MANAGEMENT REPORT

CONSOLIDATED MANAGEMENT REPORT OF THE SCHLOTT GROUP AND THE AG FOR THE FISCAL YEAR 2005 / 06 AS PER SEPTEMBER 30, 2006

— 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 as well as publishers. The core competence is in the area of intaglio printing – the printing process for high-volume editions of qualitatively first class printing products as well as for the further processing of printing products. The catalogue of services is supplemented by activities in the area of offset printing as well as in *direct marketing.* The sum of products and services of the *schlott group* reflects to a large extent the demands and requirements of major European customers.

During fiscal year 2005/06, the *schlott group* employed 4,062 persons. For the benefit of our customers, we are represented with distribution and service sites throughout Europe. Our productions sites during the reporting year were domiciled primarily in Germany.

In the business segment print, and more specifically in intaglio printing, we are one of two companies with production facilities in both northern and southern Germany. Our sites in the North near Hamburg as well as in the Southeast near Nuremberg enable us to offer comprehensive services to publishers that for reasons of timeliness require periodicals in both Northern and Southern editions.

At the same time, the afore-mentioned sites as well as the sites in the Southwest in Landau and Freudenstadt, the latter specializing in advertising materials, allow us to service the important adjacent markets in Central Europe. Mail order catalogues are printed at all sites. In addition, we are represented in the Northeast of France in Hambach for further processing of printing products.

Starting with the reporting year, the newly acquired *reus group* in Plzen, Czech Republic, provides us with a further processing site near the German border enabling us to produce with a very attractive cost structure. Northern and Western Europe will be covered even more effectively by the intaglio printing site in Maarsen, south of Amsterdam, The Netherlands, which we have obtained at the end of the reporting year in connection with the acquisition of *biegelaar B.V.*

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 production site in Sweden has been closed down at the end of the business year as already advised during the year; existing technical plant and machinery has been transferred to Schwandorf. Our Scandinavian customers continue to be serviced by our existing local marketing and distribution teams.

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The following tables show key financial data of the schlott group for the past three years:

PROFIT AND LOSS ACCOUNT	2005/06		2004/05		2003/04	
	€ MIL.	IN %	€ MIL.	IN %	€ MIL.	IN %
print	240.2	79.5	268.9	80.2	269.0	78.9
direct marketing	59.6	19.7	63.8	19.0	70.4	20.7
corporate services / Holding	10.8	3.6	12.8	3.8	12.4	3.6
Consolidation	–8.6	–2.8	–10.3	–3.0	–10.9	–3.2
Value-added turnover	302.0	100.0	335.2	100.0	340.9	100.0
Other operating income	13.1	4.3	14.5	4.3	19.9	5.8
Personnel expenses	–174.2	–57.7	–190.4	–56.8	–202.4	–59.4
Other operating expenses	–79.3	–26.3	–87.7	–26.2	–85.9	–25.2
EBITDA	61.6	20.4	71.6	21.4	72.5	21.3
Scheduled depreciation	–29.6	–9.8	–35.1	–10.5	–35.0	–10.3
EBIT	32.0	10.6	36.5	10.9	37.5	11.0
Financial results	–10.0	–3.3	–10.6	–3.2	–11.9	–3.5
EBT	22.0	7.3	25.9	7.7	25.6	7.5
Taxes	–10.2	–3.4	–10.1	–3.0	–10.0	–2.9
Net income	11.8	3.9	15.8	4.7	15.6	4.6
– of which related to shareholders of the group	11.8	3.9	15.8	4.7	15.6	4.6
– of which related to minority interest	0.0	0.0	0.0	0.0	0.0	0.0

FIGURES PER SHARE	2005/06	2004/05	2003/04
Shares outstanding	6,204,200	6,204,200	6,190,020
Net income per share (in €)	1.91	2.55	2.51
Dividend per share (in €)	1.00*	1.00	0.90
Share price; XETRA, September 30. (in €)	24.68	29.35	20.30

** Recommendation*

BALANCE SHEET AND CASH FLOW	2005/06		2004/05		2003/04	
	€ MIL.	IN %	€ MIL.	IN %	€ MIL.	IN %
Total long-term assets	443.8	83.3	418.7	83.0	413.7	79.2
Liquid assets	2.9	0.5	1.8	0.4	1.8	0.3
Total short-term assets	89.2	16.7	85.8	17.0	108.8	20.8
Shareholders equity	153.5	28.8	144.9	28.7	135.5	25.9
Due to banks	194.0	36.4	179.3	35.5	197.4	37.8
Total liabilities	379.5	71.2	359.6	71.3	387.0	74.1
Balance sheet total	533.0	100.0	504.5	100.0	522.5	100.0
Cash flow from ordinary business activities	50.0	—	71.0	—	54.1	—
Cash flow for capital expenditures	–50.2	—	–32.2	—	–14.0	—
Cash flow for acquisitions	6.6	—	–0.1	—	0.0	—
Cash flow for dividends	–6.2	—	–5.6	—	–5.0	—
Cash flow from financing activities	1.0	—	–33.2	—	–36.1	—
Cash flow for the period	1.2	—	–0.1	—	–1.0	—

KEY FIGURES	2005/06	2004/05	2003/04
EBT / ROE (in %)	14.8	18.5	19.6
EBIT / ROCE (in %)	6.8	7.8	7.7
Free cash flow	–6.4	33.2	35.1
Free cash flow as % of value-added turnover	–2.1	9.9	10.3
Net liabilities	191.1	177.5	195.6
Net liabilities/EBITDA	3.1	2.5	2.7

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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VALUE-ADDED STATEMENT FOR THE FISCAL YEAR 2005/06

in € million

ORIGIN	
Total revenue (including interest income and income from participations)	527.0
Cost of materials	–212.2
Other operating expenses (excluding non-deductible taxes)	–78.1
Gross value-added	236.7
Depreciation expenses	–29.7
Net value-added	207.0

APPLICATION		Share
Personnel expenses	174.2	84.2 %
Public domain (income and other taxes)	11.4	5.5 %
Creditors	9.6	4.6 %
Shareholders*	6.2	3.0 %
Group	5.6	2.7 %
Net value-added	207.0	100.0 %

** Recommendation to the Annual General*

— CORPORATE STRATEGY:

To define leadership in European intaglio printing

OUR STRATEGIC GOALS

I. Customers and products:

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

II. Market positioning:

We support our customers with their requirements on a Europe-wide basis. The printing industry does currently offer little opportunity for organic growth. Therefore, we look to acquisitions to further enhance our position in European intaglio printing and to accelerate the consolidation process in the industry. Today, as the second largest player, we belong to the market leaders in Europe.

III. Providers of capital:

Intaglio printing is traditionally characterized by high levels of capital investment. To secure our competitiveness and to uphold the interests of our shareholders, we consider the efficiency of capital employed as the central strategic and operational goal. Our margins are above the average of the industry. Our strategic goal is to sustain these margins during difficult economic conditions and to enhance these margins during positive market conditions.

HOW WE INTEND TO ACHIEVE OUR GOALS

Flexibility and quality

In this current difficult economic environment, our customers are even more preoccupied with the prices of services purchased. We are dealing with the resultant lower market prices by emphasizing our reputation for quality and by providing consistently above-average services. Customers, which are demanding dependable top performance, find the appropriate partner in us. We are offering processing assurances through quality and timely delivery in concert with maximum flexibility and short reaction times. We are squarely focused on providing our customers with quality of service that cannot be surpassed by anyone in the industry. We are in a position to be a leader as we enjoy highest efficiencies in our internal processes. Thus, we create customer satisfaction through the efficient utilization of resources employed. Leadership in cost efficiencies is an ongoing concern.

Management of growth through acquisitions

The European intaglio printing industry with its nearly 30 companies is still relatively decentralized despite the high levels of capital investment required. The pressure to consolidate is currently rising due to the high levels of capital employed and in as much as procurement and sales markets have already consolidated and are further consolidating.

We anticipate that the three largest European intaglio printing entities will increase their market share from today's 45 percent to more than 60 percent over the next three years. The European market will undergo a similar development as the one in North America: there, three large providers cover the entire market. However, the European consolidation will not advance as much as the North American one since the European market does not represent a uniform domestic market, but is formed out of diverse partial markets. The consolidation will affect positively the providers of printing services in Europe.

The *schlott group* has pressed ahead with the consolidation process. Already ten years ago, we have formulated a long-term acquisition strategy. We intent to increase our market share through acquisitions since a strategy banking on organic growth can not be implemented successfully in the price transparent intaglio printing industry. In addition, printing companies can realize economies of scale through specialization above the level of critical mass and thus achieve above-average rates of return. Since 1995, we have increased out value-added turnover through acquisitions from € 38 million to € 302 million, representing an average increase of 21 percent per year.

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THE SCHLOTT GROUP
HAS EXCELLENT

KNOW-HOW

IN THE MANAGEMENT

OF ACQUIRED GROWTH

The *schlott group* has gained an excellent know-how in the management of acquired growth and volume in our core competence intaglio printing. We have proved several times our ability to successfully integrate acquisitions. An important ingredient for success in our acquisition policy is the careful selection of target companies. Turn-around candidates do not rank prominently – the selection is made entirely on the basis of strategic fit. The integration of acquired companies was achieved on a timely basis and without difficulties.

For financing acquisitions, the share of *the schlott group* 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 clearly formulated internal financial criteria to be applied to new acquisitions.

In this connection, the high level of internal financial resources of the *schlott group* play a central role. 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 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 goal. As the lower boundary of an optimal capital structure we consider a factor of two. In the past, we have always achieved these plan targets.

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— CORPORATE COORDINATION:

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, at various sites different activities are coordinated by separate subsidiaries (see "Legal Structure" on page 49). 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 of the individual links in the value-added chain. To prevent various sites from competing against one another in the market, all sites are being operated as cost centers to assure high levels of efficiency.

Subsidiaries are managed tightly. For example, intaglio printing sites are not operating as profit centers but as cost centers, i.e. they receive printing orders from the central order office, which coordinates centralized marketing activities as well as all market orders. Consequently, individual sites are not competing against one another, which facilitates the sharing of know-how among sites. Internal benchmarks promote competition leading to highest levels of efficiency in production.

With this constellation, we are able to realize a variety of measurable synergies: included in these are product-technical specialization of the sites and the assignment of most appropriate orders to the various sites. As a consequence of the specialization, the structural need for capital expenditures within the *group* is reduced. The central coordination of orders provides for the balanced utilization of capacities, leading to reduced idle times of machinery and a reduction in high-cost overtime shifts. The cost center organization also reduces management risks within the Corporation. For this purpose, Members of the Board of Management are represented in the management of the larger subsidiaries.

