MANAGEMENT REPORT

CONSOLIDATED MANAGEMENT REPORT OF THE SCHLOTT GROUP AND THE AG FOR THE FISCAL YEAR 2004/05 AS PER SEPTEMBER 30, 2005

— **COMPANY PROFILE:** *The structure of the schlott group*

The *schlott group* is one of the leading European providers of printing and *direct marketing* services for the advertising industry and publishers. The catalogue of services reflects to a large extent the demands and requirements of major European customers. The core competence in the area of print is being supplemented by the services of the business segment *direct marketing* in line with customer requirements.

During fiscal year 2004/05, the *schlott group* employed about 4,000 persons. With our geographic positioning we are servicing our customers on a Europe-wide basis: our Northern German sites as well as the marketing office in Manchester address our markets in Scandinavia, Great Britain and the Benelux countries. The French mail order houses, which are domiciled in the region around Lille, as well as the French marketing agencies, which are mainly located in Paris, are serviced by our sites in Freudenstadt and Landau in the Southwestern part of Germany as well as by a finishing site in Hambach in the Northeast of France.

In intaglio printing, we are one of two 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.

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. The Czech company also functions as a supplementary production site for the main facility in Schwandorf. In addition, *direct marketing* has a production site in Sweden as well as sales and distribution offices in France and the Netherlands.

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SUPPLEMENTARY REPORT: KEY FIGURES AND CONTROL PARAMETERS OF THE SCHLOTT GROUP

The following tables show key financial data of the *schlott group* for the last three years. All figures during that time period are fully comparable, while comparisons to even earlier years are comparable only to a limited extent due to the abbreviated fiscal year resulting from the conversion from HGB to IAS/IFRS.

PROFIT AND LOSS ACCOUNT	2004 / 05		2003 / 04		2002 / 03	
	€ MIL.	IN %	€ MIL.	IN %	€ MIL.	IN %
print	457.7	—	466.3	—	488.8	—
direct marketing	107.1	—	114.4	—	119.5	—
digital services	—	—	—	—	4.4	—
corporate services	0.2	—	0.3	—	1.0	—
Net sales	565.0	—	581.0	—	613.7	—
Value-added turnover	335.2	100.0	340.9	100.0	335.4	100.0
Other operating income	14.5	4.3	19.9	5.8	29.6	8.8
Personnel expenses	–190.4	–56.8	–202.4	–59.4	–205.7	–61.3
Other operating expenses	–87.7	–26.2	–85.9	–25.2	–93.5	–27.9
EBITDA	71.6	21.4	72.5	21.3	65.8	19.6
Scheduled depreciation	–35.1	–10.5	–35.0	–10.3	–34.4	–10.3
EBITA	36.5	10.9	37.5	11.0	31.4	9.4
Amortization of goodwill	0.0	0.0	0.0	0.0	–5.8	–1.7
EBIT	36.5	10.9	37.5	11.0	25.6	7.6
Financial results	–10.6	–3.2	–11.9	–3.5	–12.7	–3.8
EBT	25.9	7.7	25.6	7.5	12.9	3.8
Taxes	–10.0	–3.0	–10.0	–2.9	–8.2	–2.4
Other partners share of losses (profits)	–0.1	0.0	0.0	0.0	0.0	0.0
Net income	15.8	4.7	15.6	4.6	4.7	1.4

FIGURES PER SHARE	2004 / 05	2003 / 04	2002 / 03
Shares outstanding	6,204,200	6,190,020	6,190,020
Net income per share (in €)	2.55	2.51	0.76
Dividend per share (in €)	1.00*	0.90	0.80
Share price; XETRA, September 30. (in €)	29.35	20.30	13.71

* *Recommendation*

A summary of data since the IPO in 1997 is presented in the jacket of this Annual Report.

BALANCE SHEET AND CASH FLOW	2004 / 05		2003 / 04		2002 / 03	
	€ MIL.	IN %	€ MIL.	IN %	€ MIL.	IN %
Total fixed assets	418.2	82.9	413.7	79.2	430.6	78.2
Liquid assets	1.8	0.4	1.8	0.3	2.9	0.5
Total current assets (incl. deferred charges and taxes)	86.3	17.1	108.8	20.8	119.9	21.8
Shareholders equity	144.9	28.7	135.5	25.9	125.5	22.8
Due to banks	179.3	35.5	197.4	37.8	221.7	40.3
Total liabilities	359.6	71.3	387.0	74.1	425.0	77.2
Balance sheet total	504.5	100.0	522.5	100.0	550.5	100.0
Cash flow from ordinary business activities	71.0	—	54.1	—	65.2	—
Cash flow for capital expenditures	–32.2	—	–14.0	—	–45.1	—
Cash flow for acquisitions	–0.1	—	0.0	—	–17.4	—
Cash flow for dividends	–5.6	—	–5.0	—	–3.3	—
Cash flow from financing activities	–33.2	—	–36.1	—	1.2	—
Cash flow for the period	–0.1	—	–1.0	—	0.6	—

KEY FIGURES	2004 / 05	2003/04	2002/03
EBT / ROE (in %)	18.5	19.6	10.8
EBIT / ROCE (in %)	7.8	7.7	5.7
Free cash flow	33.2	35.1	16.8
Free cash flow as % of value-added turnover	9.9	10.3	5.0
Net liabilities	177.5	195.6	218.8
Net liabilities / EBITDA	2.5	2.7	3.3

DEFINITIONS OF KEY FIGURES

Capital employed: Balance sheet total - Accounts payable - Down payments received

Free cash flow: Cash flow from ordinary business activities - Cash flow for capital expenditures - Cash flow for dividends

Net liabilities: Due to banks - Liquid assets

Return on equity (ROE): EBT as % of the average shareholders equity at the beginning and the end of the fiscal year

Return on capital employed (ROCE): EBIT as % of the average capital employed at the beginning and the end of the fiscal year

Value-added turnover: Net sales +/- Changes in inventory and capitalized internal activity - Cost of material - Services purchased

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1. 1. VALUE-ADDED STATEMENT FOR THE FISCAL YEAR 2004 / 05

in € million

DEVELOPMENT	
Total revenue (including interest income and income from participations)	581.1
Cost of materials	– 230.9
Other operating expenses (excluding non-deductible taxes)	– 86.5
Gross value-added	263.7
Depreciation expenses	– 35.1
Net value-added	228.6

APPLICATION		Share
Personnel expenses	190.4	83.3 %
Public domain (income and other taxes)	11.1	4.8 %
Creditors	10.9	4.8 %
Shareholders*	6.2	2.7 %
Group	10.0	4.4 %
Net value-added	228.6	100.0 %

** Recommendation to the Annual General*

— CORPORATE STRATEGY:

Top-rate performance to enhance the value of the Corporation

OUR STRATEGIC GOALS

I. Customers and products:

The *schlott group* considers itself a service organization that supports its customers in the dialog with their clients in a comprehensive manner. We are positioning ourselves at the top of the market when it comes to the printed media.

II. Market positioning:

As our customers are active on a European scale, we are positioning ourselves as a provider of European solutions. We intend to further enhance our position in the European intaglio printing industry and to pro-actively shape the consolidation process of that industry.

III. Providers of capital:

Intaglio printing is traditionally characterized by high levels of capital investment. In the interest of our shareholders, and to secure our competitiveness, we consider the highest possible efficiency of capital employed as the central strategic as well as operational goals.

HOW WE INTEND TO ACHIEVE OUR GOALS

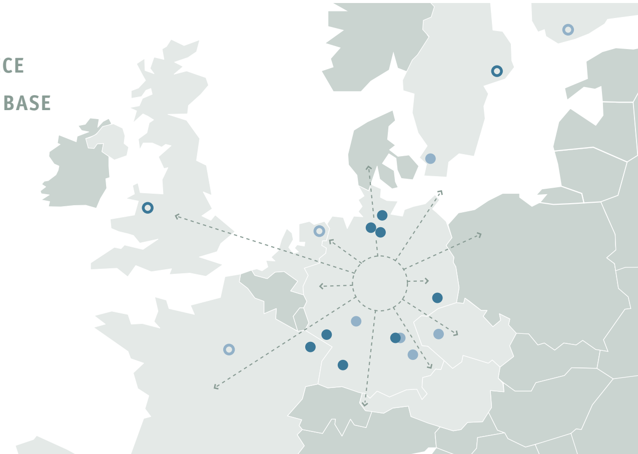
Flexibility and quality

The spectrum of our services is determined by the demands of the market place. Therefore, our product mix is geared towards securing highest levels of flexibility and quality.

This we achieve through close customer contacts, short communication channels, efficient processes and an integrated value-added chain enjoying the most modern production machinery in Europe at state-of-the art sites and proven logistics with long-standing partners. In this way, we are able to guarantee the shortest possible delivery times, enabling our customers to set sales prices today for advertising inserts distributed tomorrow in high-volume editions. We are among the few large providers in Europe that are able to offer such services.

2. OPTIMAL SELECTION OF SITES TO SERVICE OUR HIGH-VOLUME EUROPEAN CUSTOMER BASE

- *print* (production site)
- *print* (distribution)
- *direct marketing* (production site)
- *direct marketing* (distribution)



The instrument of the permanent optimization of processes over the total value-added chain supports two pivotal corporate goals: to create customer satisfaction on a level that cannot be exceeded in terms of service and quality and, at the same time, to realize the highest levels of resource allocation.

Flexibility is further secured by the geographic positioning of our printing sites, enabling us to cover in a nearly optimal fashion the European high-volume markets. To this effect, we have customized our sites with regard to machine capacity and diversity of configuration. This represents a material competitive advantage as the requirement for capital expenditures can be structurally reduced. It is for this reason, that we have vigorously implemented these steps immediately upon reaching the necessary critical mass in connection with our acquisition policy.

To maximize the benefits of this constellation, the printing and finishing sites are centrally coordinated. Thus, we make capacity available where customer demands in terms of product configuration and time-critical orders can be met in an economically efficient manner. Less time-critical printing orders are filled where free capacity exists.

The central coordination of the printing sites supports the best possible allocation and efficiency of capital: we optimize the utilization of our capacity outside of peak periods and minimize idle and set-up times. The best possible and flexible utilization of our capacities enables us to achieve short lead times for our customers, thus enhancing customer satisfaction.

Management of growth

The European intaglio printing industry still consists of about 30 companies despite the high levels of capital expenditures required. Moreover, there are one Italian and two German printing firms aligned with publishing houses. However, a consolidation process has been underway for a long time, mirroring the development in North America: there, three large providers cover the entire market.

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The consolidation process in the European printing industry has recently accelerated. One of the main reasons is that publishing houses were willing to divest of their printing activities in order to concentrate their resources to their core business. We anticipate that the three largest European intaglio printing companies will increase their market share from today's 45 percent to at least 60 percent over the next three to five years. The consolidation will impact positively on the providers of printing services without leading to a similar level of concentration as in North America.

The *schlott group* has pressed ahead with this consolidation process for various reasons and for many years. Firstly, to increase market share and growth through acquisitions. A growth strategy banking on organic growth, i.e. developing additional capacity through technical innovation and replacement of fixed assets, is not possible in the price-transparent intaglio printing industry. Secondly, companies active in this industry need, as stated above, a critical mass in order to realize economies of scale through specialization and broadening of the product mix. Thirdly, acquisitions represent an important part of our value-added philosophy. The *schlott group* has increased its value-added turnover over the last ten years by nearly ten times.

