MANAGEMENT REPORT

CONSOLIDATED MANAGEMENT REPORT OF SCHLOTT GRUPPE AND THE AG
FOR THE FISCAL YEAR 2003/04 AS PER SEPTEMBER 30, 2004

— **COMPANY PROFILE:** *The structure of schlott gruppe*

schlott gruppe is one of the leading European providers of printing and communication services for the advertising industry and publishers. The catalogue of services reflects the demands and requirements of major European customers. The core competence of *high performance printing* – gravure and offset printing as well as further processing – was, therefore, over the past years continually enhanced based on customers requirements in the business segments *direct marketing* and *digital services*.

During the past fiscal year, the integration of activities in the area of *digital services* into the business segments *high performance printing* and *direct marketing* was prepared and was implemented at the beginning of the new business year. Aside from this simplification of the management structure, the complete range of services of *schlott gruppe* is retained.

During fiscal year 2003/04, *schlott gruppe* had nearly 4,300 employees. With the current geographic positioning we are accompanying our customers on a Europe-wide basis: in gravure printing, we are the sole providers with production facilities in both Northern and Southern Germany. Our sites around Hamburg as well as in Nuremberg allow us to offer comprehensive services to publishers, which for reasons of timeliness require periodicals in both Northern and Southern editions. At the same time, we are able to reach Scandinavia, Great Britain and the Benelux countries via our Northern German sites.

French mail-order houses, which are domiciled in the region around Lille, as well as French marketing agencies that are mainly situated in Paris, are being served by our sites in Freudenstadt and Landau in the Southwestern part of Germany as well as by a site for further processing in the Northeast of France.

The business segment *direct marketing* has its largest production site in Schwandorf close to the border of the Czech Republic. From this site, we coordinate the production of labor-intensive orders for our Czech facility, which has been significantly enlarged over the past years. In addition, *direct marketing* has a production site in Scandinavia as well as sales and distribution offices in France, Great Britain and the Netherlands.

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— COORDINATION WITHIN SCHLOTT GRUPPE:

Central coordination of transparent processes generates synergy potential and reduces risks

Following the reorganization of the business segment *direct marketing, schlott gruppe* is now active with 31 subsidiaries *(see page 35)*. The formal registration of the new subsidiaries took place shortly after the end of the fiscal year. This marked break down of the group has developed historically over time. From the perspective of the group, however, this break down produces transparency with respect to services and costs of individual sites as well as to the cost of processes.

As Members of the Board of Management of the group are present within all large subsidiaries, an inflation of overhead expenses of the group and an unintended level of independence of the individual subsidiaries does not result from this break down.

The subsidiaries are tightly managed. For example, the gravure sites are pure cost centers, i.e. they receive their printing orders from the central office responsible for the coordination and distribution of orders within the group. With this break down, we are able to realize multiple synergies between the various sites, ranging from a balanced utilization of capacities to possible specialization. This would not be possible with profit centers managed in a decentralized fashion. In addition, we are able to reduce significantly the management risks within the group.

direct marketing operates with a comparable organizational structure. Orders for the production sites at Schwandorf and in Sweden are distributed on the basis of production capacities, capabilities and logistics. The facility in the Czech Republic functions as an extension to the Schwandorf site.

— SUMMARY OF FISCAL YEAR 2003/04: *Further successful development of schlott gruppe*

schlott gruppe had a very successful year. While the industry environment again failed to give positive impulses, the group realized a strong increase in earnings with EBT rising by 55 percent to about € 20 million (prior to the suspense of amortization of goodwill), and to about € 26 million after the discontinuation of goodwill amortization. This increase in EBT reflects principally the positive development in the segment *high performance printing*, in which earnings rose by 38.5 percent to € 33.1 million.

1. VALUE-ADDED STATEMENT 2003/04

in € million

DEVELOPMENT	
Total Revenue (including interest income and results from participations)	599.2
Cost of Materials	– 237.5
Other op. exp. ex taxes expensed	– 85.9
Gross Value-Added	275.8
Depreciation Expense	– 35.0
Net Value-Added	240.8

APPLICATION		Percentage
Personnel Expenses	202.4	84.0 %
Public Domain (including taxes)	10.0	4.2 %
Creditors	12.5	5.2 %
Shareholders *	5.6	2.3 %
Group	10.3	4.3 %
Net Value-Added	240.8	100.0 %

* *Recommendation to the Annual General Meeting*

The comprehensive optimization steps undertaken and the high levels of investment in fixed assets are now clearly reflected in the results: during the last years we have within a very short time built a high-tech gravure printing site at Nuremberg harbor, where the necessary labor input per ton of printing capacity was materially reduced due to the speed and efficiency of this new production site. Further, we had introduced flexible work-time models in the area of further processing and have tightened and optimized our offset printing sites.

During the past fiscal year, capacities that had been temporarily unavailable due to relocations were again fully at our disposal. These capacities were well utilized with orders obtained at short notice in spite of generally weak demand in the industry. Our ability to accept orders at short notice and to execute these in a flexible and customer-oriented fashion is one of our strengths. As a result, we were able to strengthen our market position within our industry.

During the fiscal year 2003/04, the business segment *direct marketing* has developed significantly poorer than expected. While our excellent processes in *high performance printing* produce positive results even in difficult economic environments, poor market conditions for *direct marketing* expose our sub-optimal internal organization in this market segment.

Nevertheless, the results during the past fiscal year for this business segment can be characterized as “further successful development”: we have developed a comprehensive optimization concept for the segment *direct marketing* immediately after completing the relocations in the area of *high performance printing*. In light of the less than satisfactory business development in this segment, we have broadened the optimization concept and have accelerated its implementation. Consequently, the segment started the new fiscal year in its new configuration and is expected to produce positive results in the current fiscal year.

Finally, we have during the past year prepared for the integration of subsidiaries active in the segment *digital services* into the afore-mentioned two business segments and have implemented these steps at the beginning of the new fiscal year. Thus, the activities of the group in this area are managed more tightly as well.

During the past year, we have introduced in our communication with financial markets the term “Value-Added Sales” in order to enhance the transparency of our reporting. The amount of net sales reported, especially in the area of printing activities, has only limited informational value. The concept of “Value-Added Sales” enables us to eliminate a material factor unrelated to operating performance, i.e. the paper placed at our disposal by our customers. In the chapter “Factors Influencing the Preparation of Financial Statements” *on page 57*, we will elaborate in detail on the significance and value of this new term.

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TO THE POINT:

WE HAVE DEVELOPED FAVORABLY IN 2003/04.

— BUSINESS SEGMENT DIRECT MARKETING:

As planned, optimization measures were implemented

The competitiveness of the business segment *direct marketing* has been significantly strengthened over the past years by utilizing the labor cost advantages of our Czech site for labor-intensive products. Today, there are 404 employees at that site, which is only one hour away from our central office of *direct marketing* activities at Schwandorf. During the past year, it became apparent, however, that these steps are insufficient to sustain a satisfactory profitability in the longer term. Prior to year-end, we have therefore implemented a set of actions that will address this weakness.

While the *direct marketing* industry was able to differentiate itself from the general weakness of the advertising industry, the rate of growth was significantly lower than in prior years. Consequently, the excess capacities existing in this market influenced the level of prices realized. In addition, customers have during the past year increasingly tested new forms of communication. For example, lottery firms have reallocated a portion of their budgets to telemarketing. Moreover, business conditions for *schlott gruppe* in *direct marketing* were affected by the negative development in the mail order industry. Mail order houses represent the largest customer group in this business segment.

In order to sustain the competitiveness of *direct marketing* in the longer term, we have implemented during the past year the restructuring of activities along the lines of business processes. In this way, we have increased the transparency of earnings, costs and processes.

With the beginning of the new fiscal year, we are working in the area of *direct marketing* with several companies active in further processing, finishing and lettershop. With this configuration, we are able to coordinate the further processing in *direct marketing* with that in *high performance printing*, and thus optimize capacity utilization.

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Additionally, internal logistical services were transferred into an independent entity in line with the structure of other internal services within the group. At the same time, processes were reorganized and a new production layout was implemented. With the new layout, three production areas were created that are geographically separated. Thus, the organizational structure and processes were simplified.

Moreover, we have adjusted our personnel resources to reflect reduced demand for our products. By means of several steps, we have reduced our headcount by the equivalent of 140 full-time employees. Employment contracts with expiration dates were not renewed and the weekly hours for unskilled labor were reduced from 35 to 30. Through these measures we were able to limit redundancies to 65 employees.

A significant improvement of our cost structures was achieved through the increase in flexible hour accounts to 150 hours per year, enabling us to meet high capacity demands by drawing on these accounts without increasing personnel expenses.

All these measures can be strategically successful only if marketing and distribution activities are broadened and new markets are developed. Consequently, we have strengthened our marketing team, have sharpened our focus and have revamped our organizational structure.

— ECONOMIC ENVIRONMENT:

Only modest positive impulses for our industry

GENERAL TRENDS

The fiscal year 2003/04 was characterized by strong global economic growth, which was sustained well into 2004 in spite of a somewhat more restrictive monetary policy of central banks and uncertainties with respect to record high prices for raw materials. However, Germany once again lagged behind.

While the development in oil prices dampened consumer demand, corporate capital investments were the worldwide economic locomotive. The six leading German economic institutes prognosticate for the year 2004 a robust increase in the global Gross Domestic Product of 3.9 percent.

As was the case in the previous year, the regional variances in growth were pronounced: the Far East, notably China, continued to boom; Japan finally came out of its stagnation and growth in the USA continued robustly.