The structuring of activities at the *direct marketing* site at Schwandorf along the value-added chain into separate GmbHs has materially contributed to the positive development of this site: through this increased transparency, costs can be more accurately analyzed and reduced, and the coordination of order-execution between Schwandorf and the site in the Czech Republic can be further refined. In the meantime, the personnel-intensive business has been largely transferred to the Czech Republic, while the German site executes orders requiring high levels of process automation as well as orders involving privacy-sensitive document printing orders.

— SUMMARY OF FISCAL YEAR 2005 / 06

General market trends burden the schlott group

The past business year was more difficult for the *schlott group* than anticipated. Both business segments failed to meet expectations for a variety of reasons. The market environment is expected to be difficult in the future; in spite of this expectation, we are looking to the future with self-assurance: quality, service capability and efficiency are our strengths. We are convinced that the *schlott group* will gain strength out of the current difficult market trends and out of the expected market consolidation.

The lower than expected results for the business year 2005/06 resulted essentially from a significantly more difficult environment. In the segment *print,* the traditional price pressure in our industry has again increased materially in the course of the year. In the months of weak utilization of capacity, from the beginning of January to the beginning of May, the printing industry was confronted with customers demanding aggressive price concessions. Some customers have found providers that accepted significant price discounts in order to utilize short-term excess capacity. Moreover, orders were reallocated in the course of the year so that the months with traditionally low levels of utilization were even more difficult than usual.

All this had led to high short-term price reductions, which could not be compensated by corresponding cost reduction measures. Additionally, the lower price levels also influenced negatively the levels in the months with seasonally better capacity utilization. In terms of volume, however, the results were more agreeable: the *schlott group* processed the same volume of paper as in the previous year.

During the course of the past year, we have initiated a number of measures for the continued improvement of our processes and for the reduction of our cost basis. These measures will in the course of the fiscal year 2006/07 positively effect earnings results. In the current market environment, the measures undertaken will strengthen the competitiveness of the *schlott group* without adequately contributing to growth in net income. With our facility to implement permanent improvements in efficiency we are in a better position than most providers in the industry and we will continue to seek ways in further reducing our costs. Our goal is to become the industry leader in cost effectiveness. For that reason, we are convinced that the *schlott group* will in the medium-term be able to gain strength out of this current difficult market phase.

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In the segment *direct marketing,* we have gained significant strength: our two sites at Schwandorf and the Czech Republic have during the past year reached breakeven results and thus achieved a positive turn-around. Our Scandinavian activities, however, experienced significant problems in a rapidly changing market environment, in which demand shifted to products for which our local production basis was not well suited.

We have, therefore, decided in the course of the business year to close the Scandinavian production site and to execute future orders for the Scandinavian market in Schwandorf. The operating losses of the Scandinavian site, coupled with the provisions established in the course of the business year for closing this site, have lead to a significant loss in the business segment *direct marketing.*

— BUSINESS AND GENERAL CONDITIONS

ECONOMIC TRENDS

The global economy continued to grow during 2006: the International Monetary Fund expects solid real growth of 5.1 percent, driven by the double-figure growth engine of China. In the industrial countries, the real gross domestic product (GDP) rose according to leading economic research institutes by about 2.9 percent in 2006, compared to 4.3 percent in the previous year. The relative weights have shifted: while the growth rate moderated in the United States, the European economies grew in terms of both breadth and strength.

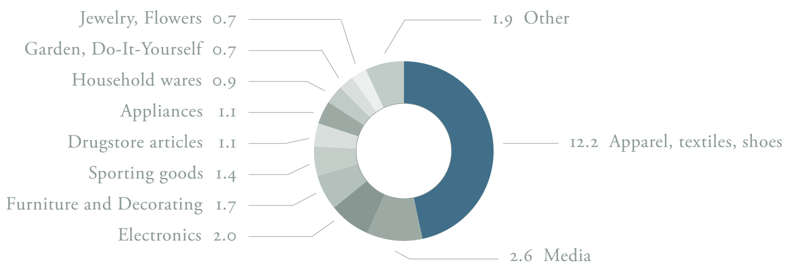
Economic growth in the USA declined from 3.6 percent in 2005 to 3.3 percent in 2006 due to interest rate rises by the Federal Reserve Bank and a marked slowdown in real estate. Europe, on the other hand, experienced appreciably higher levels of economic activity. The European Commission expects the Euro-Zone GDP to increase by 2.6 percent in 2006 after only 1.4 percent in the previous year. In as much as Great Britain and the other members of the European Union also registered robust economic growth, the real growth in GDP of the 25 EU countries is expected to average 2.8 percent after 1.7 percent in the previous year.

The German economy has grown significantly faster than initially expected by most market observers. Growth registered 2.4 percent after only 1.0 percent in the previous year due not only to the continuing high levels of demand from abroad, as in the previous year, but also for the first time in many years due to a measurable increase

STRUCTURE OF THE GERMAN MAIL ORDER INDUSTRY

(Source: TNS-Infratest / Federal Association of the German Mail Order Industry)

Turnover per annum in € billion



in domestic demand. Both capital investment and private consumption contributed to the results. However, in view of the January 2007 increases in value-added tax (VAT) and insurance tax, private consumption toward the end of 2006 increased in anticipation of the higher VAT in 2007. The surprisingly strong economic activity has also influenced the labor market, resulting in an increase in full-time employment for the first time in many years.

FACTORS INFLUENCING TRENDS IN THE PRINTING INDUSTRY

The state of the printing industry, and therefore also our core competence in intaglio printing, is closely correlated with 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. About 60 percent of the turnover in printing products are accounted for by the production of advertising materials. The domestic weakness in consumption expenditures of the past years has been an important reason for the very unsatisfactory development in our industry.

This period of weakness over many years has affected negatively the earnings results of important customer segments of the printing industry. This applies particularly to the universal mail order houses. As a result, these customer groups have reduced their marketing budgets, which in turn led to order reductions and earnings problems in the printing industry.

Weak consumer demand coupled with significant changes in the media environment over the past years have caused important customer groups to reexamine their marketing strategies and to test new paths and time intervals of advertising initiatives. This led to lower budgets for printing products and made the planning of capacity utilization in the printing industry more complex.

As a result, 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; in the following years this turnaround did, however, not mature into a sustainable positive trend.

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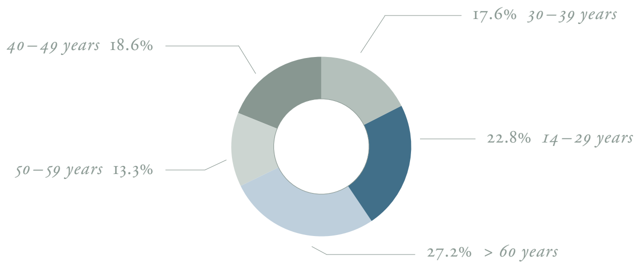
STRUCTURE OF THE GERMAN MAIL ORDER INDUSTRY

Customer segments in terms of age (%)

(Source: TNS-Infratest / Federal Association of the German Mail Order Industry)



As a result of these changes over the past years, both consumers and providers of printing products and services experience pressure on margins. Consequently, customers negotiate more price-sensitively and providers solicit more aggressively orders so that available capacity can be utilized. All this leads to an enormous price pressure in the market.

There are, however, good reasons to believe that over the short and medium term conditions might improve. Experts agree that printed advertising media in form of catalogues and inserts will continue to be the most effective advertising vehicles, while the Internet will essentially function as an order medium. Formerly pure Internet companies have recognized this trend and are increasingly reverting to printed advertising.

A current study solidifies the importance of the mail order industry in Germany. The market volume of € 26.3 billion is significantly higher than hitherto estimated. 46 percent of this volume are related to apparel, textiles and shoes, i.e. products where absolute color representation in the advertising medium is pivotal for sales success. This can only be accomplished by printed products.

The age group 14 – 29 years represents the second largest customer group accounting for 22.8 percent of total turnover, while the group of age 60 and over accounts for 27.2 percent. This illustrates that the mail order industry is an attractive purchase channel for customers of all age groups. Positive impulses will also be generated through higher levels of differentiation and specialization within the industry. While the universal mail order houses have to deal with sales problems, the special houses have enjoyed average rates of growth of over three percent per annum since the beginning of the nineties and are accounting for about one half of the total German mail order business, according to the Federal Association of the German Mail Order Industry.

STRUCTURE OF THE EUROPEAN INTAGLIO PRINTING INDUSTRY

Germany is the European country with the deepest tradition in intaglio printing. Economic strength and number of consumers have paved the way for high volume editions and customers required a printing process for high quality products. Moreover, the universal mail order houses with their catalogues have traditionally been an important customer group. The mail order business has greater importance in Germany than in other European countries because it has high population density also outside of its metropolitan areas. As a consequence, an important part of European intaglio printing capacity is accounted for by German companies; they offer by far the highest percentage of European capacity. Following the acquisition of *biegelaar B.V.*, the *schlott group* has clearly established itself as number two in Europe.

Intaglio printing is the most economical printing process for high volume printing. It also offers better quality and higher flexibility for high volume editions, particularly when it is important to bring time-critical products to the market. Moreover, intaglio printing allows for more variability as to formats. The latter has recently assumed more importance in relation to periodicals with smaller dimensions. The schlott group employs machinery with medium width and high flexibility and variability. Very wide machinery provides these benefits only to a limited extent.

TRENDS IN THE PRINTING INDUSTRY 2006

According to the media and advertising research institute Nielsen Media Research, gross advertising expenditures in the classical media of newspapers, magazines and periodicals, television and radio increased by 5.1 percent to € 14 billion in the first nine months of 2006 in comparison to the same time period of the previous year. For the first time since the boom years of the turn of the century, the rate of growth in advertising expenditures ranges clearly above the general level of economic growth.

The largest portion of total expenditures is accounted for by the television industry (€ 5.6 billion), followed by newspapers (€ 3.8 billion) and by periodicals (€ 2.9 billion). The latter registered a growth of 8.7 percent and trade publications even grew by 9.2 percent. For the printing industry, the amount of advertising expenditures is not the only important parameter, but also the volume, i.e. the number of advertising pages in any given magazine. Therefore, gross advertising expenditures, which also mirror price trends, represent only to a limited extent general conditions in the printing industry. The print volume of periodicals seems to have been constant in 2006, influenced by a starkly reduced number of new editions during 2006 and the ever shorter life cycles of such periodicals.

The Federal Association Print and Media (bvdm) reported toward year-end 2006 that business conditions in the printing industry have worsened after conditions had been stagnant over the entire year. Prices for print services have declined further during 2006 and the earnings situation of companies has correspondingly deteriorated. The bvdm calls for further cost reductions within the industry.