Long before our initial public offering in 1997, we had formulated a long-term strategy, which was implemented with the acquisition of wwk druck in 1996 with the goal of materially accelerating growth. Going public facilitated further external growth: with the takeover of the sebaldus group we realized a further leap in size and a significant broadening of our product mix. The acquisition of lithorex propelled us to the leadership in Scandinavian direct marketing. The purchase of the broschek group enhanced in a significant way our market access in Scandinavia and Great Britain and increased considerably our share of the European business.

The *schlott group* has gained an excellent know-how in the management of acquired growth and volume. We have proven several times our ability to successfully integrate acquisitions. An important ingredient for success with our acquisition policy is the careful selection of possible target companies. Turn-around candidates do not rank prominently – the selection is made entirely on the basis of the strategic fit in terms of customer base, production sites, potential for specialization, the state of production machinery and the rounding-off of our product mix.
All acquisitions contributed positively to corporate earnings already in their first year. The integration of the acquired companies was consistently implemented as per plan and without difficulty. The foregoing represents a further characteristic of our acquisition policy: visible benefits from the very beginning. Actual synergies are especially realized through the immediate integration of the acquired company into our central product coordination. This

is reflected in shorter lead and set-up times and, thus in additional capacity, over and beyond the acquired volume. Consequently, we are able to generate additional value-added turnover with the existing production machinery resulting in an overall lower structural requirement for fixed assets.

For financing acquisitions, the share of *schlott group AG* as acquisition currency represents a pivotal strategic instrument. Therefore, the creation of value plays a central role in the implementation of corporate strategy. Moreover, we have formulated clearly specified financial criteria and budgets with which to undertake new acquisitions.

In this connection, the high level of internal financial resources of the *schlott group* are an important instrument. The strength of our cash flow represents the financial starting point for our ability to undertake acquisitions. The most central key figure in the capital-intensive intaglio printing industry is the ratio of net liabilities to EBITDA (earnings before interest, taxes, depreciation and amortization), i.e. the indicator for the cash flow from ordinary business activities.

A central financial goal of the *schlott group* is the maintenance of the plan target for net liabilities during the year in which acquisitions are undertaken; this target is about 3.5 times EBITDA. Already in the following year, three times EBITDA is the minimum goal. As the lower boundary of an optimal capital structure we consider a factor of two.

For example, during the year of the takeover of the broschek group, the factor of 3.3 was not exceeded; in the following year 2.7 was reached and in the second year after the takeover, i.e. at the end of this reporting year, the factor was less than 2.5 (net liabilities: € 177.5 million; EBITDA: € 71.6 million). From this recent example, we can extrapolate that acquisition intervals are currently between three to four years.

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FISCAL YEAR 2004/05:

EFFICIENCY RAISED
COSTS LOWERED
LIABILITIES REDUCED

— COORDINATION OF THE CORPORATION:

Central product coordination and transparent processes

The *schlott group* coordinates its activities via legally independent subsidiaries. Aside from the international activities, the domestic production sites within each business segment are domiciled in independent companies. In addition, various parts of the value-added chain at the respective sites are coordinated by separate subsidiaries (see "Legal Structure" on page 39). This configuration of the Corporation leads to a high level of transparency in terms of both performance and costs of each site as well as the individual links in the value-added chain.

The presence of Members of the Board of Management at the largest subsidiaries assures that administrative expenses are controlled and that the interests of the subsidiaries are congruent with those of the Corporation.

Subsidiaries are managed tightly. For example, intaglio printing sites are not operating as profit centers but as pure cost centers, i.e. they receive printing orders from the central order office, which coordinates all market orders. Consequently, individual sites are not competing against one another, which facilitates the sharing of know-how between sites. With this constellation, we are able to realize a variety of synergies between our sites, which would not be possible if we were to organize these sites as profit centers. Such synergies range from the balanced utilization of capacities to possible specialization of the sites, and reductions in the management risks within the Corporation.

During the past business year, we have applied the successful configuration in printing to other segments within the Corporation. For example, the sites active in further processing in the segments *print* and *direct marketing* are now centrally coordinated leading to a more economic and efficient capacity utilization, and enabling us reduce bottlenecks with their attendant high expenses.

In addition, in the segment *direct marketing*, we have structured the activities of the Schwandorf site into separate GmbHs along the value-added chain. With this restructuring, we have increased the transparency, allowing us to further strengthen the division of tasks between the production sites in this business segment. While the labor-intensive low-end business has by now been largely transferred to the Czech Republic, high-end orders are concentrated at the highly automated sites in Germany and Sweden. In addition, the privacy-sensitive documents

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business is also carried out by the afore-mentioned sites. These two sites, specializing in highly automated solutions, receive orders based on optimal production and logistics parameters.

— SUMMARY OF FISCAL YEAR 2004/05

The schlott group finishes the fiscal year with new strength

We look back with satisfaction to the business year 2004/05. We faced numerous challenges: a continued difficult economic environment, price pressure in the European printing industry, revision of our marketing strategy with focus on German mail order houses, strong competitive pressure in *direct marketing* and harmful strikes in the course of the re-negotiations of the wage agreements. The *schlott group* has successfully met these challenges and has exceeded the earnings results of the previous year through further improvements in efficiencies. Net liabilities were reduced more than planned and the structure of the balance sheet, particularly in short-term items, was further enhanced.

The reporting year is characterized by further progress in efficiency improvements realized during the past years, particularly in the area of employee productivity.

In the business segment *print*, we have made further significant progress in reducing costs. The decision for additional investments at the site in Freudenstadt was made and will be implemented in the course of the current business year. Two presses, which have reached the end of their technological and economic life, will be retired and replaced by a new intaglio printing complex. This step will result in an annual cost reduction of between € 1.5 million and € 2.0 million during the following year, because the new press will have a slightly higher capacity than the two it replaces and because only one production crew will be needed. Moreover, supplemental personnel expenses will be lower. The negotiations leading to a new collective bargaining agreement concluded with an only modestly higher level of personnel expenses and allows, if only in steps, cost reductions for the companies involved. We expect a significant annual cost reduction, which will be fully realized starting in the year 2008.

In the business segment *direct marketing*, we have accelerated the program of optimization with the result that during the fourth quarter of the reporting year the segment became again profitable. Personnel resources were adjusted, flexible working hours were introduced and processes were further optimized. We have also further expanded the cost-optimizing division of labor between our two sites in Germany and our site in the Czech Republic.

The sum of these steps undertaken resulted in an improved result before taxes despite a significant decline in the results of the segment *direct marketing*, a slightly lower value-added turnover and the absence of the positive one-time effect in the previous year as a result of the sale of real estate at the former site in the City of Nuremberg.

— ECONOMIC ENVIRONMENT:

As in the previous year, the media industry again did not benefit from any recovery in 2005

GENERAL TRENDS

While the world economy continued to grow strongly, the improvements in the European economies were again modest. Due to continued weak domestic demand, the German economy again performed markedly below the average of the EU countries.

During the business year 2004/05, the world economy continued to grow strongly albeit with significant regional variances. This is the verdict of the leading economic research institutes in their report issued in the fall of 2005. While higher prices for crude oil and other raw materials dampened economic activity, a globally more accommodating monetary policy, lower interest rates, higher values for many asset categories as well as higher corporate earnings provided positive impulses. Particularly in the growth locomotives USA and China, the gross domestic product continued to grow well in excess of three percent, and even Japan realized positive growth after years of stagnation.

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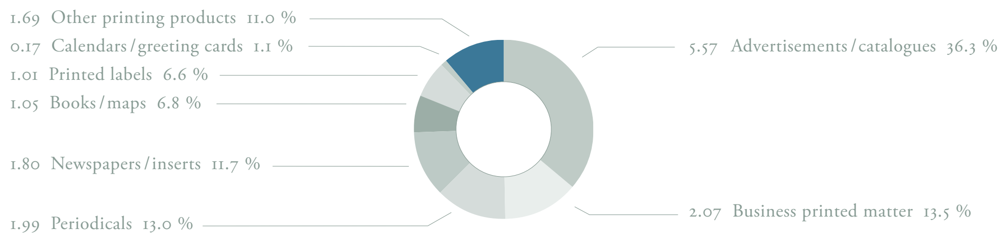
3. STRUCTURE OF TURNOVER OF PRINTING PRODUCTS IN GERMANY 2004

in € billion (100% = € 15.35 billion; source: Federal Statistics Office)



In contrast, the Euro-zone was different: according to the economic research institutes, the economic development continued to lack dynamics. The steep increase in energy prices limited the demand by the private sector and negatively impacted on consumer confidence. In the industrial sector, however, sentiments improved during the course of the year, which must be ascribed primarily to the increase in orders. These came again primarily from areas outside of Europe and foreign trade remained the engine for growth together with somewhat higher levels of capital expenditures stimulated by the aforementioned rising levels of orders. In total, the growth rate for 2005 in the Euro-zone is expected to be only 1.3 percent.

Economic conditions in Germany lagged those of the Euro-zone. The growth in gross domestic product continued to be less than one percent and capacity utilization was lower than in the previous year. The German economy continues to rely on impulses from international markets as the domestic activity stagnated for the entire year of 2005 following a similar performance in the previous year.

INDUSTRY ENVIRONMENT AND TRENDS

Summary of the German printing industry

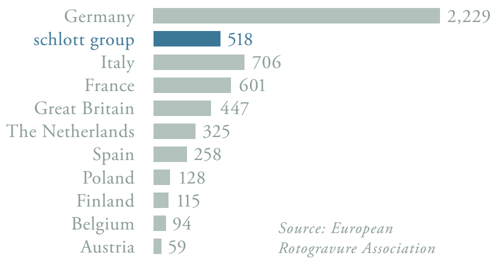
The state of the German printing industry is closely correlated to general economic activity. Its growth is considerably influenced by the level of consumer demand. It is also to a large extent relying on advertising expenditures, which in turn are an indicator for the level of consumer demand. 62 percent of the turnover of printing products is accounted for by the production of advertisement materials. Due to the size of the German domestic market, the very unsatisfactory development of our industry in the last years has been caused by domestic weakness in consumption.

It must be noted that the advertising industry - and thus also the printing industry - has experienced a more pronounced cycle than the consumption sector. The advertising industry had to cope with a deep recession lasting three years following the New Economy Boom. After the record year of 2000, advertising expenditures during the years 2001 to 2003 experienced considerable reductions. Such a phase had never been experienced by the German advertising industry since the end of WWII.

During 2004, the trend was reversed and a growth of one percent was realized. 2005 is not expected to show any measurable pick-up in activities, and the volume of expenditures for advertising for the year 2001 will not nearly be reached. Expenditures for advertising as a percentage of gross domestic product was 1.34 percent in 2004 compared to 1.64 percent in 2000.

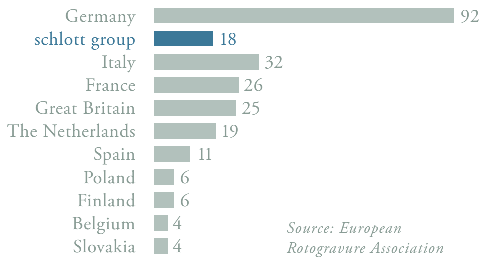
4. INTAGLIO PRINTING CAPACITY IN THE EUROPEAN PRINTING INDUSTRY

10 largest countries, in thousands of tons, publications



5. NUMBER OF INTAGLIO PRINTING PRESSES IN THE EUROPEAN PRINTING INDUSTRY

10 largest countries, publications



German intaglio printing is a Europe-wide industry

As stated before, business trends for German intaglio printing enterprises are determined by domestic consumer demand and domestic advertising expenditures. Germany represents the largest market in Europe for our industry. Traditionally, the large German mail order houses, which distribute catalogues in high volumes, are an important customer group for intaglio printing products. In other European countries, mail order houses play a less important role. Nonetheless, the German intaglio printing tradition and the capital-intensive nature of the industry have led to a progressive Europeanization of the activities of the leading German intaglio printing enterprises. Compared to offset printing, the required level of capital expenditures in intaglio printing is significantly higher resulting in higher entry barriers.