The European countries, however, lagged markedly behind global economic trends in spite of a noticeable rejuvenation as compared to the previous year. The region of the 25 EU countries is expected to achieve a growth rate of 2.4 percent in 2004 after only 1.0 percent in 2002/03. However, the uptrend is largely accounted for by the EU's new entrants, which will likely realize economic growth to the tune of 5.1 percent.

Significantly weaker growth of only 1.9 percent is expected for the countries with the common Euro currency. Of the 15 EU countries prior to the 2004 expansion, Great Britain, Ireland, Sweden and Greece experienced disproportionate growth of at least 3.0 percent; Italy, the Netherlands and Portugal grew by only about 1.0 percent and are the laggards. The two large European economies of France and Spain achieved economic growth rates of 2.4 and 2.7 percent, respectively.

After experiencing a slightly negative growth during 2002/03, the German economy achieved a modest revival in 2004. However, Germany remains below the European average. The expected growth for 2004 will be around 2.0 percent as per pronouncements made by the Federal Government, the German Council of Economic Advisors (SVR) and the International Monetary Fund (IMF). The German economy remains split: while exports reached new heights and represented the main impulse for economic growth, the domestic economy barely achieved positive results due to the continued reluctance of consumers to spend.

INDUSTRY ENVIRONMENT AND TRENDS

According to the Federal Association Print and Media (bvdm), the printing industry has overcome weak conditions in its industry during the turn of the year 2003/04. Since then, business conditions have improved and the industry is looking again favorably into the future. This positive change reflects primarily the improvement in general economic conditions as well as higher levels of activity by publishers and rising advertising expenditures across the board, according to the bvdm, September 2004.

The Federal Office of Statistics concludes that the printing industry realized an increase in production of 2.1 percent in the first half of 2004 compared to the same period of the prior year, thereby raising capacity utilization to 82.5 percent and overcoming its lowest level for the past 20 years. Total revenue of the printing industry rose to € 8.1 billion during the first half of 2004, representing an increase of 1.8 percent compared to the previous

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year. Capital expenditures for 2004 are expected to fall again by about 5.0 percent after a 10.0 percent decline in 2002/03 and a total of 28.0 percent during the preceding two years.

For the future, the industry is cautiously optimistic. Especially the more vibrant advertising market and the ongoing modest improvement in general economic conditions are expected to lead to positive growth rates of about 2.0 percent in 2004. This will be the first positive result since the year 2000.

The general trends and data of the printing industry are applicable to *schlott gruppe* only to a limited extent; the printing industry consists mainly of medium-sized and small enterprises making it necessary to look more closely at the opinions and pronouncements of the largest consumers of printed matter. The Association of German Communication Agencies (GWA) is looking to the future with modest optimism. According to its Fall Report, 44 percent of the agencies were satisfied with business conditions during the first half of 2004; a large majority of 84 percent expect turnover in the second half of the year to be at least at the level of the first half. A rise in turnover of 2.0 percent is expected for the entire year.

The Association of the German Advertising Industry has become more optimistic as well. It expects a modest rejuvenation of the German advertising market with total revenue of
€ 29.2 billion, representing an increase of about 1.0 percent after three years of recession and stagnation. This change in trend must be seen, however, in light of the very low baseline – in 2002/03, the percentage of gross domestic product expended for advertising had fallen to the lowest level since 1978.

More optimistic are the data of Nielsen Media Research, according to which gross advertising expenditures for the classical media rose by 5.5 percent to € 14.5 billion during January to October 2004. The highest growth rates were achieved by daily newspapers and radio, which benefited by 10.8 percent and 8.1 percent, respectively. Popular periodicals registered an increase of 3.9 percent. The important year-end business will likely grow by 5.0 percent, resulting in total advertising expenditures of € 18 billion plus, after € 17.2 billion in 2002/03.

Another important segment for *schlott gruppe* is the mail order industry. In general, the mail order industry was characterized by stable conditions since 1992; however, the Association of the German Mail Order Industry (BVH) expects a reduction in turnover during 2004 by about 2.0 percent to € 20.6 billion.

direct marketing continues on its growth path. For the direct contact with customers, expenditures during 2004 will rise by nearly 4.0 percent compared to 2002/03, according to the "*Direct Marketing* Monitor 2004" of Deutsche Post. Total expenditures for *direct marketing* will rise from € 30.8 billion to about 32.0 billion; however, during the prior year an increase of 6.2 percent had been realized.

— CURRENT CHANGES IN THE INDUSTRY:

Properly positioned for emerging business potential

During the past business year, we have witnessed the fortification of a trend that has been observed for a number of years: shorter cycles and greater topicality of printed products. We have recognized and understood this trend in a timely way and are now positioned to profit from it.

While this trend was first noticed in the area of periodicals and publishers, as well as specialty mail order houses, the universal houses have now joined. Universal mail order houses are expected to issue three focused editions per year rather than the former two main catalogues. In addition, these houses may issue topical advertising matter in the interim periods.

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SHORTER CYCLES AND REDUCED
LIFE SPANS OF PRINTING PRODUCTS:
WITH OUR

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GRAVURE PRINTING SITES
WE ARE POSITIONED WITH FLEXIBILITY.

We have positioned ourselves early on to deal with these shorter cycles and reduced life spans of printed matter. At our four gravure printing sites, we are employing medium and large-sized equipment with a width of up to 3.64 meters. Deliberately, we are not installing equipment with a width of more than 4 meters. In this way, we are optimally structured to take advantage of the opportunities arising out of changing marketing strategies and advertising concepts employed by our customers.

We expect that the usual summer and winter main catalogues consisting of about 1,500 pages will be replaced by reduced main catalogues in combination with specialty editions. These catalogues will remain in the domain of gravure printing due to the high count of pages and the continued high volume per edition. Our competitiveness will not be affected by these changes, since the specialty editions are targeted at millions of consumers and gravure printing will produce these products.

The more frequent editions of mail order catalogues will reduce in the medium term the current capacity overloads during seasonal peaks, allowing for a more balanced utilization of capacity than in the past. Since during the current peak seasons additional personnel expenses are incurred due to additional shifts and work on weekends, we look forward to reduce such costs in the medium term. On the other hand, the higher frequency of printed products will in the short term create additional expenses. According to all opinions, especially those of our customers, the total level of printed products will be sustained at current levels in the future.

— FINANCIAL DEVELOPMENTS: *Goals achieved*

FACTORS INFLUENCING ANNUAL FINANCIAL STATEMENTS: FISCAL YEAR 2003/04 FOR THE FIRST TIME WITHOUT EXTRAORDINARY ITEMS

After several years of great efforts, *schlott gruppe* can review for the first time a fiscal year that was not impacted by special items and factors such as fire damage to machinery and equipment, the adoption of IAS, the change of the fiscal year, closures and relocations of sites, and acquisitions.

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In line with the foregoing, the results achieved reflect the earlier than expected completion of the optimization program in *high performance printing* over an entire year as well as the sustainable increase in profitability of the company. This is particularly noteworthy, since the fiscal year 2003/04 was again burdened by difficult market conditions.

During the previous year, the data was still influenced by the relocation of two printing presses, which reduced capacity by about 25,000 tons and resulted in the loss of relevant margin contributions. For the reporting year, we had at our disposal for the first time since 1999 essentially our total capacity.

"VALUE-ADDED SALES" AS A NEW CONCEPT FOR COMMUNICATION WITH FINANCIAL MARKETS

The stated level of net sales in our financial statements and the ratios calculated on that basis reflect only to a limited extent the actual business trends and conditions of *schlott gruppe*. We have, therefore, during the course of the past fiscal year, introduced in our reporting the concept of "Value-Added Sales".

A significant factor impacting net sales and materials expenses for printing enterprises is the amount of paper provided by customers.

Derivation of "Value-Added Sales"

IN € MILLION (IAS/IFRS)	***2003/04***	***2002/03***
Net Sales	581.0	613.7
Changes in Inventory	–2.6	–1.9
Other Capitalized Internal Services	0.0	0.0
Cost of Materials	–183.1	–220.0
Cost of Purchased Services	–54.4	–56.4
Value-Added Sales	340.9	335.4

Whether a customer purchases and places at our disposal paper for orders rendered, or whether the paper will be purchased by the printing firm for such orders, cannot be influenced by us. Paper purchased by printing firms is reported as cost of materials and reflected in turnover, while paper provided by customers is not captured in financial statements.

All other things being equal, an increase in paper provided will proportionately reduce the turnover and cost of materials of the printer. The reduction in turnover, as well as the resultant increase in margins, does, however, not represent a change in business conditions.

From the perspective of the printer, a higher level of paper provided is attractive since working capital, and thus debt levels, are positively influenced. On the other hand, changes in business data as a result of changes in paper provided are difficult to communicate to financial markets. Particularly sensitive is the "reduced" turnover as a result of the foregoing. The volatility resulting from the above cannot be influenced by the printer, but can influence in a negative way the value of its shares.

The "Value-Added Sales" eliminates the cost of materials and services and reflects the actual level of value-added generated by the company. The effect of paper provided by customers is thereby neutralized *(see derivation on page 58)*. The cost of paper represents the major component of costs of materials since expenses of other materials are insignificant.

Based on this concept, the actual financial and business conditions of the company can be highlighted and communicated more accurately. Ratios calculated on the basis of "Value-Added Sales" are therefore a valuable tool for the financial markets in valuing the shares of *schlott gruppe*.

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INCREASE IN TONNAGE BY FIVE PERCENT TO

576,600

TONS

PRODUCTIVITY INCREASED STRONGLY

During fiscal year 2003/04, *schlott gruppe* has grown faster than the industry as a whole. Moreover, the optimization of processes undertaken over the past years has given positive and ongoing impetus to the profitability of the group.

