Compensation report

The Compensation report outlines the principles used for determining the compensation of the Managing Board of Siemens AG and sets out the level and structure of Managing Board remuneration. In addition, the report describes the policies and levels of compensation paid to Supervisory Board members. The Compensation report is based on the recommendations and suggestions of the German Corporate Governance Code and is in compliance with the applicable legal requirements of §§ 314 (1) no. 6a and 315 (2) no. 4 of the HGB. As an integral part of the Notes to Consolidated Financial Statements, the Compensation report is part of the audited Consolidated Financial Statements. The Compensation report is presented within the section "Corporate Governance", included in this Annual Report for the fiscal year 2009.

Report on expected developments

WORLDWIDE ECONOMY

The global economy showed first signs of recovery in the second half of 2009 following the most serious recession since the Second World War. IHS Global Insight anticipates that global gross domestic product in real terms, which is expected to fall by 2.1% in 2009 as a whole, will increase by 2.6% in 2010 and by 3.3% in 2011. The speed and strength of the recovery are expected to vary widely from region to region, however, with forecasts predicting GDP growth of 5.2% in 2010 and 5.1% in 2011 in real terms for the Asia, Australia region but a much more restrained development in the Americas and the region Europe, C.I.S., Africa and Middle East, which is the most important market for Siemens. For the Americas region GDP is expected to grow by 2.3% in 2010 and 3.3% in 2011, while the Europe, C.I.S., Africa and Middle East region can expect growth of just 1.4% in 2010 and 2.2% in 2011 according to IHS Global Insight. Smoothing the path of the global recovery are government stimulus programs and the measures enacted to help stabilize the financial markets, the positive effects of both of which are now becoming increasingly apparent. Continued growth will, however, be conditional on the leading central banks maintaining their expansive monetary policy.

Even at this point there remain a number of factors that could derail the economic recovery now under way. Banks might further restrict their lending activities as a result of the deterioration in the quality of loans triggered by the financial crisis and the need to further shore up their own equity resources. Rising unemployment and a blow dealt to consumer confidence by the recession could easily put a lasting damper on consumer spending, especially in Europe and the USA. There is also a risk that the expansive economic policy currently in favor might be replaced too soon and too abruptly, with central banks siphoning off the liquidity that has been pouring into the markets in order to counter the threat of inflation and governments introducing austerity measures in an attempt to put public finances back on a more sustainable footing.

The value-added manufacturing sector, in which Siemens largely operates, collapsed in all our reporting regions in 2009, especially in our two strongest revenue-generating regions, Europe, C.I.S., Africa, Middle East and the Americas. IHS Global Insight estimates a decline of more than 9% in 2009, yet it foresees growth of 4.2% in 2010 followed by likely growth of 5.4% in 2011. In both years, growth in value-added manufacturing is expected to be driven by dynamic development in the Asia, Australia region.

The plunge in investment activity witnessed in 2009 also continues to restrict growth. IHS Global Insight expects gross fixed investments, which accounts for a large share of gross domestic product and is significant for Siemens as a supplier of plant and infrastructure, to rise by 3.9% worldwide in 2010, following a decline of 6.4% in 2009. Even an increase of this magnitude will still leave gross fixed investments in 2010 slightly below 2007 levels. The differences between regions will be even more pronounced on this measure than for gross domestic product. According to IHS Global Insight, gross fixed investments in 2010 will rise by 9.5% in the Asia, Australia region and 3.0% in the Americas region but fall by 0.8% in the Europe, CIS, Africa and Middle East region, which is where we generate the majority of our revenue. The forecast for 2011 predicts growth in global gross fixed investments of 5.7%. This time the Europe, C.I.S., Africa and Middle East region should also see some growth, albeit it a modest 2.8%. The Americas region is expected to see much stronger growth of around 9% in 2011 as a result, in large part, of a surge in activity in the USA. IHS Global Insight anticipates that gross fixed investments will increase by 6.2% in the Asia, Australia region in 2011.

