
MANAGEMENT REPORT

CONSOLIDATED MANAGEMENT REPORT OF THE SCHLOTT GROUP AND THE AG
FOR THE FISCAL YEAR 2006/07 AS PER SEPTEMBER 30, 2007

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

The *schlott group* is one of the leading European providers of printing services for the advertising industry as well as publishers. The core competence is in the area of industrial printing processes, especially in high-volume editions of qualitatively first class printing products. To this end, the *schlott group* employs intaglio and roll-offset printing as well as the whole spectrum of further processing. The catalogue of services is supplemented by activities in the area of preprint and sheet-offset printing. The sum of products and services of the *schlott group* reflects to a large extent the demands and requirements of major European customers.

At the beginning of the calendar year 2007, the *schlott group* decided to concentrate on its core competence *print* and, therefore, to dispose of the business segment *direct marketing*. This process was completed successfully within a very short time frame. After the disposal, the Corporation employed 2,994 persons in the business segments *print* and *corporate services* at the end of the fiscal year 2006/07.

We service our customers throughout Europe via our sales and distribution sites. Our production sites are mainly located in Germany. We are one of two companies with production facilities in both Northern and Southern Germany. This enables us to deliver our products within very short “time-to-market” periods in Germany and also to optimally reach all ad-joining foreign markets. Northern and Western Europe will be covered even more effectively by our Dutch intaglio printing site in Maarssen, south of Amsterdam, which we have obtained at the beginning of the reporting year in connection with the acquisition of *biegelaar B.V.* Moreover, we have two additional further processing sites in neighboring countries: one in Hambach in the Northeast of France and one in Plzen in the Czech Republic.

All intaglio printing sites produce mail-order catalogues. In addition, they specialize in the production of either advertisement inserts or periodicals. This specialization has two effects: on the one hand, it leads to a structural optimization of capital expenditure activities both for individual sites and the *group* as a whole. On the other hand, our employees gain technical expertise enabling them to produce highly complex products more efficiently. In this manner, we have positioned ourselves as one of the leading suppliers in terms of quality, especially for sophisticated printing products.

The *schlott group* has at its disposal very well appointed production sites with state-of-the-art machinery of an average age much below the industry average. In offset printing and in further processing we enjoy as well a first class production base.

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— SUPPLEMENTARY REPORT: KEY FIGURES OF THE SCHLOTT GROUP

The following tables show key financial data of the schlott group. Due to the divestiture of the business segment *direct marketing* during the course of the fiscal year, the presentation fo-cuses on the past two years.

PROFIT AND LOSS ACCOUNT	2006/07		2005/06	
	MIL. €	IN %	MIL. €	IN %
print	247.8	98.4	240.2	98.2
corporate services	10.0	4.0	10.9	4.5
Consolidation	- 6.1	- 2.4	- 6.5	- 2.7
Value-added turnover	251.7	100.0	244.6	100.0
Other operating income	12.3	4.9	12.5	5.1
Personnel expenses	- 146.7	- 58.3	- 136.7	- 55.9
Other operating expenses	- 68.4	- 27.2	- 61.0	- 24.9
EBITDA	48.9	19.4	59.4	24.3
Scheduled depreciation	- 28.8	- 11.4	- 24.2	- 9.9
EBIT	20.1	8.0	35.2	14.4
Financial results	- 9.1	- 3.6	- 8.5	- 3.5
EBT	11.0	4.4	26.7	10.9
Taxes	7.9	3.1	- 8.9	- 3.6
Net income after taxes from continu-ing operations	18.9	7.5	17.8	7.3
Net income after taxes from discon-tinued operations	14.8	5.9	- 6.0	- 2.5
Group net income	33.7	13.4	11.8	4.8
- of which related to shareholders of schlott gruppe AG	33.7	13.4	11.8	4.8
- of which related to minority shareholders	0.0	0.0	0.0	0.0
FIGURES PER SHARE	2006/07		2005/06	
Shares outstanding	6,204,200		6,204,200	
Net income per share (in €) from continuing operations	3.04		2.87	
Group net income per share (in €)	5.42		1.91	
Dividend per share (in €)	1.00*		1.00	
Share price; XETRA, last day of) trading (in €)	19.25		24.44	

* Recommendation

BALANCE SHEET AND CASHFLOW	2006/07		2005/06	
	MIL. €	IN %	MIL. €	IN %
<i>Total long-term assets</i>	417,1	81,9	443,8	83,3
Liquid assets	2,6	0,5	2,9	0,5
<i>Total short-term assets</i>	92,1	18,1	89,2	16,7
<i>Shareholders equity</i>	181,5	35,6	153,5	28,8
Due to banks	171,0	33,6	194,0	36,4
<i>Total liabilities</i>	327,7	64,4	379,5	71,2
<i>Balance sheet total</i>	509,2	100,0	533,0	100,0
Cashflow from ordinary business activities	28,4	—	46,3	—
Cashflow for capital expenditures	-10,4	—	-46,8	—
Cashflow for acquisitions	11,9	—	6,6	—
Cashflow for dividends	-6,2	—	-6,2	—
Cashflow from financing activities without dividends	-23,0	—	2,0	—
Cashflow for the period	0,7	—	1,9	—
KEY FIGURES	2006/07		2005/06	
EBT-ROE (%)	6,6		17,9	
EBIT-ROCE (%)	4,3		7,4	
Free cashflow	11,8		-6,7	
Free cashflow in % of value-added turnover	4,7		-2,7	
Net liabilities	168,4		191,1	
Net liabilities / EBITDA	3,4		3,2	

DEFINITIONS OF KEY FIGURES

Capital Employed: Balance sheet total – Accounts payable – Down payments received

Free cashflow: Cashflow from ordinary business activities – Cashflow for capital expenditures – Cashflow for dividends

Net liabilities: Due to banks – Liquid assets

Return on Equity (ROE): EBT as % of 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 materials – Services purchased

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— **CORPORATE STRATEGY:**

We are Positioning Ourselves at the Forefront of the European Printing Industry

OUR STRATEGIC GOALS

The strategy of the *schlott group* is to be a service organization geared towards meeting customer requirements. Our strategic goals are aligned with this philosophy:

- I. Our specialty is to support our customers in the dialogue with their clients with highest quality and maximum flexibility. We support our customers on a Europe-wide basis. Therefore, we are positioning ourselves at the top of the market for printed media.
- II. As one of the leading European service providers in a highly competitive industry, we look to acquisitions to further enhance our position in the European printing market and to accelerate the consolidation process in the industry.
- III. The printing industry is traditionally characterized by high levels of capital investment. To secure our competitiveness we consider the ongoing improvement in the efficiency of capital employed as a central strategic and operational goal.
- IV. In the interest of our shareholders and in order to access the stock market as a source of capital, value enhancement is a central objective for the *company*. We, therefore, strive for a return on investment above the industry average.

OUR PATH

Flexibility and Quality

Due to continuing and ever higher levels of competition in the European printing industry, the pricing of products and services remains for many printing entities the only remaining factor for obtaining customer orders. We are dealing with the resultant lower market prices by emphasizing our reputation for quality and

service. 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 response times. With this portfolio of products and services, we are claiming a top position in our industry.

Competitive Prices

We are securing the competitiveness of our prices through our processes of highest efficiency. On a daily basis, our operating management is focused on the most efficient utilization of our resources. This applies to all levels and to all individuals. Detailed measures undertaken with respect to the effective management of costs, the full application of the contents of the collective bargaining agreement, the optimal adjustment of capacity in the direction of higher levels of efficiency and flexibility and a capital expenditures policy that is concentrated on returns on investments are the important ingredients in our competitiveness.

Growth in a Demanding Market

The European printing industry with its nearly thirty players is highly fragmented and in spite of its capital intensiveness and price competition has only marginally changed. The recent past has shown, however, that the pressure to consolidate and to create larger entities has intensified among the largest players in the industry. A further incentive for consolidation and the creation of larger entities is the structure of industries impacting the printing industry, e.g. suppliers of raw materials on the one hand and publishing and advertising industries on the other, in which consolidated structures have already emerged.

Our expectations with respect to further developments in our industry are unchanged: the three largest European intaglio printing entities will increase their collective market share by approximately 15 percent to over 60 percent in the next years.

The acquisition strategy of the *schlott group* has over the past decade contributed to the consolidation process and will do so in the future. We intend to continue increasing our market share through acquisitions since a strategy counting on organic growth can not be implemented successfully in the price-intensive and price-transparent printing industry. In addition, larger entities and specialization will lead to the realization of economies of scale benefits.



THE
CONSOLIDATION PROCESS
WITHIN OUR INDUSTRY HAS BEEN
SIGNIFICANTLY ADVANCED BY US
FOR OVER TEN YEARS.

However, the *schlott group* is not undertaking acquisitions at any price. The most important criterion in connection with the selection of possible acquisition candidates remains the compatibility with our long-term strategic direction. We continue to not focus on companies in difficulty. In all of our acquisitions, we emphasise the timely and successful integration of acquired entities into the *group*; and that ability we have exhibited repeatedly in the past.

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. In addition, detailed internal criteria exist in connection with the balance sheet impact of acquisitions. In this connection, the high level of internal financial resources of the *schlott group* play a central role; it represents the financial basis for our growth through acquisitions. The key figure in this regard is the ratio of net liabilities and EBITDA (earnings before interest, taxes, depreciation and amortization), i.e. the indicator for cashflow from ordinary business activities. During the year in which acquisitions are undertaken, net liabilities are not to exceed EBITDA by 3.5 times; already in the following year, three times EBITDA is the goal.

— **CORPORATE COORDINATION:**

Central Product Coordination and Transparent Processes

The *schlott group* coordinates its activities via legally independent subsidiaries. Both the domestic as well as the international production sites are domiciled in independent companies. 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.

Subsidiaries are managed closely and are organized as individual cost centers, receiving orders from central production planning. Marketing and distribution are also centrally coordinated. Consequently, individual sites are not competing against one another, which facilitates the sharing of know-how among sites. Internal benchmarks promote competition leading to and sustaining highest levels of efficiency and quality 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 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. Finally, the cost center organization reduces management risks within the Corporation.

— SUMMARY OF FISCAL YEAR 2006/07:

Pooling of all Strengths in a Difficult Environment

The business year 2006/07 had to cope with hitherto unknown challenges. Price pressure in intaglio printing has assumed new dimensions and we expect that the consolidation of the industry will again gather additional momentum. We will take advantage of such developments in order to strengthen the *schlott group*.

We started well into the business year 2006/07, but have identified early on the risks inherent in the further development of our industry – risks that burden earnings in the short-term, but that in the medium-term create opportunities in the course of the accelerating consolidation of the industry. It was for that reason, and taking into consideration the then imminent liberalization of European postal markets, that we have announced on January 24, 2007, that we shall divest of the business segment *direct marketing*. After stringent efforts to improve the earnings position, this business segment had achieved very good results. It was time to find a partner for these activities who considers *direct marketing* as part of its core business and who can thus develop fully its strategic potential.

