it comes to differentiating ourselves and we stand out reaching all our stakeholders, from potential customers and employees to decision-makers and public authorities. Our brand plays an important role in unfolding this potential and accelerating profitable growth."**

**Why 'Engineering Tomorrow'?**
'Engineering Tomorrow' summarizes what Danfoss does. Engineering is about know-how, quality, solving challenges and experience.

**"Engineering is really what Danfoss is all about and the strong foundation of our heritage. Also, engineering is a key driver in our societies as we need to get more from less",** says Mette Refshauge.

Tomorrow is about innovation, understanding needs, growth and progress.

**"We aspire to unfold the potential of tomorrow, and our solutions and products are already a key element to address tomorrow's challenges in infrastructure, food, climate and energy technologies,"** says Mette Refshauge.

**METTE REFSHAUGE**
Head of Danfoss Corporate Communication & Reputation

ENGINEERING TOMORROW

# We are **engineering tomorrow**

At Danfoss, we see opportunities everywhere – from feeding a growing population, to saving energy, to letting everyone enjoy a more comfortable, better quality of life. We aim to rise to ever more complex challenges and, through knowledge and hard work, engineer solutions that achieve more with less.

Quality, innovation and reliability are rooted in our DNA. Our technologies and products can be trusted to push the boundaries for what is possible, deliver exceptional performance and answer the real needs of our customers.

With leading expertise in refrigeration and air conditioning, controls for electric motors, heating systems for buildings and cities, and hydraulic solutions to power agricultural and construction machinery, our impact can be felt everywhere. This is what drives us. To realize more of the potential of this amazing world. And engineer the dreams of tomorrow, today.

We engineer technologies that enable the world of tomorrow to do more with less. Our ambition is to realize the vast potential for better infrastructure, improved food supply, higher energy productivity and more climate-friendly solutions. For our customers, we deliver unprecedented quality, reliability and innovation in everything we do.

Our innovative engineering first began in 1933, and today Danfoss is a world leader, employing 24,100 people and serving customers in more than 100 countries.

**Watch the movie about how Danfoss is 'Engineering Tomorrow' here.**

# Engineering impact **where it counts**

Danfoss engineers technologies that enable the world of tomorrow to do more with less. Danfoss solutions meet the growing need for infrastructure, food supply, energy efficiency and climate-friendly solutions.

**CASE:** INFRASTRUCTURE

## Water supply and waste water treatment in Kazan, Russia

Kazan is one of Russia's key economic, scientific and sports cities, and has a population of approximately 1,200,000. To provide such a large city with water, the municipal unitary enterprise, Vodokanal, is rapidly developing its capacity and introducing state-of-the-art equipment.

The enterprise services more than 2,000 km of water-supply and sewage networks, along with various hydraulic structures.

Vodokanal's energy-consuming facilities include about 150 water-supply and sewage pumping stations.

To ensure energy efficiency and a failure-proof operation, Danfoss and a partner have developed engineering solutions, which utilize variable frequency drives for different pumping operations.

The pumping equipment in water-supply and sewage pumping stations are regulated by Danfoss' frequency converters and soft starters. The frequency converters control the pumps, optimizing operating procedures. This saves a great deal of electricity; for example, a 50% reduction in energy consumption has been achieved at pumping station No. 45.

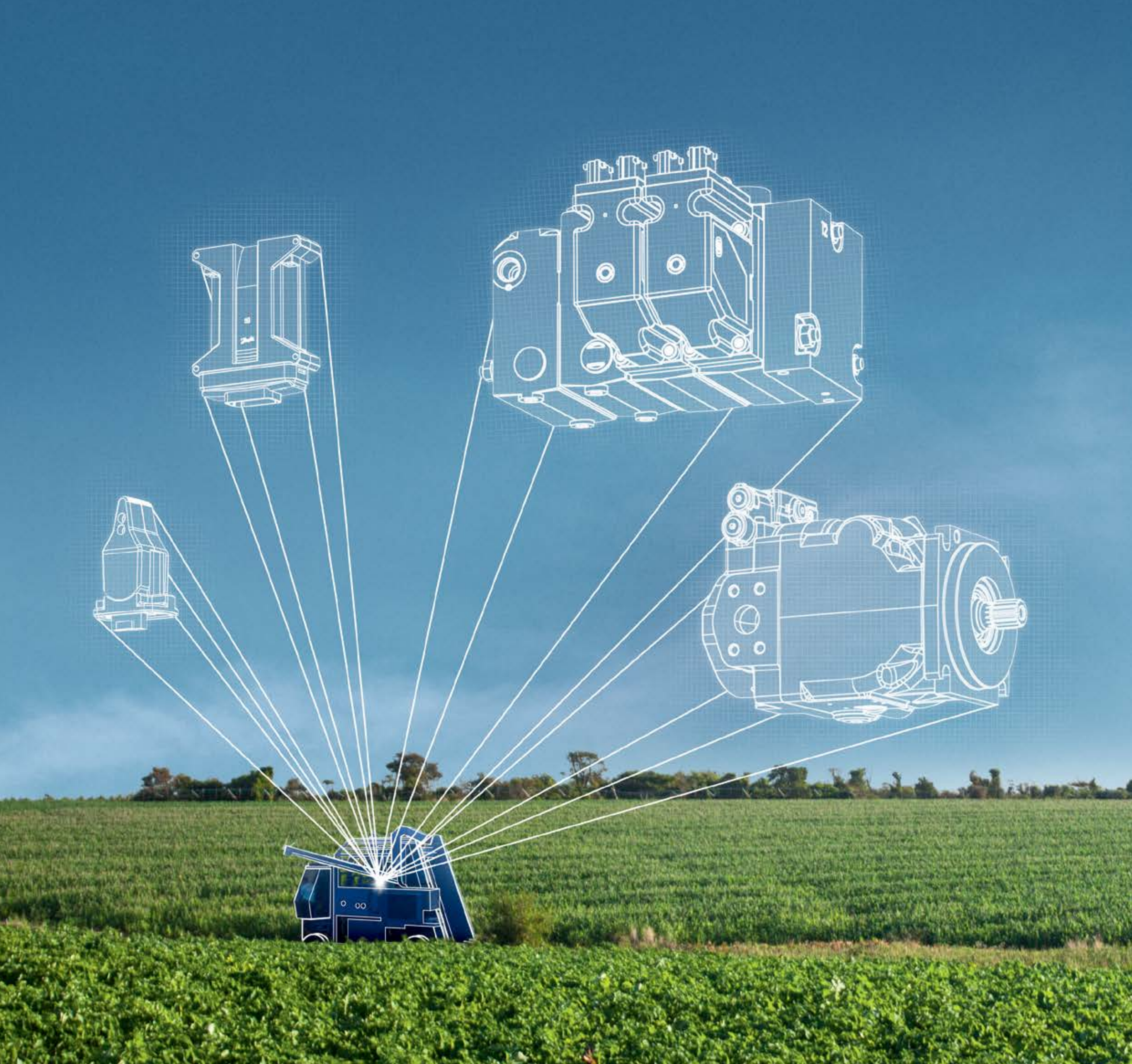
For Vodokanal, the use of variable frequency drives and soft starters saves a considerable amount of resources; reducing production costs in the process. Thus, the primary target of providing a reliable water supply for the people of Kazan has been achieved.


## INFRASTRUCTURE

By 2030, a further 1.5 billion people will live in cities. The demand for infrastructure to support this is massive. We help build the roads, buildings and energy systems for the world's growing cities and support progress for people, communities and businesses across the world. A well-functioning infrastructure is the vehicle for transforming low and middle income countries into emerging or developing nations. Our solutions are developing the cities of tomorrow.

**50%**

**reduction in energy consumption at pumping station**



# FOOD

We help meet the constant need for more and better food by improving agricultural productivity and keeping food fresh all the way to consumers in the most efficient and safe way with minimum waste. Our products are everywhere, whether you look in a grain harvester, at the workings of the cold room and conveyor belt at a slaughterhouse or behind the refrigeration counters of a supermarket.

**42%**
**fuel saving from using fewer components**

**CASE:** FOOD

# New coffee harvester increases productivity by 50%

Together with TDI Máquinas Agrícolas, a Brazilian manufacturer of agricultural machines, Danfoss has designed a new coffee bean harvester that meets the world's growing need for food supply - and which may create a new standard for coffee bean harvesting.

Intensive research by TDI and Danfoss engineering teams led them to a hydraulic solution with fewer hydraulic components and fewer mechanical controls, making the machine less complex and more efficient. The outcome has been a coffee bean harvester that provides fuel savings of about 42% and increases productivity by 50% compared to conventional models.

The harvester uses different Danfoss products on its conventional hydraulic circuit. In this new TDI coffee harvester are, among other things, S45 piston pumps and PVG proportional control valves; solutions that make the circuit more simple and achieve fuel savings, and less heating in the circuit. Furthermore, the system can have interchangeable parts, or be easily adapted to accommodate new functions.

All functions have been incorporated and are controlled by Danfoss' PLUS+1® technology, which includes a microcontroller, joystick and display. This allows the user to easily interact with the machine through the display installed in the cabin. Also, the electronic control functions generate better crop yield, as parameters set by the operator are controlled by the program, reducing chances of errors or losses.

**1.5m EUR**

**saved annually from using variable speed compressors**

**CASE:** ENERGY

# Keeping data safe while saving energy

The need for data centers to house computer systems is rapidly increasing, with a resulting rise in energy consumption. However, solutions are at hand that will help keep consumption down. A data center owner has had highly efficient cooling units installed, which use Danfoss technology, and now saves 33% energy annually.

Quite a lot of the energy consumption in a data center is used for heat removal, to keep data safe at the right temperature and humidity. A UK based climate solutions company, has installed cooling units for a scalable data center, which use Danfoss variable speed compressors. This has resulted in an excellent power usage effectiveness rating of 1.21 for the data center. In a recent survey, the average rating of more than 500 data centers was 1.8. The low power use means that the owner saves 33% energy and 1.5m EUR annually.

The installation in the data center consists of 12 highly-efficient cooling units, each supplied with multiple variable-speed fans and compressors in order to minimize energy use and ensure quick and precise temperature control.
For security reasons, we cannot reveal the name and the location of the data center, because the information managed by the servers is often very sensitive.

## ENERGY

No matter what we produce, the goal is to optimize performance, increase efficiency and minimize waste. This means that, today we are a world leader in the field of energy-efficient technologies that enable our customers and society as a whole to get more from less. Energy that we don't use doesn't pollute and doesn't cost money. By picking the low-hanging fruits that energy-efficient technologies offer, we can meet the growing energy demand, boost the economy and afford renewable energy sources.

## CLIMATE

Danfoss combines a comfortable and healthy indoor climate with energy and cost savings, and protection of the environment. Danfoss supply technology for renewable energy within wind, solar and automotive. Thinking about the indoor climate is really about the future of the outdoor climate. While meeting the global climate challenge, Danfoss' products also contribute to human productivity and well-being indoors by optimizing heating, ventilation and air conditioning systems to suit individual needs and lifestyles.

**Perfect temperature**
**control from using the Danfoss Link™ central Controller System**

**CASE:** CLIMATE

# Intelligent house full of Danfoss tech

## Across the world, demands on new homes are rising. So, when a family of four in Aarhus, Denmark, built their dream home, they expected a whole new level of comfort and control.

The family wanted to create a home where everything is interconnected – from furnishing to energy systems. To meet their expectations, they chose Danfoss One®: an intelligent home solution which makes heating and ventilation systems communicate together and automatically adjusts to the needs of the homeowners, ensuring optimal comfort, air quality and temperature at all times, while keeping energy bills to an absolute minimum.

The solution is controlled by the Danfoss Link™ Central Controller system. This intuitive system ensures perfect temperature control and stability in the house, because it adjusts automatically to the family's energy usage pattern. The heat pump, for example, only starts heating when it receives a signal from the under-floor heating system. Moreover, the system automatically regulates the quantity of fresh air, or lowers the temperature depending on the time of day or the season of the year.

The family has not yet lived in their new home for a full year, but the members point to several advantages of the intelligent home solution: they never have to worry about the indoor climate. It's never too cold nor too hot, and energy efficiency is optimal.

"We wanted to have state-of-the-art energy control systems to prepare our home for the future – and that's what we have now," they point out.

**Danfoss One® in short:**
Danfoss One® is the central part of a system which efficiently integrates floor heating, ventilation and heat pump in houses. Optimal energy optimization is obtained through electronic and wireless communication between the components. Everything is controlled centrally using the Danfoss Link™ Central Controller, which leads to perfect temperature control and stability.

# Building a **world-class** supply chain

In 2014, Danfoss continued to improve productivity and reduce complexity. The Group has adopted best practice tools and processes to support the constant quest for improvement and going beyond the ordinary.

In a period marked by a global economic low-growth environment, Danfoss has been able to achieve strong results despite difficult market conditions. A key contributor is a global supply chain giving Danfoss competitive advantages.

**"To deliver great results, we have to be free and agile. During the first five years of working with our strategy, Core & Clear, we have had a strong focus on ensuring the Group's ability to rapidly adapt to market developments and improve our competitiveness,"** says Executive Vice President and COO, Kim Fausing.

**Implementing best practice processes**

Danfoss Business System (DBS) is a key lever in driving continuous improvement of Danfoss' supply chain. DBS is using methods that streamline operations and supply chain to minimize losses, optimize profitability and secure top quality across the entire supply chain.

**"Our approach to ensuring optimal processes is highly systematical and implemented in every corner of Danfoss. It is, more than anything, our commitment to align and optimize processes across the entire supply chain including everything from procurement, the shop floor and to logistics that enables us to deliver high quality, increase productivity and ensure on-time delivery,"** says Kim Fausing. And he adds: **"Like in production, we have harvested strong productivity gains in our administrative functions through the global roll-out of our Global Services covering all general administration processes, finance, real estate and logistics."**

**Improvements continued in 2014**

Starting out the year at already high levels, Danfoss achieved double-digit productivity enhancements across the Group's factories. At the same time, the Group continued to cut the number of product codes, reducing complexity in the business and improving transparency across product families and business areas.

Procurement savings have over recent years significantly boosted Danfoss' competitiveness. The total savings on procurement reached an all-time high in 2014 exceeding the record level of 2013. Continuing to accelerate the impact from the global category management, Danfoss has further cut the number of suppliers it uses to bring benefits in the form of less complexity, faster delivery and better prices, and a supplier quality program has been implemented across the Group.

**"Combined, the many efforts we put in to working smarter and more efficiently have resulted in a world-class supply chain which benefits our customers through improved quality, reliability and on-time delivery,"** says Kim Fausing.

And he continues:
**"We will keep on harvesting the full potential. Particularly by continued complexity reduction and further initiatives to utilize our global scale to drive enhanced productivity thereby allowing us to focus even more on how to add value to our customers."**

**KIM FAUSING**
Executive Vice President and COO

## About Danfoss Business System

Danfoss Business System (DBS) is how Danfoss drive processes and performance. DBS started with the Danfoss Productivity Program, followed by programs for Procurement, Sales & Marketing and Innovation.

All programs consist of the same building blocks:

- Clearly defined tools and processes for each core process
- Structured execution approach for step changes and continuous improvement
- Structured capability building approach covering all levels in line organization
- Stretched target setting and a systematic performance management approach

## Consolidated procurement improves productivity

Scale is an important parameter when it comes to procurement. By consolidating procurement spend across the Group into a global category management system, Danfoss has obtained significant synergies and scale leading to procurement savings and in the end improved productivity.

As procurement scale is vital to stay competitive in the drives and solar inverter markets, synergies and increased scale was a part of the strategic rationale behind the acquisition of the drives company Vacon and the strategic partnership with the solar inverter company SMA Solar Technology AG. The combined procurement volume coming from these bold moves enables increased procurement savings on materials and parts for drives and solar inverters.

# Earning the **customer's loyalty**

Danfoss' customer promise is quality, reliability and innovation. Every day, Danfoss employees strive to push boundaries on these longstanding cornerstones.

Danfoss Executive Vice President and COO Kim Fausing explains: **"We are recognized for high quality and being a reliable and innovative business partner by our customers. We have as a part of our strategic focus invested significantly to keep us at the forefront of the development as we continue to create solutions that set the global engineering standard."**

At Danfoss, it is crucial that earning the customer's loyalty is not just talk, but something that the customers experience when working with Danfoss.

**KIM FAUSING**
Executive Vice President and COO

**QUALITY**

Berendsen Fluid Power is one of North America's largest distributors of hydraulic and pneumatic products and services. With over 400 employees in more than 45 different cities the company is available to serve customer needs in fluid power applications through-out the US and Canada. Berendsen Fluid Power is a full-line distributor of Danfoss Power Solutions products and solutions.

Ranjit Salan, Customer Service Representative at Berendsen Fluid Power, says: **"I am thankful to represent Danfoss. Always excellent service and the Danfoss people always try and go that extra mile to satisfy me. We much appreciate the people, product and quality of the products. They sell themselves. Thank you!"**

In 2014, Danfoss continued with a dedicated follow-up process, and the Group raised its product quality even further. Much of the improvement was achieved through the systematic approach and aligned processes implemented across the Group through the Danfoss Business System. The goal is for all business areas to comply with ISO/TS16949, one of the toughest quality standards in the world, by the end of 2016. In 2014, five more factories were certified to ISO/TS16949, bringing the current total to 19.

**RELIABILITY**

GIndustries produce a complete range of solutions for comfort and industrial process cooling, focusing on high efficiency and environmentally sustainable products. GIndustries have more than 20 years of cooperation with Danfoss.

Paolo Baldissin, CEO at G.I. HOLDING Group, says: **"With Danfoss we can find the right balance between price, logistics and development. They always inform us up front and act fast to fix any issues that might occur."**

At Danfoss, ease of doing business, excellent service, extensive component insight and application knowledge and delivery performance are some of the cornerstones in being a reliable business partner. In 2014 via systematic follow-up, Danfoss further improved its on-time delivery performance and the increased customer focus has been emphasized with the launch of the next phase in the Group's strategy. Executive Vice President and COO Kim Fausing says:

**"We build our business on trust and integrity. In everything from product design to sales, delivery and service, we stand by our customers, respond to their needs and keep our promises. Being a reliable business partner to our customers is an asset that every day we work hard to protect."**

**INNOVATION**

The GEA Group is one of the largest providers for equipment and process technology particularly for the long-term growth industry of food and beverage where it ranks among the market and technology leaders. Danfoss' variable speed drives is part of the GEA Group's efficient solutions for demanding production processes.

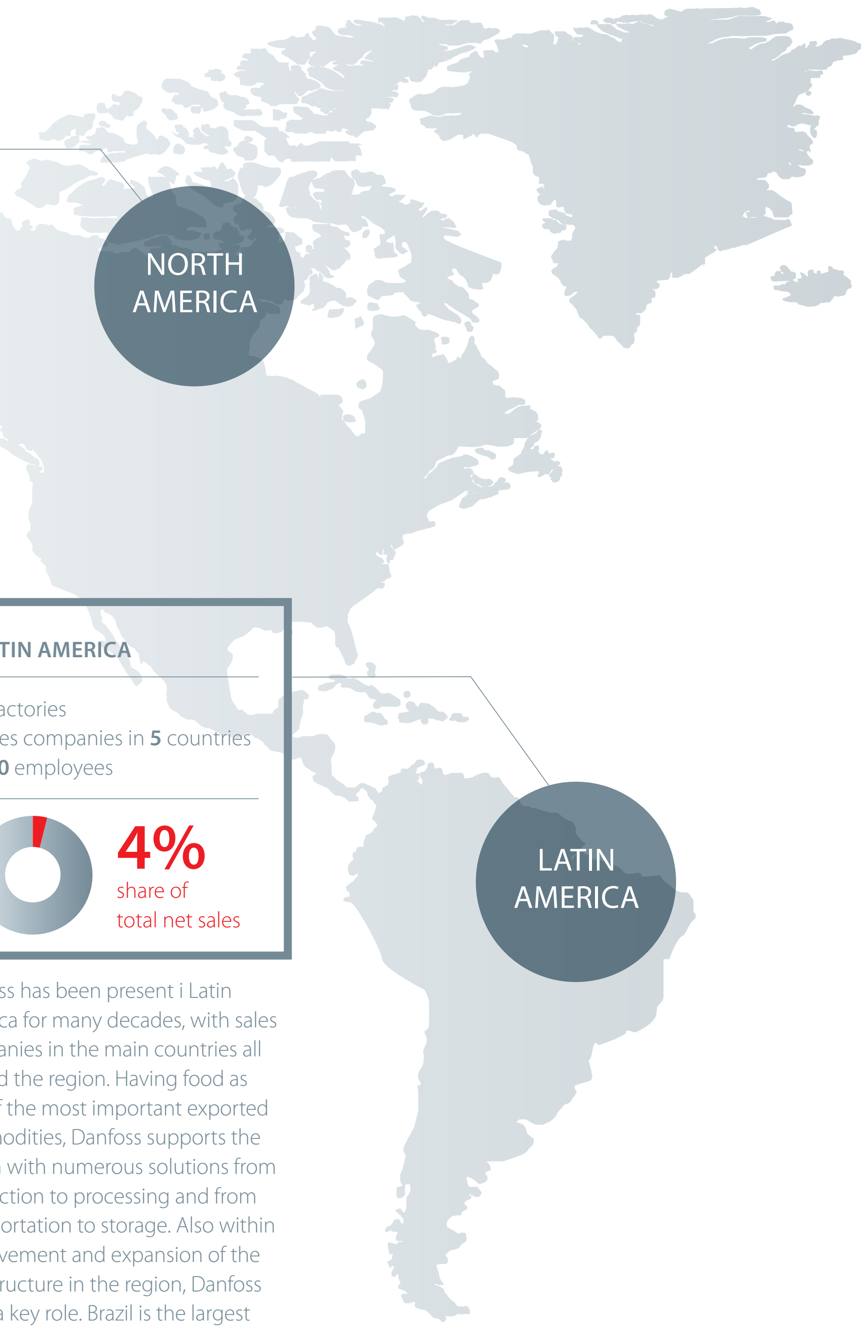
Mario Giannini, Head of Supply Chain at GEA Process Engineering, says:

**"I think that Danfoss' level of innovation is quite, quite high, and this is important to us. GEA and Danfoss are also in contact in developing new innovative solutions for our customers. And this is normally achieved only from what I call strategic suppliers. Danfoss produces intelligent products and the products are, let's say, much more sophisticated. This enables us to deliver something better to the customers than our competitors. We always have as a final goal: what is good for our customer? And through Danfoss, this can be achieved."**

Danfoss has strengthened its innovation capacity and product development programs during the Core & Clear journey. Compared to other players in the industries, relative to its size Danfoss is among the companies spending the most on innovation. Danfoss focuses the investments in innovation from the core and creating solutions that enable the customers to make more out of less. In 2014, measured as a percentage of sales, the investment in innovation was 3.9%. Overall, Danfoss invested DKK 1,331m in innovation in 2014. During the year, Danfoss filed 274 new patent applications and was granted 213 patents. At December 31, 2014, the Group had a total of 1986 patents.

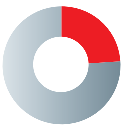
# A strong
# **global footprint**

Danfoss has a strong global footprint with 63 factories in 19 countries, and the Group sells its products in more than 100 countries. Danfoss is headquartered in Nordborg, Denmark.




### NORTH AMERICA

**13** factories
Sales companies in **3** countries
**4,286** employees



**24%**
share of
total net sales

North America is a strategically important market for Danfoss. The US is Danfoss' largest country in terms of net sales. Danfoss holds a strong position and strong presence in this market with double digit sales growth in 2014 and vast potential for further growth in all core business areas. This mature market has a strong economy; it is the largest manufacturing economy in the world, and the home for Danfoss' top, global customers. Energy efficiency in buildings, a changing refrigerant landscape, and reshoring are major trends in North America that represent significant growth opportunities for Danfoss.

### LATIN AMERICA

**2** factories
Sales companies in **5** countries
**420** employees

**4%**
share of
total net sales

Danfoss has been present i Latin America for many decades, with sales companies in the main countries all around the region. Having food as one of the most important exported commodities, Danfoss supports the region with numerous solutions from production to processing and from transportation to storage. Also within improvement and expansion of the infrastructure in the region, Danfoss plays a key role. Brazil is the largest market in the region.

EU is the number one region in Danfoss in terms of net sales, with Germany being the largest market in the region. Danfoss has a very strong footprint in the EU. Despite being a mature market, the EU countries still hold a number of growth opportunities for Danfoss, particularly due to ambitious plans to improve energy efficiency in the region. 'Energiewende', which is the transition of Germany's energy portfolio to be dominated by renewable energy, energy efficiency and sustainable development, is a concrete example of how a mature market is still a growth pocket with huge potential for Danfoss.

Russia is the largest market in this region. Danfoss was one of the companies to rapidly set up a business in Russia, when the country opened up. Today, Danfoss has a strong organization and enjoys a good reputation. In combination, the cold climate, an increased focus on energy efficiency in Russia and the large number of district heating systems hold huge potential for Danfoss. Another country with a large growth potential is Turkey: cold winters and hot summers create a demand for heating and cooling technologies. As part of the initiatives to accelerate growth, Danfoss accelerates investments in Turkey.

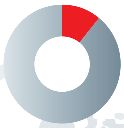
**EU**

**33** factories
Sales companies in **20** countries
**12,617** employees

**40%**
share of
total net sales

**OTHER EUROPE**

**2** factories
Sales companies in **7** countries
**1,341** employees



**11%**
share of
total net sales

EU

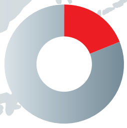
OTHER EUROPE

AFRICA/ MIDDLE EAST

ASIA-PACIFIC

**ASIA-PACIFIC**

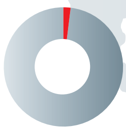
**13** factories
Sales companies in **12** countries
**5,392** employees



**19%**
share of
total net sales

**AFRICA/MIDDLE EAST**

Sales companies in **2** countries
**61** employees

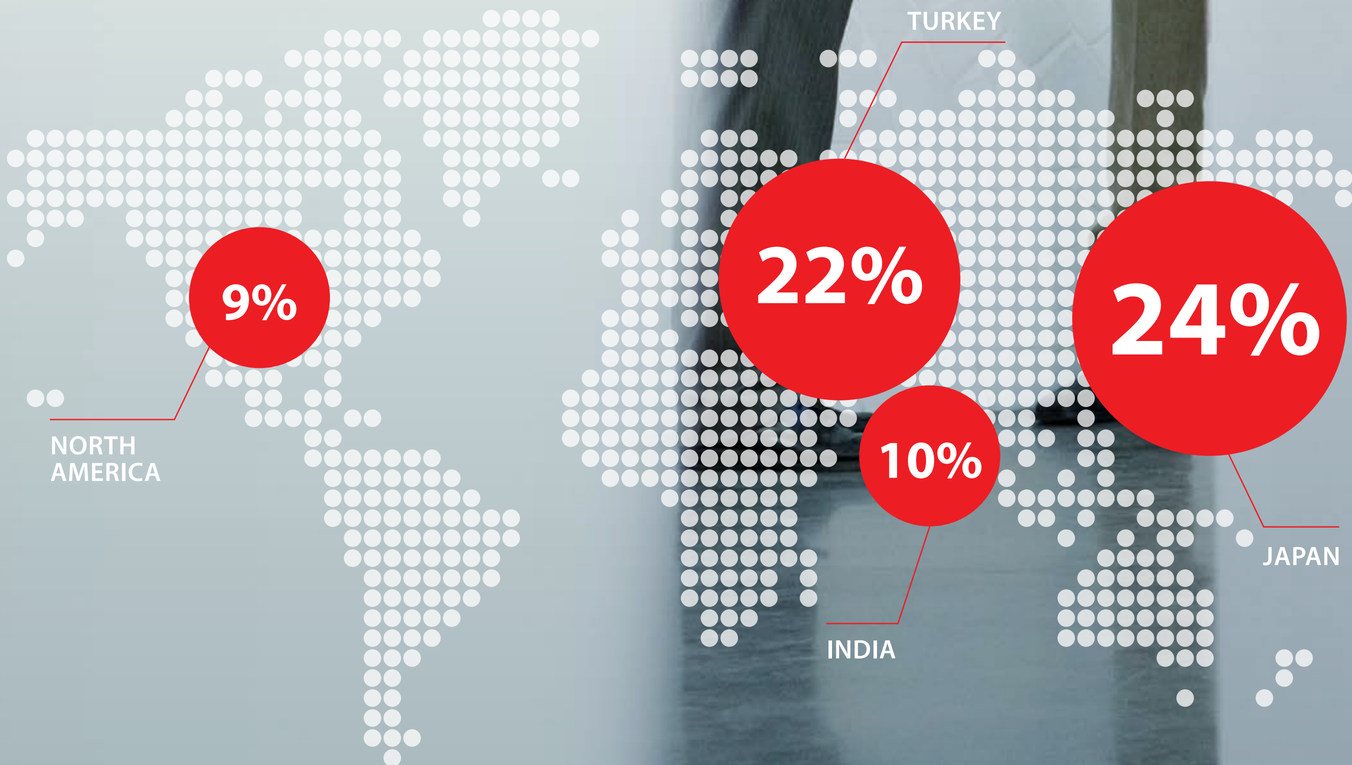


**2%**
share of
total net sales

The Africa/Middle East region is the most diversified region in Danfoss with more than 66 countries. Despite being characterized by a volatile business climate in parts of the region, Africa and the Middle East are also representing a promising potential, with in general a growing population and increasing urbanization, fast-growing economies on the African continent and focus on more efficient energy systems in the oil producing countries. Also, a wide range of Danfoss solutions are addressing key challenges in the region such as the scarcity in power supply, as well as within the almost non-existent food cold chain.

Asia-Pacific is Danfoss' largest region in terms of sourcing, and a large proportion of Danfoss production is located there. China is the Group's largest market in the region, and the country's high growth rates, which have been obtained over the few past years, is one of the reasons that the BRIC countries' share of the Group net sales have reached 22%. China continues to hold major potential within urban district heating projects in particular, which Danfoss helps to develop. The second-largest market in the region is India, which is also identified as offering a huge growth potential for Danfoss. Therefore, in 2014, Danfoss opened a large new India Campus, including production and development facilities.

**TOP GROWTH AREAS IN 2014,** IN LOCAL CURRENCY



# Continued **strong** financial **performance**

In 2014, Danfoss maintained a strong momentum in its core businesses and likewise delivered strong financial results. Sales were up by 4% in local currency, earnings reached a new record level while free cash flow was maintained at a high level.

In 2014, Danfoss increased its total net sales to the record level of DKK 34,375m against DKK 33,628m in 2013, which was satisfactory and in line with expectations. In local currency sales grew by 4%.

2014 was characterized by the continuing low, global growth conditions. However, the need for infrastructure, food supply, energy efficiency and climate-friendly solutions continued to be the drivers of the demand for Danfoss technologies. The Group had growth throughout all quarters.

From a geographical point of view, the Group continued its vigilant focus on a few high potential growth opportunities. India is one of these opportunities. Due to urbanization and the need for an efficient cold-chain to keep food fresh and lowering food waste in the Indian agriculture and food-industry, the region holds great potential for Danfoss' cooling and air-conditioning business. In 2014, the region delivered growth of 10% in local currency. Another geographical opportunity with a promising potential for the Group is Turkey, where a growing population and a climate of very hot summers and cold winters drives the demand for energy efficient heating and cooling solutions. In 2014, Danfoss further strengthened its presence in the country, and although being a relatively new market for Danfoss, Turkey proved its potential with a growth rate of 22% in local currency.

The BRIC countries have for some years been the primary growth markets for Danfoss, and Brazil, Russia, India and China still hold great potential for the Group. As mentioned above, growth in India was double-digit, whereas sales in Brazil after a record level in 2013 declined slightly. In China, the year began with sales well above 2013 level, but over the quarters the growth decreased, and China ended up just above 2013 level for the full year. In Russia, considering the difficult market conditions with a Russian economy impacted by international sanctions and declining oil prices, thus a significant decline for the Ruble, Danfoss had a satisfactory year in the region with sales close to the level of 2013. In total, 2014 was a year of mixed market conditions in the BRIC countries and the share of total sales coming from Brazil, Russia, India and China was at year end at 22% compared to 22% in 2013.

Still coping with the aftermath of the financial crisis and also impacted by the economic effects of the trade sanctions against Russia, Europe was characterized by low growth overall.

Whereas 2014 was marked by low growth in some regions, it was also the year of a strong comeback for North America. The trend of growth picking up in the region started already in the second half of 2013. Almost one-quarter of the Groups net sales came from North America, and a growth rate of 9% in local currency had a very positive impact on the Group's sales performance in 2014. Also, in the Asia-Pacific region, the Group saw a positive trend in sales, driven by increasing sales in several countries. Japan, one of the largest markets in the region, had a growth rate of 24% in local currency.

**Operating profit (EBIT) excluding other operating income and expenses** grew by 13% to reach DKK 4,356m, up from DKK 3,870m in 2013. The main drivers of these improved results were the growing sales and operational improvements such as procurement savings, productivity increase and reduced complexity, combined with good cost control. Accordingly, EBIT was in line with the expected level, which was satisfactory. Earnings were particularly strong in mid-year, which is traditionally Danfoss' peak season. 2014 was the strongest year in the history of Danfoss in terms of profitability.

# FINANCIAL REVIEW

**Operating profit (EBIT)** amounted to DKK 3,925m, against DKK 3,624m in 2013 equal to an increase of 8%.

**Financial items** totaled an expense of DKK 449m, against an expense of DKK 369m in 2013.

**Net profit** was at DKK 2,290m against DKK 2,285m in 2013.

## Balance sheet

Equity stood at DKK 13,242m at December 31, 2014, compared to DKK 11,443m at December 31, 2013. The strong earnings are the main reason for the positive development in equity.

**The return on equity** was 18.4% compared to 18.2% in 2013.

**Total assets amounted** to DKK 36,883m at December 31, 2014, against DKK 26,116m at the year-earlier date. This change was due to Danfoss acquiring the Finnish drives manufacturer Vacon and 20% of the shares in the German solar inverter company SMA Solar Technology AG.

**Net interest-bearing debt** stood at DKK 11,439m at December 31, 2014, compared with DKK 4,116m at the year-earlier date. This change was also due to M&A activities in 2014, where Danfoss acquired Vacon at the total price of DKK 7.748m and 20% of the shares in SMA Solar Technology AG at the total price of DKK 2,257m. The level of debt is equal to 2.0 × EBITDA for the last four quarters, which is in line with the target range of 0 to 2 times EBITDA for the last four quarters. The Group management considers the level of debt to be satisfactory.

