



»HEIDELBERG ON TRUE COURSE...

ANNUAL REPORT 2004/2005

**HEIDELBERG**

> THE FIGURES CONSOLIDATED FINANCIAL STATEMENTS

...TOWARDS THE FUTURE«



> 5-YEAR OVERVIEW – HEIDELBERG GROUP

Figures in € millions	2000/2001	2001/2002	2002/2003	2003/2004	2004/2005
<b>Incoming orders<sup>1)</sup></b>	5,606	4,667	4,170	3,852	<b>3,700</b>
<b>Net sales<sup>1)</sup></b>	5,372	5,117	4,231	3,746	<b>3,360</b>
<b>Foreign sales share in percent<sup>1)</sup></b>	86.7	86.5	87.6	88.8	<b>85.3</b>
<b>Result of operating activities<sup>1)2)</sup></b>	561	418	163	79	<b>167</b>
<b>Expenditures from special items</b>	–	–	210	335	<b>13</b>
<b>Profit before taxes</b>	531	335	–164	–506	<b>108</b>
<b>Net profit/loss</b>	283	201	–138	–695	<b>61</b>
<b>– in percent of sales</b>	5.3	3.9	–3.3	–18.6	<b>1.8</b>
<b>Cash flow<sup>1)</sup></b>	552	402	51	–121	<b>235</b>
<b>– in percent of sales</b>	10.3	7.9	1.2	–3.2	<b>7.0</b>
<b>Free cash flow</b>	17	–323	207	114	<b>154</b>
<b>Investments</b>	237	252	243	164	<b>162</b>
<b>ROCE in percent<sup>1)2)</sup></b>	20.9	12.9	2.7	0.3	<b>6.7</b>
<b>Profit contribution in percent<sup>1)2)</sup></b>	9.8	2.1	–7.7	–9.9	<b>–3.1</b>
<b>Total assets</b>	5,442	5,735	5,131	4,232	<b>3,629</b>
<b>Fixed assets</b>	1,229	1,316	1,157	897	<b>832</b>
<b>Current assets</b>	4,213	4,419	3,974	3,335	<b>2,797</b>
<b>Shareholders' equity</b>	2,450	2,470	1,950	1,230	<b>1,230</b>
<b>Liabilities</b>	2,992	3,265	3,181	3,002	<b>2,399</b>
<b>Equity ratio in percent</b>	45.0	43.1	38.0	29.1	<b>33.9</b>
<b>Return on equity in percent<sup>3)</sup></b>	11.6	8.1	–7.1	–56.5	<b>5.0</b>
<b>Financial debt<sup>4)</sup></b>	341	922	796	718	<b>587</b>
<b>Net financial debt<sup>5)</sup></b>	–146	483	398	278	<b>102</b>
<b>Cash flow per share in €<sup>1)</sup></b>	6.10	4.85	1.16	–1.40	<b>2.74</b>
<b>Earnings per share in €</b>	3.30	2.32	–1.67	–8.16	<b>0.64</b>
<b>Dividends in €</b>	1.80	1.40	–	–	<b>0.30</b>
<b>Dividend yield in percent<sup>6)</sup></b>	2.73	2.77	–	–	<b>1.22</b>
<b>Share price at financial year-end in €</b>	65.99	50.06	16.21	27.99	<b>24.65</b>
<b>Market capitalization at financial year-end</b>	5,669	4,301	1,393	2,405	<b>2,118</b>
<b>Average number of employees for the year<sup>7)</sup></b>	24,271	24,905	23,787	22,641	<b>18,671</b>

<sup>1)</sup> Previous years' values adjusted

<sup>2)</sup> Before special items

<sup>3)</sup> After taxes

<sup>4)</sup> Liabilities to banks including private placement and convertible bond

<sup>5)</sup> The sum of financial debt less marketable securities and cash as well as cash equivalents

<sup>6)</sup> In terms of the financial year-end price

<sup>7)</sup> Hourly wage earners and salaried employees

## > THE FIGURES

ANNUAL REPORT 2004/2005

### CONSOLIDATED FINANCIAL STATEMENTS OF HEIDELBERGER DRUCKMASCHINEN AKTIENGESELLSCHAFT

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**Consolidated  
income statement  
of the Heidelberg Group  
2004/2005**

**> INCOME STATEMENT<sup>1)</sup>**

Figures in € thousands	Note	1-Apr-2003 to 31-Mar-2004	<b>1-Apr-2004 to 31-Mar-2005</b>
Net sales	8	3,745,994	3,360,267
– of which: discontinuing operations		(631,872)	(153,175)
Change in inventories		– 76,194	46,898
Other own work capitalized		80,803	64,691
<b>Total operating performance</b>		<b>3,750,603</b>	<b>3,471,856</b>
Other operating income	9	283,942	238,005
Cost of materials	10	1,566,842	1,510,032
Personnel expenses	11	1,293,646	1,138,143
Depreciation and amortization		173,648	114,220
Other operating expenses	12	920,984	780,338
Result of operating activities before special items		<u>79,425</u>	<u>167,128</u>
Expenditures from special items	13	335,024	13,074
Result of operating activities after special items		– 255,599	154,054
– of which: discontinuing operations		<u>(– 316,465)</u>	<u>(– 42,009)</u>
Result from financial assets and marketable securities	14	– 195,639	1,850
– of which: result from the equity valuation		(– 186,454)	(– 9,466)
– of which: discontinuing operations		(– 187,773)	(– 8,236)
Net interest income	15	– 55,147	– 48,373
Financial result		<u>– 250,786</u>	<u>– 46,523</u>
<b>Income before taxes</b>		<b>– 506,385</b>	<b>107,531</b>
– of which: discontinuing operations		(– 516,882)	(– 54,650)
Taxes on income	16	188,515	46,415
– of which: discontinuing operations		<u>(136,263)</u>	<u>(7,626)</u>
<b>Net loss/profit</b>		<b>– 694,900</b>	<b>61,116</b>
– of which: discontinuing operations		<u>(– 653,145)</u>	<u>(– 62,276)</u>
Minority interests		6,033	6,057
Net loss/profit – Heidelberg portion		– 700,933	55,059
<b>Undiluted/diluted earnings per share according to IAS 33 (in € per share)<sup>2)</sup></b>	35	<b>– 8.16</b>	<b>0.64</b>
– of which: discontinuing operations		<u>(– 7.60)</u>	<u>(– 0.73)</u>

<sup>1)</sup> The previous year's figures have been restated due to the Heidelberg Group's restructuring (see Note 3)

<sup>2)</sup> Earnings per share before special items amount to € 0.79 (previous year: € – 1.49)

**Consolidated  
balance sheet of the  
Heidelberg Group  
as of March 31, 2005**



**> ASSETS**

Figures in € thousands

	Note	31-Mar-2004	31-Mar-2005
<b>Fixed assets</b>			
Intangible assets	17	219,535	239,943
Tangible assets	18	629,858	539,090
Financial assets <sup>1)</sup>	19	47,517	53,103
		<u>896,910</u>	<u>832,136</u>
<b>Current assets</b>			
Inventories	20	930,783	785,666
Accounts receivable from customer financing	21	769,182	564,677
Trade receivables	21	713,226	575,766
Other receivables and other assets	21	241,764	240,192
Marketable securities	22	347,619	353,828
Cash and cash equivalents	22	91,824	131,376
		<u>3,094,398</u>	<u>2,651,505</u>
<b>Deferred taxes</b>	23	214,389	123,123
<b>Prepaid expenses</b>	24	26,755	22,525
		<u>4,232,452</u>	<u>3,629,289</u>
<b>– of which: discontinuing operations</b>			
Digital		(107,022)	(–)
Web Systems <sup>2)</sup>		(348,080)	(–)

<sup>1)</sup> Of which: financial assets carried according to the equity method € 0  
(previous year: € 7,090 thousand)

<sup>2)</sup> Including Web Finishing

## &gt; EQUITY AND LIABILITIES

Figures in € thousands

	Note	31-Mar-2004	31-Mar-2005
<b>Shareholders' equity and minority interests</b>	25		
Subscribed capital		219,926	219,926
Capital and revenue reserves		1,679,358	920,159
Net loss/profit – Heidelberg portion		– 700,933	55,059
		1,198,351	1,195,144
Minority interests		31,299	35,330
		1,229,650	1,230,474
<b>Provisions</b>	26		
Provisions for pensions and similar obligations	27	582,774	594,532
Tax provisions	28	170,474	172,806
Other provisions	29	773,518	479,705
		1,526,766	1,247,043
<b>Liabilities</b>			
Financial liabilities <sup>1)</sup>	30	748,881	615,430
Trade liabilities	31	266,983	211,430
Other liabilities	31	331,905	209,772
		1,347,769	1,036,632
<b>Deferred taxes</b>	23	80,265	66,902
<b>Deferred income</b>	32	48,002	48,238
		4,232,452	3,629,289
<b>– of which: discontinuing operations<sup>2)</sup></b>			
Digital		(121,274)	(–)
Web Systems <sup>3)</sup>		(310,842)	(–)

<sup>1)</sup> Of which: long-term interest-bearing financial obligations € 377,741 thousand (previous year: € 61,271 thousand)

<sup>2)</sup> Excluding shareholders' equity/minority interests/internal refinancing

<sup>3)</sup> Including Web Finishing

**> CONSOLIDATED CASH FLOW STATEMENT 2004/2005<sup>1)</sup>**

Figures in € thousands

	2003/2004	2004/2005
Net loss/profit	- 694,900	61,116
Depreciation and amortization/write-ups to fixed assets/ reversal of negative goodwill	333,915	115,609
Change in pension provisions	22,936	24,587
Change in deferred taxes/tax provisions	154,019	33,423
Result from the equity valuation <sup>2)</sup>	68,386	9,466
Result from the disposal of fixed assets	- 5,011	- 8,955
<b>Cash flow</b>	- 120,655	235,246
- of which: discontinuing operations	(- 299,193)	(- 40,866)
Change in inventories <sup>3)</sup>	140,512	- 53,691
Change in customer financing	77,302	177,688
Change in receivables/trade payables	94,974	39,410
Change in other provisions <sup>4)</sup>	99,932	- 78,352
Change in other balance sheet items	- 4,674	- 57,243
<b>Other operating changes</b>	408,046	27,812
<b>Net cash from operating activities</b>	287,391	263,058
- of which: discontinuing operations	(- 123,089)	(- 88,958)
Intangible assets/tangible assets		
Investments	- 164,378	- 162,046
Proceeds from disposals	46,268	56,399
Financial assets		
Investments	- 58,794	- 10,071
Proceeds from disposals	3,295	6,359
<b>Outflow of funds from investment activity</b>	- 173,609	- 109,359
- of which: discontinuing operations	(- 66,253)	(- 12,579)
<b>Free cash flow</b>	113,782	153,699
- of which: discontinuing operations	(- 189,342)	(- 101,537)
Dividend payment	- 1,538	- 1,817
Raising of financial debt	365,242	741,739
Repayment of financial liabilities	- 435,474	- 877,214
<b>Cash outflow from financing activity</b>	- 71,770	- 137,292
- of which: discontinuing operations	(191,198)	(104,116)
<b>Net change in cash and cash equivalents</b>	42,012	16,407
<b>Cash and cash equivalents at the beginning of the year</b>	82,771	120,092
Changes in the scope of the consolidation	- 1,915	- 2,877
Currency adjustments	- 2,776	- 2,085
Net change in cash and cash equivalents	42,012	16,407
<b>Cash and cash equivalents at year-end</b>	120,092	131,537

<sup>1)</sup> See explanations in Note 36

<sup>2)</sup> In financial year 2003/2004: excluding an impairment loss of € 118,068 thousand in connection with discontinuing operations

<sup>3)</sup> In financial year 2003/2004: including impairments resulting from discontinuing operations totalling € 27,884 thousand

<sup>4)</sup> In financial year 2003/2004: including allocations to provisions for discontinuing operations totalling € 181,110 thousand



## > DEVELOPMENT OF SHAREHOLDERS' EQUITY AND MINORITY INTERESTS<sup>1)</sup>

	Figures in € thousands						
	Subscribed capital <sup>2)</sup>	Capital reserve	Other revenue reserves	Foreign currency translation	Revenue reserves		Total retained earnings
					Market evaluation of hedging transactions	Market evaluation of other financial assets	
<b>April 1, 2003</b>	219,926	947,804	923,700	44,881	-9,232	-61,449	897,900
Dividend payment <sup>3)</sup>	-	-	-	-	-	-	-
Net loss/profit	-	-946,263	802,492	-	-	-	802,492
Foreign currency changes	-	-	-	-78,155	-	-	-78,155
Market evaluation of financial assets / cash flow hedges	-	-	-	-	29,847	38,725	68,572
Reversals booked to the income statement	-	-	-	-	-34,509	21,263	-13,246
Consolidations / other changes	-	-	51,135	-50,881	-	-	254
<b>March 31, 2004</b>	<b>219,926</b>	<b>1,541</b>	<b>1,777,327</b>	<b>-84,155</b>	<b>-13,894</b>	<b>-1,461</b>	<b>1,677,817</b>
<b>April 1, 2004</b>	219,926	1,541	1,777,327	-84,155	-13,894	-1,461	1,677,817
Dividend payment <sup>3)</sup>	-	-	-	-	-	-	-
Net loss/profit	-	-	-700,933	-	-	-	-700,933
Foreign currency changes	-	-	-	-19,623	-	-	-19,623
Market evaluation of financial assets / cash flow hedges	-	-	-	-	34,158	8,004	42,162
Reversals booked to the income statement	-	-	-	-	-23,166	-5,204	-28,370
Consolidations / other changes	-	-1,541	-3,375	-47,519	-	-	-50,894
<b>March 31, 2005</b>	<b>219,926</b>	<b>-</b>	<b>1,073,019</b>	<b>-151,297</b>	<b>-2,902</b>	<b>1,339</b>	<b>920,159</b>

Total capital and revenue reserves	Net profit/ loss Heidelberg portion	Shares of the Heidelberg Group	Minority interests	Total
1,845,704	- 143,771	1,921,859	28,374	1,950,233
-	-	-	- 1,538	- 1,538
- 143,771	- 557,162	- 700,933	6,033	- 694,900
- 78,155	-	- 78,155	- 1,570	- 79,725
68,572	-	68,572	-	68,572
- 13,246	-	- 13,246	-	- 13,246
254	-	254	-	254
<u>1,679,358</u>	<u>- 700,933</u>	<u>1,198,351</u>	<u>31,299</u>	<u>1,229,650</u>
1,679,358	- 700,933	1,198,351	31,299	1,229,650
-	-	-	- 1,817	- 1,817
- 700,933	755,992	55,059	6,057	61,116
- 19,623	-	- 19,623	- 228	- 19,851
42,162	-	42,162	-	42,162
- 28,370	-	- 28,370	-	- 28,370
- 52,435	-	- 52,435	19	- 52,416
<u>920,159</u>	<u>55,059</u>	<u>1,195,144</u>	<u>35,330</u>	<u>1,230,474</u>

<sup>1)</sup> Please refer to Note 25 for additional explanations

<sup>2)</sup> Of Heidelberger Druckmaschinen Aktiengesellschaft

<sup>3)</sup> Dividend payment of Gallus Holding AG, St. Gallen, Switzerland

## Notes to the Consolidated Financial Statements for the Financial Year April 1, 2004 to March 31, 2005

## &gt; DEVELOPMENT OF FIXED ASSETS

Figures in € thousands

	1-Apr-2004	Change in the scope of the consolidation	Additions	Transfers	Currency adjustments	Disposals	Acquisition and manufacturing cost 31-Mar-2005
<b>Intangible assets</b>							
Goodwill	213,844	- 6,288	-	-	8	125,449	82,115
Development costs	194,341	- 35,483	32,858	-	143	582	191,277
Software and other rights	121,780	- 11,554	9,493	964	- 662	17,407	102,614
Payments on account	2,006	-	2,070	- 964	- 17	26	3,069
	<u>531,971</u>	<u>- 53,325</u>	<u>44,421</u>	<u>-</u>	<u>- 528</u>	<u>143,464</u>	<u>379,075</u>
<b>Tangible assets</b>							
Land and buildings	866,425	- 73,233	3,489	- 68,546	- 1,848	20,452	705,835
Investment property	-	-	12	70,447	-	-	70,459
Technical equipment and machinery	717,680	- 139,551	38,357	3,801	- 65	27,462	592,760
Other equipment, factory and office equipment	855,906	- 48,972	79,149	1,177	- 2,832	103,289	781,139
Payments on account and assets under construction	7,410	- 725	7,595	- 6,879	15	17	7,399
	<u>2,447,421</u>	<u>- 262,481</u>	<u>128,602</u>	<u>-</u>	<u>- 4,730</u>	<u>151,220</u>	<u>2,157,592</u>
<b>Financial assets</b>							
Shares in affiliated enterprises	28,818	60,858	301	-	- 416	63,865	25,696
Loans to affiliated enterprises	7,050	-	306	-	- 161	296	6,899
Shares in associated companies / joint ventures	311,710	-	7,590	- 3,901	1,271	316,670	-
Other participations	13,879	-	13,876	3,901	- 665	-	30,991
Long-term investments	9,193	- 95	1,016	-	- 148	214	9,752
Other loans	3,489	-	858	-	-	1,032	3,315
	<u>374,139</u>	<u>60,763</u>	<u>23,947</u>	<u>-</u>	<u>- 119</u>	<u>382,077</u>	<u>76,653</u>
<b>Total fixed assets</b>	<u>3,353,531</u>	<u>- 255,043</u>	<u>196,970</u>	<u>-</u>	<u>- 5,377</u>	<u>676,761</u>	<u>2,613,320</u>

<sup>1)</sup> Impairment loss (previous year: € 187,976 thousand)

1-Apr-2004	Change in the scope of the consolidation	Depreciation	Reversals/transfers	Currency adjustments	Disposals	Accumulated depreciation		Book values	
						Write-ups	31-Mar-2005	31-Mar-2004	31-Mar-2005
131,512	- 6,555	-	-	7	124,964	-	-	82,332	82,115
82,559	- 35,395	10,845	-	55	272	-	57,792	111,782	133,485
98,365	- 9,572	9,848	-	- 39	16,497	- 765	81,340	23,415	21,274
-	-	-	-	-	-	-	-	2,006	3,069
<u>312,436</u>	<u>- 51,522</u>	<u>20,693</u>	<u>-</u>	<u>23</u>	<u>141,733</u>	<u>- 765</u>	<u>139,132</u>	<u>219,535</u>	<u>239,943</u>
510,855	- 39,049	19,080	- 41,022	- 777	8,856	- 174	440,057	355,570	265,778
-	-	2,022	41,022	-	-	-	43,044	-	27,415
596,869	- 101,551	22,960	160	502	18,978	-	499,962	120,811	92,798
709,839	- 43,211	49,465	- 160	- 2,965	77,529	-	635,439	146,067	145,700
-	-	-	-	-	-	-	-	7,410	7,399
<u>1,817,563</u>	<u>- 183,811</u>	<u>93,527</u>	<u>-</u>	<u>- 3,240</u>	<u>105,363</u>	<u>- 174</u>	<u>1,618,502</u>	<u>629,858</u>	<u>539,090</u>
14,537	-	-	-	- 409	-	-	14,128	14,281	11,568
5,688	-	-	-	- 162	-	-	5,526	1,362	1,373
304,620	-	8,236	-	1,020	313,876	-	-	7,090	-
230	-	795	-	-	-	-	1,025	13,649	29,966
1,084	-	1,397	-	- 70	-	-	2,411	8,109	7,341
463	-	136	-	-	139	-	460	3,026	2,855
<u>326,622</u>	<u>-</u>	<u>10,564<sup>1)</sup></u>	<u>-</u>	<u>379</u>	<u>314,015</u>	<u>-</u>	<u>23,550</u>	<u>47,517</u>	<u>53,103</u>
<u>2,456,621</u>	<u>- 235,333</u>	<u>124,784</u>	<u>-</u>	<u>- 2,838</u>	<u>561,111</u>	<u>- 939</u>	<u>1,781,184</u>	<u>896,910</u>	<u>832,136</u>

## Consolidated Segment Report 2004/2005

### > SEGMENT INFORMATION BY DIVISION

Figures in € thousands

	Press		Postpress		Financial Services	
	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>
External sales	2,670,154	2,797,207	358,694	348,376	85,274	61,509
Scheduled depreciation	129,094	103,239	8,417	4,655	599	660
Non-cash expenses	280,700	291,654	28,979	37,371	51,789	21,460
Research and development costs	195,972	173,270	31,806	23,173	–	–
Result of operating activities before special items	151,058	183,366	– 18,158	– 2,246	40,750	26,116
Expenditures from special items	56,894	10,782	31,076	391	24,814	–
– of which: impairment loss	(–)	(–)	(12,513)	(–)	(–)	(–)
Result of operating activities after special items	94,164	172,584	– 49,234	– 2,637	15,936	26,116
Result from the equity valuation	1,319	– 1,230	–	–	–	–
Carrying amount of the shares in equity companies	7,090	–	–	–	–	–
Investments	133,859	142,942	12,003	14,415	2,008	772
Segment assets	2,107,463	2,134,143	225,834	254,563	797,398	590,557
Segment debt	1,378,123	1,349,353	121,374	100,914	211,838	162,056
Number of employees	16,957	16,653	2,022	1,946	85	80

### > SEGMENT INFORMATION BY REGION

Figures in € thousands

	Europe, Middle East and Africa		Eastern Europe		North America	
	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>
External sales by customer location	1,272,932	1,363,567	364,806	366,268	554,342	517,708
Investments	136,671	129,055	4,759	5,050	1,766	19,278
Segment assets	1,757,105	1,800,480	226,351	156,771	437,958	359,982

For additional explanations see Note 37

Continuing Operations		Discontinuing Operations		Heidelberg Group	
1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>
3,114,122	3,207,092	631,872	153,175	3,745,994	3,360,267
138,110	108,554	35,538	5,666	173,648	114,220
361,468	350,485	74,401	54,139	435,869	404,624
227,778	196,443	89,006	14,491	316,784	210,934
173,650	207,236	- 94,225	- 40,108	79,425	167,128
112,784	11,173	222,240	1,901	335,024	13,074
(12,513)	(-)	(33,180)	(-)	(45,693)	(-)
60,866	196,063	- 316,465	- 42,009	- 255,599	154,054
1,319	- 1,230	- 187,773	- 8,236	- 186,454	- 9,466
7,090	-	-	-	7,090	-
147,870	158,129	16,508	3,917	164,378	162,046
3,130,695	2,979,263	387,798	-	3,518,493	2,979,263
1,711,335	1,612,323	416,824	-	2,128,159	1,612,323
19,064	18,679	3,718	-	22,782	18,679

Latin America		Asia/Pacific		Continuing Operations		Discontinuing Operations		Heidelberg Group	
1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>	1-Apr-2003 to 31-Mar- 2004	<b>1-Apr-2004 to 31-Mar- 2005</b>
129,982	137,322	792,060	822,227	3,114,122	3,207,092	631,872	153,175	3,745,994	3,360,267
2,552	1,850	2,122	2,896	147,870	158,129	16,508	3,917	164,378	162,046
227,363	249,344	481,918	412,686	3,130,695	2,979,263	387,798	-	3,518,493	2,979,263

## Notes

### 1 Basis for the presentation of the consolidated financial statements

We have prepared the consolidated financial statements in accordance with the International Financial Reporting Standards (IFRS), which were obligatory as of the balance sheet date. The IFRS comprise new standards issued by the International Accounting Standards Board (IASB), the International Accounting Standards (IAS), as well as the interpretations of the International Financial Reporting Interpretations Committee (IFRIC) and the Standing Interpretations Committee (SIC).

The provisions of Section §292a of the German Commercial Code (HGB) for the exemption from the obligation to provide consolidated financial statements in accordance with German Commercial Law are complied with. The assessment of these provisions is based on the German Accounting Standard No.1 (DRS 1) issued by the German Accounting Standards Council.

In accordance with IAS 36 (revised in 2004), beginning on April 1, 2004 capitalized goodwill is no longer subject to scheduled depreciation. Rather, goodwill amounts are subject to impairment tests either on an annual basis or if a corresponding indication of an impairment arises.

The changes in various standards or new standards approved within the framework of the IASB's 'Improvement Project' will be applied in financial year 2005/2006.

Certain income statement and balance sheet items have been combined to improve the clarity of presentation. A breakdown of these items is presented in the Notes to the Financial Statements. The income statement has been prepared in accordance with the total cost method. The restructuring expenses and the extraordinary expenditures from discontinuing operations incurred in the previous year are shown separately in the income statement under 'Expenditures from special items'.

All amounts are stated fundamentally in € thousands. For subsidiaries located in countries that are not members of the European Monetary Union, the translation to euros occurs by translating the annual financial statements generated in the respective local currency to € (see Note 6).

### 2 Significant differences between the German Commercial Code and the IFRS

The following significant differences result for Heidelberg in comparison to accounting and valuation principles according to commercial law:

- > Inventory valuation (IAS 2),
- > Formation of deferred taxes on the basis of the balance sheet liability method (IAS 12),
- > Differing definition of the manufacturing costs of tangible assets (IAS 16),
- > Change in the assignment of economic ownership of finance lease contracts (IAS 17),

- > Valuation of the provisions for pensions and similar liabilities in accordance with the projected unit credit method taking into account future salary developments and the corridor procedure (IAS 19),
- > Translation of foreign currency receivables and liabilities at the financial year-end exchange rate (IAS 21),
- > No scheduled amortization of goodwill; amortization based exclusively on impairment tests (IFRS 3 together with IAS 36 (2004)),
- > Consolidation of the specialized investment funds (IAS 27 in connection with SIC 12),
- > Waiver of the creation of provisions for expenses and other provisions if the probability that they will be called upon is less than 50 percent; long-term provisions are calculated at the net present value (IAS 37),
- > Recognition of self-generated intangible fixed assets – in particular, development costs – if certain activation prerequisites exist (IAS 38),
- > Recognition and measurement of primary and derivative financial instruments (IAS 39).