The forecasts presented above for gross domestic product and gross fixed investments are based upon a report prepared by IHS Global Insight dated October 14, 2009, and the data for value-added manufacturing are based upon a report prepared by IHS Global Insight dated November 2009. This information has not been independently verified by Siemens. The uncertainties mentioned above make it difficult to produce a reliable forecast for expected developments at Siemens in fiscal 2010 and, in particular, for fiscal 2011.

MARKET DEVELOPMENT

Due to the severe recession, most markets served by the **Industry** Sector bottomed out during fiscal 2009, and those that did not are likely to do so during the first half of fiscal 2010. Within the Sector, we anticipate a continued decline in markets served by Industry Automation in early 2010, though significantly less drastic than during fiscal 2009. The Division's markets with longer business cycles are likely to be the most affected, whereas a slight recovery is possible for the short-cycle markets, even in the next quarters. The markets served by Drive Technologies are tending to develop in a similar way to those served by Industry Automation, but with a foreseeable time lag. These markets are therefore expected to continue to contract, especially in the early part of fiscal 2010. We anticipated that this will involve the Americas region in particular, but also Europe, C.I.S., Africa and Middle East. Building Technologies serves markets in which the business cycle typically runs behind overall economic development, and market volume is therefore expected to decline slightly in fiscal 2010. Here too, the decline will be largely the result of slowing in the Americas and in Europe, C.I.S., Africa and Middle East. The lighting solutions market in which OSRAM operates is expected to recover fairly quickly from the effects of the recession, such that it will grow in fiscal 2010 compared with fiscal 2009. The business cycle in markets served by Industry Solutions runs slightly behind economic development as a whole; this applies especially for supplies to the steel industry. It is therefore expected that these markets will continue to shrink slightly in fiscal 2010. For the worldwide transportation markets served by Mobility a continued growth is expected in the coming fiscal year, albeit growth might be below the rate of 2009.

Following a clear decline in the markets served by the **Energy** Sector in fiscal 2009, signs of renewed growth are considered possible during the second half of fiscal 2010 at the earliest. Significant for this development is growth in global energy demand, infrastructure development in emerging economies, the need for investment in replacement technologies in the developed world and increased environmental awareness generally. The market for the fossil power generation business, which was slowing in fiscal 2009, could start to recover toward the end of fiscal 2010. The market environment for renewable energy solutions is expected to remain competitive in fiscal 2010. Market development in the established markets of Europe and the U.S. benefits from state subsidies. Within Asia, particularly in China and India, growth in renewable energy is expected in the next years. After the significant marked decline in volume in the oil and gas markets in 2009, there is a chance of growth for the next year. This expectation is based on the continuing increase in global demand for energy and the return of rising oil prices, which favor the opening up and exploitation of hard-to-reach sources of oil. Market growth is expected to remain moderate, with overall volume, at least in fiscal 2010, remaining well below the level it reached before recession. As far as the power transmission market is concerned, a slight growth overall over the next few years is expected, driven in particular by infrastructure development in emerging economies, investment in replacement technologies in industrialized countries and the integration of renewable energies. As for the power transmission and distribution market, we anticipate that following its decline in fiscal 2009 it will stagnate in fiscal 2010.

Market climate for the healthcare industry, within which our **Healthcare** Sector operates, is expected to remain difficult in fiscal 2010. In particular, there is still uncertainty regarding both the implementation and potential impact of health reform in the US. It is expected that the markets served by Imaging & IT will not develop uniformly, but will tend to shrink slightly. The potential reduction in public spending related to budget deficits may affect the healthcare industry in particular, and therefore have a negative influence on growth prospects.

National stimulus programs are expected to have different results on our Sectors. In particular, we expect these programs to support order growth in Divisions within the Industry and Energy Sectors that serve infrastructure equipment markets. In contrast, investments in economic and financial stabilization programs combined with lower tax revenues due to the recession may reduce public sector spending in coming years and therefore adversely affect the growth prospects outside of the infrastructure equipment markets.

