1. Trends in Schneider Electric's core markets

Industries and machine manufacturers

Continuing improvement of global growth and business climate (PMI) over the year has at last resulted in a rise of industry market during the second half of 2013. However, it remains subdued on a global level with varied positions across major regional blocks.

Western Europe GDP exited from recession in Q2 and slightly increased since then. Against this backdrop, industry market stabilized one quarter later lifting out of a long and severe recession. Most zones have experienced a sequential improvement at year end, including Spain and Italy.

In North America, manufacturing companies have benefited from stronger external demand from Europe and China in the course of the year. Companies were also helped by lower energy costs thanks to shale gas. Despite those positive factors, the growth of industry market, mainly driven by investment in equipment and production of machines, was moderate.

Indeed, the market has already reached a high level after the strong cyclical recovery in 2010 and 2011 and generous taxation policies for equipment spending. Furthermore, uncertainties linked to the debt ceiling debate and Government shutdown weighed on companies' investment behavior.

In China, industry market growth rebounded, driven by improvement of external demand and investment in machines. Automation offer benefited from Chinese manufactures' needs to increase efficiency so to reduce impact from labor cost increases.

In Japan, industry market bounced during the second half of the year, machine manufacturers producers benefiting from gain in competitiveness allowed by Yen depreciation.

In other new economies as a whole, industry market slowed down during the second half of the year, hampered by capital outflows and tightened credit markets (Russia, India, some East Asian countries…).

Non residential and residential buildings

Non residential buildings

In Western Europe, non residential construction continued to fall, notably in Southern Countries (Spain, Italy, and France), penalized by private-sector deleveraging and public-sector austerity. In United Kingdom, improving business confidence has encouraged firms to lift their investment, and non residential construction has stabilized in the course of the year.

In the US, non residential construction as a whole grew at a low pace. Positive growth in commercial buildings was offset by a decrease in public buildings. Most publicly funded segments recorded decrease as a result of fiscal pressure and government spending cuts.

In China, the market experienced a strong growth in 2013, driven by a rebound in company's capex, government investments, continuously raising rental prices and urbanization. Growth stayed resilient during the second half of the year, despite reportedly tighter mortgage conditions.

In Australia, the market has recovered at a moderate pace.

In India, market grew at a low pace, hampered by high interest rates and structural constraints.

In Saudi Arabia, despite a vast pipeline of projects the market was hit by labor shortages resulting from new labor laws.

Residential

Growth in residential market outperformed other construction categories in 2013, driven by the US, Japan, and a lower rate of decrease in Western Europe.

In North America, residential construction has continued to recover at a strong pace in the US, for the third consecutive year, sustained by employment growth, demography, price increase and lower inventory. On the contrary, the market turned down in Canada and Mexico.

In Western Europe, residential market bottomed out during the third quarter and slightly decreased on a yearly basis compared to 2012. The decrease was due to Southern Countries: Spain, Italy and France. The market was close to flat in Germany and Nordics and slightly rose in United Kingdom.

In Australia, the market returned to growth after a deep recession in 2012.

In China, residential construction has gradually risen during the year despite reportedly tighter mortgage conditions and the introduction of new tightening measures in big cities.

In other new economies as a whole, residential market continued to grow in 2013, notably in South America and Africa. India, Russia and some East Asian countries were impacted by the financial turmoil in emerging markets, higher interest rates and fiscal tightening.

Utilities and Infrastructures

Electrical Utilities

Strong regional differences have recently emerged in the utility space. Europe is in the middle of turbulences during the early steps of the energy transition, primarily affecting the conventional power generators, while other geographies follow a more stable path.

On the grid side of mature economies, the attention paid to quality of supply (outages, power quality) is greater than ever, justifying investments to rejuvenate aging networks, incorporation new smart grid technologies while integrating the increasing number of distributed energy resources.

Utilities must meet these regulatory obligations in a context of weak or even negative consumption growth, as well as societal pressure to maintain competitive electricity prices. In emerging economies, the need of additional capacities to meet consumption growth keeps on driving the utility sector.