Interest-bearing debt included DKK 11,063m (97%) non-current debt maturing after more than 12 months. At December 31, 2014, the Group had unutilized and non-terminable long-term credit commitments of DKK 7.0bn. In addition to this, Danfoss had cash and cash equivalents and ordinary operating credits.

## Cash flow statement

The free cash flow before mergers and acquisitions was maintained at a very high level, driven by strong earnings and improvements to the working capital. Free cash flow before mergers and acquisitions amounted to DKK 3,389m, against DKK 3,513m at December 31, 2013.

Cash flow from operating activities of DKK 4,351m and DKK -10,576m cash flow from investing activities amounts to a free cash flow of DKK -6,225m, against DKK 3,527m in 2013. This change was mainly due to M&A activities of DKK 9,614m in 2014, where Danfoss acquired the Finnish drives manufacturer Vacon and 20% of the shares in the German solar inverter company SMA Solar Technology AG.

## Innovation

In 2014, the Group's innovation activities were concentrated on developing energy-efficient and performance-enhancing solutions in the Group's core business areas. Danfoss spent DKK 1,331m on product development in 2014, compared to DKK 1,383m in 2013. Measured as a percentage of sales, investment was 3.9% against 4.1% in 2013. During the year, Danfoss filed 274 new patent applications, and 213 patents were granted to the Group. At December 31, 2014, the Group had 1,986 patents.

## Employees

Being able to attract and retain people with the right knowledge and skills is essential for Danfoss to retain and expand its leading market position in its core business areas. Danfoss makes an ongoing structured effort to build and develop employee qualifications through on-the-job training, courses and other learning activities.

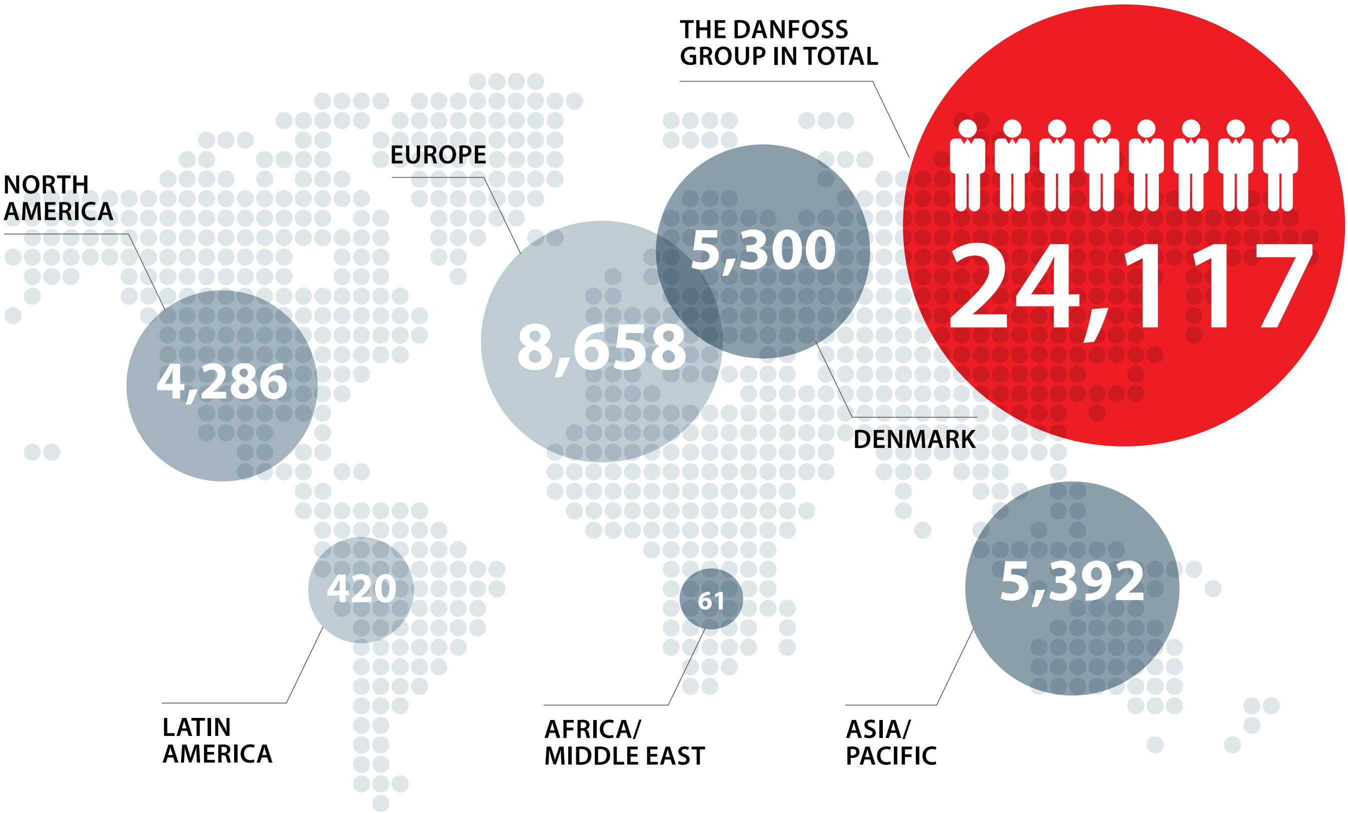
In addition, Danfoss holds frequent employee performance reviews in support of the continuing development of employee qualifications, ensuring consistency between levels of responsibility and levels of competency.

Danfoss seeks to develop and attract employees from all over the world. It is therefore of great importance to embrace diversity at all levels of the Group. In 2015 Danfoss introduced Danfoss behaviors in action where employees are guided in how to interact with each other and create a best in Class Company.

The Group's latest Survey of Performance Management measures the extent to which the organization is working in accordance with the Danfoss strategy. In 2015 the score maintained at a high score. The high score gives an indication of a strong culture and commitment to the company's long term strategy.

The Danfoss Group had 24,117 employees at December 31, 2014, including approximately 1,600 employees joining the Group following the Vacon acquisition. The Group had 22,463 at the year-earlier date. The Group's employees were distributed as follows by geography: 8,658 in Europe excluding Denmark (2013: 7,772), 4,286 in North America including Mexico (2013: 3,920), 420 in Latin America (2013: 412), 5,392 in Asia-Pacific including China (2013: 4,889) and 61 in Africa-Middle East (2013: 55). At December 31, 2014,

## EMPLOYEES 2014




Danfoss had 5,300 employees in Denmark compared to 5,415 a year earlier.

**Acquisitions, business expansions and establishments in 2014**

In May, Danfoss and the world's largest producer of solar inverters, German SMA Solar Technology AG (SMA), entered a strategic partnership. Danfoss bought 20% of the shares in SMA at a price of EUR 302m, making Danfoss an anchor investor in SMA. As a part of the partnership, SMA took over the rights to all Danfoss solar products, including sales and service.

In October, Danfoss and Bosch Thermotechnik GmbH signed an agreement to form a joint venture to develop and manufacture a new innovative and energy-efficient oil-free compressor technology. The joint venture is owned in equal shares by Bosch Thermotechnik and Danfoss.

In November, the Group's new campus in India was officially inaugurated. The campus is a giant leap forward for Danfoss in India, and the new facilities, including R&D and production, will secure a strong foundation and support in the development and quest for accelerated growth in the region.

In December, Danfoss completed its acquisition of the Finnish drives company Vacon. Danfoss acquired all shares of Vacon at a price of EUR 34 per share and a total purchase price of EUR 1,038m (DKK 7,748m). In connection with the Vacon acquisition, the company will be delisted from the Helsinki stock exchange during 2015.

In December, the Group issued a 7-year corporate Euro bond of EUR 500m under the established Euro Medium Term Note program (EMTN) program with a capacity of EUR 1,000m in total. This transaction provided the Group with funding for the M&A activities at attractive terms and further strengthened its financial position by diversifying the Group's funding on several sources.

**Accounting policies**

The Annual Report has been prepared in accordance with International Financial Reporting Standards (IFRS) and Danish disclosure requirements for annual reports of companies in Reporting Class D. Changes have been made to the accounting policies in 2014 as a result of the implementation of new standards and interpretations. The changes have not had a material effect on recognition nor measurement.

Danfoss A/S has, starting from 2014, decided to include share of profit from associates and joint ventures after tax in Operating profit (EBIT). Before 2014, it was classified below Operating Profit (EBIT).

Danfoss considers associates and joint ventures to be an integrated part of the Group, as the shareholdings in associates and joint venture participate in generating the operating profit of the consolidated Group. Comparison figures for 2013 have been increased with DKK 8m in order to reflect this change. No key figures other than Operating profit (EBIT) are impacted.

# Danfoss solutions make more out of less

**90%**

**of the surplus heat i reused**

## Industry heats the houses in Hamburg

Up to 60% of the energy used at power plants in Europe is emitted as surplus heat. This is inefficient and leads to $CO_2$ emissions which could have been avoided. At HafenCity in Hamburg, Germany, the reasoning is different: Europe's largest and highly ambitious city development project uses surplus heat from industrial companies and power plants to heat the majority of the houses in the area. District heating technology makes it possible to utilize 90% of the energy from the power plants.

# FINANCIAL HIGHLIGHTS, QUARTERLY

DKKm

| | Q1 2013 | Q2 2013 | Q3 2013 | Q4 2013 | 2013 | Q1 2014 | Q2 2014 | Q3 2014 | Q4 2014 | 2014 |
|---|---|---|---|---|---|---|---|---|---|---|
| **PROFIT AND LOSS ACCOUNTS** | | | | | | | | | | |
| Net sales | 8,063 | 8,752 | 8,712 | 8,100 | 33,628 | 8,303 | 8,617 | 8,784 | 8,670 | 34,375 |
| Operating profit before depreciation, amortization, impairment and other operating income and expenses | 1,106 | 1,408 | 1,688 | 1,347 | 5,549 | 1,401 | 1,450 | 1,802 | 1,426 | 6,079 |
| Operating profit before depreciation, amortization and impairment (EBITDA) | 1,057 | 1,340 | 1,590 | 1,317 | 5,304 | 1,341 | 1,448 | 1,737 | 1,135 | 5,661 |
| Operating profit excl. other income and expenses | 679 | 987 | 1,273 | 931 | 3,870 | 996 | 1,043 | 1,394 | 924 | 4,356 |
| Operating profit (EBIT) | 638 | 911 | 1,175 | 900 | 3,624 | 913 | 1,042 | 1,323 | 647 | 3,925 |
| Financial items | -36 | -133 | -96 | -104 | -369 | -80 | -83 | -86 | -201 | -449 |
| Profit before tax | 603 | 778 | 1,079 | 796 | 3,255 | 833 | 959 | 1,237 | 447 | 3,476 |
| Net profit | 422 | 556 | 708 | 598 | 2,285 | 555 | 632 | 828 | 274 | 2,290 |
| **BALANCE SHEET** | | | | | | | | | | |
| Total non-current assets | 17,024 | 16,691 | 16,127 | 16,052 | 16,052 | 15,760 | 18,029 | 18,737 | 25,822 | 25,822 |
| Total assets | 28,546 | 28,450 | 27,472 | 26,116 | 26,116 | 26,436 | 29,064 | 29,811 | 36,883 | 36,883 |
| Total shareholders' equity | 14,637 | 10,445 | 10,942 | 11,443 | 11,443 | 11,946 | 11,783 | 13,030 | 13,242 | 13,242 |
| Net interest-bearing debt | 2,767 | 6,721 | 5,421 | 4,116 | 4,116 | 3,913 | 6,639 | 5,874 | 11,439 | 11,439 |
| Net assets | 17,332 | 17,089 | 16,284 | 15,476 | 15,476 | 15,785 | 15,953 | 15,796 | 22,432 | 22,432 |
| **CASH FLOW STATEMENT** | | | | | | | | | | |
| Cash flow from operating activities | 435 | 1,265 | 2,623 | 4,444 | 4,444 | 405 | 1,071 | 2,754 | 4,351 | 4,351 |
| Cash flow from investing activities | -56 | -340 | -505 | -917 | -917 | -178 | -2,673 | -3,593 | -10,576 | -10,576 |
| Acquisition of intangible assets and property, plant and equipment | -167 | -471 | -612 | -1,004 | -1,004 | -215 | -456 | -711 | -996 | -996 |
| Acquisition of subsidiaries and activities | 0 | 0 | 2 | 0 | 0 | 0 | 0 | 0 | -7,377 | -7,377 |
| Acquisition(-) and sale of other investments etc. | 111 | 131 | 105 | 87 | 87 | 37 | -2,217 | -2,882 | -2,203 | -2,203 |
| Free Cash flow | 378 | 925 | 2,118 | 3,527 | 3,527 | 227 | -1,602 | -839 | -6,225 | -6,225 |
| Free cash flow before M&A | 365 | 918 | 2,121 | 3,513 | 3,513 | 228 | 660 | 2,090 | 3,389 | 3,389 |
| Cash flow from financing activities | -530 | -974 | -2,202 | -3,623 | -3,623 | -490 | 1,340 | 609 | 6,194 | 6,194 |
| **KEY FIGURES** | | | | | | | | | | |
| Organic net sales growth ( %) | -4 | -1 | 3 | 5 | 1 | 7 | 3 | 3 | 3 | 4 |
| EBITDA margin excl. other operating income etc. (%) | 13.7 | 16.1 | 19.4 | 16.6 | 16.5 | 16.9 | 16.8 | 20.5 | 16.4 | 17.7 |
| EBITDA margin (%) | 13.1 | 15.3 | 18.2 | 16.3 | 15.8 | 16.2 | 16.8 | 19.8 | 13.1 | 16.5 |
| EBIT margin excl. other operating income etc. (%) | 8.5 | 11.3 | 14.6 | 11.5 | 11.5 | 12.0 | 12.1 | 15.9 | 10.7 | 12.7 |
| EBIT margin (%) | 7.9 | 10.4 | 13.5 | 11.1 | 10.8 | 11.0 | 12.1 | 15.1 | 7.5 | 11.4 |
| Equity ratio (%) | 51.3 | 36.7 | 39.8 | 43.8 | 43.8 | 45.2 | 40.5 | 43.7 | 35.9 | 35.9 |
| Leverage ratio (%) | 18.9 | 64.3 | 49.5 | 36.0 | 36.0 | 32.8 | 56.3 | 45.1 | 86.4 | 86.4 |
| Net interest bearing debt to EBITDA ratio | 0.5 | 1.2 | 1.0 | 0.8 | 0.8 | 0.7 | 1.2 | 1.0 | 2.0 | 2.0 |
| **GEOGRAPHICAL SEGMENTS** | | | | | | | | | | |
| ***Total net sales*** | | | | | | | | | | |
| EU | 3,268 | 3,377 | 3,405 | 3,266 | 13,316 | 3,480 | 3,378 | 3,427 | 3,320 | 13,607 |
| Rest of Europe | 803 | 944 | 1,153 | 1,011 | 3,911 | 735 | 862 | 1,110 | 982 | 3,689 |
| Asia | 1,242 | 1,551 | 1,604 | 1,493 | 5,890 | 1,324 | 1,528 | 1,600 | 1,687 | 6,139 |
| North America | 2,081 | 2,113 | 1,811 | 1,661 | 7,666 | 2,151 | 2,212 | 1,946 | 2,004 | 8,313 |
| Africa | 51 | 68 | 65 | 46 | 230 | 60 | 70 | 61 | 74 | 264 |
| Pacific | 128 | 128 | 149 | 133 | 538 | 120 | 121 | 128 | 122 | 491 |
| Latin America | 400 | 449 | 435 | 401 | 1,685 | 339 | 344 | 406 | 375 | 1,464 |
| Middle East | 90 | 122 | 90 | 90 | 392 | 94 | 102 | 106 | 106 | 408 |
| Total | 8,063 | 8,752 | 8,712 | 8,100 | 33,628 | 8,303 | 8,617 | 8,784 | 8,670 | 34,375 |
| ***Number of employees*** | | | | | | | | | | |
| Europe excl. Denmark | 7,973 | 8,041 | 7,972 | 7,772 | 7,772 | 7,727 | 7,754 | 7,682 | 8,658 | 8,658 |
| North America incl. Mexico | 3,994 | 4,039 | 3,946 | 3,920 | 3,920 | 3,861 | 4,077 | 4,105 | 4,286 | 4,286 |
| Latin America | 441 | 427 | 418 | 412 | 412 | 424 | 422 | 398 | 420 | 420 |
| Asia-Pacific incl. China | 4,894 | 4,950 | 4,936 | 4,889 | 4,889 | 4,887 | 5,002 | 5,007 | 5,392 | 5,392 |
| Africa - Middle East | 57 | 58 | 58 | 55 | 55 | 58 | 59 | 62 | 61 | 61 |
| Denmark | 5,684 | 5,640 | 5,512 | 5,415 | 5,415 | 5,329 | 5,319 | 5,368 | 5,300 | 5,300 |
| Total exclusive sold companies/activities | 23,043 | 23,155 | 22,842 | 22,463 | 22,463 | 22,286 | 22,633 | 22,622 | 24,117 | 24,117 |

# Danfoss **Climate & Energy**

**Segment description**
The Danfoss Climate & Energy segment covered five areas: refrigeration and air-conditioning controls, power electronics, heating solutions, commercial compressors, and district energy. The segment played a leading role in R&D, production, sales and service of mechanical and electronic products and solutions sold on the global market for cooling and air conditioning, comfort and heating, control of electric motors, and for a number of industries in which energy efficiency is important.

**Market and regional trends**
Sales trends in the Danfoss Climate & Energy segment were as expected for 2014, with the segment gaining gradually stronger traction throughout the year. As for the whole Danfoss Group, the year was for the segment characterized by low growth market conditions. However, the global megatrends such as the need for intelligent cooling and heating infrastructure and keeping food fresh from the field all the way to the consumer continued to drive the demand for the segment's energy-efficient, climate-friendly solutions and technologies.

The refrigeration and air-conditioning business, which supplies energy-saving components for a wide range of refrigeration and air-conditioning systems, and the power electronics business, which, among other things, produces variable speed drives for the energy efficient control of electric motors, performed especially well during the year. Also, the district energy business performed strongly in 2014 benefitting from an increased global awareness of the great-scale energy efficiency potential that countries and cities can achieve from district energy. Another remarkable contributor - also with great potential - to the positive development in the segment was the Danfoss Turbocor compressor: a relatively new, innovative, variable speed, oil-free compressor technology with outstanding energy efficiency performance. With a double-digit global growth rate in 2014, the Turbocor compressor also proved its potential in the commercial air-conditioning market.

Overall, the segment continued to see a steady level of demand for energy-efficient solutions.

Seen from a regional perspective, the segment maintained or grew its market share in all regions. Growth staged a comeback in North America, reaching 9% in local currency for the full-year. Also in India and Turkey, the bold strategic moves to utilize the growth potential of the regions paid off. India had 9% growth, while Turkey reached 28%, both in local currency. The European market ended up at last year's level. Sales to the Russian market were maintained at the 2013 level, which was satisfactory considering the difficult market conditions in the region. In China and Brazil the segment had low single-digit growth.

**Segment development**
The work to develop the core businesses in the segment continued in 2014.

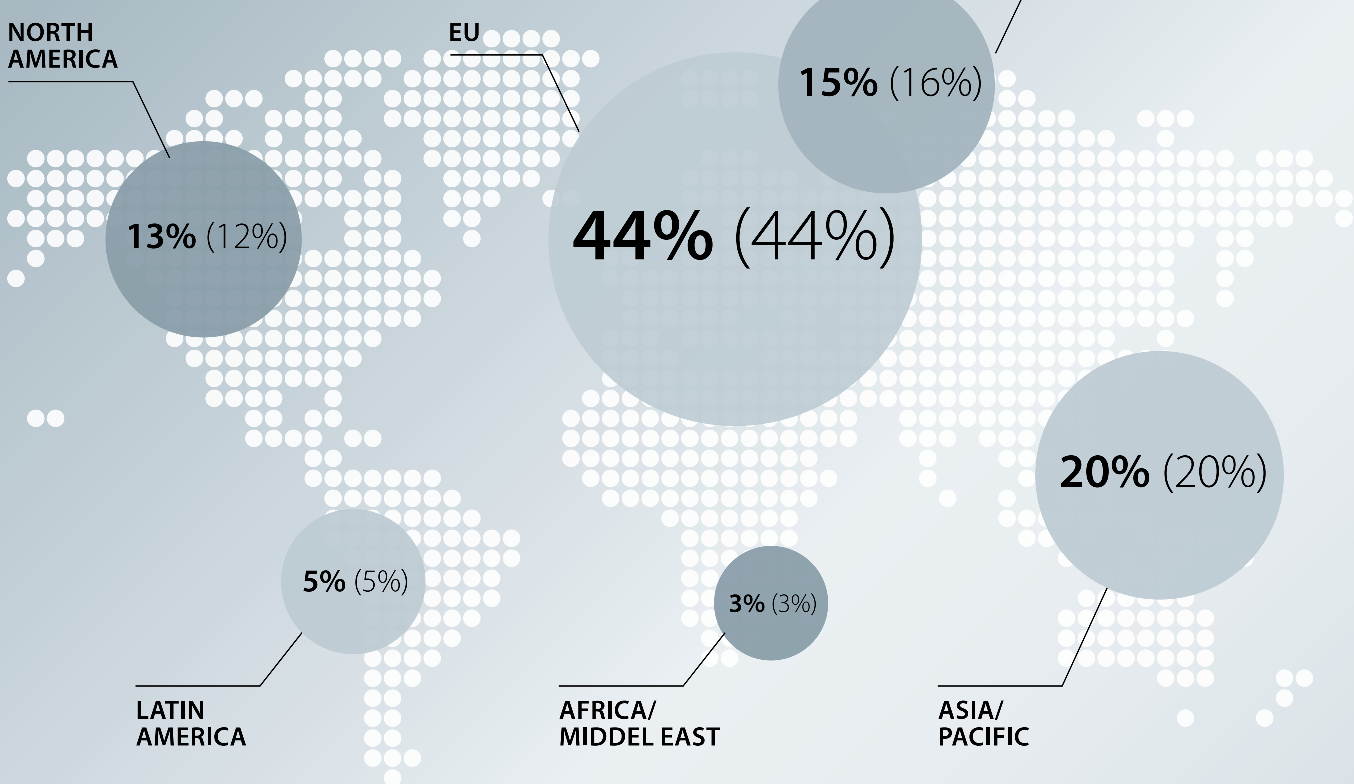
At the beginning of the year, Danfoss entered a strategic partnership with German SMA Solar Technology AG (SMA). This alliance is in line with the Core & Clear strategy's ambition to be a number one or two in the markets where Danfoss operates. The potential of the two significant players joining forces is significant, and already during 2014 the benefits from increased procurement scale began to materialize.

At year end, a significant strengthening of the segment's drives business was made with the acquisition of the Finnish drives manufacturer Vacon. The combination of Vacon and Danfoss has created one of the world's leading players in the drives market. Joining forces also means that the new drives business will be able to invest further in both innovation and in the sales force and gain additional scale, which is a key success factor in the global drives market. The ambition for the new drives business is to grow faster than the drives market.

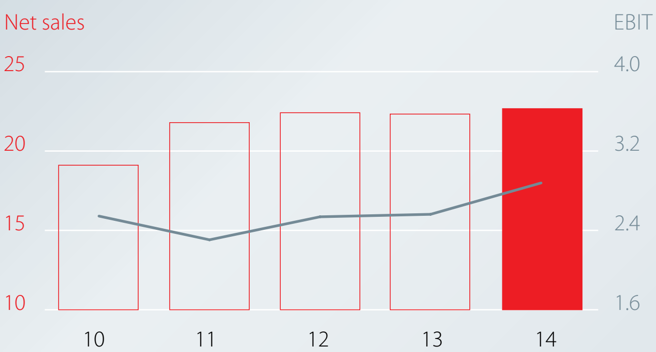
The segment's spent on product development remained at the very high level of 4.0% of net sales leading to a significant number of new and updated products brought to the market during the year. Also, the segment continued to expand its position on the Indian market with the inauguration of a new production and innovation campus in Chennai.

**Financial performance**
For the full-year, the segment had sales growth of 4% in local currency and 1% in DKK. Net sales amounted to DKK 22,669m, against DKK 22,330m in 2013. Due to the increased sales and substantial productivity improvements and increasing procurement savings, profitability in the segment was significantly improved from an operating profit (EBIT) of DKK 2,561m last year to DKK 2,878m in 2014, equal to an improvement of 12%, lifting the EBIT margin to 12.7% from 11.5% in 2013.

## SALES DISTRIBUTION BY REGION 2014 (2013)




## NET SALES & EBIT bn. DKK




## FINANCIAL HIGHLIGHTS

| DKKm | 2013 | **2014** |
|---|---|---|
| **INCOME STATEMENT** | | |
| Net sales | 22,330 | 22,669 |
| Operating profit (EBIT) | 2,561 | 2,878 |
| **BALANCE SHEET** | | |
| Intangible assets | 3,966 | 11,621 |
| Property, plant and equipment | 4,140 | 4,396 |
| Total assets | 14,336 | 25,249 |
| **OTHER INFORMATION** | | |
| Net investments excluding M&A | 695 | 658 |
| Depreciation/amortization | 855 | 880 |
| **NUMBER OF EMPLOYEES** | | |
| Number of employees | 13,657 | 14,891 |
| **KEY FIGURES** | | |
| EBIT margin | 11.5% | 12.7% |

# Danfoss **Power Solutions**

**Segment description**
The Danfoss Power Solutions covered four areas: hydrostatics, work function, controls and stand-alone business operations. Within each business area, the segment played a leading position in R&D, design, manufacture and sale of innovative and performance-enhancing hydraulic and electronic systems and components used in mobile machinery operating in the agriculture, construction, materials handling, and specialty equipment markets.

**Market and regional trends**
Danfoss Power Solutions began 2014 with a positive momentum. The demand for the segment's efficiency- and performance-enhancing hydraulic and electronic systems and components used in mobile machinery continued, driven by global megatrends such as the need for better infrastructure in growing cities and improving the efficiency in food production across the world. This was experienced in all regions with positive trends in the construction, road building and material handling markets and solid execution of sales growth plans. In the second half of the year, the segment experienced weakening sales on the mobile hydraulics market in China and the agricultural market in North America and Europe. Despite the weakening markets in the latter part of the year the total sales grew by 5% in local currency. The segment's growth performance was spread across several geographic markets with North America reporting 8% growth in local currency. The bold strategic move to utilize the growth potential of the India region paid off and the strong growth experienced in 2013 continued in the region growing 13% in 2014, in local currency. Europe ended up at the same level as the year before, especially driven by Germany maintaining a high level of sales.

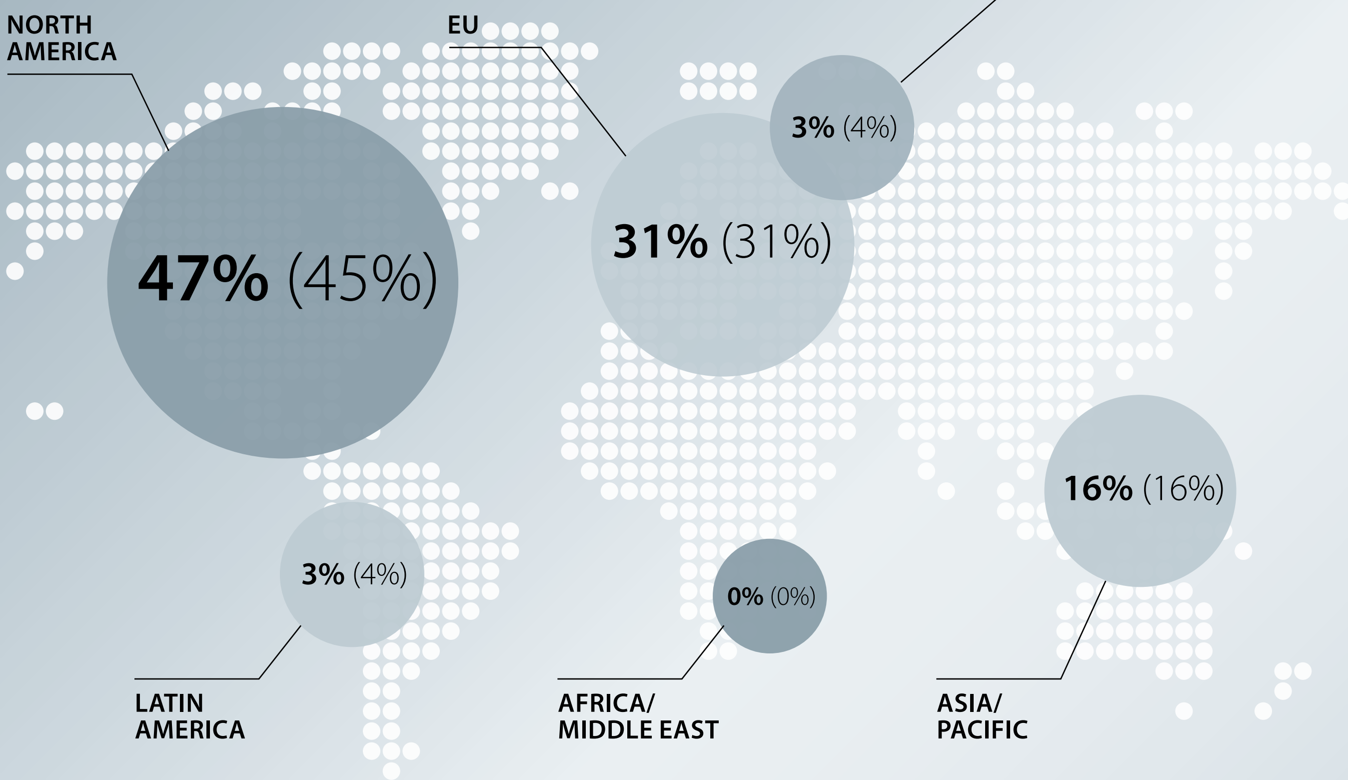
**Segment development**
Danfoss Power Solutions' spent on product development increased slightly to 3.6% of net sales.

The segment has throughout 2014 continued to further optimize the factory footprint, which has resulted in changes in Slovakia, Denmark, Poland, Italy and Sweden. Consequently, the usage of square meters has been reduced and cost levels have been lowered.

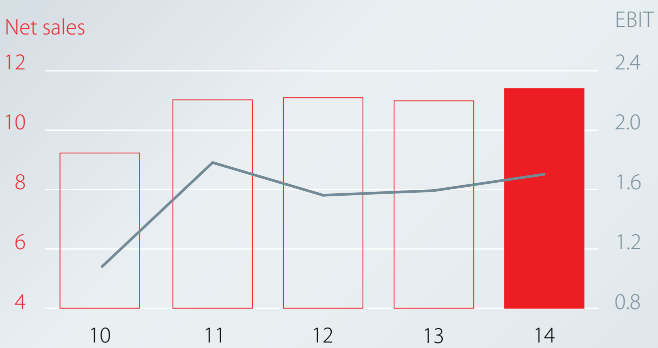
The segment also upheld its long-term investment in developing the Chinese market, further developing innovative products and ramping up the new factory in Haiyan which manufactures products tailored to the Chinese market.

**Financial performance**
For the full-year, the segment had sales growth of 5% in local currency and 4% in DKK. Net sales amounted to DKK 11,406m, against DKK 10,989m in 2013. Due to continuing implementation of improvement activities, among other things leading to procurement cost savings and productivity enhancements, as well as a strong focus on costs earnings was also improved. Operating profit (EBIT) grew by 7% to DKK 1,703m, against DKK 1,593m the previous year, lifting the EBIT margin to 14.9% from 14.5% in 2013.

**SALES DISTRIBUTION BY REGION 2014** (2013)




**NET SALES & EBIT** bn. DKK




**FINANCIAL HIGHLIGHTS**

| DKKm | 2013 | **2014** |
|---|---|---|
| **INCOME STATEMENT** | | |
| Net sales | 10,989 | 11,406 |
| Operating profit (EBIT) | 1,593 | 1,703 |
| **BALANCE SHEET** | | |
| Intangible assets | 4,023 | 4,045 |
| Property, plant and equipment | 2,080 | 1,903 |
| Total assets | 8,821 | 8,838 |
| **OTHER INFORMATION** | | |
| Net investments excluding M&A | 377 | 347 |
| Depreciation/amortization | 772 | 744 |
| **NUMBER OF EMPLOYEES** | | |
| Number of employees | 6,320 | 6,111 |
| **KEY FIGURES** | | |
| EBIT margin | 14.5% | 14.9% |

# Expectations for **2015**

## Net sales

**Net sales including full-year impact of the acquisition of Vacon is expected to grow by 5-10%.**

## Operating profit

**Underlying profitability is expected to slightly improve through the continuous operational improvements and the targeted strategic initiatives already launched. However, integration cost in the first year of Vacon ownership is expected to keep operating profit (EBIT) excluding other income and expenses on par with 2014.**

The Danfoss Group is proactively adapting to market conditions on the basis of dynamic contingency and scenario planning. The key focus is to invest in the core businesses to accelerate profitable growth, while ensuring the long-term profitability of the business by having a scalable and flexible business model.

During 2014, the global financial volatility increased due to among other factors the decreasing growth rates in some emerging markets, lower oil prices and the sanctioned trade cooperation between the EU and Russia. This has resulted in a more uncertain outlook in regards to the development of the global economic environment and Danfoss expects the global, low growth scenario to continue in 2015. However, the global need for infrastructure, food supply, energy efficiency and climate-friendly solutions is expected to continue to drive the demand for Danfoss technologies and solutions. In addition, the effects of already conducted and further targeted investments in leading market positions for the core businesses and geographical areas and markets with high growth potential is expected to generate a positive impact on the Group's results.

Based on the above, net sales including full-year impact of the acquisition of Vacon is expected to grow by 5-10%.

Underlying profitability is expected to slightly improve through the continuous operational improvements and the targeted strategic initiatives already launched. However, integration cost in the first year of Vacon ownership is expected to keep operating profit (EBIT) excluding other income and expenses on par with 2014.

The expectations do not include the impact of potential divestments, discontinued activities or acquisition of companies/activities.