### 3 Realignment of the Heidelberg Group

#### Discontinuing Operations

As of March 7, 2004 a contract was signed with Eastman Kodak Company, New Jersey, USA, covering the sale of the Digital Division. Following fulfillment of the contractual conditions, the contract went into effect on May 1, 2004. The agreement covers the production, service and sales of our digital black-and-white and color printing presses.

The contract with Goss International Corporation, Delaware, USA, covering the sale of the web offset printing press division ('Web Systems') went into effect on August 6, 2004. The transaction included the Commercial Web and Newspaper Printing Presses business units in Heidelberg as well as the processing installations for web printing presses in the US. We are continuing the sales and services operations for Goss International Corporation in selected countries. Heidelberg is a new shareholder, holding a 15 percent interest in Goss International Corporation, Delaware, USA.

#### Continuing Operations

Following the reorientation of the Heidelberg Group, our principal focus is on the Press Division (Sheetfed including Prepress and Gallus, as well as Web Systems Distribution) and the Postpress Division (Print Finishing). As an additional area of operations, the Financial Services Division is responsible for our entire range of Customer Financing services. Consequently, we already adapted the structure of segment reporting as of April 1, 2004. To increase reporting transparency, after adjusting the previous year's figures we shifted



the interest income and interest expenses of the Financial Services Division to net sales and cost of materials, respectively. Due to the realignment and the remaining accounts receivable from customer financing at Heidelberg associated with the divestiture of business divisions the previous year's figures were adjusted as follows:

	Previously	Adjusted	Change
Sales revenue	3,660,720	3,745,994	85,274
Cost of materials	1,541,414	1,566,842	25,428
Result of operating activities before special items	19,579	79,425	59,846
Restructuring expenses	93,053	117,867	24,814
Extraordinary expenditures from discontinuing operations	241,971	217,157	- 24,814
Expenditures from special items	335,024	335,024	-
Other interest and similar income	91,660	6,386	- 85,274
Interest and similar expenses	86,961	61,533	- 25,428
Net interest	4,699	- 55,147	- 59,846
Result before taxes	- 506,385	- 506,385	-
- of which: discontinuing operations	(- 541,696)	(- 516,882)	(24,814)

#### 4 Scope of the consolidation

The consolidated financial figures of Heidelberger Druckmaschinen Aktiengesellschaft include a total of 79 (previous year: 82) domestic and foreign companies in which Heidelberger Druckmaschinen Aktiengesellschaft is in a position to exercise a controlling influence as defined by IAS 27. A controlling influence exists as defined by IAS 27 if the financial and corporate policy of a company can be influenced in order to derive benefits from its activity. The inclusion in the Group consolidated financial statements occurs at the time the controlling relationship is established. Shares in subsidiaries that are of minor importance are excluded. The presentation of the shareholdings of the Heidelberg Group has been deposited with the Commercial Register of Companies of the Heidelberg District Court (Company Register No. 4). The significant consolidated subsidiaries included in the consolidated annual financial statements are listed in the Appendix to the Notes to the Financial Statements headed 'Major shares in affiliated companies'.

The companies in Germany and abroad that are included in, or excluded from, the consolidated financial figures are broken down as follows:

	Domestic 31-Mar- 2005	Abroad 31-Mar- 2005	<b>Total 31-Mar- 2005</b>	Total 31-Mar- 2004
Wholly consolidated companies <sup>1)</sup>	14	66	80	83
Non-consolidated companies due to their minor importance	8	26	34	37
Associated companies measured according to the equity method	–	–	–	2
Associated companies not measured according to the equity method due to their minor importance	–	3	3	2
Other participations	–	5	5	3
	<u>22</u>	<u>100</u>	<u>122</u>	<u>127</u>

<sup>1)</sup> Including five specialized investment funds

Compared with the previous year, the scope of the consolidation changed as follows:

> Initial consolidation:

Our subsidiary HJP Service & Education Center Co. Ltd., Tokyo, Japan, and Heidelberg International Finance B.V., Boxmeer, Netherlands, were consolidated for the first time during the financial year.

> Deconsolidation:

Due to the sale of the Digital and Web Systems divisions, the following companies were deconsolidated during the financial year:

- NexPress GmbH, Kiel;
- Heidelberg Digital LLC, Rochester, New York, USA;
- NexPress Solutions LLC, Rochester, New York, USA (equity method);
- Heidelberg Web Systems S.A., Montataire, France;
- Heidelberg Web Systems Inc., Dover, New Hampshire, USA.

Furthermore, due to its minor significance for the Heidelberg Group, Heidelberg Middle East FZ Co., Dubai, United Arab Emirates, is no longer measured according to the equity method.

> Merger:

The firm Brehmer Buchbindereimaschinen GmbH, Leipzig, was merged with Heidelberg Postpress Deutschland GmbH, Heidelberg, on April 1, 2004.

The change in the scope of the consolidation had the following effects:

	2003/2004	2004/2005
Fixed assets	-4,846	-19,710
Current assets	6,300	-316,769
<b>Total assets</b>	<b>1,454</b>	<b>-336,479</b>
Shareholders' equity	-	-7
Liabilities	1,454	-336,472
<b>Equity and liabilities</b>	<b>1,454</b>	<b>-336,479</b>
Sales	42,099	-322,394
Net result	-2,899	535,352

The companies measured according to the equity method are carried as follows:

	2003/2004	2004/2005
Fixed assets	124,185	-
Current assets	37,121	-
- of which: long-term assets	(10,603)	(-)
<b>Total assets</b>	<b>161,306</b>	<b>-</b>
Shareholders' equity	125,158	-
Liabilities	36,148	-
- of which: long-term debt	(2,361)	(-)
<b>Equity and liabilities</b>	<b>161,306</b>	<b>-</b>
Sales	121,303	7,819
Income	1,720	306
Expenses	191,409	17,591
Net loss	-68,386	-9,466

Due to the divestiture of NexPress Solutions LLC, Rochester, as well as the reclassification of Heidelberg Middle East FZ Co., Dubai, no equity valuation was undertaken at financial year-end.

## 5 Principles of consolidation

In accordance with IFRS 3, which beginning in the reporting year must be applied together with IAS 36 (2004) and IAS 38 (2004), all mergers are to be carried according to the purchase method.

In accordance with IFRS 3 in association with IAS 36 (2004), beginning in the reporting year capitalized goodwill is no longer amortized according to plan. However, the carrying amounts of goodwill are subjected to an impairment test if there is an indication of a decrease in value. Regardless of whether or not there are grounds for an impairment, goodwill is monitored annually for evidence of a decline in value (impairment test). An impairment loss occurs when the recoverable amount is less than the carrying amount of a cash-generating item that is associated with the goodwill. Any additional write-down requirement is taken into account through a pro-rata reduction in the carrying amounts of other assets.

Sales, expenses and income, receivables and liabilities, and contingent liabilities among consolidated companies are eliminated. Transactions among consolidated companies in goods and services are calculated both on the basis of market prices and also on the basis of arm's length transfer prices. Assets from commercial transactions among consolidated companies included in inventories are adjusted to eliminate intercompany profits. Taxes on intercompany profits are taken into account and applied to deferred taxes.

## 6 Foreign currency translation

In the individual financial statements of the consolidated companies, which are drawn up in local currencies, monetary items in foreign currencies (cash and cash equivalents, receivables, and liabilities) are evaluated at the financial year-end exchange rate and booked directly to the income statement. Non-monetary items denominated in foreign currencies are posted at their historic exchange rates.

The translation of the financial figures of the companies included in the consolidation that are drawn up in foreign currencies is undertaken on the basis of the concept of the functional currency (IAS 21) in accordance with the 'modified financial year-end exchange rate method'. Since our subsidiaries financially, economically, and organizationally effect their transactions on an independent basis, the functional currency is fundamentally identical with each subsidiary's respective local currency. Assets and debts are accordingly translated at the financial year-end rates and expenses and income at the average exchange rates for the year. The difference resulting from the foreign currency translation is offset from revenue reserves without effect on the income statement.

Foreign currency differences arising vis-à-vis the previous year's translation in the Heidelberg Group are offset from revenue reserves without effect on the income statement.

Accounting under the terms of IAS 29 was not required, as the Heidelberg Group does not have any significant subsidiaries located in countries with high rates of inflation.

The foreign currency translation is based on the following exchange rates:

	Average rates of the year		Financial year-end rates	
	2003/2004 1 € =	2004/2005 1 € =	2003/2004 1 € =	2004/2005 1 € =
<b>USD</b>	1.1780	1.2642	1.2187	1.2943
<b>GBP</b>	0.6925	0.6832	0.6681	0.6877
<b>AUD</b>	1.6935	1.7085	1.6179	1.6790
<b>HKD</b>	9.1673	9.8528	9.5012	10.0949
<b>CAD</b>	1.5916	1.6081	1.5922	1.5685
<b>JPY</b>	132.4325	135.6800	128.9900	139.1300

USD = US Dollar

GBP = Pound Sterling

AUD = Australian Dollar

HKD = Hong Kong Dollar

CAD = Canadian Dollar

JPY = Japanese Yen

The foreign currency changes had the following effect:

	2003/2004	2004/2005
Fixed assets	- 33,937	- 2,539
Current assets	- 94,730	- 27,842
<b>Total assets</b>	<b>- 128,667</b>	<b>- 30,381</b>
Shareholders' equity	- 79,725	- 19,851
Liabilities	- 48,942	- 10,530
<b>Equity and liabilities</b>	<b>- 128,667</b>	<b>- 30,381</b>
Sales <sup>1)</sup>	- 267,234	- 65,082

<sup>1)</sup> Previous year's figures were restated (see Note 3)

## **7 General accounting and valuation policies**

The accounting and valuation policies that are applied in the consolidated financial figures are presented below. Further explanations concerning individual items of the consolidated income statement and the consolidated balance sheet as well as corresponding figures are presented in Note 8 and following.

### **General principles**

In the view of the IASB, the annual financial statements present a true and fair view as well as a fair presentation (overriding principle) if the qualitative criteria of the presentation of accounts are met and the individual IFRS guidelines are complied with. Consequently, if a true and fair view is to be presented, it is imperative that no deviation from the individual provisions occurs.

### **Uniform accounting and valuation policies**

The annual consolidated financial figures are prepared on the basis of accounting and valuation policies that are applied uniformly throughout the Group. The same accounting and valuation policies are applied to determine pro-rata shareholders' equity for the companies measured according to the equity method.

### **Continuity of accounting and valuation policies**

The accounting and valuation policies were fundamentally retained.

### **Intangible assets**

With the exception of goodwill, all intangible assets have a limited useful life and are therefore amortized according to plan. In accordance with IFRS 3 in association with IAS 36 (2004), goodwill is no longer amortized according to plan beginning in the reporting year. Rather, it is subject to an impairment test both annually and if there is an indication of a reduction in value. Purchased intangible assets are capitalized at their cost of acquisition and amortized on a straight line basis over their expected useful life. Necessary non-scheduled depreciation was taken in the previous year for restructuring measures as well as discontinuing operations. Intangible assets produced within the Group are capitalized to the extent that the criteria of IAS 38 are fulfilled. Manufacturing costs largely include all directly attributable costs.

### Research and development costs

Development costs for newly developed products are capitalized at manufacturing cost to the extent that an unambiguous expense classification is possible and if both the technical feasibility and the marketing of the newly developed products are assured (IAS 38). There must also be a sufficient degree of probability that the development activity will lead to future revenue flows. The cost of manufacture encompasses those costs both directly and indirectly attributable to the development process. Scheduled depreciation is based on the estimated period during which sales may be expected.

In accordance with IAS 38, research costs may not be capitalized and are therefore charged as an expense directly to the income statement.

### Tangible assets

Tangible assets are assessed at acquisition or manufacturing costs less scheduled straight-line depreciation and non-scheduled depreciation taken for restructuring measures. The cost of manufacture encompasses all costs that are directly or indirectly attributable to the manufacturing process.

There was no revaluation of tangible assets in accordance with the options provided in IAS 16.

Interest on borrowed funds is booked as a direct expense (IAS 23). Depreciation based exclusively on tax rules is not applied.

All repair costs for tangible assets are charged as an expense and are only capitalized if the incurred costs result in an extension or substantial improvement of the respective asset.

### Investment Property

Investment property (IAS 40: Real Estate Held as a Financial Investment) is carried at the amortized acquisition or manufacturing cost. The notes to the financial statements provide information on the fair value of investment real estate, which is recorded in line with internationally acknowledged valuation methods or is derived from the current market price of comparable real estate.

### Financial leases

Under financial lease contracts, economic ownership is attributed to lessees in those cases in which they bear virtually all of the risks and opportunities associated with the ownership of the asset (IAS 17). To the extent that economic ownership is attributable to the Heidelberg Group, the cost is capitalized from

the date on which the lease contract is concluded at the lower of the fair value or the present value of the minimum leasing payments. Depreciation is taken using the straight-line method on the basis of the lower of useful economic life or the duration of the lease.

### Scheduled depreciation

The scheduled depreciation of fixed assets is recorded primarily on the basis of the following useful life periods, which are applied uniformly by the Group:

	Years
Development costs	3 to 6
Software and other rights	3 to 5
Buildings	25 to 50
Technical equipment and machinery	3 to 15
Motor vehicles	5 to 9
Factory and office equipment	3 to 13

### Non-scheduled depreciation

The maintenance of the book value of all intangible assets (including capitalized development costs) and of all tangible assets is systematically reviewed at the end of each financial year. Non-scheduled depreciation is taken to the extent that the recoverable amount for the asset is lower than the book value. The recoverable amount is always the higher of the net market value or the net present value of the estimated future revenue flows from the asset. Provided the asset is part of an independent cash-generating unit, amortization is determined on the basis of the recoverable amount of this cash-generating unit. Should the reasons for non-scheduled depreciation be eliminated, a write-up is taken up to the amount of the acquisition or manufacturing cost, reduced by the amount of scheduled depreciation (IAS 36).

The carrying amounts of the goodwill are subject to an impairment test if there is an indication of a decline in value. Regardless of whether there are grounds for an impairment, goodwill is monitored annually for possible impairment by means of an impairment test. An impairment loss occurs when the recoverable amount is less than the carrying amount of an item that generates cash, to which goodwill is associated.



### **Joint ventures and associated companies**

Shares in joint ventures and associated companies are carried according to the equity method. Pro rata consolidation is not applied. The acquisition cost of associated companies consolidated in accordance with the equity method is increased or decreased each year in line with any changes in shareholders' equity relating to the shares held by the Heidelberg Group.

### **Shares in subsidiaries and securities**

For such financial instruments, the provisions of IAS 39 differentiate between whether they are 'held for trading purposes', 'held to maturity', or 'available for sale'.

Participations (including shares in affiliated enterprises), long-term investments, and marketable securities are classified as 'available for sale'. In line with IAS 39, these financial instruments are fundamentally carried at fair value. Long-term investments and marketable securities are fundamentally measured at their stock market prices, provided this value can be recorded reliably. The initial valuation occurs as of the settlement date. Unrealized profits and losses arising from changes in fair value are posted to shareholders' equity without effect on the income statement, taking into consideration deferred taxes. At the time of a sale, realized profit or loss is booked directly to the income statement in the financial result. In accordance with IAS 39, corresponding amortization is taken in situations in which substantial objective indications for an impairment of an asset have occurred.

During the financial year, no transfers occurred among the various categories.

The appropriate classification of securities is established at the time of purchase and is monitored at the respective financial year-end. All ordinary purchases and sales of financial investments are carried on the balance sheet as per the settling day.

### **Loans**

Loans are credits we grant, which in accordance with IAS 39 are measured at adjusted acquisition costs. Long-term non-interest bearing and low-interest bearing loans are carried at their net present values. Impairment losses are taken if there is a substantial objective indication of an impairment.

### **Inventories**

Inventories are carried at the lower of acquisition or manufacturing cost and net realizable value. Valuations are fundamentally determined on the basis of the weighted average cost method. The Fifo method is applied for certain inventories.

Manufacturing cost includes production-related full costs determined on the basis of normal capacity utilization.

In particular, the manufacturing cost of products includes directly attributable direct costs (such as production materials and wages), as well as fixed and variable production overheads (for example, handling, general material, and general production costs), including an appropriate proportion of depreciation charges on production plant and equipment. Particular account is taken of costs that are charged to the specific production cost centers. Borrowing costs are not capitalized as part of acquisition or manufacturing costs (IAS 23).

The risks of holding inventories arising from reduced salability are accounted for by appropriate reductions in value. These value write-downs are recorded on the basis of the future production program or actual consumption. In this regard, depending on the respective inventory item, individual periods of consideration are taken as a basis, which are monitored and adjusted based on appropriate judgment criteria. The valuation takes into account lower realizable net selling prices at financial year-end. If the reasons for a lower valuation no longer apply to inventories that have formerly been reduced in value and the net selling price has therefore risen, the resultant appreciation is recorded as a reduction of material costs.

### **Receivables from customer financing**

Receivables from customer financing represent claims under loans that are granted to our customers in connection with the financing of machinery sales, as well as receivables under finance leases.

Finance leases include leased-out installations that may be regarded financially as sales under long-term financing. In accordance with IAS 17, these receivables are shown in the amount of discounted future minimum lease payments.

In the framework of customer financing, the risks of creditworthiness and of default arise due to the potential danger that our customers do not comply with their payment obligations. As a consequence, assets may deteriorate in value. Recognizable risks of non-payment are taken into account by establishing adequate risk provisions.

### **Other receivables and other assets**

Other receivables and other assets are measured at their adjusted acquisition cost. Account has been taken of all recognizable risks of non-payment through corresponding write-downs.

### **Customer-specific production orders**

In accordance with IAS 11, customer-specific production orders are carried on the basis of the percentage-of-completion method, with the amounts realized included in sales and, after deduction of customer payments on account received, in trade receivables. The stage of completion is determined based on the accrued expenses (cost-to-cost method). There were no significant orders at financial year-end that would necessitate recognition in accordance with IAS 11.

### **Cash and cash equivalents**

Cash on hand and bank deposits are carried at their nominal amount.

### **Deferred taxes**

Deferred taxes are calculated in accordance with the internationally customary balance sheet liability method (IAS 12). Under this method, deferred tax entries are made for all temporary accounting and valuation differences in the balance sheet between IFRS valuations and fiscal valuations of the individual subsidiaries or controlled companies as well as of corresponding consolidation measures. Deferred tax assets for future benefits from tax loss carry-forwards are also taken into account. We have, however, only taken into account deferred tax assets for accounting and valuation differences as well as for tax loss carry-forwards where there is sufficient certainty that they will be realized. Deferred taxes are measured on the basis of the income tax rates of the respective countries. A tax rate of 37.61 percent (previous year: 39.28 percent) is used as a basis for the calculation of domestic deferred taxes. In addition to the corporation tax of 25 percent and the solidarity surtax of 5.5 percent, the rate of the average trade tax on income was also taken into account.

In accordance with the provisions of IAS 12, neither deferred tax assets nor liabilities have been discounted. Deferred tax claims were offset against deferred tax liabilities when required according to the provisions of IAS 12.

### Provisions for pensions and similar obligations

The provisions for pensions and similar obligations comprise the obligations of the Group to establish provisions under both benefit-oriented as well as contribution-oriented plans. In the case of benefit-oriented pension plans, the pension obligations are calculated by the so-called projected unit credit method (IAS 19). Under this method, expert actuarial reports are commissioned each year. The calculations are based on an assumed trend of 2.75 percent (previous year: 3.0 percent) for salary increases, 1.75 percent (previous year: 2.0 percent) for the growth in pensions, and a discounted interest rate of 4.75 percent (previous year: 5.5 percent). The probability of death is calculated on the basis of the current Heubeck mortality tables or comparable foreign mortality tables. In the case of contribution-oriented plans (e.g., direct insurance policies), compulsory contributions are offset directly as an expense. No provisions for pension obligations are formed, as in these cases our Company does not have any liability over and above its obligation to make premium payments. Actuarial gains and losses that exceed a band of 10 percent of the higher of the extent of the obligation or the fair value of the plan assets are distributed over the average remaining service period. Expenses for service periods are carried under personnel expenses and the interest portion of the additions to provisions under the financial result.

### Other provisions

Other provisions are formed to the extent that a past event gives rise to a current obligation, that the amount of the charge is more probable than improbable, and that the amount can be reliably estimated (IAS 37). This means that there must be a probability greater than 50 percent that the liability will be realized. The valuation is based on the amount that is most likely to be incurred. Provisions are only formed for legal or de-facto obligations vis-à-vis third parties. No positive profit contributions occurred as defined by IAS 37, and consequently none are shown in the accounts. Provisions are measured based on the full cost principle in relation to production, taking into consideration possible cost increases.

Provisions for restructuring measures were formed to the extent that the criteria of IAS 37 were met.

Long-term provisions with a term to maturity of more than one year are carried at the discounted settlement value on the balance sheet date on the basis of appropriate interest rates, provided that the interest rate effect is significant. The underlying interest rates depend on the term of the obligation.

### Liabilities

In accordance with IAS 39, liabilities are stated at their adjusted acquisition costs. Liabilities arising from financial leasing contracts are accrued in the amount of the present value of the minimum lease payments.

### Advance payments from customers

Advance payments received from customers are recorded under liabilities.

### Deferred income

Deferred income is booked on a straight-line basis in line with depreciation to the extent that it relates to tax-exempt allowances and taxable subsidies for investments.

### Derivative financial instruments

Derivative financial instruments comprise hedging transactions that are entered into for the purpose of managing risks associated with fluctuations in interest rates and exchange rates. These instruments serve to reduce income volatility. Trading positions, i.e. derivatives without an underlying transaction, are not entered into. We currently make use of over-the-counter (OTC) instruments. These include:

- forward exchange transactions,
- foreign currency options, and
- interest-rate swaps.

Derivative transactions are generally undertaken only in connection with corresponding underlying transactions. The scope of hedging by financial derivatives extends to booked, open, and highly likely underlying transactions.

In accordance with IAS 39, derivatives fulfill the criteria of assets and debts, as a result of which they must be capitalized (other assets) or accrued (other liabilities) at market value. The initial measurement occurs as of the trading date.

In compliance with IAS 39, the differentiation between a fair value hedge and a cash flow hedge is of basic importance for hedge accounting.

The goal of a fair value hedge is to offset the changes in market value of assets and debts shown on the balance sheet by means of countervailing changes in the market value of the hedging transaction. Any profit or loss resulting from the market value change in the hedging transaction must immediately be recorded in the income statement. With regard to the hedged risk, the underlying transaction is also to be recorded in the income statement from the beginning of the hedging transaction.

A cash flow hedge serves to hedge changes in payment flows that typically arise in connection with floating-rate assets or debt shown in the balance sheet, that arise from pending transactions in foreign currencies or from planned future transactions. The profits and losses from the derivatives are included in shareholders' equity without effect on the income statement up until the time the respective secured underlying transaction goes into effect.

### **Contingent liabilities**

Contingent liabilities are potential obligations that relate to past events and whose existence will not be confirmed until one or several uncertain future events occur. These future events, however, lie outside the sphere of influence of the Heidelberg Group. Furthermore, current obligations may represent contingent liabilities if the outflow of resources is not sufficiently probable for the formation of a respective provision, and/or if it is not possible to estimate the amount of the obligation to a sufficiently reliable extent. The valuation of contingent liabilities on the balance sheet date is based on the existing extent of liability.

## Notes to the Income Statement

### 8 Net sales

**Product sales** are recorded if the relevant risks and opportunities that are related to the ownership of the sold merchandise and products become the property of the buyer. Neither a residual right nor a power of disposal over the sold merchandise and products remain. The revenue amount can be reliably determined; the inflow of economic benefit from the sale is probable to an adequate degree.

Due to the restructuring, net sales comprise the interest revenues generated by the Financial Services area. The previous year's figures were accordingly restated.

As already in the previous year, substantial order income from **customer-specific manufacturing** arising from the application of the percentage-of-completion method again did not occur in business year 2004/2005.

Sales from **services** are recorded when the services are made available, provided that the amount of the income can be reliably allocated and the inflow of economic benefit arising from the transaction is sufficiently probable. Long-term service contracts are generally subject to linear allocation of sales.

Income from **operating and finance leasing relationships** is recorded based on the provisions of IAS 17.

Explanations concerning net sales are presented in the Reports of the Divisions as well as in the Reports from the Regions.

### 9 Other operating income

	2003/2004	2004/2005
Reversal of other provisions	77,920	102,580
Income from written-off receivables	30,291	23,347
Income from operating facilities	15,888	21,024
Foreign exchange profits	26,013	17,647
Income from disposals of intangible assets and tangible assets	12,259	10,258
Income from job research projects	45,076	8,166
Other income	76,495	54,983
	<u>283,942</u>	<u>238,005</u>

The decline in income from job research projects is connection with NexPress GmbH, Kiel, which was already deconsolidated back in the first quarter of the financial year. Other income comprises a large number of individual items. Foreign exchange profits are offset from foreign exchange losses, which are included in other operating expenses.