Key financial data of the Income Statement

IN € MILLION (IAS/IFRS)	2003/04	Percentage	2002/03	Percentage
Net Sales	581.0	170.4 %	613.7	183.0 %
Value-Added Sales	340.9	100.0 %	335.4	100.0 %
EBITDA	72.5	21.3 %	63.4	18.9 %
EBIT	37.5	11.0 %	23.2	6.9 %
EBT	25.6	7.5 %	12.9	3.8 %
Net Income	15.6	4.6 %	4.7	1.4 %
Earnings per Share (€)	2.51		0.76	

While during the fiscal year 2003/04, the general situation in our markets has somewhat improved, advertising expenditures in the classical print media have moved only minimally away from its years-long low point; production in the printing industry grew by about 2.2 percent and thus registered only a modest movement away from its recession levels. *schlott gruppe* was able to achieve an increase in tonnage of about 5.0 percent to 576,600 tons. This increase mirrors essentially the increased capacity that was created during the year in gravure printing following the completion of the relocation of two presses to the new site at Nuremberg harbor in the late fall of 2003. The generation of additional orders enabled us to fully utilize our increased capacity and to strengthen our market position.

In spite of the above positive developments, net sales as stated in the financial statements for this fiscal year fell by 5.3 percent to € 581.0 million. Responsible for this decrease is solely the again higher level of paper provided by customers. The percentage of paper provided rose to 72.3 percent after 64.3 percent in the previous year. Consequently, nearly three fourths of paper utilized by *schlott gruppe* is not reflected in net sales.

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The “Value-Added Sales” has however risen by 1.6 percent to € 340.9 million. In our largest business segment *high performance printing*, our gravure printing activities rose by 3.9 percent to € 265.4 million. As this growth rate correlates closely with the increase in tonnage, one can conclude that the average prices in gravure printing were essentially unchanged compared to the prior year.

It is noteworthy that the decidedly disproportionate increase in net income is the result of higher levels of productivity. EBIT rose by 61.6 percent to € 37.5 million despite, as advised, a decrease in other operating income by € 6 million to € 19.9 million. EBT increased by 98.4 percent to € 25.6 million, while net income rose by 231.9 percent.

The major factors contributing to dynamic earnings growth are improved labor productivity, the permanently reduced other operating expenses, as well as the less than 40 percent tax rate.

In the area of *high performance printing*, fewer employees have produced significantly more than in the prior year. In terms of tonnage output per employee, the increase amounted to 7.5 percent from 196.6 tons to 211.4 tons. Besides the higher levels of productivity of our updated equipment, the optimization of processes resulting from the completion of the relocation to the Nuremberg site and the central capacity coordination of our four gravure printing sites were influencing factors. This increase in efficiency is sustainable and will support the profitability of the group in the coming years.

Following high levels of capital expenditures over the past years, *schlott gruppe* enjoys the most modern inventory of machinery and equipment in European gravure printing. As a consequence, capital expenditures during the reporting year have been more than halved. The decline in depreciation expenses by € 5.2 million to € 35.0 million does not yet reflect the reduced level of capital expenditures, but represents the discontinuation of amortization of goodwill. Amortization expenses amounted to € 5.8 million in 2002/03. During the past year, amortization of goodwill as per IFRS 3 (2004) was suspended and goodwill was subjected to an impairment test as per IAS 36.

Other operating expenses declined by 6.8 percent, or € 6.3 million, in spite of an extraordinary depreciation expense of € 1.4 million on account of real estate not required in the course of ordinary business operations. Of the recurring items, only maintenance expenses have risen appreciably. This is the result of utilizing the entire equipment capacity, which had partly been suspended due to relocations. All other items are on the level of the prior year or have fallen, some items even significantly. This applies particularly to administrative overhead expenses, which declined by nearly 28 percent due to lower legal and consulting expenses. All other expenses, including reserves for impending losses, amounted to € 2.5 million, which is less than half the level of the previous year.

Results from financing activities amount to € – 11.9 million after € – 10.3 million in 2002/03. In this connection it must be noted that for the purpose of more transparency in our quarterly reporting and in line with recommendations of Deutsche Börse AG, we have included in the financial statements gains and losses resulting from changes in interest rates. These were € 1.9 million lower than in 2002/03, resulting in an improved result from financing activities of
€ 0.3 million.

Foreign exchange transactions are utilized exclusively as hedging instruments for our ordinary business operations: we hedge orders as soon as we accept them. In the event the foreign exchange rate changes to our detriment, we lose margin contributions on such orders, but realize commensurate gains from the hedging transactions. Foreign exchange rate fluctuations are therefore neutralized in our income statement.

Even after accounting for the effects of the changed treatment of amortization of goodwill, the tax rate for the reporting year declined significantly from 43.9 percent in 2002/03 to 39.1 percent in 2003/04. The major reasons for this decline are losses generated by foreign subsidiaries that cannot be compensated for tax purposes.

The net income for the group of € 15.6 million after € 4.7 million in the prior year correlates with earnings per dividend-eligible share of € 2.51 as compared to € 0.76 in the previous year. The undiluted and diluted average number of shares outstanding was 6,187,412 as per September 30, 2004, after 6,144,952 in the previous year. The number of shares outstanding and dividend-eligible was 6,190,020 at year-end and had not changed compared to the previous year.

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Chart 2

The financing structure was improved during the business year 2003/04 as planned.

BALANCE SHEET AND CASH FLOW OF THE GROUP

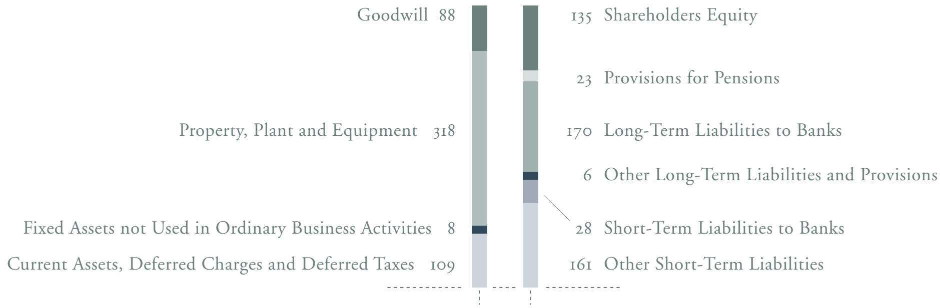
During the past fiscal year we were again able to demonstrate the cash flow strength of the group and thus improve in a material way the quality of our balance sheet.

Key Balance Sheet Figures

IN € MILLION (IAS/IFRS)	*09-30-2004*	*Percentage*	*09-30-2003*	*Percentage*
Fixed Assets	413.7	79.2 %	430.6	78.2%
Goodwill	87.8	16.8 %	88.4	16.1%
Current Assets	106.6	20.4 %	116.1	21.1%
Trade Receivables	57.4	11.0 %	64.5	11.7%
Cash and Cash Equivalents	1.8	0.3 %	2.9	0.5%
Deferred Taxes	0.1	0.0 %	1.8	0.3%
Deferred Charges	2.1	0.4 %	2.0	0.4%
Total Assets	522.5	100.0 %	550.5	100.0%
Shareholders Equity	135.5	25.9 %	125.5	22.8%
Liabilities	350.7	67.1 %	388.7	70.6%
Provisions	74.0	14.2 %	77.0	14.0%
Due to Banks	197.4	37.8 %	221.7	40.3%
Trade Payables	42.2	8.1 %	50.4	9.2%
Deferred Taxes	33.5	6.4 %	31.5	5.7%
Deferred Charges	2.8	0.5 %	4.8	0.9%
Total Liabilities	522.5	100.0 %	550.5	100.0%

2. BALANCE SHEET STRUCTURE AS PER SEPTEMBER 30, 2004

in € million



The balance sheet of *schlott gruppe* has been considerably extended due to the high level of capital expenditures and the initial consolidation of the *broschek gruppe* in the previous year. In the course of the reporting year, capital expenditures have been significantly reduced and no acquisitions have taken place. Consequently, the balance sheet totals contracted by around 5.0 percent to € 525.5 million due to standard depreciation of fixed assets and due to the lower levels of working capital as a result of higher levels of efficiency.

In various balance sheet items one can see the successful disposal of the land as well as buildings of the former site in the center of Nuremberg. An agreement for the sale of this real estate was concluded, with the closing to take place at the beginning of the calendar year 2005.

As a result of this agreement, we have a transfer of value from the balance sheet position investment properties to the item land, land-rights and buildings. Concurrent with the closing of the aforementioned agreement, the city of Nuremberg requires payment for the deferred purchase price of the new site at Nuremberg harbor. A corresponding adjustment from long-term debt to short-term liabilities has been made. The deferral of the purchase price originated out of negotiations with the city, which had a right of first refusal for the property in the City center in the event *schlott gruppe* had no use for the property.

While there were no notable changes in asset values, the structure of financing was measurably improved as planned. Shareholders equity rose by 8 percent or € 10.0 million to
€ 135.5 million due to the positive earnings situation, while liabilities were reduced by nearly 10 percent or € 38.0 million. Interest-bearing liabilities to banks were reduced by € 24.3 million of which € 7.2 million were applied to long-term debt and € 17.2 million to short-term liabilities.

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Chart 3

Nearly € 70 million in Cash Flow from operations pave the way for a significant reduction in debt.