# Danfoss solutions make more out of less

**34%**
**lower $CO_2$ emissions**

## Making a small supermarket an international first-mover

In Denmark, SuperBrugsen supermarkets always make shoppers feel welcome. But in the town of Høruphav, Danfoss has engineered a very special kind of warmth. The supermarket has been equipped with an innovative $CO_2$ refrigeration system that keeps food fresh and cool while providing the entire store with a constant source of heating. The local supermarket used to use gas to heat water, particularly in the deli section and the bakery. However, the new $CO_2$ system has cut the annual gas bill by more than DKK 200,000, and reduced $CO_2$ emissions by 34%.

# Sustainability

Danfoss treasures sustainable results and aims to play an active role in sustainable global development. More than a decade ago, Danfoss became a signatory to the UN Global Compact Initiative. Danfoss continues to support the Global Compact as a governing principle in the Group's sustainability efforts. Danfoss prepares an annual sustainability report that also serves as the Communication on Progress report it submits to the UN. This report serves as Danfoss' report on corporate responsibility, as required under section 99a of the Danish Financial Statements Act. The report is available on Danfoss' website at www.danfoss.com/sustainability2014.

## Sustainability program

In 2014, Danfoss continued implementing the Group's sustainability program that combines existing and new initiatives. During the implementation period from 2014 to 2017, this program will guide the work on sustainability in four focus areas of: energy efficiency; environment, health and safety; ethical behavior and finally product compliance and transparency.

## Energy efficiency

The so-called 3x25 climate strategy commits Danfoss to cutting $CO_2$ emissions by 25% while increasing the share of renewable energy used by 25% (relative to the 2007 level) by the year 2025.

Danfoss has in 2014 committed to align with the Caring for Climate "Business Leadership Criteria on Carbon Pricing". The company furthermore supports the "Statement on Putting a Price on Carbon" initiated by The World Bank Group and the United Nations Global Compact to demonstrate strong global support and action towards pricing carbon.

In 2014, Danfoss emitted approximately 218,000 tons of $CO_2$ from electricity and heat consumption. This is 3.7% more than in 2013. The increase was attributable to an increased electricity consumption in the Chinese factories by 21% and an increased share of fossil fuels in the Danish electricity mix. The $CO_2$ emissions in the remaining parts of the Group fell as a result of energy saving activities.

At the 15 largest factories, Danfoss continued the efforts to reduce energy consumption and $CO_2$ emissions. The energy-saving projects focuses primarily on energy consumption in buildings, whereas the energy used for production processes and transportation will be added as focal points from 2015. Danfoss expects the projects to reduce the global energy consumption by 35,000 MWh. This will cut approximately 15,000 tons or 6% off the Group's $CO_2$ emissions.

The solar park established in 2014 at the headquarters in Nordborg produced more electricity than expected and ended up producing 2.2 million kWh $CO_2$ neutral energy. This corresponds to the consumption of 500 households and supplies the main administration building in Nordborg with all electricity needed for the 23,000 $m^2$ building.

In Chennai, India, a solar cell park has been constructed at Danfoss' new campus. The campus is among the first of the industries in India certified to LEED Platinum (Leadership in Energy and Environmental Design) which means that they live up to very specific requirements in terms of the water and electricity consumed in the buildings.

## Environment, health and safety

Taking care of both employees and the surrounding environment is deeply rooted in the Group. Therefore Danfoss has, for many years, worked systematically to reduce any negative effects of the production activities.

In 2014, Danfoss initiated a global safety program – Safety on the shop floor. The project enhances the focus on safety in all Danfoss factories around the world. From 2015, safety shoes and safety glasses will be mandatory for anyone entering the shop floor in any Danfoss factory worldwide. Hearing protection will also be mandatory for employees working at machines with a high noise-level and safe walkways will have to be identified for pedestrians in all factories.

This is a clear signal of Danfoss' continued dedication to common, aligned, and very high health and safety standards across the Group. For the coming years this work will continue.

**18%**
**female managers in 2014**

**1,100**
**tons lower $CO_2$ emissions due to new solar park in Nordborg**

Danfoss' total LTIF – Lost Time Injury Frequency was 4.4 in 2014, versus 4.7 in 2013. The LTIF – Lost Time Injury Frequency is the number of accidents that results in absence from work of one or more calendar days in addition to the day of the accident per one million hours worked.

The injured employees were absent for a total of 2,458 days, corresponding to an average absence of 15 days per accident. This is a 12% reduction from 2013.

The Lost Day Rate in 2014 was 66 (the number of days with absence from work due to Lost Time Injuries per one million working hours). This is a reduction from 82 in 2013.

The reductions are achieved through a dedicated focus on safety in the factories and the implementation of aligned safety rules across the segments.

**Ethical behavior**

In 2014, Danfoss updated the Danfoss Ethics Handbook, which sets out guidelines for responsible behavior which all employees and managers must observe.

The updated Ethics Handbook was also distributed to all employees in the Group's new segment Danfoss Power Solutions' in 2014. To accompany the Ethics Handbook, Danfoss Group Sustainability has developed a voluntary test to increase the understanding of business ethics.

In 2014, Danfoss strengthened the company's focus on compliance with internationally defined human rights through the development of assessment tools and pilot assessments in two Asian countries.

The assessments provided valuable information about the actual and potential human rights status in the assessed countries and will in 2015 be followed up by site visits and mitigation activities to ensure that Danfoss continuously limits the company's human rights risks. Danfoss continued in 2014 to focus on ethical behavior training for all people managers, and more than a thousand managers and other key employees have completed the Group's Competition Compliance Program. In 2015, Danfoss will launch a compliance program covering export control rules. All managers within Danfoss will also have to conduct a new, extensive ethics e-learning in 2015.

**Diversity**

Danfoss considers diversity among its employees to be an asset that brings value with it competitive advantages as well as added creativity and innovation. In particular, Danfoss emphasizes diversity in its recruitment policy. When recruiting a new employee, the objective is to identify at least three qualified candidates that together represent diversity in terms of culture, nationality, gender and age. If two or more candidates are equally qualified, Danfoss will aim towards diversity among its employees and in the workplace in the final selection process.

A dedicated initiative aims at raising the number of female managers throughout the Group. The Group's overall goal is to increase the percentage of female managers to 20% by 2015 from 18% in 2014, in order to ensure that the Group's managers increasingly reflect the diversity of the Danfoss workforce, of which 29% were women in 2014.

Danfoss aims for the composition of its top governing body to reflect the diversity of the rest of the Group. Women are underrepresented in the Group, and the Board of Directors has as yet no female members, other than an employee elected representative.

At its annual meeting in 2017, Danfoss will attempt to raise the number of women serving on the Board to at least one of the six members. In order to achieve that goal, the Board will, before recommending candidates for the Board, work to identify at least one candidate representing diversity. Should two candidates be equally qualified, the Board of Directors will recommend the candidate representing diversity for election by the shareholders.

# Corporate Governance

Corporate governance is a crucial aspect of the way Danfoss runs its business. Key concepts like responsibility, integrity and openness about the Group's activities form the basis for the high standards of corporate governance to which the Danfoss Group holds itself.

Legislation provides the general framework for the company's governance, but corporate governance is also about how the business is managed within this framework. The Group structure supports Danfoss' management values and determines a clear distribution of management responsibilities. This structure and these well-defined principles drive the interaction between the company's management, owners and other stakeholders. The company's Articles of Association and a comprehensive set of internal management and control procedures also form part of corporate governance at Danfoss.

**Management structure**

Danfoss has a two-tier management system consisting of its Board of Directors and the Executive Committee. The Board of Directors lays the general course for the company by approving strategies and targets. The Executive Management develops the strategy and handles the day-to-day management of the company and execution of the strategy.

**The Board of Directors**

The Danfoss Board consists of six members elected at the Annual General Meeting and three employee-elected members. Of the six members elected by the shareholders, four (Henrik Poulsen, Kasper Rørsted, William Ervin Hoover and Björn Rosengren) are independent.

The Board of Directors meets at least five times a year. In addition, the Board holds extraordinary meetings as and when required. The Board regularly assesses the aggregate competencies of its members to ensure that they are consistent with the company's requirements at all times.

**Audit Committee**

The duties and responsibilities of Danfoss' Audit Committee, as well as its powers, can either be organized in an independent committee or be executed by the entire Board. At Danfoss, the entire Board performs the function of the Audit Committee. The Committee's activities and tasks are set out in its rules of procedure, and it held four meetings in 2014.

**Internal audit function**

The company's internal audit function presents its conclusions directly to the Board's audit committee or its chairman. The internal audit function is intended to provide independent and objective auditing to ensure:

- The Group follows good administrative practice.
- The Group has comprehensive internal controls and business processes in place in all essential areas of activity.
- The Group's IT systems have adequately segregated functions.

**COMPOSITION OF THE BOARD OF DIRECTORS [1)]**

| | NATIONALITY | INDEPENDENT | AUDIT COMMITTEE |
|---|---|---|---|
| Jørgen Mads Clausen (Chairman) | DK | No | • |
| Henrik Poulsen (Vice-Chairman) | DK | Yes | • |
| Mads-Peter Clausen | DK | No | • |
| William Ervin Hoover | US | Yes | • |
| Kasper Rørsted | DK | Yes | • |
| Björn Rosengren | SE | Yes | • |
| Lars Grau [2)] | DK | - | • |
| Jens Peter Nielsen [2)] | DK | - | • |
| Sandra N. Bertelsen [2)] | DK | - | • |
| Bitten Clausen (Honorary Member) | DK | - | - |

[1)] From the Annual General Meeting held in April 2014 to the 2015 Annual General Meeting
[2)] Elected by the employees
• Chairman of the Audit Committee

**SHAREHOLDERS WITH MORE THAN 5% OF SHARE CAPITAL**

Bitten og Mads Clausens Fond,
Nordborg, Denmark
**46,33%** SHARES
**84,96%** VOTES

Clausen Controls A/S,
Sønderborg, Denmark
**25,59%** SHARES
**5,40%** VOTES

Henrik Mads Clausen, Lake Forrest, USA
**10,75%** SHARES
**2,26%** VOTES

Karin Clausen, Holte, Denmark
**7,06%** SHARES
**1,49%** VOTES

The internal audit function visited a number of Group companies in 2014. No matters of material importance to the Group's overall risk management and control environment were detected.

Danfoss filed in November 2014 a Euro Medium Term Program on the Irish Stock Exchange and is therefore as of that date considered a listed company. Danfoss has to comply with the rules applying to listed companies with listed bonds including the exceptions regarding issuers of bonds above EUR 100.000 as set out in section 107b of the Danish Financial Statements Act. For the complete account of Danfoss' corporate governance, please see the corporate website at www.danfoss.com/corporategovernance2014.

**Shareholders**

Danfoss' share capital amounts to DKK 1,023m and is divided into two share classes: A-shares accounting for DKK 425m and B-shares accounting for DKK 598m. A-shares entitle holders to ten votes for every DKK 100 nominal value of shares held. A-shareholders also have a pre-emption right to A-shares in the event of share capital increases. Apart from this, no shares carry special rights. The Bitten and Mads Clausen Foundation and the Clausen family hold all issued A-shares and a number of B-shares corresponding to 98,64% of the votes. At the end of 2014, Danfoss had approximately 3,000 registered shareholders. Approximately three in four shareholders were resident in Denmark.

**Share price development**

The Danfoss share price is set once a year, based on a valuation prepared by Danske Markets (a division of Danske Bank A/S) immediately before the Annual General Meeting held in April. The price was first set in 2001 when Danfoss issued its first employee shares. The 2001 price was DKK 749 per share. The share price is calculated on the basis of the financial performance of Danfoss, the Group's expectations for the upcoming year, its ability to meet expectations, the financial development of a number of comparable companies and their expectations for the future, as well as general developments in the stock market. In 2014, the price was set at DKK 4,116 per share. The new price will be announced at the 2015 Danfoss Annual General Meeting in April.

**Dividends and General Meeting**

The Annual General Meeting will be held in Nordborg on April 24, 2015. The Board of Directors will recommend to the General Meeting that a dividend of 21,8% of the Group's net profit be paid in 2014, corresponding to 48.9% per share.

# Board of Directors

| | COMPANIES WITH CONSIDERABLE BOARD ACTIVITIES | OTHER POSITIONS |
|---|---|---|
| **Jørgen M. Clausen**<br>Chairman (born 1948)<br>Member since 1985 | **Chairman of:** Danish Energy Industries Federation, The InnovationsFonden<br><br>**Board member of:** Bitten and Mads Clausen Foundation, Fonden for Universe Science Parken | Bachelor of Science Engineering, MBA<br>Professional experience managing a Danish-based international company and from other board memberships<br><br>**Decoration:**<br>Kammerherre title bestowed by H. M. The Queen of Denmark<br>Knight 1st Class of the Order of the Dannebrog, Denmark<br>Verdienstkreuz erster Klasse of the Federal Republic of Germany |
| **Henrik Poulsen**<br>CEO and President of Dong Energy<br>Deputy Chairman (born 1967)<br>Member since 2014 | **Board member of:** ISS A/S<br><br>**Member of Shareholders' Committee:** Danske Bank A/S | Master of Science in Finance & Accounting, Aarhus University<br>Bachelor of Science in International Business, Aarhus University<br>Professional experience in managing major companies in Denmark |
| **Mads-Peter Clausen**<br>Senior M&A Associate Danfoss A/S<br>Board member (born 1976)<br>Member since 2014 | **Board member of:** miniBOOSTER A/S | MBA, University of Georgia<br>Bachelor of Science in Engineering, University of Southern Denmark |
| **William Erwin Hoover Jr.**<br>Director (born 1949)<br>Member since 1993 | **Chairman of:** ReD Associates Holding A/S<br><br>**Vice-Chairman of:** GN Store Nord A/S (Great Nordic)<br><br>**Member of the board of:** Sanistål A/S, Neopost S/A and Lego Foundation | B.A., Dartmouth College<br>MBA, Havard University<br>Professional experience with supply chain, performance transformation, organization changes and mergers & acquisitions |
| **Kasper Rørsted**<br>CEO of Henkel AG & Co. KGaA (born 1959)<br>Member since 2010 | **Board member of:** Bertelsmann AG | Professional experience in managing major international companies in Switzerland, the UK and Germany |
| **Björn Rosengren**<br>CEO and President of Wärtsilä Corporation (born 1959)<br>Member since 2010 | **Board member of:** Outotec Oy | Master of Science in technology, Chalmers University of Technology<br>Head of a global company focusing on profitable growth, international and cultural experience from stays and jobs in China, North America, Switzerland, Netherlands, Finland and Sweden |
| **Lars Grau**<br>Employee-elected Board member<br>Shop steward at Danfoss Nordborg (born 1963)<br>Member since 2014 | | Cooperation courses and experience from other board memberships |
| **Sandra N. Bertelsen**<br>Employee-elected Board member<br>Senior Legal Advisor (born 1982)<br>Member since 2014 | | Master of Laws, Aarhus Universitet<br>Bachelor of Laws, Aarhus Universitet<br><br>Cooperation courses and experience from other board memberships |
| **Jens Peter Nielsen**<br>Employee-elected Board member<br>Senior Shop Steward at Danfoss Kolding (born 1957)<br>Member since 2006 | **Chairman of:** Group Club Danfoss Denmark and Danfoss Employee Foundation<br>**Board member of:** Metal Kolding and LO-Kolding | Cooperation courses and experience from other board memberships |
| **Bitten Clausen**<br>Honorary member | | |

# Executive Committee

**Niels B. Christiansen**
President and CEO of Danfoss A/S
(born 1966)
Member since 2004

COMPANIES WITH CONSIDERABLE BOARD ACTIVITIES
**Chairman of:** Board of Axcel A/S
**Board member of:** AP Moller-Maersk A/S, William Demant Holding A/S

**Kim Fausing**
Executive Vice President and COO of Danfoss A/S
(born 1964)
Member since 2008, (2,400 warrants)

COMPANIES WITH CONSIDERABLE BOARD ACTIVITIES
**Vice-Chairman of:** Velux A/S, SMA Solar Technology AG
**Board member of:** Hilti AG, Danish-German Chamber of Commerce

**Jesper V. Christensen**
Executive Vice President and CFO of Danfoss A/S
(born 1969)
Member since 2013

# Danfoss Leadership Team

| | |
|---|---|
| **Niels B. Christiansen** | President and CEO of Danfoss A/S (born 1966) |
| **Kim Fausing** | Executive Vice President and COO of Danfoss A/S (born 1964) |
| **Jesper V. Christensen** | Executive Vice President and CFO of Danfoss A/S (born 1969) |
| **Anne Wilkinson** | Senior Vice President, Corporate HR (born 1965) |
| **Mette Refshauge** | Senior Vice President, Corporate Communication (born 1973) |
| **Jürgen Fischer** | Segment President (born 1963) |
| **Lars Tveen** | Segment President (born 1963) |
| **Eric Alström** | Segment President (born 1966) |
| **Vesa Laisi** | Segment President (born 1957) |

# Risk management and compliance

This section briefly describes the Danfoss Risk Management and compliance activities, its governance and defined Group risks.

Danfoss takes a systematic and holistic approach to managing risk. Maintaining efficient risk management is a cornerstone at Danfoss as well as a prerequisite for running a business and responding rapidly and flexibly when conditions change.

**Governance**
As per Board Procedure, the Danfoss Board performs risk oversight and the Audit Committee assesses effectiveness of the Danfoss Risk Management.

Overall, the Executive Committee is responsible for risk management at Danfoss. It ensures that risk management policies and processes are effective at all relevant levels. Responsibility for the actual performance of risk management activities lies with the company's respective managers and corporate functions.

The structure for handling risk management at Danfoss includes:
- Internal Auditing, which performs independent internal reviews and submits the outcome directly to the Board's audit committee.
- The Risk & Compliance Committee, set up by the Executive Committee, approves methodologies and generic process design regarding risk management and takes position on critical Group Risks, and assesses effectiveness and adequacy of current risk management standards.
- Group Risk & Compliance, whose duties include responsibility for the content of the Group's risk management program, for preparing and implementing the Group's compliance programs and for the Group's whistle- blower function.
- Corporate Treasury, the central unit that manages the Group's financial risks, and provides insurance services.
- The day-to-day management is in charge of activities aimed at safeguarding assets and earnings, handling business risks, monitoring and interpreting legislation and standards, and managing IT security, patents and trademark rights, product quality, fire prevention, environmental and occupational health and safety standards, etc.

**Risk reporting and control**
Risks are reported on an ongoing basis between the various managerial levels, for example at quarterly business review meetings. In addition, the Risk & Compliance function annually prepares a report on the most significant risks which they submit to the Board of Directors and the Audit Committee. The Risk & Compliance Committee provides overall supervision of the risk management process and monitors selected corporate risks as well as potential new risks.

# RISK MANAGEMENT AND COMPLIANCE

**Risk profile**
While there is no single risk factor threatening the Group's survival, it is exposed, in its aggregate risk profile, to a number of external and internal risk factors.

Specific measurement criteria have been defined in order to provide the best basis for assessment of the Group's performance in relation to its specific risk exposure, along with the risks themselves also being assessed on a regular basis.

Important risk factors relate to the following conditions:
- Global market conditions and mega-trends, including a sustained stronger focus on energy- efficient and socially sustainable solutions
- Fair and equal access to markets
- Competition, especially from China and India
- Geopolitical conflicts
- Global economic growth
- Key markets, such as the US, Germany, China, Russia, Brazil and India
- The Danfoss Growth themes: Infrastructure, food, energy and climate
- Customer relations and reputation, including Danfoss' ability to build business on trust and integrity
- Competitive strength and innovation, including the ability to support customers in providing efficient solutions, attractive cost levels and high product quality
- Financial sustainability, including the Group's ability to fund new growth

**Compliance**
Danfoss wishes to maintain and continually improve its reputation as a company that conducts itself properly and responsibly. This means that Danfoss will do its utmost to live up to its legal and ethical responsibilities. As a global enterprise, Danfoss supports the growing international focus on regulation and legislation in areas such as anti-corruption, competition law, export control and good business ethics. Better regulation across the globe would help ensure a level playing field, which would be a huge advantage for a company like Danfoss. For this reason, Danfoss is strongly focused on compliance with current rules and legislation, and the Group has established internal programs and control mechanisms to minimize the risk of rule violations.

**Training and compliance follow-up**
Compliance efforts are based on an extensive program of prevention based on employee training and clear rules and guidelines. Follow-up procedures to verify the effectiveness of such rules form an integral part of internal controls and audits at Danfoss, as do spot checks conducted by the company's internal auditing function.

The Group has compliance programs in a number of areas (e.g. anti-corruption and ethical behaviors). A special focus in 2014 was the roll-out of the Competition law compliance manual in the organization. It was mandatory for employees who are in connection with business partner or industry organizations to attend respective training program (eLearning) and pass a test at the end of the course.

As part of the competition compliance program, a dawn-raid manual has also been released and implemented. Furthermore, as part of the Export Control program, processes regarding product screening which deals with identification of possible dual-use products within the portfolio of Danfoss have been established.

**Compliance hotlines**
In addition to the compliance programs, Danfoss has also a query function AskUs, where the Group's employees can find answers to any questions and doubts they may have regarding ethics and compliance. The purpose of AskUs is to minimize uncertainty among the Group's employees and prevent unintended non-compliance. In 2014, AskUs received 75 enquiries from employees seeking guidance on how best to follow ethical guidelines or compliance requirements in a specific situation. Danfoss also has a whistle-blower function, the Ethics Hotline where employees can report suspected breaches of internal guidelines and legislation anonymously and without involving a manager. A total of 123 cases were reported to the Ethics Hotline in 2014. Disciplinary action has been taken in all substantiated cases: none of these cases have had significant consequences for Danfoss.

# Risk overview

Like its industry peers, Danfoss is exposed to a number of general and basic risks. These are risks relating to customers and markets, factories and suppliers in the supply chain, law and regulatory regimes, and internal processes and systems. Danfoss' exposure to such risks is similar to the general risk exposure of its peers.

The Executive Committee has defined three specific risk areas of the risk management process that, due to their special nature, are of particular importance to Danfoss. The three areas are described in the table below. This overview does not include financial risk, which is described in Note 16 to the financial statements on financial risk and instruments.

## ETHICAL CONDUCT

The ethical behavior of companies and their employees is increasingly becoming a focus of attention, with stricter laws and possible sanctions being introduced worldwide in areas such as anti-corruption, data protection law and competition law.

Unethical or outright illegal conduct by Danfoss employees could cause considerable damage to Danfoss' reputation and result in substantial financial sanctions.

**RISK MITIGATION MEASURES**

Danfoss has implemented ethical guidelines and compliance programs. Compliance is verified through follow-up procedures that include internal inspections and other measures. In addition, Danfoss has an "AskUs" enquiry function, from which employees can seek advice and guidance on ethical conduct. Danfoss also operates an Ethics Hotline which employees can use to anonymously report suspected violations of the law or internal guidelines.

## GEOPOLITICAL AND ECONOMIC RISKS IN RUSSIA

Danfoss provides heating solutions for both public- and private-sector customers in Russia. Demand is closely correlated with the condition of and changes in the Russian economy and the ongoing progress of urban renovation projects in the country. Danfoss also sells a number of different products to Russian industry, which also to a great extent relies on raw materials extraction and processing.

The Russian market has in recent months undergone significant changes. The Ukraine conflict and following stricter export control regulations but also the decrease of the world market prices for energy and commodities have a significant impact on Russia's economy and the value of the Russian Ruble. It is likely that the expected GDP decline and currency devaluation in Russia to some extent will affect Danfoss' performance in the region in 2015.

**RISK MITIGATION MEASURES**

Danfoss considers Russia a significant market with a great deal of potential that management at both Group and business segment level monitors closely and systematically: an ongoing process of monitoring general economic trends in the country, changes in national and local legislation and the content of Danfoss' internal reporting. To maintain market share and profitability Danfoss applies the Group's commercial tools and ensures superior commercial execution. At Group level, the risks in Russia are balanced by Danfoss' presence in other growth markets. Furthermore, Danfoss is investigating opportunities for natural hedging by increasing purchases from Russian suppliers and local manufacturing.

## FOOD PRICE TRENDS

Rising and falling food prices have an impact on the financial position of the agricultural sector and thus on its ability to invest in renovation and new equipment. For example, because Danfoss develops and manufactures solutions for this sector, any fluctuations in its financial situation will have a direct effect on the business.

**RISK MITIGATION MEASURES**

Danfoss aims to balance this cyclical exposure partly by cultivating new markets in several different regions, other segments and other sectors and by having an adaptable and flexible supply chain. The risk will also be balanced by offering customers solutions that can directly improve efficiency or otherwise reduce their operating costs.

# Management statement

The Board of Directors and Executive Committee have today discussed and approved the Danfoss A/S Annual Report for the financial year January 1-December 31, 2014.

The Annual Report has been presented in accordance with the International Financial Reporting Standards and additional Danish disclosure requirements in the Danish Financial Statements Act.

In our opinion, the consolidated financial statements and the parent company financial statements give a true and fair view of the Group's and the Parent Company's assets, liabilities and financial position at December 31, 2014, and of the results of the Group's and the Parent Company's operations and cash flows of the financial year January 1-December 31, 2014.

We also consider the Management's review to give a true and fair view in the development of the Group's and Parent Company's operations and financial matters, of the results for the year and the overall financial position of the Parent Company related to the companies included in the Group accounts and describes the significant risks and uncertainties of the group's and the Parent Company.

We recommend that the Annual General Meeting approves the Annual Report.

**NORDBORG, MARCH 24, 2015**

EXECUTIVE COMMITTEE

Niels B. Christiansen

Jesper V. Christensen

Kim Fausing

BOARD OF DIRECTORS

Jørgen M. Clausen
Chairman

Sandra N. Bertelsen

Mads-Peter Clausen

Lars Grau

William Erwin Hoover

Jens Peter Nielsen

Henrik Poulsen

Björn Rosengren

Kasper Rørsted

# Independent auditor's report

To the Shareholders of Danfoss A/S

## Report on Consolidated Financial Statements and Parent Company Financial Statements

We have audited the Consolidated Financial Statements and the Parent Company Financial Statements of Danfoss A/S for the financial year 1 January to 31 December 2014, which comprise income statement, statement of comprehensive income, statement of financial position, statement of changes in equity, statement of cash flows and notes, including summary of significant accounting policies, for the Group as well as for the Parent Company. The Consolidated Financial Statements and the Parent Company Financial Statements are prepared in accordance with International Financial Reporting Standards as adopted by the EU and Danish disclosure requirements for listed companies.

### Management's Responsibility for the Consolidated Financial Statements and the Parent Company Financial Statements

Management is responsible for the preparation of Consolidated Financial Statements and Parent Company Financial Statements that give a true and fair view in accordance with International Financial Reporting Standards as adopted by the EU and Danish disclosure requirements for listed companies, and for such internal control as Management determines is necessary to enable the preparation of Consolidated Financial Statements and Parent Company 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 the Consolidated Financial Statements and the Parent Company Financial Statements based on our audit. We conducted our audit in accordance with International Standards on Auditing and additional requirements under Danish audit regulation. This requires that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the Consolidated Financial Statements and the Parent Company Financial Statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Consolidated Financial Statements and the Parent Company Financial Statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the Consolidated Financial Statements and the Parent Company Financial Statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the Company's preparation of Consolidated Financial Statements and Parent Company Financial Statements that give a true and fair view 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 Company'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 Consolidated Financial Statements and the Parent Company Financial Statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

The audit has not resulted in any qualification.

### Opinion

In our opinion, the Consolidated Financial Statements and the Parent Company Financial Statements give a true and fair view of the Group's and the Parent Company's financial position at 31 December 2014 and of the results of the Group's and the Parent Company's operations and cash flows for the financial year 1 January to 31 December 2014 in accordance with International Financial Reporting Standards as adopted by the EU and Danish disclosure requirements for listed companies.

## Statement on the Management's Review

We have read Management's Review in accordance with the Danish Financial Statements Act. We have not performed any procedures additional to the audit of the Consolidated Financial Statements and the Parent Company Financial Statements. On this basis, in our opinion, the information provided in Management's Review is consistent with the Consolidated Financial Statements and the Parent Company Financial Statements.

Nordborg, 24 March 2015
PricewaterhouseCoopers
Statsautoriseret Revisionspartnerselskab

| | |
|---|---|
| Mogens Nørgaard Mogensen | Claus Lindholm Jacobsen |
| State Authorised Public Accountant | State Authorised Public Accountant |

# Group
# Accounts and notes

# INCOME STATEMENT

January 1 to December 31

| DKKm | Note | 2013 | 2014 |
|---|---|---|---|
| Net sales | 1 | 33,628 | 34,375 |
| Cost of sales | 2 | -21,766 | -22,209 |
| **GROSS PROFIT** | | **11,862** | **12,166** |
| | | | |
| Research and development costs | 2 | -1,359 | -1,324 |
| Selling and distribution costs | 2 | -5,063 | -4,943 |
| Administrative expenses | 2 | -1,570 | -1,543 |
| **OPERATING PROFIT EXCLUDING OTHER OPERATING INCOME AND EXPENSES** | | **3,870** | **4,356** |
| | | | |
| Other operating income and expenses | 2 | -254 | -244 |
| Share of profit from associates and joint ventures after tax | 3 | 8 | -187 |
| **OPERATING PROFIT (EBIT)** | 1 | **3,624** | **3,925** |
| | | | |
| Financial income | 4 | 33 | 37 |
| Financial expenses | 5 | -402 | -486 |
| **PROFIT BEFORE TAX** | 1 | **3,255** | **3,476** |
| | | | |
| Tax on profit | 6 | -970 | -1,186 |
| **NET PROFIT** | | **2,285** | **2,290** |
| | | | |
| Attributable to: | | | |
| Shareholders in Danfoss A/S | | 2,037 | 2,104 |
| Minority interests | | 248 | 186 |
| | | **2,285** | **2,290** |

# STATEMENT OF COMPREHENSIVE INCOME

January 1 to December 31

| DKKm | Note | 2013 | 2014 |
|---|---|---|---|
| **NET PROFIT** | | **2,285** | **2,290** |
| | | | |
| **OTHER COMPREHENSIVE INCOME** | | | |
| Actuarial gain/loss (-) on pension and healthcare plans | 15 | 207 | -283 |
| Tax on actuarial gain/loss on pension and healthcare plans | 14 | -80 | 96 |
| Items that cannot be reclassified to profit or loss | | **127** | **-187** |
| | | | |
| Foreign exchange adjustments on translation of foreign currency into DKK etc | | -550 | 783 |
| Fair value adjustment of hedging instruments: | | | |
| Hedging of net investments in subsidiaries | | 149 | -21 |
| Hedging of future cash flows | | 25 | -134 |
| Hedging transferred to net sales in the income statement | | 53 | -25 |
| Tax on hedging instruments | | -57 | 42 |
| Items that can be reclassified to profit or loss | | **-380** | **645** |
| | | | |
| **OTHER COMPREHENSIVE INCOME AFTER TAX** | | **-253** | **458** |
| | | | |
| **TOTAL COMPREHENSIVE INCOME** | | **2,032** | **2,748** |
| | | | |
| Attributable to: | | | |
| Shareholders of Danfoss A/S | | 1,866 | 2,503 |
| Minority interests | | 166 | 245 |
| | | **2,032** | **2,748** |

# STATEMENT OF FINANCIAL POSITION

As of December 31

| DKKm<br>ASSETS | Note | 2013 | 2014 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| **INTANGIBLE ASSETS** | 7 | **8,054** | **15,732** |
| **PROPERTY, PLANT AND EQUIPMENT** | 8 | **6,506** | **6,558** |
| Investments | 3 | 83 | 2,249 |
| Pension benefit plan assets | 15 | 42 | 84 |
| Non-current receivables | | 27 | 39 |
| Deferred tax assets | 14 | 1,340 | 1,160 |
| **OTHER NON-CURRENT ASSETS** | | **1,492** | **3,532** |
| **TOTAL NON-CURRENT ASSETS** | | **16,052** | **25,822** |
| **CURRENT ASSETS** | | | |
| **INVENTORIES** | 9 | **3,849** | **4,085** |
| Trade receivables | 10 | 4,428 | 5,167 |
| Receivable corporation tax | 17 | 266 | 441 |
| Derivative financial instruments (positive fair value) | 16 | 57 | 14 |
| Other receivables | | 727 | 638 |
| **RECEIVABLES** | | **5,478** | **6,260** |
| **CASH AND CASH EQUIVALENTS** | 16 | **737** | **716** |
| **TOTAL CURRENT ASSETS** | | **10,064** | **11,061** |
| **TOTAL ASSETS** | | **26,116** | **36,883** |

# STATEMENT OF FINANCIAL POSITION

As of December 31

| DKKm<br>**LIABILITIES AND SHAREHOLDERS' EQUITY** | Note | 2013 | 2014 |
|---|---|---|---|
| **SHAREHOLDERS' EQUITY** | | | |
| Equity, shareholders in Danfoss A/S | 11 | 10,587 | 12,284 |
| Minority interests | | 856 | 958 |
| **TOTAL SHAREHOLDERS' EQUITY** | | **11,443** | **13,242** |
| **LIABILITIES** | | | |
| Provisions | 12 | 486 | 396 |
| Deferred tax liabilities | 14 | 1,722 | 1,964 |
| Pension and healthcare benefit plan obligations | 15 | 930 | 1,279 |
| Borrowings | 16 | 3,093 | 11,063 |
| Derivative financial instruments (negative fair value) | 16 | 16 | 37 |
| Other non-current debt | | 225 | 250 |
| **NON-CURRENT LIABILITIES** | | **6,472** | **14,989** |
| Provisions | 12 | 426 | 619 |
| Liabilities under share incentive programs | 13 | 99 | 81 |
| Borrowings | 16 | 1,806 | 1,109 |
| Trade payables | | 3,023 | 3,572 |
| Debt to associates and joint ventures | | 10 | 12 |
| Corporation tax | 17 | 243 | 295 |
| Derivative financial instruments (negative fair value) | 16 | 5 | 106 |
| Other debt | | 2,589 | 2,858 |
| **CURRENT LIABILITIES** | | **8,201** | **8,652** |
| **TOTAL LIABILITIES** | | **14,673** | **23,641** |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | | **26,116** | **36,883** |

# STATEMENT OF CASH FLOWS

January 1 to December 31

| DKKm | Note | 2013 | 2014 |
|---|---|---|---|
| Profit before tax | | 3,255 | 3,476 |
| Adjustments for non-cash transactions | 18 | 2,287 | 1,982 |
| Change in working capital | 19 | 296 | 196 |
| **CASH FLOW GENERATED FROM OPERATIONS** | | **5,838** | **5,654** |
| Interest received | | 29 | 15 |
| Interest paid | | -259 | -218 |
| Dividends received | | 7 | 7 |
| **CASH FLOW FROM OPERATIONS BEFORE TAX** | | **5,615** | **5,458** |
| Paid tax | 17 | -1,171 | -1,107 |
| **CASH FLOW FROM OPERATING ACTIVITIES** | | **4,444** | **4,351** |
| | | | |
| Acquisition of intangible assets | | -91 | -99 |
| Acquisition of property, plant and equipment | | -1,118 | -1,134 |
| Proceeds from sale of property, plant and equipment | | 205 | 237 |
| Acquisition of subsidiaries etc. | 20 | | -7,376 |
| Proceeds from disposal of subsidiaries etc. | 20 | | -1 |
| Acquisition (-)/sale of other investments etc. | 21 | 87 | -2,203 |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | **-917** | **-10,576** |
| | | | |
| **FREE CASH FLOW** | | **3,527** | **-6,225** |
| | | | |
| Cash repayment of (-)/cash proceeds from interest-bearing debt | | 1,179 | 7,150 |
| Repurchase of treasury shares | | -116 | -14 |
| Addition/disposal of minority interests | | -4,092 | 5 |
| Dividends paid to shareholders in the Parent Company | | -396 | -789 |
| Dividends paid to minority shareholders | | -198 | -158 |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | **-3,623** | **6,194** |
| | | | |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | | **-96** | **-31** |
| | | | |
| Cash and cash equivalents as of January 1 | | 888 | 737 |
| Foreign exchange adjustment of cash and cash equivalents | | -55 | 10 |
| **CASH AND CASH EQUIVALENTS AS OF DECEMBER 31** | | **737** | **716** |

**STATEMENT OF FREE CASH FLOW ADJ. FOR ACQUISITION AND DISPOSAL OF SUBSIDIARIES ETC. (M&A)**

| | Note | 2013 | 2014 |
|---|---|---|---|
| Free cash flow | | 3,527 | -6,225 |
| Acquisition of subsidiaries etc. | 20 | | 7,376 |
| Proceeds from disposal of subsidiaries etc. | 20 | | 1 |
| Acquisition (-)/sale of other investments | 21 | -14 | 2,237 |
| **FREE CASH FLOW BEFORE M&A** | | **3,513** | **3,389** |

The cash flow statement cannot be derived on the basis of the Annual Report alone.