## 10 Cost of materials

	2003/2004	2004/2005
Expenses for raw materials, consumables and supplies, as well as for goods purchased	1,399,092	1,328,830
Costs of purchased services	142,322	164,486
Interest expense of Financial Services	25,428	16,716
	<u>1,566,842</u>	<u>1,510,032</u>

Due to the restructuring, pro-rata interest expense in connection with the Financial Services Division is included in the cost of materials. The previous year's figures were accordingly restated (see Note 3).

The ratio of the cost of materials to total operating performance increased from 41.8 percent to 43.5 percent.

## 11 Personnel expenses and number of employees

	2003/2004	2004/2005
Wages and salaries	1,053,229	924,251
Social security contributions and other pension costs	240,417	213,892
– of which: for pensions	(28,263)	(33,021)
	<u>1,293,646</u>	<u>1,138,143</u>

The expenses for the pension plan include the expenses for pension claims without the corresponding interest portion, which is shown under the item interest and similar expenses.

The number of **employees** totaled:

	Average		As of	
	2003/2004	2004/2005	31-Mar-2004	31-Mar-2005
Wage earners	9,846	7,351	9,503	7,090
Salaried employees	12,795	11,320	12,515	10,911
Apprentices	849	780	764	678
	<u>23,490</u>	<u>19,451</u>	<u>22,782</u>	<u>18,679</u>



**12 Other operating expenses**

	2003/2004	2004/2005
Other deliveries and services not included in the cost of materials	137,509	139,289
Special direct sales expenses including freight charges	95,632	92,201
Rent and leases (excluding car fleet)	88,332	70,885
Travel expenses	77,590	63,176
Provisions for doubtful accounts and other assets	92,580	53,334
Information technology	45,343	49,071
Additions to provisions (relates to several expense accounts)	68,531	41,432
Legal and consulting fees	30,169	24,892
Insurance	22,528	20,900
Costs of mail and payment transactions	19,899	15,518
Public-sector fees and other taxes	20,206	14,528
Car fleet	13,557	13,470
Operating facilities	13,439	10,748
Exchange rate losses	5,180	10,534
Other research and development costs	17,582	10,197
License fees	10,859	6,019
Commissions	6,915	5,701
Office supplies, newspapers, technical literature	5,785	4,511
Losses from disposals of intangible assets and tangible assets	5,881	1,447
Other overhead costs	143,467	132,485
	<u>920,984</u>	<u>780,338</u>

Other operating expenses largely reflect business developments, the reorientation of the Heidelberg Group, and the implementation of the program to reduce costs and enhance efficiency.

### 13 Expenditures from special items

	2003/2004	2004/2005
Impairment loss on intangible and tangible assets	12,716	–
Cost of materials	3,926	–
Personnel expenses	33,966	1,402
Other costs <sup>1)</sup>	67,259	11,672
<b>Restructuring expenses</b>	<b>117,867</b>	<b>13,074</b>
Impairment loss on intangible and tangible assets	32,977	–
Cost of materials	27,884	–
Personnel expenses	18,989	–
Other costs <sup>1)</sup>	137,307	–
<b>Extraordinary expenditures from discontinuing operations</b>	<b>217,157</b>	<b>–</b>
<b>Expenditures from special items</b>	<b>335,024</b>	<b>13,074</b>

<sup>1)</sup> Previous year's figures were accordingly restated (see Note 3)

The restructuring expenses arose in connection with our program for medium-term cost reduction and efficiency enhancement.

Extraordinary expenditures from discontinuing operations of the previous year were attributable to the divestiture of the Digital and Web Systems divisions.

### 14 Result from financial assets and marketable securities

	2003/2004	2004/2005
Result from the equity valuation	– 186,454	– 9,466
– of which: impairment loss in connection with discontinuing operations	(– 118,068)	(–)
Expenses from financial assets	3,648	10,446
– of which: affiliated enterprises	(3,454)	(8,100)
Income from loans or securities included under financial assets	1,246	3,487
Income from profit transfer agreements	532	893
Expenses from assumption of losses	76	115
<b>Income from financial assets</b>	<b>– 188,400</b>	<b>– 15,647</b>
<b>Result from marketable securities</b>	<b>– 7,239</b>	<b>17,497</b>
	<b>– 195,639</b>	<b>1,850</b>

The result from marketable securities only includes income from the specialized investment funds.

The result from financial assets includes expenses from discontinuing operations of € 8,236 thousand (previous year: € 187,773 thousand). The impairment loss in connection with discontinued operations of the previous year results from NexPress Solutions LLC, Rochester, New York, USA.

The result from specialized investment funds of the previous year comprises expensed continuing impairments to securities of € 20,000 thousand. Write-ups booked to the income statement during the financial year amounted to € 4,424 thousand.

Expenses from financial assets include amortization of financial assets amounting to € 1,397 thousand (previous year: € 203 thousand).

Income from profit transfer agreements relates to Print-Assekuranz Versicherungsvermittlungsgesellschaft mbH, Heidelberg, and Heidelberg Catering Services GmbH, Wiesloch. The expenses from the assumption of losses relate to Sporthotel Heidelberger Druckmaschinen GmbH, Heidelberg.

## 15 Net interest income

The net interest income is apportioned as follows:

	2003/2004	2004/2005
Interest from financial investments	1,424	1,146
Other interest income	4,962	5,442
– of which: affiliated enterprises	(447)	(1,434)
<b>Other interest and similar income</b>	<b>6,386</b>	<b>6,588</b>
Bank interest	16,632	16,043
Interest for trade payables	94	53
Other interest expenses	44,807	38,865
– of which: interest portion from additions to pension provisions	(28,965)	(26,126)
– of which: to affiliated enterprises	(57)	(76)
<b>Interest and similar expenses</b>	<b>61,533</b>	<b>54,961</b>
<b>Net interest result</b>	<b>–55,147</b>	<b>–48,373</b>

Due to the restructuring, interest revenues and expenditures generated by the Financial Services Division are included in sales revenues and cost of materials, respectively. The previous year's figures were restated to ensure comparability (see Note 3).

## 16 Taxes on income

The effective and deferred tax expenses and income, which apply to German and foreign taxes on income, are broken down as follows:

	2003/2004	2004/2005
Effective taxes		
Germany	- 4,222	7,412
Abroad	11,803	8,357
	<u>7,581</u>	<u>15,769</u>
Deferred taxes		
Germany	41,614	5,042
Abroad	139,320	25,604
– of which: extraordinary expenditures in connection with discontinuing operations <sup>1)</sup>		
Digital	(18,159)	(–)
Web Systems	(97,583)	(–)
	<u>180,934</u>	<u>30,646</u>
	<u>188,515</u>	<u>46,415</u>

<sup>1)</sup> Totaling € 0 (previous year: € 115,742 thousand)

The taxes on income comprise the domestic corporation tax, including the solidarity surtax, as well as the trade tax on income, and comparable taxes of the foreign subsidiaries.

As in the previous year, no significant income accrued from the application of loss carry-backs during the financial year.

There were no significant changes in tax expenses as a result of modifications to respective tax rates in the countries in which Heidelberg does business.

There was no impact on deferred taxes as a result of the introduction of new taxes levied in the countries in which Heidelberg does business.

Furthermore, the retention of the balance sheet generation and valuation methods did not result in additional tax expenses or tax income.

There were no tax expenses during the reporting year in connection with extraordinary expenses.

Taxes on income from discontinuing operations total € 7,626 thousand (previous year: € 136,263 thousand). Of this amount, taxes on income amounting to € 10,737 thousand (previous year: € 108,657 thousand) are attributable to Web Systems (including Web Finishing), and tax income of € 3,111 thousand (previous year: € 27,606 thousand in taxes on income) is attributable to the Digital Division.

All still unused tax loss carry-forwards amounting to € 629,230 thousand (previous year: € 1,026,990 thousand) are primarily attributable to foreign subsidiaries. Total tax loss carry-forwards, for which no deferred tax claims were formed, amount to € 547,875 thousand (previous year: € 966,419 thousand). Of this total, potential utilization amounts to € 1,339 thousand through 2006, € 192 thousand through 2007, € 420 thousand through 2008, € 650 thousand through 2009, € 497 thousand through 2010, and € 544,777 thousand through 2011 and later.

Taxes on income are reduced due to the generation of deferred tax assets for tax loss carry-forwards not yet utilized in the amount of € 12,899 thousand (previous year: increased by € 116,048 thousand).

As in the previous year, during the financial year no deferred tax assets were formed relating to not yet applicable tax loss carry-forwards. Deferred tax income is only shown for tax loss carry-forwards if their realization is assured in the near future. During the reporting year, write-downs of deferred tax assets for loss carry-forwards created in previous years amounting to € 4,152 thousand (previous year: € 139,798 thousand) were formed.

Effective taxes were reduced during the reporting year by € 6,441 thousand (previous year: € 1,036 thousand) as a result of deferred tax assets that had not previously been taken into account. The still unused tax credits for which no deferred tax claims have been capitalized in the balance sheet, amount to € 7,327 thousand (previous year: € 13,251 thousand); they expire by the latest on March 31, 2024.

Expenses and income not related to the reporting period arising from effective income taxes amount, respectively, to € 289 thousand (previous year: € 22,910 thousand) and € 615 thousand (previous year: € 14,881 thousand).

Taxes on income developed as follows with relation to income before taxes:

	2003/2004	2004/2005
Income before taxes	- 506,385	107,531
Theoretical tax rate in percent <sup>1)</sup>	39.28	37.61
<b>Theoretical tax income/expense</b>	<b>- 198,908</b>	<b>40,442</b>
Change in theoretical tax income/expense due to:		
- differing tax rate	- 3,207	- 10,466
- losses	97,905	27,857
- tax decrease due to tax-exempt income/ other deductible amounts	- 9,127	- 22,465
- tax increase due to non-deductible expenses	12,705	12,070
- extraordinary expenditures from discontinuing operations/ restructuring expenses	284,803	-
- change in tax provisions/taxes attributable to previous years	- 3,971	591
- other	8,315	- 1,614
<b>Taxes on income</b>	<b>188,515</b>	<b>46,415</b>
<b>Tax rate in percent</b>	<b>- 37.23</b>	<b>43.16</b>

<sup>1)</sup> The reduction in the theoretical tax rate results from the adjustment of the trade tax assessment rates

The theoretical tax rate is based on the domestic income tax rate which is composed of the corporate income tax (25 percent), the solidarity surcharge (5.5 percent), and the average trade tax.

## Notes to the Balance Sheet

### 17 Intangible assets

The carrying amount of intangible assets developed as follows in financial years 2003/2004 and 2004/2005.

	2003/2004	2004/2005
<b>Status at the beginning of the financial year</b>	265,842	219,535
Changes in the scope of the consolidation	502	- 1,803
Additions	56,239	44,421
Depreciation and amortization	97,253	20,693
Currency adjustments	- 4,071	- 551
Reversals	2,217	1,731
Other	493	765
<b>Status at financial year-end</b>	219,535	239,943

The book value of intangible assets as of March 31, 2005 comprises: goodwill (€ 82,115 thousand), development costs (€ 133,485 thousand), software and other rights (€ 21,274 thousand), and prepayments (€ 3,069 thousand).

**Goodwill** includes amounts arising from the acquisition of businesses (asset deals) and from the capital consolidation. Goodwill carried by cash-generating units is allocated to the segment level in connection with execution of the impairment tests. The carrying amounts of the goodwill associated with the Press and Postpress segments total, respectively, € 66,014 thousand (previous year: € 65,718 thousand) and € 16,101 thousand (previous year: € 16,101 thousand). The carrying amount of the goodwill that was reported in the previous year for the Digital segment of € 513 thousand was dissolved in its entirety due to the divestiture.

According to IAS 36 (2004), the recoverable amount of the cash-generating units is determined by the impairment test based on the fair value less the cost of a sale, or the value in use. In this process, the fair value reflects the best estimate of the amount for which an independent outside party would acquire the cash-generating units at the financial year-end. The fair value is recorded based on the process of determining corporate value. Determination of the fair value and the value in use is based on medium-term, five-year cash flow planning as authorized by the Management Board. This planning process results from past experience as well as forecasts of future market development.

Medium-term planning is based on assumptions regarding the future development of the basic economic data generated from economic and financial studies, as well as interest rates and nominal wage data.

The discount rates are developed on the basis of market data and amount to 7.6 percent after taxes and 11.7 percent before taxes for the cash-generating units.

Capitalized **development costs** relate for the most part to the development of assets in the Press Division. Non-capitalized development costs from all Divisions – including research expenses – amount to € 178,076 thousand in the reporting year (previous year: € 268,308 thousand).

## 18 Tangible assets

The fair value of investment real estate (IAS 40: Real Estate Held as a Financial Investment) amounts to € 51,150 thousand. This figure was determined by independent experts or it was derived from existing preliminary contractual agreements. During the current financial year, only income or expenses of minor importance accrued in connection with investment real estate.

The book values of the assets included in fixed assets originating from finance lease contracts, in which we act as lessee, amounts to € 13,283 thousand (previous year: € 4,559 thousand) for other equipment, factory and office equipment.

The book values of the assets arising from operating leasing relationships, which are capitalized in fixed assets and which we have leased to our customers, are of minor financial significance.

The book values of tangible assets that are at times unused, are no longer used, or are pledged as collateral, are currently of minor importance within our Group.

In the case of the finance lease agreements under which our customers are considered to be the economic owners, appropriate receivables have been capitalized under current assets in the amount of the discounted minimum future lease payments. The leased objects are therefore not included under fixed assets.

## 19 Financial assets

Non-scheduled depreciation is largely attributable to the share of results arising from application of the equity method. A detailed presentation is provided in the Development of Fixed Assets.

Of the shares in affiliated enterprises, of other shares in subsidiaries, and of long-term investments, an amount of € 48,875 thousand (previous year: € 36,039 thousand) is classified as 'available for sale'.

There was no significant change in the market values of the assets 'available for sale' during the reporting year.

The sale of financial assets did not result in any significant profits or losses during the financial year.



## 20 Inventories

	31-Mar-2004	31-Mar-2005
Raw materials, consumables and supplies	172,428	119,474
Work and services in process	339,640	275,136
Manufactured products and merchandise	412,709	387,225
Prepayments	6,006	3,831
	<u>930,783</u>	<u>785,666</u>

The book value of the inventories carried at the net selling price is € 56,136 thousand (previous year: € 84,531 thousand). The reason for the downward valuation to the lower net selling price is primarily the decreased likelihood of market success for a small part of our inventories. No inventories were pledged as collateral either during the reporting year or in the previous year.

## 21 Receivables and other assets

	31-Mar-2004	of which term to maturity			31-Mar-2005	of which term to maturity		
		1 year or less	from 1 to 5 years	over 5 years		1 year or less	from 1 to 5 years	over 5 years
<b>Receivables from customer financing</b>	<u>769,182</u>	<u>164,598</u>	<u>356,951</u>	<u>247,633</u>	<u>564,677</u>	<u>171,993</u>	<u>277,832</u>	<u>114,852</u>
<b>Trade receivables</b>	<u>713,226</u>	<u>703,490</u>	<u>9,736</u>	<u>–</u>	<u>575,766</u>	<u>575,766</u>	<u>–</u>	<u>–</u>
<b>Other receivables and other assets</b>								
Receivables from affiliated enterprises	54,258	53,886	372	–	27,020	27,020	–	–
Receivables from associated companies/joint ventures	22,071	22,071	–	–	–	–	–	–
Tax reimbursement claims	51,608	51,584	24	–	30,218	29,201	1,017	–
Loans granted	775	485	259	31	705	639	66	–
Derivative financial instruments	31,302	27,226	4,076	–	36,628	24,982	11,646	–
Deferred interest payments	6,812	6,812	–	–	5,497	5,497	–	–
Other assets	74,938	52,379	16,206	6,353	140,124	73,632	58,055	8,437
	<u>241,764</u>	<u>214,443</u>	<u>20,937</u>	<u>6,384</u>	<u>240,192</u>	<u>160,971</u>	<u>70,784</u>	<u>8,437</u>

The asset-backed transaction program begun in financial year 2001/2002, in which receivables were transferred to a respective specialized company, continued to be in effect during the financial year as well. This company assumes the irrevocable power of control over these receivables, which is the reason why Heidelberg derecognized these receivables. Since neither control nor a decisive influence can be exerted and this company undertakes such transactions on behalf of a number of other firms, the company must be excluded from the scope of consolidation. The transferred receivables volume totaled € 98,159 thousand at financial year-end (previous year: € 181,727 thousand).

**Receivables arising from customer financing** are shown in the following table:

Contract currency	Book value 31-Mar-2004	Term to maturity in years	Effective interest rate in percent	Book value 31-Mar-2005	Term to maturity in years	Effective interest rate in percent
USD	283,517	up to 10	up to 12	171,236	up to 9	up to 12
EUR	289,914	up to 8	up to 12	233,151	up to 8	up to 12
JPY	31,221	up to 10	up to 5	25,373	up to 10	up to 5
GBP	49,981	up to 7	up to 14	44,750	up to 7	up to 13
Other	114,549	–	–	90,167	–	–
	<u>769,182</u>			<u>564,677</u>		

Receivables arising from customer financing include leasing receivables under finance lease agreements for which in particular our financing companies act as lessors. Lease agreements are subject to the following parameters:

	31-Mar- 2004	of which			31-Mar- 2005	of which		
		1 year or less	from 1 to 5 years	over 5 years		1 year or less	from 1 to 5 years	over 5 years
Total lease payments	127,972	–	–	–	76,357	–	–	–
Lease payments received	–21,162	–	–	–	–17,402	–	–	–
Outstanding lease payments	106,810	10,017	43,079	53,714	58,955	4,562	22,455	31,938
Interest portion of the outstanding lease payments	–21,112	–809	–8,765	–11,538	–7,870	–292	–2,716	–4,862
Present value of outstanding lease payments (book value)	<u>85,698</u>	<u>9,208</u>	<u>34,314</u>	<u>42,176</u>	<u>51,085</u>	<u>4,270</u>	<u>19,739</u>	<u>27,076</u>

In the case of receivables and other assets, the book values are largely identical with market values. Any discrepancies that arise are of minor financial importance.

The increase in the positive market values of the **derivative financial instruments** during the financial year – after consideration of deferred tax liabilities – totaling € 759 thousand (previous year: decrease € – 7,099 thousand), is shown in shareholders' equity without effect on the income statement (cash flow hedges).

The increase in the positive market values of the derivative financial instruments for the purpose of securing balance sheet items (fair value hedges), which amounted to € 3,087 thousand (previous year: decrease € – 959 thousand) net of effective taxes, was booked directly to the income statement.

Receivables carried under other assets, which in legal terms only originate subsequent to the closing date of the annual financial statements, are of minor economic importance.

## 22 Marketable securities as well as cash and cash equivalents

The entire portfolio of marketable securities of € 353,828 thousand (previous year: € 347,619 thousand) is classified as 'available for sale' in accordance with IAS 39. The fixed-interest securities included under this item total € 215,970 thousand (previous year: € 203,413 thousand). Of the total amount, fixed-interest securities amounting to € 14,988 thousand (previous year: € 23,107 thousand) have a term to maturity of up to one year. The remaining marketable securities comprise equities.

Sustained impairment to securities amounts to € 10,821 thousand (previous year: € 20,000 thousand). The reduction in the impairment to securities results from the reversal of value-adjusted securities and the write-up that was implemented during the financial year and booked directly to the income statement.

Unrealized profits from changes in market values, taking into consideration deferred taxes, of € 7,888 thousand (previous year: € 38,161 thousand) were recorded to the shareholders' equity without effect on the income statement.

During the financial year, a realized profit amounting to € 1,142 thousand (previous year: € – 446 thousand loss) resulted from the sale of securities, which is included in the income statement in the financial result under the item 'Result from marketable securities'.

Cash and cash equivalents comprise cash on hand and bank deposits. There are no restraints of disposal with regard to cash and cash equivalents. Bank balances are held at banks with unquestionable credit standing exclusively for short-term cash management purposes.

## 23 Deferred taxes

The deferred taxes are broken down as follows:

	31-Mar-2004		31-Mar-2005	
	Asset	Liability	Asset	Liability
Loss carry-forwards	23,085	–	30,085	–
Fixed assets	16,752	74,303	9,053	68,014
Current assets	123,581	91,939	62,380	95,880
Special items with an equity portion	–	3,480	–	681
Provisions	145,953	–	115,861	–
Liabilities	8,599	14,124	14,789	11,372
Gross amount	<u>317,970</u>	<u>183,846</u>	<u>232,168</u>	<u>175,947</u>

Based on the provisions of IAS 12, deferred tax assets and liabilities were offset at the level of the individual companies in the total amount of € 109,045 thousand (previous year: € 103,581 thousand).

A total of € – 15,272 thousand (previous year: € – 22,966 thousand) in deferred taxes resulting from the translation of the financial figures of foreign subsidiaries as well as € – 31,985 thousand (previous year: € 2,595 thousand) arising from assessment without effect on the income statement, were offset with the shareholders' equity during the financial year.

As in the previous year, reductions in corporation tax resulting from future dividend payouts amount to approximately € 100 million; this amount was not capitalized. These corporation tax decreases may be applied at the latest in financial year 2019/2020. According to the Law on the Reduction in Tax Concessions (Steuervergünstigungsabbaugesetz), which provides for a three-year moratorium, corporation tax decreases due to dividend payments may not be applied until financial year 2005/2006.

## 24 Prepaid expenses

Prepaid expenses are attributable largely to deferred financing costs, insurance premiums, rents and leases, as well as taxes.

Short-term prepaid expenses as of financial year-end amount to € 22,167 thousand (previous year: € 25,336 thousand).

## 25 Shareholders' equity and minority interests

### Share capital and the number of issued shares

The share capital of Heidelberger Druckmaschinen Aktiengesellschaft continues to amount to € 219,925,708.80 and is divided into 85,908,480 shares.

RWE Gesellschaft für Finanzbeteiligungen mbH, Essen, whose exclusive shareholder is RWE Aktiengesellschaft, Essen, sold its shareholding in Heidelberger Druckmaschinen Aktiengesellschaft, Heidelberg, directly in an accelerated tender offer on May 7, 2004 and issued an exchangeable bond on the shares of Heidelberger Druckmaschinen Aktiengesellschaft, Heidelberg. A 50.016 percent portion was placed with institutional investors. Of this, a partial amount of 15.096 percent is earmarked for the exchangeable bond.

### Convertible bond

On February 9, 2005, a convertible bond in the nominal amount of € 280 million was issued by Heidelberg International Finance B.V., Boxmeer, Netherlands, our wholly-owned financing subsidiary, under the guarantee of Heidelberger Druckmaschinen Aktiengesellschaft, Heidelberg. Each bond has a face value of € 100,000 and matures on February 9, 2012. This issue carries a conversion right to no-par shares of Heidelberger Druckmaschinen Aktiengesellschaft which, at the discretion of the respective bearer, may be exercised from March 22, 2005 to January 30, 2012 in accordance with the conditions governing the bonds at a conversion price determined upon issue of € 39.63 (before possible adjustments for dividend payouts and changes in capitalization). The interest coupon is 0.875 percent p.a. and is payable annually – for the first time on February 9, 2006. Beginning on February 9, 2009, in accordance with the conditions governing the bonds, following a corresponding announced period of notice Heidelberg is entitled to repay the convertible bond in its entirety or in part through payment of the then accrued face value plus interest accrued up to the day of the repayment. On February 9, 2010, the respective bearer of the convertible bond has the right to the accelerated repayment of the bond through payment of the then accrued face value plus interest accrued up to the day of the repayment.

The market value of the borrowed funds component and the market value of the shareholders' equity component were ascertained at the date of issue of the convertible bond. The market value of the borrowed funds component that is included in long-term financial liabilities was recorded based on a market interest rate for a corresponding fixed-interest bond, with the pro-rata transaction fees for the borrowed funds component also taken into account. The residual amount was included in the share premium after deducting applicable transaction fees. Furthermore, deferred tax liabilities against the share premium were established without effect on the income statement. Accrued interest exceeding the face value is formed annually and is booked directly to the income statement, where it is included under 'other provisions'.

At the time of the issue of the convertible bond, a total of approximately 7 million no-par shares from contingent capital would correspond to the granted conversion rights.

#### **Treasury stock**

As of financial year-end, Heidelberger Druckmaschinen Aktiengesellschaft does not hold any of its own shares in the form of treasury stock.

#### **Contingent and authorized capital**

According to a decision of the Annual General Meeting of September 29, 1999, the share capital may be increased on a contingent basis by a maximum of € 10,996,288.00 through the issue of up to 4,295,425 shares (Contingent Capital I).

According to a decision of the Annual General Meeting of July 21, 2004, the share capital may be increased on a contingent basis by a maximum of € 21,992,570.88 through the issue of up to 8,590,848 new no-par bearer shares in the pro-rata amount of € 2.56 each (Contingent Capital II). The increase in contingent capital is for the purpose of supporting the granting of option rights or option obligations to the bearers of warrants under bonds with warrants in accordance with the option conditions; or for the purpose of granting conversion rights or conversion obligations to the bearers of convertible bonds in accordance with the convertible bond conditions, which are issued by the Company or a subsidiary affiliated company up until July 20, 2009 as authorized in the enabling resolution of the Annual General Meeting of July 21, 2004.