Those factors will drive sustainable investments in utility networks across all geographies.

The regulatory pressure on electric utilities is increasing, mainly in mature markets. In addition to the mandates on renewable integration, energy efficiency targets are being implemented, giving new obligations to utility operators to stimulate their customers towards more energy efficient consumption practices and demand-side participation to grid operation.

The traditional utility business model where revenues were predominantly based on electricity volumes is slowly challenged. Conventional centralized generation is gradually losing ground to new distributed generation plants.

Oil and Gas

In 2013, Oil & Gas markets have confirmed the recovery engaged since 2010.

The global gas market is undergoing significant changes. The US became self-sufficient in Energy and is preparing export capabilities, Europe consumption is pausing due to the crisis, and infrastructures are being build-up in Asia (export from Australia, Pipelines into China…).

In the Oil & Gas market, Schneider Electric is positioned to deliver solutions across all the Oil & Gas value chain, with application focus on energy management and infrastructure optimization.

The Invensys acquisition further reinforces Software and Process Automation capabilities, in particular in downstream and petrochemicals.

Data centers and Networks

In 2013, the Global IT markets (Information Technologies) were impacted by a weaker economic environment. In particular in the United States, the uncertainty linked to the debt ceiling debate and Federal Reserve tapering of bond-buying combined with the October Government shutdown created conditions for a slowdown and a volatility of IT investments.

In Europe, some Western countries remained in recession in 2013, but the country which has faced the sharpest decrease of its IT market is Russia. Capital outflows, restrictive fiscal and monetary policies in order to fight inflation created adverse economic conditions for investment.

The transactional single phase market experienced a significant growth in Asia offsetting more difficult situations in North America, Western Europe and Russia.

The migration to the Cloud, Collocation and growth in larger Data Centers accelerated, needing new customer engagement models as well as faster adaptation of Schneider Electric's offer.

Strong growth of Data-centers market in Asia was offset by softer trends in North America and to lower extent in Western Europe.

2. Review of the consolidated financial statements

Review of business and consolidated statement of income

Changes in the scope of consolidation

Acquisitions

Schneider Electric finalized on March 28, 2013, the acquisition of 100% of Electroshield – TM Samara, further to the 50% acquired in October 2010, after obtaining the requisite regulatory approvals in Russia. Electroshield – TM Samara is one of the leading Russian players in medium voltage. The cumulative price for 100% of equity is RUB 20.4 billion (about EUR510 million) with net debt of zero as of today. As agreed, the second half of the equity was acquired on March 28, 2013 at the same value paid for the first half in October 2010. Previously it was accounted under the equity accounting method. It is fully consolidated since April 1, 2013 in the segment Infrastructure.

Since then, Electroshield – TM Samara is consolidated with full consolidated method.

Acquisitions and disposals that took place in 2012 and that had an impact on the 2013 financial statements*

M&C Energy Group has been acquired during financial year 2012 and consolidated from June 15, 2012. Its consolidation on a full-year basis for financial year 2013 had a scope effect compared to financial year 2012.

Changes in foreign exchange rates

Changes in foreign exchange rates relative to the euro had a material impact over the year. This negative effect amounts to EUR879 million on consolidated revenue and to EUR233 million on Adjusted EBITA[1].

Revenue

On December 31, 2013, the consolidated revenue of Schneider Electric totaled EUR23,551 million, a decrease of 1.6% at current scope and exchange rates compared to December 31, 2012.

This variance breaks down into an organic increase of 0.4%, a contribution of acquisitions net of disposals of 1.7%, mainly due to Electroshield, and a negative exchange rate effect of 3.7%.

Changes in revenue by operating segment

The Partner business generated revenues of EUR8,476 million, or 36% of the consolidated total. This represents a decrease of -3.0% on a reported basis and **+0.2%** on a like-for-like basis. The Product business was slightly up, supported by continued investment in the residential market in the United States, overall good performance in China and fast-growing mid-market offers in new economies. The sluggish economy in Europe and the slow construction market in Australia weighed on performance. The Solution business declined, impacted by high comparables in the Middle East and difficulties in the renewable market in Western Europe, while data center projects in North America recorded growth.

