Financial Position and Results of Operations

Highlights 2012

- → Sales grow to exceed the € 10 billion for the first time driven by solid organic growth rates of the three largest divisions as well as changes from foreign exchange rates
- → Strong operational performance while substantially advancing with the transformation of the company
- → Good profitability and strong working capital management lead to increased free cash flow
- → Merck Serono generates solid top and bottom-line results while implementing major restructuring programs and efficiency initiatives across global administrative functions, R&D operations and country organizations
- → Performance Materials delivers exceptional performance driven by liquid crystal materials, while the Pigments business remains sluggish
- → Sales growth of Merck Millipore driven by all business units, predominantly through biotech manufacturing products in Process Solutions
- → Net financial debt significantly lowered to below € 2 billion
- → Proposal to increase dividend by 13% to € 1.70 demonstrates the current and future strength of the underlying business

Merck Group | Key figures

€ million	2012	2011	Change in %
Total revenues	11,172.9	10,276.4	8.7
Sales	10,740.8	9,905.9	8.4
Operating result (EBIT)	963.6	1,132.1	–14.9
Margin (% of sales)	9.0	11.4	–
EBITDA	2,360.2	2,730.9	–13.6
Margin (% of sales)	22.0	27.6	–
EBITDA pre one-time items	2,964.9	2,723.8	8.9
Margin (% of sales)	27.6	27.5	–
EPS pre one-time items (in €)	7.61	6.79	12.1
Free cash flow	2,039.9	1,436.4	42.0

→ Financial position and results of operations

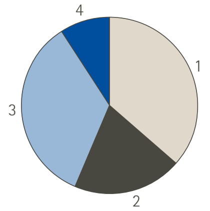
In 2012, Merck delivered a strong business performance while significantly transforming the company. Total revenues of the Merck Group rose 8.7% to € 11,173 million (2011: € 10,276 million). This increase reflects 4.8% organic growth, a 3.6% benefit from changes in foreign exchange rates, and a 0.3% effect from acquisitions. At € 432 million (2011: € 370 million), royalty, license and commission income, which is disclosed as part of total revenues, was € 62 million higher than in 2011. This was primarily due to higher royalty income related to Humira® and the stronger U.S. dollar.

Sales growth driven by organic growth and foreign exchange rates

Sales grew by 8.4% to € 10,741 million (2011: € 9,906 million) reflecting a 4.5% organic increase, 3.6% growth based on changes in foreign exchange rates and 0.3% growth due to acquisitions. On an absolute basis, Merck Serono was the strongest contributor to organic sales growth followed by Merck Millipore and Performance Materials.

Merck Group | Sales by region – 2012

€ million / in %



1 Europe	3,943	37%
2 North America	2,128	20%
3 Emerging Markets	3,712	34%
4 Rest of World	958	9%

North America and Emerging Markets expand their share of total sales

From a regional perspective, North America generated low double-digit organic sales growth, expanding its contribution to 20% of Group sales (2011: 18%). This resulted from strong organic sales growth of the Merck Serono prescription medicines portfolio, particularly the MS treatment Rebif® and to a smaller extent recovering sales of Pigments & Cosmetics products in the Performance Materials division. The Emerging Markets region, consisting of Latin America and Asia (excluding Japan), also slightly increased its share of sales to 35% (2011: 33%). The region grew organically by a high single-digit rate to which all four divisions contributed. Europe reported a 1.6% decline in organic sales triggered by flat to declining organic sales in all divisions except for Merck Millipore. Accordingly, Europe's contribution to Group sales decreased to 37% in 2012, representing a continuous decline from 46% three years ago. This development is primarily due to the Millipore acquisition which included a strong U.S. franchise, a revised U.S. marketing and pricing strategy of Merck Serono as well as softening economic conditions and pricing pressures in the eurozone. Sales in the Rest of World region, which comprises Japan, Africa, and Australia/Oceania, increased by 9.6%, generating an unchanged 9% of Group sales.