As a consequence, a large part of the demand for intaglio printing products in Europe is met by German companies. They have by far the biggest share of capacity for the printing of publications. Based on calculations by the European Rotogravure Association (ERA).

45 percent of intaglio printing capacity in terms of tons in the ten largest European countries is accounted for by Germany. The *schlott group* provides about 23 percent of the German intaglio printing capacity and about 10 percent of the European total; thus, the group exceeds the total capacity installed in Great Britain. Of the total number of European intaglio printing presses, 41 percent are installed in German companies. The *schlott group* operates 20 percent of the intaglio printing presses operational in Germany and 8 percent of the European total.

Demand trends in Europe, according to the ERA, are clearly pointing in the direction of intaglio printing, while offset printing is on a declining trend. This even applies to products with only modest volume. Thus, intaglio printing enters further market areas in addition to the classic domain of high and highest volumes areas as, for example, advertising materials and inserts. Intaglio printing has the advantage of relatively higher printing quality, which is becoming increasingly important in the area of catalogues that are distributed in smaller editions by demanding niche mail order houses.

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6. 2004 INTAGLIO PRINTING MARKET SHARE IN THE EUROPEAN PRINTING INDUSTRY

(Source: European Rotogravure Association)

Another strength of intaglio printing is the higher level of flexibility, particularly when it is important to bring to the market time-sensitive products. Last, but not least, intaglio printing enjoys a higher level of variability in formatting, which has assumed importance lately, particularly with magazines with reduced measurements. The *schlott group* focuses on flexibility and variability when making capital expenditures for medium printing widths. Very wide presses offer these advantages only to a limited extent.

2005 Trends in the printing industry

According to the Federal Association Print and Media (bvdm), the slow positive trend, which had begun already at the beginning of the previous year after reaching the years-long bottom, continued at a modest pace during 2005. The business index calculated by bvdm for the printing industry has turned positive for the first time in five years only late in the year after it had eroded until the summer of 2005.

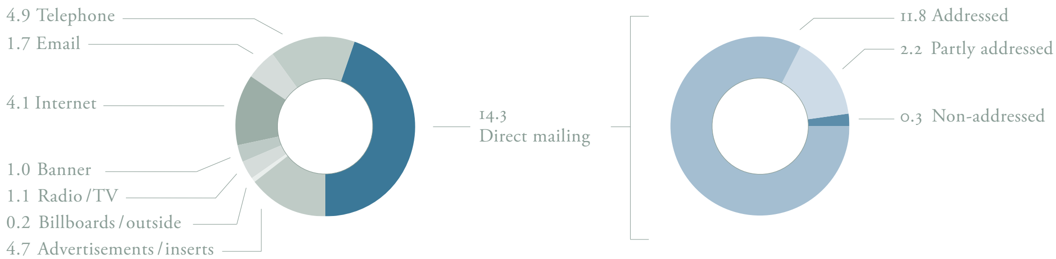
Also, printing enterprises reported for the first time in five years that their business conditions improved rather than deteriorated. By the autumn of 2005, an increasing number of firms reported higher levels of demand and higher order books. The erosion in price, however, continues unabated. The bvdm concludes that the upswing will not be pronounced and it will take some time until the level of the year 2000 is reached again.

While the universe of companies includes a large number of middle market firms, and is thus not representative for the business of the *schlott group* specializing in higher volume activities, the general findings and trends nonetheless apply to our Corporation as well: no positive economic impulses in 2005, even though the Association of Communication Agencies (GWA) sees for the first time since 2001 growth in the advertising industry exceeding the general level of economic growth. However, the classical advertising media in the form of magazines experienced again reductions in advertising billings in 2005 and thus no increase in revenue.

The 1.3 percent growth in tonnage achieved by the *schlott group* during the past year is the result of initiatives undertaken by the Corporation. We were able to again distance ourselves from the general market.

7. 2004 EXPENDITURES BY DIRECT MARKETING CATEGORIES

in € billion (100% = € 32.0 billion; as per Deutsche Post AG 2005 Direct Marketing Study)



Direct marketing

The terms *direct marketing* or dialogue communication subsume a very broad spectrum of applications and utilizations. Statistical data are therefore frequently inconsistent, especially when including the employment of *direct marketing* in the internet and when circumscribing the catalogue business. The media employed in *direct marketing* range from telephone marketing, internet / banner / email marketing, to the classical print-supported *direct marketing* such as direct mailings, advertisements and inserts. The important elements of print-supported *direct marketing* products are the addressing or lack thereof as well as the varying response elements.

Direct marketing is a growth industry with very broad applications over the entire economic process. The 2005 study Direct Marketing Deutschland concludes that 83.6 percent of companies have employed direct marketing tools in 2004. This represents an increase of more than two percent compared to the previous year. Generally, several *direct marketing* instruments are employed as a package in order to directly reach recipients of advertising and product messages. Direct mailings, advertisements, spots as well as billboards and other outside advertisements, which contain the address and telephone number of the advertising enterprise, increase the efficiency of the advertising campaign.

In spite of broad acceptance of *direct marketing* in all areas of the economy, the *direct marketing* industry is characterized by high levels of competition for the available advertising budgets; the medium internet has intensified the competitive pressure over the past years. However, while internet activities have grown strongly, the lion's share of *direct marketing* expenditures in 2004, i.e. € 19 billion or nearly 60 percent of the total of € 32 billion, is accounted for by print-supported media such as advertisements, inserts and direct mailings.

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— FINANCIAL DEVELOPMENTS:

Reductions in costs and liabilities offset the effects of strikes and a slowdown in direct marketing

INDUSTRY-TYPICAL PERFORMANCE INDICATORS OF THE SCHLOTT GROUP

Value-added turnover: the key indicator for status assessment

The stated turnover and related ratios for the *schlott group* do not reflect sufficiently the actual performance and economic situation. In elaborating on the activities for the reporting year and the economic situation of the Corporation, we employ the concept of value-added turnover. This approach closely follows the parameters applied to internal coordination and administration.

Derivation of "Value-added turnover"

IN € MILLION (IAS / IFRS)	*2004 / 05*	*2003 / 04*
Net sales	565.0	581.0
Changes in inventory	1.1	– 2.6
Other capitalized internal services	0.0	0.0
Cost of materials	– 177.7	– 183.1
Cost of purchased services	– 53.2	– 54.4
Value-added turnover	335.2	340.9

An important factor influencing turnover is the extent to which paper is being provided by our customers. We cannot and do not wish to influence a customer's decision to either provide paper for his orders or to request us to purchase paper on his behalf. Paper procured by us impacts on the stated turnover as it is included in the cost of materials, while paper provided is not reflected in our financial statements.

Total tonnage

IN TONS (000)	2004 / 05	in %	2003 / 04	in %
Paper provided by customers	427.7	73.2	416.6	72.3
Paper procured	156.6	26.8	160.0	27.7
Total tonnage	584.3	100.0	576.6	100.0

All other things being equal, a higher level of paper provided by customers reduces the stated turnover as well as costs of materials by a like amount. Both a reduction in the stated turnover as a result of a higher level of paper provided and the arithmetically resultant improvement in gross margin represent, however, no change in the economic situation of the *schlott group*.

During fiscal year 2004/05, the level of paper provided has again risen: it increased by 0.9 percent to 73.2 percent; two years ago that figure was below 65 percent. Thus, nearly three fourth of the 584.3 thousand tons of paper used by the *schlott group* were provided by customers during 2004/05. The increase in the level of paper provided during the reporting year equates to 11,000 tons with a commensurate negative effect on stated turnover.

The value-added turnover is calculated essentially by adjusting the stated turnover by the cost of materials and the cost of purchased services, thereby eliminating the effects of paper provided by customers.

The muted improvement in the general condition of our markets that began in the previous year has continued during the business year 2004/05. However, competitive price pressure continued unabated, particularly in the second half of the business year. Aside from the existing excess capacity in intaglio printing outside of seasonal peak times, the reduced level of advertising expenditures in the area of periodicals was a reason for this development.

In addition, the general mail order houses have adjusted their marketing strategies and have increased the frequency in issuing their catalogues: instead of traditionally distributing semi-annual catalogues, issuers now distribute three to four seasonal partial editions. These more focused advertising initiatives result in more frequent purchase impulses.

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While this new strategy by issuers creates positive trends for providers in terms of volume, the cautious level of expenditures by this important customer group produces additional price pressure.

The tonnage of paper processed by the *schlott group* in the business segment *print* has increased from 576.6 thousand tons in the previous year by 1.3 percent to 584.3 thousand tons of paper in the reporting year. The bulk of this increase was generated in the first half of the reporting year in line with improved business conditions. The value-added turnover in this segment remained, however, at the level of the previous year (€ 268.9 million as compared to € 269.0 million). This is indicative of the reduction in prices realized in intaglio printing.

The segment *direct marketing* registered a disproportionate decrease in value-added turnover, which fell by 9.4 percent to € 63.8 million due to difficult market conditions. In total, the value-added turnover of the Corporation fell by 1.7 percent to € 335.2 million after € 340.9 million in the previous year.

INCOME STATEMENT: PROFITABILITY CONSOLIDATED AT A HIGH LEVEL

The *schlott group* succeeded in maintaining the appreciably higher level of profitability achieved in the previous year also during the business year 2004/05, in spite of production stoppages at various sites during the third quarter. The cost of the strikes amounted to nearly € 2 million. However, net income before taxes and the net results achieved by the Corporation were modestly improved due to the above plan reduction in net liabilities by € 18.1 million.

Key financial data of the income statement

IN € MILLION (IAS/IFRS)	*2004 / 05*	*in %*	*2003 / 04*	*in %*
Net sales	565.0	168.6 %	581.0	170.4 %
Value-added turnover	335.2	100.0 %	340.9	100.0 %
EBITDA	71.6	21.4 %	72.5	21.3 %
EBIT	36.5	10.9 %	37.5	11.0 %
EBT	25.9	7.7 %	25.6	7.5 %
Net income	15.8	4.7 %	15.6	4.6 %
Earnings per share (€)	2.55		2.51	

The analysis of earnings trends for the business year 2004/05 accentuates the validity of optimization measures undertaken over the last years: during a phase of numerous challenges, the profitability level achieved in the previous year was maintained even though profitability in the segment *direct marketing* was again lower contrary to our expectations. Restructuring initiatives undertaken in *direct marketing* started to produce positive results only in the fourth quarter of the business year.

EBIT amounts to € 36.5 million following € 37.5 million in the previous year. One must note, however, that other operating income was significantly lower and fell by 27.1 percent or € 5.4 million to € 14.5 million; this reduction was fully anticipated and planned for. It is essentially accounted for by the absence of a one-time effect related to the disposal of the old Nuremburg site. Moreover, modest amounts of reserves were dissolved during the reporting year.

On the expense side, scheduled depreciation increased only modestly after a more pronounced reduction in the previous year, while other operating expenses increased by 2.1 percent. The continual effort to reduce administrative and general overhead expenses could not compensate the increase in the cost of employee benefits and particularly higher logistics and freight expenses due to the price of oil and the cost of highway tolls.

