



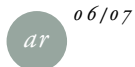
ANNUAL REPORT SCHLOTT GRUPPE AG

2006/07

Change.

CHANGE.

Annual Report 2006/07



SCHLOTT GRUPPE AG, FREUDENSTADT

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LETTER TO SHAREHOLDERS

FROM THE MANAGEMENT BOARD, SCHLOTT GRUPPE AG

DEAR SHAREHOLDERS, BUSINESS ASSOCIATES
AND READERS.

Against the backdrop of industry-wide overcapacity, the European printing sector as a whole had to contend with another significant rise in competition over the course of the financial year just ended. Having anticipated this general trend within our immediate market environment, we took swift action and initiated far-reaching strategic measures. In acquiring the Dutch-based gravure printing specialist *biegelaar* in October 2006, we underlined our out-and-out focus on the core competence of printing and bolstered our position within the European market. This was followed by an announcement in January 2007, outlining our decision to dispose of the company's *direct marketing* unit, the rationale being to concentrate fully on our key business activities within the field of printing.

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SCHLOTT GRUPPE AG

There's a lot to do.



fig.01: WALNUT

FOCUSING ON OUR CORE BUSINESS

A nut we've already cracked.

Although it was impossible to predict the sheer scale of price erosion induced by more intense competition in the printing industry, we were nevertheless able to take remedial action at a relatively early stage in an attempt to counteract price-specific trends. The overriding objective of these measures was to curtail the adverse effects on earnings to the greatest extent possible by streamlining our cost structures and introducing additional flexibility within our service portfolio.

On the whole, the financial year just ended was uninspiring as regards our operating bottom-line results. By contrast, however, we made significant progress in strengthening our position within the competitive environment. The sale of *direct marketing* was executed swiftly and on attractive terms, thus enabling us to focus our management resources fully on

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„The European printing market offers a future with attractive financial returns. We shall unlock these opportunities by pursuing our rigorous cost-reduction programme. Additionally, we remain as determined as ever to play an active part in shaping the process of consolidation within the European printing market.“

Heiko Arnold, Member of the Management Board

the company’s European printing business. In addition, the sale unlocked hidden reserves and allowed us to reduce bank borrowings by a significant margin. We intend to use these newly found resources and the greater freedom of manoeuvre to generate additional growth within the European printing sector, firm in the belief that this market offers a future with attractive financial returns.

schlott gruppe is better positioned today than a year ago.

Yet again, our flexible approach and advantageous geographical positioning with locations in the south and north of Germany as well as in the Netherlands clearly contributed to our solid operational performance in the financial year under review. Benefiting from our centralised management of the respective operating facilities within the group, we

are able to coordinate production in such a way as to ensure that each printing contract is executed on the basis of the most favourable cost structures, while also maintaining the capacity to respond quickly and efficiently. This system is complemented by versatile machines equipped with a range of additional functions that make them far superior to conventional plant designed solely for standard mass production. Drawing on the operational functionality of the machinery currently installed at our facilities, we are very well positioned when it comes to fulfilling the increasingly complex requirements of today's market.

Our clearly defined locational policy, pursued incisively through a number of well-judged acquisitions over recent years, and our targeted investments aimed at introducing greater operational flexibility have proved their worth in chal-

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lenging times. Indeed, the direction taken by our company has produced tangible advantages within the competitive arena. In embracing a flexible, market-focused approach, we have been able to respond more effectively to ever changing customer demands. Within the area of advertising supplements, for instance, we have seen a growing trend towards quality rather than quantity: our customers are focusing on more frequent and targeted communication. As a result, advertising supplements are being published more often over the course of a year. At the same time, the volume of pages per print item has fallen, while in many cases the overall print run has been extended.

These changes constitute a significant challenge for conventional gravure printing, particularly given the emergence of offset printing as a serious competitor now that machines

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There's a lot to do.



fig.02: HAZELNUT

HR COST STRUCTURES

*We are beginning to see the positive impact of measures already implemented
and those currently being rolled out.*

„Our cost-reduction programme is scheduled for a period of three years. Full implementation of these measures is likely to produce annual cost savings of a substantial double-digit amount in the million-euro range.“

Werner Reiser, Member of the Management Board

deployed within this segment are capable of producing higher volumes. With a portfolio of highly flexible printing machines, *schlott gruppe* is equal to the challenge. We are able to offer our customers best-in-class quality from a single source and with maximum speed – a clear benefit when it comes to printed media requiring rapid turnaround.

Our superior flexibility has proved particularly valuable in recent times.

Irrespective of these strengths, *schlott gruppe* also has to remain competitive when it comes to price. With this in mind, the issue of cost reduction must be at the top of our agenda. Here, too, the locational and investment policy embraced by our company in recent years has stood us in good stead, providing us with a solid foundation when it

came to lowering our break-even threshold by a substantial margin. What is more, the extensive action plan initiated in mid-2006/7 and gradually implemented over the ensuing months will allow us to rein back costs even further as time progresses.

