
CORPORATE GOVERNANCE

VALUE ENHANCEMENT THROUGH RESPONSIBLE BALANCING OF INTERESTS

LEGAL FRAMEWORK

schlott gruppe AG is a corporation organized under the laws of the Federal Republic of Germany. It is subject to the legal provisions governing the management and control of corporations. The Board of Management and the Supervisory Board are responsible for the administration of corporations. The statutes of *schlott gruppe AG* reflect the standards established and subscribed to by the German industry. The management and supervision of the Corporation are based on the German Code of Corporate Governance.

CORPORATE GOVERNANCE-PHILOSOPHY OF THE SCHLOTT GROUP

The corporate statutes of *schlott gruppe AG* do not contain any rules and provisions, which deviate in a marked way from general market standards in Germany. This applies particularly to the rights of shareholders, which are observed to the fullest extent – all shareholders are treated equal in line with legal regulations. This applies also to the purchase of own shares and to acquisitions. The shareholders of *schlott gruppe AG* are guaranteed the basic participation in corporate earnings, the unimpeded purchase and sale of shares of the Corporation and identical voting rights for each basic share. All shares issued by *schlott gruppe AG* are of the same type with uniform shareholder rights.

The Board of Management recognizes that shareholders of *schlott gruppe AG* as owners of the Corporation provide capital for growth and thus participate in the entrepreneurial risk. The Board is, therefore, especially indebted to shareholders. Our management philosophy is characterized by comprehensive, timely and transparent communication taking into consideration competitive factors. It is further characterized by modern and efficient risk management, observance of exchange regulations and by a management that sets as the most important goals the ongoing and strategic enhancement of the value of the Corporation.

Consistent value enhancement is, however, only possible if the Corporation is managed in such a way that the interests of all stakeholders are being observed. Stakeholders, aside from shareholders, are customers, employees, debtors and all other business partners. The management of the *schlott group*, therefore, is guided by the need to consider all interests of all stakeholders.

Beyond the reporting and disclosure requirements legally mandated (annual and quarterly reports, events requiring ad hoc reports, Directors' dealings and changes in shareholder structure), the *schlott group* reports regularly

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in accordance with the required equal treatment of all shareholders (“fair disclosure”) on trends in the Corporation by means of press releases and conferences with analysts, the press and shareholders. All reports and information provided, as well as the major presentations at conferences, are being published on the Internet under www.schlottgruppe.de.

INTERACTION BETWEEN THE BOARD OF MANAGEMENT AND THE
SUPERVISORY BOARD

The *schlott group* has set forth in a policy statement the tasks of and the interrelationship between the Board of Management and the Supervisory Board. These policy statements, in particular the rights and responsibilities of the Members of the Supervisory Board and the Board of Management, were formulated and adopted in line with the requirements contained in the German Code of Corporate Governance.

While acting as Members of the Board of Management, Members are subject to far-reaching non-competition clauses. Additional business activities of Members, particularly the acceptance of memberships on supervisory boards, require always the consent of the Supervisory Board. The same applies to extension of credit by the Corporation to Members of the Board of Management or the Supervisory Board.

The rights and responsibilities under the Code of Corporate Governance are part of the statutes of the Supervisory Board to the extent that no deviations from the Code were declared. It was further defined that Members of the Supervisory Board, who are also members of management boards of publicly-traded corporations, may not assume more than five mandates on supervisory boards of publicly-traded corporations outside of the corporation for which they are members of the management board.

The Supervisory Board may not have more than two former Members of the Board of Management, nor may Members of the Supervisory Board be involved in official functions or consulting roles with major competitors of the Corporation.

COMPENSATION OF THE MEMBERS OF THE BOARD OF MANAGEMENT

The compensation for Members of the Board of Management consists of fixed parts and performance-related payments. In addition, Members receive benefits in-kind as well as retirement benefits. Stock options or similar constructions were not issued.

About half of the compensation of the Board is variable. This variable compensation includes incentives for increasing the valuation of the Corporation. A major element in the valuation of an enterprise by the capital markets is the dependability in terms of achieving goals and expectations. That is why the amount of performance-related compensation for Members of the Board of Management is directly tied to the achievement of the prognosticated results of the Corporation (EBT), aside from individually agreed performance criteria.

Furthermore, incentives exist for optimizing the balance sheet structure in addition to reaching EBT goals. To this effect, the *schlott group* has developed a detailed proprietary concept for the control and optimization of its balance sheet structure. Depending on each stage of the acquisition cycle, goals and limits as to indebtedness were defined and had to be reached and complied with (see page 59). In this way, due consideration is given to the strategic goal of generating on average, over several, years the minimum cost of capital of nine percent.