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Merck Group | Sales growth components by region – 2012

€ million / change in %	Sales	Organic growth	Exchange rate effects	Acquisitions/ divestments	Reported sales growth
Europe	3,942.7	–1.6	0.5	0.6	–0.4
North America	2,128.3	10.3	8.3	0.3	19.0
Emerging Markets	3,712.2	8.8	4.3	–	13.0
Rest of World	957.6	3.5	5.7	0.3	9.6
World in total	**10,740.8**	**4.5**	**3.6**	**0.3**	**8.4**

Gross profit increased by 7.0% to € 8,015 million (2011: € 7,491 million), or 74.6% as a percentage of sales (2011: 75.6%). Higher start-up costs for Merck Serono's Large-Scale-Biotech (LSB) manufacturing site in Vevey (Switzerland) as well as idle costs in production and selected factory shut-downs as a result of initiatives to lower inventories in the Performance Materials and Merck Millipore divisions lowered the gross margin compared to 2011.

Marketing and selling expenses grow less than sales, demonstrating first efficiency gains

Group marketing and selling expenses increased moderately by 1.1% to € 2,411 million (2011: € 2,386 million) but at a significantly lower growth rate than sales, reflecting the first results of the ongoing restructuring initiatives and indicating more focused discretionary spending. Through this, the ratio of marketing and selling expenses to total sales declined from 24.1% to 22.4%.

Royalty, license and commission expenses increased by 15.8% to € 580 million (2011: € 500 million), reflecting the strong performance of Rebif® as well as changes in foreign exchange rates, most notably the U.S. dollar.

Administration expenses rose by 3.1% to € 552 million (2011: € 536 million). This increase was primarily due to the fact that Merck Millipore is headquartered in the United States and the related translation effect stemming from the U.S. dollar. In addition, administration expenses in Corporate and Other increased due to higher bonus accruals.

Restructuring costs related to “Fit for 2018” lead to significant increase in other operating expenses

Other operating income and expenses amounted to € –1,127 million (2011: € –417 million). Of this amount, € –664 million was classified as one-time items. Within the scope of its “Fit for 2018” efficiency program, the Group incurred € 504 million in restructuring costs (excluding impairments), incurred mainly in the Merck Serono division. In relation to in prior years discontinued businesses, reported under Corporate and Other, follow-up expenses of € 60 million were booked in 2012, in contrast to the previous year, when Merck reported a gain of € 152 which included the proceeds from the sale of the CropBioscience business. During 2012, impairments of € 59 million were classified as one-time items, with the majority related to site closures as a consequence of the restructuring. In 2011, asset impairments of € 332 million were recognized, including € 165 million for the LSB manufacturing site in Vevey.

Stable R&D spending

At € 1,511 million, R&D spending remained roughly at last year's level (2011: € 1,514 million). At 14.1%, the ratio of R&D expenses to total sales fell around one percentage point compared to 2011. Lower R&D expenses in the Merck Serono and Consumer Health divisions more than offset higher investments by Merck Millipore and Performance Materials.

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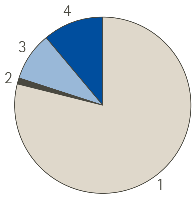
Merck Group | R&D by division – 2012

€ million / in %



1 Merck Serono	1,187	79%
2 Consumer Health	19	1%
3 Performance Materials	137	9%
4 Merck Millipore	166	11%

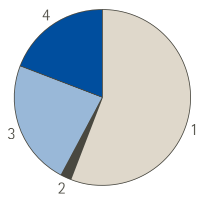
Amortization of intangible assets, mainly including amortization of intangible assets in connection with the purchase price allocations of the Serono and Millipore acquisitions, declined by 13.3% to € 872 million (2011: € 1,005 million). In 2011, in addition to amortization, impairments related to three Merck Serono development products were recorded, amounting to € 149 million. The current amount more typically reflects normal levels.

Restructuring costs lead to decline in EBIT

The Group reported a decline in the operating result (EBIT) of 14.9% to € 964 million (2011: € 1,132 million) while the operating result excluding depreciation and amortization (EBITDA) was down 13.6% to € 2,360 million (2011: € 2,731 million) primarily due to the one-time restructuring costs. Adjusted for one-time items, however, EBITDA pre one-time items increased 8.9% to € 2,965 million, or 27.6% of sales (2011: € 2,724 million, or 27.5% of sales).