SIEMENS GROUP

Results of operations

We are basing our outlook for the Siemens Group and its Segments on the above mentioned expectations of the cyclical economic situation, and in particular of moderate growth in global GDP over the next two fiscal years. We further assume economic growth without significant setbacks and relatively stable foreign currency exchange rates for the U.S. dollar. To the extent that we report revenue on an organic basis, however, currency translation effects are not relevant. Our outlook does not include potential impacts of major portfolio transactions. Our investments within Equity Investments may result in impairments due to further deterioration in their business prospects or aggressive competitor movements. We hold considerable amounts of long-term tangible and intangible assets including goodwill, in our clinical diagnostics business among others, and continually test its recoverable value. Here again, adverse developments in the markets or competition could result in impairments. Such potential effects are not included in our outlook because at this time we are unable to reliably estimate whether or in what amount they might occur.

To a certain extent, the challenging conditions in our markets may make restructuring measures necessary. Financial impacts from such measures are not included in the following outlook. Furthermore, our outlook is conditional on no significant increase in price pressure in markets for our products and services in the coming two years, and also on a general market upturn in the second half of fiscal 2010, particularly for our short-cycle businesses.

Following a double-digit decline in orders in fiscal 2009, we expect only a mid-single-digit percentage decline in organic revenue in fiscal 2010 due to the stabilizing effect of our strong order backlog. Our Fit4 2010 goal of growing organic revenue twice as fast as global GDP growth will presumably not be reached. This goal is based on normal business cycles unlike the current conditions characterized by the recession and effects of the financial crisis on the global economic environment. Assuming a positive effect from government stimulus programs and continued growth in our environmental portfolio, we should be able to achieve organic growth in revenue in 2011. We plan to achieve revenue of approximately €25 billion in fiscal 2011 from the sale of environmentally friendly products and services.

Due particularly to the anticipated lower revenue, Total Sectors profit in fiscal 2010 is expected to decline compared to fiscal 2009. We expect Total Sectors profit between €6.0 and €6.5 billion in fiscal 2010, and an increase of approximately 20% in income from continuing operations compared to €2.457 billion in the prior year. For fiscal 2011, we expect that Siemens could benefit from tailwinds from a recovering world economy.

One of our most important goals is to increase Siemens' capital efficiency. We measure achievement of this goal via return on capital employed (ROCE), which is the ratio of income from continuing operations before interest to average capital employed, minus the balance of assets and liabilities held for disposal related to discontinued operations. Our midterm goal for ROCE is between 14% and 16%. This goal is based on normal business cycles. We therefore do not expect to reach it in fiscal 2010. We expect that ROCE development follows the expected income development in fiscal 2010 and 2011.

Financial position

We expect Free cash flow to decrease in fiscal 2010 compared to fiscal 2009, which benefited strongly from reduction of inventories, particularly in the fourth quarter and collection of receivables. Thereby Free cash flow showed a clear seasonal development through the fiscal year. Furthermore, fiscal 2010 Free cash flow could be burdened by changing customer behavior regarding prepayments. We consider the possibility of declining billings in excess of cost, which would continue a trend in parts of our project business existing for several quarters. Over the business cycle, we aim to ensure that the ratio of Free cash flow to earnings (the cash conversion rate) is greater than one minus our rate of revenue growth adjusted for portfolio and currency effects.

Two key factors influencing Free cash flow are management of net working capital within cash provided by or used in operating activities, and additions to intangible assets, property, pant and equipment within cash used in investing activities. In principle we aim to achieve a ratio of investments in intangible assets and fixed assets to depreciation and amortization expense in a range from 95% to 115%. We will retain our stringent approval process for capital expenditures, which goes up to the Managing Board level and takes into account the macroeconomic environment and the development of new orders. In fiscal 2010, we aim to keep our combined Sectors in the lower end of the range.

In the area of investment planning, the Industry Sector intends to focus on investments in new products for automation and drive solutions, building technologies and lighting solutions. In addition, Industry will pursue selected investments in equipment replacement and rationalization. The Energy Sector plans continued investments mainly in expanding its capacity in major sales markets and emerging economies. The Healthcare Sector plans to continue investing in development of software and IT solutions, primarily relating to imaging systems, and in developing its markets for clinical diagnostics solutions.