#### **Revenue reserves**

The revenue reserves include:

- > earned but not yet distributed profits of Heidelberger Druckmaschinen Aktiengesellschaft and its consolidated subsidiaries in previous years,
- > the effects of consolidation,
- > exchange rate effects, and
- > market valuation without effect on the income statement in accordance with IAS 39.

The change in revenue reserves arising from market valuation according to IAS 39 is attributable to the recording, without effect on the income statement, of unrealized profits of primary financial instruments totaling € 2,800 thousand (previous year: € 59,988 thousand), as well as unrealized losses from derivative financial instruments (cash flow hedges) totaling € 10,992 thousand (previous year: € 4,662 thousand).

### Minority interests

Minority interests comprise the minority interests in shareholders' equity. A detailed breakdown of minority interests is shown in the presentation of the development of shareholders' equity.

### Proposed appropriation of the profits of Heidelberg Druckmaschinen Aktiengesellschaft

The proposed appropriation of profits for financial year 2004/2005 calls for the allotment of the distributable profit of € 26,797,241.89 as follows: distribution of a dividend of € 0.30 per share (total dividend: € 25,772,544.00) and allocation in other revenue reserves of € 1,000,000.00, with the remainder of € 24,697.89 carried forward.

## 26 Provisions

The provisions are explained in detail in Notes 27 – 29.

	1-Apr-2004	Change in the scope of consolidation, currency adjustments, transfers	Utilization	Release	Addition	31-Mar-2005
<b>Provisions for pensions and similar obligations</b>	582,774	– 12,829	25,962	1,533	52,082	594,532
<b>Tax provisions</b>	170,474	– 445	8,644	735	12,156	172,806
<b>Other provisions</b>						
Liabilities arising from sales and service activities	176,715	– 42,210	56,906	36,461	93,347	134,485
Liabilities arising from human resources	187,419	– 23,091	85,064	4,867	109,933	184,330
Liabilities arising from research and development	9,330	– 3,279	4,275	1,372	3,789	4,193
Liabilities arising from restructuring measures	111,719	835	45,331	31,098	4,860	40,985
Liabilities arising from extraordinary expenditures for discontinuing operations	181,110	– 181,110	–	–	–	–
Other	107,225	33,394	74,348	30,542	79,983	115,712
	<u>773,518</u>	<u>– 215,461</u>	<u>265,924</u>	<u>104,340</u>	<u>291,912</u>	<u>479,705</u>
	<u>1,526,766</u>	<u>– 228,735</u>	<u>300,530</u>	<u>106,608</u>	<u>356,150</u>	<u>1,247,043</u>

	Note	31-Mar-2004 Maturity			31-Mar-2005 Maturity		
		1 year or less	from 1 to 5 years	over 5 years	1 year or less	from 1 to 5 years	over 5 years
<b>Provisions for pensions and similar obligations</b>	27	23,395	84,086	475,293	21,682	86,153	486,697
<b>Tax provisions</b>	28	11,173	159,301	–	7,015	165,791	–
<b>Other provisions</b>							
Liabilities arising from sales and service activities	29	147,965	19,145	9,605	117,337	12,236	4,912
Liabilities arising from human resources	29	114,532	53,004	19,883	108,776	54,928	20,626
Liabilities arising from research and development	29	9,330	–	–	4,193	–	–
Liabilities arising from restructuring measures	29	82,110	29,609	–	40,985	–	–
Liabilities arising from extraordinary expenditures for discontinuing operations	29	181,110	–	–	–	–	–
Other	29	101,325	5,659	241	100,267	14,374	1,071
		<u>636,372</u>	<u>107,417</u>	<u>29,729</u>	<u>371,558</u>	<u>81,538</u>	<u>26,609</u>
		<u>670,940</u>	<u>350,804</u>	<u>505,022</u>	<u>400,255</u>	<u>333,482</u>	<u>513,306</u>

## 27 Provisions for pensions and similar obligations

We maintain benefit programs for the majority of employees for the period following their retirement – either through the direct program or one financed by payments of premiums to private institutions. The level of benefit payments depends on the conditions in particular countries. The amounts are generally based on the term of employment and the salary of the employees. The liabilities include both those arising from current pensions as well as vested pension rights for pensions payable in the future. The pension payments expected following the beginning of benefit payments are apportioned over the employee's overall period of employment. The group of beneficiaries participating in the benefit-oriented plans financed by funds, which are applied at some of our foreign subsidiaries, has been closed; new employees participate in a comparable pension scheme solely on the basis of a premium-oriented plan. Due to the sale of the Web Systems Division, as of March 31, 2005 obligations to cover the medical costs of employees following their retirement no longer exist.



The provisions for pensions and similar obligations developed as follows:

	2003/2004	2004/2005
Status at the beginning of the financial year	559,471	582,774
Change in the scope of the consolidation, currency adjustments, transfers	367	- 12,829
Utilization	23,088	25,962
Reversal	6,155	1,533
Addition	52,179	52,082
Status at financial year-end	582,774	594,532

The provisions for pensions and similar obligations are broken down as follows:

	31-Mar-2004	31-Mar-2005
Present value of funded claims	181,204	191,628
Less attributable market value of fund assets	- 164,659	- 177,092
Shortfall of fund coverage	16,545	14,536
Present value of non-funded pension claims	577,305	607,377
Total present value of pension claims	593,850	621,913
Adjustment amount due to (not offset)		
actuarial profits or losses	- 13,762	- 29,577
Sub-total	580,088	592,336
Therein capitalized reported assets of foreign employee pension funds	2,686	2,196
Provisions for pensions and similar obligations	582,774	594,532

Assets apportioned in funds developed as follows:

	2003/2004	2004/2005
Attributable market value of the assets of the funds at the beginning of the financial year	123,347	164,659
Expected fund income	7,791	9,689
Contributions to the funds	4,732	5,701
Pension benefit payments from the funds	-4,674	-5,185
Actuarial profits or losses	13,702	5,758
Changes in the scope of the consolidation, currency adjustments, other changes	19,761	-3,530
Attributable market value of the fund assets at financial year-end	164,659	177,092

Due to the limitation imposed by IAS 19.58 b), an amount of € 4,507 thousand (previous year: € 2,316 thousand) is not recorded as an asset.

The expense for the pension plan breaks down as follows:

	2003/2004	2004/2005
Expenses for pension claims added during the financial year <sup>1)</sup>	17,059	24,423
Interest expense for existing claims	28,965	26,126
Net addition to pension provisions	46,024	50,549
Expenses for other pension plans <sup>1)</sup>	11,204	8,598
	57,228	59,147

<sup>1)</sup> The expense for the pension plan included in personnel expenses totals € 33,021 thousand (previous year: € 28,263 thousand)

The expenses for the pension claims added during the financial year include actuarial losses totaling € 508 thousand (previous year: € 1,589 thousand). Past service costs that require subsequent settlement total € 2,888 thousand (previous year: € 0 thousand).

We include the interest expense for already existing pension benefits under interest and similar expenses.

## 28 Tax provisions

As in previous years, **tax provisions** largely cover the risk of additional assessments. This item also includes risks arising from the merger of Linotype-Hell Aktiengesellschaft with Heidelberger Druckmaschinen Aktiengesellschaft.

## 29 Other provisions

The **provisions from sales and service activities** largely comprise warranty and guarantee obligations of € 105,959 thousand (previous year: € 162,605 thousand). The provisions for warranty obligations or obligations to undertake subsequent performance, or vis-à-vis product liability, are designed to cover risks that are either not insured or which go beyond insurable risks. The provisions for guarantee obligations are mainly connected with customer financing. Obligations for which appropriate provisions have not been created are carried under contingent liabilities.

The provisions from the **human resources area** largely include bonuses of € 24,585 thousand (previous year: € 30,564 thousand), vacation, overtime and flextime balances totaling € 51,989 thousand (previous year: € 49,984 thousand), service anniversary expenses in the amount of € 17,560 thousand (previous year: € 17,310 thousand), and provisions for the stock option program totaling € 10,064 thousand (previous year: € 10,074 thousand).

Liabilities in connection with **research and development** activities comprise patent and litigation risks of € 4,193 thousand (previous year: € 9,330 thousand).

The **provisions for restructuring measures** amounting to € 40,985 thousand (previous year: € 111,719 thousand) are in connection with the program of medium-term cost reduction measures.

The provisions for **liabilities arising from extraordinary expenditures for discontinuing operations** at the beginning of the financial year totaling € 181,110 thousand are attributable to the termination of operations of the Digital and the Web Systems divisions and have been dissolved.

**Other provisions** include provisions for potential losses arising from pending transactions totaling € 5,522 thousand (previous year: € 8,912 thousand), as well as provisions for outstanding supplier invoices totaling € 13,007 thousand (previous year: € 24,196 thousand).

In connection with the provisions for guarantee obligations, claims against third parties exist with regard to the assignment of printing presses. There is no additional **right of recourse** against third parties. The resulting receivables are not capitalized.

### 30 Financial liabilities

	31-Mar- 2004	of which term to maturity			31-Mar- 2005	of which term to maturity		
		1 year or less	from 1 to 5 years	over 5 years		1 year or less	from 1 to 5 years	over 5 years
Convertible bond	–	–	–	–	269,960	–	–	269,960
Private placement	50,279	3,779	28,000	18,500	101,759	7,259	83,000	11,500
To banks	667,273	655,727	11,524	22	215,647	208,801	6,846	–
Financial lease contracts	5,259	2,047	3,212	–	13,417	6,982	6,435	–
To affiliated enterprises	2,079	2,079	–	–	1,537	1,537	–	–
Other	23,991	23,978	13	–	13,110	13,110	–	–
	<u>748,881</u>	<u>687,610</u>	<u>42,749</u>	<u>18,522</u>	<u>615,430</u>	<u>237,689</u>	<u>96,281</u>	<u>281,460</u>

#### Liabilities to banks

Liabilities to banks (including private placement) are shown in the following table:

Type	Contract currency	Book value 31-Mar-2004	Term to maturity in years	Effective interest rate in percent	Book value 31-Mar-2005	Term to maturity in years	Effective interest rate in percent
Loan	EUR	341,733	up to 7	up to 6.0	152,712	up to 6	up to 3.3
Loan	USD	304,632	up to 1	up to 1.3	139,199	up to 1	up to 3.3
Loan	JPY	38,773	up to 1	up to 0.5	5,392	up to 1	up to 0.5
Current account	USD	10,199	–	–	–	–	–
	Other	22,215	up to 3	up to 6.0	20,103	up to 3	up to 4.8
		<u>717,552</u>			<u>317,406</u>		

The **credit lines** not yet fully used in our Group amount to € 1,461,473 thousand at financial year-end (previous year: € 1,057,426 thousand).

In February 2002, Heidelberg was granted a € 750 million five-year revolving credit facility. Short-term liabilities to financial institutions (with a term to maturity of up to one year) totaling € 208,801 thousand (previous year: € 655,727 thousand) include credit totaling € 139,071 thousand (previous year: € 405,500 thousand) under this long-term committed credit line.

### Convertible bond

For information on the convertible bond, please refer to the information provided in Note 25 Shareholders' Equity and Minority Interests.

### Private placement

Two private placements with face values totaling € 101,500 thousand (previous year: € 50,000 thousand) are currently outstanding. One of them carries an amortizing repayment structure and matures in 2012, the other has a bullet maturity in 2009.

## 31 Liabilities

	31-Mar-	of which term to maturity			31-Mar-	of which term to maturity		
	2004	1 year or less	from 1 to 5 years	over 5 years	2005	1 year or less	from 1 to 5 years	over 5 years
<b>Trade payables</b>	266,983	264,623	2,360	–	211,430	211,430	–	–
<b>Other payables</b>								
Advance payments received on orders	88,982	88,982	–	–	58,973	58,973	–	–
Arising from the acceptance of drawn bills and the issue of own bills	8,426	8,426	–	–	–	–	–	–
To affiliated enterprises	7,996	7,996	–	–	1,525	1,525	–	–
To associated companies and joint ventures	1,835	1,835	–	–	–	–	–	–
From derivative financial instruments	37,976	10,410	6,538	21,028	20,708	11,993	4,115	4,600
From taxes	42,930	42,930	–	–	42,483	42,483	–	–
Relating to social security	27,302	27,302	–	–	24,046	24,046	–	–
Other	116,458	114,874	1,584	–	62,037	56,619	5,418	–
	<u>331,905</u>	<u>302,755</u>	<u>8,122</u>	<u>21,028</u>	<u>209,772</u>	<u>195,639</u>	<u>9,533</u>	<u>4,600</u>

### Derivative financial instruments

The decrease in the negative market values of derivative financial instruments during the reporting year amounting to € 9,938 thousand (previous year: € 9,169 thousand) is shown in shareholders' equity without effect on the income statement (cash flow hedge), taking into consideration capitalized deferred taxes. The decrease in the negative market values amounting to € 201 thousand (previous year: increase € 1,935 thousand) to hedge balance sheet items was booked directly to the income statement (fair value hedge), taking into consideration effective taxes.

### Additional information

With regard to liabilities, the book values are largely in line with the market values. Any discrepancies that may arise are of minor financial importance.

Liabilities are not secured by collateral, with the exception of trade payables for which the usual reservation of proprietary rights exists.

Liabilities that do not legally arise until after the financial year-end are of minor financial importance.

## 32 Deferred income

	31-Mar-2004	31-Mar-2005
Investment subsidies:		
Taxable subsidies	4,500	5,729
Tax-exempt allowances	4,126	4,612
Other	39,376	37,897
	<u>48,002</u>	<u>48,238</u>

The share of the deferred income outstanding in the following financial year amounts to € 24,993 thousand at financial year-end (previous year: € 22,090 thousand).

**Taxable subsidies** are predominantly funds under the regional economic promotion program for investing in Brandenburg. The subsidies were mostly for Heidelberger Druckmaschinen Aktiengesellschaft in connection with universal responsibility for the development area totaling € 5,511 thousand (previous year: € 4,281 thousand).

**Tax exempt allowances** primarily comprise still to be released investment premiums according to Section 4 of the Investment Allowance Act (InvZulG) of 1986 for the Research and Development Center in Heidelberg in the total amount of € 2,323 thousand (previous year: € 2,555 thousand). This item also includes allowances according to the Investment Allowance Act of 1991/1996/1999 amounting to € 2,289 thousand (previous year: € 1,560 thousand), which mainly concern the Brandenburg plant.

**Other deferred income** comprises largely advance payments for future maintenance and services, and non-recurring payments for inheritable building rights under sale-and-lease-back agreements. These amounts are released to the income statement over the term of the agreement.

## 33 Derivative financial instruments

The Corporate Treasury Department, which is organized as part of Heidelberger Druckmaschinen Aktiengesellschaft, is responsible for all hedging and financing activities of Heidelberger Druckmaschinen Aktiengesellschaft and our subsidiaries. It is also responsible for the cash pooling operations of our Group as a whole.

The prerequisite for an adequate risk management system is a well-founded database. The Corporate Treasury Department of Heidelberger Druckmaschinen Aktiengesellschaft operates a Group-wide financial reporting system – the Treasury Information System. This system is used to identify interest rate, currency, and liquidity risks within the Group, and also to derive appropriate action plans and strategies with which to manage these risks on a central basis in accordance with guidelines issued by the Management Board.

Within the Corporate Treasury Department, we ensure that there is both a functional and a physical separation of the trading, processing, and risk control activities, and this is regularly reviewed by our internal audit department. The risk control activities include an ongoing market evaluation of contractual transactions.

Corresponding contracts with outside banks with top credit ratings are concluded exclusively with Heidelberger Druckmaschinen Aktiengesellschaft. The credit ratings of these business partners are reviewed on a regular basis.

The positive and negative market values of derivative financial instruments are offset by opposing value developments of the underlying transactions. All derivative financial instruments are carried as assets or liabilities at their corresponding market values.

**Currency risks** arise in particular as a result of US dollar and Japanese yen exchange rate fluctuations in connection with receivables and liabilities, as well as anticipated payment flows and pending transactions. These risks as well as **risks arising from interest rate movements** are hedged by derivative financial instruments as follows:

	Nominal volumes		Market values	
	31-Mar-2004	31-Mar-2005	31-Mar-2004	31-Mar-2005
<b>Hedging of anticipated payment flows and pending transactions (cash flow hedges)</b>				
Forward exchange transactions	387,555	262,488	1,786	-2,103
Currency options transactions	574,085	956,499	26,272	28,041
	<u>961,640</u>	<u>1,218,987</u>	<u>28,058</u>	<u>25,938</u>
<b>Interest rate hedging (cash flow hedges)</b>				
Interest rate swaps	556,776	379,102	-29,072	-8,750
<b>Hedging of balance sheet items (fair value hedges)</b>				
Forward exchange transactions	300,801	524,929	-5,661	-1,268

The nominal volumes result from the sum total of all the purchase and sale amounts of the underlying transactions. The market values correspond to changes in values arising from a notional revaluation taking into consideration market parameters applicable at financial year-end. The determination of market values occurs with the aid of standardized valuation methods (discounted cash flow and option pricing models).

Under the **value at risk method**, the maximum loss potential that could result from a change of market prices is calculated based on historic price fluctuations with a confidence interval of 95 percent and a holding period of one day. We make use of professional treasury software to determine the value at risk, which at financial year-end amounts to € 8,176 thousand (previous year: € 11,305 thousand) for the overall position of all derivative financing transactions (interest rate and foreign currency) – thus below the previous year's level.

The existing derivative financial instruments result in a theoretical **risk of nonpayment (credit risk)** of € 19,688 thousand (previous year: € 4,056 thousand). Since the counterparties are banks with top credit ratings, an actual loss from derivatives is currently not expected.

#### Cash flow hedges

The forward exchange and currency options transactions that were open at financial year-end secure the currency risks over the next 24 months that are expected from purchase volumes of our subsidiaries. Therefore, the term to maturity of these derivatives at financial year-end was up to two years. Of the underlying transactions, 74 percent (previous year: 47 percent) are denominated in US dollars and 6 percent (previous year: 8 percent) in Japanese yen.

#### Hedging of anticipated payment flows and pending transactions

Valuation profits, which totaled € 25,938 thousand (previous year: € 28,058 thousand), resulted from hedging transactions at financial year-end and were recorded without effect on the income statement. They are to be booked to the income statement over the subsequent 24 months.

#### Interest-rate hedging

With the aid of interest-rate swaps, from which we receive variable-rate interest for various currencies and pay fixed interest, we restrict the risk from increasing interest expenses in our respective refinancing currency. The terms to maturity of these interest-rate swaps correspond to our planning horizon; interest-rate swaps in the nominal amount of € 191,319 thousand (previous year: € 284,370 thousand) have a term to maturity of less than 5 years, with the remaining having a term to maturity of over 5 years. The valuation of these transactions at financial year-end resulted in negative market values of € 7,593 thousand



(previous year: € 26,826 thousand), which were recorded without effect on the income statement in shareholders' equity and will be booked to net interest income during the time span of the transactions. Moreover, the market values of the interest-rate swaps still include accrued interest expense for the reporting period in the amount of € 1,157 thousand (previous year: € 2,246 thousand), as a result of which the overall negative market value totals € 8,750 thousand (previous year: € 29,072 thousand).

### Fair value hedges

#### Hedging of balance sheet items

This item concerns the exchange rate hedging of foreign currency-denominated loans receivable. The opposing results of the market valuation of the hedging transactions and the conversion of the underlying transactions at cash prices are collectively shown in the income statement.

### 34 Contingent liabilities and other financial liabilities

	31-Mar-2004	31-Mar-2005
Liability arising from the endorsement of bills of exchange	243	–
Guarantees and warranties	321,132	362,591
	<u>321,375</u>	<u>362,591</u>

**Contingent liabilities** primarily include guarantees provided for the liabilities of third parties in connection with long-term customer financing, which in turn largely contrast with recourse rights on the delivered assets.

**Other financial liabilities** are broken down as follows:

	31-Mar-2004	Maturity			31-Mar-2005	Maturity		
		1 year or less	from 1 to 5 years	over 5 years		1 year or less	from 1 to 5 years	over 5 years
Minimum lease payments	417,935	48,295	117,054	252,586	361,003	38,472	106,497	216,034
Orders for investments	23,656	23,656	–	–	19,807	19,807	–	–
Future lease obligations	65,483	18,083	42,918	4,482	72,072	16,806	42,827	12,439
Additional obligations	6,711	6,682	29	–	–	–	–	–
	<u>513,785</u>	<u>96,716</u>	<u>160,001</u>	<u>257,068</u>	<u>452,882</u>	<u>75,085</u>	<u>149,324</u>	<u>228,473</u>

The figures shown are nominal values.

The minimum lease payments for operating leases primarily comprise:

- > the Print Media Academy (Heidelberg) in the total value of € 57,752 thousand (previous year: € 60,941 thousand);
- > the administrative and manufacturing building in Rochester in the total value of € 104,571 thousand (previous year: € 115,086 thousand) which was sublet during the reporting year due to the sale of our Digital Division;
- > the World Logistic Center (WLC) (Wiesloch plant) in the total value of € 39,811 thousand (previous year: € 41,236 thousand); and
- > motor vehicles in the total value of € 21,481 thousand (previous year: € 23,198 thousand).

## Additional information

### 35 Earnings per share in accordance with IAS 33

	2003/2004	2004/2005
Net loss/profit – Heidelberg portion in € thousands	– 700,933	55,059
– of which: discontinuing operations	(– 653,145)	(– 62,276)
Number of shares in thousands (financial year-end)	85,908	85,908
Result in € per share	– 8.16	0.64
– of which: discontinuing operations	(– 7.60)	(– 0.73)

The undiluted earnings per share are calculated by dividing the net loss/profit accruing to Heidelberg by the weighted average number of the shares outstanding during the financial year of 85,888 thousand shares (previous year: 85,900 thousand shares). A dilution of the earnings per share can result from so-called potential shares. At financial year-end, no consideration of shares that could potentially have a watering down effect for each share due to the issue of the convertible bond in February 2005 was necessary, since none of the required conditions for the conversion were fulfilled at financial year-end. Please refer to Note 25 Shareholders' Equity and Minority Interests regarding the structure of the convertible bond issue.

The options available under the stock option plan of the Heidelberg Group also have no watering down effect on earnings (IAS 33.38). Undiluted earnings per share thus correspond to diluted earnings per share. Excluding the restructuring expenses and the extraordinary expenditures arising from discontinuing operations, earnings per share amount to € 0.79 (previous year: € – 1.49).

### 36 Information on the cash flow statement

The cash flow statement shows the changes in cash and cash equivalents of the Heidelberg Group during the financial year as a result of the inflow and outflow of funds. This cash flow statement covers payment flows that are broken down in terms of business, investment, and financing activities (IAS 7).

Taxes on income paid and refunded, respectively, during the financial year totaled € 3,111 thousand (previous year: € 42,674 thousand) and € 17,777 thousand (previous year: € 33,338 thousand). Interest expenses and interest income amount to € 37,208 thousand (previous year: € 53,761 thousand) and € 67,602 thousand (previous year: € 90,515 thousand), respectively.

The additions from finance leasing relationships in the amount of € 10,977 thousand are not included in the investments in intangible assets and tangible assets.

Detailed information on the cash flow statement is provided in the Management Report.

Total liquidity breaks down as follows:

	31-Mar-2004	31-Mar-2005
Marketable securities (excluding securities held in the specialized investment funds)	266	161
Cash and cash equivalents/short-term finance receivables	119,826	131,376
<b>Total liquidity</b>	<b>120,092</b>	<b>131,537</b>

During the previous year, cash and cash equivalents included short-term finance receivables of € 28,002 thousand. No short-term finance receivables arose during the financial year.

The discontinuing operations have the following effect on the cash flow statement:

	Digital		Web Systems <sup>1)</sup>		Total	
	2003/2004	2004/2005	2003/2004	2004/2005	2003/2004	2004/2005
Net cash from operating activities	- 38,424	3,968	- 84,665	- 92,926	- 123,089	- 88,958
Net cash from investment activities	- 58,790	- 8,125	- 7,463	- 4,454	- 66,253	- 12,579
Net cash from financing activities	97,189	4,307	94,009	99,809	191,198	104,116
<b>Net change in cash and cash equivalents</b>	<b>- 25</b>	<b>150</b>	<b>1,881</b>	<b>2,429</b>	<b>1,856</b>	<b>2,579</b>

<sup>1)</sup> Including Web Finishing

### 37 Information concerning segment reporting

The segment information is based on the 'risk and reward approach'. Inter-segmental sales are of minor financial significance and can therefore be ignored.

**Discontinuing operations** are broken down as follows:

	Digital		Web Systems <sup>1)</sup>		Total	
	1-Apr-2003 to 31-Mar-2004	1-Apr-2004 to 31-Mar-2005	1-Apr-2003 to 31-Mar-2004	1-Apr-2004 to 31-Mar-2005	1-Apr-2003 to 31-Mar-2004	1-Apr-2004 to 31-Mar-2005
External sales	230,861	21,667	401,011	131,508	631,872	153,175
Scheduled depreciation	16,368	1,069	19,170	4,597	35,538	5,666
Non-cash expenses	20,662	6,755	53,739	47,384	74,401	54,139
Research and development costs	57,215	3,798	31,791	10,693	89,006	14,491
Result of operating activities before special items	- 16,777	- 7,311	- 77,448	- 32,797	- 94,225	- 40,108
Expenditures from special items	128,541	1,072	93,699	829	222,240	1,901
– of which: impairment loss	(20,026)	(–)	(13,154)	(–)	(33,180)	(–)
Result of operating activities after special items	- 145,318	- 8,383	- 171,147	- 33,626	- 316,465	- 42,009
Result from the equity valuation	- 187,773	- 8,236	–	–	- 187,773	- 8,236
– of which: impairment loss in connection with discontinuing operations	(- 118,068)	(–)	(–)	(–)	(- 118,068)	(–)
Investments	9,045	535	7,463	3,382	16,508	3,917
Segment assets	93,344	–	294,454	–	387,798	–
Segment debt	117,399	–	299,425	–	416,824	–
Number of employees	1,475	–	2,243	–	3,718	–

<sup>1)</sup> Including Web Finishing

Please refer to Note 3 for information concerning the restructuring of the divisions.