The Infrastructure business generated revenues of EUR5,728 million, or 24% of the consolidated total. This represents an increase of +6.7% on a reported basis and **+1.2%** on a like-for-like basis. The Product business was up slightly, as the good performance of secondary distribution products offset the decline of primary MV components. The Solution business grew despite continued weak utility investment in Western Europe, mainly driven by the success of installed base and advanced services across regions, demand in the Oil & Gas segment in Australia and in the data center segment in North America.

** Correspond to the dates on which the Group gained control of the acquired companies.*

(1) Adjusted EBITA is EBITA before restructuring costs and before other operating income and expenses, which includes acquisition, integration and separation costs.

The Industry business generated revenues of EUR4,311 million, or 18% of the consolidated total. This represents a decrease of -3.8% on a reported basis and an increase of **+1.3%** on a like-for-like basis. The product business was up slightly, reflecting good demand from OEMs (machine manufacturers) across all regions after a soft start in mature countries in the first half. The solution business posted good growth, driven by the success of SoMachine OEM solutions and installed base services.

The IT business generated revenues of EUR3,442 million, or 15% of the consolidated total. This represents a decrease of -6.4% on a reported basis and **-1.4%** like-for-like basis, with mixed trends between Products and Solutions. The Product business grew, supported by the success of Luminous and sustained demand for critical power in some new economies. The Solution business declined, as North America experienced slow project activity for small to mid-sized data centers and demand in Western Europe was soft.

The Buildings business generated revenues of EUR1,594 million, or 7% of the consolidated total. This represents a decrease of -5.2% on a reported basis, while organic growth was flat at **-0.2%**. Products declined due to the continuing challenging external environment. Solutions business was up driven by services growth that offset the decline of building management systems, impacted by low public investments in mature countries.

Gross profit

Gross profit decreased from EUR9,057 million for the year ended December 31, 2012 to EUR8,891 million for the year ended December 31, 2013, or -1.8%, the performance being weighed down by negative scope and currency effect. As a percentage of revenues, gross profit remained stable at 37.8% in 2012 and 2013 thanks to the industrial productivity that was the key driver along with positive pricing for the organic improvement despite a low volume environment and unfavorable mix effect.

Support Function Costs: Research and development and selling, general and administrative expenses

Research and development expenses, excluding capitalized development costs and development costs reported as cost of sales, increased by 5.5% from EUR507 million for the year ended December 31, 2012 to EUR535 million for the year ended December 31, 2013. As a percentage of revenues, the net cost of research and development increased to 2.3% of revenues for the year ended December 31, 2013 (2.1% for the year ended December 31, 2012).

Total research and development expenses, including capitalized development costs and development costs reported as cost of sales (see note 4 to the Audited Consolidated Financial Statements) increased by 8.2% from EUR1,058 million for the year ended December 31, 2012 to EUR1,145 million for the year ended December 31, 2013. As a percentage of revenues, total research and development expenses increased to 4.9% for the year ended December 31, 2013 from 4.4% for the year ended December 31, 2012.

In 2013, the net effect of capitalized development costs and amortization of capitalized development costs amounts to EUR179 million on operating income (EUR153 million in 2012).

Selling, general and administrative expenses decreased by 1.8% from EUR5,035 million for the year ended December 31, 2012 to EUR4,944 million for the year ended December 31, 2013. As a percentage of revenues, selling, general and administrative expenses remained stable at 21.0% for both 2013 and 2012, as operational efficiency had compensated most of investments.

Combined, total support function costs, that is, research and development expenses together with selling, general and administrative costs, totaled EUR5,479 million for the year ended December 31, 2013 compared to EUR5,542 million for the year ended December 31, 2012, a decrease of 1.1%. Consequently to the investments in research and development expenses and commercial initiatives for new economies and services, in line with the strategic plan, our support functions costs to sales ratio increased from 23.1% for the year ended December 31, 2012 to 23.3% for the year ended December 31, 2013.