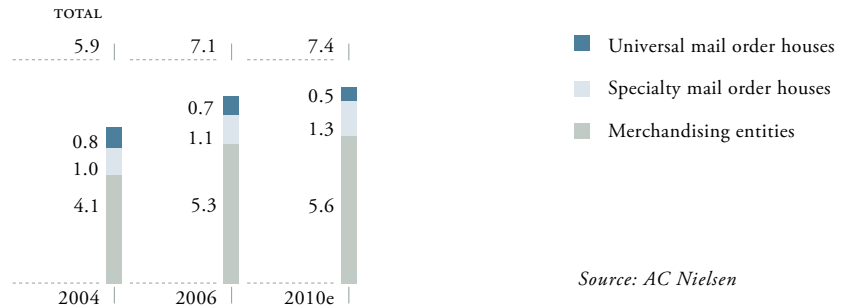
We now concentrate all of our efforts and resources on our core business, the European intaglio printing market. This market has traditionally produced attractive returns and growth opportunities via acquisitions and we are certain that this will hold true in the future.

Already on May 10, 2007, we were able to announce the successful sale of these activities to Österreichische Post AG. We were thus successful in completing the divestiture at attractive conditions within a very short time. The disposal of the business segment *direct marketing* resulted in the realization of hidden reserves and significantly reduced liabilities to financial institutions and also freed management capacity. These resources will be applied to further growth initiatives in the European intaglio printing market.

In the course of the business year, short-term risks in terms of earnings became apparent in our core business *print*; the speed and extent of price pressure reached hitherto unknown dimensions. Consequently, we have developed a comprehensive program designed to adapt our cost basis to the new price levels in our industry to enable us to again generate attractive margins and returns on capital.

POSITIVE DEVELOPMENT IN VOLUME OF CATALOGUES / MAILED BROSHURES

In billions of pieces in Germany



The cost reduction program initiated during the reporting year encompasses all areas of the Corporation – from purchasing and production to marketing, distribution and administration. We shall take full advantage to reduce personnel expenses in the context of the collective wage agreement. This includes adjustments to personnel allocations and the selective reduction in printing capacity. This cost reduction program is still being negotiated at the several sites, but is already partly implemented at others. During the business year 2007/08, we will report on a continuing basis the status of these negotiations as well as the implementation of cost reductions.

— GENERAL ECONOMIC ENVIRONMENT

ECONOMIC TRENDS

Emerging markets, particularly China, India and Russia were the pillars of global economic activity in 2007. The International Monetary Fund (IMF) prognosticates that the global gross domestic product will again rise by about 5.2 percent in spite of significantly lower growth rates in the United States. In the U.S., the initial economic effects caused by the crisis in real estate, mortgage and the so-called sub-prime markets are being felt.

The Euro-Zone is not immune to the turmoil in financial markets and is further burdened by the historically high levels of the Euro. Yet, in spite of the stark increases in the price of oil since the summer, the European economy has grown well above 2 percent in 2007, supported by high levels of capital expenditures.

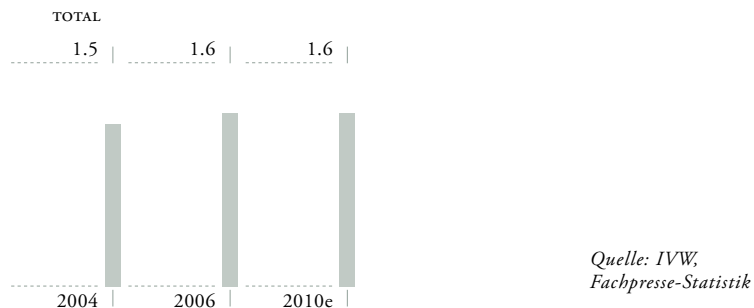
As a result of the increase in value-added taxes at the beginning of the year, the German economy started timidly into the New Year. Private consumption has not recovered appreciably despite a marked reduction in unemployment during the course of the year. Yet, the German economy was supported by high levels of capital expenditures in select industries and by unchanged high levels of exports. The leading economic research institutes and the Council of Economic Advisors forecast a growth rate of 2.6 percent in the German gross domestic product.

FACTORS INFLUENCING TRENDS IN THE PRINTING INDUSTRY

The German printing industry was in 2007 again affected by significant overcapacity and price pressures, which became more acute in the course of the year. The scope and speed of price declines were the negative surprise for the entire industry during 2007.

STABLE PRINTING VOLUME IN PERIODICALS

In millions of tons in Germany



While prices for the printing of periodicals, catalogues and advertisement inserts fell by a total of 7 percent during the period 2001 to 2005, representing a decline of about 1.8 percent per annum, prices fell at nearly triple speed in 2006, i.e. by 5.2 percent. 2007 did not bring a recovery; in fact, pricing pressures have again intensified and declines were partly in double figures.

The printing industry depends to a large extent on consumer confidence and expenditures and on the resultant advertising activities of business. At the beginning of 2007, the reluctance of consumers to spend due to the increase in value-added tax had negative consequences in the German market for printing products in spite of relatively high levels of economic growth.

The printing industry was one of the economic segments in Germany and in Europe that did not profit from the otherwise favorable economic developments.

For the entire year 2007, the Federation of the German Printing Industry expects a growth in its industry of only 2 percent. This modest growth must be viewed alongside higher costs for energy, partly also for paper as well as other raw materials.

These negative influencing factors were responsible for the continuation of the already existing unfavorable industry trends. In particular, the continuing excess capacity in intaglio printing is a major problem and jeopardizes the existence of smaller players. In order to secure the short-term utilization of their capacity, some participants agree to prices that, despite rising costs, go even beyond levels that are demanded in any case by the industry's customers.

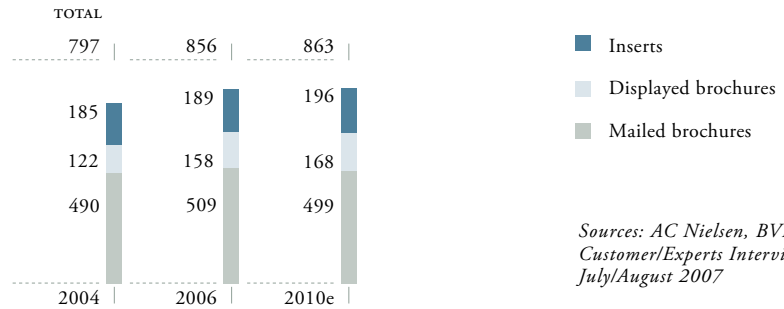
The excess capacity results from organic capacity increases due to more efficient production machinery and facilities and also from the continuing Europeanization of the printing industry in the past years. Personnel expenses, which differ markedly among the various countries, have become a pivotal factor in the competitiveness and site location of printing companies.

In Great Britain, for example, capacity of nearly 300,000 tons per annum has been created during the past years influencing also the Continental European markets. As a consequence, the intensity of competition has increased in Continental Europe and exports to Great Britain were impeded.

Furthermore, the technological progress in offset printing created new potential and opportunities in areas of classical intaglio printing. Significantly higher levels of productivity make it possible to produce high volumes

TRENDS IN THE VOLUME OF PRINTED ADVERTISEMENTS

In billions of pages per annum in Germany



in reel-fed offset printing, which in former times was exclusively reserved for intaglio printing. On the other hand, modern and flexible intaglio printing machines are nowadays in the position to compete against reel-fed offset printing. We have recognized this early-on and have positioned ourselves in terms of production techniques accordingly; we do not have large inflexible ‘jumbos’ in our production machinery inventory and the new line placed into operation recently at our site in Freudenstadt is unique on a global scale in terms of configuration and flexibility.

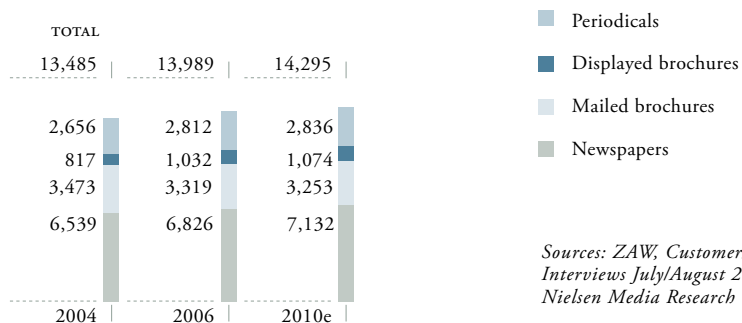
Competition is particularly pronounced in the area of less flexible straight-on-printing without multiple inline options. Included in this are printing lines of very large width, which are designed almost completely for ‘simple’ high volume printing. The *schlott group* employs a collection of machinery that is above the industry average in terms of flexibility and which operates mainly with medium *print* widths.

Contrary to the problems created by excess capacity, trends in the volume of printing products do not burden the *schlott group* in their relevant markets. The total volume of catalogues, brochures and periodicals has grown over the past years and is expected to remain stable or even grow further in the coming years in spite of changes in demographics and in spite of some significant dislocations within the different categories.

The continuing pressure for consolidation in the industry is expected to gather momentum in view of the capital-intensive nature of the printing industry, the already consolidated relevant supplier industries as well as select customer markets with relatively few participants; furthermore, high levels of price transparency are also expected to contribute to the ongoing consolidation process. The configuration of production machinery and the size of printing entities are important competitive factors in the European market for high-volume printing products. The *schlott group* confronts all these challenges, and as proven repeatedly that it will be in the forefront and an important actor in the further consolidation of the industry.

ADVERTISING REVENUE BY TYPE OF ADVERTISER AND ADVERTISEMENT

In € millions in Germany



FINANCIAL DEVELOPMENTS

INDUSTRY-TYPICAL PERFORMANCE INDICATORS OF THE SCHLOTT GROUP

Value-Added Turnover: Key Internal Policy Tool

The stated turnover and related ratios for the *schlott group* do not reflect adequately the actual performance and economic situation. Therefore, we are employing the concept of value-added turnover as a management tool in both internal and external reporting as well as in our elaboration on business conditions and the economic position of the Corporation. Value-added turnover produces additional transparencies as a mirror of operating trends.

Derivation of "Value-added turnover"

IN MIL. € (IAS/IFRS)	2006/07	2005/06
Net sales	482.2	425.6
Changes in inventory	4.4	-2.7
Other capitalized internal services	0.0	0.1
Cost of materials	-234.9	-178.4
Value-added turnover	251.7	244.6

Total tonnage

IN TONS 000	2006/07		2006/07		2005/06	
	includes biegejaar	in %	excludes biegejaar	in %		in %
Paper provided by customers	442.4	72.5	417.2	77.1	434.1	79.9
Paper procured	168.0	27.5	124.2	22.9	109.1	20.1
Total tonnage	610.4	100.0	541.4	100.0	543.2	100.0

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An important factor influencing turnover is the extent to which paper is being provided by our customers, i.e. the extent to which 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.

While the economic position of the *schlott group* is not changed by an increase in paper provided by customers, the stated turnover and cost of materials decline by an identical amount, all other things being equal. Both a reduction in the stated turnover and the arithmetically resultant improvement in gross margin represent, however, no change in the economic situation of the *schlott group*, but may lead to erroneous interpretations.