Development of the equity to fixed asset ratio in 2003/04

IN € MILLION (IAS/IFRS)	***09-30-2004***	***09-30-2003***
Fixed Assets	413.7	430.6
Real Estate Held as Financial Assets	–8.3	–15.4
Total Fixed Assets	405.4	415.2
Shareholders Equity	135.5	125.5
Long-Term Liabilities to Banks	169.6	176.8
Provisions for Pensions	22.6	22.3
Other Long-Term Liabilities	2.3	14.6
Fixed Assets not Used in Ordinary Business Activities	–8.3	–15.4
Total Long-Term Liabilities	321.7	323.8
Long-Term Coverage of Fixed Assets	79.4%	78.0%

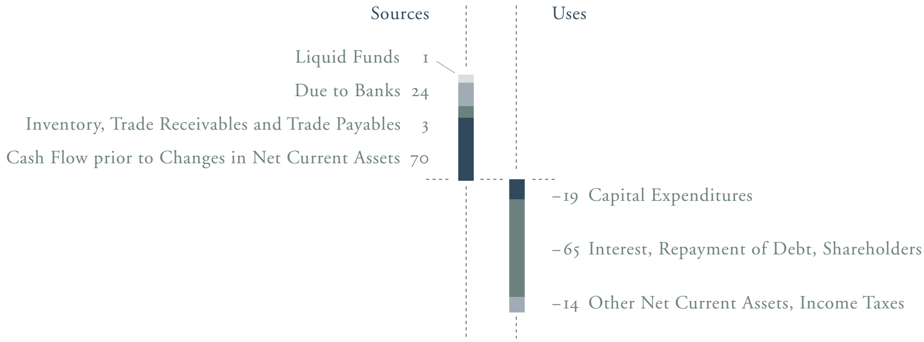
The long-term coverage of fixed assets utilized in the ordinary course of business has risen slightly as compared to the previous year. The equity ratio rose from 22.8 percent to 25.9 percent. With our sustainable higher profitability we will be able to further improve the financing structure and thus the quality of our balance sheet in the course of the current fiscal year.

Deferred taxes in the amount of € 33.5 million (€ 31.5 million in the previous year) are the result primarily of the dissolution of long-term reserves for tax purposes in the course of the implementation of IAS/IFRS. In addition, tax effects due to temporary variances between IAS valuations and taxation-based values are included in this account. The increase reflects essentially regular deferred taxes, the varying taxation-based service lives of fixed assets, and a decrease of deferred taxes due to disposals of fixed assets.

schlott gruppe achieved during the reporting year a cash flow of € 69.6 million prior to changes in net working capital. This result exceeds by 13.0 percent the already significantly higher amount of the previous year. The increase is exclusively due to sources pertaining to ordinary business operations.

3. CASHFLOW 2003/04

in € million



After changes in working capital and after deduction of tax payments of € 5.9 million, the net cash flow generated from ordinary business activities amounted to € 54.1 million after € 65.3 million in the previous year. The reduction is accounted for primarily by a reduction in trade payables in the amount of € 8.1 million; in the previous year, these liabilities registered a notable increase due to timing differences at year-end in the balance sheet treatment of various items.

The very high cash flow from ordinary business operations gives us a great deal of satisfaction. Based on a "Value-Added Sales" of € 340.9 million, net cash of € 54.1 million was generated, representing a cash flow margin of 15.9 percent.

Key figures of Cash Flow

IN € MILLION (IAS/IFRS)	*2003/04*	*2002/03*
Results from Ordinary Business Activities	38.0	25.6
Cash Flow prior to Changes in Net Current Assets	69.6	61.5
Cash Flow from Ordinary Business Activities	54.1	65.3
Cash Flow from Financing Activities prior to Acquisitions	–14.0	–45.1
Cash Flow from Acquisitions of Subsidiaries	0.0	–17.4
Cash Flow from Financing Activities	–41.2	–2.1
Cash Flow for the Period	–1.0	0.6

With this cash flow, all capital expenditures, which were halved as planned and as mentioned previously, were fully financed, interest expenses of € 10.5 million were defrayed and a distribution to shareholders more than 50 percent higher than in the previous year was undertaken (the increase in dividends is due to the proportionately reduced distribution in the previous year, based on the abbreviated fiscal year 2002). Moreover, cash was allocated to a significant reduction in net liabilities. At year-end, net liabilities were reduced by € 23.3 million to € 195.6 million; in the previous year these liabilities had increased by € 12.8 million. The level of liabilities at year-end is in line with our expectations.

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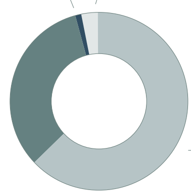
4. EMPLOYEES IN THE VARIOUS SEGMENTS 2003/04

100 percent = 4,294



— **REPORTING BY SEGMENT:**

Strong growth of profitability in high performance printing

For the last time, *schlott gruppe* reports for the past fiscal year, as in prior years, along the lines of its three segments *high performance printing* (hpp), *direct marketing* (dm) and *digital services* (ds). The segment *corporate services / Holding* (cs) encompasses the usual holding company and intercompany functions. In the future, *digital services* will be integrated into the other two business segments stated above, which, in turn, will be retitled “print” and “direct marketing”. As secondary segments, in line with IAS/IFRS, we will show, as in the past, also revenue, net assets and capital expenditures based on geographic regions.

PRODUCTS AND SERVICES

The segmentation of our businesses is patterned after the integrated value-added chain within *schlott gruppe*, although various segments have their separate indigenous value-added chains.

In the segment *high performance printing*, printing preparation, gravure and offset printing as well as further processing are concentrated. This segment is principally responsible for the printing of catalogues, inserts and periodicals with high or very high volume.

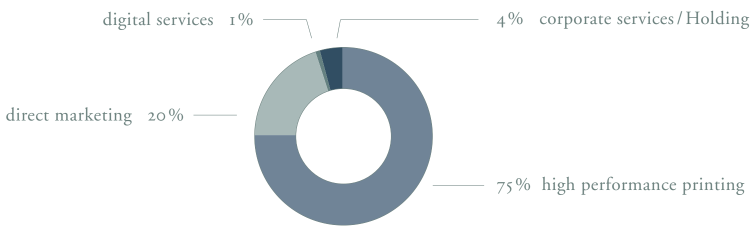
The segment *direct marketing* develops marketing concepts and unifies activities in further processing, finishing, lettershop, as well as services. further processing includes, as in *high performance printing*, adhesive tape, lamination and albums for collectibles as well as the customization of printing products such as catalogues and mailings.

finishing encompasses all activities connected with the preparation of mailings. Addresses are added in the lettershop, mailings are folded, enveloped and confectioned. In the area of services, *direct marketing* offers its Service Center Response-Management and Classical Fulfillment that represent separate indigenous value-added chains. In addition, printing products out of *high performance printing* are customized.

The segment *digital services* was prepared for integration into the business segments *high performance printing* and *direct marketing*. In this area, which is operated as a break-even activity, performance modules are developed to enable our customers to digitalize their internal product data in a platform-neutral and multi-medial

5. VALUE-ADDED SALES BY SEGMENTS 2003/04

100 percent = € 351.8 million



fashion and to organize successfully their product communication. For example, print and online campaigns can be integrated within a single digital workflow.

With this structure and positioning we are going beyond the standard services of a pure printing enterprise and are meeting the demands and expectations of our core customer group – large European enterprises. We also profit from the trend of customers demanding more complex solutions. We are thus at the forefront in shaping the competitive landscape and only few competitors have the potential to offer such a comprehensive range of solutions in a successful and efficient fashion.

Transition from segment data to group data 2003/04

IN € MILLION (IAS/IFRS)	Total Segments	Transition	Group
External Sales	581.0	0.0	581.0
Net Sales	19.5	–19.5	0.0
Net Value-Added Sales	351.8	–10.9	340.9
Segment Results	34.0	–1.9	32.1
Results from Long-Term Financing, Foreign Exchange	–6.5	0.0	–6.5
EBT	27.5	–1.9	25.6
Total Segment Assets	525.5	–3.0	522.5
Total Segment Liabilities	406.7	–19.7	387.0
Segment Capital Expenditures	24.1	–0.3	23.8

CORPORATE SERVICES / HOLDING

The results achieved during the past fiscal year in this segment improved from € –2.4 million in 2002/03 to € –1.8 million. As in prior years, we are refraining from a detailed elaboration on activity, as changes are essentially the result of internal allocations at year-end.

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GRAVURE PRINTING, WITH ITS VALUE-ADDED SALES OF MORE THAN

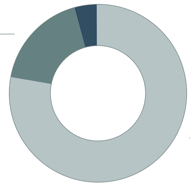
182

€ MILLION

CONTINUES TO BE THE MOST IMPORTANT CONTRIBUTOR TO THE EARNINGS OF SCHLOTT GRUPPE.

6. EXTERNAL SALES — HIGH PERFORMANCE PRINTING 2003/04

100 percent = € 462.1 million



BUSINESS SEGMENT HIGH PERFORMANCE PRINTING

Results of segment high performance printing

(IAS/IFRS)	2003/04		2002/03	
	€ MILLON	PERCENTAGE	€ MILLION	PERCENTAGE
External Net Sales	462.1	174.1%	488.8	191.4%
Value-Added Sales	265.4	100.0%	255.4	100.0%
EBIT	39.1	14.7%	27.2	10.6%
Short-Term Interest Expenses	−2.2	−0.8%	−2.0	−0.8%
Segment Result	36.9	13.9%	25.2	9.9%
Long-Term Interest Expenses	−4.4	−1.7%	−3.7	−1.4%
Foreign Exchange Gains/Losses	0.5	0.2%	2.4	0.9%
EBT	33.1	12.5%	23.9	9.4%
Total Segment Assets	367.2	—	380.3	—
Total Segment Liabilities	202.5	—	177.1	—
Segment Capital Expenditures	18.8	—	114.4	—

In the production of printing products with large print runs and sizes, flexibility, timeliness and adherence to delivery dates are the essential success factors. Highest performance across the entire printing value-added chain is therefore the decisive quality factor of our sites. Efficiency and performance require an optimal technological positioning. The overwhelming portion of revenue in this segment is accounted for by gravure printing (78 percent during the reporting year). Gravure printing is also the main contributor to earnings both within the segment *high performance printing* as well as for the entire group.