# STATEMENT OF CHANGES IN EQUITY

DKKm

| | SHARE CAPITAL | SHARE PREMIUM | Hedging reserves | Currency translation | Reserve own shares | Other reserves | RESERVES | PROPOSED DIVIDENDS | EQUITY, SHAREHOLDERS IN DANFOSS A/S | MINORITY INTEREST | TOTAL EQUITY |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **BALANCE AS OF JANUARY 1, 2013** | **1,020** | **370** | -41 | -257 | -275 | 10,638 | **10,065** | **400** | **11,855** | **2,338** | **14,193** |
| **COMPREHENSIVE INCOME IN 2013** | | | | | | | | | | | |
| Net profit | | | | | | 1,237 | **1,237** | **800** | **2,037** | **248** | **2,285** |
| **Other comprehensive income** | | | | | | | | | | | |
| Foreign exchange adjustments on translation of foreign currencies | | | | -472 | | | **-472** | | **-472** | **-78** | **-550** |
| Fair value adjustment of hedging instruments | | | 80 | 149 | | | **229** | | **229** | **-2** | **227** |
| Actuarial gain/loss (-) on pension and healthcare plans | | | | | | 209 | **209** | | **209** | **-2** | **207** |
| Tax on other comprehensive income | | | -20 | -37 | | -80 | **-137** | | **-137** | | **-137** |
| Total other comprehensive income | | | 60 | -360 | | 129 | **-171** | | **-171** | **-82** | **-253** |
| Total comprehensive income for the period | | | 60 | -360 | | 1,366 | **1,066** | **800** | **1,866** | **166** | **2,032** |
| **TRANSACTIONS WITH OWNERS** | | | | | | | | | | | |
| Dividends to shareholders | | | | | | 4 | **4** | **-400** | **-396** | **-179** | **-575** |
| Purchase of minority interest | | | | | | -2,623 | **-2,623** | | **-2,623** | **-1,469** | **-4,092** |
| Capital increase/purchase of treasury shares | **2** | **39** | | | -156 | | **-156** | | **-115** | | **-115** |
| Total transactions with owners | **2** | **39** | | | -156 | -2,619 | **-2,775** | **-400** | **-3,134** | **-1,648** | **-4,782** |
| **BALANCE AS OF DECEMBER 31, 2013** | **1,022** | **409** | 19 | -617 | -431 | 9,385 | **8,356** | **800** | **10,587** | **856** | **11,443** |
| **COMPREHENSIVE INCOME IN 2014** | | | | | | | | | | | |
| Net profit | | | | | | 1,604 | **1,604** | **500** | **2,104** | **186** | **2,290** |
| **Other comprehensive income** | | | | | | | | | | | |
| Foreign exchange adjustments on translation of foreign currencies | | | | 724 | | | **724** | | **724** | **59** | **783** |
| Fair value adjustment of hedging instruments | | | -159 | -21 | | | **-180** | | **-180** | | **-180** |
| Actuarial gain/loss (-) on pension and healthcare plans | | | | | | -283 | **-283** | | **-283** | | **-283** |
| Tax on other comprehensive income | | | 37 | 5 | | 96 | **138** | | **138** | | **138** |
| Total other comprehensive income | | | -122 | 708 | | -187 | **399** | | **399** | **59** | **458** |
| Total comprehensive income for the period | | | -122 | 708 | | 1,417 | **2,003** | **500** | **2,503** | **245** | **2,748** |
| **TRANSACTIONS WITH OWNERS** | | | | | | | | | | | |
| Dividends to shareholders | | | | | | 11 | **11** | **-800** | **-789** | **-158** | **-947** |
| Purchase of minority interest | | | | | | -2 | **-2** | | **-2** | **-1** | **-3** |
| Capital increase/purchase of treasury shares | **1** | **54** | | | -70 | | **-70** | | **-15** | **16** | **1** |
| Total transactions with owners | **1** | **54** | | | -70 | 9 | **-61** | **-800** | **-806** | **-143** | **-949** |
| **BALANCE AS OF DECEMBER 31, 2014** | **1,023** | **463** | -103 | 91 | -501 | 10,811 | **10,298** | **500** | **12,284** | **958** | **13,242** |

# Notes

# **Note 1** SEGMENT REPORTING

DKKm

| MAIN BUSINESS SEGMENTS | 2013 Danfoss Climate & Energy | 2013 Danfoss Power Solutions | 2013 Other areas | 2013 GROUP | 2014 Danfoss Climate & Energy | 2014 Danfoss Power Solutions | 2014 Other areas | 2014 GROUP |
|---|---|---|---|---|---|---|---|---|
| **INCOME STATEMENT** | | | | | | | | |
| Net sales | 22,330 | 10,989 | 309 | 33,628 | 22,669 | 11,406 | 300 | 34,375 |
| internal net sales | 24 | 25 | -49 | | 29 | | -29 | |
| Net sales, external | 22,306 | 10,964 | 358 | 33,628 | 22,640 | 11,406 | 329 | 34,375 |
| Depreciation/amortization | 855 | 772 | 44 | 1,671 | 880 | 744 | 41 | 1,665 |
| Net gain/loss (-) upon disposal of activities | | -1 | -3 | -4 | | | -3 | -3 |
| Impairment losses on tangible fixed assets | 5 | | 4 | 9 | 4 | 12 | 61 | 77 |
| Reversal of impairment losses on tangible fixed assets | 2 | | | 2 | 2 | | 3 | 5 |
| Share of profit from associates and joint ventures after tax | 7 | | 1 | 8 | -187 | | | -187 |
| Operating profit (EBIT) | 2,561 | 1,593 | -530 | 3,624 | 2,878 | 1,703 | -656 | 3,925 |
| Financial income | | | 33 | 33 | | | 37 | 37 |
| Financial expenses | | | -402 | -402 | | | -486 | -486 |
| Profit before tax | 2,561 | 1,593 | -899 | 3,255 | 2,878 | 1,703 | -1,105 | 3,476 |
| **BALANCE SHEET** | | | | | | | | |
| Total assets *) | 14,336 | 8,821 | 2,959 | 26,116 | 25,249 | 8,838 | 2,796 | 36,883 |
| Net investments excluding M&A | 695 | 377 | -61 | 1,011 | 658 | 347 | -49 | 956 |
| Impairment losses | 9 | | | 9 | 4 | 12 | 61 | 77 |
| Investment in associates and joint ventures | 39 | | 12 | 51 | 2,361 | | | 2,361 |
| Total liabilities *) | 4,338 | 2,432 | 7,903 | 14,669 | 5,498 | 2,651 | 15,492 | 23,641 |
| **OTHER INFORMATION** | | | | | | | | |
| Number of employees | 13,657 | 6,320 | 2,486 | 22,463 | 14,891 | 6,111 | 3,115 | 24,117 |

*) Cash and cash equivalents, interest-bearing debt and deferred tax liabilities/assets have been recorded in the column "Other areas".

The two segments, "Danfoss Climate & Energy" and "Danfoss Power Solutions" are further described in separate sections in the Financial review.

# **Note 1** SEGMENT REPORTING (continued)

DKKm

**PRODUCTS AND SERVICES**

| | 2013 | 2014 |
|---|---|---|
| Heating, Ventilation and Air Conditioning (HVAC) | 22,102 | 22,402 |
| Hydraulics | 11,222 | 11,651 |
| Other | 304 | 322 |
| | 33,628 | 34,375 |

**GEOGRAPHICAL SEGMENTS**

| 2013 | Denmark | Other EU | Other Europe | Asia | North America | Africa | Pacific | Latin America | Middle East | **Total** |
|---|---|---|---|---|---|---|---|---|---|---|
| Net sales | 1,288 | 12,028 | 3,911 | 5,890 | 7,666 | 230 | 538 | 1,685 | 392 | 33,628 |
| Total non-current assets *) | 4,296 | 4,020 | 207 | 1,362 | 4,768 | | 11 | 48 | | 14,712 |

| 2014 | Denmark | Other EU | Other Europe | Asia | North America | Africa | Pacific | Latin America | Middle East | **Total** |
|---|---|---|---|---|---|---|---|---|---|---|
| Net sales | 1,276 | 12,331 | 3,689 | 6,139 | 8,313 | 264 | 491 | 1,464 | 408 | 34,375 |
| Total non-current assets *) | 3,973 | 13,393 | 142 | 1,713 | 5,395 | | 2 | 44 | | 24,662 |

*) Deferred tax assets are not included.

The geographical distribution of "Net sales" is based on the external customers' country of residence.
The distribution of "Total non-current assets" is based on the actual geographical location of the assets.

# Note 1 SEGMENT REPORTING (continued)

DKKm

**SPECIFICATION OF OTHER AREAS - EXTERNAL NET SALES**

| | 2013 | 2014 |
|---|---|---|
| Non-reportable segments | 358 | 329 |
| Total net sales | 358 | 329 |

**SPECIFICATION OF OTHER AREAS - PROFIT BEFORE TAX**

| | 2013 | 2014 |
|---|---|---|
| Financial income | 33 | 37 |
| Financial expenses | -402 | -486 |
| Non-reportable segments | -88 | -87 |
| Central functions, not allocated*) | -435 | -508 |
| Other | -7 | -61 |
| Profit before tax | -899 | -1,105 |

**SPECIFICATION OF OTHER AREAS - ASSETS**

| | 2013 | 2014 |
|---|---|---|
| Non-reportable segments | 164 | 117 |
| Central functions not allocated *) | 2,796 | 2,680 |
| Other | -1 | -1 |
| Total assets | 2,959 | 2,796 |

**SPECIFICATION OF OTHER AREAS - LIABILITIES**

| | 2013 | 2014 |
|---|---|---|
| Non-reportable segments | 313 | 54 |
| Central functions not allocated *) | 2,689 | 3,264 |
| Interest bearing debt | 4,899 | 12,172 |
| Other | 2 | 2 |
| Total Liabilities | 7,903 | 15,492 |

*) Central functions, not allocated, are primarily administrative expenses and central functions' assets and liabilities, deferred tax as well as cash and cash equivalents.

# Note 2 EXPENSES AND OTHER OPERATING INCOME

DKKm

**A. PERSONNEL EXPENSES**

| | 2013 | 2014 |
|---|---|---|
| Salaries and wages | 7,841 | 7,821 |
| Severance payments | 185 | 180 |
| Share-based remuneration *) | 3 | |
| Social security | 696 | 646 |
| Defined contribution plans | 454 | 496 |
| Defined benefit plans excluding gains from reductions and redemptions **) | 36 | 30 |
| Gains from reductions and redemptions | | -3 |
| | 9,215 | 9,170 |
| | | |
| Average number of employees | 23,030 | 22,494 |
| Total number of employees as of end of the year | 22,463 | 24,117 |

*) Benefits cf. further information in Note 13. Share incentive programs.
**) Expenses for defined benefit plans are described in Note 15. Pension and healthcare obligations.

| | 2013 | 2014 |
|---|---|---|
| Board of Directors: | | |
| Directors' fees | 6 | 6 |
| | 6 | 6 |
| Executive Committee: | | |
| Salaries | 21 | 23 |
| Pension costs re. defined contribution plans | 7 | 8 |
| Bonuses | 53 | 52 |
| | 81 | 83 |
| Danfoss Leadership Team excluding Executive Committee: | | |
| Salaries | 22 | 17 |
| Pension costs re. defined contribution plans | 3 | 2 |
| Bonuses | 24 | 21 |
| | 49 | 40 |
| Total compensation | 136 | 129 |

Bonuses of total DKK 73m (2013: 77m) can be divided into long-term and short-term bonuses with DKK 31m and DKK 42m respectively (2013: 28m and 49m respectively).

# **Note 2** EXPENSES AND OTHER OPERATING INCOME (continued)

DKKm

**B. DEPRECIATION/AMORTIZATION AND IMPAIRMENT LOSSES**

| | 2013 | 2014 |
|---|---|---|
| Classification by nature: | | |
| Amortization of intangible assets | 478 | 511 |
| Impairment on intangible assets | 2 | |
| | 480 | 511 |
| Depreciation of property, plant and equipment | 1,193 | 1,155 |
| Impairment on property, plant and equipment | 7 | 77 |
| Reversal of impairment losses on property, plant and equipment | | -5 |
| | 1,200 | 1,227 |
| Depreciation/amortization and impairment losses | 1,680 | 1,738 |
| Classification of intangible assets by functions: | | |
| Cost of sales | 305 | 323 |
| Selling and distribution costs | 145 | 145 |
| Administrative expenses | 28 | 43 |
| Other operating expenses | 2 | |
| | 480 | 511 |

**C. OTHER OPERATING INCOME AND EXPENSES**

| | 2013 | 2014 |
|---|---|---|
| Gain on disposal of intangible assets | | 30 |
| Gain on disposal of property, plant and equipment | 45 | 106 |
| Reversal of impairment losses on property, plant and equipment | | 5 |
| Other | 82 | 50 |
| Other operating income | 127 | 191 |
| Loss on disposal of activities | -3 | -3 |
| Loss on disposal of property, plant and equipment | -34 | -34 |
| Impairment | -9 | -77 |
| Restructuring costs | -186 | -185 |
| Other | -149 | -136 |
| Other operating expenses | -381 | -435 |
| Other operating income and expenses | -254 | -244 |

Impairment for the year is based on expected value in use or fair value.
Restructuring cost in 2014 mainly relates to terminations in France, Denmark, Germany, China and the USA.
Impairment loss in 2014 relates to buildings. Other includes DKK 52m costs related to acquisitions of Vacon and SMA Solar Technology AG.
Restructuring cost in 2013, mainly related to terminations in France, Denmark, Germany, China and the USA.
In 2013, the item Other included DKK 110m in one-off costs relating to acquisition of outstanding shares in Sauer-Danfoss Inc.

**D. FEES TO AUDITORS APPOINTED AT THE ANNUAL GENERAL MEETING**

| | 2013 | 2014 |
|---|---|---|
| Audit fee | 21 | 18 |
| Tax and VAT advice | 6 | 9 |
| Other fees | 4 | 5 |
| Total fee to Group Auditor | 31 | 32 |

# Note 3 INVESTMENTS

DKKm

| | 2013 | | | 2014 | | |
|---|---|---|---|---|---|---|
| | Investments in associates and joint ventures | Other investments | TOTAL | Investments in associates and joint ventures | Other investments | TOTAL |
| Costs as of January 1 | 153 | 134 | 287 | 91 | 135 | 226 |
| Foreign exchange adjustments etc. | -1 | -1 | -2 | -3 | | -3 |
| Additions | | 2 | 2 | 2,364 | | 2,364 |
| Addition through aquisition of subsidiaries | | | | | 5 | 5 |
| Disposals | -61 | | -61 | -22 | | -22 |
| Costs as of December 31 | 91 | 135 | 226 | 2,430 | 140 | 2,570 |
| | | | | | | |
| Adjustments as of January 1 | -73 | -106 | -179 | -40 | -103 | -143 |
| Foreign exchange adjustments etc. | | 1 | 1 | 4 | | 4 |
| Net profit/value adjustment | 9 | 2 | 11 | -187 | -4 | -191 |
| Dividends | -7 | | -7 | -7 | | -7 |
| Disposal | 31 | | 31 | 16 | | 16 |
| Adjustments as of December 31 | -40 | -103 | -143 | -214 | -107 | -321 |
| | | | | | | |
| Carrying amount as of December 31 | 51 | 32 | 83 | 2,216 | 33 | 2,249 |

Where possible, "Other investments" are recognized at fair value. Alternatively, they are recognized at cost less accumulated impairment losses.

Where indicators for impairment were present at the end of 2014, impairment tests were performed on the carrying amount of "Investments in associates and joint ventures". Main indicators are loss giving activities, or if the carrying amount is higher than the equity in the local accounts or, where relevant, higher than valuation using a listed share price. When performing the impairment test, the present value of cash flow from associates and joint ventures is compared with their carrying amount. The principles are unchanged compared to the impairment tests performed in 2013.
Additions for the year to "Investments in associates and joint ventures" mainly relate to the acquisition of SMA Solar Technology AG.
Disposal of "Investments in associates and joint ventures" relates to the sale of Promeos GmBH and Flexucell ApS.

Disposal for the year 2013 of "Investments in associates and joint ventures" relates to the sale of Danfoss Sanhua Micro Channel Heat Exchanger Co Ltd.

Further information on associates and joint ventures is provided in the notes Note 4. Financial income, Note 5. Financial expenses, Note 16. Financial risks and instruments and Note 23. Related parties.

# Note 3 INVESTMENTS (continued)

DKKm

**MATERIAL ASSOCIATES AND JOINT VENTURES**

Summarized information for associates and joint ventures that are material to Danfoss has been amended to reflect adjustments made for differences in accounting policy. The financial information is stated below at their full values, not Danfoss' proportionate ownership interests. Due to that SMA Solar Technology AG is a listed company, the stated financial information below is based on public information available.

| | 2014 |
|---|---|
| | SMA Solar Technology AG |
| Place of Business | Germany |
| Share of ownership | 20% |
| **SUMMARIZED PROFIT AND LOSS STATEMENT (OFFICIAL GUIDANCE)** | |
| Revenue | 5,778 |
| EBIT before restructuring charges | -857 |
| **SUMMARIZED BALANCE SHEET (Q3 2014 NUMBERS)** | |
| Non-current assets | 4,366 |
| Current assets | 4,810 |
| Non-current liabilities | 2,180 |
| Current liabilities | 1,973 |
| Equity | 5,023 |
| Group share of equity as of December 31 | 805 |

On the basis of the stock exchange quotation, the fair value of SMA Solar Technology AG as of December 31, 2014 was DKK 4.0b.

**IMMATERIAL ASSOCIATES AND JOINT VENTURES**

In addition to the interests in associates and joint ventures disclosed above, Danfoss also has interests in a number of individually immaterial associates and joint ventures.

| | 2013 | | | 2014 | | |
|---|---|---|---|---|---|---|
| Danfoss' proportionate share of: | Associates | Joint Ventures | TOTAL | Associates | Joint Ventures | TOTAL |
| Profit or loss from continuing operations | | 8 | 8 | -1 | 9 | 8 |
| Other comprehensive income | | | | | -1 | -1 |
| Total comprehensive income | | 8 | 8 | -1 | 8 | 7 |
| Carrying amount as of December 31 | 1 | 50 | 51 | | 47 | 47 |

**RECONCILIATION OF CARRYING AMOUNT**

| | 2013 Associates | 2013 Joint Ventures | 2013 TOTAL | 2014 Associates | 2014 Joint Ventures | 2014 TOTAL |
|---|---|---|---|---|---|---|
| Group share of equity of material associates and joint ventures | | | | 805 | | 805 |
| Goodwill concerning material associates and joint ventures | | | | 1,364 | | 1,364 |
| Carrying amount of immaterial associates and joint ventures | 1 | 50 | 51 | | 47 | 47 |
| Total carrying amount as of December 31 of associates and joint ventures | 1 | 50 | 51 | 2,169 | 47 | 2,216 |

For further information on associates and joint ventures please see the list of "Danfoss Group Companies".

## Note 4 FINANCIAL INCOME

DKKm

| | 2013 | 2014 |
|---|---|---|
| Interest from banks etc. | 29 | 14 |
| Calculated expected return on defined benefit plan assets | 2 | 23 |
| Gain on other investments | 2 | |
| | 33 | 37 |
| | | |
| Interest on financial assets measured at amortized cost amounts to | 29 | 14 |

## Note 5 FINANCIAL EXPENSES

DKKm

| | 2013 | 2014 |
|---|---|---|
| Interest to banks etc. | -192 | -190 |
| Interest element on discounted liabilities | | -4 |
| Calculated interest on defined benefit plans | -40 | -55 |
| Foreign exchange losses, net | -151 | -206 |
| Fair value adjustment of share options and warrants | -14 | -29 |
| Impairment/loss on loans | -7 | |
| Loss on other investments | | -4 |
| Borrowing costs recognized in the cost of assets | 2 | 2 |
| | -402 | -486 |
| | | |
| Interest on financial liabilities at amortized cost amounts to | -192 | -194 |

An effective interest rate equal to Group's weighted average general borrowing costs was used for the calculation of borrowing costs pertaining to the cost of assets. No specific loans have been raised for the construction or development of assets.

## Note 6 TAX ON PROFIT

DKKm

| | 2013 | 2014 |
|---|---|---|
| Current tax expense | -1,129 | -1,072 |
| Change in deferred tax | 195 | -117 |
| Adjustments concerning previous years | -36 | 3 |
| | -970 | -1,186 |
| | | |
| Tax on profit is defined as: | | |
| Tax on profit before tax | 25.0% | 24.5% |
| Adjustment of tax in foreign subsidiaries calculated at 24.5% (2013: 25.0%) | 2.7% | 4.6% |
| Tax exempt income/non-deductible expenses | -0.9% | -0.2% |
| Adjustment of net tax assets | -0.4% | 0.2% |
| Income from associates and joint ventures after tax | -0.1% | 1.3% |
| Effect of change in corporate tax rate | -1.3% | |
| Other taxes | 2.7% | 4.3% |
| Adjustments concerning previous years | 2.1% | -0.6% |
| Effective tax rate | 29.8% | 34.1% |

| | 2013 | 2014 |
|---|---|---|
| Tax on profit (income statement) | -970 | -1,186 |
| Tax on fair value adjustment of hedging instruments (other comprehensive income) | -57 | 42 |
| Tax on actuarial gain/loss on pension and healthcare plans (other comprehensive income) | -80 | 96 |
| Total taxes | -1,107 | -1,048 |

# **Note 7** INTANGIBLE ASSETS

DKKm

**2013**

| | **Good-will** | Software | Brand | Techno-logy | Custo-mer relations | Patents, trade-marks etc. | Develop-ment costs | **TOTAL Other** | **TOTAL** |
|---|---|---|---|---|---|---|---|---|---|
| Cost as of January 1 | 5,390 | 672 | 902 | 3,136 | 1,770 | 391 | 572 | 7,443 | 12,833 |
| Foreign exchange adjustments in foreign companies | -121 | 1 | -22 | -83 | -42 | -3 | -5 | -154 | -275 |
| Additions | | 63 | | | | 3 | 24 | 90 | 90 |
| Disposals | | -3 | | | | -3 | | -6 | -6 |
| Cost as of December 31 | 5,269 | 733 | 880 | 3,053 | 1,728 | 388 | 591 | 7,373 | 12,642 |
| | | | | | | | | | |
| Amortization and impairment losses as of January 1 | 1,089 | 534 | | 1,161 | 735 | 334 | 331 | 3,095 | 4,184 |
| Foreign exchange adjustments in foreign companies | -2 | | | -34 | -22 | -2 | -3 | -61 | -63 |
| Amortization | | 49 | | 194 | 143 | 22 | 70 | 478 | 478 |
| Impairments | | 2 | | | | | | 2 | 2 |
| Disposals | | -6 | | | | -7 | | -13 | -13 |
| Amortization and impairment losses as of December 31 | 1,087 | 579 | | 1,321 | 856 | 347 | 398 | 3,501 | 4,588 |
| | | | | | | | | | |
| Carrying amount as of December 31 | 4,182 | 154 | 880 | 1,732 | 872 | 41 | 193 | 3,872 | 8,054 |

**2014**

| | **Good-will** | Software | Brand | Techno-logy | Custo-mer relations | Patents, trade-marks etc. | Develop-ment costs | **TOTAL Other** | **TOTAL** |
|---|---|---|---|---|---|---|---|---|---|
| Cost as of January 1 | 5,269 | 733 | 880 | 3,053 | 1,728 | 388 | 591 | 7,373 | 12,642 |
| Foreign exchange adjustments in foreign companies | 275 | 4 | 60 | 203 | 120 | 53 | 18 | 458 | 733 |
| Addition through acquisition of subsidiaries | 5,514 | 88 | 120 | 1,126 | 699 | | | 2,033 | 7,547 |
| Transfers | | 397 | | | | | | 397 | 397 |
| Additions | | 83 | | | | 8 | 7 | 98 | 98 |
| Disposals | | -34 | | -72 | -3 | -4 | -34 | -147 | -147 |
| Cost as of December 31 | 11,058 | 1,271 | 1,060 | 4,310 | 2,544 | 445 | 582 | 10,212 | 21,270 |
| | | | | | | | | | |
| Amortization and impairment losses as of January 1 | 1,087 | 579 | | 1,321 | 856 | 347 | 398 | 3,501 | 4,588 |
| Foreign exchange adjustments in foreign companies | 14 | 4 | | 116 | 67 | 53 | 11 | 251 | 265 |
| Transfers | | 303 | | | | | | 303 | 303 |
| Amortization | | 90 | | 200 | 147 | 15 | 59 | 511 | 511 |
| Disposals | | -26 | | -67 | -2 | | -34 | -129 | -129 |
| Amortization and impairment losses as of December 31 | 1,101 | 950 | | 1,570 | 1,068 | 415 | 434 | 4,437 | 5,538 |
| | | | | | | | | | |
| Carrying amount as of December 31 | 9,957 | 321 | 1,060 | 2,740 | 1,476 | 30 | 148 | 5,775 | 15,732 |

Addition through acquisition of subsidiaries relates to Vacon. For further information, see Note 20. Acquisition and sale of subsidiaries and activities.

**IMPAIRMENT TESTS**

At the end of 2014, impairment tests have been performed on the carrying amount of goodwill and brand (assets with indefinite useful lives). The impairment tests were performed on divisions representing the base level of cash generating units (CGUs) to which the carrying amount of goodwill and brand can be allocated with reasonable accuracy. The basis for determining the recoverable amount is value in use for all cash generating units.

Acquired activities and companies are integrated as quickly as possible into the division for optimum synergy. One of the consequences is that soon after it will not be possible to allocate the carrying amount of goodwill to the acquired companies and activities with reasonable accuracy, and thus it will no longer be possible to perform impairment tests on these individual acquisitions. At the impairment test, the net present value of the estimated net cash flow from the CGUs is compared with the carrying amounts of the assets. The expected cash flow is based on budgets and forecasts for the years 2015-2024 prepared and approved by management in the respective CGUs and Group management. The forecasts were elaborated for a 10-year period in accordance with the fact that decisions on acquisitions are made on the basis of 10-year forecasts. The primary variables are sales, EBIT, working capital and investments. The discount rates are set under consideration of the individual CGU's size, main geographical markets, risks and the coherence with Danfoss' core business areas.

The principals are unchanged compared to the impairment tests performed in 2013.

# **Note 7** INTANGIBLE ASSETS (continued)

The most significant goodwill allocations as well as the most significant assumptions for the performed impairment tests have been described below.

| 2013 | Danfoss Power Electronics | Danfoss Heating Solutions | Danfoss Commercial Compressors | Danfoss Power Solutions | Danfoss Refrigeration & A/C Controls | Other |
|---|---|---|---|---|---|---|
| Goodwill at the end of 2013 | 89 | 1,232 | 1,041 | 872 | 523 | 425 |
| Brand with indefinite useful life at the end of 2013 | | | | 880 | | |
| Expected growth in net cash flow during the terminal period in % | 2% | 2% | 2% | 2% | 2% | 2% |
| Discount rate before tax in % as of December 31 | 13% | 13% | 13% | 13% | 13% | 13% |

| 2014 | Danfoss Power Electronics | Danfoss Heating Solutions | Danfoss Commercial Compressors | Danfoss Power Solutions | Danfoss Refrigeration & A/C Controls | Other |
|---|---|---|---|---|---|---|
| Goodwill at the end of 2014 | 5,602 | 1,230 | 1,176 | 947 | 582 | 420 |
| Brand with indefinite useful life at the end of 2014 | | | | 941 | | |
| Expected growth in net cash flow during the terminal period in % | 2% | 2% | 2% | 2% | 2% | 2% |
| Discount rate before tax in % as of December 31 | 11% | 11% | 13% | 12% | 12% | 11% |

Management does not assess that a reasonable change in the fundamental assumptions used in the impairment tests will result in a recoverable amount lower than the carrying amount. The same conclusion was made for 2013.

*Danfoss Power Electronics*
The Goodwill allocated to Danfoss Power Electronics derives primarily from the Acquisition of Vacon (Finland) in December 2014. The carrying amount of Technology and Customer relations acquired in connection with business combinations amounts end 2014 to DKK 1.9b or approximately 37% of the corresponding total carrying amount.
The carrying amount of Technology and Customer relations recognized in connection with the acquisition of Vacon is amortized until 2026 and 2029 respectively. The impairment test was performed before the acquisition of Vacon. Danfoss expects significant synergies in the form of a decreasing operating cost ratio for the combined Drives business, which is confirmed in the business case for acquiring Vacon.
EBIT and cash flow were at a satisfactory level in 2014 and remained at the same levels compared to the year before. The result and cash flow is expected at a satisfactory level in the future. The weighted average growth rate until 2024 is estimated to be approximately 5%, which is at or above the general market development.
The net cash flow during the terminal period from 2025 and onwards is estimated at a 2% annual growth level, which is assumed to be at or below the market development.
The EBIT margin is expected to remain unchanged during the terminal period, and so is the working capital as a percentage of sales. Investments are assumed to be at the same level as the depreciations. These assumptions are unchanged compared to the impairment tests performed in 2013.

*Danfoss Heating Solutions*
The Goodwill allocated to Danfoss Heating Solutions (HS) derives primarily from the acquisition of the DEVI Group (Denmark) in 2003 and Thermia Wärme AB (Sweden) in 2005. The carrying amount of Technology and Customer relations acquired in connection with business combinations amounts end 2014 to DKK 25m or approximately 1% of the corresponding total carrying amount.
EBIT and cash flow were at a satisfactory level in 2014 and remained at the same levels compared to the year before. The result and cash flow is expected at a satisfactory level in the future. The weighted average growth rate until 2024 is estimated to be approximately 4%, which is at or above the general market development and therefore assuming an increasing market share. The growth in Net sales is driven from strong R&D investments in products and expected high growth from emerging markets like China and Russia.
The net cash flow during the terminal period from 2025 and onwards is estimated at a 2% annual growth level, which is assumed to be at or below the market development.
The EBIT margin is expected to remain unchanged during the terminal period, and so is the working capital as a percentage of sales. Investments are assumed to be at the same level as the depreciations. These assumptions are unchanged compared to the impairment tests performed in 2013.

*Danfoss Commercial Compressors*
The Goodwill allocated to Danfoss Commercial Compressors (CC) derives primarily from the acquisitions of Scroll Technologies, USA in 2006 and Danfoss Turbocor Compressors, USA in 2012. The carrying amount of Technology and Customer relations acquired in connection with business combinations amounts end 2014 to DKK 186m or approximately 4% of the corresponding total carrying amount.
EBIT and cash flow were at a satisfactory level in 2014. EBIT improved compared to the year before, whereas cash flow remained unchanged. The result and cash flow is expected to increase further in the future. The weighted average growth rate until 2024 is estimated at approximately 3%, which is at or above the general market development. The increased EBIT and Cash flow is mainly driven from increased operating efficiency.
The net cash flow during the terminal period from 2025 and onwards is estimated at a 2% annual growth level, which is assumed to be at or below the market development.
The EBIT margin is expected to remain unchanged during the terminal period, and so is the working capital as a percentage of sales. Investments are assumed to be at the same level as the depreciations. These assumptions are unchanged compared to the impairment tests performed in 2013.

# **Note 7** INTANGIBLE ASSETS (continued)

*Danfoss Power Solutions*
The Goodwill allocated to Danfoss Power Solutions (PS) derives from the Danfoss Group's acquisition of the additional 38.2% of the share capital in Sauer-Danfoss Inc. in 2008. The brand recognized in that connection has an indefinite useful life. The carrying amount of Brand, Technology and Customer relations acquired in connection with business combinations amounts end 2014 to DKK 3.1b or approximately 58% of the total corresponding carrying amount.
The carrying amount of Technology and Customer relations is amortized until 2023 and 2020 respectively.
EBIT and cash flow were at a satisfactory level in 2014 and remained at the same levels compared to the year before. The result and cash flow is expected at a satisfactory level in the future. The weighted average growth rate until 2024 is estimated to be approximately 3%, which is at or above the general market development.
The net cash flow during the terminal period from 2025 and onwards is estimated at a 2% annual growth level, which is assumed to be at or below the market development.
The EBIT margin is expected to remain unchanged during the terminal period, and so is the working capital as a percentage of sales. Investments are assumed to be at the same level as the depreciations. These assumptions are unchanged compared to the impairment tests performed in 2013.