Value-added turnover eliminates the effects of the level of paper provided and generates transparency with respect to actual business trends. For that reason, value-added turnover is applied to the internal management of operations. Value-added turnover is derived by eliminating from stated turnover the cost of materials and expenses incurred for purchased services and represents, therefore, internally generated value-added for the *schlott group*.

During fiscal year 2006/07, the level of paper provided has fallen slightly for the first time in many years and amounted to 77.1 percent after 79.9 percent in the previous year, net of the effects of initial consolidation of *biegelaar*. Four years ago, that figure was below 65 percent. On a comparable basis, the tonnage of paper processed totalled 541,400 tons as compared to 543,200 tons in the previous year in spite of high levels of competitiveness in the industry. Including *biegelaar*, the total tonnage of paper processed by the *schlott group* amounted to 610,400 tons during the past business year and the level of paper provided was 72.5 percent influenced by the traditionally different behaviour of customers of *biegelaar*.

EARNINGS SITUATION

The tremendous price pressure in the industry has detrimentally affected the earnings results of the business segment *print* during the past fiscal year. At the Corporate level, this negative factor was compensated by the sale of the business segment *direct marketing* and the resultant realized gain.

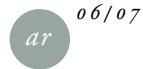
Key financial data of the profit and loss statement

IN MIL. € (IAS/IFRS)	2006/07	%	2005/06	%
Net sales	482.2	191.6 %	425.6	174.0 %
Value-added turnover	251.7	100.0 %	244.6	100.0 %
EBITDA	48.9	19.4 %	59.4	24.3 %
EBIT	20.1	8.0 %	35.2	14.4 %
EBT	11.0	4.4 %	26.7	10.9 %
Net income from continuing operations	18.9	7.5 %	17.8	7.3 %
Net income from discontinued operations	14.8	5.9 %	-6.0	-2.5 %
Group net income after taxes	33.7	13.4 %	11.8	4.8 %
Net income per share				
from continuing operations (€)	3.04	—	2.87	—
Group net income per share (€)	5.42	—	1.91	—

For the past business year, changes in accounting or valuation standards have not materially influenced the comparability of financial data.

The most significant change in our reporting results from the successful divestiture of the business segment *direct marketing* during the business year 2006/07. The transaction was consummated on July 31, 2007. The segment *direct marketing* is stated in this Annual Report as discontinued operations. Consequently, both the profit and loss statement and the cashflow statement do not contain any data related to *direct marketing*. The data of the prior year were adjusted accordingly.

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THE DIVESTITURE OF
DIRECT MARKETING

RESULTED IN

THE REALIZATION OF HIDDEN RESERVES,
THE REDUCTION IN LIABILITIES TO BANKS,
AND HAS FREED MANAGEMENT CAPACITY.

Our new Dutch subsidiary *biegelaar* was initially consolidated on November 1, 2006. During the reporting year, *biegelaar* contributed to the *group* € 19.3 million in terms of value-added turnover and negative € 0.8 million in terms of earnings before taxes. Due to market trends, the results were somewhat lower than expected, but the operating expectations were generally met; through *biegelaar*, orders were obtained, which were executed at German production sites. Included in the financial statements for the business year 2006/07, are the data attributable to *reus*, which was initially consolidated on May 1, 2006.

Due to the consolidation of *biegelaar*, the *group* achieved an increase in value-added turnover to € 251.7 million compared to € 244.6 million in the previous year. Earnings before taxes from continuing operations totaled € 11.0 million after € 26.7 million in the previous year. Reflected in this pronounced decline is the tremendous price pressure in our industry.

Various cost categories in the profit and loss statement show in part significant increases in comparison to the previous year. The increases on account of consolidations significantly exceed the cost reductions that have been implemented in various areas and which have positively influenced the results of the past business year.

The addition of *biegelaar* led to a pronounced increase in the cost of materials since this entity has traditionally a lower rate of paper provided by customers than the *schlott group*. Accordingly, more paper flows through our profit and loss accounts, which is reflected in both the cost of materials and net revenue. Moreover, purchased services registered a strong increase. Aside from the effects of consolidation, markedly higher energy costs are also reflected in the accounts.

Personnel expenses rose appreciably less than the other cost categories as we were able to avoid cost-intensive production shifts due to central production planning. In addition, *biegelaar* is in a position to employ higher levels of temporary workers based on collective bargaining agreements in The Netherlands, reducing personnel expenses on the one hand, but producing a corresponding increase in other operating expenses on the other.

Other operating expenses reflect the increase in rental and leasing expenses attributable to leased production facilities of *biegelaar* and *reus*, in contrast to the *schlott group*, which owns the majority of its facilities. The marked increase in scheduled depreciation during the past business year is the result of the high levels of capital expenditures in previous years, particularly in the new intaglio printing line in Freudenstadt.

The financial results include rising levels of interest expenses due to higher utilization of credit lines during the year in connection with the funding of capital expenditures and the acquisition of *biegelaar* and *reus*. On the other hand, significantly higher earnings from financial assets, aided by the optimal application of interest rate hedging instruments, mitigated to a large extent the increase in interest expenses. Moreover, the indebtedness to financial institutions was significantly reduced in the second half of the year due to the sales proceeds realized from the divestiture of the business segment *direct marketing*.

During the year 2006/07, income taxes paid were a negative € 7.9 million compared to € 8.9 million in the previous year; the gains realized by the divestiture of the business segment *direct marketing* were essentially tax free. Moreover, the reduction in deferred taxes in the context of the German Corporate Income Tax Reform Act and the required capitalization of corporate income tax credits had a positive impact on earnings. Net income after taxes from continuing operations amounted to € 18.9 million after € 17.8 million in the previous year.

The business segment *direct marketing*, which is shown in the financial statements as discontinued operations, performed positively as expected during fiscal year 2006/07. Until the closing date of the transaction, income before taxes came to € 3.1 million after a loss of € 4.7 million during the entire previous year. A portion of this improvement, i.e. € 1.8 million resulted from the suspension of scheduled depreciation for fixed assets held for divestiture in line with IFRS 5. Earnings after taxes amounted to € 3.2 million after a loss of € 6.0 million in the previous year. Inclusive of the net gains after taxes from the sale of this business segment in the amount of € 11.6 million, net results from continuing operations totaled € 14.8 million following a loss of € 6.0 million in the previous year. In sum, total net income for the *group* increased from € 11.8 million in fiscal year 2005/06 to € 33.7 million for the reporting year.

FINANCIAL POSITION

Balance sheet footings of the *schlott group* have markedly declined in the course of the divestiture of the business segment *direct marketing*. The equity ratio registered a strong increase. Likewise, free cashflow developed favorably during the business year.

Key balance sheet figures

IN MIL. € (IAS/IFRS)	9-30-2007	%	9-30-2006	%
<i>Long-term assets</i>	417.1	81.9 %	443.8	83.3 %
Goodwill	81.8	16.1 %	89.6	16.8 %
Property, plant and equipment	307.5	60.4 %	342.4	64.2 %
Investment properties	6.1	1.2 %	7.6	1.4 %
<i>Short-term assets</i>	92.1	18.1 %	89.2	16.7 %
Inventory	24.6	4.8 %	21.4	4.0 %
Accounts receivable	47.8	9.4 %	57.7	10.8 %
Cash and cash equivalents	2.6	0.5 %	2.9	0.5 %
Total assets	509.2	100.0 %	533.0	100.0 %
<i>Shareholders equity</i>	181.5	35.6 %	153.5	28.8 %
<i>Long-term debt</i>	157.0	30.8 %	181.7	34.1 %
Provisions	26.4	5.2 %	30.0	5.6 %
Due to banks	99.7	19.6 %	115.3	21.6 %
Deferred taxes	28.3	5.6 %	32.5	6.1 %
<i>Short-term liabilities</i>	170.7	33.5 %	197.8	37.1 %
Due to banks	71.3	14.0 %	78.7	14.8 %
Accounts payable	54.2	10.6 %	45.1	8.5 %
Total liabilities	509.2	100.0 %	533.0	100.0 %

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Key Figures of Cashflow

IN MIL. € (IAS/IFRS)	2006/07	2005/06
Cashflow from ordinary business activities	28,4	46,3
Investments in property, plant and equipment	- 11,0	- 46,8
Receipts from disposals of property, plant and equipment	1,1*	—
Investments in intangible assets	- 0,6*	—
Receipts from disposals of intangible assets	0,1*	—
Investments in financial assets	- 10,4	- 46,8
Distributions to shareholders	- 6,2	- 6,2
Free Cashflow	11,8	- 6,7
Receipts from disposals of property, plant and equipment	—	15,6*
Investments in intangible assets	—	- 1,7*
Receipts from disposals of intangible assets	—	3,9*
Acquisition of subsidiaries	- 17,7	- 11,4
Divestiture of subsidiaries	29,6	0,2
Net cashflow from acquisition activities	11,9	6,6
Cashflow from financing activities	- 23,0	2,0
Cashflow for the period	0,7	1,9

*The disposals of property, plant and equipment as well as the changes in intangible assets result from ordinary business activities during 2006/07, while for the business year 2005/06 the changes are accounted for by acquisition activities.

The changes in the balance sheet as per September 30, 2007, in comparison to the previous year, are primarily attributable to the divestiture of the segment *direct marketing* and the initial consolidation of *biegelaar*. Total footings as of year-end amounted to € 509.2 million after € 533.0 million in the previous year. At the same time, the equity ratio at year-end rose to 35.6 percent after 28.8 percent in 2005/06. Net total debt declined from € 191.1 million to € 168.4 million. The important policy ratio for the management of the *schlott group* of total debt to sustainable EBITDA rose, however, from 3.2 to 3.4 in fiscal year 2006/07 due to the high level of price pressure.

The composition of the asset side of the balance sheet remained essentially unchanged. At year-end, 81.9 percent of total assets represent long-term assets after 83.3 percent in the previous year; short-term assets accounted for 18.1 percent of total assets after 16.7 percent in the previous year. Within these two large balance sheet positions, no marked changes have occurred.

On the liabilities side of the balance sheet, the share of long-term debt declined from 34.1 percent to 30.8 percent, while the share of short-term debt was reduced from 37.1 percent to 33.5 percent. The repayment of financial liabilities has taken place in both positions.

Cashflow from ordinary business activities amounted to €28.4 million in the reporting year, compared to €46.3 million in the previous year. The decrease is partly accounted for by weaker earnings, but particularly by a reduction in provisions, especially provisions for in-come taxes. Cashflow from changes in net current assets was immaterial.

The free cashflow of the *schlott group* totaled €11.8 million for the reporting year following a negative cashflow of €6.7 in the previous year; details to this effect are included in the tabulation “Key figures of cashflow”. In this connection it must be noted that in the previous year only cash utilized for capital expenditures was allocated to ordinary business activities, while the other changes were attributable to acquisition activities. During the reporting year, the latter are exclusively accounted for by cash utilized for the acquisition of subsidiaries or by cash generated through the divestiture of subsidiaries.