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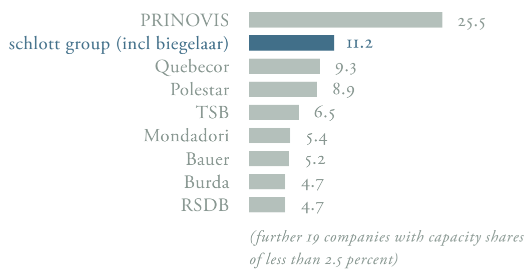
OUR GOAL IS TO CLAIM MARKET LEADERSHIP IN COST EFFECTIVENESS

SCHLOTT GROUP AS NUMER TWO IN EUROPEAN INTAGLIO PRINTING

Capacity share of companies in the European intaglio printing industry (based on total arithmetic standard capacity in %)

(Source: European Rotogravure Association / schlott group)



DIRECT MARKETING

The terms direct marketing or dialogue communication subsume a very broad spectrum of applications and utilizations. 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 has a solid base within the entire economy and is being utilized by more than three fourths of all businesses. Generally, several direct marketing instruments are employed as a package. 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 available advertising budgets; the medium Internet has intensified the competitive pressure again over the past years.

— FINANCIAL DEVELOPMENTS:

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. Value-added turnover creates additional transparencies as it mirrors operating trends on the one hand and publicly available financial data on the other. In addition, the congruency of communication is assured as value-added turnover follows closely the parameters applied to internal coordination and administration.

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Derivation of "Value-added turnover"

in € million (ias / ifrs)	***2005/06***	***2004/05***
Net sales	517.6	565.0
Changes in inventory	– 3.4	1.1
Other capitalized internal services	0.0	0.0
Cost of materials	– 148.3	– 177.7
Cost of purchased services	– 63.9	– 53.2
Value-added turnover	302.0	335.2

Total tonnage

in tons (000)	***2005/06***	***in %***	***2004/05***	***in %***
Paper provided by customers	434.1	79.9	427.7	73.2
Paper procured	109.1	20.1	156.6	26.8
Total tonnage	543.2	100.0	584.3	100.0

An important factor influencing turnover is the extent to which paper is being provided by our customers, i.e. customers procure and place at our disposal paper for their printing orders. Paper procured by us for customer orders impacts the stated turnover as it is included in the cost of materials, while paper provided by customers is not reflected in our financial statements.

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 2005/06, the level of paper provided has risen again: it increased by 5.0 percent to 79.9 percent, adjusted for the sale of the offset subsidiary *heckel* at the beginning of the business year 2005/06. Three years ago, that figure was below 65 percent. The increase in the level of paper provided during the reporting year equates to 27,000 tons.

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 tonnage of paper processed in intaglio and offset printing remained for the reporting year with 543.2 thousand tons minimally below the comparable level of 544.0 thousand tons in the previous year. The value-added turnover in the business segment *print* fell from € 253.0 million in the previous year to € 240.2 million in the reporting year as the result of lower prices achieved. In the business segment *direct marketing,* paper provided by customers plays an unimportant role.

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EARNINGS SITUATION

For the year 2005/06, value-added turnover of the *schlott group* fell short of the level of the previous year. Cost reductions mitigated the effects on earnings before taxes. In general, the *schlott group* continues to operate on a profitability level far above the industry average.

Key financial data of the profit and loss statement

IN € MILLION (IAS / IFRS)	*2005/06*	*in %*	*2004/05*	*in %*
Net sales	517.6	171.4 %	565.0	168.6 %
Value-added turnover	302.0	100.0 %	335.2	100.0 %
EBITDA	61.6	20.4 %	71.6	21.4 %
EBIT	32.0	10.6 %	36.5	10.9 %
EBT	22.0	7.3 %	25.9	7.7 %
Net income	11.8	3.9 %	15.8	4.7 %
Earnings per share (€)	1.91		2.55	

To present operating developments with transparency, we will comment in detail on the influences of additions to as well as exits from consolidation and changes in accounting principals and standards.

Heckel GmbH, which was sold on October 1, 2005, was removed from consolidation at the beginning of the reporting year. This company had net sales of € 30.4 million in fiscal year 2004/05 as well as a value-added turnover of € 15.9 million. As the company operated around break-even levels, EBT was not materially affected.

On May 1, 2006, the new subsidiary *reus* was initially consolidated. This company achieved during the reporting year for the time frame of consolidation sales of € 4.4 million and a value-added turnover of € 2.8 million; due to general and planned integration costs a break-even result was generated.

Moreover, during the reporting year we have reviewed the useful lives of fixed assets in conformity with IAS 16 and have lengthened the depreciation periods. A positive earnings effect of € 4.5 million resulted from these adjustments, which will be repeated and sustained in future years. On the other side, non-recurring negative earnings effects in the amount of € 2.6 million resulted from the closure of the Scandinavian *direct marketing* production. On a net basis earnings before taxes for 2005/06, compared to the previous year, were positively influenced to the tune of € 2.0 million.

For the reporting year, the *schlott group* generated a value-added turnover of € 302.0 million; without *reus* the value-added turnover was € 299.2 million. The comparable value of the previous year, adjusted for heckel, amounted to € 319.3 million.

Earnings before taxes amounted to 22.0 million after 25.9 million in the previous year. In addition to the market related effects on value-added turnover, a reduction in other operating income of € 1.4 million to € 13.1 million needed to be digested. This trend will continue in the future. A positive event was the slightly improved result from financing activities of € 10.0 million after € 10.6 in the previous year. This improvement is essentially accounted for by interest expenses lower than in the previous year, as we were able to streamline the structure of liabilities.

After deduction of increased income taxes (€ 10.2 million, or 46.4 percent of EBT, compared to € 10.1 million, or 39 percent in the previous year), caused by the non-deductible losses in Scandinavia, *group* profit amounts to € 11.8 million for the reporting year, compared to € 15.8 million in the previous year.

Earnings per dividend-eligible share amount to € 1.91 after € 2.55 in the previous year, with the total number of shares outstanding remaining unchanged at 6,204,200. The diluted and undiluted weighted average number of shares amounted to 6,204,200, after 6,191,202 diluted and 6,190,020 undiluted, in the previous year. The diluted and undiluted earnings per share amounted for the reporting year to € 1.91, as compared to € 2.56 in the previous year. Taking into consideration a normalized tax rate without the special effects of Sweden, the diluted and undiluted earnings per share would be € 2.22.

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FINANCIAL POSITION

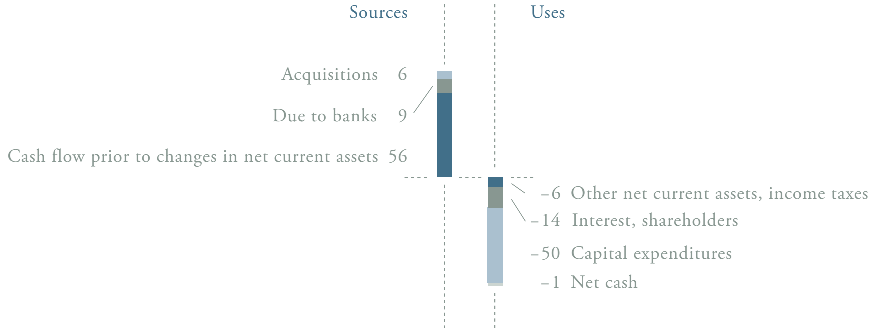
The *schlott group* continues to enjoy a solid balance sheet with sufficient levels of equity. For the reporting year, the free cash flow was impacted by the weaker than expected income results as well as the unusually high levels of capital expenditures at the Freudenstadt site.

Key balance sheet figures

IN € MILLION (IAS/IFRS)	*9-30-2006*	%	*9-30-2005*	%
Long-term assets	443.8	83.3 %	418.7	83.0 %
Goodwill	89.6	16.8 %	87.8	17.4 %
Property, plant and equipment	342.4	64.2 %	320.2	63.5 %
Investment properties	7.6	1.4 %	8.0	1.6 %
Short-term assets	89.2	16.7 %	85.8	17.0 %
Inventory	21.4	4.0 %	24.8	4.9 %
Accounts receivable	57.7	10.8 %	49.9	9.9 %
Cash and cash equivalents	2.9	0.5 %	1.8	0.4 %
Total assets	533.0	100.0 %	504.5	100.0 %
Shareholders equity	153.5	28.8 %	144.9	28.7 %
Long-term debt	181.7	34.1 %	172.3	34.2 %
Provisions	30.0	5.6 %	30.6	6.1 %
Due to banks	115.3	21.6 %	107.4	21.3 %
Deferred taxes	32.5	6.1 %	31.1	6.2 %
Short-term liabilities	197.8	37.1 %	187.3	37.1 %
Due to banks	78.7	14.8 %	71.9	14.3 %
Accounts payable	45.1	8.5 %	43.0	8.5 %
Total liabilities	533.0	100.0 %	504.5	100.0 %

CASH FLOW 2005/06

in € million



Key figures of cash flow

IN € MILLION (IAS/IFRS)	2005/06	2004/05
Results from ordinary business activities	31.4	36.3
Cash flow prior to changes in net current assets	56.3	68.4
Cash flow from ordinary business activities	50.0	71.0
Cash flow for capital expenditures prior to acquisitions	–50.2	–32.2
Cash flow for dividends	–6.2	–5.6
Free cash flow	–6.4	33.2
Cash flow for acquisitions	6.6	–0.1
Cash flow from financing activities	1.0	–33.2
Cash flow for the period	1.2	–0.1

The changes in the balance sheet as of year-end 2005/06, compared to the previous year, reflect the initial consolidation of *reus* as well as the exit from consolidation of heckel; therefore, these changes do not mirror the operating activities of the reporting year. In line with the foregoing, the cash flow positions of the business year 2005/06 do not relate in a transparent fashion the balance sheet figures as of September 30, 2005, to the balance sheet figures as of September 30, 2006. We are commenting in detail on the structure of the balance sheet as of year end 2005/06 and present the changes on the basis of cash flow data, which make the true operating trends more transparent.

The *schlott group* continues to enjoy a solid equity base. The equity ratio at the end of the reporting year was 28.8 percent as compared to 28.7 percent in the previous year. Total footings have increased from € 504.5 million in the previous year to € 533.0 million during the reporting year. This increase is essentially attributable to the high level of capital expenditures at our site in Freudenstadt.

Property, plant and equipment amounted at year-end to € 342.4 million, or 64.2 percent of total footings. Intangible assets totaled € 92.3 million, or 17.3 percent, while total long-term assets were € 443.8 million, or 83.3 percent of total footings.

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In the area of short-term assets, inventory was slightly reduced. On the other hand, accounts receivable increased. Total short-term assets amounted to € 89.2 million, or 16.7 percent of total footings.

The structure of the liabilities side of the balance sheet has not changed materially. The increase in total footings was financed by a corresponding increase in equity out of net income for the year with the result that the equity ratio remained essentially unchanged compared to the previous year. Liabilities to financial institutions amounted to € 194.0 million, or 36.4 percent of total footings, compared to € 179.3 million, or 35.5 percent, in the previous year. 40 percent of all liabilities are financed on a short-term basis, while 60 percent represent long-term liabilities; even short-term liabilities are hedged by appropriate caps.