Positive effects were derived from personnel expenses, which declined by 5.9 percent as a result of ongoing efforts to improve all operational processes and in particular the structural initiatives in the segment *direct marketing*. In this segment, personnel expenses were lowered by 14.4 percent, in the segment *print* these expenses declined by 3.6 percent. The savings compared to the previous year amount to a total of € 12.0 million. In terms of value-added turnover, the proportion of personnel expenses for the Corporation as a whole fell from 59.4 percent to 56.8 percent; employee productivity measured in terms of value-added turnover was thus noticeably improved. In terms of tonnage, labor productivity has also risen: after 211.4 tons in the previous year and 196.6 tons in the year before, tons of paper processed per employee during the reporting year rose to 214.2 tons in the segment *print*. The pronounced increase in efficiency of the previous year was thus not only sustained, but further enhanced.

The consistent repayment of debt resulted in a reduction in interest expense of 19.3 percent, or € 2.6 million, to € 10.9 million. Results from financial activities, including gains and losses arising from movements in exchange rates, were improved by € 1.3 million to € -10.6 million after € -11.9 million in the previous year. Foreign exchange transactions are employed exclusively for hedging business transactions: orders are hedged at the time they are

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8. BALANCE SHEET STRUCTURE AS PER SEPTEMBER 30, 2005

in € million

recorded in our books. Unfavorable trends in exchange rates result in a negative impact on the profitability of each order, while favorable changes cause the opposite. Through hedging, the effects of exchange rate movements on the income statement are neutralized.

The level of EBT, which had nearly doubled during the previous year, was sustained and even improved by 1.2 percent to € 25.9 million during the reporting year. Relative to value-added turnover, the EBT margin has risen from 7.5 percent to 7.7 percent. Net income improved slightly from € 15.6 million in the previous year to € 15.8 million in the reporting year due primarily to a somewhat lower tax rate of 38.7 percent.

Net income per share rose from € 2.51 in the previous year to € 2.55 on the basis of 6,204,200 eligible shares as compared to 6,190,020 in the previous year. The undiluted weighted average number of shares amounts to 6,190,020, while the diluted number as per year-end amounts to 6,191,202. The diluted and undiluted earnings per share amount to € 2.56. In the context of the share program for employees, 14,180 dividend-eligible shares were issued after year-end.

BALANCE SHEET AND CASH FLOW OF THE GROUP

The business year 2004/05 yielded from ordinary business activities a cash flow, which was 31 percent higher than in the previous year. The strength of the group to generate cash was thus again reconfirmed and the quality of the balance sheet was considerably improved through internal sources.

During the reporting year, capital expenditures were increased according to plan in connection with the installation of a new and state-of-the-art intaglio printing press and attendant infrastructure at our Freudenstadt site as well as the acquisition of an offset printing machine at the facility in Lübeck. In line with the installation progress made in Freudenstadt, down payments made were capitalized at year-end, contributing to the increase in fixed assets in the absence of essentially unchanged scheduled depreciation.

On the other hand, funds tied up in current assets were again considerably reduced as a result of a further enhanced management of working capital: while at year-end a modest increase in supplies (unfinished services) is reflected in the balance sheet, accounts receivable for goods and services were again significantly reduced. Moreover, deferred taxes included in the balance sheet of the previous year were collected in the course of the fiscal year 2004/05.

Key balance sheet figures

IN € MILLION (IAS / IFRS)	9-30-2005	in %	9-30-2004	in %
Fixed assets	418.2	82.9 %	413.7	79.2 %
Goodwill	88.7	17.6 %	87.8	16.8 %
Current assets	84.1	16.7 %	106.6	20.4 %
Accounts receivable	49.9	9.9 %	57.4	11.0 %
Cash and cash equivalents	1.8	0.4 %	1.8	0.3 %
Deferred taxes	0.4	0.1 %	0.1	0.0 %
Deferred charges	1.8	0.4 %	2.1	0.4 %
Total assets	504.5	100.0 %	522.5	100.0 %
Shareholders equity	144.9	28.7 %	135.5	25.9 %
Total debt	326.0	64.6 %	350.7	67.1 %
Provisions	79.5	15.8 %	74.0	14.2 %
Due to banks	179.3	35.5 %	197.4	37.8 %
Accounts payable	43.0	8.5 %	42.2	8.1 %
Deferred taxes	31.1	6.2 %	33.5	6.4 %
Deferred charges	2.5	0.5 %	2.8	0.5 %
Total liabilities	504.5	100.0 %	522.5	100.0 %

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The reduction in other current assets corresponds to a proportionate decline in other current liabilities. This was achieved in connection with the completed disposal of the former site in the City of Nuremberg at the beginning of the business year. The share of current assets as a percentage of total assets was reduced from 20.4 percent to 16.7 percent. Total footings declined by € 18.0 million, or 3.4 percent, to € 504.5 million at the end of the business year 2004/05.

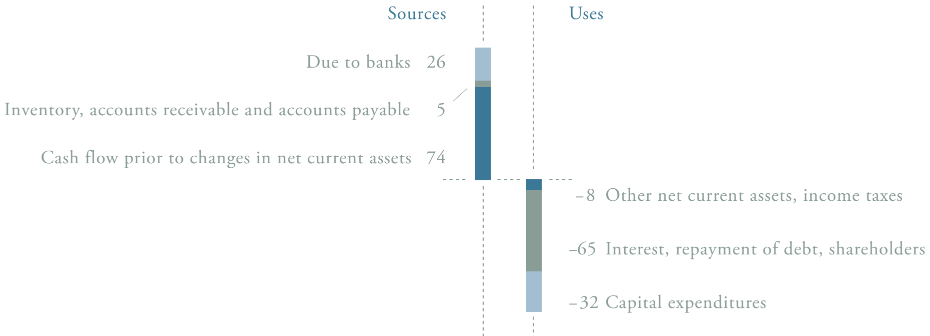
The financing structure of the group's assets was again improved as per plan. Shareholders equity rose by 6.9 percent, or € 9.4 million, to € 144.9 million due to retained earnings; total debt was again reduced by 7.0 percent, or € 24.7 million, compared to the previous year. Interest-bearing liabilities to banks were reduced by € 18.1 million, or 9.2 percent, to € 179.3 million.

Development of the equity to fixed asset ratio in 2004/05

IN € MILLION (IAS / IFRS)	9-30-2005	9-30-2004
Fixed assets	418.2	413.7
Real estate held as financial assets	– 8.0	– 8.3
Total fixed assets	410.2	405.4
Shareholders equity	144.9	135.5
Long-term liabilities to banks	139.1	169.6
Provisions for pensions	22.8	22.6
Other long-term liabilities	4.4	5.7
Fixed assets not used in ordinary business activities	– 8.0	– 8.3
Total long-term financing	303.2	325.1
Long-term coverage of fixed assets	73.9 %	80.2 %

9. CASHFLOW 2004 / 05

in € million



The long-term coverage of fixed assets required for ordinary business activities has fallen from 80.2 percent in the previous year to 73.9 percent in the reporting year. It must be noted, however, that the capitalized installation progress made at the Freudenstadt site was still primarily financed by short-term bank debt as of year-end. During the course of the current business year, this short-term financing will be restructured for longer tenors, resulting again in a higher level of coverage of fixed assets.

The equity ratio was again improved during the reporting year, i.e. from 25.9 percent to 28.7 percent. The sustainable high levels of profitability will continue in the current year to enhance the financing structure and thus the balance sheet quality. The *schlott group* does, however, not focus exclusively on the equity ratio or on an optimally leveraged financing structure. In light of the strength of cash flow generation, the financing structure will be geared primarily to the ratio between liabilities due to banks and EBITDA (see page 59).

Due to smaller prepayments, short-term provisions for taxes have increased at year-end. Deferred taxes in the amount of €31.1 million (€33.5 million in the previous year) are the result primarily of timing differences in the depreciations of fixed assets and the dissolution of tax-motivated special reserves.

Key figures of cash flow

IN € MILLION (IAS / IFRS)	*2004 / 05*	*2003 / 04*
Results from ordinary business activities	36.3	38.0
Cash flow prior to changes in net current assets	73.8	69.6
Cash flow from ordinary business activities	71.0	54.1
Cash flow for capital expenditures prior to acquisitions	–32.2	–14.0
Cash flow for acquisitions	–0.2	0.0
Cash flow from financing activities	–38.7	–41.1
Cash flow for the period	–0.1	–1.0

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The *schlott group* generated a cash flow prior to changes in net current assets of €73.8 million during the reporting year, representing an increase of 6.0 percent over the pervious year; over the last two business years, the increase amounted to a total of 20 percent. The improvement in cash flow resulted exclusively from operating sources.

After changes in current assets as well as lower tax payments of €3.7 million (€5.9 million in the previous year), net cash flow generated from ordinary business activities amounted to €71.0 million after €54.1 million in the prior year. This improvement by 31.2 percent, or €16.9 million, resulted, as already mentioned before, primarily from the enhanced management of working capital.

The value-added turnover of €335.2 million generated €71.0 million in cash for the *schlott group*. The cash flow margin in relation to value-added turnover rose to 21.2 percent during the reporting year following 15.9 percent in the previous year.

The increase in capital expenditures by €10.1 million, or 43.4 percent, representing a considerable increase over the previous year, was fully funded by cash flow generated from ordinary business activities. Interest payments of €9.0 million and a dividend distribution, which was 12 percent higher than in the prior year (€5.6 million after €5.0 million), were also defrayed from internally generate funds.

In addition, we again had funds available for the reduction of net liabilities: after a material reduction in the previous year, a further €18.1 million in debt was retired, resulting in a reduction in net liabilities from €195.6 million in the previous year to €177.5 million at the end of the reporting year. The balance of net liabilities at the end of the fiscal year 2004/05 is thus lower than anticipated at the beginning of the reporting year.

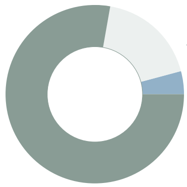
— SEGMENT REPORTS:

Market positioning was significantly improved

During the reporting year, the *schlott group* has divested of parts of the activities of the former business segment *digital services* and has consolidated the residual parts into its other two segments. Concurrent with these changes, the business segment *high performance printing* was renamed *print*. As a result, the segment reports deal with the business areas *print*, *direct marketing* and *corporate services*. The data of prior years were adjusted so that comparability is fully assured. As secondary segments we continue to display and will do so in the future also turnover, net assets and capital expenditures by geographic regions in line with IAS/IFRS.

10. VALUE-ADDED TURNOVER BY SEGMENTS 2004 / 05

100 percent = € 345.6 million (prior to consolidation)



PRODUCTION, PRODUCTS AND SERVICES

Within the *schlott group*, the segmentation of our businesses is patterned after the integrated value-added chain. In the business segment *print*, we concentrate printing preparation, intaglio and offset printing as well as further processing. Arranged according to type of printing products, 30 percent of the value-added turnover in the business segment *print* is accounted for by catalogues for the general mail order houses and 17 percent by niche mail order houses. Periodicals accounted for 22 percent of value-added turnover and inserts for 31 percent.

The margins for periodicals and catalogues are approximately the same; however, generally we benefit from longer-term contracts for the printing of periodicals enabling us to plan capacity utilization more efficiently. Inserts are often low-margin products, particularly when these are produced in the off-season, because such orders are assigned primarily to the so-called spot market.