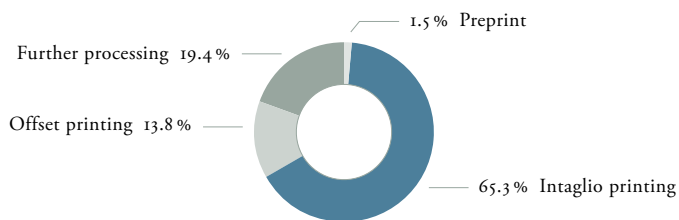
The marked improvement in free cashflow for fiscal year 2006/07 resulted from the planned reduction of capital expenditures to an amount of €11.0 million, after having expended unusually high levels of €46.8 million in the previous year – particularly for the new intaglio printing line in Freudenstadt as well as the construction of necessary buildings.

Acquisition activities produced a net cashflow for the *schlott group* of €11.9 million in the reporting year. Receipts from the divestiture of the business segment *direct marketing* are to be viewed alongside cash expended for the acquisition of *biegelaar* as well as for the residual purchase price for *reus* in the amount of €10 million. In the previous year, receipts from acquisition activities produced a cashflow of €6.6 million.

The free cashflow for fiscal year 2006/07, together with the receipts from the dissolution of group financing for discontinued operations in the amount of €14.5 million, was applied to the payment of interest expenses and the reduction in liabilities to financial institutions. The reduction in liabilities to financial institutions amounted to €26.4 million in the reporting year compared to an increase of €10.5 million in the previous year. In total, the net change in cash for the reporting year was €0.7 million after €1.9 million in the previous year. >>

— VALUE-ADDED TURNOVER BY SERVICE ACTIVITY IN THE BUSINESS SEGMENT PRINT

100 percent = € 247.8 million



— **SEGMENT REPORTING:** *The Business Segment Print was not Insulated from the Effects of General Market Conditions – Marked Deterioration of Earnings during the Business Year.*

Following the divestiture of the business segment *direct marketing*, segment reporting includes the business segments *print* and *corporate services*. The delineation of these two segments has not changed. In conformity with IFRS, we continue to display as secondary segments turnover, net assets and capital expenditures as well as the value-added turnover by geographic regions.

— **BUSINESS SEGMENT PRINT**

PRODUCTION, PRODUCTS AND SERVICES

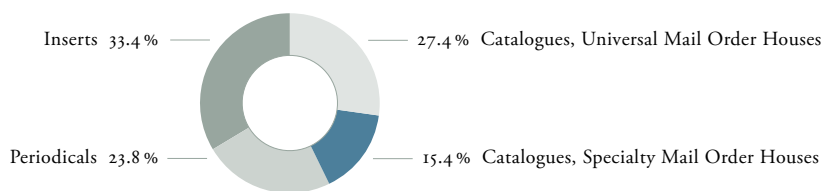
Results of the segment print

IN MIL. € (IAS/IFRS)	Value-Added Turnover		External Sales	
	2006/07	2005/06	2006/07	2005/06
Preprint	3.8	4.0	4.1	4.2
Intaglio printing	161.8	163.3	363.0	323.6
Offset printing	34.2	32.2	81.0	71.2
Further processing	48.0	40.7	33.0	24.6
Total	247.8	240.2	481.1	423.6

The services of the *schlott group* in the business segment *print* include the areas of preprint, intaglio printing, offset printing as well as further processing. The shares of these different services in relation to value-added turnover have not materially changed from the previous year. The initial consolidation of *biegelaar* has led to a slight increase in the share of intaglio printing, while the share of further processing declined compared to the previous year.

VALUE-ADDED TURNOVER BY PRODUCT IN THE BUSINESS SEGMENT PRINT

100 percent = € 247.8 million



The major part of the business activity of the *schlott group* is accounted for by intaglio printing. We are servicing our market with 21 flexible printing lines having medium and larger widths out of four domestic and one international site. Intaglio printing is the classical printing process for high quality and high volume printing products, which are produced at high speeds.

The offset printing activities include the modest, but attractive business of sheet offset printing as well as the execution of orders at our site in Lübeck where we work with so-called flat formats. In this way, we are employing a printing process, which optimally complements our service and product mix.

The steps that are positioned after the end of the printing process are domiciled in the area of further processing. The *schlott group* is positioned uniquely in this area on a Europe-wide basis; we enjoy the largest further processing capacities in Europe, all of which are favorably positioned in terms of logistics.

Traditionally, the *schlott group* generates the highest margins by far in the area of intaglio printing. In spite of the enormous price pressures that affected earnings during the past business year, a significant contribution to *group* results came again from this segment. In the areas of offset printing and further processing, we were able to again improve results during the past year. In this regard, our new line in Lübeck and improvements in processes are paying dividends.

In terms of printing products, 27.4 percent of the value-added turnover in the business segment *print* was generated by catalogues for universal mail order houses and 15.4 percent by catalogues for specialty or niche mail order houses. Periodicals account for 23.8 percent of value-added turnover and advertisement inserts are responsible for 33.4 percent. In comparison to the previous year, the share of inserts has increased, while the share of catalogues for both types of mail order houses was slightly lower. Our focus on advertisement inserts, which drove the acquisition of *biegelaar* and the establishment of the new line in Freudenstadt, has been successfully executed.

The *schlott group* enjoys a special competence in the area of sophisticated advertisement inserts, where we have developed special expertise, particularly at our sites in Landau and Freudenstadt. This enables us to produce in intaglio printing unique and sophisticated products in an economically efficient manner and with highest levels of quality.

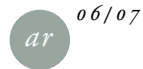
With the activation of our new line in Freudenstadt at the beginning of the reporting year, we have considerably expanded our capacities in this area; two lines, which had reached the end of their service lives, have been shut down. The new line with its variable formats and flexible folding options covers an unusually wide range of production variations at the typical high production speeds inherent in intaglio printing. The line was configured to the exact requirements of the *schlott group* and has no equal anywhere in the world. In addition, our process efficiencies in the preprint and further processing stages permit short reaction and production times. We are well positioned to grow in this attractive market segment for sophisticated advertisement inserts.

In strategic terms, the *schlott group* has the goal of increasing in terms of value-added turnover the shares of catalogues for specialty mail order houses, for periodicals and, as described above, for advertisement inserts. The business prospects for universal mail order houses continue to be burdened by the changed behavior and preferences of German consumers. Specialty mail order houses, on the other hand, are benefiting from sustained positive impulses. Periodicals continue to represent an attractive market in which we foresee opportunities for growth. Moreover, our Dutch subsidiary *biegelaar* is expected to generate additional growth opportunities for us.

Developments in the segment print

IN MIL. € (IAS/IFRS)	2006/07	%	2005/06	%
External sales	481.1	194.1 %	423.6	176.4 %
Value-added turnover	247.8	100.0 %	240.2	100.0 %
<i>EBIT</i>	19.1	7.7 %	36.1	15.0 %
Short-term interest result	- 4.9	- 2.0 %	- 1.7	- 0.7 %
<i>Segment results</i>	14.2	5.7 %	34.4	14.3 %
Long-term interest result	- 1.6	- 0.6 %	- 2.9	- 1.2 %
Foreign exchange result	0.3	0.1 %	- 0.4	- 0.2 %
<i>EBT</i>	12.9	5.2 %	31.1	12.9 %
Total segment assets	418.2	—	395.6	—
Total segment liabilities	249.3	—	226.4	—
Segment capital expenditures	48.4	—	72.1	—

The business segment *print* achieved during the business year 2006/07 an increase in value-added turnover of 3.2 percent from € 240.2 million in the previous year to 247.8 million. Earnings before taxes amounted to € 12.9 million compared to € 31.1 million in the previous year. Value-added turnover increased due to the effects of initial consolidations and would have declined by 4.9 percent had *biegelaar* not been included in the consolidation; the decline was due to price pressure. When comparing the increase in tonnage processed of 12.4 percent from 543,200 tons in the previous year to 610,400 tons in 2006/07, with the results, the extent of price pressure that we had to digest becomes clear (see “industry-typical performance indicators of the *schlott group*” on page 59). The effects of price declines are slightly overstated when comparing tonnage processed with value-added turnover. This is due to the trend to utilize paper with higher grammage, resulting in higher tonnage processed without increasing the printed area. The basic argument, however, is valid.



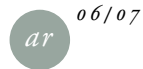
In the future we will concentrate
all our strengths and resources
on our core competence
EUROPEAN PRINTING

Following the deconsolidation of the business segment *direct marketing*, the totality of operations within the *group* is accounted for by the segment *print*. Outside of this segment, the only other functions consolidated are those of the business segment *corporate services*. Accordingly, the Notes regarding developments in the individual positions of the profit and loss statement for continuing operations of the *group* as shown on pages 61 pp also apply to the business segment *print*, making it unnecessary to restate these Notes here.

CORPORATE SERVICES

As in prior years, all service activities, including those of *schlott gruppe AG*, are domiciled in the segment *corporate services*. The developments in value-added turnover and earnings in this area accounted for exclusively by the internal allocation of services and overhead expenses. During the reporting year, EBT of this business segment amount € 2.7 million after negative € 3.8 million in the previous year.

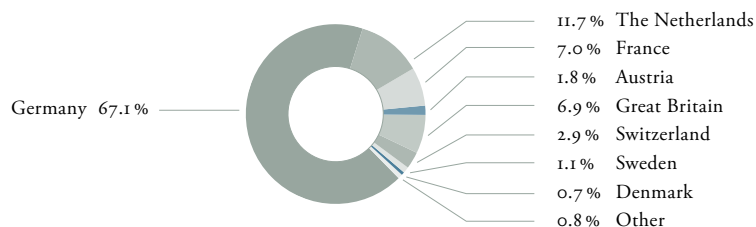
As a result of the deconsolidation of the business segment *direct marketing*, many positions in the profit and loss accounts related to the segment *corporate services* have fallen markedly. Personnel expenses, however, have risen as a result of increased provisions for bonuses for the Members of the Board of Management after very modest bonuses in the previous year. Moreover, the position of Chief Financial Officer was vacant until May 31, 2006. Finally, in the course of personnel adjustments, redundancy payments were made. The expenses due to financing activities in the segment *corporate services* remained significantly under the previous year's level, mainly due to the positive effects of optimal hedging policies related to interest rate risks.



With the acquisition of *biegelaar*
we were able to significantly increase
our share of the European
VALUE-ADDED TURNOVER

VALUE-ADDED TURNOVER BY DOMICILE OF CUSTOMERS 2006/07

100% = € 247.8 million



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 base, particularly in intaglio printing, remains mostly in Germany.

Outside of Germany, we have an intaglio printing site in Maarsse, south of Amsterdam, The Netherlands, as well as further processing sites in France and in the Czech Republic. Based on this constellation, 81.7 percent of the *group's* assets were in Germany at the end of fiscal year 2006/07. As a result of the initial consolidation of *biegelaar*, this share has slightly fallen compared to the previous year.

The international share of our operations is reflected in the table showing value-added turn-over by geographic regions. Allocations are made on the basis of target markets for which a printing product is produced. For example, the printing product of a German customer for the French market is aligned with France.