Merck Group | EBITDA pre one-time items by division – 2012

€ million / in %



1 Merck Serono	1,785	56%
2 Consumer Health	63	2%
3 Performance Materials	731	23%
4 Merck Millipore	596	19%

Not shown: Group EBITDA pre one-time items lowered by € 211 million in Corporate and Other

Increase in EBITDA pre one-time items driven by all divisions

All divisions contributed to the increase in EBITDA pre one-time items, more than offsetting the higher costs reported by Corporate and Other, which mainly resulted from currency hedging losses. Merck Serono was by far the largest contributor to the EBITDA pre increase based on growing sales as well as improved profitability. In addition, Performance Materials contributed strongly thanks to an exceptionally strong business momentum. The EBITDA pre contribution of Merck Millipore of 19% slightly declined (2011: 20%, excluding Corporate and Other) as the division invested in both R&D and marketing and selling to ensure future growth.

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During 2012, the Group already realized around € 115 million in net savings as a result of the restructuring. The majority of savings were achieved in Merck Serono followed by Consumer Health, which delivered substantial savings relative to its size. Two-thirds of the restructuring costs incurred were reported in the Merck Serono division. The restructuring costs booked in Corporate and Other mainly related to several divisions at the same time and cannot be directly allocated.

Reduced financing costs mainly due to lower interest expenses on debt and pension provisions

The Group's financial result improved by 13.2% to € –255 million (2011: –293 million). Lower interest expenses on debt following the repayment of € 500 million worth of bonds in March 2012 (followed by another € 500 million repaid in December 2012) as well as lower interest expenses on pension provisions more than offset reduced interest income due to low interest rate yields. In addition, gains related to the fair value of foreign exchange options benefited the financial result. Merck began using foreign exchange options as hedging instruments in the fourth quarter of 2011 and books fluctuations of corresponding fair values under the financial result. As a consequence, this line may continue to be impacted by the volatility of foreign exchange rates.

Income tax amounted to € –130 million (2011: € –221 million). One-time items substantially distorted the reported income tax ratio in 2012. The adjusted income tax ratio of 25.5% continues to be at the midpoint of the company's underlying tax ratio of 25% to 26%.

Profit after tax amounted to € 579 million (2011: € 618 million), a decrease of 6.3% mainly due to the one-time items which were incurred in 2012. One-time items (including impairments) of € 664 million also weighed on reported net income (profit after tax attributable to Merck KGaA shareholders) of € 567 million (2011: € 607 million) or earnings per share (EPS) of € 2.61 (2011: € 2.79). However, adjusted for one-time items, EPS pre one-time items (EPS adjusted by net of tax effect of one-time items and amortization of purchased intangible assets) increased 12.1% to € 7.61 (2011: € 6.79).

We will propose to the Annual General Meeting on April 26, 2013 to raise the dividend from € 1.50 to € 1.70 per share.

Efficiency initiatives lead to good growth rates especially in the second half of 2012

Merck got off to a moderate start in 2012 since in the first quarter the Performance Materials division faced a difficult year-on-year comparison. In the first quarter of 2011, this division generated organic sales growth of 15% due to unusually high customer demand for its liquid crystal materials. Group organic sales growth in the first quarter of 2012 was entirely driven by Merck Serono and Merck Millipore. During the following quarters of 2012, Group sales grew consistently between 5% and 6% organically compared to the year-ago-quarter due to healthy demand in the Merck Serono, Performance Materials and Merck Millipore divisions. All regions contributed to growth with the exception of Europe, where organic sales declined between 1% and 2% each quarter compared to 2011 mainly due to weakening economic conditions.

As of the second quarter of 2012, Merck started to focus primarily on organizational changes and optimizing its cost structure across all businesses. While the full amount of savings will be realized during 2014, growth in EPS pre one-time items was already realized in 2012 based on improved top-line performance and tighter cost management.

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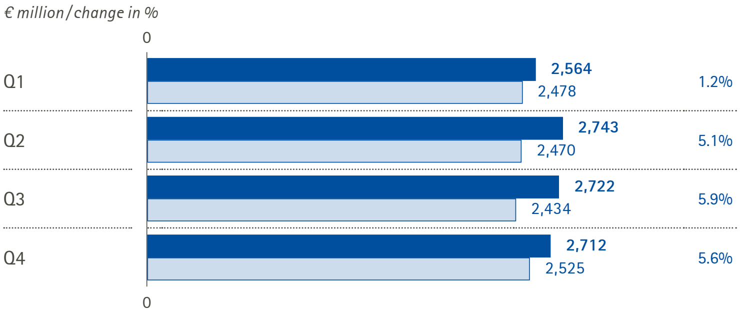
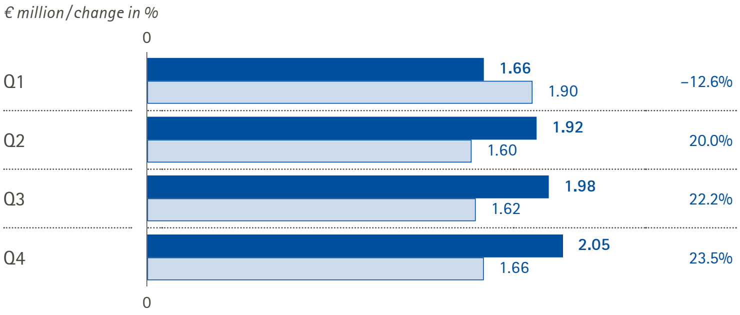
Merck Group | Sales and organic growth by quarter[1]