EBT and the coverage of the cost of capital are the central steering mechanisms of the Corporation in its implementation of its strategic goals, particularly the active shaping of the European intaglio printing industry. The performance criteria and incentives for the Board of Management are therefore directly and clearly derived from the strategic direction of the *schlott group*. During the business year 2004/05, the total compensation for the Board of Management amounted to € 2.9 million, of which € 1.4 million were performance-related.

COMPENSATION OF THE MEMBERS OF THE SUPERVISORY BOARD

During the past year, the Members of the Supervisory Board received for their services a total of € 202,500. Travel expenses incurred were reimbursed. The individual amounts were € 15,000 for Members, € 30,000 for the Chairman and € 22,500 for the Deputy Chairman.

SHARE OWNERSHIP OF THE BOARDS AS OF DECEMBER 31, 2005

SHARE OWNERSHIP BOARD OF MANAGEMENT	50,090
SHARE OWNERSHIP SUPERVISORY BOARD	1,311,123
of which:	
<i>Erwin J. Kiefer (via EKS Beteiligungs-GmbH)</i>	565,000
<i>Sigmund Kiener (via S.K. Vermögensholding GmbH)</i>	244,016
<i>Joachim Kohm</i>	500,000
TOTAL NUMBER OF SHARES ON DEZEMBER 31, 2005	6,204,200

SHARE OWNERSHIP OF BOARDS

The share ownership of Members of the Supervisory Board is illustrated above. The siblings Broschek, Mr. Nikolaus Broschek and Ms. Anja Schneckeburger-Broschek, had agreed to a staggered retention period for the shares, which they had received in connection with the acquisition of the broschek group. The final retention period for the last one third of their shares expired on October 1, 2005. No member of the Board of Management owns more than one percent of the capital stock, thus making an individual breakdown unnecessary.

In connection with an inheritance, Mr. Joachim Kohm and his brother Andreas have received shares of *schlott gruppe AG*. As a consequence, the respective ownership of Messrs. Kohm exceeded the five percent hurdle on November 13, 2004, requiring publication. *schlott gruppe AG* has complied with this requirement on November 18, 2004, as per paragraph 25 of the WpHG.

During the reporting year, the transactions stated in the following table required public notification as per paragraph 15a of the WpHG.

Directors' Dealings (paragraph 15a of the WpHG) October 1, 2004 to December 31, 2005

<i>Name</i>	<i>Function</i>	<i>Date of Notification</i>	<i>Type</i>	<i>Number of Shares</i>	<i>Price in €</i>
Joachim Kohm	Member of the Supervisory Board	11.24.2004	Purchase	2,500	51,325.00
Joachim Kohm	Member of the Supervisory Board	01.21.2005	Purchase	15,000	383,250.00
EKS Beteiligungs-GmbH	Connection to the Chairman	03.04.2005	Sale	100,000	2,720,000.00
EKS Beteiligungs-GmbH	Connection to the Chairman	03.04.2005	Sale	35,000	948,500.00
Joachim Kohm	Member of the Supervisory Board	04.29.2005	Purchase	3,583	90,113.17
Joachim Kohm	Member of the Supervisory Board	04.29.2005	Purchase	10,000	253,506.00
Joachim Kohm	Member of the Supervisory Board	05.02.2005	Purchase	1,417	35,901.92
S.K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.04.2005	Purchase	600	15,604.65
S.K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.09.2005	Purchase	900	22,859.34
S.K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.09.2005	Purchase	1,600	40,502.42