During fiscal year 2006/07, turnover by geographic regions has changed due to the deconsolidation of the business segment *direct marketing*. For the purpose of transparent reporting, we are also showing the allocation of value-added turnover for the business segment *print* for the previous year.

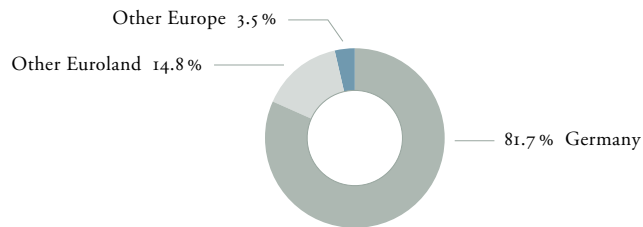
Value-Added Turnover in the Business Segment print by Domicile of Customers

IN MIL. € (IAS/IFRS)	2006/07	2005/06
Germany	166.2	181.5
The Netherlands	29.1	11.9
France	17.3	18.0
Austria	4.5	2.5
Great Britain	17.0	14.5
Switzerland	7.2	5.5
Sweden	2.8	3.0
Denmark	1.7	1.9
Other	2.0	1.4
Total value-added turnover	247.8	240.2

>>

TOTAL SEGMENT ASSETS AS PER SEPTEMBER 30, 2007, PRIOR TO CONSOLIDATION

100% = € 429.8 million



The above table depicts the ongoing weakness in the German market while international markets have developed more favorably. The main factor of this differing development is the disproportionate share universal mail order houses have in German retail trade compared to other European countries; and universal mail order houses are directly affected by low levels of consumption and changes in customer preferences.

In view of the above, the value-added turnover in Germany of the *schlott group* declined by 8.4 percent to € 166.2 million during the past business year. Mirrored in this result is the continuing price pressure.

In international markets, however, we experienced visible growth. Even in Great Britain, where considerable additional capacity was added, we were able to register growth. We are gaining market share in international markets and our growth comes particularly from our existing customer base with which we were able to expand our business relationships. The *schlott group* can therefore generate additional business via its competitive advantage in terms of positioning on a European scale and with its high levels of reputation among customers.

Due to above-average capabilities of the domestic printing industry, the demand for printing products on the part of international customers has grown disproportionately. We have taken advantage of this trend in order to strengthen further our market position. In spite of the appreciation for the capabilities of the German printing industry, the Europe-wide competition with its often more favorable cost structures reduces prices achievable in Germany to the European level. We are challenged, therefore, to alleviate the disadvantages arising out of collective wage agreements applicable to the domestic intaglio printing industry through further cost reduction measures and via additional acquisitions.

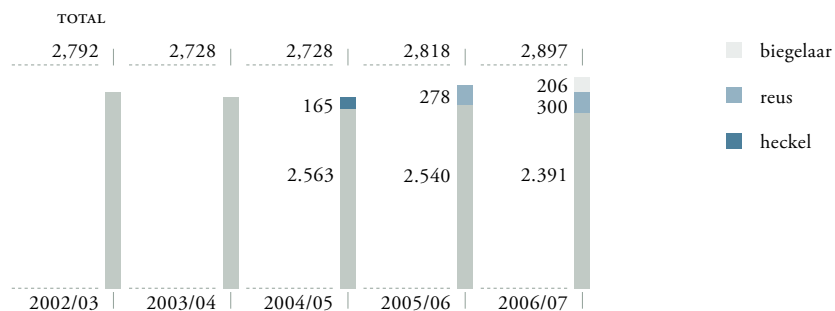
PERSONNEL: *Comprehensive Cost Reductions are Required*

The general market environment necessitates fundamental and broadly-based cost reduction measures.

During the past business year, various measures have already been implemented with further substantial steps to follow.

In the course of the past year, we have reached agreements with the workers' council regarding headcount adjustments, a portion of which has already been implemented. With these steps, we have largely exhausted the possibilities of changes in personnel policies in the context of the collective bargaining agreement. Excluding changes

TRENDS IN THE STAFF COUNT OF THE BUSINESS SEGMENT PRINT



in headcount attributable to the two subsidiaries *reus* and *biegeelaar*, headcount in the business segment *print* was reduced by 149, or by 5.9 percent, to 2,391 after 2,540 in the previous year. Part of this adjustment is accounted for by the outsourcing of internal logistics at the intaglio printing sites in Freudenstadt, Hamburg and Landau. In addition to the foregoing, a variety of smaller adjustments were undertaken in various areas within the *group*.

At *reus*, we have increased headcount to 300 in the course of the business year, after 278 in the previous year, to enable us to execute a significantly higher order volume. In addition, headcount in the business segment *print* grew in the course of the year due to the acquisition of *biegeelaar* as of November 1, 2006. As per September 30, 2007, *biegeelaar* employed 206 persons. In sum, headcount in the segment *print* totaled 2,897 at the end of the fiscal year 2006/07, after 2,818 in the previous year.

Personnel employed in the segment *direct marketing*, which numbered 1,137 at the end of fiscal year 2005/06, were eliminated from headcount in the course of the deconsolidation on July 31, 2007.

In the segment *corporate services*, we also practice strict cost control. The number of persons employed at year-end totaled 97 following 107 at the end of the previous fiscal year.

In total, the *schlott group* employed at the end of the business year 2006/07, 2,994 persons compared to 2,925 persons in the previous year without the segment *direct marketing*, and 4,062 persons including *direct marketing*.

The measures undertaken during the past business year evidence our continued focus on the need to make necessary cost reductions in order to secure the competitiveness of the *schlott group*. For that reason, we are currently engaged in negotiations with workers' representatives with the goal of agreeing to further cost reductions. These negotiations are expected to make a positive contribution already in the course of the current year; more substantial savings are expected to be realized in the following fiscal year with the full impact and benefit being felt in the fiscal year 2009/10. The costs of these restructuring measures will lead to one-time expenses, which will be mostly incurred in fiscal year 2007/08.

— EARNINGS AND FINANCIAL POSITIONS 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 by the *AG* remained essentially the same as in the previous year.

The *AG* does not have its own operating activities, but provides the central service functions within the *group*, such as controlling, internal audit, investor relations, marketing, corporate development as well as treasury operations for subsidiaries. Consequently, the revenue of the *AG* represents essentially cost allocations to subsidiaries; changes at year-end reflect primarily timing differences.

Personnel expenses of the *AG* have risen appreciably during the past year as a result of higher provisions for performance-based compensation for Members of the Board of Management; in the previous year, only very modest bonuses were distributed. Moreover, the position of Chief Financial Officer was vacant until May 31, 2006. The reduction in other operating expenses is accounted for by the planned reduction in legal and consulting fees, which were unusually high in the previous year.

The profit and loss accounts of the *AG* are materially influenced by profit and loss absorption agreements with affiliated companies. The year-end financial statements are thus affected by investments in affiliated companies, the operating results of such companies as well as the results from financing activities within the *AG*.

The divestiture of the business segment *direct marketing*, i.e. the sale of *meiller direct GmbH* and its subsidiaries, has influenced the profit and loss statement of the *AG* at year-end 2006/07. On the one hand, the gain from disposals is included in income from profit absorption agreements inasmuch as *meiller direct GmbH* was owned by the *AG* indirectly via two subsidiaries.

On the other hand, following the sale of these substantial assets, the book value of an intermediary subsidiary had to be adjusted, which was reflected in depreciation expenses of financial assets. On a net basis, the *AG* realized a gain of € 20.6 million from the sale of *meiller*: a gain in book value in the amount of € 40.4 million is reduced by the aforementioned depreciation expenses in the amount of € 19.8 million. The increase in gains from profit absorption agreements of € 38.7 million after € 23.4 million in the previous year resulted exclusively from the sale of *meiller*. Without this one-time gain, the high price pressure in intaglio printing and the resultant deterioration in earnings of

the respective subsidiaries would have become visible. Expenses on account of loss absorption agreements increased during the business year to €6.6 million compared to €0.2 million in the previous year.

In total, earnings from ordinary business activities of the *AG* totaled €13.6 million after €23.0 million in the previous year. The position “Income taxes” shows a positive €3.5 million following an expense of €7.6 million in the previous year. This is due on the one hand to the essentially tax-free treatment of the gains realized from the *meiller* transaction; on the other, positive effects resulted from the required capitalization of corporate income tax credits. Through these two effects, the net income for the reporting year of *schlott gruppe AG* rose to €17.1 million after €15.4 million in the previous year.

FINANCIAL POSITION

Since the *AG* assumes the service functions of the *group* as well as the financing of subsidiaries, it does not possess significant fixed assets. The structure and development of the balance sheet reflects essentially the *AG*'s financial assets and items arising out of its financing function. The former contains as its major position shares in affiliated companies; the latter is shown on both sides of the balance sheet in either accounts receivable from or payable 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 slightly during the reporting year to €329.9 million following €316.4 million in the previous year. The expansion of the balance sheet followed essentially from higher levels of receivables related to affiliated companies, which rose from €112.3 million to €124.4 million. Shares in affiliated companies fell slightly from €167.0 million to €163.8 million at year-end 2006/07. The adjustment of the book value of an intermediary subsidiary was contrasted by additions on account of the *biegelaar* acquisition.

Shareholders equity increased from €148.8 million to €159.7 million in line with the net in-come for the year; the equity ratio rose from 47.0 percent to 48.4 percent. The increase in shareholders equity must be seen alongside a reduction in provisions for taxes from €8.3 million to €0.3 million. Total liabilities rose from €156.7 million to €166.3 million at the end of 2006/07.

The cashflow from ordinary business activities of *schlott gruppe AG* rose to € 29.7 million in the reporting year compared to € 13.5 million in the previous year; the previous year's amount was unusually low due to year-end timing differences. Cash generated was employed to the extent of € 26.5 million for funding the acquisition of new subsidiaries. Included is the purchase price of *biegelaar* as well as the residual purchase price of € 10 million for *reus*. Total cashflow from investment activities amounted to € 26.7 million after € 12.5 million in the previous year.

Cash consumed by financing activities in the amount of € 3.1 million (€ 1.0 million in the previous year) is accounted for essentially by the unchanged distribution to shareholders of € 6.2 million, the repayment of financial loans in the amount of € 2.8 million after € 1.3 million in the previous year as well as by € 10.1 million required in the context of *group* financing activities; the latter was financed by contracting financial credits in the amount of € 16.0 million. In the previous year, € 6.1 million were derived by the *AG* from its *group* financing activities, thus making it unnecessary to take on additional debt. On a net basis, the cash position was unchanged compared to the previous year.

— ADDITIONAL INFORMATION

MARKETING AND DISTRIBUTION

The *schlott group* specializes in printing services for high volume editions on the basis of state-of-the-art industrial processes. The customer base, which requires printing products with high volumes on a Europe-wide basis, is clearly defined and well-known to us. Our marketing and distribution activities are thus focused primarily on the direct and individual support and maintenance of our existing customer base as well as on the acquisition of new customers.