*Danfoss Refrigeration & A/C Controls*
The Goodwill allocated to Danfoss Refrigeration and A/C Controls (RC) derives primarily from the acquisition of Aztec Energy Partners, USA in 2006 and Chatleff LLC, USA in 2007. The carrying amount of Technology and Customer relations acquired in connection with business combinations amounts end 2014 to DKK 38m or approximately 1% of the total corresponding carrying amount.
EBIT and cash flow were at a satisfactory level in 2014 and improved compared to the year before. The result and cash flow is also expected at a satisfactory level in the future. The weighted average growth rate until 2024 is estimated at approximately 4% which is at or above the general market development.
The higher growth is mainly driven from an expansion of the product portfolio.
The net cash flow during the terminal period from 2025 and onwards is estimated at a 2% annual growth level, which is assumed to be at or below the market development.
The EBIT margin is expected to remain unchanged during the terminal period, and so is the working capital as a percentage of sales. Investments are assumed to be at the same level as the depreciations. These assumptions are unchanged compared to the impairment tests performed in 2013.

*Other intangible assets*
Software in progress amounts to DKK 76m. Of the entire Group's development activities capitalized development expenditure in progress amounts to DKK 16m. Development activities in progress are related to a larger amount of development projects in several segments. Software and capitalized development expenditure were mainly built up internally.
In 2014, the Group performed impairment tests for the carrying amount of software and development in progress. The project development process related to the actual expenses and achieved milestones has been evaluated according to the approved project and business plans. This has not led to an impairment of current development assets.

# Note 8 PROPERTY, PLANT AND EQUIPMENT

DKKm

| 2013 | Land and buildings | Plant and machinery | Equipment | Assets under construction | TOTAL |
|---|---|---|---|---|---|
| Cost as of January 1 | 5,248 | 7,862 | 2,012 | 527 | 15,649 |
| Foreign exchange adjustments in foreign companies | -94 | -51 | -34 | -34 | -213 |
| Transfers | 138 | 226 | 27 | -391 | |
| Additions | 69 | 242 | 98 | 712 | 1,121 |
| Disposals | -261 | -435 | -299 | -3 | -998 |
| Cost as of December 31 | 5,100 | 7,844 | 1,804 | 811 | 15,559 |
| | | | | | |
| Depreciation and impairment losses as of January 1 | 2,365 | 5,025 | 1,319 | | 8,709 |
| Foreign exchange adjustments in foreign companies | -26 | -2 | -25 | | -53 |
| Transfers | -87 | 87 | | | |
| Depreciation | 186 | 843 | 164 | | 1,193 |
| Impairment | 7 | | | | 7 |
| Disposals | -175 | -404 | -224 | | -803 |
| Depreciation and impairment losses as of December 31 | 2,270 | 5,549 | 1,234 | | 9,053 |
| | | | | | |
| Carrying amount as of December 31 | 2,830 | 2,295 | 570 | 811 | 6,506 |
| | | | | | |
| Hereof assets held under finance leases | 2 | 7 | 59 | | 68 |

| 2014 | Land and buildings | Plant and machinery | Equipment | Assets under construction | TOTAL |
|---|---|---|---|---|---|
| Cost as of January 1 | 5,100 | 7,844 | 1,804 | 811 | 15,559 |
| Foreign exchange adjustments in foreign companies | 26 | 126 | 26 | 22 | 200 |
| Addition through acquisition of subsidiaries | 24 | 173 | | | 197 |
| Transfers | 291 | 252 | -250 | -690 | -397 |
| Additions | 237 | 298 | 69 | 537 | 1,141 |
| Disposals | -253 | -143 | -97 | | -493 |
| Cost as of December 31 | 5,425 | 8,550 | 1,552 | 680 | 16,207 |
| | | | | | |
| Depreciation and impairment losses as of January 1 | 2,270 | 5,549 | 1,234 | | 9,053 |
| Foreign exchange adjustments in foreign companies | 5 | 9 | 3 | | 17 |
| Transfers | 50 | -109 | -244 | | -303 |
| Depreciation | 188 | 829 | 138 | | 1,155 |
| Impairment | 60 | 12 | | | 72 |
| Disposals | -131 | -123 | -91 | | -345 |
| Depreciation and impairment losses as of December 31 | 2,442 | 6,167 | 1,040 | | 9,649 |
| | | | | | |
| Carrying amount as of December 31 | 2,983 | 2,383 | 512 | 680 | 6,558 |
| | | | | | |
| Hereof assets held under finance leases | | 5 | 37 | | 42 |

The Group's finance leases mainly concern machinery and IT equipment. The Group has an option to acquire the leased machinery at favourable prices at the expiry of the leases. The leased assets are pledged as collateral for the lease liabilities.

## Note 9 INVENTORIES

DKKm

| | 2013 | 2014 |
|---|---|---|
| Raw materials and consumables | 1,508 | 1,609 |
| Work in progress | 458 | 475 |
| Finished goods and goods for resale | 1,883 | 2,001 |
| Inventories | 3,849 | 4,085 |
| | | |
| Write-downs of inventories | 384 | 404 |
| Carrying amount of inventories stated at net realizable value | 327 | 215 |
| Expensed adjustment of inventories to net realizable value included in cost of sales | 75 | 50 |
| Cost of goods sold included in cost of sales | 16,309 | 16,694 |

## Note 10 TRADE RECEIVABLES

DKKm

| | 2013 | 2014 |
|---|---|---|
| Trade receivables before provision for bad debts | 4,595 | 5,246 |
| Provision for bad debts | -170 | -156 |
| Trade receivables | 4,425 | 5,090 |
| Receivables from associates and joint ventures | 3 | 77 |
| Total trade receivables | 4,428 | 5,167 |
| | | |
| Hereof trade receivables due after 1 year | 11 | 9 |
| | | |
| Provision for bad debts as of January 1 | -151 | -170 |
| Foreign exchange adjustments | 7 | 4 |
| Additions through acquisition of subsidiaries | | -28 |
| Change in provisions | -35 | -15 |
| Realized loss | 9 | 53 |
| Provision for bad debts as of December 31 | -170 | -156 |

# Note 11 SHARE CAPITAL

**SHAREHOLDERS HOLDING MORE THAN 5% OF THE SHARES OR 5% OF THE VOTES**

| | SHARES | VOTES |
|---|---|---|
| Bitten & Mads Clausen Foundation, Nordborg, Denmark | 46.33% | 84.96% |
| Clausen Controls A/S, Sønderborg, Denmark | 25.59% | 5.40% |
| Henrik Mads Clausen, Lake Forrest, USA | 10.75% | 2.26% |
| Karin Clausen, Holte, Denmark | 7.06% | 1.49% |

**DISTRIBUTION OF SHARES**

**2013**

| A shares | | | B shares | | | Total shares | |
|---|---|---|---|---|---|---|---|
| No. | Nominal value | DKKm | No. | Nominal value | DKKm | No. | DKKm |
| 4,250,000 | 100 DKK | 425.0 | 5,965,743 | 100 DKK | 596.6 | 10,215,743 | 1,021.6 |

**2014**

| A shares | | | B shares | | | Total shares | |
|---|---|---|---|---|---|---|---|
| No. | Nominal value | DKKm | No. | Nominal value | DKKm | No. | DKKm |
| 4,250,000 | 100 DKK | 425.0 | 5,979,143 | 100 DKK | 597.9 | 10,229,143 | 1,022.9 |

Class A shares entitle the holder to ten votes for each share while Class B shares entitle the holder to one vote for each share. The holders of class A shares also have pre-emptive rights to class A shares in the event of any increases in share capital. Otherwise no shares have special rights.

Resolutions regarding amendments to the Articles of Association or Danfoss A/S' dissolution require at least two-thirds of the votes cast as well as two-thirds of the voting share capital represented at the general meeting to be adopted. The share capital is fully paid in.

**DIVIDEND PER SHARE (DKK)**

| | 2013 | 2014 |
|---|---|---|
| Proposed dividend per 100 DKK share | 78.3 | 48.9 |
| Dividend paid per 100 DKK share | 39.2 | 78.3 |

Dividend payment to shareholders has no tax consequences for Danfoss A/S.

**DEVELOPMENT IN THE GROUP'S HOLDING OF TREASURY SHARES (NO. OF B-SHARES OF 100 DKK)**

| | 2013 | 2014 |
|---|---|---|
| Holding as of January 1 | 89,142 | 134,178 |
| Acquired in the year | 18,584 | 17,641 |
| Acquired from Bitten & Mads Clausen Foundation | 28,902 | |
| Sold in the year | -2,450 | -600 |
| Holding as of December 31 | 134,178 | 151,219 |

The primary purpose of holding treasury shares is to secure the share option programme in Danfoss A/S. The total cost in 2014 for own shares amounts to DKK 72m (2013: 164m). The total selling price relating to treasury shares amounted to DKK 2m in 2014 (2013: 8m). The Group's holding of treasury shares represents 1.48% (2013: 1.31%) of the Group's share capital. The value of treasury shares held amounts to DKK 622m (2013: 464m).

**CAPITAL STRUCTURE**

The Capital structure of Danfoss is intended to ensure sufficient financial flexibility and stability for the company to reach its strategic goals. It is the policy of the Group to always qualify for a "BBB credit rating", and the Group aims for the net-interest bearing debt to EBITDA ratio and cash flow generation to be in line with this policy over the cycle.

Danfoss is currently rated "BBB/A2 with a stable outlook" by Standard and Poor's. End of 2014 the net-interest bearing debt to EBITDA ratio was 2.0 (2013: 0.8) on a reported basis. The increase is due to the acquisition of Finish Vacon in December 2014 and the acquisition of a 20% share in German SMA Solar Technology AG in early part of 2014.

Danfoss aims to use the free cash flow before M&A to repay interest bearing debt and for acquisitions that will develop the existing business further, or for dividend distribution to shareholders according to policy.

# Note 12 PROVISIONS

DKKm

| | 2014 | | | | |
|---|---|---|---|---|---|
| | Warranty | Restruc-turing | Contingent considera-tion | Other | TOTAL |
| Provisions as of January 1 | 458 | 93 | 1 | 360 | 912 |
| Foreign exchange adjustments etc. | 10 | | | 20 | 30 |
| Additions through acquisition of subsidiaries | 82 | | | 7 | 89 |
| Provisions used | -240 | -60 | | -79 | -379 |
| Reversal of unused provisions | -78 | -5 | -1 | -80 | -164 |
| Additional provisions recognized | 272 | 19 | | 234 | 525 |
| Interest element on provisions | | | | 2 | 2 |
| Provisions as of December 31 | 504 | 47 | | 464 | 1,015 |

| Estimated maturity of above provisions: | 2013 | 2014 |
|---|---|---|
| Within 1 year | 426 | 619 |
| Between 1 and 5 years | 347 | 337 |
| After more than 5 years | 139 | 59 |
| | 912 | 1,015 |

Provisions for warranty comprise expected costs arising during the warranty period of the Group's products. As of December 31 receivables of DKK 61m related to provisions for warranty were recognized (2013: 60m).

The Group's provision for restructuring mainly relates to expected costs for termination benefits. Contingent consideration consists of earn out acquisitions. The Group's other provisions mainly consist of certain employee expenses, including jubilee costs.

Provisions have been discounted to net present value if the values are significant.

# **Note 13** SHARE INCENTIVE PROGRAMS

In the Danfoss Group, share incentive programs exist only in Danfoss A/S. The programs are described below.

The calculation of fair values for the balance sheet as of the balance sheet dates and for stating the values as per the grant dates is based on the Black-Scholes model. The assumptions for the calculation of outstanding options and warrants are:

| | 2013 | 2014 |
|---|---|---|
| Share price | 3,460 | 4,116 |
| Expected volatility | 37.0% | 22.0% |
| Expected dividends | 1.0% | 1.0% |
| Risk-free interest rate | 0,6-0,9% | 0,1-0,8% |
| Exercise prices and terms of maturity for the programs | See below | |

Since Danfoss is not a listed company, the above share price calculation, which has been made by an independent third party, has been based on a comparison with a number of comparable domestic and international listed companies. The share price for 2014 of 4,116 was most recently adjusted at the Annual General Meeting in 2014 and will next be fixed at the Annual General Meeting in 2015.

**SHARE INCENTIVE PROGRAMS ESTABLISHED IN 2004 AND SUBSEQUENT PROGRAMS**

In 2004 and 2007, Danfoss A/S established share incentive programs for the Board and a warrant program for executive committee members and senior managers. The condition for participation in the program was for the executive committee members and the senior managers to purchase compulsory shares. The main condition for achieving the right to be granted options/warrants was for RONA to exceed a certain minimum level for the respective financial years. The granted options and warrants give the right to purchase/subscribe for class B shares (at 100 DKK each) at fixed exercise prices 3 years after the allotment date at the earliest.

In 2009, Danfoss A/S set up a new warrant program for executive committee members and senior managers. Participation in the 2009 program was not conditional on the purchase of shares. Also, no minimum RONA level was defined for the program.

Since Danfoss A/S has an obligation to buy back shares under the share option programs, provision is made in the balance sheet for this obligation.

Information on the 2004 and subsequent programs

| | Granted (year) | Granted (number) | Fair value at grant date (DKK each) | Earliest exercise | Latest exercise |
|---|---|---|---|---|---|
| Options/warrants - exercise price at 1,222 | 2005 | 86,459 | 564 | May 2008 | May 2015 |
| Options/warrants - exercise price at 1,522 | 2006 | 84,895 | 762 | May 2009 | May 2016 |
| Options/warrants - exercise price at 1,932 | 2007 | 97,121 | 983 | May 2010 | May 2017 |
| Options/warrants - exercise price at 1,808 | 2008 | 59,053 | 895 | May 2011 | May 2014 |
| Warrants - exercise price at 1,100 | 2009 | 139,050 | 365 | May 2012 | May 2015 |
| | | 466,578 | | | |

# Note 13 SHARE INCENTIVE PROGRAMS (continued)

Holdings and grants/disposals of options and warrants in relation to the 2004 and subsequent programs are specified below:

| | The Board (number) | Executive Committee (number) | Executives (number) | Other (number) | Fair value (DKK each) | Fair value (DKKm) |
|---|---|---|---|---|---|---|
| Granted options/warrants 1 January: | | | | | | |
| Options/warrants - exercise price at 1,222 | | | | 5,406 | 2,195 | 12 |
| Options/warrants - exercise price at 1,522 | | | | 6,346 | 1,941 | 12 |
| Options/warrants - exercise price at 1,932 | | 2,400 | | 23,582 | 1,689 | 44 |
| Options/warrants - exercise price at 1,808 | 150 | 1,875 | | 4,725 | 1,646 | 11 |
| Warrants - exercise price at 1,100 | | | | 8,600 | 2,310 | 20 |
| | 150 | 4,275 | | 48,659 | | 99 |
| Changes in the share price/fair value: | | | | | | |
| Options/warrants - exercise price at 1,222 | | | | | 662 | 4 |
| Options/warrants - exercise price at 1,522 | | | | | 590 | 4 |
| Options/warrants - exercise price at 1,932 | | | | | 431 | 11 |
| Options/warrants - exercise price at 1,808 | | | | | 659 | 4 |
| Warrants - exercise price at 1,100 | | | | | 669 | 6 |
| | | | | | | 29 |
| Disposal due to subscription of shares: | | | | | | |
| Options/warrants - exercise price at 1,222 | | | | -1,693 | 2,893 | -5 |
| Options/warrants - exercise price at 1,522 | | | | -1,633 | 2,594 | -4 |
| Options/warrants - exercise price at 1,932 | | | | -3,734 | 2,182 | -8 |
| Options/warrants - exercise price at 1,808 | -150 | -1,875 | | -4,725 | 2,308 | -15 |
| Warrants - exercise price at 1,100 | | | | -4,950 | 3,016 | -15 |
| | -150 | -1,875 | | -16,735 | | -47 |
| Granted options/warrants 31 December: | | | | | | |
| Options/warrants - exercise price at 1,222 | | | | 3,713 | 2,857 | 11 |
| Options/warrants - exercise price at 1,522 | | | | 4,713 | 2,531 | 12 |
| Options/warrants - exercise price at 1,932 | | 2,400 | | 19,848 | 2,120 | 47 |
| Warrants - exercise price at 1,100 | | | | 3,650 | 2,979 | 11 |
| | | 2,400 | | 31,924 | | 81 |

The total provision as of December 31, 2014 for 2004 and subsequent share incentive programs has been calculated at DKK 81m (2013: 99m) and is recognized under current liabilities.

DKKm

**RECOGNITION OF PROGRAMS IN THE INCOME STATEMENT**

| | Financial items 2013 | Financial items 2014 | Personnel expenses 2013 | Personnel expenses 2014 |
|---|---|---|---|---|
| Subsidiaries | 4 | 6 | 3 | |
| Parent company | 10 | 23 | | |
| The Danfoss Group | 14 | 29 | 3 | |

# Note 14 DEFERRED TAX

DKKm

**CHANGES IN DEFERRED TAXES**

| | 2013 | 2014 |
|---|---|---|
| Deferred taxes as of January 1 (net) *) | -549 | -382 |
| Additions through acquisition of subsidiaries | | -386 |
| Foreign exchange adjustment in foreign companies | -19 | 9 |
| Adjustments concerning previous years | 71 | -28 |
| Deferred tax recognized in the income statement | 195 | -117 |
| Deferred tax recognized in other comprehensive income | -80 | 100 |
| Deferred taxes as of December 31 (net) *) | -382 | -804 |

*) Liability (-)

**SPECIFICATION OF DEFERRED TAXES**

| | 2013<br>Deferred tax asset | 2014<br>Deferred tax asset |
|---|---|---|
| Intangible assets | 102 | 70 |
| Property, plant and equipment and financial assets | 80 | 160 |
| Current assets | 219 | 341 |
| Liabilities | 573 | 734 |
| Tax loss carry-forwards | 650 | 438 |
| Non-capitalized tax assets regarding tax losses | -185 | -197 |
| | 1,439 | 1,546 |
| Set-off within the same legal entities and jurisdiction | -99 | -386 |
| Deferred tax assets | 1,340 | 1,160 |

| | 2013<br>Deferred tax liability | 2014<br>Deferred tax liability |
|---|---|---|
| Intangible assets | 1,263 | 1,724 |
| Property, plant and equipment and financial assets | 227 | 204 |
| Current assets | 68 | 83 |
| Liabilities | 198 | 275 |
| Deferred tax regarding Danish joint taxation | 65 | 64 |
| | 1,821 | 2,350 |
| Set-off within the same legal entities and jurisdiction | -99 | -386 |
| Deferred tax liabilities | 1,722 | 1,964 |

The tax asset related to tax loss carry-forwards of DKK 241m net (2013: 465m) is largely related to companies that have suffered tax losses in the last three financial years. This tax asset is expected to be utilized within 3 years primarily through higher future taxable income in the respective companies.

Of the total capitalized tax asset concerning tax loss carry forwards, 14% (2013: 4%) has a remaining period of 3 years or less, whereas the share of tax loss carry-forwards with a remaining period of 10 years or more totals 84% (2013: 77%).

The tax value of unrecognized tax assets related to tax loss carry-forwards amounts to DKK 197m (2013: 185m). The amount is not recognized as an asset, as the tax losses carried forward are not expected to be utilized.

Of the deferred tax liability of DKK 1.964m (2013: 1.722m), DKK 64m (2013: 65m) can be attributed to taxes relating to joint taxation with foreign subsidiaries in previous years. The Group has deferred tax liabilities concerning temporary differences in foreign subsidiaries, associates and joint ventures of DKK 1.534m (2013: 1.131m). The liabilities are not recognized because the Group decides on their utilization and it is likely that the liabilities will not be recognized in the foreseeable future.

# Note 15 PENSION AND HEALTHCARE OBLIGATIONS

The major part of the Group's pension plans are defined contribution plans funded by pension and insurance companies. However, a number of foreign subsidiaries have obligations concerning defined benefit plans which are unfunded or only partly funded.

It is the Group's policy that pension and healthcare plans within the Group should generally be arranged as defined contribution plans. However, in countries like the USA, the UK and Germany there is a tradition for defined benefit plans.
The defined benefit plans still open for new employees are mainly located in Danfoss Power Solutions (US) Company and Danfoss Power Solutions GmbH & Co. OHG (Germany).
Geographical split of net liability is Germany 49% (2013: 52%), US 36% (2013: 30%) and others 15% (2013: 18%).
The pension plans are based on the individual employee´s salary and years of service in the company. The plans have no requirements for risk diversification or for matching strategies.
A few countries may require that the liability is funded but this is not the case for the majority of the countries. Defined benefit plans that are unfunded are mainly related to pension plans in some of the German subsidiaries and the healthcare plan in the US. Unfunded plans amount to approximately DKK 629m (2013: DKK 535m). All material defined benefit plans have been computed by independent actuaries.

**THE GROUP'S DEFINED BENEFIT PLAN OBLIGATIONS**

| | 2013 | 2014 |
|---|---|---|
| Present value of provisions | 2,973 | 3,732 |
| Fair value of plan assets | -2,085 | -2,537 |
| | 888 | 1,195 |
| Pension benefit plan assets | 42 | 84 |
| Pension and healthcare plan obligations | 930 | 1,279 |

**DEVELOPMENT IN THE PRESENT VALUE OF DEFINED BENEFIT PLAN OBLIGATIONS**

| | 2013 | 2014 |
|---|---|---|
| Provision as of January 1 | 3,128 | 2,973 |
| Additions through business combinations | | 65 |
| Foreign exchange adjustments | -76 | 236 |
| Pension costs for the year | 37 | 30 |
| Calculated interest on plan liabilities | 115 | 127 |
| Actuarial gains(-)/losses from changes in demographic assumptions | 16 | 46 |
| Actuarial gains(-)/losses from changes in financial assumptions | -111 | 435 |
| Gains from reductions and redemptions | | -3 |
| Plan participants' contribution liabilities | 7 | 7 |
| Disbursed benefits from the Group | -38 | -28 |
| Disbursed benefits from plan assets | -105 | -117 |
| Net transfer to provisions | | -39 |
| Provision as of December 31 | 2,973 | 3,732 |

**DEVELOPMENT IN THE FAIR VALUE OF PLAN ASSETS**

| | 2013 | 2014 |
|---|---|---|
| Plan assets as of January 1 | 1,941 | 2,085 |
| Additions through acquisition of subsidiaries | | 28 |
| Foreign exchange adjustments | -65 | 179 |
| Calculated interest on plan assets | 77 | 95 |
| Plan participants' contribution asset | 8 | 7 |
| Return for the year on plan assets excluding calculated interest | 111 | 198 |
| Payments by the Group | 114 | 89 |
| Disbursed benefits | -105 | -117 |
| Net transfer to provisions | 4 | -27 |
| Plan assets as of December 31 | 2,085 | 2,537 |

# **Note 15** PENSION AND HEALTHCARE OBLIGATIONS (continued)

**EXPENSES RELATING TO PENSION AND HEALTHCARE OBLIGATIONS**

| | 2013 | 2014 |
|---|---|---|
| Pension costs for the year | 37 | 30 |
| Calculated interest on liabilities | 115 | 127 |
| Calculated expected return on assets | -78 | -95 |
| Gains from reductions and redemptions | | -3 |
| Expensed in the income statement | 74 | 59 |
| | | |
| Pension cost stated under cost of sales | 13 | 14 |
| Pension cost stated under selling and distribution costs | 8 | 6 |
| Pension cost stated under administrative expenses | 15 | 10 |
| Other operating income and expenses | | -3 |
| Interest concerning pension and healthcare obligations posted under financial items | 38 | 32 |
| | 74 | 59 |

**ESTIMATED MATURITY OF PROVISIONS**

| | 2013 | 2014 |
|---|---|---|
| Within 1 year | 137 | 154 |
| Between 1 and 5 years | 596 | 660 |
| After more than 5 years | 2,240 | 2,918 |
| | 2,973 | 3,732 |

**PENSION PLAN ASSETS ARE SPECIFIED AS FOLLOWS:**

| | 2013 | 2013 | 2014 | 2014 |
|---|---|---|---|---|
| Shares and similar securities | 869 | 42% | 1,381 | 54% |
| Listed corporate bonds | 574 | 28% | 501 | 20% |
| Bonds | 486 | 22% | 478 | 19% |
| Other | 156 | 8% | 177 | 7% |
| | 2,085 | 100% | 2,537 | 100% |

Plans in which the pension funds are invested in financial instruments are exposed to risk. 54% (2013: 42%) of the funds are invested in shares, which have historically been subject to value fluctuations.

**SIGNIFICANT ASSUMPTIONS FOR CALCULATION OF PENSION AND HEALTHCARE OBLIGATIONS AND RELATED COSTS**

| | 2013 | 2013 | 2014 | 2014 |
|---|---|---|---|---|
| | Range | Weighted average | Range | Weighted average |
| Discount rate | 2.0-9.9% | 4.3% | 0.8-3.9% | 3.4% |
| Estimated future salary increase | 2.0-7.0% | 3.6% | 1.5-4.1% | 3.6% |
| Estimated return on plan assets | 1.5-8.0% | 3.9% | 2.3-5.4% | 3.5% |

Life expectancy is based on relevant statistics available on the individual countries included in the calculation.

The estimated return on the plan assets is based on external actuarial calculations and determined based on the composition of the assets and considering the general expectations with regard to economic developments.

The Group expects to pay in DKK 133m to defined benefit plans in 2015 (2013: DKK 117m).

**SENSITIVITY ANALYSIS**

| | 2013 | 2014 |
|---|---|---|
| Reported defined benefit liability | 2,973 | 3,732 |
| | | |
| Sensitivity on discount rate: | | |
| Increase in discount rate of 0.5 percentage point affects the defined benefit plan liability by | -194 | -267 |
| Decrease in discount rate of 0.5 percentage point affects the defined benefit plan liability by | +216 | +292 |
| | | |
| Sensitivity regarding future salary: | | |
| Increase in future salary increase of 0.5 percentage point affects the defined benefit plan liability by | +55 | +53 |
| Decrease in future salary increase of 0.5 percentage point affects the defined benefit plan liability by | -54 | -53 |
| | | |
| Sensitivity on average life expectancy: | | |
| Increase in average life expectancy of 1 year affects the defined benefit plan liability by | +104 | +107 |
| Decrease in average life expectancy of 1 year affects the defined benefit plan liability by | -103 | -106 |

## **Note 16** FINANCIAL RISKS AND INSTRUMENTS

**FINANCIAL RISKS**

Danfoss Group's rate of profitability and cash flow are exposed to financial risks, among other factors as a consequence of Danfoss' international business profile. These risks include currency, commodity, credit, interest rate and liquidity risks. Risk management activities focus on risk coverage and mitigation, with a particular emphasis on reducing fluctuations in the company's cash flows and profitability in local currency within a 15 month horizon.

It is the Group's policy not to undertake active speculation regarding financial risks. The Group's financial control is therefore solely aimed at controlling and reducing the financial risks that are a direct result of the Group's operations, investments and financing activities.

For a description of accounting policies and procedures such as applied recognition criteria and basis of measurement, please see the disclosure under Note 25. Basis for preparation and accounting policies.

**CURRENCY EXPOSURE**

Currency exposure consists of three elements:

1. *Transaction risk:* Major consolidated risks and 15 months' expected cash flows in foreign currency are covered on an ongoing basis except in cases where natural hedge exists or in cases where hedge is not practically possible.

2. *Translation risk:* The Group is primarily exposed to EUR, USD and USD-related currencies. Danfoss does not generally cover translation risks, as these do not directly affect the underlying cash flows. Danfoss does however in some cases reduce translation risks through financing in local currencies.

3. *Economic/structural risk (strategic risk):* Economic/structural currency exposure cannot be covered effectively using financial instruments and is therefore not part of Danfoss' financial risk management strategy. However, it is controlled in as far as possible at a strategic level, as Danfoss aims for products to be produced as close as possible to the customer.

| | **2013** | | | | **2014** | | | |
|---|---|---|---|---|---|---|---|---|
| **NOMINAL POSITION** | EUR DKK | USD DKK | GBP DKK | **Total** | EUR DKK | USD DKK | GBP DKK | **Total** |
| Receivables and payables | -298 | -76 | -4 | -378 | -469 | -92 | -19 | -580 |
| Cash and loans | -2,096 | -1,710 | -80 | -3,886 | -4,756 | -386 | -181 | -5,323 |
| Derivative financial instruments for hedging of fair value | 2,387 | -146 | 85 | 2,326 | 3,982 | 294 | 195 | 4,471 |
| Derivative financial instruments for hedging of future cash flows | -340 | -298 | -241 | -879 | -2,382 | -465 | -366 | -3,213 |
| **SENSITIVITY** | | | | | | | | |
| Probable increase in exchange rate | 1% | 10% | 10% | | 1% | 10% | 10% | |
| Hypothetical impact on profit and loss for the year | | -15 | | -15 | -2 | -18 | | -20 |
| Hypothetical impact on Equity | -31 | -223 | -24 | -278 | -36 | -65 | -37 | -138 |

A decrease in the exchange rates as stated would have had the opposite effect on the profit and equity.

**COMMODITY RISK**

Movements in global commodity prices can affect the Group's earnings. It is Danfoss' policy to ensure that significant risks related to raw materials are reduced through the combination of fixed price agreements with suppliers, active price adjustment and in some cases financial hedging. The raw material consumption is hedged for a minimum of six months and a maximum of 18 months, if they are considered essential.
Danfoss has not performed financial hedging of raw materials in 2014 nor 2013.

# Note 16 FINANCIAL RISKS AND INSTRUMENTS (continued)

**CREDIT RISK**

The Group's credit risks primarily apply to trade receivables and bank deposits (the so-called counterpart risk). It is Danfoss' policy to minimize the risk of one or several of Danfoss' financial partners not being able to fulfill a commitment. The counterparty risk is prevented, in so far as possible, by only using solid regional and global financial partners with a minimum credit rating of "A-" according to Standard & Poors credit rating terminology.

The carrying amount of DKK 716m (2013: 737m) represents the maximum exposure risk related to cash and cash equivalents.

Trade receivables are distributed on a number of customers and geographical areas. The geographical distribution is not significantly different from the allocation of Net sales according to note 1. Segment reporting. A systematic credit rating is carried out of customers and any provision for bad debts is made on the basis of this credit rating. The rating also serves as the basis for the terms of payment offered to the customers. Historically, the Group has only had limited losses on bad debts.

Ageing of trade receivables as of December 31:

| | 2013 | 2014 |
|---|---|---|
| Overdue less than 30 days | 74 | 228 |
| Overdue from 30 to 90 days | 73 | 94 |
| Overdue more than 90 days | 13 | 49 |
| Neither impaired nor overdue at the reporting date | 4,268 | 4,796 |
| Net carrying amount | 4,428 | 5,167 |

The carrying amount of trade receivables is estimated to represent their fair value and the maximum credit risk as well.

**INTEREST RATE RISK**

The Group's interest rate risk derives primarily from interest-bearing debt and cash funds. The Group makes use of both fixed and floating-rate loans, as well as derivative interest rate products.

All things being equal, a reasonably likely increase in the interest rate amounting to one percentage point compared to the interest rate level on the balance sheet date, would have had the following hypothetical impact on the profit for the year and equity at the end of the year:

| | 2013 | | 2014 | |
|---|---|---|---|---|
| | Income Statement | Equity | Income Statement | Equity |
| Cash and debt with floating interest rates | -5 | -5 | -33 | -33 |
| Hedge instruments (interest swaps) | | 53 | | 84 |
| | -5 | 48 | -33 | 51 |

A decrease in the interest rate level amounting to one percentage point, compared to the interest rate level as of the balance sheet date, would have had the opposite effect on the profit and the equity.

The stated sensitivities are based on the recognized financial assets and liabilities at December 31, 2014. In 2014, adjustments have not been made for instalments, borrowing, etc. All hedging of floating-rate loans is deemed 100% effective. Furthermore the calculated expected fluctuations are based on the current market situation and expectations for the market development in interest rate levels.

# Note 16 FINANCIAL RISKS AND INSTRUMENTS (continued)

**LIQUIDITY RISK**

Danfoss’ policy is to ensure at all times that the Group has the liquidity necessary to meet its obligations and to finance its planned strategic action. The Group minimizes its liquidity risk through a combination of effective liquidity management and planning, by establishing non-terminable credit facilities and by ensuring that cash funds are liquid and accessible. It is Danfoss' policy to have a "BBB credit rating" and to have a significant liquidity reserve of minimum DKK 3bn and a staggered maturity profile with an average maturity profile of minimum 3 years.

At the end of 2014, Danfoss' liquidity reserve in the form of unused non-terminable long-term credit facilities was recorded at DKK 7.0bn (2013: 5.8bn). In addition to this, Danfoss had cash and significant amounts of short-term credit lines. The Group considers the liquidity reserve to be sufficient in relation to the current plans and the market situation in general. The Danfoss Group's loan agreements comprise no financial covenants.

The major part of the Group's cash and cash equivalents of DKK 716m (2013: 737m) is placed on short-term deposit with an interest rate below 1% p.a.

**THE GROUP'S DEBT CATEGORIES AND MATURITIES**

| | 2013 | | | | | 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Maturity | | | | | Maturity | | |
| | Carrying amount | Contractual cashflow | 0-1 year | 1-5 years*) | Over 5 years | Carrying amount | Contractual cashflow | 0-1 year | 1-5 years*) | Over 5 years |
| Bank debt and corporate bond | 3,538 | 3,590 | 1,738 | 1,141 | 711 | 10,882 | 11,527 | 1,141 | 4,219 | 6,167 |
| Mortgage debt | 1,210 | 1,645 | 53 | 113 | 1,479 | 1,187 | 1,612 | 29 | 118 | 1,465 |
| Employee bonds | 88 | 89 | 44 | 28 | 17 | 63 | 63 | 47 | | 16 |
| Finance lease liabilities | 63 | 67 | 29 | 38 | | 40 | 42 | 22 | 19 | 1 |
| Trade payables | 3,023 | 3,023 | 3,023 | | | 3,572 | 3,572 | 3,572 | | |
| Debt to associates and joint ventures | 10 | 10 | 10 | | | 12 | 12 | 12 | | |
| Derivative financial liabilities | 21 | 35 | 25 | 10 | | 143 | 146 | 116 | 30 | |
| | 7,953 | 8,459 | 4,922 | 1,330 | 2,207 | 15,899 | 16,974 | 4,939 | 4,386 | 7,649 |

*) Maturity is evenly spread over the period.