Other operating income and expenses

For the year ended December 31, 2013, other operating income and expenses amounted to a net income of EUR73 million, including costs linked to acquisitions for EUR52 million, a EUR173 million gain on the curtailment of employee benefit plans in the U.S., in France and in Norway and miscellaneous other operating incomes and expenses amounting to a net expense of EUR48 million. Costs linked to acquisitions are acquisition, integration and separation costs on 2013 acquisitions, notably Electroshield – TM Samara and acquisition costs linked to Invensys (see note 30, Post-closing events). Net other operating expense includes mainly provisions for litigation or claims and gain on disposal of fixed assets.

For the year ended December 31, 2012, other operating income and expenses amounted to a net expense of EUR10 million, including costs linked to acquisitions for EUR52 million, a EUR21 million gain on the curtailment of a U.S. employee benefit plan and miscellaneous other operating incomes and expenses amounting to a net of EUR21 million. Costs linked to acquisitions are acquisition, integration and separation costs on 2011 and 2012 acquisitions, notably Telvent and M&C Energy Group. Net other operating income includes mainly reversal of provisions for litigation or claims that expired on December 31, 2012.

Restructuring costs

For the year ended December 31, 2013, restructuring costs amounted to EUR176 million compared to EUR164 million for the year ended December 31, 2012. These costs related to industrial and support functions restructurings.

EBITA and Adjusted EBITA

We define EBITA as earnings before interest, taxes and amortization of purchase accounting intangibles. EBITA comprises operating profit before amortization and impairment of purchase accounting intangible assets and before goodwill impairment.

We define adjusted EBITA as EBITA before restructuring costs and before other operating income and expenses, which includes acquisition, integration and separation costs.

Adjusted EBITA amounted to EUR3,412 million for the year ended December 31, 2013, compared to EUR3,515 million for the year ended December 31, 2012, representing a decrease of 2.9%, due to negative currency effect of EUR233 million that offset high industrial productivity. As a percentage of revenue, adjusted EBITA decreased from 14.7% for the year ended December 31, 2012 to 14.5% for the year ended December 31, 2013, only due to negative currency and scope effects.

EBITA decreased by 1.0% from EUR3,341 million for the year ended December 31, 2012 to EUR3,309 million for the year ended December 31, 2013, mainly linked to the decrease of adjusted EBITA. As a percentage of revenue, EBITA increased to 14.1% in 2013 compared with 14.0% in 2012.

EBITA and Adjusted EBITA by business segment

The following table sets out EBITA and adjusted EBITA by business segment:

Full year 2013

(in millions of euro)	Partner	Infrastructure	Industry	IT	Buildings	Corporate costs	Total
Revenue	8,476	5,728	4,311	3,442	1,594	-	23,551
Adjusted EBITA*	1,801	560	833	650	94	(526)	3,412
Adjusted EBITA (%)	*21.2%*	*9.8%*	*19.3%*	*18.9%*	*5.9%*	-	*14.5%*
Other operating income and expense	53	(17)	35	(5)	9	(2)	73
Restructuring costs	(74)	(59)	(22)	(7)	(12)	(2)	(176)
EBITA	1,780	484	846	638	91	(530)	3,309
EBITA (%)	*21.0%*	*8.4%*	*19.6%*	*18.5%*	*5.7%*	-	*14.1%*

** Adjusted EBITA: EBITA before Restructuring costs and before Other operating income and expenses (of which Costs of acquisition, integration and separation).*

Full year 2012

(in millions of euro)	Partner	Infrastructure	Industry	IT	Buildings	Corporate costs	Total
Revenue	8,738	5,366	4,483	3,677	1,682	-	23,946
Adjusted EBITA*	1,813	575	823	698	107	(501)	3,515
Adjusted EBITA (%)	*20.7%*	*10.7%*	*18.4%*	*19.0%*	*6.4%*	-	*14.7%*
Other operating income and expense	17	(6)	(2)	(3)	(3)	(13)	(10)
Restructuring costs	(84)	(32)	(21)	(4)	(12)	(11)	(164)
EBITA	1,746	537	800	691	92	(525)	3,341
EBITA (%)	*20.0%*	*10.0%*	*17.8%*	*18.8%*	*5.5%*		*14.0%*

** Adjusted EBITA: EBITA before Restructuring costs and before Other operating income and expenses (of which Costs of acquisition, integration and separation).*

Partner business recorded an adjusted EBITA margin of 21.2% for the year ended December 31, 2013, up 0.5% compared to 20.7% for the year ended December 31, 2012, due to good industrial productivity.