Over the past years, there has been considerable fluctuation in the printing industry: customers gained additional strength in their price negotiations due to existing excess capacity in the industry, resulting in an increase in competitive pressures and negative impacts on earnings. This general change in market conditions causes long-term customer relationships to be less predictable at a time when the receipt of orders is essentially based on price considerations. On the other hand, new opportunities present themselves through dislocations of demand between the different *print* media and due to changes in market structure.

Our reputation for being a high-quality provider in the industry has been built over decades. We will retain this positioning and expand on it further. We are differentiating ourselves markedly from the competition on the basis of very high levels of service, high technological know-how and the extraordinary flexibility of our production machinery. Competitive pricing is part of the equation as long as returns permit sustainable business activity. A significant reduction in the cost basis will enable us to again generate attractive margins and returns on capital even at the current price levels. We will continue to be a long-term dependable partner for our customers.

LOGISTICS AND PROCUREMENT

The permanent improvement in internal logistics at the individual sites is an important part of ongoing optimization measures applied within the *schlott group*. Following improvements achieved in the course of property enhancements at the various sites during the past years, we have continued our efforts during the past business year to outsource internal logistics at our German intaglio printing sites. In addition, a multiple number of small steps and measures undertaken on an ongoing basis will in their sum lead to substantial cost savings.

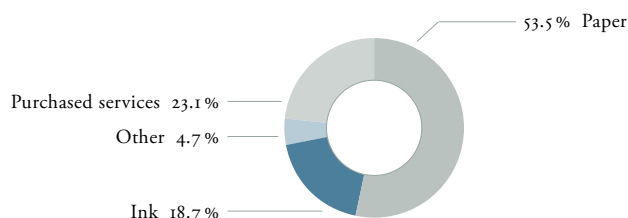
Paper and ink are the decisive procurement items of the category raw materials and supplies. In this connection, even after the acquisition of *biegelaar*, paper procured by us continues to represent a considerably smaller share of total tonnage processed.

Even in today's market environment, the price risk for paper is not assumed by us as paper continues to be largely a flow-through item. Rising prices for paper do, however, burden the budgets of our customers as an increase in the price of paper rarely leads to an automatic adjustment in their spending plans; indirectly, competition is increased further and price pressure in the industry intensifies.

Major positions within the category "purchased services" are expenses for freightin, which is provided by external forwarders, as well as the cost of energy.

COST OF MATERIALS 2006/07

100 % = € 234.9 million



Composition of the Cost of Materials

IN MIL. € (IAS/IFRS)	2006/07	2005/06
Paper	125.7	80.9
Ink	43.9	40.1
Other	11.0	7.8
Services purchased	54.3	49.6
Total	234.9	178.4

The markets for materials procured are highly concentrated and are controlled by a small number of international suppliers. We have already in the past undertaken steps to avoid dependency on individual suppliers, to minimize delivery times and to reduce costs via centrally coordinated purchasing for the entire *group*; just-in-time delivery plays an important role in this process. In the future, we will strive to reduce costs further by applying technical possibilities and expertise related to the utilization of paper qualities, ink and ancillary materials. The procurement function will develop even further into a strategic instrument and will make an important contribution to the cost reduction initiatives of the *schlott group*.

SUSTAINABILITY

Sustainability within the *schlott group* does not only represent a part of the value-added process, it is the core of the process. We recognize the obligations we have toward future generations. At the same time, we are convinced that companies recognizing the importance of sustainability will in the longer term generate higher rates of return, have access to a more broadly-based customer universe and have a greater appeal to investors.

Concern for the environment is an important factor in our orientation for sustainability. As a *company* utilizing and processing paper we are consuming natural resources to a high degree. In addition, the printing process requires the employment of a multitude of chemicals and other substances dangerous to the environment. We are handling these substances carefully and responsibly and accept that we are operating in an ecologically sensitive area.

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 and identify additional opportunities for improvement. We are documenting our efforts in this area and include these in the context of our environmental reporting.

In addition, our production sites have been certified for several years as per ISO 9001: 2000 as well as per DIN EN ISO 14001 and 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 rate significantly below such limits.

Examples evidencing environmental measures going beyond the norms can be found at many sites: 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. The new facility in Freudenstadt operates with state-of-the-art technology and significantly lower energy consumption.

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 to 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 reverseosmoses process.

In addition, we are certified by the Forest Stewardship Council (FSC) in line with the “Program for the Endorsement of Forest Certification Schemes” (PEFC). What was initially developed as a program for evidencing our responsible behavior with respect to forestry is now being applied to all components of our product range. The same certification applies to companies that work with or trade in wood and wood products.

As a consequence, the entire path of wood from certified forests to the finished good is made transparent and can be monitored; the same holds true for the entire value-added chain. This “Chain of Custody” assures that any prohibited amalgamation of certified and non-certified wood products is avoided, which is also in the interest of the consumer. As a certified *company* the *schlott group* may use the official certification logo and PEFC certificate in its presentation to its markets and customers.

RESEARCH AND DEVELOPMENT

The *schlott group* does not engage in extensive research and development activities. It is a service organization involved in the production of print-supported advertisement and marketing products required by our customers. In this process, no own products are employed or developed. Instead, we are employing creatively and competently technologies available in the general market often in close coordination with suppliers for configuration to our special needs. We are thus able to realize a broad range of printing products within short time frames in an economically efficient manner.

STATEMENT ON RISKS

INTRODUCTION

The *schlott group* is an internationally active corporation facing a multitude of possible risks. To this effect, we employ a group-wide risk management system that goes beyond legal requirements and that is continually upgraded. The purpose of the system is to identify risks in a timely fashion, to evaluate risks and to communicate these to Management. All operating units within the Corporation are firmly embedded in this process. Each operating unit manages independently all existing risks within their areas of responsibility. At the corporate level, all risks within the *schlott group* are collected and managed. The entire process of the risk management system is defined and documented in a procedure manual.

The “Risk-Monitor TM” supports the EDP-technical implementation of the risk management. All risks are evaluated in terms of their probabilities to occur and in terms of the possible financial impact. All risk factors are designated in terms of probabilities as ‘modest’, ‘medium’, ‘high’ or ‘very high’. Multiplying probabilities by the possible loss leads to the following categorization:

- *risks to be observed*
- *risks to be monitored*
- *(material) risks to be reported*

Risks that are to be monitored and material risks to be reported are communicated to the Board of Management and the Supervisory Board on a quarterly basis; unexpected events are reported on an ad-hoc basis. Each subsidiary has appointed a risk management officer who is responsible for the recording of local risks and for

reporting these to local management; the latter communicates directly with the senior risk management officer at the corporate level.

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 external auditor.

All types of risks recorded in the Risk Monitor are described in greater detail below. Aside from its functions as an early-warning and monitoring system, the risk management system also provides for the identification and quantification in the Annual Report of risks related to the future development of the Corporation.

GENERAL ECONOMIC RISKS

Trends in the printing industry continue to lag the economic revival in Germany. Reasons for this are the Europe-wide excess capacity in intaglio printing, the enormous competitive pressure produced by our customer group of universal mail order houses, the higher costs for paper and energy and, finally, the only modest increase of advertising expenditures. In this connection, as stated under the chapter “Logistics and Procurement” on page 81, the *schlott group* is only affected to a limited degree by higher prices for paper in contrast to many other companies in the industry. Moreover, the high cost structure in Germany represents a competitive disadvantage in the European context, particularly in the area of intaglio printing.

— RISK CATEGORIES

CUSTOMER AND INDUSTRY RISKS

The greatest risks faced by the *schlott group* in terms of earnings continue to be found in the areas of customers and the industry, as already described in our risk report for the business year 2005/06. The reasons for the poor trends in our industry during the past years are the additional capacity created in the intaglio printing market and an increased competition from offset printing in the area of high volume production of printing products.

At the same time, the demand for printing products in important markets is stagnating as a result of difficult business conditions in important customer groups of intaglio printing as well as of weak customer demand in Germany. In addition, changed marketing strategies of universal mail order houses having transferred orders from periods of high utilization and price to so-called low seasons when capacity is plentifully available, produced negative consequences to the entire price structure of the industry.

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In the risk report contained in our Annual Report for 2005/06, we have identified and described the risks in our industry, which could negatively influence the earnings position. Price pressure during the past business year has, however, once again gathered intensity and speed such that the positive effects of the then already implemented as well as planned cost reduction measures were more than offset.

By now, price levels in our industry have fallen to an extent that significant cost reduction measures, which go beyond the usual productivity improvements sought on an ongoing basis, must be undertaken. A short-term reaction to the described market trends yielded only limited results, requiring, as a consequence, a new urgent response to this issue.

We are currently preparing cost reductions at all intaglio printing sites to the extent collective agreements permit a reduction in production capacity and the concurrent reduction in personnel. Through these measures, we will compensate continued price pressure and will operate profitably on a sustainable basis.

FINANCIAL RISKS

Interest rate, foreign exchange and liquidity risks represent the most important financial risks to the *schlott group*. In addition, the consolidated balance sheet faces the risk of impairments of capitalized assets.

The *group's* central treasury department is responsible for hedging transactions arising from ordinary business activity as well as for the planning and management of liquidity. Currently existing credit lines and loan commitments assure the future availability of sufficient financing and liquidity resources. A comprehensive system of managing accounts receivable is designed to minimize losses; accounts receivable are also reinsured to the extent possible.

To guard against possible losses related to transactions that are undertaken with international partners or customers, forward foreign exchange transactions are employed. Interest rate risks inherent in floating rate credit facilities are hedged through respective derivative instruments. All hedging transactions are exclusively employed for minimizing risks; no open positions are being maintained.

In compliance with IFRS, capitalized goodwill must be subjected to an annual impairment test to assure that it is covered by the book value of the underlying entity. Due to the ongoing weakness in the printing industry, the *schlott group* is facing the risk of a fundamentally lower level of profitability, which may require a value adjustment in capitalized goodwill. This risk is addressed by the *schlott group* with ongoing measures of sustainable reductions in the cost structure. Moreover, financial liabilities are planned to be significantly reduced over the next years using the respective operating cashflow generated. At the end of fiscal year 2006/07, there was no need to record an impairment of goodwill.

IT-RISKS

Backup and safety systems are installed to guard against loss of data and downtimes of IT-systems, particularly in the area of production processes. Both hardware and software are up-dated on an ongoing basis to state-of-the-art security standards in order to secure permanent access to all necessary resources. Incoming data and emails are scanned for viruses, Trojans, etc., by means of applicable security systems. Each entity within the *schlott group* has appointed IT protection managers in order to minimize risks in this pivotal area.

LEGAL RISKS

The legal department at the Corporate level assures that risks arising out of contracts and agreements, particularly in the areas of warranties and contingent risks, are minimized. The divestiture of the *meiller group* gave rise to a warranty risk that is usual for this type of transaction. Based on current knowledge, no claims under this warranty are expected.

According to current estimates, no unit of the *schlott group* is involved in litigation or arbitration disputes, which could have a material negative impact on the financial condition of the Corporation.