We provide detailed information concerning the divisions in the Reports of the Divisions and the Reports from the Regions. The establishment of transfer prices for internal Group sales is undertaken using a market-driven approach, based on the principle of 'dealing at arm's length'.

**Non-cash expenses** comprise the following:

	2003/2004	2004/2005
Provisions for doubtful accounts and other assets	92,580	53,334
Allocations to provisions	343,289	351,290
	<u>435,869</u>	<u>404,624</u>

Allocations to provisions exclude expenditures from special items, as these are shown separately under segment information.

**Research and development costs** result from development costs incurred in the financial year, however, excluding depreciation on development costs for the financial year.

**Investments** comprise investments in intangible assets and tangible assets.

The **number of employees** was recorded as of the respective balance sheet date.

**Segment assets** and **segment debt** result from gross assets or gross debts as follows:

	31-Mar-2004	31-Mar-2005
Gross assets per balance sheet	4,232,452	3,629,289
– financial assets	– 47,517	– 53,103
– marketable securities	– 347,619	– 353,828
– finance receivables	– 52,826	– 89,754
– deferred tax assets	– 214,389	– 123,123
– tax claims	– 51,608	– 30,218
Segment assets <sup>1)</sup>	<u>3,518,493</u>	<u>2,979,263</u>

	31-Mar-2004	31-Mar-2005
Gross debts per balance sheet <sup>2)</sup>	3,002,802	2,398,815
– tax provisions	– 170,474	– 172,806
– tax obligations	– 42,930	– 42,483
– financial obligations	– 580,974	– 504,301
– deferred tax liabilities	– 80,265	– 66,902
Segment debt <sup>1)</sup>	<u>2,128,159</u>	<u>1,612,323</u>

<sup>1)</sup> Due to the restructuring of segment information, segment assets and segment debt as of March 31, 2004 were accordingly restated (see Note 3)

<sup>2)</sup> Consolidated balance sheet total less shareholders' equity/minority interests

Finance receivables comprise finance receivables against affiliated enterprises and other financial assets.

Financial obligations comprise the individual items shown in Note 30, excluding financial liabilities attributable to customer financing.

### 38 Declaration of Compliance in accordance with Article 161 of the Stock Corporation Law

The Supervisory Board and the Management Board of Heidelberger Druckmaschinen Aktiengesellschaft issued the Declaration of Compliance in accordance with Article 161 of the Stock Corporation Law and made it permanently accessible to shareholders.

### 39 Information concerning the Supervisory and Management Board of the Company

#### Composition

The members of the Supervisory Board and the Management Board are shown in the separate overview on pages 79 – 81 (Supervisory Board) and page 82 (Management Board).

#### Management Board

The system of remuneration for the members of the Management Board is as follows:

Fixed remuneration	Depends on	Disbursement modus	Variability	Participation with 100 % target fulfillment
Base payment	Function, responsibility	Monthly	Fixed	50 %
Variable remuneration	Depends on	Disbursement modus	Variability	Participation with 100 % target fulfillment
Corporate bonus	Corporate performance (free cash flow, EBIT)	Annual, subsequent year	Variable	35 %
Individual bonus	Individual performance	Annual, subsequent year	Variable	15 %

Members of the Management Board additionally receive **pension rights** in the form of direct commitments and **payments in kind**. Payments in kind comprise largely the value determined by tax guidelines for the use of a company car.

The remuneration of the Management Board breaks down as follows:

	Base payment	Bonus for reporting year	Waiver of bonus	Overall entitlement	Stock options for reporting year	Stock options total
Bernhard Schreier	450	533	– 100	883	10,500	73,500
Dr. Herbert Meyer	353	427	– 80	700	10,500	73,500
Dr. Jürgen Rautert <sup>1)</sup>	206	244	– <sup>1)</sup>	450	–	–
Dr. Klaus Spiegel <sup>2)</sup>	86	86	–	172	10,500	73,500
	<u>1,095</u>	<u>1,290</u>	<u>– 180</u>	<u>2,205</u>	<u>31,500</u>	<u>220,500</u>

<sup>1)</sup> Management Board member since July 1, 2004

<sup>2)</sup> Retired from Board at the close of business on June 30, 2004

Due to the successful implementation of the restructuring measures, the members of the Management Board were able to meet or exceed the targets set at the beginning of the financial year within the framework of the variable remuneration for the financial year. During the reporting year, bonuses granted for financial year 2003/2004 resulted in expenses amounting to € 129 thousand (Mr. Bernhard Schreier), € 130 thousand (Dr. Herbert Meyer), and € 128 thousand (Dr. Klaus Spiegel). Payments in kind totaled € 31 thousand for the financial year; expenses for stock options during the reporting year totaled € 14 thousand. Please refer to Note 41 Stock Option Plan for information on the operation of the stock option plan.

The service cost for pension obligations to the current Management Board members for the financial year amounts to € 788 thousand. The present value of the total obligation, or the defined benefit obligation, amounts to € 6,681 thousand at financial year-end.

During the financial year, the former Management Board members Mr. Wolfgang Pfizenmaier and Mr. Holger Reichardt received bonuses for financial year 2003/2004, resulting in expenses totaling € 136 thousand.



### Former Members

Former members of the Management Board and their survivors received € 2,688 thousand (previous year: € 5,546 thousand). Of this amount, € 773 thousand (previous year: € 773 thousand) relate to liabilities to former members of the Management Board of Linotype-Hell Aktiengesellschaft and their survivors, which were taken over in financial year 1997/98 within the framework of universal succession. A provision of € 35,013 thousand (previous year: € 29,586 thousand) was made for pension obligations to former members of the Management Board and their survivors. Of this amount, € 10,582 thousand (previous year: € 10,055 thousand) relate to pension obligations of the former Linotype-Hell Aktiengesellschaft, acquired in financial year 1997/98 under the provisions of universal succession. Former members of the Management Board held 189,000 stock options at financial year-end.

### Supervisory Board

The remuneration of the Members of the Supervisory Board is regulated by the Articles of Incorporation and is determined by the Annual General Meeting. The Supervisory Board remuneration is made up of two components: an annual fixed remuneration of € 18,000.00 and a variable remuneration dependent on the dividend. The variable remuneration amounts to € 750.00 for each € 0.05 in dividends in excess of a dividend paid out per share of € 0.45. In other words, the Supervisory Board only receives an additional variable remuneration beginning with a dividend of € 0.50. Whereas the fixed remuneration is paid after financial year-end, the variable remuneration is only payable after the conclusion of the Annual General Meeting that decides on approving the actions of the Supervisory Board for the relevant financial year. The Chairman and the Deputy Chairman as well as the Chairmen and the members of the Committees receive remuneration that is increased by a certain multiplier in view of their additional responsibilities. The Chairman of the Supervisory Board accordingly receives double, the Deputy Chairman and Committee Chairmen 1.5-times, and members of the Committees of the Supervisory Board 1.25-times the regular Supervisory Board remuneration. A member of the Supervisory Board who holds more than one position only receives remuneration carried by the position with the highest level of remuneration. Members of the Supervisory Board who only served on that Board for part of the financial year receive a pro rata remuneration. The same applies to the application of a multiplier if a member of the Supervisory Board only held a position eligible for increased remuneration for part of the financial year. Furthermore, the members of the Supervisory Board receive a lump-sum reimbursement of € 500.00 for each meeting day to cover out-of-pocket expenses incurred in connection with the fulfillment of their responsibilities, unless they present documentary evidence for higher expenses.

The remuneration of the Supervisory Board breaks down as follows:

	<b>2004/2005</b>
Dr. Mark Wössner <sup>1)</sup>	25
Dr. Klaus Sturany	29
Josef Pitz	30
Martin Blessing	25
Prof. Dr. Clemens Börsig	25
Wolfgang Flörchinger	21
Martin Gauß	26
Gunther Heller	21
Dr. Jürgen Heraeus	25
Berthold Huber	24
Johanna Klein	21
Pat Klinis	27
Robert J. Koehler	21
Uwe Lüders	21
Dr. Gerhard Rupprecht	26
Rainer Wagner	27
Jan Zilius <sup>2)</sup>	8
<b>Total</b>	<b>402</b>

<sup>1)</sup> Member of the Supervisory Board since July 30, 2004; Chairman of the Supervisory Board since September 6, 2004

<sup>2)</sup> Member of the Supervisory Board through July 21, 2004

No variable remuneration accrued during the reporting year.

#### **Contingent liabilities**

Heidelberger Druckmaschinen Aktiengesellschaft has not entered into any contingent liabilities for either members of the Management Board or for members of the Supervisory Board.

#### 40 Transactions with Group-related companies and individuals

RWE Aktiengesellschaft, Essen, held a majority interest in our Company until May 7, 2004 (see Note 25: Shareholders' equity and minority interests).

Significant relationships with **Group-related enterprises** are as follows:

Delivering company	Nature of transactions	2003/2004	2004/2005 <sup>1)</sup>
<b>RWE Group:</b>			
RWE Mechatronics GmbH, Mechernich	Deliveries, inventories	41,660	47,872
RWE Solutions AG, Frankfurt/Main	Services	9,768	41
RWE Systems AG, Dortmund	Services	2,094	13
RWE AG, Essen	Services	228	257
<b>Allianz Group:</b>			
Allianz Versicherungs-AG, Munich	Services	3,740	3,110
Euler Hermes			
Kreditversicherungs-AG, Hamburg	Services	1,052	952

<sup>1)</sup> Covers the whole financial year

The establishment of transfer prices for internal Group sales is undertaken on a market-oriented basis under the principle of 'dealing at arm's length'.

No significant transactions were undertaken with **closely related** individuals.

#### 41 Stock option plan

The Annual General Meeting of September 29, 1999 approved a contingent increase of share capital by up to € 10,996,288.00 through the issue of up to 4,295,425 shares (Contingent Capital I). The sole purpose of the contingent capital increase is to grant subscription rights to members of the Company's Management Board, to members of the Management Board of subsidiaries in Germany and abroad, and to other senior executives within the Heidelberg Group.

##### Authorization of the Management Board and Supervisory Board

The Management Board has been authorized to grant subscription rights to eligible persons within a period of five years from the time the contingent capital goes into effect. The subscription rights are to be issued by means of their entry in the Commercial Register in tranches of no more than 30 percent of the overall volume in a single financial year. The Supervisory Board has the sole responsibility for granting subscription rights to members of the Management Board.

### **Waiting period / period of validity**

The subscription rights may only be exercised after the end of the waiting period. The waiting period commences when the subscription rights are issued and ends three years after the issue date. The period of validity of the subscription rights commences when the subscription rights are issued and ends six years after the date of issue. Subscription rights that have not been exercised or cannot be exercised by the end of the period of validity expire without compensation.

### **Exercise period and exercise waiting periods**

Subscription rights may be exercised at any time after the end of the waiting period during the respective period of validity. However, the subscription rights may not be exercised during waiting periods that have been established by the Management Board and Supervisory Board in the interests of the Company – for example, periods of at least ten trading days before dates on which reports on the Company's business development are published. The entire period or parts of the period between the end of a financial year and the conclusion of the respective Regular Annual General Meeting may also be designated as exercise waiting periods.

### **Investment for own account**

When granting subscription rights, the precondition may be imposed that the eligible persons must acquire shares of the Company on their own account and that they retain the shares for the appropriate waiting period.

### **Condition for exercising subscription rights**

The subscription rights may only be exercised if the market price of the Company's shares (calculated by the total shareholder return method) between the issue and the exercising of the subscription rights (as defined in more detail below) outperforms the value of the Dow Jones EURO STOXX Index (hereinafter referred to as the 'Index') as calculated on the basis of the total shareholder return method. The target shall be deemed to have been reached if the performance thereby determined of our share exceeds the Index. If subscription rights are not exercised despite the target having been reached, they may not be exercised again until the target has been reached again.

### **Exercise price**

The exercise price is defined as the average closing price of our shares on the final ten consecutive trading days in Frankfurt am Main before the relevant subscription period for the respective subscription rights (the 'exercise price').

If the closing price of our shares in the electronic trading system of Deutsche Börse Aktiengesellschaft (which is used to ascertain the target) is more than 175 percent of the exercise price determined in accordance with the above section (the ‘threshold amount’) on the last day of trading before the subscription rights are exercised, the exercise price shall be increased by the amount by which the relevant market price exceeds the threshold amount. This does not affect the provisions of Section 9 (1) of the German Stock Corporation Act (AktG).

#### **Non-transferability/dividend rights of the new shares**

The subscription rights are not legally transferable. The new shares are entitled to a share of profits from the beginning of the financial year in which the issue occurs.

#### **Tranches for 1999 – 2004**

The principal underlying conditions for the various tranches are shown in the following table:

	End of waiting period	End of period of validity	Exercise price in €
Tranche 1999	2-Mar-2003	2-Mar-2006	52.40
Tranche 2000	13-Sep-2003	13-Sep-2006	68.51
Tranche 2001	12-Sep-2004	12-Sep-2007	53.52
Tranche 2002	11-Sep-2005	11-Sep-2008	42.08
Tranche 2003	12-Sep-2006	12-Sep-2009	22.26
Tranche 2004	18-Aug-2007	18-Aug-2010	25.42

As of financial year-end, there was a total of 3,624,035 options for all tranches (previous year: 3,477,640 options).

#### **Servicing the subscription rights**

We have reserved the right to establish the manner in which we service the exercised subscription rights prior to the end of the waiting period for the respective tranche:

- (a) granting one share per exercised option,
- (b) payout of the stock option plan profit in the form of shares, or
- (c) cash settlement.

If alternative (a) is selected, the subscription rights may only be exercised against payment of the exercise price. Under alternatives (a) and (b), either old or new shares may be issued to a participant.

### Accounting and valuation methods

IAS 19 does not stipulate any special accounting or valuation principles. The provisions of IFRS 2 have not yet been applied at financial year-end. We therefore continued to apply the existing valuation method.

Nevertheless, on the basis of a recognized option pricing model, we have determined the value of the options for the tranches for the period 1999 – 2004, taking into consideration both the intrinsic and market values of the options as of the time of issue and establishing an appropriate provision in the amount of € 10,064 thousand (previous year: € 10,074 thousand). For the tranches for the periods 1999, 2000, and 2001, for which the respective waiting period has expired, the exercise price exceeded the price of the Heidelberg share at financial year-end.

### 42 Exemption according to Section 264 Paragraph 3 of the Commercial Code

During the financial year, the following subsidiaries have made use of the provisions of Section 264 Paragraph 3 of the Commercial Code with regard to disclosure of the exemption regulation: Heidelberger Druckmaschinen Vertrieb Deutschland GmbH, Heidelberg; Heidelberg Digital Finishing GmbH, Mühlhausen; Linotype Library GmbH, Bad Homburg; Heidelberg Postpress Deutschland GmbH, Heidelberg; Heidelberg-China Holding GmbH, Heidelberg; Heidelberg Boxmeer Beteiligungs-GmbH, Heidelberg; Print Finance Vermittlung GmbH, Heidelberg.

### 43 Information on events after financial year-end

At the end of April 2005, we came to agreement with the staff representatives on a package of measures and signed a master agreement covering job protection, reduction in staff costs, and improvement in the competitiveness of the German plants of Heidelberger Druckmaschinen Aktiengesellschaft, Heidelberg. The agreement remains in effect through March 31, 2008.

Heidelberg, May 10, 2005

### Heidelberger Druckmaschinen Aktiengesellschaft



Bernhard Schreier



Dr. Herbert Meyer



Dr. Jürgen Rautert

## Auditor's Report

We have audited the consolidated financial statements of Heidelberger Druckmaschinen Aktiengesellschaft, Heidelberg, consisting of the income statement, the balance sheet, the cash flow statement, and the statement of changes in equity, as well as the notes to the financial statements, for the business year from April 1, 2004 to March 31, 2005. The preparation and the content of the consolidated financial statements according to the International Financial Reporting Standards of the IASB (IFRS) are the responsibility of the Company's Management Board. Our responsibility is to express an opinion, based on our audit, as to whether the consolidated financial statements are in accordance with IFRS.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institute of German Certified Public Accountants (Institut der Wirtschaftsprüfer – IDW), and in addition in accordance with the International Standards on Auditing (ISA). Those standards require that we plan and perform the audit to obtain reasonable assurance that the consolidated financial statements are free of material misstatements. Knowledge of business activities and of the economic and legal position of the Group, as well as expectations of potential discrepancies, are taken into account when determining the audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements is examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by the Management Board, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations, and cash flows of the Group for the business year in accordance with IFRS.

Our audit, which according to German auditing regulations also extends to the Group Management Report prepared by the Management Board for the business year from April 1, 2004 to March 31, 2005, has not led to any objections. In our opinion, on the whole, the Group Management Report and the remaining information contained in the consolidated financial statements provide a fair understanding of the Group's position and adequately present the risks related to its future development. Furthermore, we confirm that the consolidated annual financial statements and the Group Management Report for the business year from April 1, 2004 to March 31, 2005 meet the prerequisites for exempting the Company from presenting consolidated annual financial statements and a Group Management Report under German law.

Essen, May 13, 2005

PwC Deutsche Revision  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

P. Albrecht  
Wirtschaftsprüfer

M. Theben  
Wirtschaftsprüfer



**List of major shares in affiliated companies** (Figures in € thousands according to IFRS)

Name	Location	Share in share- holders' equity	Share- holders' equity	Net profit after taxes	Sales	Yearly average number of employees
<b>Europe, Middle East and Africa</b>						
Heidelberger Druckmaschinen Vertrieb Deutschland GmbH <sup>1)</sup>	D Heidelberg	100	35,185	- 17,717	434,476	1,011
Heidelberg Graphic Equipment Ltd. <sup>2)</sup>	GB Brentford	100	115,151	- 68	218,503	430
Heidelberg France SAS	F Tremblay-en-France	100	- 61,961	- 26,475	149,300	316
Heidelberg Postpress Deutschland GmbH <sup>1)</sup>	D Heidelberg	100	31,006	692	148,409	1,011
Heidelberg Schweiz AG	CH Bern	100	13,641	- 4,358	71,191	185
Heidelberg International Ltd. A/S	DK Ballerup	100	41,764	- 909	35,452	59
Heidelberg Sverige AB	S Spanga	100	225	- 1,054	30,030	53
Print Finance Vermittlung GmbH <sup>1)</sup>	D Heidelberg	100	35,915	2,126	32,306	-
Heidelberg Graphic Systems Southern Africa (Pty) Ltd. <sup>2)</sup>	ZA Johannesburg	100	2,262	4,959	30,256	94
<b>Eastern Europe</b>						
Heidelberger Druckmaschinen Osteuropa Vertriebs-GmbH <sup>3)</sup>	A Vienna	100	149,930	- 2,468	158,848	94
Heidelberger Druckmaschinen Austria Vertriebs-GmbH	A Vienna	100	162,807	- 412	54,035	108
Heidelberger CIS OOO	RUS Moscow	100	3,081	- 3,811	48,808	261
Heidelberg Polska Sp z.o.o.	PL Warsaw	100	6,444	- 205	39,785	113
<b>North America</b>						
Heidelberg USA, Inc. <sup>2)</sup>	USA Kennesaw	100	91,417	- 13,594	342,284	912
Heidelberg Canada Graphic Equipment Ltd.	CDN Mississauga	100	11,839	- 638	102,367	256
Heidelberg Print Finance Americas, Inc. <sup>2)</sup>	USA Dover	100	139,779	12,330	20,612	13

Name	Location	Share in share- holders' equity	Share- holders' equity	Net profit after taxes	Sales	Yearly average number of employees
<b>Latin America</b>						
Heidelberg Mexico Services S. de R.L. de C.V. <sup>2)</sup>	MEX Mexico City	100	- 5,140	- 2,394	40,448	134
Heidelberg do Brasil Sistemas Graficos e Servicos Ltda.	BR São Paulo	100	- 5,096	- 7,926	20,792	256
<b>Asia / Pacific</b>						
Heidelberg Japan K.K.	J Tokyo	100	15,773	- 116	218,227	440
Heidelberg China Ltd.	RC Hong Kong	100	41,284	7,704	181,268	161
Heidelberg Hong Kong Ltd.	RC Hong Kong	100	18,243	4,046	86,494	105
Heidelberg Graphic Equipment Ltd.	AUS Melbourne	100	17,129	- 860	83,271	203
Heidelberg Malaysia Sdn Bhd	MYS Petaling Jaya	100	1,250	- 638	34,923	167
Heidelberg Asia Pte Ltd.	SGP Singapore	100	5,045	- 1,168	43,973	128
Heidelberg Graphic Equipment Ltd.	NZ Auckland	100	3,575	464	25,715	38

<sup>1)</sup> Profit and loss transfer agreement with Heidelberger Druckmaschinen Aktiengesellschaft

<sup>2)</sup> Pre-consolidated financial statements

<sup>3)</sup> Profit and loss transfer agreement with Heidelberger Druckmaschinen Austria Vertriebs-GmbH

## Report of the Supervisory Board

### **Dear Shareholders,**

The Heidelberg Group is heading in the right direction. After two money-losing years, we are again operating in the black. The focus on our core business as well as measures for adapting the cost structure have produced initial successes. Thanks to the favorable course of drupa in May 2004, financial year 2004/2005 began with our order books full. Towards the end of the year, such largely outside influences as exchange rate developments and raw material prices resulted in a slight slowdown – however, without stopping or possibly even reversing the upward trend.

During the financial year, we fulfilled the responsibilities incumbent upon us under legal provisions and the Articles of Incorporation, and closely assisted the Management Board in a cooperative and advisory capacity regarding the Company's management. During financial year 2004/2005, the Management Board kept us informed at one extraordinary and five ordinary meetings of the Supervisory Board. The Human Resources Committee met four times, the Management Committee held one meeting, and the Audit Committee came together four times. No need arose to convene the Mediation Committee in accordance with Article 27 Paragraph 3 of the Codetermination Law.

The Management Board informed us extensively and periodically concerning corporate policy. While in continuous contact with the Management Board, we intensively discussed events of importance for the Company. We passed all the necessary resolutions during the meetings on the basis of relevant documentation. The Management Board always informed us directly concerning especially important projects and processes – in between meetings as well. If appropriate, at that time decisions were approved by circulation.

**Dr. Mark Wössner**

Chairman of the  
Supervisory Board

**Focus of the Supervisory Board's Discussions**

The new strategic alignment of the Heidelberg Group following the divestiture of the two areas Digital and Web Systems as well as the greater focus on the core Sheetfed Offset business were important topics in discussions on the Supervisory Board. In this context, we also discussed the development of the Postpress area and evaluated the new manufacturing facility in China.

The convertible bond was placed through the book-building process on February 2, 2005. The Management Committee of the Supervisory Board, which had specifically been authorized for that purpose by the entire Supervisory Board, passed the necessary resolutions on that day.

We also dealt with the structure and personnel composition of the Management Board and made the necessary decisions at the extraordinary meeting of the Supervisory Board on June 28, 2004.

Advising on the development of sales, earnings, and the financial condition of the Heidelberg Group was of equal importance. This also included the cost reduction measures, whose consistent implementation has already resulted in a sustained enhancement of the Heidelberg Group's financial condition.

## **Corporate Governance**

Questions of corporate governance were a topic of discussion on numerous occasions during the reporting period. This resulted, among others, in a widening of the reach of the Rules of Procedure of the Supervisory Board in order to cover the disclosure of our individual remuneration in the future. Within the framework of the Efficiency Control over our work, we examined the cooperation between the Management Board and the Supervisory Board, the flow of information, the course of the meetings of the Supervisory Board including activity in between meetings, the structure of the membership in the Supervisory Board, cooperation with its committees, corporate governance, and general aspects of the work of the Supervisory Board. The result of the Efficiency Control was highly satisfactory overall. We have implemented corresponding measures in areas where improvement was called for.

## **Work in the Committees**

The respective chairmen of the committees reported extensively concerning the work of the committees at meetings of the Supervisory Board. To the extent deemed necessary, they submitted suggestions for approval to the plenum of the Supervisory Board. The current composition of the individual committees is shown on page 82.

At its meeting during the reporting period, the Management Committee dealt in particular with the strategic corporate orientation, the labor cost issue, and preparation for the Efficiency Control. At a total of four meetings, the Audit Committee – together with the auditor – dealt intensively with the non-consolidated and consolidated financial statements as well as with the accounting and valuation principles that are applied. The quarterly results were discussed. The discussions additionally focused on risk management, restructuring expenses, participation controlling, customer financing, transfer price methods, hedge accounting, and the basic structure of the convertible bond issue. The Personnel Committee passed the necessary resolutions concerning the employment contracts of members of the Management Board.