Infrastructure business recorded an adjusted EBITA margin of 9.8% for the year ended December 31, 2013, down 0.9% compared to 10.7% for the year ended December 31, 2012, impacted by one-off charges from delays in project execution and difficulties in public transportation business in Spain.

Industry business recorded an adjusted EBITA margin of 19.3% for the year ended December 31, 2013, up 0.9% compared to 18.4% for the year ended December 31, 2012, thanks to positive pricing and good control of commercial costs.

IT business reported an adjusted EBITA margin of 18.9% for the year ended December 31, 2013, down 0.1% in line with 19.0% margin for the year ended December 31, 2012, at all time high level.

Buildings business recorded an adjusted EBITA margin of 5.9% for the year ended December 31, 2013, down 0.5% compared to 6.4% for the year ended December 31, 2012, due to low volume in mature markets in the first half and unfavorable mix.

Corporate costs amounted to EUR526 million for the year ended December 31, 2013 or 2.2% of Group revenues, a similar level as in the year ended December 31, 2012 (2.1% of Group revenues or EUR501 million).

Operating income (EBIT)

Operating income (EBIT) increased from EUR2,866 million for the year ended December 31, 2012 to 3,091 million for the year ended December 31, 2013, representing an increase of 7.9% linked to the non-recurrence of a goodwill impairment on Buildings CGU of EUR250 million (before tax effect) recorded in 2012. Excluding this item, amortization of intangibles linked to business combinations decreased by EUR6 million (EUR218 million on the year ended December 31, 2013 compared to EUR224 million on the year ended December 31, 2012).

Net financial income/loss

Net financial loss amounted to EUR483 million for the year ended December 31, 2013, compared to EUR446 million for the year ended December 31, 2012 (restated for the application of IAS 19 Revised disclosed in note 1.2 of the consolidated financial statements). Within the net financial loss, the cost of net financial debt decreased from EUR349 million for year ended December 31, 2012 to EUR324 million for year ended December 31, 2013 thanks to a lower average interest rate. The higher net financial loss is mainly linked to the change in other financial incomes and costs, from a net expense of EUR97 million for year ended December 31, 2012 to a net expense of EUR159 million for year ended December 31, 2013. This is mainly due to a EUR50 million impairment of NVC Lighting investment described in note 15 of the consolidated financial statements.

Tax

The effective tax rate was 25.5% for the year ended December 31, 2013, increasing compared to 22.9% for the year ended December 31, 2012 (restated for the application of IAS 19 Revised disclosed in note 1.2 of the consolidated financial statements). However, excluding the EUR50 million one-off impairment of NVC investment that triggered no tax effect, the effective tax rate was limited to 25.0%. The corresponding tax expense increased from EUR554 million for the year ended December 31, 2012 to EUR665 million for the year ended December 31, 2013.

Share of profit/(losses) of associates

The share of profit of associates amounted to EUR22 million for the year ended December 31, 2013, compared to EUR34 million for the year ended December 31, 2012. From April 1, 2013, Electroshield – TM Samara in Russia is fully consolidated in Schneider Electric consolidated financial statements and thus has not contributed anymore to share of profit of associates whereas she was contributing on a 12 months basis in 2012 when it was consolidated through equity method.

Non-controlling interests

Minority interests in net income for the year ended December 31, 2013 totaled EUR77 million, compared to EUR87 million for the year ended December 31, 2012. This represented the share in net income attributable, in large part, to the minority interests of certain Chinese companies.

Profit for the period

Profit for the period attributable to the equity holders of our parent company amounted to EUR1,888 million for the year ended December 31, 2013, that is a 4.1% increase over the EUR1,813 million profit for the year ended December 31, 2012 (restated for the application of IAS 19 Revised disclosed in note 1.2 of the consolidated financial statements).