[1] Quarterly breakdown unaudited

2011 2012

Merck Group | EPS pre one-time items and growth by quarter[1]



[1] Quarterly breakdown unaudited

2011 2012

Total assets of the Merck Group amounted to € 21,643 million as of December 31, 2012 (December 31, 2011: € 22,122 million). This decrease was driven by the increased focus on working capital management and resulted in both lower trade accounts receivable and inventories. Non-current assets, mainly intangibles and property, plant and equipment, also decreased during the year.

Financial liabilities decreased during 2012 as bonds due for repayment totalling € 1 billion related to the 2010 acquisition of Millipore were repaid in March and December, respectively. On the other hand, provisions increased mainly as a result of the ongoing restructuring initiatives.

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Further reduction of net financial debt

Financial liabilities were reduced by a further € 1,086 million to € 4,453 million as of December 31, 2012 (December 31, 2011: € 5,539 million) primarily as a result of the aforementioned bond repayment. Net financial debt (financial liabilities minus cash and cash equivalents as well as short-term securities and financial assets) decreased to € 1,926 million as of December 31, 2012 (December 31, 2011: € 3,484 million). Moody's, a corporate financial rating agency, upgraded Merck's long-term issuer and senior unsecured ratings to 'Baa1' with stable outlook from 'Baa2' in December 2012, citing the substantial deleveraging underpinned by solid cash flow generation. Standard & Poor's raised the long-term credit rating to 'A-' with stable outlook from 'BBB+' in November 2012, expecting significant free operating cash flow to increase gradually over the next few years, in line with increasing sales and profit margins on the back of the efficiency program. Both ratings ensure that Merck will be able to benefit from attractive financing terms in the future. The factor of net financial debt to net cash flow from operating activities lessened from 2.7x as of December 31, 2011 to below 1x as of December 31, 2012, driven by both the reduction of financial debt as well as a strong operating cash flow.

Merck Group | Working capital[1]

million €	as of December 31, 2011	as of March 31, 2012	as of June 30, 2012	as of September 30, 2012	as of December 31, 2012	Change Dec 31, 2011 – Dec 31, 2012
Trade accounts receivable	2,328.3	2,343.5	2,284.8	2,206.7	2,114.6	
Inventories	1,691.1	1,658.9	1,667.6	1,609.6	1,533.9	
Trade accounts payable	–1,100.8	–1,112.8	–1,216.5	–1,297.9	–1,288.3	
Working capital	**2,918.6**	**2,889.6**	**2,735.9**	**2,518.4**	**2,360.2**	**–19.1%**
as % of sales (last 12 months)	29.5%	28.9%	26.7%	23.9%	22.0%	

[1] Quarterly breakdown unaudited

Working capital declines

The focus on improving working capital (trade accounts receivable plus inventories minus trade accounts payable) resulted in working capital declining to 22.0% (in % of sales) as of December 31, 2012 (29.5% as of December 31, 2011).

Investments in property, plant and equipment amounted to € 329 million in 2012 (2011: € 366 million). This included for example investments in the Merck Millipore GMP bioproduction facility in Martillac (France), which provides customers with access to single-use process technologies. Due to the 2012 focus on implementing efficiency and restructuring measures, investments in property, plant and equipment remained behind projections (€ 360 million to € 380 million).

The equity ratio was 48.1% as of December 31, 2012 (December 31, 2011: 47.4%).

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Record level of free cash flow

Merck's strong operational performance in 2012 as well as effective working capital management generated a record free cash flow of € 2,040 million (2011: € 1,436 million), up 42.0%.