<i>Name</i>	<i>Function</i>	<i>Date of Notification</i>	<i>Type</i>	<i>Number of Shares</i>	<i>Price in €</i>
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.10.2005	Purchase	2,000	50,089.82
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.11.2005	Purchase	4,500	114,075.00
Joachim Kohm	Member of the Supervisory Board	05.12.2005	Purchase	5,000	127,750.00
Joachim Kohm	Member of the Supervisory Board	05.12.2005	Purchase	5,000	127,750.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.13.2005	Purchase	1,000	25,250.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.13.2005	Purchase	20,000	506,000.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	05.24.2005	Purchase	300	7,640.00
Joachim Kohm	Member of the Supervisory Board	06.02.2005	Purchase	5,000	137,000.00
Joachim Kohm	Member of the Supervisory Board	06.16.2005	Purchase	5,000	137,000.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	06.21.2005	Purchase	3,000	81,597.30
Joachim Kohm	Member of the Supervisory Board	06.27.2005	Purchase	60,000	1,632,000.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	06.30.2005	Purchase	120,000	3,264,000.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	07.27.2005	Purchase	600	15,948.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	07.27.2005	Purchase	1,919	50,886.12
Joachim Kohm	Member of the Supervisory Board	08.01.2005	Purchase	5,000	132,500.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	08.04.2005	Purchase	23,321	613,043.79
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	08.08.2005	Purchase	5,800	155,779.88
Joachim Kohm	Member of the Supervisory Board	08.08.2005	Purchase	2,160	57,138.48
Joachim Kohm	Member of the Supervisory Board	08.10.2005	Purchase	2,840	78,057.40
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	08.17.2005	Purchase	700	18,395.02
Joachim Kohm	Member of the Supervisory Board	11.14.2005	Purchase	10,000	261,000.00
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	11.21.2005	Purchase	22,500	590,186.25
S. K. Vermögensholding GmbH	Connected to Member Supervisory Board	11.21.2005	Purchase	2,776	73,008.80

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DECLARATION OF COMPLIANCE AS PER PARAGRAPH 161
GERMAN CORPORATION ACT (AKTG)

The Board of Management and the Supervisory Board of *schlott gruppe AG* have agreed on the following declaration as per paragraph 161 of AktG:

Since the issuance of the last declaration of compliance on December 23, 2004, *schlott gruppe Aktiengesellschaft* has complied with all the recommendations made by the “Federal Commission of the German Corporate Governance Code” published in the official part of the electronic Bundesanzeiger of the German Ministry of Justice, based on the version dated May 21, 2003, with the following exceptions, which had already been stated in its last declaration: there is no deductible under the Directors-and-Officers-Liability-Insurance for Members of the Board of Management and the Supervisory Board; compensation of the Board of Management is not shown separately for each Member; the chairmanship or membership in any of the Committees of the Supervisory Board are not being separately compensated; Members of the Supervisory Board do not receive any performance-related compensation; *schlott gruppe AG* is not issuing its annual report within ninety days after the end of the fiscal year. During the period of July 20, 2005 until December 25, 2005, *schlott gruppe AG* has complied with the new version of the Code issued on June 2, 2005, with an effective date of July 20, 2005, and will in the future continue to be in conformity with the recommendations contained in the Code.

FREUDENSTADT, DECEMBER 22, 2005

THE SUPERVISORY BOARD
OF THE SCHLOTT GRUPPE AG

THE BOARD OF MANAGEMENT
OF THE SCHLOTT GRUPPE AG

REPORT OF THE SUPERVISORY BOARD

SCHLOTT GRUPPE AG

In the following report, the Supervisory Board of *schlott gruppe AG* comments on its activities during the business year 2004/05. In particular, it will elaborate on the ongoing close coordination with the Board of Management, the major issues deliberated in its meetings, the work of Committees as well as on the audit of the year-end financial statements.

The Supervisory Board has discharged its responsibilities during the reporting year as set forth by law and the statutes of *schlott gruppe AG*. With respect to the management of the Corporation, it has advised the Board of Management on an ongoing basis and has supervised the administration of the Corporation. The Supervisory Board was directly involved in all decisions fundamental to the well-being of the Corporation. The strategic positioning of the Corporation was determined in close coordination between the Board of Management and the Supervisory Board.

The Board of Management has informed the Supervisory Board on a regular basis, both orally and in writing, in a comprehensive and timely fashion of all important issues related to current business conditions, the position of the *group*, tactical planning as well as the strategic further development. On the basis of detailed reports presented by the Board of Management, all issues important to *schlott gruppe AG* were discussed in detail by the Supervisory Board.

In addition, the Supervisory Board was informed at regular intervals of risks encountered, of the state of the risk management system and of counter measures undertaken. Deviations from plans and goals were examined and discussed in detail by the Supervisory Board.

Its meetings' agendas during the reporting year regularly addressed the development of the share price of *schlott gruppe AG* and the reputation of the Corporation in the capital markets. Particular emphasis was placed on the discussion of changes in the shareholders' structure of *schlott gruppe AG*, following the divestiture of Deutsche Beteiligungs AG. The Supervisory Board applauded the successful placement of these shares among both institutional and private investors and welcomed the associated increase in free float.