Earnings per share

Earnings per share increased to EUR3.43 for the year ended December 31, 2013 from EUR3.34 for the year ended December 31, 2012 (restated for the application of IAS 19 Revised disclosed in note 1.2 of the consolidated financial statements).

Consolidated cash-flow

Operating Activities

Net cash provided by operating activities before changes in operating assets and liabilities reached EUR2,673 million for the year ended December 31, 2013, down 4.6% compared to EUR2,802 million for the year ended December 31, 2012, and represented 11.3% of revenue in 2013 compared with 11.7% in 2012.

Change in working capital requirement generated EUR228 million in cash in the year ended December 31, 2013, compared to EUR1 million in consumption in the year ended December 31, 2012, with continuing operational efficiency actions.

In all, net cash provided by operating activities increased 3.6% from EUR2,801 million in the year ended December 31, 2012 to EUR2,901 million in the year ended December 31, 2013.

Investing Activities

Net capital expenditure, which included capitalized development projects, decreased by 0.6% to EUR714 million for the year ended December 31, 2013, compared to EUR719 million for the year ended December 31, 2012, and represented 3.0% of revenues.

Our acquisitions represented a cash outflow, net of cash acquired, of EUR294 million for the year ended December 31, 2013, corresponding mainly to Electroshield – TM Samara, compared to EUR242 million in the year ended December 31, 2012 corresponding partially to M&C Energy Group.

The EUR121 million proceeds from sale of financial assets in 2012 corresponded to the proceeds net of fees of the sale of AXA shares in September 2012.

Financing Activities

The bond issuance of EUR600 million corresponds to a EUR600 million bond issue in September 2013 due 2021 as part of the EMTN program. The Group reimbursed two bonds in 2013 for EUR587 million.

The net increase in other financial debts amount to EUR1,066 million during the year ended December 31, 2013, compared to a decrease of EUR585 million during the year ended December 31, 2012. The dividend paid by Schneider Electric was EUR1,025 million the year ended December 31, 2013, compared with EUR919 million the year ended December 31, 2012.

3. Review of the parent company financial statements

Schneider Electric SA posted total portfolio revenues of EUR10 million in 2013 compared with EUR372 million the previous year. Schneider Electric Industries SAS, the main subsidiary, did not pay dividends in 2013 compared with EUR300 million dividend paid in 2012. Interest expense net of interest income amounted to EUR158 million versus EUR147 million the year before.

Current loss amounted to EUR165 million in 2013 compared to a current income of EUR207 million in 2012.

Net loss stood at EUR133 million compared with a net income of EUR225 million in 2012.

Equity before appropriation of net profit amounted to EUR10,303 million at December 31, 2013 versus EUR11,229 million at the previous year-end, after taking into account 2013 loss, dividend payments of EUR1,024 million and share issues in an amount of EUR230 million.

4. Review of subsidiaries

Schneider Electric Industries SAS

Revenue totaled EUR3.5 billion in 2013 (EUR3.6 billion in 2012).

The subsidiary posted an operating loss of EUR233 million in 2013 compared with an operating loss of EUR69 million in 2012.

Net profit amounted to EUR948 million in 2013 compared with EUR1,061 million in 2012.

5. Outlook

Recent trends indicate that North America should continue to grow though the first quarter would be impacted by severe weather. Western Europe is showing initial signs of stabilization with potential for improvement in the second half. End-market trends in China continue to be solid. Uncertainty remains in several new economies due to currency volatility.

The 2013 proforma adjusted EBITA margin including the last 12 months of Invensys* to September 2013 and the full consolidation of Electroshield – TM Samara is ~14.0%.

Based on current market conditions, the Group targets for 2014:

- low single-digit organic growth in revenue;
- 0.4 pt to 0.8 pt improvement of the adjusted EBITA margin vs. the 2013 proforma level excluding the currency impact.

The negative currency impact is currently estimated at ~0.4 pt, with most of the impact concentrated in H1.

* *Without Appliance division.*