### **Audit of the Non-Consolidated and Consolidated Financial Statements**

The Annual General Meeting held on July 21, 2004 selected PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, Essen branch, as the external auditor. This firm examined and approved without qualification the Annual Financial Statements for financial year 2004/2005, the Management Report of Heidelberger Druckmaschinen Aktiengesellschaft, and the Consolidated Financial Statements and Group Management Report of the Heidelberg Group, which were drawn up by the Management Board. We awarded the contract for auditing the financial statements at the Supervisory Board meeting held on July 21, 2004. The Financial Statements, the Consolidated Financial Statements, the Management Report of Heidelberger Druckmaschinen Aktiengesellschaft, and the Management Report of the Heidelberg Group were circulated together with the Auditor's Reports to all the members of the Supervisory Board in time for the meeting to discuss the Annual Financial Statements on June 3, 2005. The auditors chartered under German law who signed the auditor's report took part in the discussions of the Supervisory Board concerning the documents to be examined. They reported on the significant results of their examination and made themselves available to the members of the Supervisory Board to answer questions. The report of the auditor does not include any comments or indications of possible inaccuracies in the Declaration of Compliance with the Corporate Governance Code.

The Audit Committee recommended approval of the non-consolidated and consolidated financial statements. We examined and accepted the Annual Financial Statements prepared by the Management Board as well as the Consolidated Financial Statements, the Management Report of Heidelberger Druckmaschinen Aktiengesellschaft, and the Group Management Report. We therefore agreed to the audit results of both annual statements and approved the non-consolidated and consolidated financial statements as of March 31, 2005. The annual financial statements are thereby adopted.

The report by the Management Board in accordance with Section 312 of the German Stock Corporation Act on the relationships with affiliated enterprises was presented to us for our examination. Pursuant to Section 313 Paragraph 3 of the German Stock Corporation Act, the auditor provided the following auditor's certificate: "Based on our professional examination

and evaluation, we confirm that (1) the factual statements contained in the report are correct, and (2) that the payments made by the Company in connection with the transactions listed in the report are not unreasonably high.” We took note of, and approved, the results of the auditor’s examination. Following the conclusion of our own examination, we have no objections to the statement by the Management Board at the end of this Annual Report regarding relationships with affiliated enterprises.

### **Composition of the Management Board and the Supervisory Board**

Dr. Jürgen Rautert was elected as a full Management Board member on July 1, 2004. Simultaneously, we agreed to the request by Dr. Klaus Spiegel to release him from his responsibilities in the Management Board as of June 30, 2004. This occurred on good terms and by mutual agreement. We thank Dr. Spiegel for his long-standing dedication.

Mr. Jan Zilius, member of the Management Board of RWE AG, resigned his Supervisory Board mandate with effect at the end of the Annual General Meeting of July 21, 2004. Dr. Mark Wössner was appointed as the successor to the Supervisory Board by decision of the Heidelberg District Court as of July 30, 2004. Dr. Klaus Sturany resigned his mandate as Chairman of the Supervisory Board as of August 4, 2004. We elected Dr. Mark Wössner as the Chairman of the Supervisory Board with effect on September 6, 2004.

We wish to thank the Management Board, all the employees, and the staff representatives for the successful work accomplished during the financial year.

Munich, June 3, 2005

### **For the Supervisory Board**



Dr. Mark Wössner  
Chairman of the Supervisory Board

## Corporate Governance – Report of the Management Board and the Supervisory Board

- > **Heidelberg to Comply with All the Recommendations of the Code in the Future**
- > **New Internal Guideline Drawn up**

The Management Board and the Supervisory Board report jointly on corporate governance at Heidelberg. In our view, the German Corporate Governance Code describes the internationally established standards of good and responsible corporate management in a balanced and practice-oriented way. During the financial year, we established the prerequisites to comply without reservation to the recommendations of the Code in the future. This also applies to the numerous suggestions of the Code. Thus, Heidelberg wholly fulfills the suggestions listed in Items 2.3.3, 3.10, 4.2.3, 5.1.2, 5.2, 5.3.2, 5.3.3, 5.3.4 of the Code as well as in large part the suggestions in Items 3.6 and 6.8 of the Code.

### **Declaration of Compliance According to Section 161 of the Stock Corporation Act**

The Management Board and the Supervisory Board issued the Declaration of Compliance on November 26, 2004. It openly states therein that up to now, Heidelberg has not fulfilled Item 4.2.4 as well as Item 5.4.5 Paragraph 3 Sentence 1 of the Code concerning the publication of individualized remuneration of the members of the Management Board and the Supervisory Board. Furthermore, up to now the structure of the remuneration of the Management Board has only been discussed at the Annual General Meeting, but not, as is required by Item 4.2.3 of the Code, in the Annual Report and on the Internet as well. Following corresponding decisions and changes to the Rules of Procedure, on November 26, 2004 the Management Board and the Supervisory Board established all the prerequisites for Heidelberg to meet the requirements of the Code from now on and without reservation upon publication of this Annual Report and when its Internet pages are updated.

### **Transparency for Our Shareholders**

Heidelberg's shareholders are kept informed about all significant developments and events in various ways. The Financial Calendar, which is published in the Annual Report, in the Quarterly Reports to the shareholders, and on the Company's Internet site, provides information on significant dates. Our Internet Investor Relations pages contain complete and up-to-date information



concerning key performance data, publications, processes subject to reporting, and the corporate governance of the Company. During the past financial year, we considerably expanded in particular information provided by our Internet site concerning corporate governance. With our Quarterly Reports to the shareholders as well as ongoing communications in specialized and financial publications, we keep our shareholders always informed concerning the current development of our Company. This also includes ongoing control of whether significant transactions were concluded between a company of the Heidelberg Group and a member of the Company's Management Board or a member of the Supervisory Board, or an individual directly involved with the Company. This did not occur during the reporting period. As in the past, on the Heidelberg Group's Internet site we disclosed securities transactions undertaken during the reporting year that were subject to reporting in accordance with Article 15a of the Securities Trading Law.

#### **Close Cooperation by the Management Board and the Supervisory Board**

The Management Board informs the Supervisory Board regularly, extensively, and on an up-to-date basis on all developments and events that are of significance for the business development and the condition of the Heidelberg Group. Again during the past financial year, the Management Board and Supervisory Board worked together closely and trustfully. Within the framework of its Efficiency Control, the Supervisory Board spotlighted additional potential for improvement at financial year-end and began dealing with these issues. Additional details can be found in the Report of the Supervisory Board on pages 72 to 76 of this Annual Report.

#### **Remuneration of the Management Board and the Supervisory Board**

We disclosed the remuneration of the members of the Management Board on an individualized basis as early as the Annual General Meeting held on July 21, 2004, and also the value of stock options using the example of the Chairman of the Management Board. In the Notes to the Financial Statements of this Annual Report – Note 39 Information concerning the Supervisory and Management Board of the Company – for the first time this year also the individualized remuneration of the members of the Management Board and the Supervisory Board as well as an explanation of the respective remuneration structures are included.

#### **Foresighted Risk Management – Code of Conduct**

Conscious entrepreneurial risk management helps recognize, assess, and take corresponding counteraction vis-à-vis risks at an early stage. Within the framework of planning for the financial year, all areas of the Company draw up a detailed assessment of their business including risks that have already

been recognized and countermeasures introduced. The probability of occurrence and possible damage form the parameters for the risk assessment report, which is updated quarterly and in case of need, on a short-term basis. We report on the current corporate risks in the Management Report on pages 71 to 75.

Heidelberg revised and expanded its internal Rules and Regulations during the financial year under report. The current Rules and Regulations were put into effect at the beginning of the current financial year. The expanded Rules and Regulations include among other things, the Heidelberg Code of Conduct, which applies to all the members of senior management and the employees of the Heidelberg Group. We thereby intend to ensure easily understood sound behavior and an appropriate approach to conflicts of interest.

#### **Audit of the Financial Statements by Pricewaterhouse Coopers**

Before submitting the suggestion concerning the selection of an auditor, the Supervisory Board obtained a statement from the auditor concerning the extent to which relationships may exist between the auditor, the auditor's management organs, and chief auditors, and either Heidelberger Druckmaschinen Aktiengesellschaft or the Company's management organs. No doubts were raised concerning the independence of the auditor. In accordance with Article 7.2.3 of the Code, the Supervisory Board also arranged with the auditor for immediate reports to be made of all determinations and occurrences that arise from the execution of the audit and that are of fundamental importance vis-à-vis the responsibilities of the Supervisory Board. The Supervisory Board further determined that the auditor report to the Supervisory Board or include a note in the audit report concerning facts that would result in an inaccuracy in the statement issued by the Management Board and Supervisory Board in connection with the Code. No such inaccuracies were determined.

Heidelberg, May 10, 2005

For the Supervisory Board:  
Dr. Mark Wössner



For the Management Board:  
Bernhard Schreier



## The Supervisory Board

### Dr. Mark Wössner

Entrepreneur, Munich  
Member of the Supervisory Board  
– since July 30, 2004 –  
Chairman of the Supervisory Board  
– since September 6, 2004 –

- \* DaimlerChrysler Aktiengesellschaft;  
Douglas Holding Aktiengesellschaft;  
Dussmann Aktiengesellschaft & Co. KGaA;  
ECircle Aktiengesellschaft (Chairman);  
Loewe Aktiengesellschaft;
- \*\* Citigroup Global Markets Deutschland  
AG & Co. KGaA (Chairman in Germany  
and Chairman of the Advisory Council)

### Dr. Klaus Sturany

Member of the Management Board  
of RWE Aktiengesellschaft, Essen  
Chairman of the Supervisory Board  
– through August 4, 2004 –

- \* Commerzbank Aktiengesellschaft;  
Hannover Rückversicherungs Aktien-  
gesellschaft;  
RAG Aktiengesellschaft;  
RWE Energy Aktiengesellschaft;  
RWE Power Aktiengesellschaft;
- \*\* Österreichische Industrieholding  
Aktiengesellschaft;  
RWE Npower Holdings plc;  
RWE Thames Water plc

### Josef Pitz\*\*\*

Chairman of the Central Works  
Council, Heidelberg-Wiesloch  
Deputy Chairman of the  
Supervisory Board

### Martin Blessing

Member of the Management Board  
of Commerzbank Aktiengesell-  
schaft, Frankfurt am Main

- \* AMB Generali Holding Aktiengesellschaft;  
Commerzbank Inlandsbanken Holding  
Aktiengesellschaft;  
CommerzLeasing und Immobilien  
Aktiengesellschaft (Chairman);  
EUROHYPO Aktiengesellschaft;  
ThyssenKrupp Services Aktiengesellschaft;
- \*\* BRE Bank SA, Poland;  
Commerzbank (Eurasija) SAO, Russia  
(Chairman)

### Prof. Dr. Clemens Börsig

Member of the Management Board  
of Deutsche Bank Aktiengesell-  
schaft, Frankfurt am Main

- \* EUROHYPO Aktiengesellschaft;
- \*\* Foreign & Colonial Eurotrust plc, UK  
(Non-executive member of the Board  
of Directors)

### Wolfgang Flörchinger\*\*\*

Member of the Works Council,  
Heidelberg-Wiesloch

### Martin Gauß\*\*\*

Chairman of the Speakers  
Committee for the Executive Staff,  
Heidelberg

### Gunther Heller\*\*\*

Chairman of the Works Council,  
Amstetten

### Dr. Jürgen Heraeus

Entrepreneur, Hanau

- \* EPCOS Aktiengesellschaft;  
Heraeus Holding GmbH (Chairman);  
IKB Deutsche Industriebank Aktien-  
gesellschaft;  
mg technologies ag (Chairman);  
Teutonia Zementwerk Aktiengesellschaft  
(Chairman);
- \*\* Argor-Heraeus S.A., Switzerland  
(Chairman of the Administration Board)

### Berthold Huber\*\*\*

Second Chairman of IG Metall,  
Frankfurt am Main

- \* Audi Aktiengesellschaft;  
RWE Aktiengesellschaft;  
Siemens Aktiengesellschaft

### Johanna Klein\*\*\*

Chairwoman of the Works Council,  
Brandenburg

1) Information as of resignation from the Supervisory Board

\* Membership in other Supervisory Boards

\*\* Membership in comparable German and foreign control bodies of business enterprises

\*\*\* Employee Representative

**Pat Klinis\*\*\***

Former Senior Representative  
of IG Metall, Heidelberg

**Robert J. Koehler**

Chairman of the Management Board  
of SGL Carbon Aktiengesellschaft,  
Wiesbaden

\* AXA Lebensversicherung Aktien-  
gesellschaft;  
Benteler Aktiengesellschaft (Chairman);  
LANXESS Aktiengesellschaft;  
Pfleiderer Aktiengesellschaft;  
Wacker-Chemie GmbH

**Uwe Lüders**

Chairman of the Management Board  
of L. Possehl & Co. mbH, Lübeck

**Dr. Gerhard Rupprecht**

Member of the Management Board  
of Allianz Aktiengesellschaft,  
Munich

Chairman of the Management  
Board of Allianz Lebensversiche-  
rungs-Aktiengesellschaft, Stuttgart

\* Fresenius Aktiengesellschaft;  
Quelle Aktiengesellschaft;  
ThyssenKrupp Automotive Aktien-  
gesellschaft;

\*\* Allianz Elementar Lebensversicherungs-  
Aktiengesellschaft, Austria (Chairman);  
Allianz Elementar Versicherungs-  
Aktiengesellschaft, Austria;  
Allianz Life Insurance Co. Ltd., Korea;  
Allianz Life Insurance Company of  
North America, USA

**Rainer Wagner\*\*\***

Deputy Chairman of the  
Central Works Council,  
Heidelberg-Wiesloch

**Jan Zilius<sup>1)</sup>**

– through July 21, 2004 –  
Chairman of the Management Board  
of RWE Power Aktiengesellschaft,  
Essen

Member of the Management Board  
of RWE Aktiengesellschaft, Essen

\* RWE Energy Aktiengesellschaft;  
RWE Systems Aktiengesellschaft  
(Chairman);  
RWE Umwelt Aktiengesellschaft  
(Chairman)

## Committees of the Supervisory Board

### Management Committee

Dr. Mark Wössner (Chairman)  
– since September 6, 2004 –

Dr. Klaus Sturany (Chairman)  
– through August 4, 2004 –

Josef Pitz

Martin Blessing

Martin Gauß

Berthold Huber

Dr. Gerhard Rupprecht

### Mediation Committee under Article 27 Paragraph 3 of the Codetermination Act

Dr. Mark Wössner  
– since September 6, 2004 –

Dr. Klaus Sturany  
– through August 4, 2004 –

Josef Pitz

Martin Blessing

Wolfgang Flörchinger

### Committee on Arranging Personnel Matters of the Management Board

Dr. Mark Wössner (Chairman)  
– since September 6, 2004 –

Dr. Klaus Sturany (Chairman)  
– through August 4, 2004 –

Josef Pitz

Dr. Gerhard Rupprecht

### Audit Committee

Dr. Klaus Sturany (Chairman)  
– since September 6, 2004 –

Dr. Jürgen Heraeus (Chairman)  
– through August 3, 2004 –

Prof. Dr. Clemens Börsig

Pat Klinis

Rainer Wagner

## The Management Board

### **Bernhard Schreier**

Bruchsal

Chairman

- \* ABB Aktiengesellschaft;
- Gerling-Konzern Allgemeine Versicherungs-Aktiengesellschaft;
- SRH Learnlife Aktiengesellschaft;
- Heidelberger Druckmaschinen Vertrieb Deutschland GmbH (Chairman);
- \*\* Heidelberg Graphic Equipment Ltd., UK (Chairman of the Board of Directors);
- Heidelberg Japan K.K., Japan;
- Heidelberg Americas, Inc., USA (Chairman of the Board of Directors);
- Heidelberg USA, Inc., USA (Chairman of the Board of Directors);
- Heidelberger Druckmaschinen Austria Vertriebs-GmbH, Austria (Advisory Board);
- Heidelberger Druckmaschinen Osteuropa Vertriebs-GmbH, Austria (Advisory Board)

### **Dr. Herbert Meyer**

Königstein/Taunus

- \* Heidelberger Druckmaschinen Vertrieb Deutschland GmbH;
- \*\* Heidelberg Graphic Equipment Ltd., UK; Heidelberg Americas, Inc., USA; Heidelberg USA, Inc., USA; Heidelberger Druckmaschinen Austria Vertriebs-GmbH, Austria (Advisory Board); Heidelberger Druckmaschinen Osteuropa Vertriebs-GmbH, Austria (Advisory Board); Goss International Corporation, USA; Verlag Europa Lehrmittel GmbH (Advisory Board)

### **Dr. Jürgen Rautert**

Heidelberg

– since July 1, 2004 –

- \*\* IDAB WAMAC International AB, Sweden; Heidelberg Postpress Sweden AB, Sweden

### **Dr. Klaus Spiegel**

Walldorf

– through June 30, 2004 –

\* Membership in Supervisory Boards

\*\* Membership in comparable German and foreign control bodies of business enterprises

## Financial Calendar 2005/2006



<b>June 7, 2005</b>	Press Conference, Annual Analysts' and Investors' Conference
<b>July 20, 2005</b>	Annual General Meeting
<b>August 2, 2005</b>	Publication of 1st Quarter Figures 2005/2006
<b>November 8, 2005</b>	Publication of Half-Year Figures 2005/2006
<b>February 2, 2006</b>	Publication of 3rd Quarter Figures 2005/2006
<b>May 3, 2006</b>	Publication of Preliminary Figures 2005/2006
<b>June 7, 2006</b>	Press Conference, Annual Analysts' and Investors' Conference
<b>July 20, 2006</b>	Annual General Meeting
<b>August 1, 2006</b>	Publication of 1st Quarter Figures 2006/2007

Subject to change

Heidelberger Druckmaschinen Aktiengesellschaft  
Investor Relations  
Kurfuersten-Anlage 52 – 60  
D-69115 Heidelberg  
Germany  
E-mail: [investorrelations@heidelberg.com](mailto:investorrelations@heidelberg.com)  
Phone: +49-62 21-92 60 21  
Fax: +49-62 21-92 60 61

> THE FACTS CONSOLIDATED FINANCIAL STATEMENTS

HEIDELBERG  
Speedmaster



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Reports of the Divisions

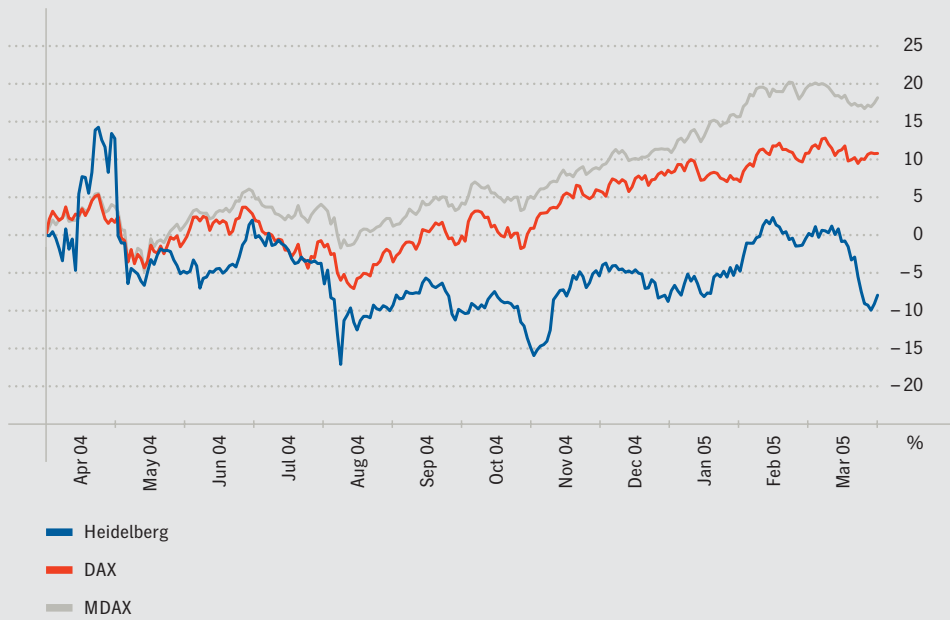
Regions

Corporate Risks

Outlook

### PERFORMANCE OF THE HEIDELBERG SHARE

compared with the DAX/MDAX (Index: April 1, 2004 = 0 percent)



04

05

06

07

08

09

April

May

June

July

August

September

4 / 2004

5 / 2004

6 / 2004

7 / 2004

8 / 2004

9 / 2004



**Top Design Award**

The Design Center of North Rhine-Westphalia bestows the red dot award on Heidelberg a full four times. The Stahlfolder KH/TH model generation even receives the prestigious 'best of the best' award for highest design quality. The panel of judges is impressed by the user-friendly and aesthetic product design.

**Divestiture of Digital Printing**

Heidelberg reacts to changed market conditions in the print media industry and sells off its Digital Printing Division to Eastman Kodak Co., thereby quickly implementing the reorientation of the Company that had been approved in November 2003.

**Expectations from drupa Surpassed**

The world's largest print media industry tradeshow attracts more than 394,000 visitors. Heidelberg introduces over 50 product innovations in an exhibition area totaling approximately 7,800 square meters (some 84,000 square feet) – and thereby again demonstrates its technological leadership. The Company's order books are filled to a greater extent than had been anticipated.

**RWE Grants Heidelberg its Freedom**

In an accelerated tender offer, RWE AG places its 50.02 percent holding in Heidelberg with international investors. The sale of the shares is in line with the long-standing wish of Heidelberg to increase its free float.



**Jürgen Rautert Named New Management Board Member for Engineering and Manufacturing**

The Supervisory Board complies with Klaus Spiegel's request to release him from his Management Board responsibilities as from June 30. Jürgen Rautert is named successor on the Management Board for engineering and manufacturing.

**Partial Outplacement of IT Services**

Hewlett-Packard, which takes over some of Heidelberg's IT operations, is now responsible worldwide for the provision of basic services to some 7,000 SAP end-users at Heidelberg. This outsourcing is expected to generate approximately € 10 million in savings.



**Substantial Resonance at Annual General Meeting**

Some 1,100 shareholders who account for approximately 65 percent of Heidelberg's share capital are represented at the Annual General Meeting. By a considerable majority, they concur with all items on the agenda. The new Supervisory Board is elected.

**Print Media Academy's Summer University**

The Summer University is held in Heidelberg for the third time. This year's focus is on modern business administration practices and their valuable day-to-day benefits.



**Dr. Mark Wössner New Supervisory Board Chairman**

The Supervisory Board elects Dr. Mark Wössner as Chairman. As of September 6, he thereby takes over the responsibilities of Dr. Klaus Sturany. Dr. Sturany nevertheless continues serving as a member of Heidelberg's Supervisory Board.

**Web Systems Goes to Goss**

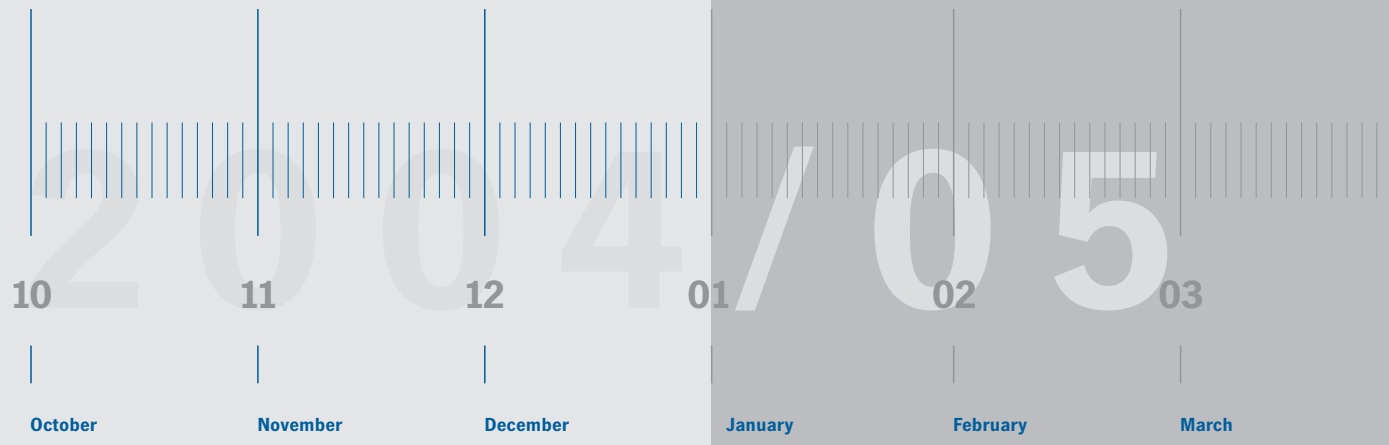
Goss International Corporation acquires the Web Systems Division as of August 6. Heidelberg, which holds a 15 percent participation in Goss, will also sell web offset products in various regions for Goss in the future.

**Speedmaster Prints for the Olympics**

Heidelberg's printing presses are 'fit for the Olympics'. This is evident in Athens, where the magazines Horizont and Focus produce their newsletters for the German Olympic team locally at the printing establishment of a Heidelberg customer.

**Auspiciously High Training Ratio**

Heidelberg also makes an impact with its training program. As of September 1, a total of 212 young people are taking part in one of the 18 different training programs and areas of study.



October

November

December

January

February

March

10/2004

11/2004

12/2004

1/2005

2/2005

3/2005

### 125 Years of Saddle Stitching

Our Leipzig operation with its 300 employees, which has been a part of the Heidelberg Group since 1999, celebrates 125 years of continual development of saddle-stitching technology.