The maturity analysis is based on all non-discounted cash flows including estimated interest payments. Interest payments are estimated according to existing market conditions. The non-discounted cash flows from derivative financial instruments are presented in gross amounts, unless the parties have a contractual right or obligation to make net settlements. Operating lease liabilities and liabilities relating to the purchase of property, plant and equipment are not included in this specification, but are included in Note 22. Contingent liabilities assets and security.

| | 2013 | 2014 |
|---|---|---|
| Non-current liabilities | 3,109 | 11,100 |
| Current liabilities | 4,844 | 4,799 |
| | 7,953 | 15,899 |

# **Note 16** FINANCIAL RISKS AND INSTRUMENTS (continued)

DKKm

**FINANCIAL INSTRUMENTS BY CATEGORY**

| | 2013 Carrying amount | 2013 Fair value | 2014 Carrying amount | 2014 Fair value |
|---|---|---|---|---|
| Other investments | 32 | 32 | 33 | 33 |
| Financial assets available-for-sale | 32 | 32 | 33 | 33 |
| | | | | |
| Derivative financial instruments for the hedging of the fair value of recognized assets and liabilities | 18 | 18 | 14 | 14 |
| Derivative financial instruments for the hedging of future cash flows | 39 | 39 | | |
| Financial assets used as hedging instruments | 57 | 57 | 14 | 14 |
| | | | | |
| Trade receivables | 4,428 | 4,428 | 5,167 | 5,167 |
| Other receivables | 727 | 727 | 638 | 638 |
| Cash and cash equivalents | 737 | 737 | 716 | 716 |
| Loans and receivables | 5,892 | 5,892 | 6,521 | 6,521 |
| | | | | |
| Interest-bearing debt | 4,899 | 4,854 | 12,172 | 12,265 |
| Trade payables and other debt | 5,847 | 5,847 | 6,692 | 6,692 |
| Financial liabilities measured at amortized cost | 10,746 | 10,701 | 18,864 | 18,957 |
| | | | | |
| Derivative financial instruments for the hedging of the fair value of recognized assets and liabilities | | | 2 | 2 |
| Derivative financial instruments for the hedging of future cash flows | 19 | 19 | 141 | 141 |
| Financial liabilites used as hedging instruments | 19 | 19 | 143 | 143 |
| | | | | |
| Derivative financial instruments for financial hedging | 2 | 2 | | |
| Financial liabilities measured at fair value via the income statement | 2 | 2 | | |

The value of derivative financial instruments is measured according to generally accepted valuation techniques based on relevant observable swap prices and exchange rates. The market value of the interest-bearing debt is recognized as the present value of expected future instalment and interest payments. The discount rate applied is the Group's current borrowing rate on loans for corresponding terms. The short-term, floating-rate debt at banks is stated at the price of 100. The fair value of trade receivables and trade payables with short credit terms are estimated to be equal the carrying amount. The methods applied remain unchanged compared to 2013.

**FAIR VALUE HIERARCHY AS OF DECEMBER 31 FOR THE GROUP**

| | 2013 Quoted prices Level 1 | 2013 Observable input Level 2 | 2013 Non-observable input Level 3 | 2013 In total | 2014 Quoted prices Level 1 | 2014 Observable input Level 2 | 2014 Non-observable input Level 3 | 2014 In total |
|---|---|---|---|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | | | | | |
| Other investments | | | 32 | 32 | | | 33 | 33 |
| Derivative financial instruments for the hedging of the fair value of recognized assets and liabilities | | 18 | | 18 | | 14 | | 14 |
| Derivative financial instruments for the hedging of future cash flows | | 39 | | 39 | | | | |
| Total financial assets | | 57 | 32 | 89 | | 14 | 33 | 47 |
| | | | | | | | | |
| **FINANCIAL LIABILITIES:** | | | | | | | | |
| Derivative financial instruments for the hedging of the fair value of recognized assets and liabilities | | | | | | 2 | | 2 |
| Derivative financial instruments for the hedging of future cash flows | | 19 | | 19 | | 141 | | 141 |
| Derivative financial instruments for financial hedging | 1 | 1 | | 2 | | | | |
| Interest-bearing debt | | 4,854 | | 4,854 | | 12,265 | | 12,265 |
| Total financial liabilities | 1 | 4,874 | | 4,875 | | 12,408 | | 12,408 |

# Note 16 FINANCIAL RISKS AND INSTRUMENTS (continued)

DKKm

**FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE BASED ON LEVEL 3**

| | 2013 | 2014 |
|---|---|---|
| | Other invest-ments Level 3 | Other invest-ments Level 3 |
| Carrying amount as of January 1 | 28 | 32 |
| Addition through aquisition of subsidiaries | | 5 |
| Gain/loss (-) in the income statement | 2 | -4 |
| Purchase | 2 | |
| Carrying amount as of December 31 | 32 | 33 |
| | | |
| Gain/loss (-) in the income statement for assets owned as of December 31 | 2 | -4 |

Gain/loss (-) in the income statement is recognized under financial income and expenses.

**DERIVATIVES AS OF DECEMBER 31 FOR THE GROUP**

| | 2013 | | | | | | 2014 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount at contract price | Gain/loss (-) on market value adjustment | Gain/loss (-) recognized in income statement | Due less than 1 year | Due between 1 and 5 years | Due after 5 years | Amount at contract price | Gain/loss (-) on market value adjustment | Gain/loss (-) recognized in income statement | Due less than 1 year | Due between 1 and 5 years | Due after 5 years |
| USD | 230 | 41 | 13 | 28 | | | -29 | 5 | 3 | 13 | -11 | |
| EUR | 363 | 3 | 4 | -1 | | | 1,455 | -2 | -3 | 1 | | |
| Other currencies | 391 | 9 | | 9 | | | -479 | -94 | 10 | -104 | | |
| Forward exchange contracts | | 53 | 17 | 36 | | | | -91 | 10 | -90 | -11 | |
| Interest swaps | | -17 | -1 | | -16 | | | -37 | | | -37 | |
| Other derivatives | | -1 | -1 | | | | | -1 | -2 | | 1 | |
| Derivatives end of year | | 35 | 15 | 36 | -16 | | | -129 | 8 | -90 | -47 | |

At the end of 2014, unrealized gain/loss(-) on derivatives recognized in equity amounted to DKK -137m (2013: 20m).

Forward exchange contracts are primarily used for hedging future sales in foreign currencies. Interest rate products are used to convert floating-rate liabilities to fixed rates.

DKK 0m was taken to income in 2014 (2013: 1m) as a consequence of testing for effectiveness.

## Note 17 CORPORATION TAX

DKKm

| | 2013 | 2014 |
|---|---|---|
| Corporation tax payable/receivable (-) as of January 1 | -115 | -23 |
| Foreign exchange adjustment in foreign companies | -29 | -25 |
| Addition through aquisition of subsidiaries | | 6 |
| Paid during the year | -1,171 | -1,107 |
| Adjustments concerning previous years | 106 | -31 |
| Current tax expenses in income statement | 1,129 | 1,072 |
| Current tax expenses in other comprehensive income | 57 | -38 |
| Corporation tax payable/receivable (-) as of December 31 | -23 | -146 |
| | | |
| The above corporation tax is recorded as follows: | | |
| Assets | 266 | 441 |
| Liabilities | 243 | 295 |
| | -23 | -146 |

## Note 18 ADJUSTMENT FOR NON-CASH TRANSACTIONS

DKKm

| | 2013 | 2014 |
|---|---|---|
| Depreciation/amortization and impairment | 1,680 | 1,738 |
| Gain(-)/loss on disposal of tangible assets and business activities | -8 | -99 |
| Share of profit from associates and joint ventures after tax | -8 | 187 |
| Financial income | -33 | -37 |
| Financial expenses | 402 | 486 |
| Other, including provisions | 254 | -293 |
| Adjustment for non-cash transactions | 2,287 | 1,982 |

## Note 19 CHANGE IN WORKING CAPITAL

DKKm

| | 2013 | 2014 |
|---|---|---|
| Change in inventories | -28 | 105 |
| Change in receivables | -359 | -13 |
| Change in trade payables and other debt | 683 | 104 |
| | 296 | 196 |

# **Note 20** ACQUISITION AND SALE OF SUBSIDIARIES AND ACTIVITIES

On December 2, 2014, the Danfoss group paid and acquired 97.9% of the share capital and obtained control of Vacon, a producer of frequency converters. In order to gain possession of all the shares in Vacon, Danfoss submitted an application on December 2, 2014 to the Redemption Committee of the Finland Chamber of Commerce for the commencement of arbitration proceedings with regard to the squeeze-out procedure concerning the minority shares in Vacon. At the end of 2014 Danfoss holds 98.5% of the share capital of Vacon, and the remaining 1.5% of the share capital has or will be acquired during 2015. End of December 2014 the remaining outstanding shares of 1.5% with a value of DKK 120m has been included in the total acquisition price with a corresponding liability in Other Debt under Current Liabilities. The liability is calculated as the number of outstanding shares multiplied with the agreed share price of 34 EUR.

Combining the two companies will create a new drives business with the clear ambition to build a leading position in the market. The Danfoss Group also expects to reduce cost through economies of scales.

The goodwill of DKK 5,514m arising from the acquisition is attributable to the value of staff, know-how and synergies expected from combining the operations of the Danfoss group and Vacon. None of the goodwill recognized is expected to be deductible for income tax purposes.

The following table summarizes the consideration paid for Vacon, the fair value of assets acquired and liabilities assumed at the acquisition date.

DKKm

| | 2013 | 2014 | 2013 | 2014 |
|---|---|---|---|---|
| | Acquisitions | Acquisitions | Disposals | Disposals |
| Intangible assets, except goodwill | | -2,033 | | |
| Property, plant and equipment | | -197 | | |
| Other non-current assets, including deferred tax assets | | -113 | | |
| Inventories | | -290 | | |
| Receivables | | -636 | | |
| Cash and cash equivalents | | -242 | | |
| Interest-bearing debts | | 121 | | |
| Provisions, including deferred tax liabilities | | 609 | | |
| Trade and other payables | | 547 | | |
| Net assets acquired | | -2,234 | | |
| Goodwill(-)/profit on disposal | | -5,514 | -3 | -3 |
| Net assets including goodwill(-)/profit on disposal | | -7,748 | -3 | -3 |
| Cash and cash equivalents | | 242 | | |
| Consideration, net of cash | | -7,506 | -3 | -3 |
| Change in short term payable/receivable | | 120 | 3 | 2 |
| Minority interest | | 10 | | |
| Net cash paid(-)/received | | -7,376 | | -1 |

Included in the acquired assets are trade receivables with a fair value of DKK 566m. The gross contractual amount for trade receivables due is DKK 594m, of which DKK 28m is expected to be uncollectible.

The initial accounting for the acquisition of Vacon is preliminary because of the short time span between the acquisition date and the time the financial statements are authorized for issue. The acquisition has been accounted for in a preliminary manner, which in accordance with IFRS 3 will be finalized within 12 months.

Acquisition-related costs, e.g. due diligence cost, of DKK 44m have been charged to other operating expenses in the consolidated income statement for the year ended December 31, 2014.

The Net sales included in the consolidated statement of comprehensive income since start of December 2014 contributed by Vacon PLC was DKK 260m. Vacon also contributed Profit before tax of DKK -57m over the same period. The Profit before tax is impacted by interest as well as Purchase Price Allocation (PPA) expenses related to reversal of inventory step-up to fair value and amortizations on intangibles assets of DKK 81m.

Had Vacon been consolidated from January 1, 2014, the combined Group Net sales would be DKK 37,160m and Profit before tax would be DKK 3,444m. The combined Profit before tax is impacted by Vacon related interest as well as PPA expenses and amortizations of DKK 335m.

**ACQUISITION AND SALE OF SUBSIDIARIES AND ACTIVITIES AFTER THE REPORTING PERIOD**
There have not been any significant acquisitions and disposals of companies/activities after the reporting period.

**ACQUISITION AND SALE OF SUBSIDIARIES AND ACTIVITIES 2013**
The Group neither acquired nor sold any subsidiaries or activities in 2013.

# **Note 21** ACQUISITION(-)/SALE OF OTHER INVESTMENTS

DKKm

| | 2013 | 2014 |
|---|---|---|
| Sale of shares and other securities | 14 | 19 |
| Purchase of shares and other securities | | -2,256 |
| Increase/decrease of lending | 73 | 34 |
| | 87 | -2,203 |

Purchase of shares and other securities is relating to purchase of shares in SMA Solar Technology AG. Further information is provided in Note 3. Investments.

# **Note 22** CONTINGENT LIABILITIES, ASSETS AND SECURITY

DKKm

**SECURITY**

| | 2013 | 2014 |
|---|---|---|
| Carrying amount of land and buildings pledged as security for bank loans and mortgages | 706 | 735 |
| Leasing assets pledged as security for leasing commitments | 66 | 38 |
| Secured loans from financial institutions | 1,283 | 1,239 |

In connection with disposal of subsidiaries, ordinary guarantees and warranties have been issued. These guarantees and warranties are considered to have no impact on the Group's financial position beyond what has been stated in the annual report.

**CONTINGENT LIABILITIES**

At the beginning of 2009 the European Commission's Directorate General for Competition along with a number of other competition authorities initiated investigations of, among others, Danfoss Household Compressors on suspicion of breach of competition regulations. These Investigations have all been concluded.
Civil lawsuits against Danfoss are still pending in Europe and North America, the outcomes of which are not yet known.

In addition, Danfoss A/S is party to a small number of disputes, lawsuits and legal actions, including tax disputes.
It is the view of the Management that the outcome of these legal actions will have no other significant impact on Danfoss A/S' financial position beyond what has been recognized and stated in the Annual Report.

**OPERATING LEASES (LEASE EXPENSES)**

| Operating lease payments fall due as follows: | 2013 | 2014 |
|---|---|---|
| Buildings: | | |
| Less than 1 year | 198 | 268 |
| Between 1 and 5 years | 522 | 674 |
| More than 5 years | 318 | 303 |
| | | |
| Equipment etc.: | | |
| Less than 1 year | 160 | 148 |
| Between 1 and 5 years | 190 | 150 |
| More than 5 years | 5 | 5 |

The Group expensed DKK 413m in operating lease payments in 2014 (2013: 446m) and they relate mainly to buildings and equipment. There were no significant contingent lease payments in 2014 or 2013.

**OPERATING LEASES (LEASE INCOME)**

| Operating lease payments fall due as follows: | 2013 | 2014 |
|---|---|---|
| Less than 1 year | 14 | 8 |
| Between 1 and 5 years | 9 | 6 |
| More than 5 years | 5 | |

The Group recognized operating lease income of DKK 32m in 2014 (2013: 47m). The above rentals relate mainly to buildings.

**CONTRACTUAL OBLIGATIONS**

| | 2013 | 2014 |
|---|---|---|
| Service contract commitment other than leases | 412 | 382 |
| Inventories | 336 | 463 |
| Property, plant and equipment | 241 | 137 |
| Hereof commitments relating to succeeding year | 817 | 821 |

# **Note 23** RELATED PARTIES

Danfoss A/S' related parties comprise Bitten & Mads Clausen Foundation and other shareholders with significant ownership interests, cf. Note 11. Share capital, as well as subsidiaries, associates, joint ventures, the Board of Directors, the Executive Committee and other members of the Danfoss Leadership Team. Further, related parties comprise companies in which the above-mentioned persons have significant interests.

**BITTEN & MADS CLAUSEN FOUNDATION, OTHER SHAREHOLDERS AND OTHER RELATED COMPANIES**

The Bitten and Mads Clausen Foundation, which holds 46.33% of the shares in Danfoss A/S and controls 84.96% of the voting power, has the controlling influence.

In the financial year a limited number of transactions have taken place between Bitten & Mads Clausen Foundation, its other subsidiaries and certain shareholders of the Clausen Family. The transactions comprise of service and financial transactions and they have been made according to the arm's length principle or on a cost covering basis. The total payment to the Danfoss Group does not exceed DKK 25m (2013: 25m). In the financial year, Bitten & Mads Clausen Foundation did not sell shares in Danfoss A/S back to the company (2013: 100m). Around 94% of Danfoss A/S' dividend payments is related to Bitten & Mads Clausen Foundation and shareholders of the Clausen Family.

**BOARD OF DIRECTORS, EXECUTIVE COMMITTEE AND OTHER MEMBERS OF DANFOSS LEADERSHIP TEAM**

In the financial year, no transactions took place with the Board of Directors, the Executive Committee or other members of the Danfoss Leadership Team other than the transactions as a result of conditions of employment, except for the following:
The Group has a rental agreement for a property in Italy with Chairman of the Board Jørgen M. Clausen. The rental agreement runs until and including 2017. The rent payment amounted to DKK 2m in 2014 (2013: 2m). Besides that, companies in which Peter M. Clausen and Jørgen M. Clausen have significant ownership interests have sold goods and services of less than DKK 5m (2013: 5m) to the Danfoss Group. All transactions were performed on an arm's length basis.

For further information about the salaries of the board and the Executive Committee see the Note 2. Expenses and other operating income, section A. Personnel expenses and Note 13. Share incentive programs.

DKKm

**TRANSACTIONS WITH ASSOCIATES AND JOINT VENTURES**

| | 2013 | 2014 |
|---|---|---|
| Sales of goods and services | 21 | 177 |
| Purchases of goods and services | 91 | 128 |

Transactions besides the above transactions with joint ventures and associates are described in Note 3. Investments, Note 4. Financial income, Note 5. Financial expenses and Note 16. Financial risks and instruments.

# **Note 24** EVENTS AFTER THE BALANCE SHEET DATE

Subsequent to December 31, 2014 there have been no further events with any significant effect on the financial statements beyond what has been recognized and disclosed in the Annual Report.

# **Note 25** BASIS FOR PREPARATION AND ACCOUNTING POLICIES

Danfoss A/S is a public limited company domiciled in Denmark. The Annual Report for the period January 1-December 31, 2014, comprises the consolidated financial statements of Danfoss A/S and its subsidiaries (the Group), according to the requirements of the Danish Financial Statements Act.

The consolidated financial statements and the financial statements of Danfoss A/S have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU and Danish disclosure requirements pursuant to the Danish Financial Statements Act. Unless otherwise indicated, the Annual Report is presented in DKK rounded to the nearest million.

The Board of Directors and the Executive Committee reviewed and approved the Annual Report 2014 on March 24, 2015, and it will be presented for approval at the Annual General Meeting to be held on April 24, 2015.

The annual report has been prepared on the basis of the historical cost convention except for the following assets and liabilities, which are measured at fair value: derivative financial instruments, financial instruments classified as available for sale, liabilities related to share options and warrants as well as pension and healthcare obligations. Non-current assets and disposal Groups held for sale are measured at the lower of carrying amount before the reclassification and fair value less costs to sell.

The accounting policies have been consistently applied in respect of the financial year and the comparative figures.

The accounting policies are consistent with those applied in the previous year except for the following changes:

**Changes in presentation of Operating profit (EBIT) in profit and loss**
Danfoss A/S has, starting from 2014, decided to include share of profit from associates and joint ventures after tax in Operating profit (EBIT). Before 2014 it was classified below Operating Profit (EBIT).

Danfoss considers associates and joint ventures to be an integrated part of the Group, as the shareholdings in associates and joint venture participate in generating the operating profit of the consolidated Group. Comparison figures for 2013 have been increased with 8 million DKK in order to reflect this change. No key figures other than Operating profit (EBIT) are impacted.

**Changes in accounting policies**
Danfoss A/S has implemented the standards and interpretations that have taken effect for 2014. None of those standards and interpretations have affected recognition and measurement in 2014, nor are they expected to have a material effect on Danfoss A/S in future.

**New financial reporting regulations**
A number of standards and interpretations have been issued that are not mandatory for Danfoss A/S in the preparation of the Annual Report for 2014.

An assessment of the impact of the standards and interpretations in question has been initiated and the expectation is that these will not have any material impact on the financial reporting of Danfoss. The new standards and interpretations are expected to be implemented from their mandatory effective dates.

**Accounting policies**

**Consolidated financial statements**
The consolidated financial statements comprise the Parent Company, Danfoss A/S and subsidiaries in which Danfoss A/S directly or indirectly hold more than 50% of the voting rights or otherwise control the company's financial and operating policies with a view to obtaining a yield or other benefits from its activities. Companies in which the Group has between 20% and 50% of the voting rights and exercises a significant influence, but does not control, are considered associates or joint ventures when the joint venture conditions of IFRS 11 are met. When assessing whether Danfoss A/S exercises control or significant influence or joint control, potential voting rights which can be utilized at the balance sheet date are taken into account.

The consolidated financial statements are prepared by aggregating the financial statements of the Parent Company and the individual subsidiaries, which have all been prepared in accordance with t h e accounting policies of Danfoss A/S.

Investments in subsidiaries are set off against the proportionate share of the subsidiaries' fair value of the identifiable net assets and recognized contingent liabilities at the acquisition date. On consolidation, intra-Group income and expenses, shareholdings, intra-Group balances and dividends and realized and un-realized profits and losses on transactions between the consolidated companies are eliminated. Unrealized losses are eliminated in the same way as unrealized profits, provided that no impairment has occurred.

In the consolidated financial statements, the items of subsidiaries are recognized in full. The minority interests' proportionate share of the profit/loss for the year is recognized as part of the Group's profit/loss for the year and as a separate share of the Group's equity.

The companies included in the Group are disclosed in the section "Danfoss Group Companies".

**Business combinations**
Newly acquired or established companies are recognized in the consolidated financial statements from the acquisition date, and divested companies are recognized in the consolidated income statement until the time of divestment. Comparative figures are not restated for newly acquired companies. Unless divested companies are classified as discontinued operations, comparative figures are not restated.

When the Danfoss Group takes over control of acquired companies, the purchase method is applied. This means that the identifiable assets and liabilities, including contingent liabilities, of the acquired companies are stated at fair value at the acquisition date.

Identifiable intangible assets are recognized if they can be separated or arise from a contractual right. The tax effect of revaluations is recognized. The time of takeover is the day when the Danfoss Group de facto obtains control of the acquired company.

The consideration for a business comprises the fair value of the consideration agreed upon, in the form of assets transferred, liabilities assumed and equity instruments issued. If part of the consideration is contingent on future events or in compliance with agreed conditions, that part of the consideration is recognized at fair value at the acquisition date. Costs attributable to business combinations are recognized directly in the income statement when incurred.

# **Note 25** BASIS FOR PREPARATION AND ACCOUNTING POLICIES (continued)

When a business is taken over in more than one transaction (step acquisition), previously acquired investments are revalued at fair value at the acquisition date, and value adjustments are recognized in the income statement under other operating income or other operating expenses. Management estimates the fair value of the total investment acquired immediately on completion of the step acquisition. Fair value is measured at the cost of the total investment acquired.

If uncertainty exists at the acquisition date concerning the identification or measurement of acquired assets, liabilities or contingent liabilities, initial recognition is made at provisional fair values. If it subsequently becomes apparent that the fair value of identifiable assets and liabilities, including contingent liabilities, differs from the assumed fair value at the acquisition date, the calculation is adjusted retroactively, including goodwill, until 12 months following the acquisition. The effect of the adjustments is recognized in the opening equity and comparative figures are restated. Subsequently, goodwill is not adjusted. Changes in estimates of contingent consideration are recognized directly in the income statement.

Any excess of the cost over the fair value of the identifiable assets and liabilities, including contingent liabilities (goodwill), is recognized as goodwill under intangible assets. Goodwill is not amortized, but is subject to annual impairment tests. The initial impairment test is carried out before the end of the acquisition year. Upon acquisition, goodwill is allocated to the cash-generating units, which form the basis for subsequent impairment tests. Identification of cashgenerating units is based on the Group's cash flows, in accordance with the structure in the internal financial reporting. Such cash flows do not always follow the legal structure of the Group.

Goodwill and fair value adjustments related to the acquisition of a foreign unit with a functional currency other than the Danfoss Group's presentation currency are treated as assets and liabilities belonging to the foreign unit and converted to the functional currency of the foreign unit at the exchange rate on the transaction day.

Gain or loss on disposal of subsidiaries, associates or joint ventures are stated as the difference between the sales amount or the disposal amount and the carrying amount of net assets, including goodwill at the date of disposal, less disposal costs.

**Minority interests**

On initial recognition, minority interests are measured either at fair value or at their proportionate share of the fair value of the acquired company's identifiable assets, liabilities and contingent liabilities. In the case of the former, goodwill is recognized in respect of the minority interests' ownership share in the acquired company, whereas in the latter case, goodwill is not recognized as a part of minority interests. The measurement of minority interests is determined for each transaction and stated in the notes under the description of acquired companies.

**Foreign currency translation**

For each of the reporting enterprises in the Group, a functional currency is determined. The functional currency is the currency used in the primary financial environment in which the reporting enterprise operates. Transactions denominated in currencies other than the functional currency are considered transactions denominated in foreign currencies. On initial recognition, transactions denominated in foreign currencies are translated to the functional currency at the exchange rates at the transaction date. Monetary assets and liabilities denominated in foreign currencies are translated at the exchange rates at the balance sheet date. Currency gains and losses arising on translation are recognized in the income statement under financial items. Non-monetary assets and liabilities denominated in foreign currencies are recognized at the foreign exchange rates at the transaction date.

On recognition in the consolidated financial statements of companies with a functional currency other than DKK, the income statements are translated at the exchange rates at the transaction date, and the balance sheet items are translated at the exchange rates at the balance sheet date. An average exchange rate for each month is used as the exchange rate at the transaction date to the extent that this does not significantly distort the presentation of the underlying transactions. Foreign exchange differences arising on translation of the opening balance of equity of such enterprises at the exchange rates at the balance sheet date and on translation of the income statements from the exchange rates at the transaction date to the exchange rates at the balance sheet date are recognized directly in equity under a separate translation reserve. The foreign exchange adjustment is allocated between the equity of the Parent Company and of the minority shareholders.

Foreign exchange adjustments of balances which are considered part of the total net investment in companies with a different functional currency than DKK are recognized directly in the equity under a separate reserve for foreign exchange adjustments. Likewise, foreign exchange gains or losses are recognized in the consolidated financial statements (directly in the equity under a separate reserve for foreign exchange adjustments) concerning the part of loans and derivative financial instruments, which has been allocated for currency hedging of net investments made in these companies and which effectively protects against similar currency rate gains or losses on net investments in the company.

On disposal of wholly-owned foreign units, the foreign exchange adjustments which have been accumulated in equity via other comprehensive income and which can be ascribed to the unit are reclassified from "Translation reserve" to the income statement, together with any gains or losses from the disposal.

On disposal of partially-owned foreign subsidiaries, the part of the translation reserve related to minority interests is not recognized in the income statement.

Repayments of balances, which are considered part of the net investment, are not considered a partial disposal of the subsidiary.

**Income statement**

**Net sales**

Net sales of goods for resale and finished goods are recognized in the income statement, provided that delivery and transfer of risk to the purchaser has taken place before the year end, and that the income can be reliably measured and payment is expected to be received. Net sales are measured at the fair value of the consideration agreed, excluding VAT, duties and discounts in relation to the sale. Related service income is recognized in the income statement as the services are performed. Accordingly, the recognized sale corresponds to the sales value of the work performed during the year. The sale of services is recognized in the income statement when the aggregated income and expenses of the service contract can be reliably measured, and it is probable that the Group will receive the financial benefits, including payments.

**Cost of sales**

Cost of sales comprises costs incurred in generating the year's net sales.

Such costs include cost of sales or manufacturing costs, including direct and indirect costs for raw materials and consumables, wages and salaries, rent and leases, and depreciation.

**Research and development cost**
Research and development costs include costs that do not qualify for capitalization including costs, like wages and salaries and consumables.

**Selling and distribution costs**
Selling and distribution costs comprise costs related to distribution of products sold during the year and sales staff, advertising and exhibition expenses etc., including depreciation. Furthermore, provisions for bad debt are included.

**Administrative expenses**
Administrative expenses comprise expenses in relation to administrative staff, management, office premises, office expenses etc., including depreciation.

**Other operating income and expenses**
Other operating income and expenses comprise items secondary to the principal activities of the companies, including gains/losses on disposal of non-current assets and companies, impairment losses and employee termination expenses.

Share of profit from investments in associates and joint ventures
The proportionate share of the results of associates and joint ventures after tax is recognized in the consolidated income statement after elimination of the proportionate share of intra-Group profits/losses and less goodwill impairment.

**Financial income and expenses**
Financial income and expenses comprise interest income and expenses, realized and unrealized gains and losses on securities, debt and transactions denominated in foreign currencies, amortization of financial assets and liabilities and surcharges and refunds under the Tax Prepayment Scheme etc. Also included is the interest element of finance leases and gains and losses on derivative financial instruments which are not designated as hedging arrangements.

Borrowing costs incurred in relation to general borrowing activities or loans which relate directly to the purchase, construction or development of qualifying assets, are allocated to the cost of such assets.

**Balance sheet**

**Intangible assets**

**Goodwill**
Goodwill is initially recognized in the balance sheet at cost and allocated to cash-generating units as described under "Business combinations. Subsequently, goodwill is measured at cost less accumulated impairment losses. Goodwill is not amortized.

**Development projects, software, patents and licenses**
Development projects that are clearly defined and identifiable, where the technical feasibility, sufficient resources and a potential future market or utilization opportunity within the company is demonstrated, and where the company intends to produce, market or use the project, are recognized as intangible assets provided that the cost can be measured reliably and that there is sufficient assurance that future earnings or the net selling price can cover cost of sales, selling and distribution costs and administrative expenses and development costs. Other development costs are recognized in the income statement when incurred.

Recognized development projects are measured at cost less accumulated amortization and impairment. Cost includes direct and indirect expenses, including salaries and borrowing costs incurred from specific and general borrowing directly pertaining to the development of development projects.

Completed development projects, including software, are generally amortized on a straight-line basis over 4 to 5 years. Development projects in progress are not amortized, but are annually tested for impairment.

Patents and licenses are measured at cost less accumulated amortization and impairment. Patents are amortized on a straight-line basis over the patent period and licenses are amortized over the shorter of the contract period and the useful life. Patent and contract periods are normally 5-10 years.

**Other intangible assets**
Other intangible assets, including intangible assets acquired in a business combination, which typically comprise technology and customer relations, are amortized on a straight-line basis over the expected useful life, which is typically a period of 10 to 20 years. Intangible assets, including trademarks, with indefinite useful lives are not amortized, but are tested annually for impairment.

Gains and losses on the disposal of intangible assets are determined as the difference between the selling price less costs to sell and the carrying amount at the selling date. Gains or losses are recognized in the income statement under Other operating income or Other operating expenses.

**Property, plant and equipment**
Land and buildings, plant and machinery and equipment are measured at cost less accumulated depreciation and impairment losses.

Cost comprises the purchase price, expenses for materials, components, sub-suppliers, direct salary expenses, borrowing costs incurred from specific and general borrowing which directly pertain to the construction of the individual asset and for self-produced assets as well as indirect construction costs. Where individual components of an item of property, plant and equipment have different useful lives, they are accounted for as separate items, and depreciated separately.

Subsequent costs, e.g. in connection with replacement of components of property, plant and equipment, are recognized in the carrying amount of the asset, if it is probable that the costs will result in future economic benefits. All costs incurred for ordinary repairs and maintenance are recognized in the income statement as incurred.

Depreciation is provided on a straight-line basis over the expected useful lives, which are as follows:

| | |
|---|---|
| Buildings and building components | 15-30 years |
| Plant and machinery | 4-10 years |
| Equipment | 2-6 years |

The depreciable amount of an asset is determined based on the residual value of the asset less any impairment charges. The residual value is determined at the acquisition date and reassessed annually. If the residual value exceeds the carrying amount of the asset, depreciation is discontinued. When changing the depreciation period or the residual value, the effect on the depreciation is recognized prospectively as a change in accounting estimates.

Depreciation is recognized in the income statement under Costs of sale, Distribution costs or Administrative expenses.

Gains and losses on disposal of property, plant and equipment are determined as the difference between the selling price less costs to sell and the carrying amount at the selling date. Gains or losses are recognized in the income statement under other operating income or other operating expenses.

The cost of assets held under finance leases is recognized at the acquisition date at the lower of fair value of the assets and the present value of the future lease payments. For the calculation of the net present value, the interest rate implicit in the lease or the Group's alternative interest rate is used as discount rate. Assets held under finance leases are depreciated and amortized like other property, plant and equipment.

Assets held under operating leases are systematically expensed over the lease period.

### Impairment of non-current assets

Goodwill and intangible assets with indefinite useful lives are tested annually for impairment, initially before the end of the acquisition year. Similarly, development projects in progress are subject to an annual impairment test. Deferred tax assets are subject to annual impairment tests and are recognized only to the extent that it is probable that the assets will be utilized.

The carrying amount of other non-current assets is tested annually for evidence of impairment. When there is evidence that assets may be impaired, an impairment test is made. Impairment is tested by calculating the recoverable amount. The recoverable amount is the higher of an asset's fair value less expected costs to sell and its value in use. The value in use is determined as the present value of expected future cash flows from the asset or the cash-generating unit (CGU). If the fair value or value in use cannot be determined on individual assets, the recoverable amount is determined as the fair value of expected future cash flows from activities or the cash-generating unit (CGU) to which the asset belongs.

Impairment losses are recognized in the income statement if the carrying amount of an asset or a cash-generating unit exceeds the recoverable amount.

Impairment of assets is reversed to the extent of changes in the assumptions and estimates underlying the impairment calculation. Impairment is only reversed to the extent that the asset's new carrying amount does not exceed the carrying amount of the asset after depreciation or amortization, had the asset not been impaired. However, impairment of goodwill is never reversed.

## Financial assets

Investments in associates and joint ventures are measured in the consolidated financial statements according to the equity method at the proportionate share of the enterprises including additional value from acquisitions, including goodwill and deduction or addition of proportionate shares of unrealized intra-group profits and losses. Investments in associates and joint ventures are tested for impairment, when evidence of impairment exists.

## Inventories

Inventories are measured at cost. Where the estimated selling price less any costs of completion and selling (net realizable value) is lower than cost, inventories are written down to this lower value. Cost is calculated on the basis of the weighted average method or the FIFO method. The cost of work in progress and finished goods comprises the cost of raw materials and consumables, conversion costs and other costs directly or indirectly attributable to the goods. Indirect production overheads comprise maintenance and depreciation of production facilities and plant as well as administration and management of factories.