Between regularly scheduled meetings of the Supervisory Board, it was advised of important developments on an ongoing basis. As Chairman of the Supervisory Board, I was in continuous contact and dialogue with the Members of the Board of Management.

During the fiscal year 2004/05, the Supervisory Board convened five times. The majority of meetings were attended by all Members. Only occasional illnesses prevented some Members from attending. For this reason, Ms. Salberg was only able to attend two meetings.

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CHANGES IN THE COMPOSITION OF THE SUPERVISORY BOARD

During the Annual General Meeting on March 22, 2005, all Members of the Supervisory Board were to be elected or reconfirmed. Based on recommendations by the Supervisory Board, the Annual General Meeting confirmed as Members Messrs. Edmund Hug, Erwin J. Kiefer, Siegmund Kiener, Joachim Kohm and Reinhold Schreiner. The former Member of the Board of Management, Mr. Nikolaus Broschek, was elected on the recommendation of the Supervisory Board. Due to the full divestiture of the Deutsche Beteiligungs AG, Mr. Reinhard Löffler was not available for reelection. Since 1996, Mr. Löffler had made valuable contributions to the development of the Corporation in his capacity as a Member of the Supervisory Board and previously of the Advisory Board of Schlott Tiefdruck GmbH. For his expert advice and his involvement, the Supervisory Board expresses herewith its thanks and appreciation to Mr. Löffler. Our thanks also goes to our former major shareholder, Deutsche Beteiligungs AG, which has accompanied and supported our Corporation since the management-buyout in 1992. Since that time, the business volume of the Corporation has grown from about €70 million to nearly €600 million today. Our second institutional investor, 3i Group, has also been connected to our Corporation as a major shareholder since 1992, albeit in a reduced capacity as of late.

The Supervisory Board wishes to thank the former Members Messrs. Karl-Heinz Gramß and Rudolf Steiner for their contributions. Mr. Gramß, in his capacity as Deputy Chairman of the Supervisory Board, has provided important and valuable impulses.

As per the statutes of *schlott gruppe AG*, all Members of the Supervisory Board were elected by the Annual General Meeting until the Annual General Meeting addressing the fiscal year 2008/09.

During its meeting on April 19, 2005, the Supervisory Board unanimously, with one abstention, elected Mr. Kiefer as Chairman of the Supervisory Board.

Members of the Supervisory Board representing employees were also newly elected on July 20, 2005. Ms. Irene Salberg and Messrs. Ivan Bebek, Dr. Herbert Pototzky and Michael Schlecht were reconfirmed. Newly elected were Ms. Andrea Raab and Mr. Harald Roller. Due to the departure of Mr. Karl-Heinz Gramß, former Deputy Chairman of the Supervisory Board and representative of employees, the position of Deputy Chairman needed to be newly filled. On November 9, 2005, the Supervisory Board unanimously elected Mr. Ivan Bebek as Deputy Chairman of the Supervisory Board. During the same meeting, the Members of the Committees were also newly elected to the extent that these were representatives of employees (see table on page 49).

THE WORK OF COMMITTEES

The Supervisory Board has established three Committees as set forth in its statutes. These Committees are chaired by the Chairman of the Supervisory Board. In this function, he has regularly and in a detailed fashion advised the full Board of the workings of the Committees.

The three Committees are the Arbitration Committee in line with paragraph 27, Chapter 3, of the Law of Co-Determination, the Personnel Committee and the Audit Committee. The Committees prepare topics, issues and decisions that are to be considered by the full Board. As per its statutes, the Supervisory Board has delegated various authorities to the Committees.

The Membership of the Committees is as follows:

ARBITRATION COMMITTEE:

Erwin J. Kiefer*, Ivan Bebek, Edmund Hug, Michael Schlecht

AUDIT COMMITTEE:

Erwin J. Kiefer*, Ivan Bebek, Reinhold Schreiner, Dr. Herbert Pototzky

PERSONNEL COMMITTEE:

Erwin J. Kiefer*, Ivan Bebek, Nikolaus Broschek, Andrea Raab

* *Chairman*

During the reporting year, there was no need to convoke the Arbitration Committee.

The Personnel Committee convened twice during the reporting year. Major topics included the determination of the variable components related of the compensation for Members of the Board of Management. Moreover, the Committee was mandated to draft the separation agreement for the departing Member of the Board of Management, Dr. Uwe Hack. The Personnel Committee was and continues to be concerned with finding a successor for the position previously held by Dr. Hack. In the meantime, the responsibilities of this position are assumed provisionally by the remaining Members.