### Innovations Introduced at Graph Expo

At the Graph Expo tradeshow in Chicago, Heidelberg displays the entire range of its solutions and services as well as new systems and also workflow tools. An especially favorable development was the sale of the 10,000th Printmaster QM 46 – a major milestone for sheetfed offset products.



### Bernhard Schreier in China

The Shanghai Office invites around 400 customers to a presentation. Bernhard Schreier, Chairman of the Management Board, is also present. Attention focuses in particular on customer requirements at this event as well.

### Printmaster PM 52 among the 'Top 50'

The readers of the US publication 'Digital Output Magazine' choose the Printmaster PM 52 as one of the 'Top 50 Products for 2004'. A crucial factor in the selection is the capability of Heidelberg's offset printing presses to be easily integrated within a digital workflow.



### First Speedmaster XL 105 in Use

The printing establishment Engelhardt & Bauer in Karlsruhe is the first end-user worldwide to put the Speedmaster XL 105, which was introduced at drupa 2004, into continuous operation.

### Remote Service Certified by Germany's Technical Inspection Association (TÜV)

Heidelberg is the first printing press builder to receive the Technical Safety Certificate from TÜV Informationstechnik GmbH for the Company's Internet-based Remote Service solution.



### Speedmaster CD 74 Duo for Medium Formats

Surface coatings can now also be added to medium formats using a single-step process. With the Speedmaster CD 74 Duo, Heidelberg implements the concept of 'flexo before offset'. Representative applications include packaging, labels, and surface-finished brochures.

### Heidelberg Celebrates 30 Years in the UK

Heidelberg's UK sales and service unit celebrates its thirtieth anniversary. The UK office was the first to be established outside of Germany. Today Heidelberg UK services the fourth-largest market worldwide.



### Seven-Year Convertible Bond Issue

To optimize its financial structure, Heidelberg floats a € 280 million convertible bond issue. This transaction lets the Company benefit from attractive conditions on the capital market and enhances its financing flexibility.

### World Debut of the Dymatrix 106 CSB

The new Dymatrix 106 CSB die-cutting machine was recently put into operation at the Krefeld plant of Freund GmbH. In combination with the Diana Pro 74 folding carton gluer as well as two Speedmaster CD 102s, Freund focuses on a comprehensive packaging solution from Heidelberg.



### The XL Goes into Series Production

The Speedmaster XL 105 team has a reason for celebration: The model line goes into series production. The XL is certain to become a regular feature in the world's printing establishments over the next few years.

## > FIGURES AND FACTS

ANNUAL REPORT 2004/2005

For the first time, we have documented our retrospective view of the past financial year within the covers of two books. We also made use of a color guide system for the first time. Information is thus presented in a more systematic manner – and you can see for yourself how, as the title already promises, we are headed on true course towards the future.

As usual, in between the various sections of the Management Report you will find pages showing photographs and text that are devoted to special topics. We have also spotlighted some key figures, and on these pages, you can learn about the achievements that underlie these figures.

Would you first like to see an overview of Heidelberg's particular focus of interest during the financial year? If so, just open up the left cover to see the high points, which are presented for you in text and images.

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## > Management Board: Reorientation Achieved ... and We Want Still More

**We made use of the profound crisis that the print media industry came out of during the past year to rigorously streamline our structures and prepare ourselves for the challenges of the future. Our initial success is reflected in our markedly improved earnings for the financial year. We will purposefully continue along the road of corporate reorientation. For example, we already reached an important milestone on April 1, 2004 when the new functional organizational structure went into effect. This was subject to further fine-tuning in subsequent months, with changes introduced in Management Board responsibilities and the appointment of a new Management Board member for Engineering and Manufacturing. On the following pages, Heidelberg's three Management Board members provide information on important events and projects in their areas of responsibility.**

A good year ago, we were working feverishly – and as you can imagine, also strenuously – in the run-up to drupa. We had trailblazing innovations to show, our presence at this world's most important trade fair of the print media industry was prepared meticulously, and a fresh wind had slowly begun to blow in our industry. Yet no one could be certain that the favorable trend would continue. But then, incoming orders in excess of a billion euros surpassed all our expectations – to be exact, by 30 percent! Important trend indicators for the printing industry remained favorable throughout the financial year. The print media industry's worst crisis periods are now behind us!

We launched a product offensive in the Sheetfed Offset area and presented new product generations in the Finishing area. The high volume of orders generated at drupa confirmed that we are supplying the market with just the right solutions at the right time. However, there were grounds for satisfaction other than just these bare facts. Across the board, our



> THE HIGH VOLUME OF ORDERS GENERATED AT DRUPA CONFIRMED THAT WE ARE SUPPLYING THE MARKET WITH JUST THE RIGHT SOLUTIONS AT THE RIGHT TIME.<

## **BERNHARD SCHREIER**

Chairman of the Management Board

CEO, born in 1954, married, three children. Engineering graduate (Diplomingenieur, BA).

Began at Heidelberg in 1975 as a student of the vocational college. Beginning in 1978, various management positions, of which five years abroad. Since 1995 member of the Heidelberg Management Board. Chairman of the Management Board since 1999.

regular customers also reacted favorably to our strategic reorientation. At drupa and in numerous discussions in Germany and abroad, customers have indicated to me that their confidence in the long-standing Heidelberg trademark has grown considerably since our renewed focus on our areas of core expertise. The sales team has also confirmed this to me.

We have not rested on our laurels, of course – that would have been a big mistake. Because although all indications are once again pointing towards growth, the underlying conditions for our customers as well as for us continue to be difficult. Our competitors have learned from the crisis years. The competitive environment for European suppliers intensified further due to unfavorable exchange rate developments. During the financial year, we therefore laid the solid foundation for stable growth over the next few years:



- > We are focusing more than ever on an orientation on our customers, and we are increasingly building printing presses in accordance with customer specifications. We have enhanced flexibility of our production processes while simultaneously reducing the cost of manufacturing. We have expanded our technological leadership – and optimized our software Prinect as well. We further improved the services we offer. Additionally, we provided intensive training for our sales organization during the financial year, ensuring an optimal introduction of our new products.
- > Moreover, with regard to the growth potential of the emerging markets, we are moving in directions that are strategically new for Heidelberg. Already in the current financial year, we will begin manufacturing folding machines in China that especially target that market. A small format printing press will be added later. These products enable us to compete in cost terms as well, thereby making it possible to penetrate an entirely new market segment.

Since we focus on achieving the very best for you – our customers, investors, and employees – on a long-term basis, in the future we will continually reexamine whether we are on the right track in terms of strategy and operations. I wish to sincerely thank you for the confidence that you have shown in us and our work!

## **DR. HERBERT MEYER**

Finance, Human Resources

CFO, born in 1946, married, two children. Graduate degree in business administration (promovierter Diplomkaufmann). 18 years with the Bosch Group, of which six years abroad. Since 1994 on the Management Board of Heidelberg.

The financial year began very well for Heidelberg – not only thanks to drupa. Our long-cherished wish for greater free float for our share came true, with RWE selling its majority ownership of our Company. In addition, we were able to finally conclude the agreements covering the sale of the high loss-generating Digital and Web Systems divisions – including

> IN RECENT YEARS, WE IMPLEMENTED FAR-REACHING  
STRUCTURAL STREAMLINING MEASURES, THEREBY  
CONSIDERABLY ENHANCING OUR COMPETITIVENESS.<



Web Finishing. This was immediately reflected in our financial figures. Beginning in the third quarter, our result was no longer burdened – and the operating return on sales rose to 5 percent for the financial year!

Of course, this return on sales was not only the result of the divestitures. In recent years, we implemented far-reaching structural streamlining measures, thereby considerably enhancing our competitiveness. However, this development has not yet gone far enough, as the raw material prices and especially the sustained record-breaking run of the euro vis-à-vis the dollar and the yen are causing an additional need to take action – after all, 68 percent of our employees are located in Germany. We therefore need to further reduce our manufacturing costs – in the human resources area as well, an area for which I am also responsible since June 2004.

We began negotiating in this matter with the works councils during the fourth quarter. At the end of April, we came to an agreement that provides for a comprehensive solution that is acceptable to all parties, for our pact to secure the future does not only deal with a high volume of savings. Since we will reduce staff costs, we can once again increasingly invest in our German plants. For example, in the future we will intensify specialized further training, with over 10 percent of our sales to be invested in this area, in investments, as well

as in research and development. During the financial year, in the human resources area we largely covered our need to catch up with developments as a consequence of recent difficult years. For our innovative solutions and the quality of our products and services represent our crucial competitive advantage – an advantage that stands or falls with the qualification and motivation of our employees.

I wish to sincerely thank our employees for their exceptionally strong commitment during the financial year! And I am very grateful that we were able to further pave Heidelberg's way to the future together with the employee representatives!



> THE CLOSE COOPERATION WITH OUR CUSTOMERS  
IN ALL AREAS OF SHEET PRINTING IS THE  
PREREQUISITE FOR PINPOINTING TRENDS AT  
AN EARLY STAGE.<



## **DR. JÜRGEN RAUTERT**

Engineering and Manufacturing

Born in 1958, married. Graduate in Mechanical Engineering. Joined Heidelberg in 1990.

Since July 1, 2004 member of Heidelberg's Management Board.

Heidelberg is the premium brand name in the print media industry in Sheet Printing. Our customers expect our Prepress, Printing, and Finishing solutions to generate above-average benefit – a demand that extends not only to the individual product, but also to the interplay of all components, i.e. the workflow.

The extent to which the overall production process is profitable can only be determined with the final product. For the following issue is critical: In Prepress, has it been possible to correctly already take into account all the production data through to the finishing phase? If the interfaces of all machines mesh, the system of calculation ensures transparency in terms of capacity utilization and costs for each step in the production process, at all times. And these are precisely the requirements of our customers in an industry – originating from the skilled trades – which has rapidly developed into fully industrialized processes.

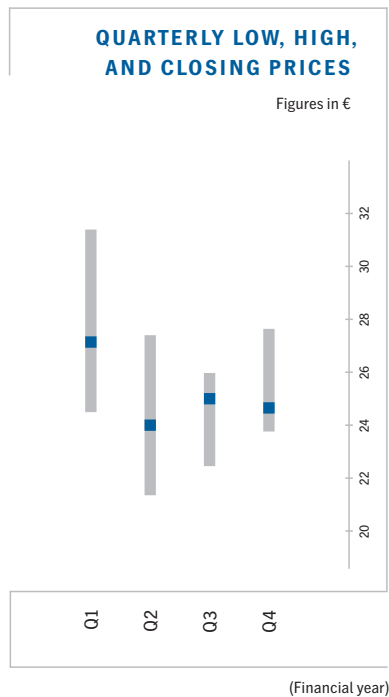
The close cooperation with our customers in all areas of Sheet Printing – from locally active commercial printers and industrial typographers ranging all the way to printing establishments specializing in labels and folding boxes – is the prerequisite for pinpointing trends at an early stage. The challenge to us, then, is to quickly and reliably develop our series-produced goods with the highest possible quality from the very first day of delivery – while simultaneously remaining sufficiently flexible to also meet the increasing demand for specially tailored solutions in the surface coating area as well as in the differentiation of printed products.

Of course, our thinking also goes beyond current issues. Our Predevelopment Department is working on solutions today that will be applicable the day after tomorrow, thereby ensuring that Sheetfed will remain the world's foremost printing process in the future. After all, the technical limits of this printing process have not yet been reached.

I wish to sincerely thank all those who have crucially helped our customers secure their competitive position – particularly our research and development and production employees – as well as, of course, our customers themselves for their close cooperation with us!

## The Heidelberg Share – Enhanced Presence Due to Greater Free Float

- > **Free Float Boosted to 57 Percent**
- > **Dividend at € 0.30 per Share**



### Stock Market Development in 2004 More Modest Than in Previous Year

The gratifying development of the international stock markets in 2003 did not continue into 2004. The initial momentum did not persist, as a result of which in autumn the DAX was slightly below its level at the beginning of the year – nevertheless, catching up through December due to strong growth, with a solid increase of 6 percent posted for the calendar year. The MDAX faced initial difficulties at the beginning of the year as well – nevertheless, subsequently growing by 19 percent overall.

The **Heidelberg share** developed in line with the indices from April through August 2004 – at times even considerably surpassing them. Following the placement by RWE Aktiengesellschaft of its 30 million Heidelberg shares in May, the price development was hampered for a time, as this served to expand the volume of Heidelberg shares offered.

After August, the shares of the heavily export-oriented German investment goods industry began to suffer from the continual weakening of the US dollar. Substantially higher raw material prices exercised additional pressure. Both factors were also reflected in the development of the price of Heidelberg's share.

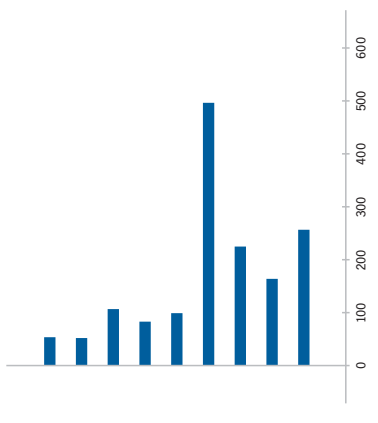
The share then strengthened at the beginning of 2005, with its price rising considerably in excess of € 27. The price only fell back again at the end of the financial year, with the share closing at € 24.65 on March 31, 2005 – 15 percent over the low for the financial year of € 21.35.

### Free Float Boosted to 57 Percent

Following the successful international placement by RWE AG of its shares in Heidelberg in an accelerated tender offer in May of the financial year, the Heidelberg share's **free float** rose to 57 percent. This will increase to 72 percent over the next three years as the result of an exchangeable bond issue. The trading volume consequently increased considerably. Some 250,000 shares per day have been traded since the placement, compared with the approximately 90,000 shares traded on average daily during the previous twelve months.

### AVERAGE DAILY SALES VOLUME OF THE HEIDELBERG SHARE

Figures in thousands of shares



01 02 03 04 01 02 03 04 01  
2003 2004 2005

The international diversification of the Heidelberg share was also considerably enhanced after May 2004, with English, US and Canadian investment funds meanwhile accounting for 60 percent of the free float; German investors account for an 18 percent share. Approximately 5 percent of shares are held by private investors. Around half of our shareholders are interested in long-term appreciation of value and focus on Heidelberg's robust earnings power – which from the investors' point of view is not fully reflected in the price.

#### Convertible Bond Successfully Placed

On February 2, 2005 we issued a seven-year convertible bond totaling € 280 million, which has been listed on the Luxembourg Stock Exchange since April. This transaction benefits us due to the attractive conditions on the capital market and the increase in our financing flexibility.

#### Extensive German and International Coverage

A total of some 30 banks have been publishing regular and extensive reports on Heidelberg for a number of years. Most analysts recommend buying or holding Heidelberg shares, although some subsequently revised their ratings downwards due to the restrained industry assessments for the first calendar quarter of 2005.

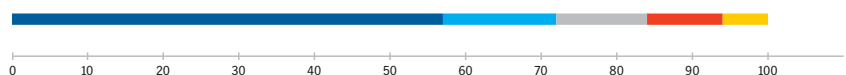
#### Investor Relations Activities

The goal of our investor relations activities is to spark new interest or further strengthen existing interest in the Heidelberg share. During the financial year, at more than 40 road shows in Germany and abroad we presented ourselves to institutional investors and provided a forum for questions.

### SHAREHOLDER STRUCTURE

March 31, 2005

Share in percent



Free Float <sup>1)</sup>	57 %
RWE	15 %
Allianz	12 %
Commerzbank	10 %
Munich Re	6 %

<sup>1)</sup> Of which Brandes Investment Partners LLC accounts for 10 percent (status February 2005) and Fidelity International Ltd. for 5 percent (status November 2004)

We also presented our Company at over ten international conferences and numerous individual meetings – in part with first-time contacts. Plant visits and informative tours of the Print Media Center aroused considerable interest among analysts and investors.

For more information about Heidelberg, please refer to our newly published 'Factbook' – a comprehensive and up-to-date look at Heidelberg's organizational structure and product portfolio. The 'Factbook' can be found at the following Internet address: '<http://www.heidelberg.com/Factbook>'

## KEY PERFORMANCE DATA OF THE HEIDELBERG SHARE

Figures in €

	2003/2004	2004/2005
Earnings per share	- 8.16	0.64
Price-earnings ratio <sup>1)</sup>	- 3.43	38.52
Cash flow per share	- 1.40	2.76
Price-cash flow ratio <sup>1)</sup>	- 19.99	8.93
Dividend per share	-	0.30
Dividend yield in percent <sup>1)</sup>	-	1.22
Share price – high	34.60	31.39
Share price – low	16.00	21.35
Share price – beginning of financial year	16.45	26.78
Share price – financial year-end	27.99	24.65
Market capitalization – financial year-end – in € millions	2,405	2,118
Number of shares in thousands	85,908	85,908

<sup>1)</sup> In terms of the financial year-end price in Xetra trading; source of prices: Bloomberg

### Management Board Proposes Dividend Payment

We have laid the foundation for a sustained increase in our future earnings. The Management Board and the Supervisory Board therefore propose to the Annual General Meeting the payment of a dividend of € 0.30 per share for financial year 2004/2005.

Our investor relations team will be pleased to receive your suggestions or questions.

Heidelberger Druckmaschinen Aktiengesellschaft

Investor Relations

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HEBERG  
Spezialer

> DIMENSIONS IN THE WORLD OF PRINTING

ANNUAL REPORT 2004/2005



19

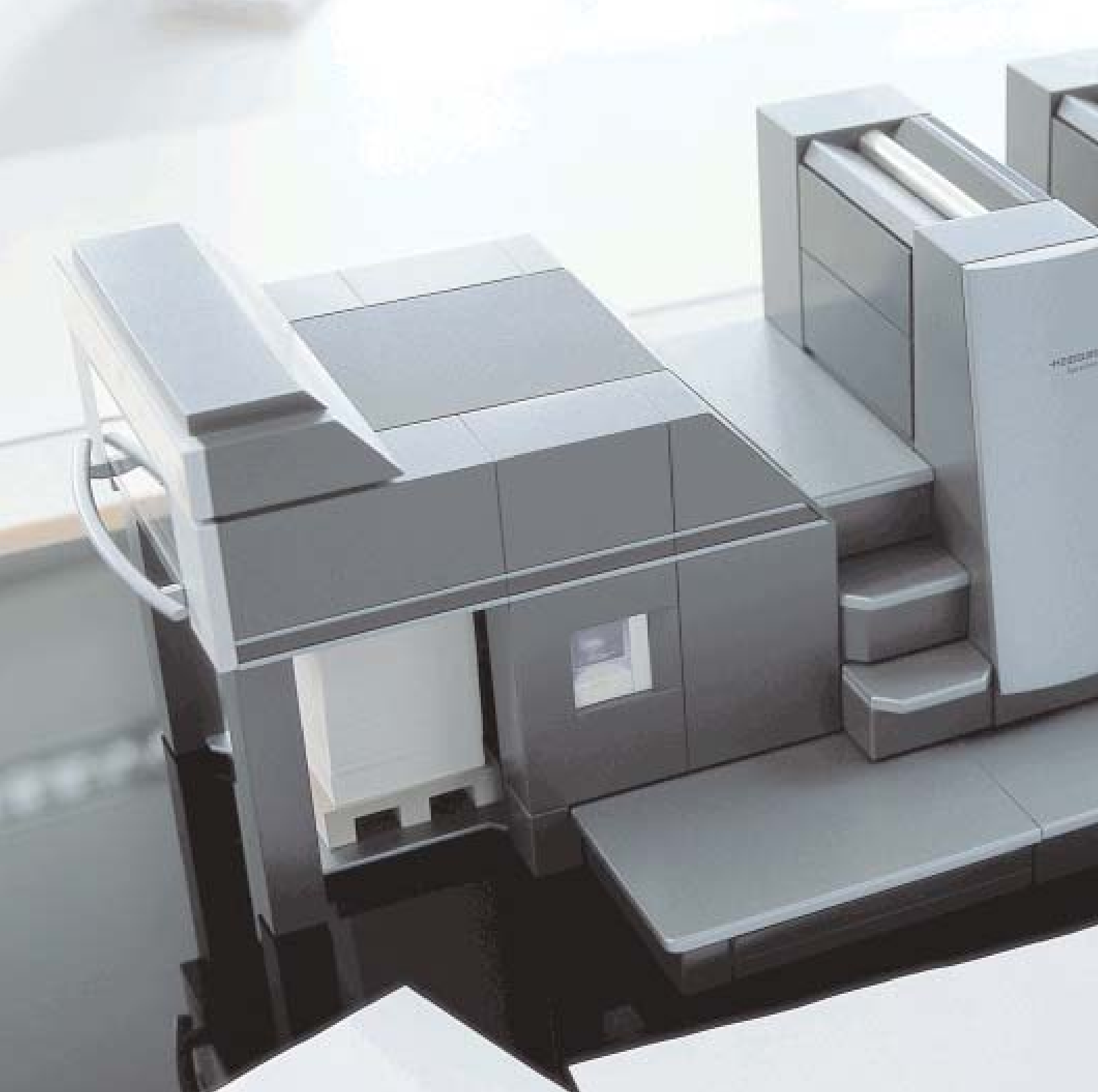
5,500

40,000,000

120,000

58,000





Clarity in form and function:



Relief 1000  
Kochi 50m x 10m

19

design prizes in 5 years

## OUR COMPETITION? THE BEAUTIFUL THINGS IN LIFE.

**Our rejoicing was great** when we heard the news. With our Stahlfolder TH/KH folding machine, we were named among the 'best of the best' in the red dot design award. Winning wasn't all that easy considering that our functional capital goods had to contend with perfectly designed jewelry and outlandish furniture ... Our Prinect workflow system also won this prize – for ease of use and the user interface design. What pleases us most about this? With the prospects of maximum productivity, we have repeatedly succeeded in winning over customers who enjoy producing with our printing presses – among others, because our products engender an agreeable atmosphere with their clear forms and colors. How do our creative heads bring this about? From the first idea through to market introduction, they engage in measuring, comparing, constructing, examining, and improving – until the critical eyes of customers and top-flight juries are satisfied.



Heidelberg received **7** awards

for product design in 2004 alone. One from Chicago Athenaeum (Good Design), five from Designzentrum North Rhine-Westphalia (red dot design award), and one from Industrie Forum Design Hannover (iF).

**Did you already know** that Heidelberg received the Design Prize of the Federal Republic of Germany for the Speedmaster CD 74, which the President of Germany presented in person?

## Underlying Conditions – Indicators Again Pointing to Growth

- > **Strong Growth of the Global Economy; Slight Growth in Europe**
- > **Modest Turnaround for the Print Media Industry**
- > **Exchange Rates and Raw Material Prices as Restraining Factors**

Heidelberg generates approximately 85 percent of its sales internationally. The development of international markets is thus crucial for the Company's business development. The **global economy** grew by 4.9 percent – the highest increase in quite some time. By the end of the year, however, the pace of growth had weakened somewhat, with the high price of crude oil and the continuing weak dollar having a restraining effect.

### Engine for Global Economy: the US and Emerging Markets

How did various regions and countries that are important to Heidelberg contribute to the remarkable growth of the global economy? The table on the left provides an overview.

The **US**, whose growth of 4.4 percent was the strongest in many years, was favored by economic stimuli: tax cuts and an expansionary monetary policy advanced the investment climate. However, the upswing lost more and more of its strength from quarter to quarter. The primary restraining factors were, as elsewhere, the rising prices of oil and raw materials. Furthermore, the enormous increase in the budget deficit reduced the scope for taking action in terms of an additional fiscal-policy impetus, and the key interest rates rose again during the year.

Although exports developed favorably, growth in the **euro region** of 1.8 percent continued to be weak after the previous year's 0.5 percent increase. Domestic economic problems prevented a quicker economic turnaround. Investment activity picked up again for the first time, with private consumer spending nevertheless remaining weak. In **Germany**, our second largest single market, although economic conditions remained stable, only demand from abroad developed favorably. Although the earnings position of companies improved – among others, due to low interest rates and only modest increases in real wages – domestic investments were still declining somewhat. Overall, economic growth of only 1.0 percent was realized. In terms of growth, Germany has thereby brought up the rear among EU countries since the mid-1990s!

### GROSS DOMESTIC PRODUCT

Change from previous year in percent

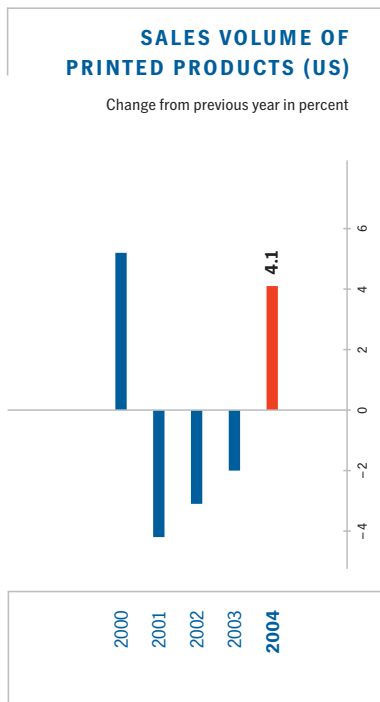
	2002	2003	2004
<b>World</b>	2.9	3.9	4.9
USA	1.9	3.0	4.4
EU	0.9	0.5	1.8
Germany	0.1	-0.1	1.0
Asia <sup>1)</sup>	6.9	8.5	8.0
China	10.0	11.6	10.6
Japan	-0.3	1.4	2.6
Latin America	-0.4	1.7	5.4
Brazil	1.9	-0.2	5.2
Eastern Europe	3.6	5.8	6.2
Russia	4.7	7.3	7.1

Source: UBS Warburg, March 2005

<sup>1)</sup> Excluding Japan

**Japan** benefited from the strong world economy in 2004, in particular intensifying its economic relations to China. Nevertheless, growth weakened considerably already in the third quarter. Serious structural problems such as deflation have not yet been overcome.