## Receivables

Receivables are measured at amortized cost. Receivables are written down for bad debt losses in case of evidence of impairment on the basis of customers' anticipated ability to pay and expectations of any changes to this ability, taking into account historical payment patterns, terms of payment, customer segment, creditworthiness and prevailing market conditions in the individual markets. Impairment losses are calculated as the difference between carrying amount and present value of expected cash flows, including the expected realizable value of any collateral provided. The discount rate is the effective interest rate used at the time of initial recognition of the receivable.

## Equity

### Share capital

The share capital comprises the nominal portion of the amounts paid in accordance with the subscription for shares. Share capital can only be released according to the rules relating to capital reduction.

### Share premium

Share premium comprises amounts not included in the nominal share capital which have been paid by the shareholders in connection with capital increases, and gains and losses from the sale of treasury shares. The reserve is part of the company's free reserves.

### Reserve for proposed dividends

Dividends are recognized as a liability at the date when they are adopted at the Annual General Meeting. Proposed dividends for the financial year are included in equity under proposed dividends.

### Hedging reserve

In connection with hedging of future sales and purchase transactions (cash flows), changes in the fair value of instruments qualifying for hedge accounting (documentation etc.) are recognized in the statement of comprehensive income under hedging reserve, until the hedged transaction is realized. The recognized changes in the fair value are recognized in the hedging reserve under equity.

### Translation reserve

Foreign exchange differences arising on the translation of the opening balance of equity of foreign companies at the exchange rates at the balance sheet date, and on translation of income statements from the exchange rates at the transaction date to the exchange rates at the balance sheet date are recognized directly in a separate translation reserve in the statement of comprehensive income under the item Foreign exchange adjustments.

Foreign exchange adjustments of non-current balances with foreign subsidiaries and associates, which are considered additions to or deductions from the subsidiaries' equity as well as foreign exchange adjustments of hedging transactions for the purpose of hedging the Group's net investments in subsidiaries, are also recognized directly in the consolidated statement of comprehensive income. The translation reserve in the equity comprises the parent company shareholders' share of the foreign exchange adjustments. On complete or partial disposal of a foreign entity or on repayment of balances which constitute part of the net investment in the foreign entity, the share of the cumulative amount of the exchange differences recognized in other comprehensive income relating to that foreign entity is recognized in the income statement when the gain or loss on disposal is recognized..

Reserve for treasury shares

The reserve for treasury shares comprises the acquisition cost for the company's portfolio of treasury shares. The dividend from treasury shares is recognized directly in the retained earnings in equity. Gains and losses from the sale of treasury shares are recognized in share premium.

**Provisions**

A provision is recognized in the balance sheet when the Group has a legal or constructive obligation as a result of a past event in the financial year or previous years, and it is probable that the settlement of the obligation may lead to an outflow of the Group's financial resources which can be reliably measured at the balance sheet date. The amount recognized as a provision is Management's best estimate of the expenses required to settle the obligation. In measuring provisions, the costs required to settle the liability are discounted if the effect is material to the measurement of the liability.

For the measurement, a pre-tax discount factor is used which reflects the current market interest rate level and the specific risks related to the liability. Changes in present values for the financial year are recognized under financial expenses.

Warranty provisions are recognized as the underlying goods and services are sold based on warranty costs incurred in the financial year and in previous years.

Provisions for restructuring and employee termination costs are made when the Group has agreed on a detailed and formal plan, and the Group has started implementing the plan or has announced the plan to the persons affected. Restructuring provisions do not include costs for the ongoing operations during the restructuring phase.

**Share-based remuneration**

The Board, Executive Committee and several senior employees are covered by option and warrant schemes based on the Parent Company's shares.

The value of services received in exchange for granted options/warrants is measured at the fair value of the options/warrants.

For share options and warrants where the option or warrant holder has the right to receive cash settlement of the option or warrant, fair value of the instruments is initially measured at the grant date and recognized in the income statement as personnel costs over the vesting period.

Subsequently, the fair value of the instruments is measured at the balance sheet date and changes in fair values are recognized in the income statement under financial items.

On initial recognition of the share options and warrants, the Company estimates the number of options and warrants expected to vest, cf. the service condition described in note 13 Share incentive programs. That estimate is subsequently revised for changes in the number of options expected to vest. Accordingly, recognition is based on the number of options ultimately vested.

The fair value of granted instruments is measured based on the Black-Scholes model (warrant and option pricing model) taking into account the terms and conditions upon which the instruments were granted.

**Employee shares**

On the granting of employee shares, any bonus element is recognized as an expense under personnel costs. The counter entry is recognized directly in equity. The bonus element is determined at the subscription date as the difference between the fair value and the subscription price of the shares.

**Pension obligations and defined benefit healthcare plans**

The Group has entered into pension schemes and similar arrangements with the majority of the Group's employees. In addition, the Group has healthcare plans contributing with payment for medical expenses for certain employee Groups in the USA after their retirement.

Contributions to defined contribution plans, where the Group currently pays fixed pension payments to independent pension funds, are recognized in the income statement in the period to which they relate, and any contributions outstanding are recognized in the balance sheet as other debt.

For defined benefit pension and healthcare plans, the Group is under an obligation to pay a specific benefit upon retirement (e.g. a fixed amount or a percentage of the exit salary). For these plans, an annual actuarial calculation (Projected Unit Credit method) is made of the present value of future benefits under the defined benefit plan. The present value is determined on the basis of assumptions about the future development in variables such as salary levels, interest rates, inflation and mortality. The present value is determined only for benefits earned by employees from their employment with the Group. The actuarial present value less the fair value of any plan assets is recognized in the balance sheet under pension and healthcare obligations.

Pension and healthcare costs for the year are recognized in the income statement based on actuarial estimates and financial expectations at the beginning of the year. Any difference between the expected development in assets and liabilities and realized amounts determined at year end constitutes actuarial gains or losses and is recognized directly in other comprehensive income. If changes in benefits relating to services rendered by employees in previous years result in changes in the actuarial present value, the changes are recognized as past service costs. Past service costs are recognized immediately, provided that the benefits have already vested. If the benefits have not vested, the past service costs are expensed in the income statement over the period in which the changed benefits vest.

If a pension or healthcare plan constitutes a net asset, the asset is only recognized if it offsets future refunds from the plan or will lead to reduced future payments to the plan.

**Other long-term employee benefits**

Similarly, other long-term employee benefits are recognized based on an actuarial calculation. However, actuarial gains and losses are recognized in the income statement immediately. Other long-term employee benefits include jubilee benefits.

**Financial liabilities**

Financial liabilities are initially recognized at fair value less transaction costs. Subsequently, they are measured at cost/amortized cost. Amortized cost implies the recognition of a constant effective interest rate to maturity. Amortized cost is calculated as initial cost less any principal

## Note 25 BASIS FOR PREPARATION AND ACCOUNTING POLICIES (continued)

repayments and plus or less the cumulative amortization of any difference between cost and nominal amount. Any capitalized residual obligation on finance leases is recognized in the balance sheet as a liability. The interest element of the lease payment is expensed in the income statement under financial items.

**Corporation tax and deferred tax**

Companies belonging to Danfoss A/S are generally liable to pay tax in the countries where they are domiciled. The current tax includes both Danish and foreign income taxes.

Income statement

The current and deferred taxes for the year are recognized in the income statement, except for tax related to transactions recognized in the statement of comprehensive income or directly in equity.

Surcharges, premiums and refunds relating to tax payments are recognized in financial income and expenses.

Balance sheet

Current tax payable and receivable are recognized in the balance sheet as tax computed on the taxable income for the year, adjusted for tax paid under the tax prepayment scheme. Deferred tax liabilities and deferred tax assets are measured according to the balance sheet liability method, which means that all temporary differences between the carrying amount and the tax base of assets and liabilities are recognized in the balance sheet as deferred tax liabilities and deferred tax assets, respectively. Exceptions are any tax incurred by selling shares in subsidiaries and which the Group can identify as being a tax liability and tax relating to goodwill which is not deductible for tax purposes. Deferred tax assets are recognized at the expected value of their utilization; either as a set-off against tax on future income or as a set-off against deferred tax liabilities in the same legal tax entity and jurisdiction. Adjustment is made for deferred tax resulting from elimination of unrealized intra-Group profits and losses. Deferred tax is measured according to the tax rules and at the tax rates applicable in the respective countries at the balance sheet date when the deferred tax is expected to crystallize as current tax.

**Derivative financial instruments**

Derivative financial instruments, such as forward exchange contracts or options and commodity contracts, are recognized and measured at fair value. Positive and negative fair values of derivative financial instruments are shown as separate items in the balance sheet. Set-off of positive and negative values is only made when the Company has the right and the intention to settle several financial instruments net.

Provided that the documentation requirements etc. are met, hedge accounting is applied to the instruments. In connection with hedging of future sales and purchase transactions (cash flows), changes in the fair value of instruments qualifying for hedge accounting are recognized in the statement of comprehensive income under the hedging reserve until the hedged transaction is realized.

At this point, gains or losses relating to such hedging transactions are transferred from the statement of comprehensive income and are recognized in the same item as the hedged transaction. If the instruments do not qualify for hedge accounting, changes in market value are recognized directly in the income statement under financial items.

**Statement of Cash flows**

The statement of cash flows shows the cash flows from operating, investing and financing activities for the year, and cash equivalents at the beginning and the end of the year. The cash flow effect of acquisitions and disposals of companies is shown separately under cash flows from investing activities.

Cash flows relating to acquired companies are recognized in the statement of cash flows at the acquisition date, and cash flows relating to divested companies are included until the disposal date.

Cash flows from investing activities

Cash flows from investing activities comprise payment in connection with the acquisition and disposal of companies and activities, intangible assets and property, plant and equipment as well as securities classified as investing activities. Acquisitions of assets under finance leases are treated as non-cash transactions.

Cash flows from financing activities

Cash flows from financing activities comprise changes in the size or composition of the share capital, the raising and repayment of long-term and short-term bank debt, acquisition of minority interests, acquisition and disposal of treasury shares and payment of dividends to shareholders.

Cash flows from operating activities

Cash flows from operating activities are calculated according to the indirect method on the basis of profit before tax/profit before tax from continuing operations and adjusted for non-cash operating items, changes in working capital, paid financial items, received dividend and paid corporation taxes.

Cash and cash equivalents

Cash and cash equivalents comprise bank account deposits and cash balances.

**Segment information**

The segment information applies to the internal management reporting and is prepared according to the Group's accounting policies. Segment income, expenses, assets and liabilities comprise those items which can be allocated on a reliable basis. Items which are not allocated primarily include income and expenses incurred by corporate functions, deferred tax (assets and liabilities), receivable and payable tax, cash and interest-bearing liabilities.

Non-current segment assets are those non-current assets which are used directly for segment operations, including intangible assets and property, plant and equipment as well as investments in associates and joint ventures. Current assets are those current assets which are used directly for segment operations, including inventories, trade receivables and other receivables.

Segment liabilities comprise both non-current and current liabilities derived from segment operations, including trade payables, other debt and warranty obligations as well as other provisions.

Trade between segments takes place on market terms or on a cost recovery basis.

**Financial ratios**

Earnings per share (EPS) and diluted earnings per share (DEPS) are calculated in accordance with IAS 33.

Where defined, other financial ratios are calculated in accordance with the Danish Society of Financial Analysts' guidelines on the calculation of financial ratios, "Recommendations and Financial Ratios 2010".

The financial ratios in the annual report are calculated in the following manner:

**Organic net sales growth**
Sales growth adjusted for additions and disposals of companies and exchange rate effects.

**EBIT margin excluding other operating income, etc.**
Operating profit excluding other operating income and expenses/Net sales

**EBIT margin**
Operating profit (EBIT )/Net sales

**EBITDA margin**
EBITDA/Net sales

**EBITDA margin excluding other operating income etc.**
Operating profit before depreciation, amortization, impairment and other operating income and expenses/Net sales

**EBIT after tax**
Operating profit (EBIT) reduced with tax on profit

**Invested Capital**
Net interest bearing debt added to Shareholders Equity

**Invested Capital excluding tax**
Net interest bearing debt and tax balance sheet items (net) added to Shareholders Equity

**Return on Invested Capital (ROIC)**
EBIT/average invested capital

**Return on Invested Capital (ROIC) after tax**
EBIT after tax/average invested capital excluding tax

**Return on equity**
Net profit after minority interests' share/Average equity excluding minority interests

**Equity ratio**
Equity/total assets

**Leverage ratio**
Interest bearing debt/equity at year end

**Net interest bearing debt to EBITDA ratio**
(Interest bearing debt less interest bearing assets)/EBITDA

**EBITDA**
Operating profit (EBIT ) before depreciation, amortization and impairment

**Dividend pay-out ratio**
Total dividends distributed to shareholders/Net profit

# **Note 26** CRITICAL ACCOUNTING ESTIMATES

As a consequence of the accounting policies, determining the carrying amount of certain assets and liabilities requires estimates of how future events will affect the value of these assets and liabilities at the balance sheet date. The volatility of the global economy and the financial markets has made it more difficult to forecast the development of some future key assumptions – such as liquidity risk, credit risk, interest level and capital management etc. Therefore, Danfoss provides additional information about items in the consolidated financial statements whose carrying amount is at risk of being adjusted considerably over the next few years. Estimates which are significant for the preparation of the financial statements include goodwill, investments in associates and joint ventures, assessment of depreciation, amortization and impairment of non-current assets, measurement of deferred tax assets and measurement of provisions and pension and healthcare obligations. The estimates used are based on Management assumptions which are assessed to be reliable, but which are inherently subject to uncertainty.

Accordingly, the Company is subject to risks and uncertainties which may cause actual results to differ from these estimates. For the Group, the measurement of intangible assets could be materially affected by significant changes in estimates and assumptions on which the measurement is based.

**Impairment of goodwill**
In performing the annual impairment test of goodwill, an assessment is made of whether the individual units of the enterprise (cash generating units) to which goodwill relates will be able to generate sufficient positive net cash flows to support the value of goodwill and other net assets of the unit.

Due to the nature of the Company's operations, estimates have to be made of expected cash flows many years into the future, which will be subject to some degree of uncertainty. This uncertainty is reflected in the chosen discount rate. The impairment test of goodwill and the particularly sensitive parts of the test are described in detail in note 7 Intangible assets.

**Impairment of associates and joint ventures**
Danfoss performs impairment tests concerning investments in associates and joint ventures whenever indicators for impairment are present.

Due to the nature of the operations of the investments, estimates have to be made of expected cash flows many years into the future, which will be subject to some degree of uncertainty. The investments in associates and joint ventures are described in more detail in note 3 Investments.

**Useful life and residual value of non-current assets**
Non-current assets are measured at cost less accumulated amortization, depreciation and impairment. Amortization and depreciation is made on a straight-line basis over the useful lives of the assets, taking into account the asset's residual value. Expected useful lives and residual values are determined based on historical experience and expectations of the future use of the non-current assets. The expectations for future use and residual values may not be met, which may lead to a future reassessment of useful lives and residual values and a need for impairment write-downs or the incurrence of losses on the disposal of the non-current assets.

The amortization and depreciation periods used are described in the accounting policies in note 25, and the value of non-current assets is disclosed in notes 7, Intangible assets and 8, Property, plant and equipment.

**Measurement of recognized tax assets**
Deferred taxes, including the tax value of tax loss carryforwards, are recognized at their expected value. The assessment of deferred tax assets regarding tax loss carryforwards is based on the expected future taxable income of the respective units and the expiration date of the losses. Please see note 14, Deferred tax assets and liabilities for unrecognized deferred tax assets.

**Provisions**
As part of its normal business policy, Danfoss provides its products with ordinary and extended warranties. Warranty provisions are recognized based on actual historical warranty costs and expected changes in future warranty costs related to the Group's products. Future warranty costs may differ from past experience. The Company assesses other provisions, contingent assets and contingent liabilities and the likely outcome of pending or future lawsuits on an ongoing basis. The outcome depends on future events that are inherently uncertain.

In assessing the likely outcome of lawsuits and tax disputes etc., Management bases its assessment on internal and external legal assistance and common practice. Further information is disclosed in note 12, Provisions and note 22, Contingent liabilities, assets and security.

**Defined benefit plans and healthcare obligations**
The group has established defined benefit plans with certain employees at some of the Group's foreign companies. The plans place the group under an obligation to pay a certain benefit in connection with retirement (e.g. in the form of a fixed amount at retirement or a share of the employee's exit salary). The pension obligations are determined by discounting the pension obligations at the present value. The present value is determined on the basis of assumptions about the future development in economic variables such as interest rates, inflation, mortality and disability probabilities, which are subject to some degree of uncertainty. External actuaries are used for the measurement of all significant defined benefit plans. The assumptions used are disclosed in note 15, Pension plans and healthcare obligations.

# GROUP COMPANIES

**Per December 31, 2014**

The Companies are owned 100% by Danfoss unless otherwise stated after the company name.

## EUROPE

AUSTRIA
Danfoss Gesellschaft m.b.H., Guntramsdorf
Vacon AT Antriebssysteme GmbH, Leobersdorf – 70%

BELGIUM
N.V. Danfoss S.A., Groot-Bijgaarden
Danfoss Power Solutions BVBA, Groot-Bijgaarden
Hydro-Gear Europe BVBA, Tongeren
Vacon Benelux NV/SA, Heverlee

BULGARIA
Danfoss EOOD, Sofia

CROATIA
Danfoss d.o.o., Zagreb

CZECH REPUBLIC
Danfoss s.r.o., Praha
Vacon s.r.o., Praha

DENMARK
Danfoss A/S, Nordborg (Parent company)
Danfoss Compressors Holding A/S, Nordborg
Danfoss Distribution Services A/S, Rødekro
Danfoss Power Electronics A/S, Gråsten
Danfoss International A/S, Nordborg
Danfoss IXA A/S, Vejle – 60%
Danfoss PolyPower A/S, Nordborg
Danfoss Redan A/S, Hinnerup
Danfoss Semco A/S, Odense – 60%
Gemina Termix Production A/S, Sunds
Issab Holding ApS, Nordborg
Danfoss Power Solutions ApS, Nordborg
Danfoss Power Solutions Holding ApS, Nordborg
Danfoss Power Solutions Holding II ApS, Nordborg
BetterHome ApS, Frederiksberg – 25%
DecuTech ApS (being dissolved) – 23%
Vacon Drives A/S, Sønderborg

ESTONIA
Danfoss AS, Tallinn
Proekspert AS, Tallinn – 75%

FINLAND
Oy Danfoss Ab, Espoo
Danfoss Power Solutions Oy Ab, Espoo
Vacon Plc, Vaasa

FRANCE
Avenir Energie, Valence
Danfoss Commercial Compressors S.A., Trévoux
Danfoss S.a.r.l., Trappes
Danfoss Power Solutions SAS, Dammarie-lès-Lys
Vacon France SAS, Saint Pierre du Perray

GERMANY
Danfoss Esslingen GmbH, Esslingen
Danfoss Flensburg GmbH, Flensburg
Danfoss GmbH, Offenbach/Main
Danfoss Silicon Power GmbH, Flensburg
Danfoss Werk Offenbach GmbH, Offenbach/Main
Danfoss Power Solutions GmbH & Co. OHG, Neumünster
Danfoss Power Solutions Informatic GmbH, Neumünster
Danfoss Power Solutions Holding GmbH, Neumünster
Vacon GmbH, Essen
SMA Solar Technology AG, Kassel – 20% (associated company)

GREAT BRITAIN
Danfoss Heat Pumps UK Ltd., South Yorkshire
Danfoss Limited, Denham
Danfoss UK Limited, Denham
Danfoss Randall Limited, Bedford
Senstronics Holding Ltd., London – 50% (joint venture)
Danfoss Power Solutions Ltd., Swindon
Vacon Drives (UK) Ltd, Leicestershire

HUNGARY
Danfoss Ktf., Budapest

ICELAND
Danfoss hf., Reykjavik

IRELAND
Danfoss Ireland Ltd., Dublin
DEVI HEAT Ltd., Dublin

ITALY
Danfoss S.r.l., Torino
Danfoss Power Solutions S.r.l.., Castenaso
Vacon S.r.l., Postal
Vacon SpA, Reggio Emilia

LATVIA
SIA Danfoss, Riga

LITHUANIA
Danfoss UAB, Vilnius

THE NETHERLANDS
Danfoss B.V., Rotterdam
Danfoss Power Solutions B.V., Rotterdam
Vacon Benelux B.V., Gorinchem

NORWAY
Danfoss AS, Skui, Oslo
Danfoss Power Solutions AS, Skui, Oslo
Vacon AS, Holmestrand – 80%

POLAND
Danfoss Poland Sp. z.o.o., Grodzisk Mazowiecki
Danfoss Saginomiya Sp. z.o.o., Grodzisk Mazowiecki – 50% (joint venture)
Elektronika S.A., Gdynia – 50% (joint venture)
Danfoss Power Solutions Sp .z.o.o., Wroclaw
Vacon sp. z o.o., Warsaw

PORTUGAL
Danfoss Lda. (being dissolved), Carnaxide

ROMANIA
Danfoss s.r.l., Bucharest
Danfoss District Heating S.r.l., Bucharest

RUSSIA
Danfoss Dzerzhinsk LLC, Nizhny Novgorod
OOO Danfoss, Istra
ZAO Danfoss, Moscow
ZAO Ridan, Nizhny Novgorod
Danfoss Power Solutions LLC, Moscow
ZAO Vacon Drives, Moscow

SCHWITZERLAND
Danfoss AG, Frenkendorf

SERBIA
Danfoss d.o.o., Beograd

SLOVAKIA
Danfoss spol. S.r.o., Zlaté Moravce
Danfoss Power Solutions a.s. Povazska Bystrica

SLOVENIA
Danfoss Trata d.o.o., Ljubljana

SPAIN
Danfoss S.A., Madrid
Danfoss Power Solutions S.A., Madrid
Vacon Drives Ibérica S.A., Terrassa

SWEDEN
Danfoss AB, Linköping
Danfoss Värmepumpar AB, Arvika
Danfoss East Investment AB, Linköping
EP Technology AB, Malmö
Danfoss Power Solutions AB, Solna
Vacon AB, Solna

TURKEY
Danfoss Otomasyon ve Urunleri Tic Ltd., Istanbul
Vacon Motor Kontrol Sis. Ltd. Sti., Istanbul

UKRAINE
Danfoss T.o.v., Kiev

## NORTH AMERICA

CANADA
Danfoss Inc., Mississauga, Ontario
Turbocor Inc., Dorval
Vacon Canada Inc., Stratford, Ontario

MEXICO
Danfoss Industries S.A. de C.V., Apodaca, Monterrey
Danfoss S.A. de C.V., Monterrey
Vaasa Control de Mexico, Mexico City

USA
Danfoss LLC, Baltimore
Danfoss Turbocor Compressors Inc., Tallahassee, Florida
Hydro-Gear Inc., Sullivan, Illinois – 60%
Hydro-Gear Limited Partnership, Sullivan, Illinois – 60%
Danfoss Power Solutions (US) Company, Ames, Iowa
Danfoss Power Solutions Inc., Ames, Iowa
Vacon Inc., Chambersburg, Pennsylvania

## SOUTH AMERICA

ARGENTINA
Danfoss S.A., Buenos Aires

BRAZIL
Danfoss do Brasil Indústria e Comércio Ltda., São Paulo
Danfoss Power Solutions Ltda., São Paulo
Vacon America Latina Ltda., São Paulo – 97%

CHILE
Danfoss Industries Ltda., Santiago

COLOMBIA
Danfoss S.A., Santiago de Cali

VENEZUELA
Danfoss S.A., Valencia

## AFRICA

SOUTH AFRICA
Danfoss (Pty) Ltd., Rivonia, Johannesburg
Elsmark Investment Holdings (Pty) Limited in liquidation, Johannesburg

## ASIA

PHILIPPINES
Danfoss Inc., Manila

UNITED ARAB EMIRATES
Danfoss FZCO, Dubai

# GROUP COMPANIES (continued)

INDIA
Danfoss Industries Pvt. Ltd., Chennai
Danfoss Power Solutions India Pvt. Ltd., Pune
Vacon Drives & Control Pvt. Ltd, Chennai

INDONESIA
PT Danfoss Indonesia, Jakarta

JAPAN
Daikin-Sauer-Danfoss Ltd., Osaka – 45%
Danfoss Power Solutions Ltd., Osaka

KAZAKHSTAN
Danfoss LLP, Almaty

CHINA
Danfoss (Anshan) Controls Co. Ltd., Anshan
Danfoss Energy Products (Guiyang) Co., Ltd., Guiyang
Danfoss Automatic Controls Management (Shanghai) Co. Ltd., Shanghai
Danfoss ( Tianjin) Limited, Tianjin
Danfoss Industries Limited, Hong Kong
Tau Energy Holdings (HK) Limited, Hong Kong
Zheijang Holip Electronic Technology Co. Ltd., Zheijang
Danfoss Plate Heat Exchanger (Hangzhou) Co., Ltd. Zheijang
Danfoss Micro Channel Heat Exchanger (Jiaxing) Co., Ltd., Haiyan
Danfoss Semco ( Tianjin) Fire Protection Equipment Co., Ltd., Tianjin – 60%
Danfoss Shanghai Hydrostatic Transmission Co. Ltd., Shanghai – 60%
Danfoss Power Solutions (Shanghai) Co. Ltd., Shanghai
Danfoss Power Solutions (Zhejiang) Co., Ltd.
Danfoss Power Solutions Trading (Shanghai) Co., Ltd.
Vacon China Drives Co. Ltd., Suzhou

MALAYSIA
Danfoss Industries Sdn Bhd, Selangor

SINGAPORE
Danfoss Industries Pte. Ltd., Singapore
Danfoss Power Solutions Pte. Ltd. Singapore
Danfoss Power Solutions China Holding Pte. Ltd., Singapore
Vacon Pte. Ltd., Singapore

SOUTH KOREA
Danfoss Ltd., Seoul
Danfoss Power Solutions Ltd., Seoul
Vacon Korea Ltd., Seoul

TAIWAN
Danfoss Co. Ltd., Tapei

THAILAND
Danfoss ( Thailand) Co. Ltd., Bangkok

## AUSTRALIA

AUSTRALIA
Danfoss (Australia) Pty. Ltd., Mt. Waverly
Danfoss Power Solutions Pty. Ltd., Huntingwood
Vacon Pacific Pty Ltd, Melbourne

NEW ZEALAND
Danfoss (New Zealand) Ltd., Auckland

# Parent Company
Accounts and notes


TOUCH

# Management report for Danfoss A/S (Parent company)

Danfoss A/S is the parent company of the Danfoss Group. In addition to holding the shares of most of the other Danfoss Group companies, an important function of the company is to fund the Group's activities. The company also constitutes the corporate framework for some of Danfoss' Danish activities and therefore includes a number of Danfoss' Danish factories and Group functions. Danfoss A/S had 2,675 employees at the end of 2014.

Net sales in 2014 ended at DKK 8,110m, which is at the same level as in 2013.

The profit before other operating income and expenses was DKK 739m against DKK 759m in 2013. The company's operating profit was DKK 664m against DKK 724m the previous year.

Financial income and expenses amounted to a net income of DKK 3,722m against a net income of DKK 2,236m the previous year. This was mainly attributable to an increase in distributed dividends from subsidiaries.

The profit after tax in 2014 was DKK 4,327m against DKK 2,584m the previous year.

Equity stood at DKK 11,164m at the end of 2014 against DKK 7,659m at the end of 2013. The increase was mainly attributable to recognition of the profit for the year less dividends paid to the owners.

In 2014, Danfoss A/S issued a 7-year corporate Euro bond of EUR 500m under the established Euro Medium Term Note program (EMTN).

The subsidiary Gemina Ejendomsselskab A/S and its assets merged with Danfoss A/S in 2014. The merger was recognized in accordance with IFRS (International Financial Reporting Standards) in 2013, and, consequently, the comparison figures for 2013 have been adjusted.

Danfoss A/S expects net sales for 2015 to be on a level with the 2014 figures, and the company expects to report a profit in 2015.

# INCOME STATEMENT

January 1 to December 31

| DKKm | Note | 2013 | 2014 |
|---|---|---|---|
| Net sales | | 8,117 | 8,110 |
| Cost of sales | 1 | -5,914 | -5,878 |
| **GROSS PROFIT** | | **2,203** | **2,232** |
| | | | |
| Research and development costs | 1 | -295 | -225 |
| Selling and distribution costs | 1 | -643 | -696 |
| Administrative expenses | 1 | -506 | -572 |
| **OPERATING PROFIT EXCLUDING OTHER OPERATING INCOME AND EXPENSES** | | **759** | **739** |
| | | | |
| Other operating income and expenses | 1 | -35 | -75 |
| **OPERATING PROFIT (EBIT)** | | **724** | **664** |
| | | | |
| Financial income | 2 | 2,534 | 4,242 |
| Financial expenses | 3 | -298 | -520 |
| **PROFIT BEFORE TAX** | | **2,960** | **4,386** |
| | | | |
| Tax on profit | 4 | -376 | -59 |
| **NET PROFIT** | | **2,584** | **4,327** |
| | | | |
| Attributable to: | | | |
| Proposed dividends reserve | | 800 | 500 |
| Other reserves | | 1,784 | 3,827 |
| | | **2,584** | **4,327** |

# STATEMENT OF COMPREHENSIVE INCOME

January 1 to December 31

DKKm

| | 2013 | 2014 |
|---|---|---|
| **NET PROFIT** | **2,584** | **4,327** |
| | | |
| **OTHER COMPREHENSIVE INCOME** | | |
| Actuarial gain/loss (-) on pension and health care plans | -4 | -4 |
| Tax on actuarial gain/loss on pension and health care plans | 1 | 1 |
| Items that cannot be reclassified to profit or loss | **-3** | **-3** |
| | | |
| Fair value adjustment of hedging instruments: | | |
| Hedging of future cash flows | -1 | -54 |
| Hedging transferred to financial expenses in the income statement | 54 | 34 |
| Tax on hedging instruments | -14 | 5 |
| Items that can be reclassified to profit or loss | **39** | **-15** |
| | | |
| **OTHER COMPREHENSIVE INCOME AFTER TAX** | **36** | **-18** |
| | | |
| **TOTAL COMPREHENSIVE INCOME** | **2,620** | **4,309** |

# STATEMENT OF FINANCIAL POSITION

As of December 31

| DKKm<br>**ASSETS** | Note | 2013 | 2014 |
|---|---|---|---|
| **NON-CURRENT ASSETS** | | | |
| **INTANGIBLE ASSETS** | 5 | **644** | **696** |
| **PROPERTY, PLANT AND EQUIPMENT** | 6 | **1,362** | **1,300** |
| Investments | 7 | 13,621 | 14,969 |
| Non-current receivables | | 3 | |
| **OTHER NON-CURRENT ASSETS** | | **13,624** | **14,969** |
| **TOTAL NON-CURRENT ASSETS** | | **15,630** | **16,965** |
| **CURRENT ASSETS** | | | |
| **INVENTORIES** | | **649** | **642** |
| Trade receivables external | | 206 | 210 |
| Trade receivables from subsidiaries | | 662 | 603 |
| Short-term loans to subsidiaries | | 2,476 | 12,698 |
| Receivable corporation tax | 10 | | 30 |
| Derivative financial instruments (positive fair value) | 9 | 38 | |
| Other receivables | | 116 | 102 |
| **RECEIVABLES** | | **3,498** | **13,643** |
| **CASH AND CASH EQUIVALENTS** | 9 | **1** | |
| **TOTAL CURRENT ASSETS** | | **4,148** | **14,285** |
| **TOTAL ASSETS** | | **19,778** | **31,250** |

# STATEMENT OF FINANCIAL POSITION

As of December 31

| DKKm<br>LIABILITIES AND SHAREHOLDERS' EQUITY | Note | 2013 | 2014 |
|---|---|---|---|
| **SHAREHOLDERS' EQUITY** | | **7,659** | **11,164** |
| **LIABILITIES** | | | |
| Provisions | | 52 | 49 |
| Deferred tax liabilities | 8 | 340 | 193 |
| Pension and healthcare benefit plan obligations | | 25 | 25 |
| Borrowings | 9 | 2,882 | 10,880 |
| Derivative financial instruments (negative fair value) | 9 | 16 | 37 |
| Other non-current debt | | 82 | 114 |
| **NON-CURRENT LIABILITIES** | | **3,397** | **11,298** |
| Provisions | | 61 | 79 |
| Liabilities under share incentive programs | | 99 | 81 |
| Borrowings | 9 | 1,584 | 979 |
| Trade payables | | 557 | 620 |
| Trade payables to subsidiaries | | 169 | 105 |
| Borrowings from subsidiaries | | 5,529 | 6,175 |
| Corporation tax | 10 | 122 | |
| Derivative financial instruments (negative fair value) | 9 | 4 | 102 |
| Other debt | | 597 | 647 |
| **CURRENT LIABILITIES** | | **8,722** | **8,788** |
| **TOTAL LIABILITIES** | | **12,119** | **20,086** |
| **TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY** | | **19,778** | **31,250** |

# STATEMENT OF CASH FLOWS

January 1 to December 31

| DKKm | Note | 2013 | 2014 |
|---|---|---|---|
| Profit before tax | | 2,960 | 4,386 |
| Adjustments for non-cash transactions | 11 | -1,690 | -3,470 |
| Change in working capital | | 195 | 123 |
| **CASH FLOW GENERATED FROM OPERATIONS** | | **1,465** | **1,039** |
| Interest received | | 155 | 149 |
| Interest paid | | -231 | -192 |
| Dividends received | | 1,670 | 4,095 |
| **CASH FLOW FROM OPERATIONS BEFORE TAX** | | **3,059** | **5,091** |
| Paid tax | 10 | -487 | -352 |
| **CASH FLOW FROM OPERATING ACTIVITIES** | | **2,572** | **4,739** |
| Acquisition of intangible assets | | -31 | -123 |
| Acquisition of property, plant and equipment | | -152 | -125 |
| Proceeds from sale of property, plant and equipment | | 84 | 5 |
| Acquisition of subsidiaries etc. | | -3,949 | -71 |
| Proceeds from disposal of subsidiaries etc. | | 750 | -1 |
| Loans to subsidiaries | | -672 | -9,334 |
| Acquisition (-)/sale of other investments etc. | | 31 | -2,250 |
| **CASH FLOW FROM INVESTING ACTIVITIES** | | **-3,939** | **-11,899** |
| **FREE CASH FLOW** | | **-1,367** | **-7,160** |
| Cash repayment of (-)/cash proceeds from interest-bearing debt | | 1,871 | 7,962 |
| Repurchase of treasury shares | | -116 | -14 |
| Dividends paid to shareholders in Danfoss A/S | | -396 | -789 |
| **CASH FLOW FROM FINANCING ACTIVITIES** | | **1,359** | **7,159** |
| **NET CHANGE IN CASH AND CASH EQUIVALENTS** | | **-8** | **-1** |
| Cash and cash equivalents as of January 1 | | 9 | 1 |
| **CASH AND CASH EQUIVALENTS AS OF DECEMBER 31** | | **1** | |

The cash flow statement cannot be derived on the basis of the Annual Report alone.