A significant change on the liabilities side is an increase in other short-term liabilities to € 27.0 million. Included in this position is the yet to be defrayed installment of € 10,0 million for the purchase of *reus.*

The cash flow prior to changes in net current assets declined to € 56.3 million in the current year and was significantly below the € 68.4 million generated in the previous year. The adjusted depreciation rates on property, plant and equipment are reflected in this cash flow result, as is the lower than expected earnings result.

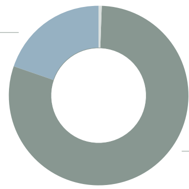
After a solid reduction over the past years of funds tied up in current assets, this position registered an increase during the current year as anticipated. Moreover, payments for income taxes rose as well. As a result, the cash flow from ordinary business activities for the business year 2005/06 amounted to € 50.0 million compared to € 71.0 million in the previous year.

This reduction, in combination with the unusually high level of capital expenditures in Freudenstadt, led to a negative cash flow for the reporting year. During 2005/06, we expended € 50.2 million for capital expenditures following € 32.2 million in the previous year. The major portion of capital expenditures is related to our Freudenstadt site. These capital expenditures exceeded the funds that would have been required for a routine replacement of an intaglio printing line because the new line has a different format and physical dimensions requiring a new production hall complete with preprint stage and the necessary other infrastructure.

The free cash flow for the business year 2005/06 under consideration of the applied definition, i.e. cash flow after distribution of dividends of € 6.2 million and prior to acquisitions, amounts to € -6.4 million after € 33.2 million in the previous year. In the area of acquisitions, the *schlott group* achieved a net cash flow of € 6.6 million during the reporting year. This amount resulted primarily from funds received for the disposal of heckel, the funds expended for the purchase of *reus,* as well as from the disposal of some activities of *reus* following the acquisition of

VALUE-ADDED TURNOVER BY SEGMENTS 2005/06

100 percent = € 302.0 million



the *reus* group. It must be noted, however, that the yet to be paid purchase price installment for *reus* in the amount of about € 10.0 million is not included. This sum was dispensed in the first quarter of the business year 2006/07.

Cash flow resulting from assumption of new financial liabilities as well as repayment of existing liabilities and payment of interest totaled € 1.0 million for the reporting year; consequently the net change in cash was € 1.2 million after € -0.1 million in the previous year.

— SEGMENT REPORTING:

Unsatisfactory earnings trends

The structure and format of segment reporting remains unchanged from the previous year. We continue to structure our activities into the three business segments *print, direct marketing* and *corporate services / Holding.* In conformity with IAS/IFRS, we continue to display as secondary segments turnover, net assets and capital expenditures as well as the value-added turnover by geographic regions. To the extent that additions to and exits from consolidation as well as adjusted depreciation periods impact on data compared to the previous year, details will be presented below.

PRODUCTION, PRODUCTS AND SERVICES

The *schlott group* structures its segment reporting in line with its different activities. 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, 28.4 percent of the value-added turnover in the business segment *print* is accounted for by catalogues for the universal mail order houses and 17.3 percent by catalogues for niche mail order houses. Periodicals accounted for 23.3 percent of value-added turnover and inserts for 31.0 percent. In comparison to the previous year, the share of periodicals grew slightly while the share of catalogues for universal mail order houses experienced a slight decline. Through the acquisition of *biegelaar B.V.*, the share of periodicals will be further enhanced while the share of catalogues for universal mail order houses is expected to decline further (please refer to “Outlook” beginning on page 112).

Inserts are traditionally low-margin products, particularly when these are produced in the off-season in the Spring and early Summer. The current market conditions reflect, however, significant price pressure in all product areas.

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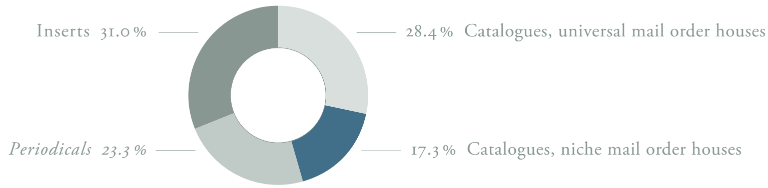
VALUE-ADDED TURNOVER BY PRODUCT IN THE BUSINESS SEGMENT PRINT 2005/06

100% = € 240.2 million



In contrast to orders for inserts, which are often rendered at short notice, mail order houses generally reserve printing capacity by means of annual agreements by which several printing providers are given a certain share of the expected annual volume. In the time critical area of periodicals, tested processes are of particular importance; therefore, longer-term agreements are usually concluded, enabling providers to plan their capacity utilization.

The business segment *direct marketing* develops dialog marketing concepts and possesses its own activities in finishing, lettershop, further processing as well as service activities. "Finishing" encompasses all activities connected to 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 being centrally coordinated within the *group* and thus conducted more cost-effectively.

It is a strategic goal of the *schlott group* to attain a higher share of catalogues for niche mail order houses, periodicals as well as inserts. While universal mail order houses continue to be burdened by the changes in the behavior of German consumers, the niche houses are enjoying a sustainable positive upswing.

Periodicals continue to be an attractive market in which we see stronger growth opportunities for us in Germany. Moreover, with our new site at Maarssen, which we have acquired at the end of the reporting year in connection with the acquisition of *biegelaar B.V.*, we have paved the way for additional growth opportunities outside of Germany.

In the area of inserts, we are differentiating ourselves from the competition by having very variable print formats and short reaction and delivery times. With the start of the business year 2006/07, we have again significantly improved out capabilities through the new production facility in Freudenstadt. In addition, we are able to offer very short reaction times in the pre- as well as post-print stages of the printing process, allowing customers to set their sales prices very close to the date of distribution of inserts.

Transition from segment data to group data 2005/06

IN € MILLION (IAS/IFRS)	Total Segments	Transition	Group
External sales	517.6	0.0	517.6
Value-added turnover	310.6	– 8.6	302.0
Segment results	29.1	– 1.2	27.9
Results from long-term financing, foreign exchange	– 6.0	0.1	– 5.9
EBT	23.1	– 1.1	22.0
Total segment assets	567.2	– 34.2	533.0
Total segment liabilities	455.3	– 75.9	379.4
Segment capital expenditures	77.9	1.9	79.8

BUSINESS SEGMENT PRINT

Results of the segment print

	Value-Added Turnover			External Sales		
IN € MILLION (IAS/IFRS)	***2005/06***	***2004/05*** Adjusted for heckel	***2004/05*** as stated	***2005/06***	***2004/05*** Adjusted for heckel	***2004/05*** as stated
Preprint	4.0	3.4	3.4	4.1	4.6	4.6
Intaglio printing	163.3	179.9	179.9	323.9	353.7	353.7
Offset printing	32.2	31.6	47.5	58.4	50.9	81.3
Further processing	40.7	38.1	38.1	23.3	18.1	18.1
Total	240.2	253.0	268.9	409.7	427.3	457.7

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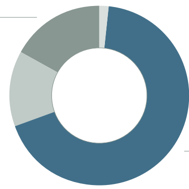
ar *05/06*

Core competence and important source of income within the *schlott group* is INTAGLIO PRINTING

VALUE-ADDED TURNOVER BY SERVICE ACTIVITY IN THE BUSINESS SEGMENT PRINT 2005/06

100% = € 240.2 million



The core competence of the *schlott group* is intaglio printing. Its share of the total value-added turnover in the business segment *print* amounted to 68.0 percent during the year 2005/06, after 66.9 percent in the previous year.

1.7 percent of the value-added turnover in the business segment *print* is accounted for by pre-print services, i.e. the pre-print stage, after 1.3 percent in the previous year. A further 13.4 percent was achieved in the area of offset printing. In the previous year, offset printing had accounted for 17.7 percent and 12.5 percent after adjustment for heckel. Aside from the small, but highly attractive activities in sheet offset printing, we have a roll offset printing site in Lübeck with so-called horizontal formats. The Lübeck site utilizes a printing process for medium volume editions, i.e. for editions that, in terms of volume, rank below those that will be processed by intaglio printing sites; the Lübeck site supplements our product mix in an optimal manner.

In the area of further processing, we realized during the reporting year, without inclusion of the *reus* acquisition, 16.0 percent of total value-added turnover of the business segment *print* (14.2 percent in the previous year). If one includes *reus,* this percentage rises to 16.9 percent. Processes that are added on to the pure printing process are domiciled in this area. Earnings margins are traditionally modest, but are expected to improve in the future since timely and sufficient capacity in further processing represent an increasingly success-critical factor in the printing process. The *schlott group* possesses one of the largest capacities in Europe for further processing, which are logistically well positioned.

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Results of the segment print

(IAS/IFRS)	***2005/06***		***2004/05***	
	€ MIL.	%	€ MIL.	%
External sales	409.7	170.6 %	457.7	170.2 %
Value-added turnover	240.2	100.0 %	268.9	100.0 %
EBIT	36.1	15.0 %	38.0	14.1 %
Short-term interest results	– 1.7	– 0.7 %	– 1.4	– 0.5 %
Segment results	34.4	14.3 %	36.6	13.6 %
Long-term interest result	– 2.9	– 1.2 %	– 3.4	– 1.3 %
Foreign exchange gains / (losses)	– 0.4	– 0.2 %	0.0	0.0 %
EBT	31.1	12.9 %	33.2	12.3 %
Total segment assets	395.6	—	360.4	—
Total segment liabilities	226.4	—	233.8	—
Segment capital expenditures	72.1	—	33.0	—

During the past business year, the business segment *print* realized a value-added turnover of € 240.2 million as well as earnings before taxes of € 31.1 million as opposed to € 33.2 million in the previous year. When adjusted for heckel, the value-added turnover for fiscal year 2004/05 was € 253.0 million. Through the acquisition of *reus,* € 2.8 million were initially consolidated during the reporting year. The development of EBT in comparison to the previous year has not been materially influenced by the acquisition of *reus* nor by the exit from consolidation of heckel.

The required prolongation of depreciation periods for property, plant and equipment affected especially the business segment *print* with its capital-intensive activities in intaglio printing. The EBT effect during the business year 2005/06 amounted to € 3.9 million. The change in EBT compared to the previous year, without the effect of changes in depreciation, mirrors clearly the current market environment of the printing industry.

Personnel expenses were not commensurately reduced in line with the lower level of value-added turnover; these expenses increased from 52.2 percent in the previous year to 54.0 percent in 2005/06. In the area of other operating expenses, however, we had the opportunity to reduce costs; these expenses moderated from 28.2 percent during 2004/05 to 26.4 percent during the reporting year. Interest expenses declined as we were able to improve the structure of our liabilities mix.