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Services in the segment high performance printing

IN € MILLION (IAS/IFRS)	Value-Added Sales		Net Sales	
	2003/04	***2002/03***	***2003/04***	***2002/03***
Gravure Printing	181.5	175.4	363.5	381.2
Offset Printing	47.1	44.5	81.8	91.1
Further Processing	36.8	35.5	16.8	16.5
Total	265.4	255.4	462.1	488.8

During fiscal year 2003/04, nearly 18 percent of the revenue of this business segment is accounted for by offset printing. With our offset activities, we offer our customers the usual schlott quality even for products with smaller print runs and are thus able to complement our service catalogue in a customer-oriented fashion. Since this market segment has significantly lower barriers to entry due to much less costly capital expenditures per printing press, it is particularly competitive. Following reorganization of these activities in the past, we have in the meantime succeeded to operate profitably in this segment.

The area of further processing accounts for about 3 percent of the revenue generated in *high performance printing*. further processing encompasses activities, which are added-on to the printing process itself. Margin contributions in this area are traditionally low.

With the completion of our comprehensive optimization program over the past years, we have focused the specialization of our four gravure printing sites. The gravure printing sites in Nuremberg and Hamburg specialize in high volume orders for magazines and periodicals where timeliness is of the essence. Being present in both Northern and Southern Germany gives us an additional geographic competitive advantage. Our site at Landau provides best services for advertisement inserts where high levels of flexibility are required. Freudenstadt addresses the widest spectrum of special products. The production of catalogues assures the basic utilization of our capacities at all sites.

In structural terms, specialization results in a lower requirement for capital expenditures since not all sites must be able to offer the entire spectrum of services. At the same time, they can define for their respective basic competences the absolutely highest level of performance. In the medium term, the group will benefit from a structurally lower level of capital expenditures and can use its generated cash flow for other purposes.

With the average age of its machinery and equipment being less than ten years, *schlott gruppe* enjoys the most modern production equipment in European gravure printing. The average in the industry is about 14 years. The useful life of a printing press is around 25 years.

During the business year 2003/04, revenue in the business segment *high performance printing* has fallen from € 488.8 million in 2002/03 to € 462.1 million due to the once again higher levels of paper provided by customers. In terms of "Value-Added Sales", however, as elaborated before, revenue rose by 3.9 percent to € 265.4 million.

The earnings result for the segment rose appreciably during the reporting year from € 25.2 million in 2002/03 to € 36.9 million. This represents an increase of 46 percent. This disproportionate increase in earnings reflects the positive effects of our optimization program with its positive impulses accruing over the whole business year 2003/04.

The EBIT margin related to the "Value-Added Sales" in this segment has risen significantly from 10.7 percent in 2002/03 to 14.7 percent. Noteworthy in this connection is that the planned reduction in other operating income within the group is overwhelmingly accounted for by this business segment.

As foreign exchange gains compared to the previous year were significantly lower, and since interest income also experienced a small decline, the segment increase in EBT by 38.2 percent to € 33.1 million follows a more modest trend line.

Our cost structure reflects the rise in labor productivity during the reporting year: the staff count amounted to 2,728 at year-end after 2,792 in the previous year. As a consequence, the "Value-Added Sales" per employee rose from € 91,500 in 2002/03 to € 97,300, representing an increase in productivity of 6.3 percent.

The by now completed optimization program in our most important revenue generator *high performance printing* is affecting positively our profitability as planned. The "old" *schlott gruppe* (without *broschek*) has at its disposal for the first time since the year 2000 its total production capacity, which, however, operates with two fewer presses than in 2000, resulting in a significant reduction of fixed costs in the area of personnel expenses as well as costs related to fixed assets. In addition, we have introduced more flexible work-time models in further processing and have improved our position in this area.

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BUSINESS SEGMENTS DIRECT MARKETING AND DIGITAL SERVICES

Results of the segment direct marketing

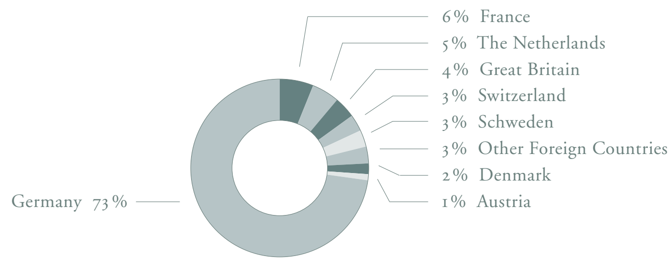
(IAS/IFRS)	2003/04		2002/03	
	€ MILLION	PERCENTAGE	€ MILLION	PERCENTAGE
External Net Sales	113.4	163.2%	119.6	159.7%
Value-Added Sales	69.5	100.0%	74.9	100.0%
EBIT	0.9	1.3%	4.9	6.5%
Short-Term Interest Expenses	–1.1	–1.6%	–1.3	–1.7%
Segment Result	–0.2	–0.3%	3.6	4.8%
Long-Term Interest Expenses	–0.2	–0.3%	–0.3	–0.4%
Foreign Exchange Gains/Losses	0.1	0.1%	0.1	0.1%
EBT	–0.3	–0.4%	3.4	4.5%
Total Segment Assets	65.8	—	71.2	—
Total Segment Liabilities	42.8	—	61.6	—
Segment Capital Expenditures	3.9	—	12.1	—

During the fiscal year 2003/04, the business segment *direct marketing* achieved a revenue of € 113.3 million after € 119.6 million in the previous year. The "Value-Added Sales" declined from € 74.9 million in 2002/03 to € 69.5 million. Results from ordinary business activities amounted to € –0.2 million after € 3.6 million in the previous year. *digital services* achieved a rise in revenue to € 5.2 million after € 4.4 million in the previous year. In terms of "Value-Added Sales", revenue increased by about 10.0 percent to € 4.4 million after € 4.0 million in the previous year. This segment contributed to results from ordinary business activities to the tune of € –1.0 million after € –0.3 million in 2002/03.

The business segment *direct marketing* has stabilized in the course of the business year 2003/04; however, beginning with the third quarter of the fiscal year, both revenue and earnings are showing a negative trend. The

7. NET SALES ACCORDING TO DOMICILE OF CUSTOMERS 2003/04

100 percent = € 581.0 million



reasons for this development are the continued poor economic climate in Germany, and especially weak consumer spending. The reaction of our customers is to employ the more cost-effective inserts at the expense of the more focused, yet more complex and costly direct mailing activities.

The segment *high performance printing* profits from this trend while *direct marketing* is negatively affected. This market-based reduction in revenue was partly countered by positive earnings impulses achieved through the transfer of labor-intensive processes to our site in the Czech Republic. At the end of the fiscal year, *direct marketing* employed 1,398 persons after 1,409 in the previous year.

EBT in this segment declined from € 3.4 million in 2002/03 to € –0.3 million in 2003/04, representing again a material deterioration in terms of both revenue and earnings. As a result, we have again accelerated during the summer of 2004 the specialization of *direct marketing* activities in the areas of mailings production (finishing), mail logistics (lettershop), and further processing. All processes were reoriented and the program was completed at the end of the fiscal year. In this connection, € 1.3 million were allocated to a reserve for a redundancy program.

Results of the segment digital services

(IAS/IFRS)	**2003/04**		**2002/03**	
	€ MILLION	PERCENTAGE	€ MILLION	PERCENTAGE
External Net Sales	5.2	118.2%	4.4	110.0%
Value-Added Sales	4.4	100.0%	4.0	100.0%
EBIT	–0.8	–18.2%	–0.2	–5.0%
Short-Term Interest Expenses	–0.1	–2.3%	–0.1	–2.5%
Segment Result	–1.0	–22.7%	–0.3	–7.5%
Long-Term Interest Expenses	0.0	0.0%	0.0	0.0%
Foreign Exchange Gains/Losses	0.0	0.0%	0.0	0.0%
EBT	–1.0	–22.7%	–0.3	–7.5%
Total Segment Assets	2.4	—	2.3	—
Total Segment Liabilities	2.6	—	5.3	—
Segment Capital Expenditures	0.1	—	0.9	—

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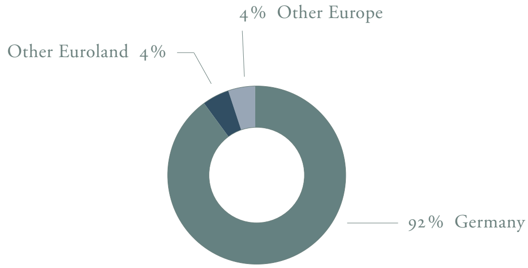
8. SEGMENT ASSETS PRIOR TO CONSOLIDATION AS PER SEPTEMBER 30, 2004

100 percent = € million 421.8



By housing these three activities in three independent companies in the form of GmbHs, our positioning became more customer-focused and the processes and costs structures more transparent. Our activities in further processing in the segments of *high performance printing* and *direct marketing* were centralized and thus made more flexible in line with the central capacity planning and coordination existing at the gravure printing sites. With this structure, we are able since the beginning of the new fiscal year to avail ourselves of additional opportunities for increasing efficiency.

In the course of the refocusing initiatives, the business segment *digital services* was structurally integrated at year-end into the other two business segments. In the future, this segment will no longer be included in this report.