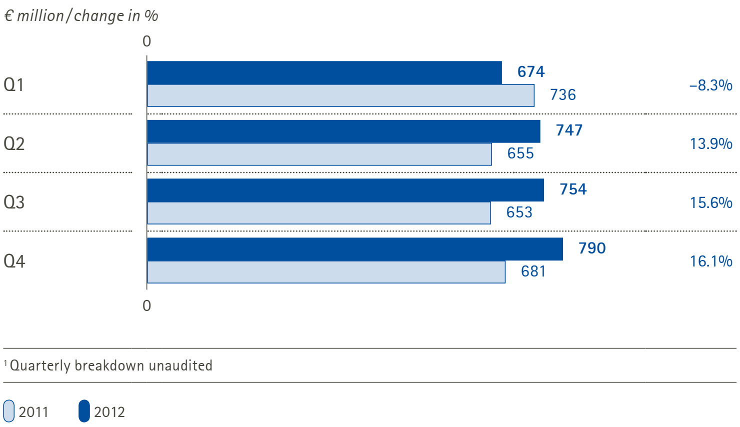
Merck Group | Free cash flow

€ million	2012	2011	Change
Profit after tax	579.0	618.0	–39.0
Depreciation/amortization/impairment losses/write-ups	1,396.6	1,597.4	–200.8
Changes in working capital	525.6	–198.3	723.9
Changes in provisions	378.6	–418.7	797.3
Changes in other assets/liabilities	–383.5	–150.0	–233.5
Others [1]	–24.1	–177.2	153.1
Net cash flow from operating activities	**2,472.2**	**1,271.2**	**1,201.0**
Investments in property, plant and equipment	–329.1	–366.3	37.2
Others [2]	–103.2	531.5	–634.7
Free cash flow	**2,039.9**	**1,436.4**	**603.5**

[1] Neutralization of gain/loss on disposal of assets, other non-cash income and expenses
[2] Investments in intangible assets, acquisitions, investments in non-current financial assets, disposal of non-current assets, purchase/sale of marketable securities

EBITDA pre one-time items is the main profitability measure of ongoing operational performance used internally and externally. It excludes from the operating result depreciation and amortization in addition to one-time items largely related to restructuring measures. It allows for an understanding of the underlying operational performance of the Merck Group and the four divisions.

Merck Group | EBITDA pre one-time items and growth by quarter [1]



[1] Quarterly breakdown unaudited

Apart from EBITDA pre, a new cash flow performance indicator was introduced in 2012 to be used as the second key indicator for internal target agreements and individual incentive plans. Broken down to the divisional level, it sums up EBITDA pre and main cash items such as investments in property, plant, equipment and software as well as changes in inventories and changes in trade accounts receivable, all of which are under full control of the individual businesses. Consequently, increases in inventory and trade accounts receivable have an adverse impact on individual incentive plans, while conversely decreases are positively incentivized. The introduction of this performance indicator has led to considerable improvements in cost awareness as well as reduced working capital requirements.

In February 2012, Merck announced its global efficiency program, which spans all regions and businesses. During the year, more than 100 individual initiatives were implemented in countries such as Spain, Italy, and the United Kingdom. For the German operations, which account for more than one-quarter of all Merck employees, an agreement was signed in September 2012 with the employee representatives aiming to eliminate around 1,100 of the 10,900 positions by the end of 2015. By making the reductions in a socially responsible manner, mainly through voluntary leaver and partial retirement programs across all divisions and functions, Merck will refrain from forced redundancies until the end of 2017, with the exception of possible site closures and transfers that are still being assessed. Further cost savings will be realized by a reduction in personnel costs as the result of a realignment of the compensation system. Merck plans to invest a total of at least € 250 million in Darmstadt and other sites within Germany during the next two years.

Socially responsible job reductions and site closures being assessed

Solid business performance during a year of significant change

In conclusion, in 2012 total revenues grew to € 11,173 million, slightly exceeding the guidance of up to € 11 billion. Merck implemented its first Group-wide efficiency program and already realized first savings. EBITDA pre one-time items amounted to € 2,965 million, including around € 115 million in savings from the efficiency program. This was slightly above guidance of up to € 2.95 billion, including € 55 million in net savings. Merck generated record cash flow due to good profitability and strong working capital management. The Group was able to again reduce net financial debt, also evidenced by an improved credit rating (Baa1/A-).

The above tables as well as those in the divisional reviews may contain rounding differences.