All three segments have growth potential once the general economic environment improves. In the current environment, new periodicals are coming to market in ever shorter intervals. However, these are often printed by the printers of the previous periodicals that the new ones replace, or they are printed by the printing shops of the publishing houses. In the catalogue business we must differentiate between general and niche mail order houses, as illustrated above. While the general mail order business suffers particularly from the lack of consumer spending in Germany, the niche houses are experiencing healthy growth rates that have averaged 3.5 percent per annum since the beginning of the 1990s.

In the area of inserts, we are differentiating ourselves from the competition by having very variable print formats and short reaction and delivery times, allowing customers to set their sales prices shortly prior to the distribution of the inserts. In general, we have the capability to accept all orders that are coming to the market at short notice and to execute these at attractive terms. Our earnings potential is enhanced by these capabilities.

The segment *direct marketing* develops dialog marketing concepts and combines activities in further processing, finishing, Lettershop, as well as services. "Finishing" encompasses all activities connected with the preparation of mailings. Addresses are added in the Lettershop, mailings are folded, enveloped and confectioned. Further processing includes, as in the segment *print*, adhesive tape, lamination and albums for collectibles as well as the customization of printing products, such as catalogues and mailings. Capacity utilization within the Corporation in the area of further processing is now being centrally coordinated and thus conducted more cost-effectively.

In the area of services, *direct marketing* offers its Service Center Response-Management and classical Fulfillment. In addition, printing products of the business segment *print* are customized.

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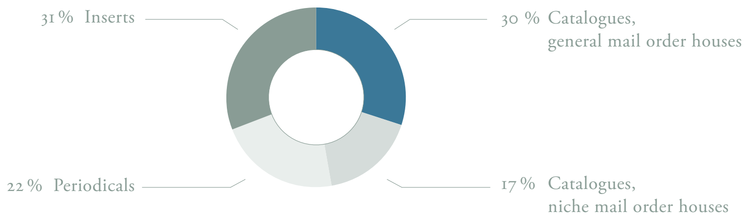
11. VALUE-ADDED TURNOVER BY PRODUCT IN THE BUSINESS SEGMENT PRINT 2004 / 05

100% = € 268.9 million



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 are thus at the forefront of 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 2004 / 05

IN € MILLION (IAS / IFRS)	Total Segments	Transition	Group
External sales	565.0	0.0	565.0
Net sales	26.7	– 26.7	0.0
Value-added turnover	345.6	– 10.4	335.2
Segment results	33.9	– 1.3	32.6
Results from long-term financing, foreign exchange	– 6.8	0.1	– 6.7
EBT	27.1	– 1.2	25.9
Total segment assets	536.7	– 32.2	504.5
Total segment liabilities	417.1	– 56.8	360.3
Segment capital expenditures	40.3	1.6	41.9

CORPORATE SERVICES

As in prior years, all service activities, including those of *schlott gruppe AG*, are consolidated in the segment *corporate services*. Turnover and earnings trends in this area result exclusively from the internal allocation of services and overhead expenses. Therefore, we refrain from further elaboration. It is important when viewing earnings trends of the Corporation to understand that the segment *corporate services* operates today with a vastly improved cost structure. EBT of this area was improved from € -4.4 million in the previous year to € -2.9 million in the reporting year as a result of sustainable cost reductions, which contribute to our ability to compensate the effects on net income of the lower activities in the area of *direct marketing*.

BUSINESS SEGMENT PRINT

Results of the segment print

(IAS / IFRS)	2004 / 05		2003 / 04	
	€ MILLION	%	€ MILLION	%
Net external sales	457.7	170.2 %	466.3	173.3 %
Wertschöpfungsumsatz	268.9	100.0 %	269.0	100.0 %
EBIT	38.0	14.1 %	38.5	14.3 %
Short-term interest expenses	– 1.2	– 0.4 %	– 2.3	– 0.9 %
Segment result	36.8	13.7 %	36.2	13.5 %
Long-term interest expenses	– 3.6	– 1.3 %	– 4.4	– 1.6 %
Foreign exchange gains / losses	0.0	0.0 %	0.5	0.2 %
EBT	33.2	12.3 %	32.3	12.0 %
Total segment assets	360.4	—	369.1	—
Total segment liabilities	214.0	—	204.6	—
Segment capital expenditures	33.0	—	18.9	—

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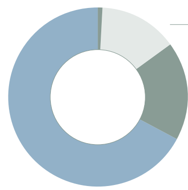
12. VALUE-ADDED TURNOVER BY SERVICE ACTIVITY IN THE BUSINESS SEGMENT PRINT 2004/05

100% = € 268.9 million



Services in the segment print

IN € MILLION (IAS/IFRS)	Value-Added Turnover 2004/05	Value-Added Turnover 2003/04	Net Sales 2004/05	Net Sales 2003/04
Preprint	3.4	3.5	4.6	4.1
Intaglio printing	179.9	182.1	353.7	363.6
Offset printing	47.5	46.9	81.3	81.8
Further processing	38.1	36.5	18.1	16.8
Total	268.9	269.0	457.7	466.3

The core competence of the *schlott group* is intaglio printing. Accordingly, the largest part of the value-added turnover during the reporting year is accounted for by activities in the business segment *print* (nearly 70 percent, as in the previous year). Furthermore, intaglio printing represents the most important contributor to earnings in the segment *print* as well as in the Corporation as a whole.

During the business year 2004/05, as in the previous year, about one percent of the value-added turnover comes from preprint activities, which had formerly been aligned with the segment digital services. Nearly 20 percent of the value-added turnover in the segment was achieved 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. Aside from the small, but highly attractive activities in sheet offset printing, we had in the past a roll offset printing site in Lübeck with so-called horizontal formats as well as a second site in Nuremberg with vertical formats, both of which serviced different customer markets.

Based on changing market trends, the synergies that exist between intaglio printing and roll offset printing with vertical formats have declined in recent years. As a result, we have disposed of the roll offset printing site in Nuremberg effective October 1, 2005. Removing this site from consolidation will result in a reduction of about € 15 million in the group's value-added turnover during the current year.

The Nuremburg subsidiary had generated losses in prior years and had reached break-even at the end of the business year 2004/05 after intensive restructuring initiatives. Consequently, there will be no effect on earnings;

however, the EBT margin in the segment will rise appreciably. The roll offset activities with horizontal formats at the Lübeck site are profitable and were, therefore, strengthened by a new machine during the past year.

Further processing accounts for about 14 percent of value-added turnover and represents the third important turnover generator in the business segment *print*. Processes that are added on to the pure printing process for customer orders are domiciled in this area. Earnings margins are traditionally modest.

During the past business year, the business segment *print* realized a value-added turnover of € 268.9 million after € 269.0 million in the previous year. Declining prices and strike-related losses were thus essentially absorbed. The segment *print* started very positively into the business year and generated in the first half EBT that were considerably above the level of the previous year, which, in turn, had risen by nearly 40 percent over the prior year. In the third quarter, however, the positive trend stopped abruptly – at the height of the collective bargaining negotiations in the months of May and June, we recorded a reduction in tonnage compared to the previous year of 18.9 percent and 12.6 percent, respectively. Thereafter, business conditions were characterized by caution. In total, this business segment achieved a slight increase in EBT from € 32.3 million to € 33.2 million in the reporting year, partly due to reduced levels of interest expenses.

It must be noted, that the results in the business segment *print* were burdened by higher levels of other operating expenses as well as the stated reduction in other operating income of the group of € 4.4 million. As a result, the reduction in personnel expenses of € 5.3 million is not reflected in EBT. In this area, however, we can evidence clearly the success of our optimization programs over the past years. This lower cost basis is sustainable and will in the future be a major contributor to our earnings power. We are committed to continuing our efforts in this area.

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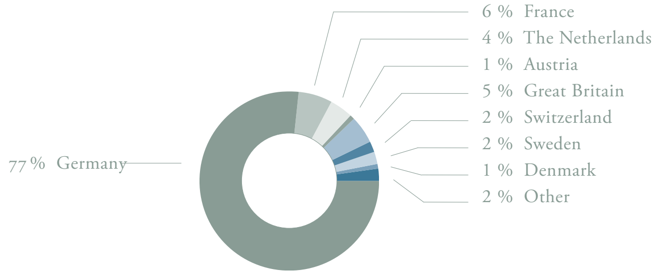
13. VALUE-ADDED TURNOVER BY DOMICILE OF CUSTOMERS 2004 / 05

100% = € 335.2 million



BUSINESS SEGMENT DIRECT MARKETING:

Results of the segment direct marketing

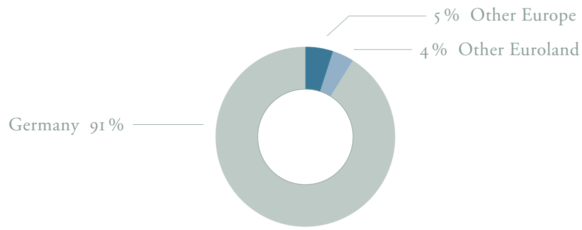
(IAS / IFRS)	2004 / 05		2003 / 04	
	€ MILLION	%	€ MILLION	%
Net external sales	107.1	167.9 %	114.4	162.5 %
Value-added turnover	63.8	100.0 %	70.4	100.0 %
EBIT	– 1.8	– 2.8 %	0.7	1.0 %
Short-term interest expenses	– 0.9	– 1.4 %	– 1.1	– 1.6 %
Segment result	– 2.7	– 4.2 %	– 0.4	– 0.6 %
Long-term interest expenses	– 0.3	– 0.5 %	– 0.2	– 0.3 %
Foreign exchange gains / losses	– 0.1	– 0.2 %	0.1	0.1 %
EBT	– 3.1	– 4.9 %	– 0.5	– 0.7 %
Total segment assets	66.5	—	66.2	—
Total segment liabilities	43.8	—	43.3	—
Segment capital expenditures	7.0	—	3.9	—

The results of the business segment *direct marketing* fell short of our expectations during the past business year. We did not reach our goal to attain sustainable profitability over the past year. We are setting ourselves the same goal for the current year. The general market environment in the area of print-supported marketing media has deteriorated considerably once again, resulting in additional pressure on achievable price levels. We have, therefore, intensified the speed at which the optimization programs are implemented and did reach a break-even result in the fourth quarter of the fiscal year.

Although the optimization program was only implemented gradually during the course of 2004/05, and thus its benefits were only accruing at about the same pace, personnel expenses were € 6.7 million lower than in the previous year. This cost reduction is permanent. The decline in the value-added turnover in the amount of € 6.6 million

14. TOTAL SEGMENT ASSETS AS PER SEPTEMBER 30, 2005, PRIOR TO CONSOLIDATION

100% = € 412.3 million



due to volume reductions and lower prices was largely compensated by the program stated above. A temporary burden for the earnings results was an increase in other operating expenses of € 3.0 million, which resulted primarily from the optimization program and will be recaptured in the course of the current year. In total, EBT in the business segment *direct marketing* deteriorated from € -0.5 million in the previous year to € -3.1 million during the past fiscal year.

SEGMENT REPORT ON THE BASIS OF SECONDARY SEGMENTS

Our marketing team services our customers on a Europe-wide basis. Our production base, however, remains largely in Germany; in intaglio 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 and the Czech Republic). Somewhat more than 90 percent of corporate assets of the group are located in Germany.