SEGMENT REPORT ON THE BASIS OF SECONDARY SEGMENTS

In terms of secondary reporting based on geographics, foreign turnover declined by 17.0 percent to € 155.6 million primarily due to the amount of paper provided by customers. Especially customers domiciled outside of the Euro-zone manage the level of paper provided by taking into consideration the development of their currencies in relation to the Euro. For example, customers in the Pound Sterling (GBP) area will ask *schlott gruppe* to provide paper if the GBP rises in relation to the Euro; *schlott gruppe* invoices the paper provided in Euro producing benefits in times of rising GBP and vice-versa.

The GBP exhibited a clear upward trend during most of fiscal year 2002/03. Consequently, revenue outside of the Euro-zone rose significantly due to the Euro/GBP development. During the reporting year, this trend reversed.

Our marketing team services our customers on a Europe-wide basis. Our production base, however, remains largely in Germany; in gravure printing all activity takes place in Germany. Abroad we have a site for further processing (in France), as well as production sites for the business segment *direct marketing* (in Sweden, Poland and the Czech Republic). Correspondingly, the actual foreign turnover within the group is mirrored by the revenue segmentation on the basis of domicile of customers.

— EARNINGS AND FINANCIAL POSITIONS OF SCHLOTT GRUPPE AG

EARNINGS POSITION: SIGNIFICANT EXTRAORDINARY EFFECTS DURING THE PREVIOUS YEAR MUST BE CONSIDERED

schlott gruppe AG maintains its accounts in line with the regulations prescribed by the German Commercial Code (HGB), whereas the consolidated statements were prepared in line with IAS/IFRS.

schlott gruppe AG provides the central service functions for the group such as controlling, internal audit, investor relations, marketing and personnel, and is responsible for financing needs / functions of the subsidiaries as well as for cash pooling of the group. Financing activities and cash pooling influence heavily the financial statements and cash flow of the AG as elaborated in detail below. The AG has no operating business and its revenue essentially consists of allocations to the subsidiaries of the group.

The financial statements of *schlott gruppe AG* of the previous year were affected by an extraordinary distribution, which limits the comparability to the reporting year: in the course of the business year 2002/03, an EK40 distribution of € 40 million to the parent company was made by a subsidiary in the context of an examination of the group's legal structure. As a result, both the AG and the group were able to secure tax advantages prior to tax law changes.

During the past fiscal year, no such distribution has taken place, which explains to a large degree the reduction in earnings from ordinary business activities from € 48.3 million in 2002/03 to € 14.2 million in 2003/04. Furthermore, in the area of participations, results declined by about € 4.0 million.

To fully understand the trends in the area of participations, it is advisable to survey the earnings from participations as well as earnings and expenses from profit and loss absorption agreements in as much as various companies have traded places between these two positions. In particular, profit absorption agreements were concluded with the subsidiaries of the *broschek gruppe* as authorized prior to the last annual general meeting; as a result, their earnings contributions will no longer be accounted for under earnings from participations in fiscal year 2003/04.

If the area of participations is viewed under consideration of the above, the total results have declined by € 5.2 million from € 23.4 million in 2002/03 to € 18.2 million in the reporting year. This earnings trend, which when viewed casually deviates materially from the trend of the group as a whole, is due to the AG being debited

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SHAREHOLDERS SHALL BENEFIT FROM THE IMPROVEMENT IN EARNINGS BY AN INCREASE IN DIVIDENDS OF

12.5

PERCENT

for items, which in turn were eliminated in the course of consolidation. Items in this category include depreciation expenses at the subsidiary realcontent GmbH in preparation of the integration of the business segment *digital services* into the other two business segments.

Furthermore, at the level of the group, year-end adjustments have been undertaken that are not reallocated to the respective operating units. While these adjustments often balance each others out, the result during the past year was largely positive.

The tax rate for *schlott gruppe AG* diminished for the past year to 35.7 percent and has again surpassed the strategic goal of a tax rate of less than 40 percent. Net results amounted to € 9.1 million after € 37.2 million in the previous year. After including the balance of profits carried-forward and after allocations to other earnings reserves, the balance of retained earnings amounts to € 26.4 million after € 26.8 million in the previous year.

The AG is therefore comfortably in a position to defray the recommended distribution of € 0.90 per share (or € 5.6 million) not only out of retained earnings, but as well out of the results of the fiscal year.

schlott gruppe has paid an unchanged dividend since the business year 2001. Since then, both the AG and the group were decidedly strengthened. From the perspective of the Board of Management, an increase in the dividend for the past year is justified.

BALANCE SHEET AND CASHFLOW: CHANGES DUE TO THE FINANCING FUNCTION FOR SUBSIDIARIES

The balance sheet total of *schlott gruppe AG* has risen only modestly during the reporting year from € 279.1 million in the previous year to € 286.1 million. With an increase in shareholders equity from € 125.9 million to € 130.4 million, the equity ratio improved slightly from 45.1 percent to 45.6 percent.

Since the AG assumes the functions of a holding company as well as the financing of subsidiaries, it does not possess significant fixed assets. The balance sheet item financial assets includes naturally the participations in subsidiaries. In addition, during the past year the AG has for the first time extended loans to affiliated companies in the amount of € 31.4 million, which are shown on the balance sheet as financial assets. In return, claims on affiliated companies declined by € 26.6 million to € 101.9 million.

Financing activities for subsidiaries are also visible on the liabilities side of the balance sheet. Other liabilities include the cash positions subsidiaries maintain with the AG. Due to the very positive cash flow during the

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reporting year – as stated before – these balances registered a healthy increase. These cash balances account to a large extent for the increase in liabilities to affiliated companies from € 96.6 million to € 117.3 million. As a result, the AG was able to reduce its liabilities to banks, which it had drawn for the purpose of financing subsidiaries, from € 51.8 million to € 33.9 million.

In the cash flow statement, the reduction in short-term liabilities to financial institutions is shown alongside changes in other uses of cash for ordinary business operations; this is the reason for this amount being € –7.9 million. Loans extended to subsidiaries, shown on the balance sheet under financial assets, resulted in a corresponding cash flow from financing activities of € –33.5 million.

The financing of subsidiaries is bundled in the cash flow calculation under financing activities, which amounted to € 41.3 million, including the dividend payment of € 5.0 million. Funds available to the AG changed by merely € –0.1 million.

All subsidiaries with which significant financing relationships exist are fully consolidated into the group's financial statements. As a result, for the AG there are no risks inherent in its participations that are not yet fully reflected in the data of the group.

— EMPLOYEEES: *Increases in efficiency secure jobs*

The Board of Management of *schlott gruppe* sets goals and realizes every year internal improvements in efficiency. In this way, the pressure exerted by the competition and the lack of positive economic impulses can be compensated for the most part. Furthermore, we are banking on reducing costs through greater flexibility of working hours after having achieved impressive improvements in various parts of the group.

schlott gruppe employed 4,294 persons at the end of fiscal year 2003/04, compared to 4,380 in the previous year. The reduction reflects essentially the positive effects gained from the comprehensive optimization program in gravure printing. This program had been fully implemented at the end of the previous business year; however, as stated in last year's annual report, not all termination dates had been reached at year-end. In the course of 2003/04, these employees departed the company as planned. Taking advantage of ordinary fluctuations due to notices given, partial retirement, etc., the number of employees in the area of gravure printing diminished from 1,659 at the end of 2002/03 to 1,596 at the end of the reporting year.

At our production sites for *direct marketing*, the number of staff declined modestly from 1,395 to 1,384, in spite of having added 20 employees, to a total of 404, at our site for labor-intensive production in the Czech Republic. At our Western European sites, the optimization program is making positive contributions. The major portion of staff reductions at these sites will, however, be visible only in the course of the current fiscal year.

Finally, in the business segment *digital services* we have reduced staff count through ordinary fluctuation by 12 to a total of 54 in anticipation of the integration of this business area into the other two segments.

All these measures are taken in close collaboration with workers councils in order to effect redundancies in a socially least damaging fashion. We are in constant contact with the respective workers councils and include them, as well as employees, at an early date in discussion dealing with changes affecting the companies and employees. At the same time, we place great value on the skills development of our employees in production and administration as well as among current and future managers. We are thus enabling our employees, as well as the company, to sustain their place at the forefront of our industry.

Finally, one of the most important and fundamental challenges of a responsible management is the safeguarding of the group's competitiveness and the securing of jobs. The Board of Management of *schlott gruppe* challenges itself permanently to examine all internal processes and to utilize all potential for increasing efficiencies. This is why we have been banking for several years on the production of labor-intensive *direct marketing* products in the Czech Republic. And that is why we continue to work on reaching higher levels of flexibility in working hours.

schlott gruppe is active in an industry characterized by highly seasonal business fluctuations. When catalogues are printed, presses operate at peak times around the clock, seven days a week. During slower seasons, however, presses are not even fully utilized during five-day workweeks with three shifts per day. Given the relatively limited flexibility in weekly working hours, enormous personnel costs are incurred. During off-seasons, it is barely possible to achieve margins sufficient to cover fixed costs; during peak seasons, the industry is burdened by supplemental personnel costs that are some of the highest among German wage agreements. These even exceed significantly those in the metals working industry.

Every improvement in the flexibility of working hours removes pressure for rationalization. In the past, *schlott gruppe* was able to introduce more flexible working hour models in further processing, and during the past business year we were able to duplicate the above also in *direct marketing*. In gravure printing, we are also seeking to broaden the limited flexible rules existing today and are hoping to secure jobs in Germany.

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— ADDITIONAL INFORMATION

MARKETING AND DISTRIBUTION: PERSONALIZED CUSTOMER SERVICE IS THE KEY TO SUCCESS

schlott gruppe offers services in printing and communication on the basis of industrial processes. The group is therefore dependent on large and very large customers, particularly in gravure printing. Since such customers increasingly employ solutions designed to cover multiple areas, which include both printing and *direct marketing* components, many of our largest customers in gravure printing are also our most important customers in *direct marketing*.