TECHNOLOGY RISKS

The *schlott group*'s machinery and equipment benefits from proactive and preventive maintenance management in order to minimize risks of disruption or downtimes. A mature quality management system, setting forth in clearly defined terms the processes employed for sustaining quality, minimizes the risk of faulty production.

In the event of downtimes at one site, orders can be shifted to other sites within the Corporation since the configuration of machinery allows such transfers. The average age of machinery employed in intaglio printing is currently about 13 years. No risks with respect to unforeseen capital expenditures exist.

ENVIRONMENTAL RISKS

The declaration on environmental standards of the *schlott group* sets forth environmental and quality standards for the entire group and represents an integral part of the Corporation's management philosophy. The unique interests of man and the environment are taken into consideration in all policy decisions. Our internal "Eco-Audit" represents an instrument for the ongoing improvement of processes, the increase in safety standards and the reduction in environmental impact.

Since paper is one of the main inputs into our production, the *schlott group* has implemented the guideline for the improvement and support of sustainable forestry. The goal of the "Chain of Custody" is a trail of the product chain – it contains complete information from the stage of sustainable forestry to the end product. In this regard, the *schlott group* has subjected itself successfully to certification procedures as per FSC 2007.

MISCELLANEOUS RISKS

Suppliers of paper, ink and energy are the most important factors in procurement; undue dependencies to suppliers do not exist. Moreover, a centrally coordinated and controlled purchasing function within the *schlott group* minimizes risks in this area.

Adequate insurance coverage exists for fire and disruptions of operations, liability, transportation and credit losses.

— CORPORATE GOVERNANCE:

Implementation to a High Degree of the German Code of Corporate Governance

On January 11, 2008, the *schlott group* has issued a Declaration of Compliance with respect to the German Code of Corporate Governance in the format as published on July 20, 2007.

All respective declarations of the *schlott group* can be viewed on the homepage 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 35 – 39. On the same pages, we are elaborating in detail on the Corporate Governance philosophy of the Corporation.

The compensation for individual Members of the Board of Management is stated for the first time in this Annual Report. In this connection, the following compensation report was pre-pared, which also includes the compensation of Members of the Supervisory Board and fundamentals of the compensation system for the two Boards.

— COMPENSATION REPORT

COMPENSATION OF THE BOARD OF MANAGEMENT

Compensation of the Board of Management 2006/07

IN €	Total Compensation	Basic Compensation	Variable Compensation	Other Compensation*
Mr. Rose	802,223	462,000	308,000	32,223
Mr. Arnold	563,489	275,000	255,000	33,489
Mr. Reiser	558,943	291,336	239,480	28,127
Mr. Valeri	559,469	275,000	255,720	28,749
	2,484,124	1,303,336	1,058,200	122,588

*Included are pension benefits, company cars, D&O insurance without deductible for the Board of Management and the Supervisory Board and senior management. An itemized allocation of the insurance premium is not possible.

The compensation of the Members of the Board of Management consists of basic / fixed and performance-related shares as can be seen in the table above. Members have received a commitment from the Corporation for pension payments beginning at the age of 60. These pension rights do not expire and may be passed on to heirs. The premiums for this pension plan are paid by *schlott gruppe AG* into an external pension fund.

Performance-related compensation is based on annually recurring factors related to the achievement of *company* goals. For the business year 2006/07, the relevant factors were the attainment of the planned net income before taxes and liabilities to financial institutions. For the Chief Executive Officer, additional factors and goals are applied, which also impact the level of performance-related compensation.

During the business year 2006/07, the goals for the entire Board of Management were at-tained. Additional compensation in line with individual goals did not take place. Long-term incentives such as share options or similar constructions were not granted. In fiscal year 2006/07, the total compensation of the Board of Management amounted to € 2,484 thousand, of which € 1,058 thousand was accounted for by performance-based compensation. No Member of the Board of Management has received financial commitments with respect to the termination of their employment. Moreover, no Member of the Board of Management has received compensation or similar financial commitments from third parties on account of being a Member of the Board of Management.

COMPENSATION OF THE SUPERVISORY BOARD

Compensation of the Supervisory Board 2006/07

IN €	<i>Compensation</i>	<i>Other Benefits</i>	<i>Total</i>
Sigmund Kiener	30,625	—	30,625
Ivan Bebek	32,500	97	32,597
Nikolaus Broschek	20,000	998	20,998
Dr. Rainer Hillebrand (effective 03/13/2007)	8,125	369	8,494
Edmund Hug	15,000	—	15,000
Joachim Kohm	15,000	—	15,000
Josef Peitz (effective 10/04/2006)	15,000	277	15,277
Dr. Herbert Pototzky	20,000	277	20,277
Andrea Raab	20,000	277	20,277
Harald Roller (until 07/31/2007)	12,500	330	12,830
Michael Schlecht	15,000	2,021	17,021
Reinhold Schreiner	20,000	79	20,079
Erwin Kiefer (until 02/12/2007)	15,000	—	15,000
Total	238,750	4,725	243,475

Compensation for services rendered by the Members of the Supervisory Board amounted to €239 thousand (€236 thousand in the previous year). Members receive €15 thousand per year, the Chairman €30 thousand and the Deputy Chairman €22.5 thousand; for every membership in any of the Committees, with the exception of the Arbitration Committee, Members receive an additional €5 thousand. Travel expenses are reimbursed. The above table shows compensation and other benefits granted to the individual Members of the Supervisory Board.

In addition, a consulting agreement existed with Nikolaus Broschek, according to which he was paid a fee in the amount of €60 thousand (€60 thousand in the previous year). The consulting agreement was ended as of September 30, 2007. For Dr. Herbert Pototzky exists a pension liability, for which a provision in the amount of €45 thousand was made during the reporting year (€35 thousand in the previous year).

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— CHANGES IN THE COMPOSITION OF THE MANAGEMENT AND SUPERVISORY BOARDS

There were no changes during the reporting year in the make-up of the Board of Management.

Erwin J. Kiefer resigned on February 12, 2007, from his position as Chairman of the Supervisory Board. The new Chairman, Sigmund Kiener, was elected on the same date. Dr. Rainer Hillebrand was elected a Member of the Supervisory Board by the Annual General Meeting on March 13, 2007.

Josef Peitz became a workers representative on October 4, 2006. He succeeded Irene Salberg, who left the Supervisory Board on April 30, 2006. The position of Harald Roller, who exited the Supervisory Board in the course of the divestiture of *meiller direct GmbH* on July 31, 2007, was assumed by Reinhard Burck on October 1, 2007.

— DECLARATIONS AS PER ARTICLE 289, CLAUSE 4, AND ARTICLE 315,
CLAUSE 4 OF THE GERMAN COMMERCIAL CODE (HGB)

The shares of *schlott gruppe AG* are admitted to the Frankfurt stock exchange and are traded in the area of the regulated market with additional subsequent requirements (Prime Standard). The subscribed capital in the amount of € 18,612,600 consists of 6,204,200 bearer shares having a nominal value of € 3.00 per share. All shares have identical rights, i.e. no voting limitations, preference shares or special rights exist. The Board of Management knows of no limitations, which may have been agreed upon between shareholders with respect to voting rights or transferability of shares.

Of the Members of the Supervisory Board, Mr. Joachim Kohm owns indirectly 594,250 shares (9.58 percent) via JUST-US GmbH, Mr. Nikolaus Broschek owns 457,688 shares (7.38 percent) and Mr. Sigmund Kiener owns indirectly 310,000 shares (4.99 percent) via S.K. Management- und Beteiligungs GmbH. All other Members of the Board of Management and the Supervisory Board own less than 1 percent of total shares.

The Spanish investment management firm Grupo Bestinver owns 620,482 shares (10.0 percent) according to the most recently available mandatory report. Further participations of companies in excess of 10 percent of the voting rights are not known to Management. A participation of employees as per Article 289, clause 4, no. 5, and Article 315, clause 4, no. 5 HGB, does not exist.

The appointment and revocation of Members of the Board of Management is regulated in Articles 84 and 85 of the German Corporation Act (AktG) and Article 31 of the Law of Co-Determination (MitbestG). Accordingly, Members of the Board of Management are appointed by the Supervisory Board for a period of maximum five years. Repeat appointments or prolongations of appointments, again for a maximum of five years, are permitted.

In line with Article 31 MitbestG, any appointment of Members of the Board of Management requires a 2/3 majority of the Members of the Supervisory Board. In the event such a majority is not obtained, the Arbitration Committee of the Supervisory Board is to make a recommendation for the appointment in question within one month from the date on which no majority was reached. The Supervisory Board will then appoint Members of the Board of Management with a simple majority of its Members. Should a simple majority be evasive, the Chairman of the Supervisory Board will have two votes in any subsequent vote.

In line with Article 6, clause 1 of the Corporation's Articles of Association, the Board of Management consists of one or more persons; the number of Members will be designated by the Supervisory Board as per Article 6, clause 2 of the Articles of Association. The Supervisory Board may elect a Chairman of the Board of Management as well as a Deputy Chairman as per Article 84 AktG. The Supervisory Board may revoke the appointment of a Member of the Board of Management as well as the appointment to Chairman in the event an important reason exists as per Article 84, clause 3 AktG. The Supervisory Board determines the number of Members of the Board of Management, their appointment, their revocation as well as consummation, change and cancellation of the respective appointment agreements.

Any change to the Articles of Association requires a shareholders resolution of the Annual General Meeting in compliance with Article 179, clause 1 AktG. Article 12, clause 3 of the Articles of Association of *schlott gruppe AG* stipulates that an adopted shareholders resolution requires a simple majority of votes unless applicable laws require otherwise; the foregoing also applies to resolutions for which, in line with the AktG, a majority of the represented authorized capital is required. The right to make non-substantive changes to the Articles of Association is assigned to the Supervisory Board as per Article 13 of the Articles of Association. In addition, the Supervisory Board was authorized by the Annual General Meeting at the time Authorized Capital I and II were established, to adjust Article 4 of the Articles of Association with respect to the utilization of Authorized Capital I and II at the expiration of the related authorizations.

The Board of Management is authorized, subject to the consent of the Supervisory Board, to increase the capital stock until March 10, 2008, by up to € 3,937,560 in cash contributions or contributions in kind via a one-time or via multiple issuances of new shares (Authorized Capital I). These shares must be offered to existing shareholders via subscription rights, which may be waived, however, to the extent that shares are issued to employees or to the extent that a contribution in kind takes place in the course of an acquisition.

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Furthermore, the Board of Management is authorized, subject to the consent of the Supervisory Board, to increase the capital stock until March 16, 2009, by up to € 5,300,000 in form of cash contributions or contributions in-kind via a one-time or via multiple issuances of new shares (Authorized Capital II). These shares must be offered to existing shareholders via subscription rights, which may be waived in the event the existing capital stock is increased by up to 10 percent in form of a capital increase in cash. In this connection, shares that are issued by an increase in Conditional Capital I (see the following paragraph) not subject to subscription rights are imputed into this 10 percent limit.