For our medium-term capital structure, we seek a ratio of adjusted industrial net debt to adjusted EBITDA in the range of 0.8 to 1.0. In fiscal 2010, we expect the ratio to increase compared to fiscal 2009.

SEGMENTS

The statements for our segments are based on the above-mentioned macroeconomic conditions and specific market developments, particularly including demand in our short-cycle businesses and pricing developments. Furthermore, our Segment statements do not include potential above-mentioned effects from portfolio transactions, impairments, restructuring measures and legal and regulatory matters.

The **Industry** Sector expects a recovery for its short-cycle businesses in the second half of fiscal 2010. The Sector expects to generate a significant amount of revenue from new orders taken during fiscal 2010, in particular in the second half of the fiscal year, while its €27.8 billion order backlog will generate approximately €13 billion in fiscal 2010 revenue. Revenue generation out of the backlog could be held back somewhat by customer cancellations or delays in execution of orders. Revenue in fiscal 2010 is expected to be below the level of fiscal 2009, which included only limited impacts from the recession in the first half of the year. As a consequence of lower revenue, profit and profitability are also expected to be below the level of fiscal 2009, and profitability is expected to lie outside the target margin range which is based on normal business cycles. Industry initiated restructuring measures in fiscal 2009 and plans to continue them to the necessary extent in fiscal 2010.

The **Energy** Sector expects its €47.1 billion order backlog to generate approximately €20 billion in fiscal 2010 revenue. Revenue generation out of the backlog could however be held back somewhat by customer cancellations or delays in execution of orders. Given expected developments in the market for energy infrastructure solutions as described above, Energy expects to generate a significant additional amount of revenue from new orders taken during fiscal 2010, which may result in total revenue close to the prior year-level. Assuming that revenue develops well, the Sector expects to keep profitability within its target margin range.

The **Healthcare** Sector estimates that approximately 50% of its revenue is recurring. The non-recurring revenue in fiscal 2010 will be generated under market conditions prevailing during the year, including the reduced capital spending by customers, weak financing markets and uncertain public policy environment, particularly in the U.S. described earlier. In this environment, Healthcare expects fiscal 2010 organic revenue slightly below the level of fiscal 2009. Sector profit is also expected to come in near the prior-year level, excluding up to €100 million in expected costs related primarily to the next phase of integration activities in the Diagnostics Division.

While we expect continued volatility in income from **Equity Investments** in the future, we anticipate that negative impacts will be clearly reduced compared to fiscal 2009, which among others included an impairment of our equity stake in NSN. Income from equity investments in the next two years will be burdened by further charges in connection with measures already announced by NSN for cutting operating expenses and manufacturing overhead costs.

The international IT services markets in which **Siemens IT Solutions and Services** operates saw a decline in fiscal 2009. Market volume is expected to be relatively stable in fiscal 2010. We expect that Siemens IT Solutions and Services will bring in revenue for fiscal 2010 at the utmost to the level of fiscal 2009. On the basis of lower volume as well as measures aimed at improving Siemens' IT infrastructure, income for Siemens IT Solutions and Services in fiscal 2010 is likely to be considerably burdened with restructuring costs.

Despite expectations of continued challenges both in market conditions and the credit environment, **SFS** aims to hold income before income taxes at the same level as in fiscal 2009.

For our cross-Sector service business **SRE**, we anticipate a significant decline in income in fiscal 2010 compared to fiscal 2009, which included a gain of €224 million from the sale of residential real estate holdings. Lower income will also reflect costs associated with reducing vacancy and consolidating locations under a multi-year program to bundle Siemens' entire portfolio within SRE. The program is expected to generate approximately €250 million in cost savings annually by 2011 and €400 million in annual savings from 2014 onward.