Our marketing and distribution activities are designed to service the above customer group in an individualized fashion and to retain that group as customers. This requires less the employment of classical advertising instruments, but rather a relationship based on trust, which is derived day-to-day from first class service and highest quality production. Quality, flexibility and timeliness represent the most important factors in our production processes. In addition, we appoint for each major customer a responsible customer care individual who is responsible for marketing the entire product and service mix of *schlott gruppe* and who sees to it that all customer needs are fully met.

Aside from large customers, *schlott gruppe* enjoys the custom of a large number of attractive smaller clients, which are solicited and serviced in the same way as our large customers. The customer portfolio strikes a balance among client groups and allows capacities to be better utilized in off-seasons. For a capital-intensive enterprise like *schlott gruppe* it is of utmost importance to achieve a balanced utilization of capacity in order to secure profitability. This is why our smaller customers are as important to us as our key customers. Accordingly, we have designed our product mix in such a way that we can be an attractive and high-quality partner for both customer groups.

In general, our customer portfolio is well balanced: not one single customer provides more than 10 percent of total revenue; the five largest customers account for 20 percent of revenue, while the 20 largest customers account for less than 50 percent of group turnover. To strengthen our market position, particularly with relatively small clients, *schlott gruppe* is traditionally present at relevant trade fairs. During the past business year, we have attended the Deutsche Versandhandelskongress (German Congress of the Mail Order Industry), the Frankfurt Book Fair, the German Mailing Days as well as the IT Systems Fair. More regionally, we were present at the *Direct Marketing* Ideas Exchanges in Freiburg and in Stuttgart.

PROCURMENT AND LOGISTICS: COST REDUCTIONS IN INTERNAL LOGISTICS IMPLEMENTED

In the area of logistics, we have to differentiate between internal tasks and the delivery of completed printing products. The ongoing improvement of production processes is one of the main sources for securing our earnings strength in a competitive market environment. During the past year, we were able to profit from material improvements in internal logistical processes in the two large business segments *high performance printing* and *direct marketing*.

In the first quarter, the relocation to the gravure site at Nuremberg harbor was completed. We have now at our disposal one of the most modern sites in the industry in Europe. From receiving materials, over the flow of printing products at the site, to the delivery of finished products – the principle of the shortest and most simple paths and ways prevails. The savings are enormous compared to the hitherto historically grown site in the City center, where production took place in several buildings with multiple stories.

In *direct marketing*, we have realized cost savings in the area of logistics in the context of the comprehensive optimization measures undertaken during the past year. These benefits will for the first time accrue in the course of the current business year. The factory layout of the Schwandorf site was totally revamped and optimized for the purpose of higher efficiency. Short and simple ways and distances were sought, dispatch and receiving were consolidated and service units for internal tasks were established.

To the extent that our customers do not arrange for pick-up of printed products – similar to customers providing paper for their orders – we are employing forwarding firms to deliver to our customers. In this connection, we are drawing on our long-term successful business relationships with forwarders because timely delivery in our industry is of utmost importance. This applies particularly to the time-critical market of periodicals, but is universally applicable as a delayed delivery can cause a printing product to be nearly or completely valueless.

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Chart 9

Paper provided by customers has again risen significantly, resulting in a reduction in the cost of materials by 14 percent.

Composition of the cost of materials

IN € MILLION (IAS/IFRS)	2003/04	2002/03
Paper	128.8	164.8
Ink	41.8	42.8
Other	12.5	12.4
Services Purchased	54.4	56.4
Total	237.5	276.4

Aside from logistical services, which represent a large part of total services purchased, paper and ink are the most important components of the purchasing function of *schlott gruppe*. The purchased paper represents only a small part of the total tonnage of paper processed. Customers decide according to their internal calculations whether they will task us to procure the paper or whether they will place it at our disposal. If we procure the paper for customers, we do not absorb the risk of price changes. Paper is an earnings-neutral item. During the past years, the portion of paper procured by us has continuously declined. During fiscal year 2003/04, the ratio was well below 30 percent (see Table).

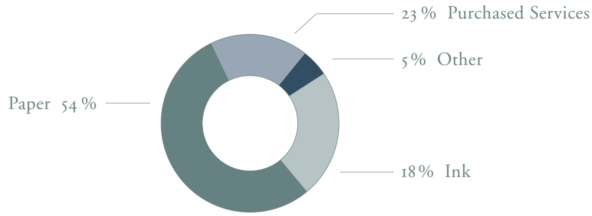
Total tonnage

IN TONS (000)	2003/04	%	2002/03	%
Paper Provided by Customers	416.6	72.3	353.1	64.3
Paper Procured	160.0	27.7	195.9	35.7
Total Tonnage	576.6	100.0	549.0	100.0

The markets for materials procured by *schlott gruppe* are highly concentrated. This influences and amplifies the pressure to consolidate the yet fragmented European gravure printing industry together with the high level of capital intensity and the concentration of customers.

9. COST OF MATERIALS 2003/04

100 percent = € 237.5 million



In the area of gravure printing, there are currently seven suppliers in Europe for paper and four for ink. By using also wholesalers, we have expanded our relationships for paper procurement to about twenty and to seven for ink. There are no undue dependencies on any individual suppliers and we are in a position to purchase nearly all qualities and grades of paper on a timely basis. Conditions are similar in the area of offset printing. We buy ink from four suppliers, two of which are also supplying the gravure printing area. Paper is procured from the same suppliers mentioned above.

In the area of *direct marketing*, offset printing equipment is used with the necessary inks and colors, while for paper the same suppliers as in *high performance printing* are utilized. Given the differing demands of the two business segments, the materials are independently managed, but purchased at prices and conditions applicable to the whole group.

Wherever feasible, *schlott gruppe* uses in all areas just-in-time delivery of materials and is thus able to reduce expenses for carrying and managing inventory.

QUALITY MANAGEMENT AND PROTECTION OF THE ENVIRONMENT: UNCHANGED CONCERN

There are two central incentives in the printing industry for having a comprehensive quality management system: on the one hand, our market is characterized by highly competitive forces and high price transparency challenging us to generate the profit margin of the group not via price but via internal process efficiencies. And efficiency means foremost of all the reduction of poor quality production and of scrap. On the other hand, printing products are exceedingly perishable goods and corrections to faulty printing products are rarely possible due to time constraints. The ability to deliver first class quality in a timely manner creates customer satisfaction and, consequently, competitiveness. The reduction of scrap is therefore a permanent challenge to the management as well as employees at all production sites.

To secure quality standards, we measure both external complaints by customers as well as internal complaints arising between the various stages of the production process. For both areas we have defined quotas, which we police and carry over as goals into future quarters. During the past year, we were successful in noticeably reducing both external and internal complaints well below levels of the previous year and in remaining well below established quotas. The high standards of our quality management are documented in DIN EN ISO 9001- certified systems at nearly all of our subsidiaries.

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The protection of the environment represents a natural and important ingredient in the management philosophy of the group. This is true particularly since we are consuming natural resources in form of paper and thus are active in an environmentally sensitive area. Moreover, ink products are special chemicals that require careful handling in order to minimize the environmental impact.

To this end, we have appointed at all facilities ecological specialists responsible for assuring compliance with defined environmental standards. Annual internal ecological audits monitor levels of compliance and identify additional improvement measures. Additionally, our production sites are certified for several years as per DIN EN ISO 14001 as well as EU directive EMAS II.

RESEARCH AND DEVELOPMENT: SERVICES TAKE FRONT SEAT

schlott gruppe, as a service provider, does not conduct research and development in terms of basic research. Accordingly, there is no budget for such activities. Rather, we purchase relevant technology in the market in order to develop solutions for our customers. Our strength is our ability to quickly incorporate new technology into our processes and to make sure that we can offer our customers state-of-the-art solutions and, at the same time, to strengthen our competitive position.

CORPORATE GOVERNANCE: RELEVANT STATEMENT ISSUED ON TIME

The relevance statement, required under the Code of Corporate Governance, has been issued. It can be viewed on the website of *schlott gruppe*. We are further elaborating on corporate governance within *schlott gruppe* in a separate chapter of this annual report *(see page 37)*.

— STATEMENT ON RISKS

INTRODUCTION

Systematic and consistent risk management supports the identification and optimization of opportunities as well as risk positions and secures the longevity of the enterprise. The comprehensive risk management system is integrated into both structural and process positions.

The risks management system is examined by the outside auditor in terms of completeness, qualitative and quantitative valuations, observation and monitoring of risks as well as compliance with standards. During the reporting year, the auditor has examined whether all standards and stipulations of the risk management system of the group have been fully complied with.

A *risk management manual* sets forth all responsibilities and competences within the group. A designated risk management officer coordinates the operation and implementation of standards. At the level of individual companies as well as for all business segments, responsible parties have been appointed.

Quarterly reports are being generated bottom-up, i.e. by the individual companies of *schlott gruppe* to the officer responsible for each business segment, from the level of business segments to the risk management officer of the group and from the latter to the Board of Management. Risks are addressed in such a way that only the most essential and critical risks are communicated to the Board of Management as well as to the Supervisory Board.

Individual risks are categorized by three types: risks that are to be "observed", "monitored" and "reported" (= critical risks). Critical risks within *schlott gruppe* are defined as risks, which have an "expected loss value" of € 2.5 million or more; the minimum value for "monitoring" a risk is set as € 0.5 million. The "expected loss value" is calculated by multiplying the amount of the loss by the probability of the loss occurring.

During the past business year, we have in May 2004 updated our existing EDP-tool "Risk-Monitor TM".