During the reporting year, we have through important initiative strengthened the business segment *print.* Most prominent is the erection of a new production hall in Freudenstadt, in which at the beginning of the current fiscal year 2006/07 a new intaglio printing line with a printing width of 364 cm was inaugurated. The new line takes the place of two existing, but significantly slower lines with a printing width of 160 cm each, which had reached the end of their economic lives.

With the erection of the new hall, we are realizing broadly-based improvements in site logistics, which will contribute to further increases in efficiency. Cost reductions resulted also out of a new agreement with the workers council, which took effect on January 1, 2007. Lastly, we look forward to additional business opportunities based on the special configuration of the new printing line. Modern in-line functionalities and the appended folding mechanisms allow the production of a broader mix of advertising inserts at costs that tend to be lower than in offset printing.

Another step in the strengthening of the business segment *print* is the announcement in April 2006, that effective May 1, 2006, we have supplemented our service capabilities in the area of further processing with an additional site in the Czech Republic through the acquisition of *reus s.r.o.,* including their marketing and distribution companies. The activities of *reus* in both book and offset printing were discontinued.

reus possesses attractive customer relationships in the European mail order and advertising industries, which are the target markets of the *schlott group.* These will be fully taken over and expanded. The new site in Plzen possesses considerable floor space reserves, which we will utilize in the future.

Last, but not least, we have during the business year 2005/06 continued our dialogue with other players in the European intaglio printing industry with respect to its consolidation. In reference to *biegelaar B.V.,* we were able to conclude successfully our negotiations in October 2006 and to announce the acquisition of this Dutch intaglio printing house.

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BUSINESS SEGMENT DIRECT MARKETING

Results of the segment direct marketing

(IAS/IFRS)	2005/06		2004/05	
	€ MIL.	%	€ MIL.	%
External sales	107.5	180.4 %	107.1	167.9 %
Value-added turnover	59.6	100.0 %	63.8	100.0 %
EBIT	−2.8	−4.7 %	−1.8	−2.8%
Short-term interest results	−1.1	−1.8 %	−0.9	−1.4 %
Segment results	−3.9	−6.5 %	−2.7	−4.2 %
Long-term interest results	−0.2	−0.3 %	−0.3	−0.5 %
Foreign exchange gains/(losses)	−0.1	−0.2 %	−0.1	−0.2 %
EBT	−4.2	−7.0 %	−3.1	−4.9 %
Total segment assets	67.4	—	66.5	—
Total segment liabilities	63.6	—	54.4	—
Segment capital expenditures	3.7	—	7.0	—

In the business segment *direct marketing,* the market situation in terms of demand and prices continued to be difficult during the reporting year. However, we are now in a position to cope with such difficult conditions much better than in the past due to our strengthened position at our site in Schwandorf.

Value-added turnover declined to € 59.6 million during the reporting year after € 63.8 million in the previous year. The reduction is essentially accounted for by higher costs for materials and purchased services in the amount of € 3.3 million. These increased costs were not fully passed on to our customers. Net sales in this business segment, as opposed to value-added turnover, amounted to € 107.5 million during the reporting year compared to € 107.1 million in the previous year.

The higher costs are related to the production site in Sweden. For that site, the operating loss for the reporting year was € 2.0 million after break-even results in the previous year. In view of the unsatisfactory development we have analyzed comprehensively the current situation and potential of that site and have decided, as made public following the end of the business year, to relocate the production lines to our site in Schwandorf. The servicing of customers will continue to be provided as before through local marketing teams.

The cost of administering a foreign production site is saved through this relocation. Moreover, existing personnel resources and capacity in Schwandorf can be better utilized. We expect through this measure to realize a positive effect that exceeds the former operating losses as well as the closing costs. The latter amount to about € 2.6 million and have been fully recognized in the results of this business segment in fiscal year 2005/06.

Earnings before taxes of this segment amounted to € -4.2 million following € -3.1 million in the previous year. Without the losses of € 4.6 million on account of the Scandinavian activities, the two sites at Schwandorf and Nyrani generated a positive result of € 0.4 million, representing an improvement of € 3.5 million. Adjusted for the positive effects of the lengthening of depreciation periods for property, plant and equipment in the amount of € 0.6 million, the results before taxes were at break-even level, representing an improvement in earnings of € 2.9 million compared to the previous year.

This welcome development is the result of measures undertaken in the previous years for increasing efficiencies and reducing costs. In this connection, the successful built-up of the Czech site must be mentioned to which we have reallocated personnel-intensive tasks to an ever larger extent. In the future, we intend to further expand the depth of value generation at that site.

We have also been successful in the more aggressive marketing of our service capabilities. We have built a broad customer base and have gained an excellent reputation in the area of print and dispatch of privacy-sensitive documents related to annual shareholder meetings. We are also increasing our customer base in the area of public utilities for services such as billing and miscellaneous customer communications; we are also becoming more active in outsourced tasks such as the printing and dispatch of wage and salary statements.

Based on our fine reputation, we are able to solicit orders for customer communications of financial institutions. We have also been successful in obtaining a number of orders related to the marketing and publicizing of trade fairs, for which we receive success-related compensation. These selected examples illustrate the potential of the business segment *direct marketing.*

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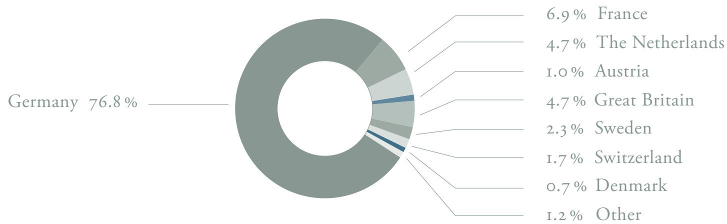
VALUE-ADDED TURNOVER BY DOMICILE OF CUSTOMERS 2005/06

100% = € 302.0 million



We have successfully repositioned the business segment *direct marketing* and have achieved the turn-around. As had been contemplated in the past with several subsidiaries with similar developments, the question arises whether these activities should be expanded further within the *group* or whether these should be housed in a different entity. We are currently in the process of a detailed examination to this effect.

Our analysis is focusing especially on the opportunities, which will arise out of the liberalization of European postal markets in 2008. Direct marketing entities, with their enormously high volume of mailings, offer postal companies attractive opportunities to secure and expand their business.

CORPORATE SERVICES / HOLDING

As in prior years, all service activities, including those of *schlott gruppe AG*, are consolidated in the segment *corporate services / Holding*. Turnover and earnings trends in this area result exclusively from the internal allocation of services and overhead expenses. During the reporting year, EBT of this business segment was € - 3.8 million after € - 2.9 million in the previous year.

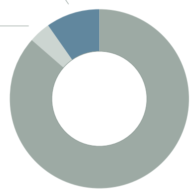
During the reporting year, EBIT amounted to € -0.2 million, which equates more to the result of a business segment having a pure service function than the extraordinarily positive result of € 1.5 million during the previous year. The negative change in EBIT of € 1.7 million is compensated by an improvement in the financing and foreign exchange result of € 0.6 million, such that the net EBT of this business segment declined by € 0.9 million as stated.

SEGMENT REPORT ON THE BASIS OF SECONDARY SEGMENTS

We support our customers on a Europe-wide basis and offer European solutions in the context of their marketing strategies. Our production basis, however, remains mostly in Germany. Outside of Germany, we are represented in the business segment *print* with a further processing site in France and with *reus* in the Czech Republic. The second most important production site in the segment *direct marketing* is also domiciled in the Czech Republic. Our Swedish production site in the area of *direct marketing* has been closed down following the end of the reporting year. Based on this constellation, 86.4 percent of the *group* assets were in Germany at the end of fiscal year 2005/06.

TOTAL SEGMENT ASSETS AS PER SEPTEMBER 30, 2006, PRIOR TO CONSOLIDATION

100% = € 453.3 million



The international share of our operations is reflected in the table showing turnover by geographic regions. Allocations are made on the basis of target markets for which a printing product is produced. For example, the French printing product of a German customer is being aligned with France. Since the business year 2004/05, we report for the purpose of comprehensive transparency these data also in terms of value-added turnover.

During fiscal year 2005/06, turnover by geographic regions was essentially unchanged over the previous year. In Germany, we achieved 76.8 percent of total value-added turnover after 76.9 percent. Euroland accounted for 12.6 percent compared to 11.8 percent in 2004/05 and the other countries amounted to 10.6 percent after 11.3 percent. The most important foreign markets for the *schlott group* remain France, The Netherlands and Great Britain, which collectively account for 16.3 percent of the total value-added turnover.

— PERSONNEL:

Continued focus on cost reductions

The market environment necessitates further significant cost reductions. The improvement of processes and the increase in productivity received focused attention during the business year 2005/06. This will be continued in the future in order to secure the competitiveness of the Corporation and employment levels within the *schlott group.*

During the business year 2005/06, we registered changes in the number of staff in connection with additions to and exits from consolidation. When adjusted for these changes, the level of personnel employed in the business segment *print* was unchanged. In the business segment *direct marketing,* optimization initiatives were continued in Schwandorf and the site Nyrani was expanded. In the business segment *corporate services / Holding* employment levels were slightly reduced.

In our largest business segment *print,* 165 staff members left at the beginning of the reporting year in connection with the exit from consolidation of heckel GmbH. When adjusted for the heckel effect, staff count at the end of the reporting year of 2,540 was essentially unchanged from the level of 2,563 at the end of 2004/05; these figures do not include the addition of the *reus* group in May of 2006.

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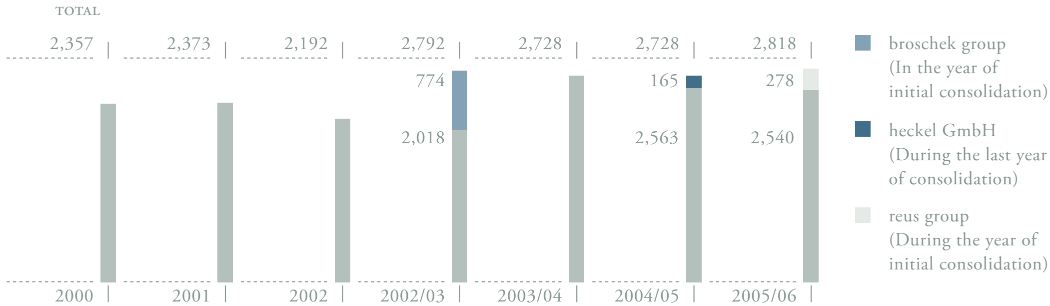
TRENDS IN THE STAFF COUNT IN THE SEGMENT PRINT



278 staff members were employed by *reus* at the end of the fiscal year. This number is already at the level planned for the further processing activities of that company. The book and roll offset activities have been sold.