# STATEMENT OF CHANGES IN EQUITY

DKKm

| | SHARE CAPITAL | SHARE PREMIUM | Hedging reserves | Reserve own shares | Other reserves | RESERVES | PROPOSED DIVIDENDS | TOTAL EQUITY |
|---|---|---|---|---|---|---|---|---|
| **BALANCE AS OF JANUARY 1, 2013** | **1,020** | **370** | -51 | -275 | 4,082 | **3,756** | **400** | **5,546** |
| Merger with subsidiary | | | | | 4 | **4** | | **4** |
| | **1,020** | **370** | -51 | -275 | 4,086 | **3,760** | **400** | **5,550** |
| **COMPREHENSIVE INCOME IN 2013** | | | | | | | | |
| Net profit | | | | | 1,784 | **1,784** | **800** | **2,584** |
| **Other comprehensive income** | | | | | | | | |
| Fair value adjustment of hedging instruments | | | 53 | | | **53** | | **53** |
| Actuarial gain/loss (-) on pension and healthcare plans | | | | | -4 | **-4** | | **-4** |
| Tax on other comprehensive income | | | -14 | | 1 | **-13** | | **-13** |
| Total other comprehensive income | | | 39 | | -3 | **36** | | **36** |
| Total comprehensive income for the period | | | 39 | | 1,781 | **1,820** | **800** | **2,620** |
| **TRANSACTIONS WITH OWNERS** | | | | | | | | |
| Dividends to shareholders | | | | | 4 | **4** | **-400** | **-396** |
| Capital increase/purchase of treasury shares | **2** | **39** | | -156 | | **-156** | | **-115** |
| Total transactions with owners | **2** | **39** | | -156 | 4 | **-152** | **-400** | **-511** |
| **BALANCE AS OF DECEMBER 31, 2013** | **1,022** | **409** | -12 | -431 | 5,871 | **5,428** | **800** | **7,659** |
| **COMPREHENSIVE INCOME IN 2014** | | | | | | | | |
| Net profit | | | | | 3,827 | **3,827** | **500** | **4,327** |
| **Other comprehensive income** | | | | | | | | |
| Fair value adjustment of hedging instruments | | | -20 | | | **-20** | | **-20** |
| Actuarial gain/loss (-) on pension and healthcare plans | | | | | -4 | **-4** | | **-4** |
| Tax on other comprehensive income | | | 5 | | 1 | **6** | | **6** |
| Total other comprehensive income | | | -15 | | -3 | **-18** | | **-18** |
| Total comprehensive income for the period | | | -15 | | 3,824 | **3,809** | **500** | **4,309** |
| **TRANSACTIONS WITH OWNERS** | | | | | | | | |
| Dividends to shareholders | | | | | 11 | **11** | **-800** | **-789** |
| Capital increase/purchase of treasury shares | **1** | **54** | | -70 | | **-70** | | **-15** |
| Total transactions with owners | **1** | **54** | | -70 | 11 | **-59** | **-800** | **-804** |
| **BALANCE AS OF DECEMBER 31, 2014** | **1,023** | **463** | -27 | -501 | 9,706 | **9,178** | **500** | **11,164** |

# Notes

# **Note 1** EXPENSES AND OTHER OPERATING INCOME

DKKm

**A. PERSONNEL EXPENSES**

| | 2013 | 2014 |
|---|---|---|
| Salaries and wages | 1,567 | 1,654 |
| Severance payments | 24 | 17 |
| Social security | 14 | 14 |
| Defined contribution plans | 118 | 130 |
| | **1,723** | **1,815** |
| | | |
| Average number of employees | 2,792 | 2,694 |
| Total number of employees as of end of the year | 2,708 | 2,675 |

| | 2013 | 2014 |
|---|---|---|
| Board of Directors: | | |
| Directors' fees | 5 | 6 |
| | 5 | 6 |
| Executive Committee: | | |
| Salaries | 20 | 23 |
| Pension costs re. defined contribution plans | 7 | 8 |
| Bonuses | 53 | 52 |
| | 80 | 83 |
| Danfoss Leadership Team excluding Executive Committee: | | |
| Salaries | 15 | 11 |
| Pension costs re. defined contribution plans | 2 | 1 |
| Bonuses | 13 | 8 |
| | 30 | 20 |
| Total compensation | 115 | 109 |

Bonuses of total DKK 60m (2013: 66m) can be divided into long-term and short-term bonuses with DKK 25m and DKK 35m respectively (2013: 22m and 44m respectively).

# **Note 1** EXPENSES AND OTHER OPERATING INCOME (continued)

DKKm

**B. DEPRECIATION/AMORTIZATION AND IMPAIRMENT LOSSES**

| | 2013 | 2014 |
|---|---|---|
| Classification by nature: | | |
| Amortization of intangible assets | 68 | 70 |
| | 68 | 70 |
| Depreciation of property, plant and equipment | 200 | 189 |
| Reversal of impairment losses on property, plant and equipment | | -2 |
| | 200 | 187 |
| Depreciation/amortization and impairment losses | 268 | 257 |
| Classification of intangible assets by functions: | | |
| Cost of sales | 54 | 45 |
| Selling and distribution costs | 7 | 15 |
| Administrative expenses | 7 | 10 |
| | 68 | 70 |

**C. OTHER OPERATING INCOME AND EXPENSES**

| | 2013 | 2014 |
|---|---|---|
| Gain on disposal of property, plant and equipment | 5 | 1 |
| Reversal of impairment losses on property, plant and equipment | | 2 |
| Other | 41 | 2 |
| Other operating income | 46 | 5 |
| Loss on disposal of property, plant and equipment | -1 | -2 |
| Restructuring costs | -24 | -17 |
| Other | -56 | -61 |
| Other operating expenses | -81 | -80 |
| Other operating income and expenses | -35 | -75 |

**D. FEES TO AUDITORS APPOINTED AT THE ANNUAL GENERAL MEETING**

| | 2013 | 2014 |
|---|---|---|
| Audit fee | 5 | 5 |
| Tax and VAT advice | 2 | 6 |
| Other fees | 1 | 2 |
| Total fee to Group Auditor | 8 | 13 |

## **Note 2** FINANCIAL INCOME

DKKm

| | 2013 | 2014 |
|---|---|---|
| Dividend from subsidiaries and associates/joint ventures | 1,597 | 4,092 |
| Gain on disposal of shares subsidiaries and associates/joint ventures | 548 | |
| Foreign exchange gains, net | 233 | |
| Interest from subsidiaries | 149 | 149 |
| Interest from banks etc. | 6 | 1 |
| Gain on other investments | 1 | |
| | 2,534 | 4,242 |
| | | |
| Interest on financial assets measured at amortized cost amounts to | 155 | 150 |

## **Note 3** FINANCIAL EXPENSES

DKKm

| | 2013 | 2014 |
|---|---|---|
| Foreign exchange losses, net | | -227 |
| Interest to banks etc. | -164 | -135 |
| Impairment/loss on disposal of subsidiaries and associates/joint ventures | -88 | -91 |
| Interest to subsidiaries | -11 | -29 |
| Fair value adjustment of share options and warrants | -10 | -23 |
| Impairment/loss on loans | -26 | -10 |
| Interest element on discounted liabilities | 1 | -4 |
| Loss on other investments | | -1 |
| | -298 | -520 |
| | | |
| Interest on financial liabilities at amortized cost amounts to | -174 | -168 |

## **Note 4** TAX ON PROFIT

DKKm

| | 2013 | 2014 |
|---|---|---|
| Current tax expense | -315 | -206 |
| Change in deferred tax | -1 | 154 |
| Adjustments concerning previous years | -60 | -7 |
| | -376 | -59 |
| | | |
| Tax on profit is defined as: | | |
| Tax on profit before tax | 25.0% | 24.5% |
| Tax exempt income/non-deductible expenses | -1.5% | 1.6% |
| Dividends exempt of tax | -13.5% | -23.8% |
| Effect of change in corporate tax rate | -0.8% | |
| Other taxes | 1.2% | 0.9% |
| Adjustments concerning previous years | 0.5% | 0.2% |
| Other adjustments | 1.8% | -2.1% |
| Effective tax rate | 12.7% | 1.3% |

| | 2013 | 2014 |
|---|---|---|
| Tax on profit (income statement) | -376 | -59 |
| Tax on fair value adjustment of hedging instruments (other comprehensive income) | -14 | 5 |
| Tax on actuarial gain/loss on pension and health care plans (other comprehensive income) | 1 | 1 |
| Total taxes | -389 | -53 |

# **Note 5** INTANGIBLE ASSETS

DKKm

| 2013 | Goodwill | Software | Patents, trade-marks*) | Develop-ment costs | Total Other | TOTAL |
|---|---|---|---|---|---|---|
| Cost as of January 1 | 462 | 444 | 232 | 147 | 823 | 1,285 |
| Additions | | 29 | 2 | | 31 | 31 |
| Disposals | | -2 | -2 | | -4 | -4 |
| Cost as of December 31 | 462 | 471 | 232 | 147 | 850 | 1,312 |
| Amortization and impairment losses as of January 1 | | 351 | 161 | 92 | 604 | 604 |
| Amortization | | 34 | 13 | 21 | 68 | 68 |
| Disposals | | -3 | -1 | | -4 | -4 |
| Amortization and impairment losses as of December 31 | | **382** | **173** | **113** | **668** | **668** |
| Carrying amount as of December 31 | **462** | **89** | **59** | **34** | **182** | **644** |

| 2014 | Goodwill | Software | Patents, trade-marks*) | Develop-ment costs | Total Other | TOTAL |
|---|---|---|---|---|---|---|
| Cost as of January 1 | 462 | 471 | 232 | 147 | 850 | 1,312 |
| Additions | | 36 | 87 | | 123 | 123 |
| Disposals | | -11 | -7 | | -18 | -18 |
| Cost as of December 31 | 462 | 496 | 312 | 147 | 955 | 1,417 |
| Amortization and impairment losses as of January 1 | | 382 | 173 | 113 | 668 | 668 |
| Amortization | | 35 | 19 | 16 | 70 | 70 |
| Disposals | | -10 | -7 | | -17 | -17 |
| Amortization and impairment losses as of December 31 | | 407 | 185 | 129 | 721 | 721 |
| Carrying amount as of December 31 | 462 | 89 | 127 | 18 | 234 | 696 |

*) The amounts under Patents, trademarks are mainly related to patents.

**IMPAIRMENT TESTS**

Goodwill in Danfoss A/S of DKK 462m (2013: 462m) is mainly a consequence of Danfoss A/S merging together with other Danish subsidiaries, in particular the merger with DEVI A/S in 2010. At the end of 2014, impairment tests have been performed on the carrying amount of goodwill (assets with indefinite useful lives). The impairment tests were performed on Danfoss A/S representing the base level of cash generating units (CGUs) to which the carrying amount of goodwill can be allocated with reasonable accuracy. The impairment test method is similar to the impairment test performed on group level described in note 7. Intangible assets in the Danfoss group accounts.

Management does not assess that a reasonable change in the fundamental assumptions used in the impairment tests will result in a recoverable amount lower than the carrying amount. The same conclusion was made for 2013.

# **Note 6** PROPERTY, PLANT AND EQUIPMENT

DKKm

| 2013 | Land and buildings | Plant and machinery | Equipment | Assets under construction | TOTAL |
|---|---|---|---|---|---|
| Cost as of January 1 | 1,664 | 2,253 | 786 | 79 | 4,782 |
| Merger with subsidiary | 24 | | | | 24 |
| Transfers | 19 | 46 | 13 | -78 | |
| Additions | | 2 | 20 | 148 | 170 |
| Disposals | -3 | -151 | -227 | -2 | -383 |
| Cost as of December 31 | 1,704 | 2,150 | 592 | 147 | 4,593 |
| | | | | | |
| Depreciation and impairment losses as of January 1 | 1,040 | 1,937 | 343 | | 3,320 |
| Merger with subsidiary | 13 | | | | 13 |
| Depreciation | 38 | 103 | 59 | | 200 |
| Disposals | -3 | -143 | -156 | | -302 |
| Depreciation and impairment losses as of December 31 | 1,088 | 1,897 | 246 | | 3,231 |
| | | | | | |
| Carrying amount as of December 31 | 616 | 253 | 346 | 147 | 1,362 |
| | | | | | |
| Hereof assets held under finance leases | | | 54 | | 54 |

| 2014 | Land and buildings | Plant and machinery | Equipment | Assets under construction | TOTAL |
|---|---|---|---|---|---|
| Cost as of January 1 | 1,704 | 2,150 | 592 | 147 | 4,593 |
| Transfers | 59 | 41 | 12 | -112 | |
| Additions | 10 | 24 | 18 | 76 | 128 |
| Disposals | | -34 | -3 | | -37 |
| Cost as of December 31 | 1,773 | 2,181 | 619 | 111 | 4,684 |
| | | | | | |
| Depreciation and impairment losses as of January 1 | 1,088 | 1,897 | 246 | | 3,231 |
| Depreciation | 42 | 90 | 57 | | 189 |
| Reversal of impairments for the year | | -2 | | | -2 |
| Disposals | | -31 | -3 | | -34 |
| Depreciation and impairment losses as of December 31 | 1,130 | 1,954 | 300 | | 3,384 |
| | | | | | |
| Carrying amount as of December 31 | 643 | 227 | 319 | 111 | 1,300 |
| | | | | | |
| Hereof assets held under finance leases | | | 37 | | 37 |

The financial leases mainly concern IT equipment. The leased assets are pledged as collateral for the lease liabilities.

# Note 7 INVESTMENTS

DKKm

| | 2013 | | | | | 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Investments in subsidiaries | Receivables from subsidiaries | Investments in associates and joint ventures | Other investments | TOTAL | Investments in subsidiaries | Receivables from subsidiaries | Investments in associates and joint ventures | Other investments | TOTAL |
| Costs as of January 1 | 9,837 | 1,003 | 155 | 133 | 11,128 | 13,579 | 971 | 108 | 134 | 14,792 |
| Merger with subsidiaries | -2 | | | | -2 | | | | | |
| Additions | 3,949 | | 2 | 1 | 3,952 | 71 | 83 | 2,258 | | 2,412 |
| Disposals | -205 | -32 | -49 | | -286 | | -971 | -20 | | -991 |
| Costs as of December 31 | 13,579 | 971 | 108 | 134 | 14,792 | 13,650 | 83 | 2,346 | 134 | 16,213 |
| | | | | | | | | | | |
| Adjustments as of January 1 | -911 | | -89 | -104 | -1,104 | -1,000 | | -68 | -103 | -1,171 |
| Value adjustment | | | | 1 | 1 | | | | -1 | -1 |
| Reversed impairment | 18 | | 3 | | 21 | 17 | | 4 | | 21 |
| Impairment for the year | -107 | | -1 | | -108 | -109 | | | | -109 |
| Disposal | | | 19 | | 19 | | | 16 | | 16 |
| Adjustments as of December 31 | -1,000 | | -68 | -103 | -1,171 | -1,092 | | -48 | -104 | -1,244 |
| | | | | | | | | | | |
| Carrying amount as of December 31 | 12,579 | 971 | 40 | 31 | 13,621 | 12,558 | 83 | 2,298 | 30 | 14,969 |

Where possible, "Other investments" are recognized at fair value. Alternatively, they are recognized at cost less accumulated impairment losses.

At the end of 2014, impairment tests were performed on the carrying amount of "Investments in subsidiaries, associates and joint ventures", if indicators for impairment were present. Main indicators are loss giving activities, or if the carrying amount is higher than the equity in the local accounts or, where relevant, higher than valuation using a listed share price. When performing the impairment test, the present value of cash flow from subsidiaries, associates and joint ventures is compared with their carrying amount. The principles are unchanged compared to the impairment tests performed in 2013.

Impairment losses for the year on "Investments in subsidiaries" of DKK 109m mainly relates to Danfoss PolyPower A/S (Denmark) and Danfoss District Heating S.r.l (Romania). The impairment losses are mainly due to that the entities in question have been loss making. Impairment losses are reported as financial expenses.

Additions for the year to "Investments in subsidiaries" is mainly capital injection in Danfoss Power Solutions Holding II ApS (Denmark).

Additions for the year to "Investments in associates and joint ventures" relates to the acquisition of SMA Solar Technology AG.
Disposal for the year of "Investments in associates and joint ventures" mainly relates to the sale of Promeos GmBH.

Impairment losses for 2013 on "Investments in subsidiaries" of DKK 107m mainly relates to Tau Energy Holdings (Hong Kong) Limited and Avenir Energie (France). The impairment losses are mainly due to that the entities in question have been loss making. Impairment losses are reported as financial expenses.

Additions for 2013 to "Investments in subsidiaries" is mainly the acquisition of the remaining shares in Sauer-Danfoss Inc.
Disposal for 2013 of "Investments in associates/joint ventures" relates to the sale of Danfoss Sanhua Micro Channel Heat Exchanger Co Ltd.

Further information on subsidiaries, associates and joint ventures is provided in the Notes 2. Financial income, 3. Financial expenses, 9. Financial risks and instruments and 13. Related parties.

# Note 8 DEFERRED TAX

DKKm

**CHANGES IN DEFERRED TAXES**

| | 2013 | 2014 |
|---|---|---|
| Deferred taxes as of January 1 (net) *) | -324 | -340 |
| Adjustments concerning previous years | -16 | -7 |
| Deferred tax recognized in the income statement | -1 | 154 |
| Deferred tax recognized in other comprehensive income | 1 | |
| Deferred taxes as of December 31 (net) *) | -340 | -193 |

*) Liability (-)

**SPECIFICATION OF DEFERRED TAXES**

| | 2013 Deferred tax asset | 2014 Deferred tax asset |
|---|---|---|
| Liabilities | 63 | 114 |
| | 63 | 114 |
| Set-off within the same legal entities and jurisdiction | -63 | -114 |
| Deferred tax assets | 0 | 0 |

| | 2013 Deferred tax liability | 2014 Deferred tax liability |
|---|---|---|
| Intangible assets | 41 | 51 |
| Property, plant and equipment and financial assets | 101 | 101 |
| Current assets | 20 | 17 |
| Liabilities | 176 | 74 |
| Deferred tax regarding Danish joint taxation | 65 | 64 |
| | 403 | 307 |
| Set-off within the same legal entities and jurisdiction | -63 | -114 |
| Deferred tax liabilities | 340 | 193 |

Of the deferred tax liability of DKK 193m (2013: 340m), DKK 64m (2013: 65m) can be attributed to taxes relating to joint taxation with foreign subsidiaries in previous years. Danfoss A/S has deferred tax liabilities concerning temporary differences in foreign subsidiaries and associates and joint ventures of DKK 395m (2013: 403m). The liabilities are not recognized because Danfoss A/S decides on their utilization and it is likely that the liabilities will not be recognized in the foreseeable future.

# Note 9 FINANCIAL RISKS AND INSTRUMENTS

DKKm

## FINANCIAL INSTRUMENTS

Relevant financial instrument specifications have been made below regarding Danfoss A/S. A description of financial risks can be found in the Group section, see Note 16. Financial risks and instruments, to which reference is made.

## CONTRACTUAL PAYMENTS ON FINANCIAL LIABILITIES

| | 2013 | | | | | 2014 | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | | | Maturity | | | | | Maturity | | |
| | Carrying amount | Contrac-tual cash flow | 0-1 year | 1-5 years *) | Over 5 years | Carrying amount | Contrac-tual cash flow | 0-1 year | 1-5 years *) | Over 5 years |
| Bank debt and corporate bond | 3,348 | 3,395 | 1,587 | 1,099 | 709 | 10,759 | 11,403 | 1,034 | 4,202 | 6,167 |
| Mortgage debt | 1,041 | 1,422 | 25 | 99 | 1,298 | 1,041 | 1,414 | 26 | 104 | 1,284 |
| Employee bonds | 61 | 62 | 34 | 28 | | 28 | 28 | 28 | | |
| Borrowings from subsidiaries | 5,529 | 5,529 | 5,529 | | | 6,175 | 6,175 | 6,175 | | |
| Finance lease liabilities | 49 | 52 | 23 | 29 | | 31 | 33 | 20 | 13 | |
| Trade payables | 557 | 557 | 557 | | | 620 | 620 | 620 | | |
| Trade payables to subsidiaries | 169 | 169 | 169 | | | 105 | 105 | 105 | | |
| Derivative financial liabilities | 20 | 20 | 4 | 16 | | 139 | 139 | 102 | 37 | |
| | 10,774 | 11,206 | 7,928 | 1,271 | 2,007 | 18,898 | 19,917 | 8,110 | 4,356 | 7,451 |

*) Maturity is evenly spread over the period.

The maturity analysis is based on all non-discounted cash flows including estimated interest payments. Interest payments are estimated according to existing market conditions. The non-discounted cash flows from derivative financial instruments are presented in gross amounts, unless the parties have a contractual right or obligation to make net settlements. Operating lease liabilities and liabilities relating to the purchase of property, plant and equipment are not included in this specification, but are included in Note 12. Contingent liabilities, assets and security.

## THE ABOVE DEBT IS RECORDED AS FOLLOWS:

| | 2013 | 2014 |
|---|---|---|
| Non-current liabilities | 2,898 | 10,917 |
| Current liabilities | 7,876 | 7,981 |
| | 10,774 | 18,898 |

# **Note 9** FINANCIAL RISKS AND INSTRUMENTS (continued)

DKKm

**FINANCIAL INSTRUMENTS BY CATEGORY**

| | 2013 Carrying amount | 2013 Fair value | 2014 Carrying amount | 2014 Fair value |
|---|---|---|---|---|
| Other investment | 31 | 31 | 30 | 30 |
| Financial assets available-for-sale | 31 | 31 | 30 | 30 |
| | | | | |
| Trade receivables | 206 | 206 | 210 | 210 |
| Trade receivables from subsidiaries | 662 | 662 | 603 | 603 |
| Short-term loans to subsidiaries | 2,476 | 2,476 | 12,698 | 12,698 |
| Other receivables | 116 | 116 | 102 | 102 |
| Cash and cash equivalents | 1 | 1 | | |
| Loans and receivables | 3,461 | 3,461 | 13,613 | 13,613 |
| | | | | |
| Derivative financial instruments for financial hedging | 38 | 38 | | |
| Financial assets, measured at fair value in the income statement | 38 | 38 | | |
| | | | | |
| Interest-bearing debt | 4,499 | 4,471 | 11,859 | 11,953 |
| Trade payables to subsidiaries | 169 | 169 | 105 | 105 |
| Borrowings from subsidiaries | 5,529 | 5,529 | 6,175 | 6,175 |
| Trade payables and other debt | 1,234 | 1,234 | 1,381 | 1,381 |
| Financial liabilities measured at amortized cost | 11,431 | 11,403 | 19,520 | 19,614 |
| | | | | |
| Derivative financial instruments for the hedging of future cash flows | 18 | 18 | 37 | 37 |
| Financial liabilites used as hedging instruments | 18 | 18 | 37 | 37 |
| | | | | |
| Derivative financial instruments for financial hedging | 2 | 2 | 102 | 102 |
| Financial liabilities measured at fair value in the income statement | 2 | 2 | 102 | 102 |

The value of derivative financial instruments is measured according to generally accepted valuation techniques based on relevant observable swap prices and exchange rates. The market value of the interest-bearing debt is recognized of the present value of expected future instalment and interest payments. The discount rate applied was the Group's current borrowing rate on loans for corresponding terms. The short-term floating-rate bank debt is stated at the price of 100. The fair value of trade receivables and trade payables with short credit terms is estimated to be equal to the carrying amount. The methods applied remain unchanged compared to 2013.

**FAIR VALUE HIERARCHY AS OF DECEMBER 31 FOR DANFOSS A/S**

| | 2013 Quoted prices Level 1 | 2013 Observ-able input Level 2 | 2013 Non-observ-able input Level 3 | 2013 In total | 2014 Quoted prices Level 1 | 2014 Observ-able input Level 2 | 2014 Non-observ-able input Level 3 | 2014 In total |
|---|---|---|---|---|---|---|---|---|
| **FINANCIAL ASSETS:** | | | | | | | | |
| Other investments | | | 31 | 31 | | | 30 | 30 |
| Derivative financial instruments for the hedging of future cash flows | | | | | | | | |
| Derivative financial instruments for financial hedging | | 38 | | 38 | | | | |
| Total financial assets | | 38 | 31 | 69 | | | 30 | 30 |
| **FINANCIAL LIABILITIES:** | | | | | | | | |
| Derivative financial instruments for the hedging of future cash flows | | 18 | | 18 | | 37 | | 37 |
| Derivative financial instruments for financial hedging | 1 | 1 | | 2 | | 102 | | 102 |
| Interest-bearing debt | | 4,471 | | 4,471 | | 11,953 | | 11,953 |
| Total financial liabilities | 1 | 4,490 | | 4,491 | | 12,092 | | 12,092 |

# **Note 9** FINANCIAL RISKS AND INSTRUMENTS (continued)

**FINANCIAL INSTRUMENTS MEASURED AT FAIR VALUE BASED ON LEVEL 3**

| | 2013 | 2014 |
|---|---|---|
| | Other invest-ments Level 3 | Other invest-ments Level 3 |
| Carrying amount as of January 1 | 29 | 31 |
| Gain/loss (-) in the income statement | 1 | -1 |
| Purchase | 1 | |
| Carrying amount as of December 31 | 31 | 30 |
| | | |
| Gain/loss (-) in the income statement for assets owned as of December 31 | 1 | -1 |

Gain/loss (-) in the income statement is recognized under financial income and expenses.

**DERIVATIVES AS OF DECEMBER 31 FOR DANFOSS A/S**

| | 2013 | | | | | | 2014 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Amount at contract price | Gain/loss (-) on market value adjustment | Gain/loss (-) recognized in income statement | Due less than 1 year | Due between 1 and 5 years | Due after 5 years | Amount at contract price | Gain/loss (-) on market value adjustment | Gain/loss (-) recognized in income statement | Due less than 1 year | Due between 1 and 5 years | Due after 5 years |
| USD | -46 | 28 | 28 | 1 | -1 | | | | | | | |
| EUR | 248 | | | | | | 1,455 | -2 | -2 | | | |
| Other currencies | 391 | 10 | 10 | | | | -532 | -100 | -100 | | | |
| Forward exchange contracts | | 38 | 38 | 1 | -1 | | | -102 | -102 | | | |
| | | | | | | | | | | | | |
| Interest swaps | | -17 | -1 | | -16 | | | -37 | | | -37 | |
| Other derivatives | | -2 | -2 | -1 | 1 | | | | | | | |
| Derivatives end of year | | 19 | 35 | | -16 | | | -139 | -102 | | -37 | |

At the end of 2014, total deferred gains and losses on derivatives recognized in equity amounted to DKK -37m (2013: -16m).

## **Note 10** CORPORATION TAX

DKKm

| | 2013 | 2014 |
|---|---|---|
| Corporation tax payable/receivable (-) as of January 1 | 237 | 122 |
| Paid during the year | -487 | -352 |
| Adjustments concerning previous years | 43 | |
| Current tax expenses in income statement | 315 | 206 |
| Current tax expenses in other comprehensive income | 14 | -6 |
| Corporation tax payable/receivable (-) as of December 31 | 122 | -30 |
| | | |
| The above corporation tax is recorded as follows: | | |
| Assets | | 30 |
| Liabilities | 122 | |
| | 122 | -30 |

## **Note 11** ADJUSTMENT FOR NON-CASH TRANSACTIONS

DKKm

| | 2013 | 2014 |
|---|---|---|
| Depreciation/amortization and impairment | 268 | 257 |
| Gain(-)/loss on disposal of tangible assets and business activities | -4 | 1 |
| Financial income | -2,534 | -4,242 |
| Financial expenses | 298 | 520 |
| Other, including provisions | 282 | -6 |
| Adjustment for non-cash transactions | -1,690 | -3,470 |

# Note 12 CONTINGENT LIABILITIES, ASSETS AND SECURITY

DKKm

**SECURITY**

| | 2013 | 2014 |
|---|---|---|
| Carrying amount of land and buildings pledged as security for bank loans and mortgages | 591 | 623 |
| Leasing assets pledged as security for leasing commitments | 54 | 37 |
| Secured loans from financial institutions | 1,090 | 1,073 |

In connection with disposal of subsidiaries, ordinary guarantees and warranties have been issued. These guarantees and warranties are considered to have no impact on the financial position beyond what has been stated in the annual report.

**CONTINGENT LIABILITIES**

At the beginning of 2009, the European Commission's Directorate General for Competition along with a number of other competition authorities initiated investigations of, among others, Danfoss Household Compressors on suspicion of breach of competition regulations. These Investigations have all been concluded.
Civil lawsuits against Danfoss are still pending in Europe and North America, the outcomes of which are not yet known.

In addition, Danfoss A/S is party to a small number of disputes, lawsuits and legal actions, including tax disputes.
It is the view of the Management that the outcome of these legal actions will have no other significant impact on Danfoss A/S' financial position beyond what has been recognized and stated in the Annual Report.

**OPERATING LEASES (LEASE EXPENSES)**

| Operating lease payments fall due as follows: | 2013 | 2014 |
|---|---|---|
| Buildings: | | |
| Less than 1 year | 15 | 15 |
| Between 1 and 5 years | 46 | 35 |
| More than 5 years | 61 | 44 |
| | | |
| Equipment etc.: | | |
| Less than 1 year | 36 | 32 |
| Between 1 and 5 years | 42 | 20 |

**OPERATING LEASES (LEASE INCOME)**

| Operating lease receivables fall due as follows: | 2013 | 2014 |
|---|---|---|
| Less than 1 year | 58 | 18 |
| Between 1 and 5 years | | 1 |

The operating lease income in Danfoss A/S primarily relates to the letting of buildings to the subsidiaries.

**CONTRACTUAL OBLIGATIONS**

| | 2013 | 2014 |
|---|---|---|
| Service contract commitment other than leases | 263 | 178 |
| Inventories | 165 | 235 |
| Property, plant and equipment | 19 | 16 |
| Hereof commitments relating to succeeding year | 338 | 376 |

# Note 13 RELATED PARTIES

For more information about related parties, see Note 23. Related parties in Group section.

DKKm

**TRANSACTIONS WITH ASSOCIATES AND JOINT VENTURES**

| | 2013 | 2014 |
|---|---|---|
| Sales of goods and services | 3 | 3 |
| Purchases of goods and services | 48 | 51 |

Transactions besides the above transactions with joint ventures and associates are described in Note 2. Financial income, Note 3. Financial expenses, Note 7. Investments and Note 9. Financial risks and instruments.

**TRANSACTIONS BETWEEN DANFOSS A/S AND THE SUBSIDIARIES**

| | 2013 | 2014 |
|---|---|---|
| Sales of goods and services | 6,813 | 7,349 |
| Purchases of goods and services | 2,871 | 2,625 |
| Purchases of intangible assets and property, plant and equipment | | 81 |
| Disposal of intangible assets and property, plant and equipment | 8 | 11 |

Transactions besides the above transactions between Danfoss A/S and subsidiaries are described in Note 2. Financial income, Note 3. Financial expenses, Note 7. Investments and Note 9. Financial risks and instruments.

# Note 14 EVENTS AFTER THE BALANCE SHEET DATE

Subsequent to December 31, 2014 there have been no further events with any significant effect on the financial statements beyond what has been recognized and disclosed in the Annual Report.

## Note 15 GENERAL ACCOUNTING POLICIES FOR DANFOSS A/S

Danfoss A/S is a public limited company domiciled in Denmark. The Annual Report for the period January 1 to December 31, 2014, comprises the financial statements of Danfoss A/S according to the requirements of the Danish Financial Statements Act.

The financial statements of Danfoss A/S have been prepared in accordance with the International Financial Reporting Standards (IFRS) as adopted by the EU and Danish disclosure requirements for listed companies pursuant to the Danish Financial Statements Act.
Unless otherwise indicated, the Annual Report is presented in DKK rounded to the nearest million.

The Board of Directors and the Executive Committee reviewed and approved the Annual Report 2014 on March 24, 2015, and it will be presented for approval at the Annual General Meeting to be held on April 24, 2015.

Besides the following section the accounting policies for Danfoss A/S are the same as for the Danfoss Group. Please refer to note 25 in the consolidated financial statements for the Danfoss Group.

**INVESTMENTS IN SUBSIDIARIES, ASSOCIATES AND JOINT VENTURES**
In Danfoss A/S's financial statements, investments in subsidiaries, associates and joint ventures are measured at cost. In case of evidence of impairment, an impairment test is made. If the recoverable amount is lower than cost, investments are writen down to this lower value.
Impairments are recognized in Danfoss A/S's income statement under financial expenses. Reversal of impairments are recognized under financial income.

Dividends from investments in subsidiaries, associates and joint ventures are recognized in Danfoss A/S's income statement under financial income in the year when the dividends are declared.

**CORPORATION TAX AND DEFERRED TAX**
Danfoss A/S is jointly taxed with its Danish subsidiaries and sister subsidiaries. Current tax and deferred tax is allocated between the jointly taxed companies. The jointly taxed companies are taxed under the tax prepayment scheme.

## Note 16 SIGNIFICANT ACCOUNTING ESTIMATES FOR DANFOSS A/S

Significant accounting estimates for Danfoss A/S concern investments in subsidiaries, associates and joint ventures.

In Danfoss A/S's financial statements, investments in subsidiaries, associates and joint ventures are measured at cost. In case of evidence of impairment, an impairment test is made. If the recoverable amount is lower than cost, investments are written down to this lower value.

Due to the nature of the operations of the investments, estimates have to be made of expected cash flows many years into the future, which will be subject to some degree of uncertainty. The investments in subsidiaries, associates and joint ventures are described in more detail in Note 7. Investments.

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