The international share of our operations is reflected in the table showing turnover by geographic domicile of customers. During the past business year, the international share of turnover amounted to € 142.1 million, representing 25.2 percent of total turnover as compared to a slightly higher 26.7 percent in the previous year. It must be noted, that these percentages refer to the total turnover of the group. Changes compared to the previous year are not only the result of business or foreign exchange trends, but also include the effects of changes in the amount of paper provided by customers.

In order to further enhance the transparency of our reporting, we are publishing for the first time in this annual report for the secondary segments the value-added turnover with the same definition as for the Corporation as a whole. Comparable data for the previous year are not available. On this basis, the *schlott group* realized during the past year a foreign turnover of 23.1 percent, of which 11.8 percent were in the Euroland and 11.3 percent in other European countries.

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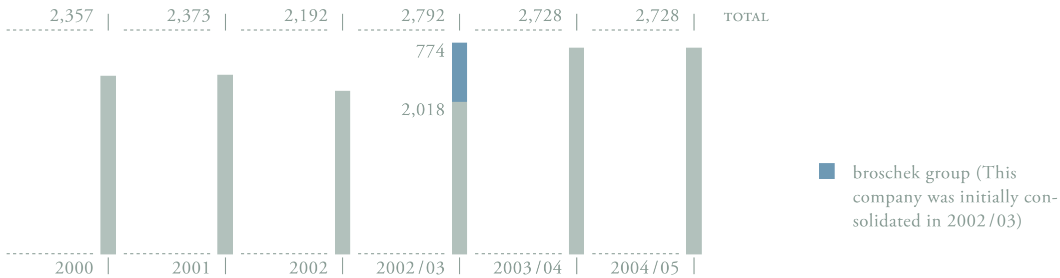
15. TRENDS IN THE STAFF COUNT IN THE SEGMENT PRINT



PERSONNEL:

Improved cost basis secures jobs

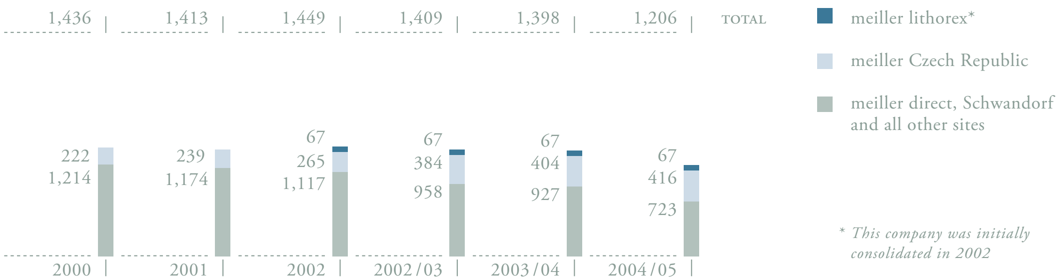
The markets for the *schlott group*'s products of both business segments are traditionally highly competitive. While the printing industry has digested the reductions in volume following the end of the New Economy Boom and has been able to stabilize the markets, the direct marketing industry is still suffering from difficult market conditions. *Direct marketing* is further burdened by budget reallocations in favor of telephone marketing at the expense of print-supported advertising. Consequently, the *schlott group* had begun at an early stage to permanently increase the efficiency of processes and to reduce its cost base in order to sustain and further enhance the earnings power of the Corporation. During the past year, we have made significant progress in both business segments and have thus improved job security within the Corporation.

Among collective wage agreements in Germany, the basic wages paid in the printing industry are the highest compared to all other industries in Germany despite the poor condition of the markets; moreover, supplemental wage costs are by far the highest as well. These conditions stem from a time when the industry was characterized by completely different technical and economic conditions. Moreover, printing products, and particularly newspapers, periodicals and advertising inserts, are time-critical products, which must be distributed into the market in a timely manner. This time element has given strength to labor in its negotiations with employers for new wage agreements.

Employers in the printing industry are working intensely on improving the cost basis in their enterprises through greater flexibility in working hours and a reduction in supplemental wage costs/benefits. A beginning has been made in this respect in June 2005, when a new collective wage agreement was adopted by both parties after lengthy negotiations accompanied by strikes. In spite of this progress, compensation for employees in the printing industry continues to occupy first place in the German manufacturing sector.

One of the important ingredients in the new agreement is the establishment of a spread for working hours ranging from 220-plus-hours to 70-minus-hours. In this way, seasonal peak utilizations will not be burdened by high levels of supplemental costs; during low seasons, costs can be reduced more effectively. Further contributors to cost reductions are the elimination of special payments for "inconvenient" starts of work and reduced break times; overtime supplements were reduced by five percent and the special payment made for urgent and necessary production of periodicals on weekends was changed from a variable payment to a fixed amount.

16. TRENDS IN THE STAFF COUNT IN THE SEGMENT DIRECT MARKETING



Costs are further lowered by a reduction in the necessary machine crew per shift in offset printing. The agreed-upon increase in wages was moderate with a one-time payment of € 340 in 2005 and an increase of one percent in wages and salaries in 2006, with a validity until the end of March 2007.

The new rules will become effective gradually over the next years. For example, over the next three years the number of days off per staff member per year will be reduced by up to six days. Consequently, the number of vacation days per staff member is falling from 36 to 30 per year. Beyond that, important rules contained in the wage agreement must be implemented in the context of employer/works council agreements. Therefore, all relevant employer/work council agreements of the *schlott group* were cancelled and are currently renegotiated.

The new collective bargaining agreement secures jobs in the *schlott group*. At the end of the current business year, two smaller printing presses will be replaced by one larger one, resulting in cost savings through the elimination of a full machine crew. The corresponding reduction in staff count is realized via several employer/works council agreements and various other measures making redundancies largely unnecessary. In the course of the decision to acquire a new press at the Freudenstadt site, employees have agreed to forgo to a significant extent supplemental payments that were formerly paid. These measures will significantly improve the cost structure at this site.

All these cost containments were instrumental in maintaining staff count in the business segment *print* at 2,728, unchanged from the previous year, after significant reductions in the previous years attributable to the construction of the new site at Nuremberg. It must be noted, however, that the segment *print* was allocated 35 employees from the former segment digital services.

In the business segment *direct marketing*, staff count was significantly reduced in the course of the business year. After 1,398 employees at the beginning of the year, the head count at the end of the year fell to 1,206. All subsidiaries in this business segment were affected with the exception of the Czech subsidiary, where 12 additional employees were hired, and meiller lithorex. The reduction in staff count reflects the implementation of the optimization program initiated in the previous year, in the course of which jobs were made redundant following the end of notice periods: these reductions are now reflected in the head count as of year-end.

However, due to the poor trends in our markets in the course of the year, we have increased once again the speed at which cost reductions needed to be achieved, allowing this business segment to return to profitability in the fourth quarter of the fiscal year. The number of redundancies was modest.

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106 staff positions were eliminated from our payroll due to the sale of our production site in Poland and on account of improving logistics activities within this business segment without the affected employees becoming unemployed. We have also benefited from natural fluctuation and have not renewed various time-limited employment contracts. Moreover, an employer/works council agreement allowed the reduction of weekly hours by five and the introduction of working-hour accounts; thus, in addition to the arithmetic reduction in staff count, personnel capacities were more optimally aligned with requirements.

— EARNINGS AND FINANCIAL POSITION OF SCHLOTT GRUPPE AG

Substantial improvement in profitability and shareholders equity

EARNINGS POSITION

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. Accounting and valuation methods employed for these financial statements remain essentially the same as in the previous year.

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 the financing needs / functions of the subsidiaries as well as for cash pooling of the group. The AG has no operating business and its revenue essentially consists of allocations to the subsidiaries. The financial statements of the AG are thus heavily influenced by the state of participations, the business development of subsidiaries and its own financing activities.

The results from ordinary business activities have improved measurably during the reporting year: net income increased from € 14.2 million in the previous year by € 10.8 million, or 76.1 percent, to € 25.0 million. The increase is mainly accounted for by higher earnings from profit-absorption agreements, which rose by € 5.0 million to € 27.0 million. This increase of 22.7 percent reflects the improvements in operating profitability achieved over the past years throughout the Corporation. Moreover, expenses incurred in connection with loss-absorption agreements declined by € 3.3 million. This decrease resulted primarily from the sale and elimination of loss-making activities in the former business segment digital services as well in *direct marketing*. In addition, interest expenses declined by € 1.0 million.

The effective tax rate of the AG has increased from 35.8 percent in the previous year to 42.4 percent in the reporting year due to the lapse of tax-free special items during the previous year as well as the recognition of taxes arising out of a tax audit. Net income for the reporting year increased by 58.2 percent from € 9.1 million in the previous year to € 14.4 million in the reporting year. The balance of retained earnings at the end of the reporting year rose from € 26.4 million in the previous year to € 28.1 million, after taking into consideration additions to other earnings reserves. This represents an increase of 6.4 percent.

schlott gruppe AG is therefore in a position to again defray the recommended distribution of € 1.00 per share (or € 6.2 million) out of the surplus generated during the fiscal year. The dividend had already been raised during the fiscal year 2003/04 by € 0.10 per share. From the perspective of the Board of Management, this renewed increase in the dividend by € 0.10 per share is justified in view of the improved net results of the AG and the fact that net total liabilities of the Corporation were considerably reduced ahead of plan.

BALANCE SHEET AND CASH FLOW

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, therefore, reflects essentially the AG's financial assets and items arising out of its financing function. Financial assets represent ownerships in subsidiaries, while current assets represent loans extended to subsidiaries.

Financing activities for subsidiaries are also visible on the liabilities side of the balance sheet. Liabilities reflect the cash positions subsidiaries maintain with the AG. The changes in this category are closely correlated with changes in the account Due to Banks. In connection with cash pooling, the AG takes on short-term debt for the benefit of subsidiaries.

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The balance sheet total of *schlott gruppe AG* has increased during the reporting year to € 298.2 million after € 286.1 million in the pervious year. This increase is primarily accounted for by an increase in shareholders equity of € 8.9 million to € 139.3 million after € 130.4 million in the previous year as a result of higher profit and lower loss absorptions from subsidiaries. As a result, the equity ratio has increased from 45.6 percent in the previous year to 46.7 percent in the reporting year. We expect that the major portion of these funds will again be placed at the disposal of subsidiaries, generating an increase in loans to affiliated companies. Furthermore, in the course of a tax audit, we have increased short-term provisions for taxes.

The cash flow statement profited from appreciably higher earnings from ordinary business activities. In addition, provisions for taxes were increased and short-term loans from financial institutions were taken on, on an interim basis, in connection with the financing of the capital expenditures related to the new press in Freudenstadt. Accordingly, as of the end of the fiscal year, these capital expenditures are not as yet reflected in the item Cash Flow for Capital Expenditures. In the course of the current business year, this short-term financing will be refinanced over a longer term.

The cash flow from financing activities is heavily influenced by cash pooling services of the AG in connection with the general financing of the Corporation. As stated above, profit absorptions from subsidiaries are recycled in form of loans to affiliated companies. Including the disbursement for dividends in the amount of € 5.6 million, the sum of disbursements totaled € 33.2 million, leaving the level of liquid resources essentially unchanged compared to the previous year.

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

— ADDITIONAL INFORMATION

MARKETING AND DISTRIBUTION

The *schlott group* specializes in printing and *direct marketing* services on the basis of high-tech industrial processes. The group is, therefore, dependent on large and very large customers, particularly in the area of intaglio printing.