During the reporting year, we have been engaged in intensive negotiations at all sites with workers councils about the implementation of the new collective bargaining agreement for the printing industry. The negotiations were concluded in the course of the year and the effects will be influencing the results of the entire fiscal year 2006/07. The most important ingredient in the new agreement is the universal introduction of working time corridors. Moreover, several additional cost reductions will already be partly realized during the current year 2006/07, with further benefits in future years. Subsidiaries, which are not part of the collective bargaining agreement, will institute longer work weeks on the basis of individual agreements or will reduce hourly compensation.

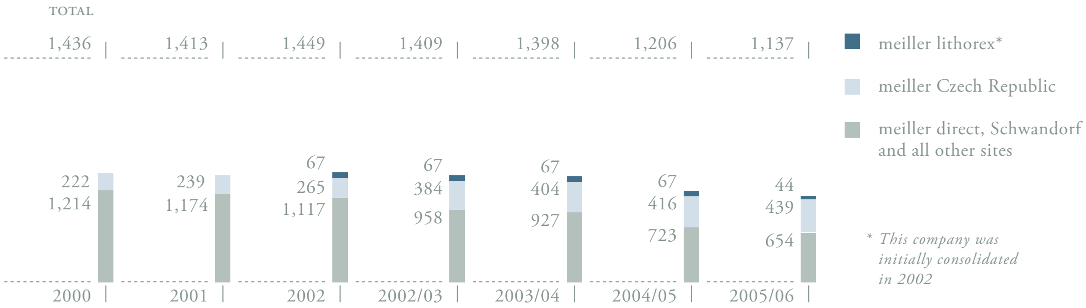
Despite the foregoing, we must continue to intensify our efforts in identifying and realizing higher levels of efficiencies in order to compensate the price pressure in the industry and to sustain the competitiveness of the *schlott group.*

In the business segment *direct marketing,* 1,137 staff members were employed at the end of the reporting year, compared to 1,206 in the previous year. At Nyrani in the Czech Republic, 23 employees were added, while all other units reduced the staff count by 92 members. The reduction in Schwandorf resulted from the maturing notice periods for employees whose jobs were made redundant in the course of a cost reduction program in 2004/05. In addition, personnel resources were adapted to the optimized processes during 2005/06.

In addition, we have concluded individual agreements with employees in Schwandorf, which include a lengthening of the work week by 2.5 hours without additional compensation. This became possible after the company ceased to be subject to a collective bargaining agreement.

In the segment *corporate services / Holding* the number of employees declined from 112 to 107 at the end of fiscal year 2005/06. This trend mirrors our efforts for raising efficiency and reducing costs also in central administration and management.

TRENDS IN THE STAFF COUNT IN THE SEGMENT DIRECT MARKETING



— EARNINGS AND FINANCIAL POSITION OF SCHLOTT GRUPPE AG

Financial data remain solid

EARNINGS POSITION

schlott gruppe AG (hereinafter referred to as *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 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 and marketing, 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 its subsidiaries. Major sources of income of *schlott gruppe AG* are the profit-absorption agreements with affiliated companies. 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 of *schlott gruppe AG* amounted to € 23.0 million during the reporting year after € 25.0 million in the previous year. The reduction in earnings during the reporting year reflects the weaker earnings trends of the operating subsidiaries. As a result, the gains out of profit-absorption agreements fell from € 27.0 million in 2004/05 to € 23.4 million during 2005/06. A positive factor was the reduction in personnel expenses from € 4.9 million in 2004/05 to € 3.0 million in the reporting year.

The effective tax rate of the *AG* declined from the extraordinarily high level of 42.4 percent (as discussed in the previous year) to 33.0 percent, thus stabilizing during the reporting year again at the more normal level of about 35 percent. As a result, net income for the year rose slightly from € 14.4 million to € 15.4 million and covers comfortably the recommended dividend distribution for the current year in the amount of € 6.2 million. From the perspective of the Board of Management, recommending a dividend distribution identical to that of the previous year despite the unsatisfactory earnings results of the reporting year is justified in as much as the *schlott group* enjoys a first class positioning within the industry and will profit in the medium-term from the ongoing market consolidation.

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FINANCIAL POSITION

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. The most important item under financial assets are the ownership positions in subsidiaries. The financing function of the *AG* is reflected on both sides of the balance sheet as claims on and liabilities to subsidiaries. Both positions are closely correlated as the *AG* employs excess liquidity of its subsidiaries for financing those with lack thereof. Liabilities to financial institutions oscillate in the realm of cash pooling as the *AG* utilizes short term credit lines for the benefit of its subsidiaries.

The balance sheet total of *schlott gruppe AG* has increased during the reporting year primarily due to initial consolidation of *reus.* Claims on affiliated companies were slightly below the level of the previous year. In total, the balance sheet footings increased from € 298.2 million in the previous year to € 316.4 million at the end of the reporting year.

The increase in the balance sheet total was financed primarily through the addition of net income for the year to shareholders equity. Correspondingly, the equity ratio has increased from 46.7 percent to 47.0 percent at the end of the reporting year.

Liabilities to financial institutions declined modestly in line with the somewhat reduced demand for funds within the *AG's* cash pooling. Other liabilities increased by about € 10,0 million, representing the yet to be defrayed installment for the acquisition of *reus,* as already detailed previously.

The cash flow from ordinary business activities of *schlott gruppe AG* amounted during the business year 2005/06 to € 13.5 million after € 31.6 million in the previous year. This significant decline does not mirror the operating results of the Corporation, but resulted essentially from cash pooling positions of subsidiaries at year-end. While in the previous year cash flow was positively influenced by an increase in liabilities due to subsidiaries in the amount of € 10.4 million, this position was erased and replaced by a balance of € 3.5 million due from subsidiaries, resulting on a net basis in a negative impact on cash flow of € 13.9 million compared to the previous year. The counter position of cash pooling is the group financing position as detailed below.

During the previous year, € 6.3 million were added to the provision for taxes; during the reporting year, the addition of € 1.0 million represents a more normal level. The cash flow out of investment activities totaled € -12.5 million due to the acquisition of *reus,* while in the previous year such cash flow was positive to the tune of € 1.6 million as a result of disposals of financial assets.

In light of reduced levels of liquidity transfers from affiliated companies, the amount of funds extended to subsidiaries by the *AG* also declined. As a result, the cash flow for the financing of the *group* amounts to € 6.1 million during fiscal year 2005/06 compared to € -26.3 million in the previous year; the cash flow from finance activities improved from € -33.2 million in 2004/05 to € -1.0 million at the end of the reporting year. In sum, the cash position of *schlott gruppe AG* has not changed from year to 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.*

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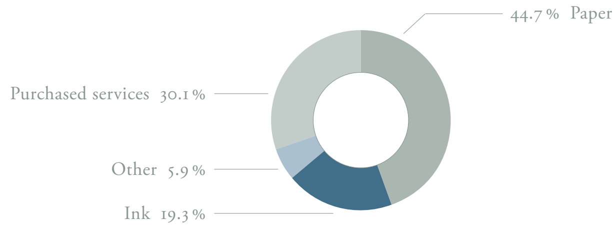
COST OF MATERIALS 2005/06

100% = € 212.2 million



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 customer base. With a large number of customers we have long standing relationships and we are always striving to turn new customers into satisfied and loyal clients.

During the business year 2005/06, price negotiations became an ever more important ingredient in our marketing activities. We are in the position to offer attractive prices based on our broadly based and centrally coordinated production facilities. In addition, the flexibility of our processes and the proximity to the market and customers of our decentralized sites equip us to produce and deliver on time even at very short notice. We are thus usually in a position to accept orders that are available in the market on short notice.

However, this does not mean that quality and timely delivery are rewarded appropriately in the current market environment. Some players in the industry are currently accepting orders at extraordinarily low prices. Our long-standing customers are fully aware of the value of quality and timely delivery and we will continue to stress these attributes in marketing negotiations as these differentiate us from our competition.

LOGISTICS AND PROCUREMENT

The optimization of site logistics is a permanent challenge and preoccupation. The most important change during the course of the reporting year is the erection of a new production hall in Freudenstadt. A new intaglio printing line was placed into operation at the beginning of the business year 2006/07. The new line has a paper width of 364 cm and replaces two lines with printing widths of 160 cm each, which had reached the end of their useful economic lives.

The new line at this site has a significantly wider printing format than the maximum width of 245 cm hitherto available. In line with this change, significant alterations were required in the preprint stage. During the construction, we have introduced far reaching optimization measures in site logistics and have, for example, newly organized shipping and receiving, resulting in shorter and more efficient paths and ways.

External logistics start at the end of our packing lines. There, we entrust our printing products to an outside freight-forwarder.

Aside from logistics services, which represent a large part of total services purchased, paper and ink are the most important components of the procurement of raw materials and supplies. 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 2005/06, the ratio was only 20.1 percent.

Composition of the Cost of Materials 2005/06

IN € MILLION (IAS/IFRS)	***2005/06***	***2004/05***
Paper	94.8	125.0
Ink	41.0	41.2
Other	12.5	11.5
Services purchased	63.9	53.2
Total	212.2	230.9

The markets for materials procured are highly concentrated. In the area of intaglio printing, the concentration in our procurement markets coupled with the capital intensity of the industry and the concentration in customer markets, give significant impetus to the consolidation pressure in the printing industry. In Europe, there are currently only seven suppliers of paper and five of ink. In the business segment *direct marketing,* roll offset machines are employed, for which paper and ink are partly provided by the same suppliers as those in the segment *print.*

The *schlott group* procures its raw materials from both producers as well as wholesalers in order to avoid potential dependencies and in order to minimize delivery times. We are thus in a position to coordinate orders even more flexibly between our different production sites.

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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, we are using in all areas just-in-time delivery of materials and are thus able to reduce expenses for carrying and managing inventory.

PROTECTION OF THE ENVIRONMENT

The protection of the environment is an integral part of the *group's* management policy, which seeks to be balanced and sustainable. Sustainability of the value creation process is one of the topics for which we feel special responsibility. As a company processing paper we are consuming natural resources and are thus active in an environmentally sensitive area. Moreover, special chemicals and other environmentally sensitive agents are used, which 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 at the individual sites of the *schlott group*. Annual internal ecological audits monitor levels of compliance, document the findings 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 partly as per the more stringent EU-directive EMAS II. Already today, we are operating at a very high level of environmental consciousness and of course remain within all legal limits – in many instances we remain significantly below such limits.

During the business year 2005/06, we have implemented a number of additional measures for the protection of the environment. For example, at our Nuremberg site we are utilizing the heat emitted by the air filtration unit for cooling water by operating a so-called absorption-cooling device with the aid of emitted heat. As a result, emitted heat is not only recycled for heating buildings, but is also used for producing cold water.