Our action plan is aimed at reducing costs in absolute terms – in purchasing, production and administration – as well as enhancing our technological position and injecting greater flexibility.

Our cost-reduction programme is scheduled for a period of three years. We expect to see palpable benefits as early as the current financial year, while full implementation is likely to produce annual cost savings of a substantial double-digit amount in the million-euro range. It goes without saying

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that individual measures will initially contribute to higher costs. However, these will be of a non-recurring nature. In the current financial year, these charges are likely to reduce bottom-line results by around €15 million.

The streamlining of staff costs represents an integral element of our overall cost-reduction package. With this in mind, we have outsourced to external service providers all our logistics at the company's German facilities in Freudensstadt, Landau and Hamburg, thus replicating the logistical structures already in place at our Nuremberg plant. In conjunction with our streamlining efforts, particularly within the area of administration, we were thus able to downsize our workforce by almost six per cent at the end of the 2006/7 financial year.

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There's a lot to do.*fig. 03: COCONUT*

CAPACITY ADJUSTMENTS

The well-judged realignment of existing standard capacities, including the utilisation of specialities, will bear fruit in months to come.

„Implementing targeted measures aimed at adapting our capacity levels, we shall contribute to the reduction of overcapacities within our sector. Our aim is to phase out „straight-line capacities“ originally centred around mass production and thus align *schlott gruppe* even more closely with flexibility and individualised operations.“

Adam Valeri, Member of the Management Board

Committed to reducing staff costs even further in the current 2007/8 financial year, we shall take advantage of the options available to us under the applicable collective wage agreement. Within this area, the instruments for future cost reductions include tailor-made employment models centred around staff working hours, demand-based shift work and a reduction in the overall headcount.

In addition, we shall actively contribute to the improvement of supply and demand structures in our industry and shall implement targeted measures aimed at adapting our capacity levels.

As part of this action plan, we will decommission out of planning machinery with lower efficiency levels, less scope or limited flexibility, thereby phasing out equipment originally

designed merely for mass-production operations. Additionally, we intend to scale down capacity levels within the area of simple standardised production by focusing on more flexible gravure printing machines with additional state-of-the-art in-line functionality. A case in point is the new rotary gravure printing unit installed at our Freudenstadt plant: this unique machine is designed to produce a broad range of highly sophisticated print media of unparalleled quality.

In pursuing this approach, we have responded to changes in customer demand, the prime focus being on more targeted business-to-consumer communication. In parallel, we are now in a strong position to unlock additional opportunities within this area of the supplement market. What is more, this particular segment is less competitive than other areas of the market, as well as offering very attractive growth prospects.

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There's a lot to do.



fig.04: PEANUT

CONSOLIDATION

Given the many uncertainties within our competitive environment as a whole, the onus is on us to act with foresight and find a combination that will generate the most lucrative financial rewards.

Beyond cost optimisation within the area of production, the measures taken by our company also address key issues relating to an important upstream component of the value chain – procurement. We intend to rein back costs within this area over the course of the current financial year. The main emphasis will be on improving purchasing processes and the organisation of our procurement system. Within this context, all structures will come under close scrutiny. In further improving the management of our working capital, we will be able to scale back tied-up capital and thus reduce overall capital costs.

This package of measures aimed specifically at production activities – ranging from projects that involve all operating sites to adjustments targeted at individual areas of work – will be complemented by a host of measures directed at the

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organisation as a whole, the objective being to make our company even more responsive and agile. Following the sale of *meiller direct*, *schlott gruppe* as a whole has become more compact in size. Therefore, it has become necessary to realign cross-departmental functions and further streamline internal administrative structures.

The European printing industry has undergone a significant shake-up in recent times. As a result of eroding prices in 2007, competition has become increasingly fierce and will continue to exert pressure on the market over the course of the current financial year, thus contributing to further consolidation in the printing industry. This is reflected in the intensive merger efforts of two large European printing companies in the second half of 2007.

Armed with an all-embracing action plan, we will safeguard the future success of schlott gruppe within this demanding environment and tackle the challenges placed before us.

We are committed to bolstering *schlott gruppe's* position as one of the leading European suppliers within the segment of premium-quality printing. Operating from a position of strength, we aim to raise to a more attractive level the financial returns achieved by shareholder investments. Last but not least, we are determined to play an active role in driving the structural evolution of our industry. In summary, we are well positioned and can look forward with confidence to the future.

FREUDENSTADT, JANUARY 2008



BERND ROSE



HEIKO ARNOLD



WERNER REISER



ADAM VALERI

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