Our marketing and distribution activities are thus focused primarily on the direct and individual support and maintenance of our long-standing customer relationships. We are the flexible provider of printing and *direct marketing* services. Our marketing team has detailed knowledge of both internal processes as well as market conditions and requirements. Members of the team have the competency to decide in a timely manner whether or not a special requirement of a customer can be met in terms of both technical considerations and time requirements in production processes, or what type of alternatives can be proposed and offered. As a result of this competency, we frequently create new product ideas and actual products, giving us a competitive advantage in the market place.

Aside from large customers, the *schlott group* enjoys the custom of a large number of attractive smaller clients. The goal of structuring our customer portfolio in this way is to strike a balance among client groups and allow capacities to be better utilized in off-seasons. For a capital-intensive enterprise like the *schlott group*, 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.

During the past year, we have fully reconfigured the way we present the group online utilizing state-of-the-art technology. We are placing at the disposal of our customers a user-friendly online form for requesting concrete offer quotations; this online form will be dynamically improved in the future. In addition, we have further refined the group's Corporate Design and have introduced for the business segment *print* the trademark "*schlott print*". An important vehicle to attain and retain customer loyalty is our internal customer magazine "crossmedial", which has been re-launched during the past year with concepts that are even more aligned with the interests of our business partners.

Trade fairs and conventions remain important marketing instruments. During the past year, the group attended again the Mail Order House Convention (Versandhandelskongress), including Mail Order World. The business segment *direct marketing* participated in the Mailings-Days in Nuremberg as well as Direct Marketing Ideas

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THE SCHLOTT GROUP POSITIONS ITSELF

FLEXIBLY AND CUSTOMER-DRIVEN

Exchanges in Freiburg and in Stuttgart. Also in the area of *direct marketing*, we organized in the summer of 2005 an internal trade fair and presented our new production machinery and processes. This new production set-up, which is laid out in such a way that our capabilities and service/product mix are readily apparent, was well received by our customers and prospects and has led to additional orders.

LOGISTICS AND PROCUREMENT

The optimization of internal logistical processes is one of the essential elements in our permanent efforts to improve our operational processes and to reduce costs. During the past year, we have achieved clearly visible positive results in the business segment *direct marketing*, where we have considerably increased the transparency of processes in connection with the reorganization of activities into three firms.

We have transferred additional activities to our site in the Czech Republic and have completely overhauled the plant lay-out of our Schwandorf site. The focus was on short and simple paths and lines. Dispatch and Receiving were consolidated and service units for internal tasks were established. The internal logistics tasks, which were housed in a subsidiary, were sold to a freight forwarding company.

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

Aside from logistics services, which represent a large part of total services purchased, paper and ink are the most important components of the procurement function of the *schlott group*. The purchased paper represents only a small part of the total tonnage of paper processed. If we procure paper for customer orders, 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 continually declined. During fiscal year 2004/05, the ratio was well below 30 percent.

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Composition of the Cost of Materials

IN € MILLION (IAS / IFRS)	*2004 / 05*	*2003 / 04*
Paper	125.0	128.8
Ink	41.2	41.8
Other	11.5	12.5
Services purchased	53.2	54.4
Total	230.9	237.5

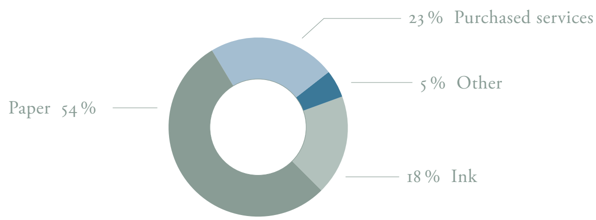
The markets for materials procured by the *schlott group* are highly concentrated. This, together with the high level of capital intensity and the concentration of customers, influences and amplifies the pressure to consolidate the European printing industry. In Europe, there are currently only seven suppliers of paper and five of ink.

By also using 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. We are shortening the distance of suppliers to our production sites and are thus in a position to purchase nearly all qualities and grades of paper specified by our customers in a timely manner. In the context of our central production planning, we are able to align customer orders with production sites even shortly before printing must commence.

General conditions in offset printing are similar to those in intaglio printing. We buy ink from four suppliers, two of which are also supplying the intaglio printing area. Paper is procured from the same suppliers mentioned above. In the area of *direct marketing*, offset printing equipment is used with the appropriate inks, while paper is provided by the same suppliers as in print. Given the differing requirements of the two business segments, the materials are independently managed, but purchased at prices and conditions applicable to the whole group. Wherever feasible, the *schlott group* uses in all areas just-in-time delivery of materials and is thus able to reduce expenses for carrying and managing inventory.

17. COST OF MATERIALS 2004 / 05

100 percent = € 230.9 million



QUALITY MANAGEMENT AND PROTECTION OF THE ENVIRONMENT

Printing products are exceedingly perishable goods and corrections of 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 *schlott group* considers itself a top-notch address for highest quality services. Quality management represents, therefore, a central ingredient in our production processes.

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 monitor and carry over as goals into future quarters. During the past year, we were successful in noticeably reducing both external and internal complaints to a level well below that of the previous year as well as significantly below defined quotas. The high standards of our quality management are documented in DIN EN ISO 9001- certified systems at nearly all of our subsidiaries.

Of particular importance is quality management in the area of "Documents" in the business segment *direct marketing*. Here, we process highly sensitive orders: on behalf of our customers we frequently assume their legal responsibilities ranging from the observation of all stipulations under privacy protection laws to the legal responsibilities in connection with the dispatch of invitations to annual general meetings on behalf of publicly traded companies in Germany and the USA.

This business area employs comprehensive security facilities from the time the data is received to the time of dispatch in order to assure the dependable production and dispatch of documents; it also allows for the reconstruction and control of all data should that become necessary. These security facilities are designed to not only process print data provided by customers, but also to process data during the lay-out and printing processes. The whole chain of data processing during the production process is captured and documented in a detailed manner; our customers can be advised at any one time of the current status of their documents production.

All documents to be produced are encoded with an identification marking prior to commencing production. These markings automatically compare the information specified by the customer with the data registered in the course of the production process (printing, folding and enveloping). The correct order of individual parts, e.g. several pages making up one document, is automatically monitored and the equipment is programmed accordingly.

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THE ABILITY TO DELIVER FIRST-CLASS QUALITY UNDER STRINGENT TIME PRESSURE, DIFFERENTIATES US FROM THE COMPETITION

To assure that 100 percent of all documents of any one order are dispatched, the finally check of the process is the registration of each finished item. The fully automated so-called "Reprint Process" guarantees that duplications are avoided and that each document is being properly dispatched.

The protection of the environment is an integral part of the group's management policy, which seeks to be balanced and sustainable. This is particularly important since we are consuming natural resources in form of paper and are thus 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 ecological specialists responsible for assuring compliance with defined environmental standards. Annual internal ecological audits monitor levels of compliance and identify additional opportunities for improvement. Additionally, our production sites have been certified for several years as per DIN EN ISO 14001 as well as the more stringent EU-directive EMAS II.

RESEARCH AND DEVELOPMENT

The *schlott group* is a service company that produces by order of its customers print-supported advertisements and marketing media. Accordingly, the company does not engage in extensive research and development activities and, therefore, has 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 such new technology and to utilize and integrate it into our production chain. In this way, we are able to offer highly customized solutions to our clients.

Our reputation is further enhanced by our internal process innovations. We have, for example, developed a process to efficiently employ postcards as response elements in intaglio printing products: we are the only company that can produce postcards inline, i.e. including the production of postcards in the intaglio printing process without loss of production speed, and making postcards an integral part of the total product without manual intervention. With such innovations, which are developed on an ongoing basis without necessitating a separate budget, we document our positioning as an innovative and customer-oriented service provider.

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CORPORATE GOVERNANCE: TIMELY SUBMISSION OF DECLARATION OF COMPLIANCE

The declaration of compliance, as required under the Code of Corporate Governance of June 2, 2005, has been issued. It can be viewed on the website of the *schlott group* (www.schlottgruppe.de) under Investor Relations / Corporate Governance, and is reproduced in this annual report in the chapter Corporate Governance on pages 41-46. In that chapter, we also elaborate on the Corporation's philosophy with respect to Corporate Governance.

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. An efficient risk management system focuses on the precise identification and classification of individual risks and on quantifying such risks, which in turn form the basis for risk mitigation and risk management.

The responsibility for risk management within *schlott gruppe AG* lies with the Board of Management. The identification and recognition of risks, the categorization, the determination of the probability-factors of such risks occurring, and the definition of counter measures to be taken, are the responsibility of the designated risk management officers of each subsidiary. Risk management officers report to the designated supervisory risk management officer at the group level. The latter reports on a quarterly basis to the Board of Management of *schlott gruppe AG*.

Individual subsidiaries determine in the course of their risk analysis, which risks are to be categorized as so-called "critical risks" requiring further analysis, and which risks are of lesser importance. This analysis is not a one-time undertaking, but an ongoing process under the responsibility of risk management officers. The categorization of identified risks is continually monitored and adjusted as necessary.

The functionality of the risk management system was examined in the course of regular reviews by internal audits, as well as in the course of the annual examination by the outside auditor, in terms of completeness, qualitative and quantitative valuations, observation and monitoring of individual risks as well as compliance with standards. During the reporting year, both parties have examined the system and have concluded that all standards and stipulations of the risk management system of the group have been fully complied with.

Excerpts of the risks captured by and recorded in the “Risk Monitor” are summarized below. General risks that have a bearing on the business activities of the *schlott group* include the economic weakness in Germany and in Europe as well as the conditions in the general mail order industry.

GENERAL ECONOMIC RISKS

During the business year 2004/05, the economic environment continued to be difficult and below expectations. For 2006, one cannot expect a significant improvement.

FINANCIAL RISKS

The monitoring and management of liquidity is done at the group level by way of cash pooling between the parent company and its subsidiaries.

Part of the funds flows within the group is in foreign currency. This applies primarily to business undertaken in Great Britain, Sweden and Norway. To prevent a possible devaluation of such foreign currency flows, the *schlott group* employs forward exchange transactions. A monthly report sets forth all of the group’s existing foreign exchange hedging transactions. No open positions are permitted. To guard against interest rate changes, interest rate swaps are employed. Other financial risks do not exist as we have access to sufficient credit lines and long-term financing.

Accounts receivable risks are essentially neutralized by insurance coverage. A group directive sets forth detailed instructions in this regard. The residual risk for the *schlott group* in case of uncollectible accounts receivable is a deductible of 15 percent of the amount insured.

CUSTOMER AND INDUSTRY RISKS

The general mail order houses have adjusted their product mix and presentations in view of changed consumer behavior and changes in the media landscape. The resultant risks for the *schlott group* are mitigated by emphasizing even more proximity to customers, flexibility in price negotiations as well as the adjustment of production levels. Long-term order agreements with our customers allow us to plan with assurance. Any residual risks in this connection are not of material importance to the *schlott group*.

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TRANSPARENCY AND RESPONSIBILITY

CHARACTERIZE THE RISK MANAGEMENT OF THE SCHLOTT GROUP

With our international positioning, we have significantly reduced the potential risks of depending on a small number of large customers in our home market. The twenty most sales-intensive customers in Germany accounted for about 59 percent of domestic turnover during 2004/05 – the twenty most sales-intensive foreign customers represent about 55 percent of foreign sales.

SKILLS, EXPERIENCE AND GROWTH RISKS

A main goal of the *schlott group* is the retention of employees. In this regard, there is an annually recurring program of awarding shares to staff members. Shares are issued by taking advantage of tax benefits; such shares are restricted for varying time periods.