In the course of the construction of the new production facility in Freudenstadt we have implemented broad measures for environmental protection in the areas of energy efficiency, protection of ground water and clean air emissions. Included in these measures are the optimization of ground water protection through the establishment of a centralized chemicals depot conforming with the standards set forth by respective ordinances (VAwS), saving water by recycling rain water, or minimizing the use of chemicals in the processing baths through utilization of the so-called reverse-osmoses process.

RESEARCH AND DEVELOPMENT

The *schlott group* is a service company that produces by order of its customers print-supported advertisements and marketing media. Own products are not employed nor developed in the context of these services. Accordingly, the company does not engage in extensive research and development activities and, therefore, has no budget for such activities. Our strength is our ability to quickly incorporate new technology available in the market in our ongoing efforts to develop highly customized solutions for our customer requirements.

— STATEMENT ON RISKS

INTRODUCTION

The *schlott group* is an internationally active corporation facing a multitude of possible risks. The early identification of risks, the monitoring and management of such risks, as well as the recognition that risks are often accompanied by opportunities is a pivotal responsibility of the Corporation's management. The Board of Management and the Supervisory Board are examining closely at quarterly intervals risk reports, which detail the risks influencing the business segments *print* and *direct marketing* as well as the *group* as a whole.

The *schlott group* employs a risks management system that complies with legal requirements for the early identification, evaluation and for steps to be taken for managing such risks. The risk management system is supported by the "Risk-Monitor TM", which forms an integral part of the total policy and reporting processes within the *group.* The *schlott group* has prepared a handbook, which is reviewed and adjusted on an annual basis. The handbook contains details as to

- *investigation and identification of risks*
- *classification and valuation of risks*
- *management of risks*
- *monitoring and mitigating risks*

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Farsightedness and Sensitivity PROMOTE THE RECOGNITION AND AVOIDANCE OF RISKS

The entire risk management system of the *schlott group* is being continually monitored and enhanced by a risk management officer. Aside from the central management of risks, risk management officers are also appointed at various subsidiaries. In addition, all management personnel of the *group* are encouraged to impart on all employees the necessity to recognize risks in a timely fashion and to avoid risks in the first place.

The functionality of the risk management system is 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 risks captured by and recorded in the "Risk Monitor TM" are summarized below. Risks are categorized as general economic risks, fundamental risks related to operating activities, as well as various discrete risks. Currently, the sustainability of the *schlott group* is not jeopardized by any of these risks.

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GENERAL ECONOMIC RISKS

Economic conditions in Germany and in Europe have improved markedly during the business year 2005/06. Even consumption expenditures have risen. Leading German economic institutes are now more optimistic and expect the positive trend to continue during the calendar year 2007 with positive impulses for the labor market and number of persons employed; this improvement is prognosticated in spite of the increase in value-added tax on January 1, 2007. This optimism does, however, not extend to the printing industry. The prospects for our industry will be dealt with in detail in the chapters dealing with customer and industry risks.

FINANCIAL RISKS

Financial risks within the *schlott group* consist of liquidity and market price risks. These are originated by operating activities and related hedging operations as well as financing activities within the *group*. Moreover, the risk of non-collectable receivables belong to this risk category.

The monitoring and management of liquidity is done at the *group* level by way of cash pooling between the parent company and its subsidiaries and thus is not burdened by significant levels of risk.

The activities of the *schlott group* outside of the Euroland are primarily in Great Britain, Sweden and Norway. To prevent a possible devaluation of such foreign currency flows due to sales, services or financial transactions with foreign countries, forward exchange transactions are employed. A monthly report sets forth all of the *group's* existing foreign exchange hedging transactions. To guard against interest rate changes, appropriate financial derivatives are employed for loans with variable interest rates. No open positions are permitted, all types of hedging operations are effected for the mitigation of risks related to standard business activities.

Currently existing credit lines and loan commitments assure the availability of sufficient financing and liquidity resources. Accounts receivable risks are essentially neutralized by insurance coverage in line with the respective *group* directive.

CUSTOMER AND INDUSTRY RISKS

The greatest risks in terms of earnings trends for the *schlott group* are found in the area of customer and industry risks. For the fiscal year 2006/07, our business plan anticipates a further reduction in the earnings of the business segment print (see Outlook on page 112), and the Corporation has initiated a number of measures in order to secure its earnings power. Nonetheless, one cannot exclude that current industry trends, which, coupled with the highly competitive environment in which we operate, will have a negative impact on earnings prospects beyond the current business year.

Combining the existing overcapacity in the industry with the difficult business conditions experienced by several competitors due to low demand over the past years will prevent improvements in the price levels for printing services and products. Price pressure continues unabated and the reductions anticipated for the business year 2006/07 are above the long-term average. Moreover, important customer groups, particularly the universal mail order houses, are experiencing declining market shares in their target markets with the result that they become more price sensitive.

Additional risks result from the business prospects of universal mail order houses due to the increase in German VAT at the beginning of 2007. These houses typically distribute catalogues with prices guaranteed until the following edition is issued. Other than the retail trade, these houses were, therefore, only able to a limited degree to increase prices during the last year in anticipation of the VAT increase. Moreover, they will be unable to react rapidly to possible short-term changes in consumer behavior in the beginning of 2007.

The *schlott group* is meeting the challenges of this market development with intensive measures for customer service and retention. We are soliciting customer agreements with longer tenors and continue to look for ways to reduce costs. In the personnel area we are striving to reduce costs for social contributions and fringe benefits, to make working hours more flexible and to increase productivity and efficiencies. In strategic terms, we have the goal of reducing the share of universal mail order houses as a percentage of total value-added turnover. In this connection, we look forward to sustain the current business volume with this customer group and, at the same time, seek to exploit the growth potential in other areas. A fundamental growth area is sales outside of Germany.

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During fiscal year 2005/06, we have successfully concluded negotiations leading to the acquisition of the Dutch *biegelaar B.V.*, which was consummated shortly after the end of the reporting year. This will result in an increase of the foreign component of value-added turnover on a pro-forma basis from 23.2 percent in 2005/06 to 29.1 percent for the current year 2006/07. In addition, the acquisition of *biegelaar B.V.* will strengthen our position in the area of periodicals.

SKILLS, EXPERIENCE AND GROWTH RISKS

A main goal of the *schlott group* is the retention of employees. Personnel risks such as loss of know-how are mitigated through internal training programs. These programs are designed to prepare younger employees for positions in middle and senior management. Internal training courses are being held in the area of accounting, EDP, personnel and procurement.

The "Balanced Scorecard" is employed as an incentive for employees throughout the group.

IT RISKS

Potential risks in the area of information technology, as for example unauthorized access to data or misuse of data, are mitigated through various measures as they relate to organization, employees, application, networks and systems. In the area of software, we are using products that are centrally coordinated and managed, and that are adapted on an ongoing basis to the changing processes of the *schlott group.* Data protection officers are appointed at all subsidiaries as well as the *AG*, whose responsibility it is to make staff members aware of existing risks.

Both hardware and software are updated on an ongoing basis to 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.

LEGAL RISKS

According to current estimates, no units of the *schlott group* are involved in litigation or arbitration disputes, which could have a material negative impact on the financial condition of the Corporation. Important agreements are being examined and approved by the Corporation's central legal department.

TECHNOLOGY RISKS

No technology risks exist. At the Freudenstadt and Lübeck sites, older machinery was replaced by new one during 2006. With these modernizations as well as the fully operational newly erected Nuremberg site, the *schlott group* has one of the most modern technical plant and machinery portfolios among European printing entities.

A dynamic preventive maintenance program is designed to avoid down or idle times. This includes the careful maintenance of all plant and machinery and appropriate training of staff members. A mature quality management system, defining the processes necessary for sustaining quality, mitigates the risk of faulty production.

As identical technology is employed at the different intaglio printing sites, down or idle times of machinery will be dealt with by reallocating printing orders to other sites.

ENVIRONMENTAL RISKS

We have undertaken and continue to undertake 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 responsible behavior with respect to the environment, health, and safety 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.

Measures undertaken in these areas are detailed beginning on page 102.

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MISCELLANEOUS RISKS

There is no undue dependency on any one supplier. The important materials paper and ink are procured from various suppliers. However, a consolidation is taking place in this area. We anticipate a further rise in energy prices and have made appropriate provisions in our planning.

For all possible risks, for which insurance coverage is available, we have contracted sufficient insurance coverage. Insurance coverage for fire/disruptions of operations, liability, transportation, credit losses, and other insurable risks, is centrally coordinated within the *group*.

— CORPORATE GOVERNANCE:

Implementation to a high degree of the German Code of Corporate Governance

During calendar year 2006, the *schlott group* has issued a Declaration of Compliance on May 30, 2006, following the resolution of the Annual General Meeting 2006, concerning the introduction of separate compensation for Members of Committees in 2005/06. The hitherto declared exception in this regard was waved.

All Declarations of Compliance of the *schlott group* can be viewed online under *www.schlottgruppe.de* under the chapter “Investor Relations/Corporate Governance”. The latest Declaration of Compliance is also reproduced in this annual report in the chapter of Corporate Governance beginning on pages 51. In that chapter, we are presenting in detail the Corporation’s philosophy on Corporate Governance as well as the fundamentals of the compensation systems for the Board of Management.

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WE CONTINUE TO BE a driving force in the consolidation OF EUROPEAN INTAGLIO PRINTING

— CHANGES IN THE COMPOSITION OF THE MANAGEMENT AND SUPERVISORY BOARDS

On June 1, 2006, Heiko Arnold became Chief Financial Officer and Member of the Board of Management of *schlott gruppe AG.* His appointment to this position as successor to Dr. Uwe Hack, who retired from the Board at the end of the business year 2004/05, was announced on March 21, 2006.

Heiko Arnold has extensive experience and know-how in the areas of controlling, financial management, mergers and acquisition, the integration of acquired companies as well as communication with the capital markets. He is responsible for financing activities and treasury operations, controlling and investor relations. Aside from the above change, the composition of the Board of Management remained the same.

Irene Salberg, resigned on April 30, 2006, as representative of employees on the Supervisory Board. She was succeeded by Josef Peitz on October 4, 2006. There were no other changes in membership of the Supervisory Board during the reporting year.

— SUPPLEMENTARY INFORMATION:

Acquisition in the business segment print

On October 10, 2006, we have announced the acquisition of the Dutch intaglio printing firm *biegelaar B.V.*. Through this acquisition, we are strengthening the European position of the *schlott group* in its core business and advance further the consolidation of the industry.

The opportunities and potential provided by this acquisition are illuminated in the following Outlook Report.

— OUTLOOK REPORT:

Expectations remain modest

GENERAL ECONOMIC AND INDUSTRY TRENDS

The global economy is expected to continue on its robust growth path in the 2007: according to the forecast of the International Monetary Fund, the global Gross Domestic Product is expected to grow by 4.9 percent in real terms and thus only slightly less than the expected growth rate of 5.1 percent during 2006. The European Commission also looks forward to real growth in 2007: in the Euroland growth is expected to be 2.1 percent after 2.6 percent in 2006, while the growth rate in the entire European Union is expected to be 2.4 percent following 2.8 percent in 2006. Looking toward 2008, growth rates are expected to remain at those levels due to expected increases in private consumption.