Excerpts of the risks defined in the Risk Monitor are summarized below:

GENERAL ECONOMIC AND INDUSTRY RISKS

The single most fundamental risk having a bearing on the business operations of *schlott gruppe* is the *economic weakness* of Germany and Europe. This weakness has resulted in a deep recession in the advertising markets during the past years and is reflected in declining volume in the classical printing media. During that market phase, *schlott gruppe* has undertaken a comprehensive optimization program in order to continue utilizing its capacity at a high level.

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The significantly improved efficiency of processes that was achieved at all levels by this program is the direct result of a value-oriented corporate strategy. A *clear and precise value-orientation* is, from our perspective, not only the most effective insurance against general economic risks, but also contributes considerably to securing the longevity of the company.

Industry risks result primarily from *structural changes* in individual sub-markets. Current examples are the trend to shorter life cycles of periodicals, more variety of periodicals as well as the expected changes that will take place in the issuance of catalogues by large mail order houses. These developments require significantly higher flexibility on the part of printing and communication service providers. *schlott gruppe* has already early on positioned itself for these changes and has defined flexibility and performance as central corporate goals. The optimization program of the past has contributed in an important way toward the attainment of these goals.

FINANCIAL RISKS

The monitoring and management of *financial risks* are the responsibility of the group's treasury department. For derivative and hedging instruments, a directive defines principles, tasks and competences. As an instrument for hedging *foreign exchange risks,* only forward foreign exchange transactions are permitted. These transactions are employed for hedging basic business transactions against exchange rate fluctuations in the context of product, service and financial transactions with foreign parties. This applies primarily to business with Great Britain, Sweden and Norway.

Other financial risks do not exist as we have access to sufficient credit lines and long-term financing. The liquidity within *schlott gruppe* is managed by centralized "cashpooling".

Trade receivable risks are essentially neutralized by insurance coverage. A group directive sets forth detailed instructions in this regard.

CUSTOMER RISKS

Customer risks encompass primarily *trends in sales markets.* Examples are risks in customer relations, risks related to the competition or related to capacity availability / utilization.

Our turnover with key customers is distributed within *schlott gruppe* over several individual projects for which customized agreements exist. The twenty most sales-intensive customers in Germany accounted for about 60 percent of domestic turnover during 2003/04 – the twenty most sales-intensive foreign customers represent about 50 percent of foreign sales. Through the internationalization of *schlott gruppe* and based on our broad service spectrum, we are able to minimize the risk of dependency on individual large customers.

SKILLS, EXPERIENCE AND GROWTH RISKS

Sufficient availability of personnel, qualifications and skills enhancement are risks that are addressed by the corporation. In this respect, our "Balanced Scorecard" sets forth incentives for employees. A *value-oriented personnel management* is an important part of our corporate philosophy and culture. Based on goals set by corporate management, targets are defined, set and implemented at the level of individual companies in concert with employees.

Internal training programs are designed to prepare younger employees for positions in middle and senior management. These programs are also an effective tool for retaining promising young people.

PROCESS RISKS

Included in this category pertaining to processes are the areas of *organization, structure, EDP and logistics.*

IT risks are addressed within *schlott gruppe* with high priority. Special security processes at the individual EDP sites are of utmost importance for the protection of both customer and corporate data. The continuous securing of our database minimizes the risk of loss of data. Data are secured on a daily basis and stored off-premise.

All servers are connected to a central uninterruptible source of power such that in the event of a complete power failure a controlled and orderly shutdown without loss of data is assured.

To exclude the risk of unauthorized access, directions regarding the use of passwords and for protecting data have been issued.

A comprehensive insurance coverage secures transport damage, building and contents damage, elementary damage such as fire, windstorms and hail (including possible losses due to an interruption of ordinary business operations) as well as damage to inventory of materials and supplies.

LEGAL RISKS

General *legal risks* of an enterprise include risks related to *customer complaints, claims for compensation and risks arising out of litigation.*

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Customer complaints are handled expeditiously by persons designated as well as by the Member of the Board of Management responsible for technological issues. Directives addressing the management of complaints have been issued. We do not expect any negative impact on our development.

All legal agreements are examined and endorsed by our legal department prior to finalization.

No pending litigation exists, which will have any material impact on the corporation.

TECHNOLOGY RISKS

In this category, risks that pertain to our *technological positioning* are addressed.

schlott gruppe enjoys modern machinery and equipment, which limits the risks of high repairs, maintenance and replacement costs in the context of technological progress. Appropriate maintenance intervals for our equipment assure the minimization of downtimes.

ENVIRONMENTAL RISKS

"Environmental Protection Concerns All Of Us – We Take Part". *schlott gruppe* subscribes to this motto and its *environmental directives* in this regard are observed by all members of the group.

Our standards for environmental protection evidence that we are in compliance with the necessary safety and diligence standards. Environmental protection is an important value of our corporate philosophy.

Our environmental directives show that aside from the utilization of environmentally friendly production processes and products, we are also seeking as a matter of course an open dialogue with customers, neighbors and the general public. We have exercised this approach recently at our new site at Nuremberg harbor.

— SUPPLEMENTAL REPORT

No important events have taken place since the end of the fiscal year 2003/04 as per September 30, 2004, which would materially affect the general business conditions of the group, or, more pointedly, the earnings or general financial condition of the corporation. The general economic environment, likewise, has not appreciably changed.

— OUTLOOK: MARKET POTENTIAL FOR 2004/05 CANNOT BE QUANTIFIED AS YET

GENERAL ECONOMIC TRENDS

For 2005, the majority of the German economic institutes anticipate an increase in gross domestic product of 1.5 percent in real terms. “The weakness of the German economy will not be overcome”, according to these institutes. Exports are expected to provide less economic impulse and, while domestic capital expenditures may register an increase, private consumption in 2005 will again hinder economic growth and will not compensate the slower increase in export growth. Consequently, even under the best of circumstances, the labor markets will only improve in the latter part of the year.

Global growth is expected to be in the area of 3.2 percent in real terms. The economic institutes assume that in spite of the increase in the price of oil and reduced impulses from monetary and fiscal policies, economic growth can be sustained. The 25 members of the EU are expected to grow at the same speed as in 2004 and are likely to achieve a growth rate of 2.3 percent. The Euro-zone, however, will grow by only 2.0 percent. With growth rates of between 2.5 and 3.0 percent, Spain, Belgium, Greece, Finland, Great Britain and Sweden are expected to grow disproportionately.

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THE MILESTONES FOR THE CURRENT BUSINESS YEAR:

IN PRINTING, CONTINUE TO ENHANCE THE HIGH LEVELS ATTAINED – IN DIRECT MARKETING, ACCELERATE.

INDUSTRY TRENDS

The advertising industry looks to 2005 with optimism. According to a prognosis issued by the media agency Zenith Optimedia, global expenditures for advertising will rise by 5.0 percent in 2005 and will be sustained on this growth path in the coming years. For Germany, Zenith Optimedia forecasts an increase in advertising expenditures of 1.8 percent – in the following year, an improvement of 3.5 percent is expected due to the soccer world championship taking place in Germany.

Growth is also forecast for 2005 by the autumn report of GWA, according to which 68 percent of German advertising agencies expect higher revenue with only 4 percent expecting declines. The market research company GfK indicates in its industry study I/2005 that company purchasing managers intend to spend on average 4.2 percent more on classical advertising than in the previous year.

The printing industry intends to profit from this upturn in the advertising industry and expects an increase in revenue of more than 2.0 percent, according to the bvdm. In the area of *direct marketing*, the growth rate for 2005 will exceed that of 2004, according to Deutsche Post AG.

OUTLOOK FOR SCHLOTT GRUPPE

schlott gruppe is cautiously optimistic about the prospects for the current year. In view of the continued reluctance of German consumers to spend, we have excluded from our expectations any positive impulses out of general economic trends.

Generally, we expect EBT to be at the level of the business year 2003/04. For the area of *high performance printing*, we expect a somewhat lower earnings contribution, while *direct marketing* will be solidly in black figures. In the latter segment, we will have a sustainable turnaround following the measures undertaken during the reporting year. As a result of focusing and strengthening our marketing and distribution activities, we expect a significant improvement of our "Value-Added Sales" from € 69.5 million to € 75.0 million.

For our segment *high performance printing*, however, we expect "Value-Added Sales" to be only at the level of the reporting year of € 265 million due to the broad changes taking place in the market environment for the products of this segment. We are, however, convinced that we are properly positioned for dealing with the trend

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to shorter cycles and greater topicality of printing products and that we can strengthen our market position in this changing environment. In terms of "Value-Added Sales" as well as earnings in this segment, however, we remain conservative in view of the ongoing changes in the marketing strategies of our customers in the mail order industry.

The first quarter of the current fiscal year (October – December 2004) will produce a similar earnings contribution as in prior years due to the seasonal high level of capacity utilization. The trend for the remainder of the business year is difficult to quantify at this time.

The cash flow from ordinary business activities is expected to be € 54.1 million and essentially in line with the level of the reporting year. Capital expenditures will amount to about € 27.0 million after reaching a low point in this cycle. As a result, we will generate sufficient cash to further reduce our net liabilities during the course of the current fiscal year even after payment of dividends and servicing of financial obligations.

In our procurement markets, paper suppliers are signaling price increases due to increased global demand for paper. One cannot determine at this time whether price increases can indeed be implemented. Should suppliers be successful, it will not affect *schlott gruppe* directly as paper is an earnings-neutral item. Our European, and particularly German customers, who are still burdened by weak consumer demand, will, however, be affected. Lower advertising budgets by our customers can then also have an impact on *schlott gruppe*. It is essential, therefore, to offer to our customers innovative solutions and convincing concepts. That we can do this successfully has been proven in the difficult past years.

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