The attainment of specified compensation parameters is also part of the responsibilities of the Personnel Committee.

The Audit Committee met once during the reporting year. It addressed primarily year-end financial statements and basic issues related to the management of risks. Moreover, it issued a mandate for the audit of financial statements, appointed the external auditor and determined the fee for the audit. One of the important tasks of the

Audit Committee is to secure and monitor on an ongoing basis the independence of the external auditor. During the reporting year, the Audit Committee has not found any evidence that the independence of the auditor was impaired and the Committee saw no need to take further steps for securing this independence. The external auditor participated in the meeting of the Audit Committee and reported in detail on its audit activities.

WORK OF THE SUPERVISORY BOARD

The regular consultations and deliberations of the Supervisory Board of *schlott gruppe AG* addressed issues such as sales and earnings trends, financial position, capital expenditures as well as employment trends within the *group*, the various subsidiaries, segments and sites.

In addition, the Board addressed on a regular basis matters concerning Corporate Governance. The Supervisory Board has adopted the recommendations and stipulations as per paragraph 161 AktG in the versions dated December 23, 2004, and December 22, 2005. On a voluntary basis, the Supervisory Board has also issued regulations with regard to the trading of company shares by its Members. Moreover, it addressed and examined the efficiency of the Supervisory Board without the presence of Members of the Board of Management. The Board of Management speaks for the Supervisory Board in the statements on Corporate Governance contained in the annual report 2004/05 of *schlott gruppe AG*.

In its deliberations during the fiscal year 2004/05 concerning the strategic development of the *group*, emphasis was again placed on the restructuring of activities in *direct marketing*. During its meeting on October 28, 2004, the Supervisory Board was informed in detail of the implementation of the new goal structure in *direct marketing* as adopted on July 23, 2004, as well as the general corporate strategic plans as outlined by the Board of Management.

Furthermore, important topics in the context of discussions about corporate strategy and general business development were the changes in the marketing strategies of mail order houses, the concentration of offset printing activities in Lübeck, as well as price developments, particularly in the business segment *print*. Moreover, in its meeting of July 20, 2005, the Supervisory Board discussed the detailed reports submitted by the Board of Management in connection with medium-term planning as well as the status of problems with the collective bargaining agreement and possible implications for *schlott gruppe AG*.

In its meeting of January 13, 2006, the Supervisory Board has reviewed in detail, in the presence of the external auditors, the year-end financial statements of the AG (HGB) and the *group* (IAS/IFRS), as well as the Management Report as prepared by the Board of Management.

In line with the exemption permitted under paragraph 292a HGB, the *group* financial statements at year-end were not prepared as per HGB. The corresponding explanations to this effect have been added in the Notes of the financial statements. AWT AUDIT WIRTSCHAFTS-TREUHAND GMBH, certified public accountants domiciled in Stuttgart, have examined the annual financial statements of *schlott gruppe AG* as of September 30, 2005, as well as the Management Report and the consolidated financial statements for the fiscal year 2004/05, and have rendered their unqualified opinion.

The Supervisory Board has examined the year-end financial statements of the AG and the *group*, the consolidated Management Report of both the AG and the *group*, as well as the recommendation with respect to the use of retained earnings and has concluded at the completion of its examination that no exceptions or objections are required. During its meeting on January 13, 2006, the Supervisory Board, on the basis of a recommendation of the Audit Committee has approved the results of the audit by the external auditor as well as the year-end financial statements of the AG and the *group*, which were thus adopted. Furthermore, the Supervisory Board concurred with the recommendation regarding the use of retained earnings. In light of the strong earnings growth in the previous year, the satisfactory earnings performance during the reporting year as well as the above-plan reduction in liabilities, there is room for a further increase in the dividend. The Supervisory Board and the Board of Management recommend to the Annual General Meeting on March 21, 2006, to raise the dividends by € 0.10 to € 1.00 per common share.

The Board of Management and all employees have again performed successfully during the past business year in a still difficult economic environment. Following inclusion of the company's share in the SDAX in the previous year, the success achieved during the reporting year has again drawn heightened attention to the share of *schlott gruppe AG*, resulting in a broadened base of both private and institutional investors. The Supervisory Board wishes to thank all those involved for their extraordinary dedication, and wants to particularly express its appreciation for the commitments and contributions of Dr. Uwe Hack, former Member of the Board of Management.

JANUARY 2006



ERWIN J. KIEFER

Chairman of the Supervisory Board