More and more economists in institutes, global organizations and governmental offices become convinced that the increase in German VAT and contributions for social security will only minimally affect economic growth in 2007. The economic recovery in Germany is generally considered to be robust and self-sustaining for 2007 and beyond. In line with the foregoing, the expectations for 2007 have been revised upward toward the end of 2006. The Council of Economic Advisors postulated in its report in the Autumn of 2006 that real economic growth for 2007 will be 1.8 percent mainly based on increases in domestic demand, including private consumption, as well as impulses from foreign demand. At year end 2006, however, the economic research institutes became more optimistic: the ifo-Institute and the Rheinisch-Westfälische Economic Research Institute expect economic growth to be nearly 2.0 percent in 2007.

However, these positive expectations in general economic conditions are not expected to positively stimulate the trend in the German printing industry. Even the optimistic expectations of the advertising industry following a satisfactory 2006, do not improve the reservations harbored by the printing industry. According to a poll taken by the Federal Association Print and Media (bvdm), the year 2007 will again be characterized by excess capacity, price pressure and the need to reduce costs. The industry starts the new year from a reduced base: the business climate index has lately fallen again significantly.

Several trends, and specifically trends affecting the intaglio printing industry will influence general conditions in 2007. The structural changes in the mail order industry, especially those in the important area of large catalogues of mail order houses, have not ended. In addition, the volume of periodicals remains unsatisfactory independent of the improved expenditures for advertising. The Association of German Publishers of Periodicals indicates that subscription volume appear stable, but the sale at retail outlets is influenced by cautious consumer behavior. This trend is likely to continue in the short term unless new distribution channels are opened, as for example, the large supermarkets or superstores.

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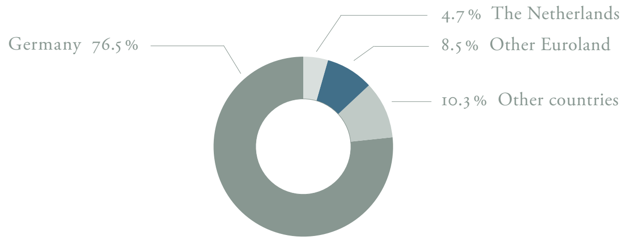
THE BIEGELAAR ACQUISITION: INTERNATIONAL BUSINESS INCREASES

schlott group

Value-Added Turnover in segment print 2005/06: € 240.2 million



OUTLOOK FOR THE SCHLOTT GROUP

The market environment for the business segment *print* will continue to be difficult and will influence the earnings position. In the segment *direct marketing,* we intend to profit from our significantly improved positioning and to increase earnings. We expect an increase in earnings before taxes to € 25 million. It must be noted, however, that the downside risks of this outlook exceed the upside opportunities.

Upside opportunities

The outlook does not yet include the opportunities that will arise out of the acquisition of *biegelaar B.V.*. With the acquisition of this profitable intaglio printing house, we are achieving a better balance in our product portfolio and are strengthening our European business. *biegelaar B.V.'s* market strength is found in the Dutch market with periodicals and advertisement inserts. There are no overlaps with customers of the *schlott group.*

On a pro-forma basis, the international share of the *group's* total value-added turnover in 2005/06 in the segment *print* rises from 23.5 percent to 30.7 percent. The dependence on domestic markets can be commensurately reduced. The share of periodicals, i.e. products permitting more efficient planning as to capacity utilization and having customer agreements with longer tenors, increases from 23.3 percent to 30.2 percent; the share of catalogues for niche mail order houses declines from 17.3 percent to 15.7 percent and inserts account for 28.5 percent after 31.0 percent. The currently difficult business with universal mail order houses appears in the pro-forma tabulation as 25.6 percent of total value-added turnover after 28.4 percent

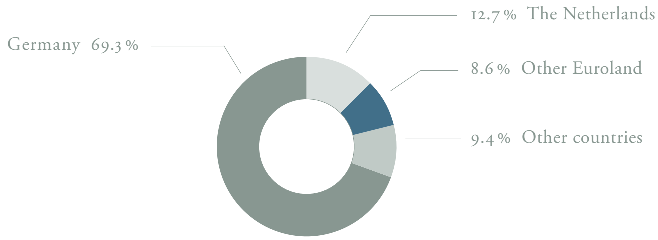
The *schlott group* possesses with its new site in Maarssen, south of Amsterdam, an excellent basis with which to expand its activities in Northern and Western Europe. This applies particularly to the time-critical periodicals business with its short time-to-market characteristic requiring close proximity of production facilities

biegelaar B.V. offers already today resources for future growth potential. The company enjoys technical plant and machinery capable of processing a higher tonnage of paper than is being processed with the existing personnel resources today. The resulting additional potential will be activated.

THE BIEGELAAR ACQUISITION: INTERNATIONAL BUSINESS INCREASES

schlott group and biegelaar (pro forma)

Value-Added Turnover in segment print 2005/06: € 265.0 million



Downside Risks

The downside risks with respect to our outlook concern especially the business segment *print,* while any risks in the segment *direct marketing* are of lesser potency. Future market developments remain the pivotal risk factor. The focus is less on the volume of production but on the trends in sales prices. One can already see today that the lower average prices in the segment *print* that characterized the market in the second half of the business year 2005/06, will impact the entire 12 months period of fiscal year 2006/07.

The scale of price pressure in the industry led to a decline in value-added turnover in the business segment *print* by 5.1 percent with essentially the same tonnage of paper processed. During 2006/07, price pressures will continue unabated and will consume cost reductions previously attained. The benefits gained from the new agreement with the workers council in Freudenstadt and the benefits arising out of the implementation of the collective bargaining agreement for the printing industry are not expected to lead to earnings improvements

Lastly, the current wage agreements expire in March 2007. It is too early to ascertain whether unions will be moderate in their demands given the difficult situation in the industry. It is, however, plausible that the union will not take second place behind elevated demands announced by unions in other industries. If that were so, we would be forced to react to higher personnel expenses with further rationalization measures, the benefits of which would be time-delayed.

Business year 2006/07

For fiscal year 2006/07, we expect an increase in the value-added turnover from € 302 million in the reporting year to € 335 million in 2006/07. *biegelaar B.V.* accounts for € 25 million of this figure. EBT is expected to rise from € 22 million to € 25 million.

The reason why cost reduction measures are not fully reflected in this expected earnings result is the expected reduction in the business segment *print* from € 31.1 million in the reporting year to below € 30 million in 2006/07; moreover, the forecast includes a very conservative outlook for the business segment *direct marketing.* In *direct marketing,* we look forward to the continuation of difficult market conditions and prognosticate, therefore, that a modest increase in earnings at the sites in Schwandorf and Nyrani can be achieved also under consideration that the extraordinary costs incurred in Sweden in the previous year are non-recurring.

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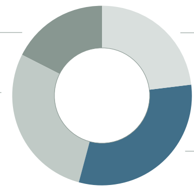
THE BIEGELAAR ACQUISITION: BALANCED MIX OF PRODUCT PORTFOLIO

schlott group

Value-Added Turnover in segment print 2005/06: € 240.2 million



The business segment *corporate services / Holding* is expected to improve somewhat on the results of € -3.8 million for the reporting year. The prognosticated earnings before taxes are derived by including the usual modest consolidation effects. Despite recognizing these premises, one cannot exclude developments in the industry that will have negative influences on the prognosticated earnings expectations in view of the current competitive conditions in the market.

The consolidation process in the industry will materially impact earnings trends of the *schlott group.* Currently, the speed of consolidation has accelerated as a result of the current pressure on margins. Many providers are examining intensively their positioning. In strategic terms, there may be opportunities for the *schlott group;* in the short-term, however, it may lead to earnings risks in case price pressure continues unabated.

The cash flow for the business year 2006/07 is forecast to be € 10.0 million approximately. Included in this forecast is the payment of the yet to be defrayed installment of € 10.0 million for the acquisition of *reus;* on a pure operating business, free cash flow would be in the area of € 20.0 million, which would be about average of the annual cash flow over the past years. The *schlott group* remains a corporation able to generate strong liquidity and is in a good position to participate in the consolidation process of the industry. After high levels of capital expenditures of the past years, no significant expenditures are planned for the business year 2006/07. Accordingly, free cash flow will be employed for strengthening the balance sheet.

Business year 2007/08

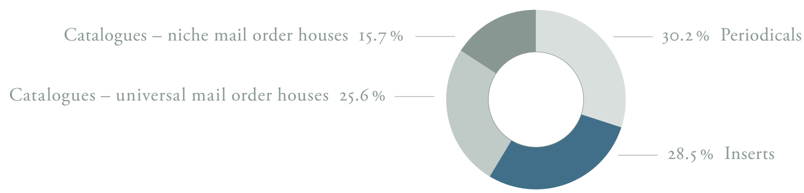
In light of current market conditions, it is difficult to forecast for the business segment *print* the prospects for the following year. Essential for a positive development of the s*chlott group* is an increase in private consumption expenditures in both Germany and Europe and thus a possible earnings improvement for important customer groups of the printing industry. This would result in the normalization of price pressures in the printing industry. In addition, the earnings prospects for the *schlott group* will be affected by the speed of consolidation of the industry during the business year 2006/07.

For the business segment *direct marketing,* we look forward to an improvement in earnings power and earnings results even without growth in the value-added turnover. Capital expenditures on a level in line with previous years will be slightly above the level of the business year 2006/07 and will be funded out of free cash flow.

THE BIEGELAAR ACQUISITION: BALANCED MIX OF PRODUCT PORTFOLIO

schlott group and biegelaar (pro-forma)

Value-Added Turnover in segment print 2005/06: € 265.0 million



Further information on future developements

The *schlott group* will continue to align its service and product mix closely with the requirements of our customers and will thus strengthen its market position. The focus is on our core competence intaglio printing and further processing, which are supplemented by the capabilities of our sites in Lübeck and Plauen, specializing in roll offset services for lower volume editions and sheet offset services, respectively.

The segment *direct marketing* is currently being reviewed for the purpose of determining whether the further development of this business should be within the *group* or whether it should be sold. In the context of this review, the prospects of this segment within the *group* versus at a different entity are examined along with the allocation of resources between these two segments within the *group*. These aspects are being analyzed under consideration of the prospects in intaglio printing, and the current consolidation process thereof, as well as in view of trends in *direct marketing* following the liberalization of postal markets.

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" beginning on page 44.

FREUDENSTADT, DECEMBER 21, 2006

BERND ROSE　　HEIKO ARNOLD　　WERNER REISER　　ADAM VALERI