Internal training programs are designed to prepare younger employees for positions in middle and senior management. One of the tasks of these programs is the improvement of communication within the group. The "Balanced Scorecard" is employed as an incentive for employees throughout the group.

PROCESS RISKS

Included in this category pertaining to processes are the areas of EDP, logistics and organizational risks. Both hardware and software are updated on an ongoing basis to the state-of-the-art security standards, assuring the security and safety of systems and data. Further steps for minimizing risks in this area include measures to assure the availability of computer systems and networks, the daily back-up of system and application data as well as the protection from external threats by means of the latest security systems, firewalls and virus protection software. A newly developed access system within the *schlott group* assigns a customized user profile to every user of our SAP system.

For all possible risks in the areas of transport, buildings, equipment, supplies as well as damage by the elements, appropriate insurance coverage exists for the minimization of losses; insurance coverage is centrally managed by the group. In the area of logistics, we are working with freight forwarders that are guaranteeing a secure and timely delivery of our products to our customers.

In sum, we cannot identify any process risks that are not adequately covered by existing mitigation and counter measures.

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LEGAL RISKS

Legal issues are handled within the *schlott group* by a central legal department. Important contracts and agreements are concluded in collaboration with in-house council for the purpose of risk minimization.

Legal disputes, litigations or claims for compensation related to taxation, competition, anti-trust or contract laws and regulations, which could have a material impact on the financial condition of the *schlott group*, are neither pending nor imminent.

TECHNOLOGY RISKS

To maintain our machinery and equipment on an up-to-date and efficient level, we have again invested in the latest available technology during the business year 2004/05. For example, we have during the course of the reporting year begun to build a new production hall at Freudenstadt for a new state-of-the-art press, which is expected to commence operations at the end of the current business year. In Lübeck, as well, we have strengthened the production site by installing latest technology equipment, which has started production already at the beginning of the business year 2005/06.

ENVIRONMENTAL RISKS

We have undertaken all necessary steps to avoid or limit to the extent possible all risks related to the environment, health and safety in connection with new and existing products and processes.

We are encouraging ecological understanding and consciousness at all levels of our staff. Furthermore, we are educating our customers and business partners about the ecological impact of our products during production, utilization and disposal. An environmental management system as per directives issued by the EU related to environmental audits, as well as documentation dealing with environmental protection, are part of the corporate policy of *schlott gruppe AG*.

— CHANGES IN THE COMPOSITION OF THE MANAGEMENT AND SUPERVISORY BOARDS

At the Annual General Meeting of *schlott gruppe AG* on March 22, 2005, the representatives of shareholders on the Supervisory Board were up for election. Mr. Nikolaus Broschek changed from membership of the Board of Management to become a Member of the Supervisory Board. In addition, employees had elected their new representatives on the Supervisory Board in the course of the year. All these changes are stated in greater detail in the report of the Supervisory Board on pages 47.

We announced on July 19, 2005, that Dr. Uwe Hack, Member of the Board of Management responsible for financial matters of *schlott gruppe AG*, had elected to seek new professional challenges. He has accepted the appointment to the Board of Management of another renowned SDAX corporation. The Supervisory Board has accepted Dr. Hack's wish to be relieved of his duties as per September 30, 2005.

Dr. Hack became a Member of the Board of Management of the *schlott group* in May 2001, having been with Deutsche Bank AG for many years. At the *schlott group*, Dr. Hack was primarily responsible for Investor Relations, Controlling and Treasury. The Board of Management and the Supervisory Board regret the departure of Dr. Hack and thank him for his contributions, his commitment to the *schlott group*, the excellent personal collaboration and wish him the best for the future.

The *schlott group* intends to continue to shape the consolidation process of the European printing industry in a pro-active manner. We expect the Corporation to continue on a growth path and to further internationalize its business. It is for these reasons, that we will fill the vacancy on the Board of the Member responsible for financial affairs. Until the position has been filled, the responsibilities of Dr. Hack will be assumed by other Board Members.

— SUPPLEMENTARY INFORMATION:

No significant events

No important events have taken place since the end of the fiscal year 2004/05 as per September 30, 2005, which would materially affect the general business conditions of the group or the AG, or, more pointedly, the earnings or general financial condition of the Corporation. The Nuremberg subsidiary for offset printing was, as stated in the segment report, excluded from consolidation effective October 1, 2005.

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TWO-YEAR PLAN:

EBT OF MORE THAN € 26 MILLION IN THE CURRENT BUSINESS YEAR AND EBT-GROWTH OF MORE THAN 10 PERCENT IN THE BUSINESS YEAR 2006/07

— OUTLOOK REPORT:

Positive development expected for the next two years

GENERAL ECONOMIC AND INDUSTRY TRENDS

Economic forecasters became more optimistic towards the end of 2005. It is the opinion of some of the leading economic research institutes that a dynamic world economy and continued growth in capital investments will fuel German growth in 2006 more than had originally been thought. The forecast for growth was therefore revised slightly upward. While the six leading economic research institutes had anticipated a growth rate of 1.2 percent shortly after the federal election, this forecast was increased to about 1.5 percent towards the end of 2005.

It is expected, that the growth will be fueled again by the export sector and by higher spending for capital goods, while the consumption sector will likely be stagnating rather than growing. Growth in consumer spending is expected to rise in real terms by a meager 0.4 percent in 2006. It is generally expected that the consumption sector in Europe will show some improvement, with Germany again lagging behind. The *schlott group's* cautious estimation with regard to growth supported by higher European consumption leading to a noticeable improvement in the demand for printing products, has thus been confirmed.

In light of the continued low levels of consumer confidence, the Association of Communication Agencies (GWA), while seeing some improvement for 2006, remains cautious. Slightly more than half of the agencies expect higher turnover, but during the two previous years the expectations had been more positive, which the Association interprets as lack of confidence. The advertising industry appears to be ready to raise spending, which according to the GWA is a positive sign.

The Association of German Newspaper Publishers expects constant prices for ads and only a limited rise in bookings during 2006. The bvdm signals a similar caution based on polls conducted. In spite of the deteriorating general economic conditions towards the end of 2005, the companies polled by the bvdm look to the first half of 2006 “less skeptically” than during the previous fall. As per the bvdm, German printing enterprises expect strong price pressure to continue.

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OUTLOOK FOR THE SCHLOTT GROUP

On the basis of only modest improvements expected in general economic and industry conditions, we have not included the effects of positive economic impulses in our planning for the next two years. The two-year plan was prepared by taking into account solely current business conditions and realizable cost reductions. The major part of the cost reduction initiatives undertaken will be realized during the fiscal year 2006/07, leading to a significant increase in earnings.

RISK FACTORS IMPACTING OUR EXPECTATIONS

The following forecast is made on the basis of a cautious evaluation of the economic environment, industry trends in prices and volumes, and developments in the cost structure of the *schlott group*. The risk of shortfalls in turnover caused by a possible loss of important customers is limited and manageable in light of our established market position and long-term customer relationships.

Personnel expenses do not pose a risk in light of the new wage agreement for the printing industry expiring only in March 2007. We are actively involved in ongoing discussions with other players in the industry in an effort to find solutions that will contribute to striking a proper balance between the interests of employers and employees. In light of the foregoing, we are convinced that material risks impacting the future earnings development of the *schlott group* are included in our forecast.

However, we are operating in a highly competitive environment and industry in which individual players may choose to gain market share and more effective capacity utilization through dumping prices. In addition, the lack of consumer spending, particularly in Germany, represents challenges to the customers of the *print* and *direct marketing* industries in general and particularly to general mail order houses, which are an important customer group for us. Price developments represent, therefore, one of the greatest risks for our industry. This risk can be influenced by individual players only to a limited degree.

BUSINESS YEAR 2005/06

For the current business year, we expect in the business segment *print* an agreeable level of orders and capacity utilization. This is already visible in the first quarter, during which we achieved a capacity utilization similar to what was realized in the previous year in spite of a reduction in the size of catalogues issued by general mail order houses.

We are profiting from additional interim advertising media, which are increasingly used by general mail order houses to induce their customers to buy. In addition, we can utilize the capacity in intaglio printing, which is no longer needed for the production of catalogues, as well as the new capacity generated by the new offset machine in Lübeck to solicit new orders based on our marketing strength and reputation.

In general, we expect in the business segment *print* to process more tonnage, which may counteract the continued price pressures in this sector and lead to an increase in value-added turnover. Margins will, however, continue to be under pressure. Earnings may be burdened temporarily due to the afore-mentioned construction at the Freudenstadt site, resulting in a disruption of and change in internal processes. These additional charges will not be fully compensated by the absence of strike costs incurred during the reporting year.

Cost reduction initiatives undertaken will only be realized to a limited extent during the current year. We expect to conclude an employer/works council agreement, implementing the provisions of the collective bargaining agreement, during the second quarter of the current year. Benefits under this agreement will, however, accrue only gradually from then until 2008. While we look forward to a significant reduction in costs, 2005/06 will only show modest benefits to this effect. In sum, we forecast on a conservative basis a reduction in earnings in the business segment *print* for the current business year.

In the business segment *direct marketing*, however, we look forward to sustain and stabilize the turnaround achieved in the fourth quarter of 2004/05, and expect that this segment will be a source of earnings growth for the group in 2005/06. While value-added turnover will grow only modestly, the cost reduction measures implemented in the previous year will affect earnings positively. Based on significantly lower personnel expenses, *direct marketing* is expected to be solidly in black figures for the entire business year 2005/06. The group's EBT will, therefore, likely exceed the € 25.9 million in the reporting year and rise to above € 26.0 million in the current year.

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The free cash flow for the current year will be below the high level of the reporting year due to capital expenditures in machinery and infrastructure in Freudenstadt. We do anticipate, however, a clearly positive cash flow of somewhat less than € 10.0 million after dividend distribution. We do live up to representations made to the capital markets: we are able to finance capital expenditures necessary in our capital-intensive industry out of own sources even under difficult market conditions, and generate net cash flow even during years of high levels of capital expenditures. We are thus in a position to continue strengthening our balance sheet and to position ourselves for further consolidation in European intaglio printing. During the course of the current year, we will again apply free cash to a further reduction in debt.

BUSINESS YEAR 2006/07

For the business year 2006/07, we forecast a marked growth in EBT by more than 10 percent. While our expectations with regard to higher levels of value-added turnover for the group will again be modest, the cost reduction measures undertaken in both business segments will yield positive results. In the segment *print*, benefits will accrue for the entire year through the implementation of the collective bargaining agreement as well as through the replacement of two smaller intaglio printing presses in Freudenstadt by the new and larger press. The latter will lead to cost savings in the area of € 1.5 to € 2.0 million.

In the business segment *direct marketing*, we are counting on a noticeable improvement in margins. In the second year following the turnaround, all processes will be fully tested and operational, leading to further cost reductions.

Positive earnings trends and the completion of the capital expenditure project in Freudenstadt at the end of the business year 2005 / 06, will again generate a noticeably higher level of free cash flow after dividends. We expect free cash flow to double compared to the previous year, resulting in a corresponding strengthening of the balance sheet.

FURTHER INFORMATION REGARDING THE FORECAST

During the current year, the *schlott group* will continue to develop organically its services and to strengthen its market position. No material changes are planned in the area of production. Neither the organizational nor the legal structures of the *schlott group* are from today's perspective in need of major revisions. Basic research and development will again not be undertaken. Our policy on dividends is stated in greater detail in the chapter "The Share" on page 35.

FREUDENSTADT, DECEMBER 16, 2005

BERND ROSE WERNER REISER ADAM VALERI