The Authorized Capital is conditionally increased by an additional € 3,750,000 (Conditional Capital I). The increase of the Conditional Capital will only be undertaken to the extent that shares issued will be utilized in servicing options and convertible debentures as these will have been issued by the Corporation or one of its wholly-owned subsidiaries by March 16, 2009. When issuing such debentures, the legal subscription rights of shareholders can be excluded up to the maximum of 10 percent of the existing capital stock. As of this date, no options or convertible debentures have been issued.

The Board of Management is further authorized to repurchase up to 10 percent of the capital stock until August 31, 2008. The purchase is to be executed via the stock exchange, or via a public offer to purchase from the Corporation's shareholders, or via a public request to the Corporation's shareholders for offers to sell shares, or via the issuance of put options to shareholders. In the event shares are acquired via the stock exchange, the amount per share paid by the Corporation may not exceed or be below by more than 10 percent the stock exchange quote as defined in greater detail in the authorization. In the other instances, the purchase price may not be below nor may exceed the stock exchange quote by more than 20 percent.

The repurchased shares may be disposed of, called or utilized in connection with acquisitions or for servicing options and convertible debentures. In these instances, the sales proceeds may be below the stock exchange quote by no more than 3 to 5 percent as defined in the authorization.

The Board of Management has decided and has announced on November 9, 2007, that it intends to make use of this authorization and to repurchase shares of up to 10 percent of the capital stock via the stock exchange beginning with November 12, 2007. The repurchase program is implemented under the leadership of DZ BANK. No redundancy payments or other indemnifications exist in favor of the Members of the Board of Management or employees in the event a third party makes an offer to acquire the Corporation. Furthermore, within *schlott gruppe AG* no agreements containing a "Change of Control Clause" exist.

— SUPPLEMENTARY INFORMATION: *Comprehensive Cost Reduction Measures Undertaken*

In the course of the business year 2006/07, the *schlott group* has commenced negotiations with the workers' council for the purpose of adjusting the cost structure of the group in line with current price levels. The time period between the end of the fiscal year and the date of completion of this Annual Report was used to arrive at an agreement with the workers' council; the agreement includes various structural initiatives as, or example, a decline in headcount, a reduction in benefits that go beyond what is foreseen in the collective agreement and a lengthening of production shifts. This catalogue of measures is expected to reduce on an on-going basis the costs in Freudenstadt by approximately € 2 million per annum.

— OUTLOOK REPORT: *The Market Continues to be Demanding*

GENERAL ECONOMIC AND INDUSTRY TRENDS

The effects of the sub-prime crisis that originated in the USA are now being felt in global financial markets. In the second half of 2007, economic observers have become increasingly apprehensive with respect to the general economic trends in Europe. While in the United States a general economic cooling became more apparent at the end of 2007 in spite of significant reductions in interest rates by the Federal Reserve Bank, the prospects for the rest of the world remained positive. However, the expected rate of economic growth for 2008 has been scaled back.

The record level of the price of oil and high levels of other raw materials represent a damper to more robust economic activity. In the Euro-Zone, export industries are burdened by the strength of the Euro versus the US Dollar. Accordingly, due to the effects of a strong Euro, economic growth within the Euro-Zone is expected to decline from 2.5 percent in 2007 to 2.1 percent in 2008. In Great Britain as well, the increase for 2008 in gross domestic product is expected to decline from 3.1 percent to 2.3 percent due to difficulties in real estate markets.

General expectations have become more modest due to the uncertainties and risks in financial markets and the international banking industry. This is reflected particularly in the prognosis for Germany: the collective opinion of the leading German economic institutes forecast an increase in 2008 of 2.2 percent in the autumn of 2007; in October 2007, the IMF revised its prognosis to 2.0 percent and the Council of Economic Advisors, as well as the Federal Government, stated in November 2007 that economic growth for 2008 is expected to be 1.9 percent.

The European printing industry does not expect positive impulses in 2008. Some hope is placed on somewhat higher consumption expenditures in Germany, which might result in higher advertising spending; but the caution signs are up in view of rising levels of inflation mainly as a consequence of record prices for oil.

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The German Association of Communication Agencies (GWA) stated in their report in the autumn of 2007 that spending for advertising is expected to grow by only 3.8 percent following an increase of 4.2 percent in the previous year. Thus, the weakening trends that began in 2006 are expected to continue.

Similarly, the Association of the German Advertising Industry (ZAW) stated in October 2007 that the advertising industry suffers from weakness and that expected expenditures in 2008 will be “stable”. As a consequence, the printing industry cannot look for impulses from the advertising industry in 2008; the trend of the previous year is sustained.

In the European printing industry, only modest changes with respect to the existing excess capacity can be expected. In the end, capacity problems can only be solved via an effective reduction in capacity. Larger entities are in a better position to do that than smaller players in the industry. It is safe to assume that the accelerating consolidation process of the industry will in the end lead to a more balanced demand and supply relationship in the European printing industry.

Initial orders at the beginning of 2008 suggest a stabilization in prices. However, orders carried over from 2007 on the basis of then prevailing prices will influence 2008 results. In sum, the market situation in the current year will again be a challenge.

OUTLOOK FOR THE SCHLOTT GROUP

The general environment for printing products will again be demanding during the business year 2007/08. Price pressures of the previous year will be felt during the entire current year and will have an impact on earnings. We expect a break-even result from ordinary business activities. A multitude of measures designed to optimize all processes will lead to satisfactory results for the *schlott group* in the near future. The costs related to these measures will, however, further burden the earnings results in fiscal 2007/08.

Upside opportunities

Our prognosis for the business year 2007/08 is taking into consideration continued difficult market conditions, particularly the excess capacity in the printing industry. If the consolidation of the industry progresses with concurrent capacity adjustments, price developments for printing products may show some improvement in the course of the current business year. Of course, the same effect could be achieved if increased demand would lead to an improved capacity utilization. The *schlott group* has positioned itself accordingly and has withdrawn capacity which was no longer aligned with market requirements.

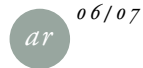
Positive impulses for price levels as a result of reductions in capacity will, however, be felt only for new orders. Significant shares of total order volume are based on longer term agreements; thus, benefits from higher prices will only be achieved once capacity reductions in the entire industry reach significant levels. Such effects will, therefore, be felt only marginally in 2008. In the longer term, these effects could be more significant.

Downside risks

We have not included in our outlook a sustainable improvement in the general level of prices. On the contrary, we have considered a further reduction inasmuch as order contracts concluded at unfavorable pricing conditions in the later part of 2007 will burden the business year 2007/08 for the entire year; moreover, we have also considered possible further price pressure for new order contracts. As in the previous year, trends in prices represent the most far-reaching risk in our outlook.

The full extent of the deterioration in price levels during 2007 was not anticipated by the industry. In spite of including in our outlook the ongoing risks with respect to pricing, we cannot fully exclude the possibility that slight improvements noted recently could be temporary in nature. The low point would then again not be reached and new orders would be contracted at lower price levels.

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We will
SUSTAINABLY STRENGTHEN
OUR COMPETITIVE POSITION
through the implementation
of far-reaching
cost reduction measures!

With respect to procurement, fundamental risks exist with respect to even more pronounced future increases in the price of raw materials, the full extent of which may not have been included in our outlook.

Furthermore, risks in relation to the timely completion of the ongoing cost reduction measures in the areas of procurement and production might postpone some of the expected benefits for 2007/08 into the following business year. We do feel, however, that this risk is manageable as we have carefully planned this initiative.

Business year 2007/08

For the current business year 2007/08, we expect a value-added turnover of about € 240 million after € 251.7 million in the previous year, producing a decline of € 10 million approximately, or about 4 percent. Earnings before taxes, prior to extraordinary expenses related to optimization measures, are expected to be at the break-even level after € 11.0 million in the previous year.

Essentially unchanged total tonnage processed evidences the impact of the already repeatedly mentioned price pressures on value-added turnover. Price discounts granted in the previous year will be felt over the entire business year 2007/08, and are the major reason for the expected decline in value-added turnover. Competitive pressure will remain unabated.

The decline in earnings before taxes from continuing operations, i.e. the business segment *print*, is fully accounted for by further unfavorable price levels. The decrease would be even more pronounced if the cost reduction measures in the areas of production and procurement would not already make initial contributions to earnings. These measures are designed to cushion and to compensate the effects of the current as well as the future price pressure.

Operating shifts and times will become more flexible and will be adapted to future demand for our products. In addition, we will fully utilize the possibilities contained in the collective bargaining agreement with respect to the retirement of older and less flexible printing capacity in order to reach higher levels of productivity. The goal is to reduce annual expenses by an amount well in double figures and to return to earnings before taxes of the same dimension as well as to satisfactory rates of return on capital.

This program is also designed to significantly reduce total debt. This will be accomplished based on relatively lower levels of capital expenditures until 2009/10, which will be mainly expenditures for maintenance purposes; due to the modern configuration of our production lines and machinery, no major capital expenditures will be required during this period.

By means of improved procurement structures, we intend to further optimize the management of current assets. As a result, funds flows will be improved resulting in a high level of free cashflow (prior to dividend distributions) in the amount of €60 million until 2009/10; the equity ratio is expected to reach 40 percent. For the current business year, we look for a free cashflow (prior to dividend distributions) of €15 million.

Although the cost reduction measures are to be implemented over a period of 3 years, the corresponding nonrecurring expenses will in large part be recognized in the current year. These expenses will total about €15 million, about half of which will be incurred in 2007/08. To the best of our knowledge, no further expenses beyond the €15 million are expected. Including these extraordinary charges, we expect net income before taxes to be negative €15 million for the business year 2007/08.

Business year 2008/09

The outlook for the following business year contains the aforementioned uncertainties with regard to the trends in the prices for printing products. We are planning conservatively on the assumption that price pressure will continue in the coming years. In terms of volume, we look forward to a modest recovery.

The increase in expected volume will be the result of improvements in general market trends as well as an increase in our market share due to improved competitiveness derived from our cost reduction measures. For the year 2008/09, we expect an increase in tonnage in the area of 1 – 2 percent; thereafter, higher rates of growth may be achieved. In general, the value-added turnover for 2008/09 may again decline slightly due to ongoing price pressure.

The most important factor in a marked improvement in earnings in the business year 2008/09, will be the success of our cost reduction program begun in the current year. The benefits of increased flexibility in shift and operating times will be reaped to a large extent in 2008/09. Benefits derived from a more stringent interpretation of the collective bargaining agreement and the adjustment of capacity during 2007/08, will materially improve earnings in 2008/09, producing net income before taxes in medium single figures. The full extent of cost reductions in double figures will lead in the business year 2009/10 to net income before taxes well in double figures.

Further information on future developments

The *schlott group* will continue to focus its range of products and services on the requirements of customers to further strengthen its market position. We will concentrate all of our resources on the industrial production of high volume and high quality printing products in intaglio and reel-fed offset printing, including on the steps of *preprint* and further finishing. Our sheet-offset printing services at our site in Plauen complement our product mix.

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 29.

FREUDENSTADT, DECEMBER 20, 2007



BERND ROSE



HEIKO ARNOLD



WERNER REISER



ADAM VALERI