Furthermore, we expect a substantial loss on the planned sale of the electronics assembly systems business in fiscal 2010. During fiscal 2009, centrally carried pension costs rose by approximately €0.5 billion from the prior-year level, and we expect no significant change year-over-year in fiscal 2010.

OVERALL ASSESSMENT

Siemens anticipates that conditions in the manufacturing sector and world financial markets will remain challenging in fiscal 2010. Following a double-digit decline in orders in fiscal 2009, we expect only a mid-single-digit percentage decline in organic revenue in fiscal 2010 due to the stabilizing effect of our strong order backlog. We expect Total Sectors profit between €6.0 and €6.5 billion in fiscal 2010, and an increase of approximately 20% in income from continuing operations compared to €2.457 billion in the prior year. This outlook is conditional on no material deterioration in our pricing power during the fiscal year and on improving market conditions in the second half, particularly for our shorter-cycle businesses. Furthermore this outlook excludes major impacts that may arise during the fiscal year from restructuring, portfolio transactions, impairments, and legal and regulatory matters.

Under the assumption of positive effects from stimulus programs and the environmental portfolio, we should be able to resume organic revenue growth in fiscal 2011. With tailwinds from a recovering world economy, we expect to resume revenue growth and realize corresponding benefits for Total Sectors profit and Income from continuing operations.

OPPORTUNITIES

As described in the section "Risk report," we have implemented a comprehensive Enterprise Risk Management (ERM) approach that is integrated into the organization and that addresses both risks and opportunities. Within the ERM approach, we regularly identify, evaluate and respond to opportunities that present themselves in our various fields of activity, even in the current difficult macroeconomic environment.

While the stabilization in the global economy is regionally unbalanced and subject to a high degree of uncertainty, and market conditions are expected to remain challenging, we also see opportunities for our business. For example, we expect to win in the coming years a significant volume of new orders generated by stimulus programs already announced by governments around the world to counter the negative impact of the macroeconomic downturn. In addition, due to a general decline in demand as a consequence of the current economic conditions, we hope to benefit from favorable price developments on our supplier markets for components, sub-assembles and other materials. Further, the current macroeconomic environment may also present increased opportunities for strategic acquisitions.

We are continuously in the process of developing and implementing initiatives to reduce cost, adjust capacities as well as streamlining our product portfolio. The successful implementation of these measures may lead to additional profit and value for our customers. For example, we expect to generate substantial and sustainable improvements in profitability from our Supply Chain Management initiative launched in fiscal 2009 aimed at optimizing our supply chain management and improving the management of our supplier-related risk. For further information regarding this initiative, see "Business and operating environment—Strategy—Important corporate programs and initiatives—Supply Chain Management initiative." The realignment of our sales and marketing activities on a global basis in our cluster structure may also represent an opportunity to improve our profitability. By sharing resources and eliminating overlapping back office functions, we see the opportunity to optimize our enterprise-wide cost position on a long-term basis. In addition, the realignment of our organizational structure and related process improvements are expected to provide further business opportunities for Siemens.

Another opportunity for us is to further benefit from the above-average growth potential in the emerging markets by strengthening local entrepreneurship in these countries. Localizing certain activities, such as procurement, manufacturing, maintenance and service in markets like the BRIC countries Brazil, Russia, India and China and the Middle East could enable us to reduce costs while enhancing our local presence, which in turn is also expected to provide additional business opportunities in these strategic growth markets.

We also have an opportunity to further grow in the areas of environment and climate protection. Our environmental portfolio comprises products and solutions with exceptional energy efficiency, systems and components for renewable forms of energy, and environmental technologies. These products and solutions are intended to help our customers to reduce their carbon dioxide footprint, cut their energy costs and improve their profitability through an increase in their productivity. We anticipate that public policy initiatives in many countries will lead to greater demand for such products and solutions in the years ahead, including from government stimulus programs already announced in connection with the current macroeconomic and financial crisis. For further information, see "Business and operating environment—Strategy—Important corporate programs and initiatives—Environmental portfolio."

In addition, through our research and development activities as well as through selective acquisitions, we constantly strive to develop new products and solutions and improve existing ones. We invest in new technologies that we expect to meet future demand in accordance with the four strategic megatrends demographic change, urbanization, climate change and globalization (for further information, see "Business and operating environment—Global megatrends)." For example, an opportunity is to develop the capabilities required to design, manufacture and sell so-called SMART products (Simple, Maintenance-friendly, Affordable, Reliable and Timely to market). Adding such products to our current portfolio would enable us to increase our revenues by serving large and fast-growing regional markets, such as in Asia, where customers may consider price as strongly as quality and innovation when making a purchase. Many of the key areas of our research and development activities focus on products and solutions capable of strengthening and expanding our environmental portfolio. These focus areas include smart power grids, the technology for electric vehicles, including their integration into these smart grids, as well as concentrated solar power that plays an important role in accelerating the implementation of the DESERTEC concept.

Our business, financial condition or results of operation could suffer material adverse effects as a result of certain risks. For an overview of our risk factors, see "Risk report."

New orders and order backlog; adjusted or organic growth rates of Revenue and new orders; book-to-bill ratio; return on equity, or ROE; return on capital employed, or ROCE; Free cash flow; cash conversion rate, or CCR; EBITDA (adjusted); EBIT (adjusted); earnings effect from purchase price allocation (PPA effects) and integration costs; net debt and adjusted industrial net debt are or may be non-GAAP financial measures. These supplemental financial measures should not be viewed in isolation as alternatives to measures of Siemens' financial condition, results of operations or cash flows as presented in accordance with IFRS in its Consolidated Financial Statements. A definition of these supplemental financial measures, a reconciliation to the most directly comparable IFRS financial measures and information regarding the usefulness and limitations of these supplemental financial measures can be found on Siemens' Investor Relations website at www.siemens.com/nonGAAP.

This document contains forward-looking statements and information – that is, statements related to future, not past, events. These statements may be identified by words such as "expects," "looks forward to," "anticipates," "intends," "plans," "believes," "seeks," "estimates," "will," "project" or words of similar meaning. Such statements are based on the current expectations and certain assumptions of Siemens' management, and are, therefore, subject to certain risks and uncertainties. A variety of factors, many of which are beyond Siemens' control, affect Siemens' operations, performance, business strategy and results and could cause the actual results, performance or achievements of Siemens to be materially different from any future results, performance or achievements that may be expressed or implied by such forward-looking statements. For Siemens, particular uncertainties arise, among others, from changes in general economic and business conditions (including margin developments in major business areas and recessionary trends); the possibility that customers may delay the conversion of booked orders into revenue or that prices will decline as a result of continued adverse market conditions to a greater extent than currently anticipated by Siemens' management; developments in the financial markets, including fluctuations in interest and exchange rates, commodity and equity prices, debt prices (credit spreads) and financial assets generally; continued volatility and a further deterioration of the capital markets; a worsening in the conditions of the credit business and, in particular, additional uncertainties arising out of the subprime, financial market and liquidity crises; future financial performance of major industries that Siemens serves, including, without limitation, the Sectors Industry, Energy and Healthcare; the challenges of integrating major acquisitions and implementing joint ventures and other significant portfolio measures; the introduction of competing products or technologies by other companies; a lack of acceptance of new products or services by customers targeted by Siemens; changes in business strategy; the outcome of pending investigations and legal proceedings and actions resulting from the findings of these investigations; the potential impact of such investigations and proceedings on Siemens' ongoing business including its relationships with governments and other customers; the potential impact of such matters on Siemens' financial statements; as well as various other factors. More detailed information about certain of the risk factors affecting Siemens is contained throughout this report and in Siemens' other filings with the SEC, which are available on the Siemens website, www.siemens.com, and on the SEC's website, www.sec.gov. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those described in the relevant forward-looking statement as expected, anticipated, intended, planned, believed, sought, estimated or projected. Siemens does not intend or assume any obligation to update or revise these forward-looking statements in light of developments which differ from those anticipated.