In addition to the US, the emerging markets served as an engine for global economic growth in 2004 as well. **China** in particular proved to be an economic motor. With an increase in gross domestic product of 10.6 percent, that country continued its highly favorable development of the past five years. For the sixth year in a row, **Russia**, which posted growth of 7.1 percent, also developed at an above-average pace. This growth was largely driven by the boom in the commodity markets. **Brazil** has left its economic difficulties behind it and realized an economic upswing of 5.2 percent with a stable currency.



Source: NAPL (National Association for Printing Leadership)

### Print Media Industry on the Upswing

The print media industry is highly dependent on the advertising market – which, in turn, is closely linked to global economic developments. It is therefore only logical that the strong growth of the global economy had a favorable impact on our industry in 2004.

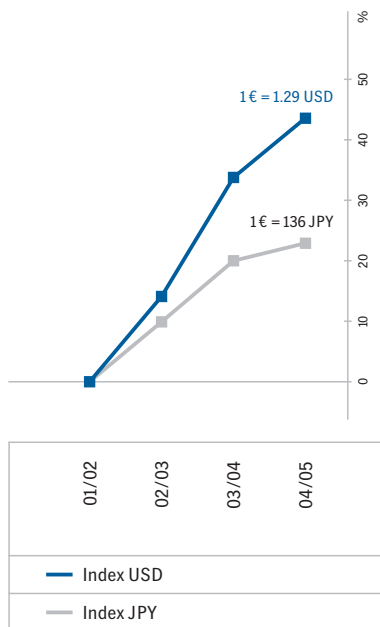
New printing establishments were again established during the financial year in the emerging markets, with China in the lead. The need for printed materials continues to grow in these booming economies – in percentage terms, at about the same pace as the growth in the respective gross domestic product.

The print media industry also finally overcame its deep crisis in the industrialized countries. In prior years, the **capacity utilization** of the printing establishments had reached ever-deeper low points. Firms faced fierce competition and falling prices for print products, with their income shrinking drastically. The propensity to invest of printing establishments was accordingly weak. Following initial signs of the appearance of a fresher wind at around the end of 2003, in 2004 the industry realized an initial upswing, with the production volumes of print media on the increase for the first time in quite some time. The graph on the left shows developments in the US, the biggest market for printed products.

Equipment suppliers and customers were anxiously anticipating drupa, which was held in May 2004. The world's most important trade fair for our sector, which takes place every four years, is regarded as a trend indicator for the print media industry. The total of around 400,000 visitors in Düsseldorf amounted to nearly as many as in boom year 2000. The considerable buyer interest also underscored the favorable developments, with the industry taking a first step out of the trough following difficult past years.

### APPRECIATION OF THE €

Average exchange rates during the financial year



(Index basis: 2001/2002)

### 'DIGITAL' AND 'WEB SYSTEMS'

'Digital' comprises the production, the service as well as sales and distribution of digital black-and-white and color printing machines; 'Web Systems' covers the business areas Commercial Web, Newspaper Printing Machines and Web Finishing.

### Foreign Currency Developments Hamper US Business of European Equipment Suppliers to the Print Media Industry

The development of **exchange rates** caused some concern in 2004. The enormous deficit in the balance of trade of the US caused a further devaluation in the already weak dollar, especially vis-à-vis the euro. Japan intervened in the financial markets in an attempt to limit the strengthening of the Japanese yen against the dollar. As consequence, among other factors, the gap between yen and euro vis-à-vis the dollar increased more and more, as can be seen in the graph on the left. This development had a direct impact on equipment suppliers in the print media industry. Japanese suppliers benefited from this development in particular in the US market, as by comparison they were able to sell their products at a considerably lower price than their European competitors.

### Heidelberg: Responding to Changed Underlying Conditions

Our international alignment makes it possible for us to generally offset weaknesses in one region by developments in other regions. Since we have divested the **DIGITAL AND WEB SYSTEMS** divisions, we are less dependent on the single US market – that country was the principal sales market of both divisions. By contrast, we have expanded our operations in the emerging markets, whose share in the overall sales of the Heidelberg Group grew further.

Our response to the period of global economic weakness has been to streamline our corporate structures and further cut back our structural costs – drastically and on a sustained basis. By divesting the Digital and Web Systems operations, we have eliminated the areas that have been generating losses in recent years. We thereby lowered our break-even point due to the reduced structural costs. We are thus able to respond more flexibly to fluctuations in customer orders. Please refer to pages 27 to 31 for more details on this topic.

Moreover, we have further expanded our position in the rapidly growing – and largely non-cyclical – package printing segment.

We discuss in detail the impact of underlying conditions on individual products and product groups in the various sections of this Annual Report. We also report more extensively on distinctive aspects of developments in various countries and regions that determine or affect the development of our business.

### **Defending Our Position as the World Market Leader in Sheetfed Offset Printing**

We hold a **market share** of more than 40 percent worldwide in the Sheetfed Offset area. With our strategy of offering integrated solutions, which give our customers crucial added value and Heidelberg advantages over competitors, we have risen considerably above our competition. This applies to the areas of technology and software, and beyond. Our international Print Media Academy Network also offers unique opportunities for specialized and general training, which are enthusiastically greeted by the print media industry.

In addition to Germany, our principal competitors are in Japan. As we mentioned above, during the financial year our Japanese competitors benefited from foreign currency advantages. However, we can offer the best and most extensive service and sales network in the industry in all regions of the world. Together with our solution offerings, this competitive advantage made it possible for us to also score points in growth markets despite the foreign currency drawbacks.

## Business Development – Renewed Upswing Following a Three-Year Pause

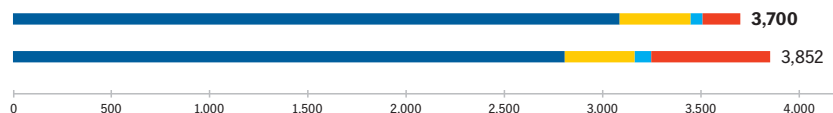
- > **High Volume of Orders at drupa**
- > **Sales Increase in Each Quarter**
- > **Emerging Markets with a Growing Share in Sales**

What was the highlight of the financial year under report? Without a doubt, for both the print media industry and for Heidelberg it was the **drupa trade fair** in May 2004. Here, the industry specialists were able to see our innovative power for themselves. We presented over 50 product innovations in Düsseldorf, generating orders totaling approximately € 1 billion (from continuing operations: € 900 million) – considerably higher than our original forecast. Although we fell short of the volume of incoming orders at the previous drupa, the trade fair was a complete success – the industry had suffered a heavy crisis during the three years prior to the trade fair.

### INCOMING ORDERS BY DIVISION

2004/2005  
2003/2004

Figures in € millions



■ Press	<b>3,087</b>	+ 10 %
■ Postpress	<b>359</b>	+ 1 %
■ Financial Services	<b>62</b>	- 27 %
<b>Continuing Operations</b>	<b>3,508</b>	<b>+ 8 %</b>
(currency adjusted:		+ 10 %)
■ Discontinuing Operations	<b>192</b>	- 68 %
<b>Heidelberg Group</b>	<b>3,700</b>	- 4 %

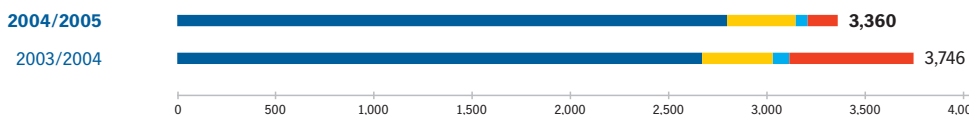
### Incoming Orders: Growth Generated in the First Quarter

Thanks to drupa, the highest volume of incoming orders of any quarter in the past three years was realized in the first quarter of the financial year: € 1,141 million from continuing operations. Although the second quarter was still in line with our expectations, we experienced declining vigor for incoming orders in the third and fourth quarters. Nevertheless, we were successful in boosting incoming orders from continuing operations by 8 percent over the previous year to a total of € 3,508 million – for the first time in three years, an increase over the previous year! Foreign currency developments, primarily the US dollar, had a negative impact on incoming orders; adjusted for foreign currency changes, growth amounted to 10 percent over the previous year.



**SALES BY DIVISION**

Figures in € millions



■ Press	<b>2,797</b>	+ 5 %
■ Postpress	<b>348</b>	- 3 %
■ Financial Services	<b>62</b>	- 27 %
<b>Continuing Operations</b>	<b>3,207</b>	<b>+ 3 %</b>
(currency adjusted:		+ 5 %)
■ Discontinuing Operations	<b>153</b>	- 76 %
<b>Heidelberg Group</b>	<b>3,360</b>	<b>- 10 %</b>

Since discontinuing operations still were fully included during financial year 2003/2004 but only for a few months during the current financial year, incoming orders declined slightly from the previous year for the Heidelberg Group as a whole.

**Sales: Every Quarter Higher than the Previous One**

Cautiously optimistic – this is how we assessed the development of our sales in the past financial year when we projected an increase in sales of at least 5 percent on a comparable basis. As you can see in the table on the left, we achieved this goal after adjusting for negative foreign currency influences.

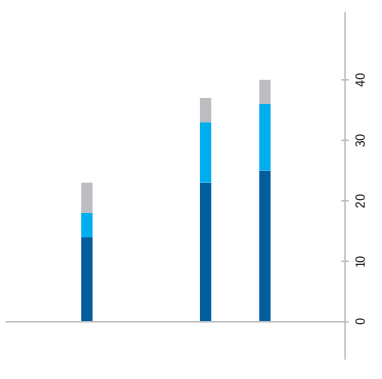
The sales trend during the financial year under report was an especially favorable development. Following a rather weak first quarter, in every quarter we realized growth over the previous quarter. During the first nine months, we also exceeded the comparable previous year’s figures. How did this happen? We began filling orders received at drupa at the beginning of the second quarter, which overall ensured growing capacity utilization.

We recorded our largest sales increase in the **Press Division** – a result of our success at drupa, where we presented many new products. Nevertheless, we are not entirely satisfied. Individual areas – for example, Prepress – fell behind the general trend, and individual markets fell short of our projections. For example, the weak dollar constrained our business in the US, and Russia was unable to continue growing as rapidly as in recent years. The Postpress Division reached approximately the previous year’s level after adjusting for foreign currency changes. Primarily packaging printing presses and mailroom systems experienced declines, which, however, were compensated for by increases in other areas – especially with folding and binding machines. Interest income of the Financial Services Division decreased due to our success – in view of the balance sheet structure – in outsourcing customer financing to a greater extent than had been expected.

Since discontinuing operations were still fully included in the figures for financial year 2003/2004, the overall sales of the Heidelberg Group inevitably declined from the previous year.

**EMERGING MARKETS' SHARE OF NET SALES**

Share in percent



	97/98	03/04	04/05
■ Latin America	5 %	4 %	4 %
■ Eastern Europe	4 %	10 %	11 %
■ Asia/Pacific	14 %	23 %	25 %
<b>Emerging markets<sup>1)</sup></b>	<b>23 %</b>	<b>37 %</b>	<b>40 %</b>

<sup>1)</sup> Including discontinuing operations

In the Underlying Conditions section, we explained how the vigorous pace of growth of the global economy results from stimulus from the US and in particular from the **emerging markets**, especially China. These emerging markets developed at an above-average pace in the print media industry as well, with the share of Heidelberg's net sales to regions with emerging markets further increasing. The graph on page 22 illustrates this development over the longer term. Why is the growth potential of these markets so high?

- > The degree of saturation of printed products is considerably lower than in the industrialized countries.
- > The example of China underscores the more rapid pace of growth in these economies.

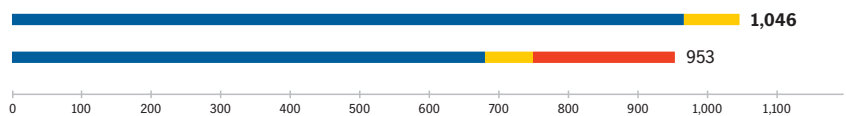
Heidelberg took note of this trend at an early stage. We maintain the industry's most efficient sales and service network in the growth regions of the world – for example, we are represented by some 500 sales and service employees in China alone.

#### ORDER BACKLOG BY DIVISION

March 31, 2005

March 31, 2004

Figures in € millions



■ Press	966	+ 42 %
■ Postpress	80	+ 16 %
■ Financial Services	-	-
<b>Continuing Operations</b>	<b>1,046</b>	<b>+ 40 %</b>
■ Discontinuing Operations	0	-
<b>Heidelberg Group</b>	<b>1,046</b>	<b>+ 10 %</b>

#### Order Backlog: Considerably Exceeding Previous Year's Figure

Incoming orders during the first quarter ensured an accordingly high order backlog, which we reduced according to plan in subsequent quarters. Nevertheless, the order backlog of € 1,046 million at financial year-end was still above average, amounting to 40 percent more than the previous year's figure. This is a comfortable reserve for the beginning of the current financial year, as a result of which high **capacity utilization** is assured for the first quarter, during which time pending deliveries will be shipped. The range of orders thereby expanded further, with the order backlog amounting to 3.9 months at financial year-end compared with the previous year's figure for continuing operations of 2.9 months.



HEIDELBERG

HEIDELBERG

HEIDELBERG

HEIDELBERG

HEIDELBERG

M180  
Laser radiation is emitted from this device. Do not stare into the beam. Do not touch the laser tube. Do not touch the laser tube. Do not touch the laser tube.

M180  
Laser radiation is emitted from this device. Do not stare into the beam. Do not touch the laser tube. Do not touch the laser tube. Do not touch the laser tube.



With over **5,500** patents

in Germany and abroad we're out in front

**AN INVENTION IS GOOD IF OUR CUSTOMERS CAN BENEFIT FROM IT.**

**Curiosity, creativity, courage** – These are the components out of which inventions are made. The engine for new ideas? Precise observation, consciously letting go of the usual way of doing things, and posing the probing question: “How can we improve on something?” Finding out today what will be important in the future – this is our leitmotif. This spirit is an inspiration for our 1,524 research and development employees, for whom innovation represents a day-to-day challenge. Only in this manner could the laser module for the Suprasetter be developed following several years of work. And now it has been accomplished. This compact invention, which fits into the palm of a hand, images even the largest format printing plates. In the US, the first of a whole series of patents was granted in August in 2004 for this little piece of mini-equipment. We are pleased about this – as are our customers, for they can now expand the unique modular system for plate imaging in line with their requirements and thereby continuously expand their throughput.



We registered patents covering a total of **156** new inventions

in the sheetfed offset, prepress, postpress and flexo printing areas during the financial year.

**Did you already know** that Heidelberg disbursed a total of € 767 thousand in compensation to its inventors during the financial year?

## Net Assets, Financial Position, and Results of Operations – Earnings Turnaround Achieved

- > **Result of Operating Activities Before Special Items Doubles to €167 million**
- > **Total Assets Reduced and Borrowed Funds Optimized**
- > **High Level of Free Cash Flow**

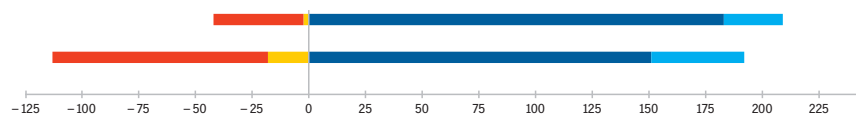
The far-reaching reorientation of the Heidelberg Group is reflected in all important key performance data for financial year 2004/2005. Following preparations for divesting the loss-generating Digital and Web Systems divisions back in the previous year, we undertook concrete action during the reporting year. The sale of these two divisions was concluded in May and August of last year. In addition, we further restructured the Group, streamlined the organization, simplified processes, and reduced the capital commitment as well as structural costs on a sustained basis. We achieved our goal of noticeably lowering the break-even point, making it possible for us to react more flexibly to fluctuations in customer orders. Our business results improved noticeably.

### RESULT OF OPERATING ACTIVITIES<sup>1)</sup>

2004/2005

2003/2004

Figures in € millions



■ Press	<b>183</b>	151
■ Postpress	<b>-2</b>	-18
■ Financial Services	<b>26</b>	41
<b>Continuing Operations</b>	<b>207</b>	<b>174</b>
■ Discontinuing Operations	<b>-40</b>	-95
<b>Heidelberg Group<sup>2)</sup></b>	<b>167</b>	<b>79</b>

### Operating Statement: Income Turnaround Achieved

Including the current loss of NexPress, the operating result improved from €10 million to approximately €160 million. The extent to which the situation changed over the course of the financial year under review is reflected in developments from quarter to quarter. The first and to a limited extent also the second quarter were relatively weak. During the third quarter – the first without the divested loss-generating operations – we already generated an 8 percent operating return on sales. And then in the fourth quarter this figure jumped to almost 14 percent! We thereby achieved an operating return on sales of 5 percent for the year as a whole.

<sup>1)</sup> Before special items

<sup>2)</sup> Including the operating loss of NexPress: €160 million (previous year: €10 million)

## INCOME STATEMENT HEIDELBERG GROUP

Figures in € millions

	2003/2004	2004/2005
<b>Net sales</b>	3,746	3,360
<b>Result of operating activities<sup>1)</sup></b>	79	167
Expenditures from special items	335	13
Financial result	-250	-47
<b>Pre-tax result</b>	-506	107
Taxes on income	189	46
<b>Net loss/profit</b>	-695	61

<sup>1)</sup> Before special items

The result of operating activities doubled from € 79 million to € 167 million. What factors influenced this result? There were no burdens from discontinuing operations beginning in the third quarter. During the financial year, we additionally further reduced our structural costs, which meanwhile have been cut back by 20 percent overall. The result also improved due to the increase in sales as well as the resulting higher profit contribution by the Press Division. Nevertheless, the ongoing weakness of the dollar had a negative impact on earnings, and the trade fair costs for our presence at drupa accrued during the financial year as well.

As the income statement above shows, only very minor expenses arose for special items during the reporting year. The situation was quite different in the previous year, when primarily due to the provisions for discontinuing operations, special items totaled € 335 million.

The financial result rose from € -250 million the previous year to € -47 million – especially because fair value adjustments were no longer required for the NexPress joint venture and the specialized investment funds. The net interest result included in the financial result improved from € -55 million the previous year to € -48 million. The divestiture of the discontinuing operations resulted in a reduction in taxes on income to € 46 million during the financial year, with a tax rate of approximately 43 percent. The previous year was hampered by fair value adjustments to deferred taxes totaling € 116 million.

All these individual effects led to an increase in our net result by over € 750 million during the financial year and thus our exceeding the break-even point once again. Net profit reached € 61 million, the net return on sales amounted to 1.8 percent, and earnings per share totaled € 0.64.

**BALANCE SHEET STRUCTURE**

Figures in € millions

	31-Mar-2004	in percent of total assets	31-Mar-2005	in percent of total assets
Fixed assets	897	21	832	23
Current assets	3,335	79	2,797	77
<b>Total assets</b>	<b>4,232<sup>1)</sup></b>	<b>100</b>	<b>3,629</b>	<b>100</b>
Shareholders' equity	1,230	29	1,230	34
Provisions	1,527	36	1,247	34
Liabilities	1,475	35	1,152	32
<b>Total assets</b>	<b>4,232</b>	<b>100</b>	<b>3,629</b>	<b>100</b>

<sup>1)</sup> Of which: discontinuing operations € 455 million

**CURRENT ASSETS OF CONTINUING OPERATIONS**

Figures in € millions

	03/04	04/05
<b>Current assets</b>	2,985	2,797
– of which: inventories	(737)	(786)
– of which: receivables from customer financing	(769)	(565)
– of which: trade receivables	(644)	(576)

**Financial Position: Improvement in Capital Structure**

The total assets of the Heidelberg Group amounted to € 3,629 million at financial year-end – more than € 600 million lower and thereby approximately 14 percent less than the previous year. Why? A major contributing factor was the adjustment of discontinuing operations, as well as negative exchange rate effects to a limited degree.

In addition, we substantially reduced the capital commitment during the financial year through the reorientation of the Group as well as active asset management. A glance at the table on the left shows that this development results largely from current assets of continuing operations, where we were able to cut back accounts receivable from customer financing in particular by over € 200 million due to their outsourcing. We also considerably reduced trade receivables. The size of inventories makes clear that some orders received at drupa have yet to be shipped.

We succeeded in reducing the commitment of funds while simultaneously decisively improving the Group's capital structure. Although shareholders' equity remained stable compared with the previous year, as a result of the reduction in the balance sheet total, however, this led to a rise in the **equity ratio** to 34 percent. The extent to which the Group's financing structure is on a solid footing is also reflected in the **equity to fixed assets ratio**, with fixed assets excluding land and buildings over 200 percent covered by shareholders' equity.



The provisions decreased considerably during the financial year. Most of the decline results from deconsolidations and utilizations in connection with the Group's reorientation.

In addition to the reduction in the commitment of funds, we also substantially reduced liabilities during the financial year. This was especially true for our financial liabilities, which we were able to cut down from € 749 million to € 615 million thanks to our extraordinarily high free cash flow. We additionally improved our financing structure on a sustained basis – on the one hand through the issuance of a convertible bond, and on the other hand due to a further private placement. Our liabilities to banks thereby amounted to € 216 million – less than a third of the previous year's figure of € 667 million.

#### Convertible Bond: Successfully Placed

In February 2005, our € 280 million convertible bond issue was successfully floated by a consortium. This issue was listed on the Luxembourg Stock Exchange in April 2005 and was extremely favorably received by the capital market. This transaction allows us to take advantage of the attractive conditions on the capital market and increase our financing flexibility. Additional details as well as the terms of the convertible bond are shown in the Notes to the Financial Statements starting on page 42.

#### CASH FLOW STATEMENT OF THE HEIDELBERG GROUP

Figures in € millions

	2003/2004	2004/2005
<b>Cash flow</b>	- 121	235
<b>Other operating changes</b>	408	28
- of which: inventories	(141)	(- 54)
- of which: accounts receivable from customer financing	(77)	(178)
- of which: trade receivables	(68)	(77)
- of which: other provisions	(100)	(- 78)
<b>Net cash used in investing activities</b>	- 173	- 109
<b>Free cash flow</b>	114	154
- of which: discontinuing operations	(- 189)	(- 102)

### Financial Condition: Free Cash Flow Exceeds the Already Excellent Previous Year's Level

Once again, we succeeded in reducing the Group's commitment of funds and generated a high degree of internal financing from current business during the financial year. This is noticeable with the Group's **cash flow**, which was € 235 million compared with € -121 million the previous year – approximately 7 percent of sales.

The results of our intensive asset management are reflected in **other operating changes**. The additional outplacement of customer financing and the reduction in trade receivables had an especially favorable impact. Net cash used during the financial year was related to the build-up of inventories; we also utilized provisions for special items for the implementation of projects in connection with the Group's reorientation.

We were successful in limiting **cash used in investing activities** to € 109 million, compared with € 173 million the previous year – primarily a result of the discontinuation of the NexPress joint venture.

Overall, we were successful in boosting the **free cash flow** to € 154 million – despite the burden from discontinuing operations and the corporate reorientation. We thereby considerably surpassed the already high previous year's level. Due to this solid internal financing, we were able to further reduce financial liabilities and are able to pay out a dividend.

## Value-Oriented Corporate Management – ROCE and Value Contribution

- > **ROCE Improves Considerably**
- > **Cost of Capital Lowered**

<b>VALUE CONTRIBUTION</b>		
Figures in percent		
	03/04	04/05
ROCE	0.3	6.7
Cost of capital	10.2	9.8
<b>Value contribution</b>	<b>-9.9</b>	<b>-3.1</b>

The principal goal of our corporate operations is to increase the corporate value of the Heidelberg Group on a sustained basis. The value contribution reflects the expectations of the providers of capital for their invested capital to earn a return with us. These expectations are met when the value contribution is favorable. The value contribution and ROCE (return on capital employed) are thereby the central control and measure quantities of our success. That is why within the Group, we calculate these key performance ratios for the individual business areas; we derive our objectives from these ratios.

### Concept Adapted

With the completion of the Group's reorientation, we have revised our concept for the return on capital and adapted it to the new conditions. As in the past, operational assets, **EBIT**, and the cost of capital are integral parts in the determination of the value contribution:

The **operational assets** contain all assets that are utilized in realizing EBIT. Goodwill arising from capital consolidations is now included among operating assets. Furthermore, what is new is that we no longer include any balance sheet items that are associated with tax transactions. As in the past, the effects from special items are adjusted.

In line with our new segment-based structure, the **operating result** now includes the net result of the Financial Services Division after refinancing costs – in past years, the refinancing costs were not taken into consideration in EBIT. With the result as well, we no longer adjust the amortization of goodwill from capital consolidation. **ROCE** reflects EBIT in relation to operational assets. Due to the conceptual changes ROCE is lower compared to the previous calculation methodology; the previous year's values were accordingly adjusted.

### EBIT

Earnings before Interest and Taxes.

In past years, we relied on a rigid **expected return on capital** of 13 percent in calculating the cost of capital. However, since the forecasted return on equity and borrowed funds varies, a rigid expected return on capital ignores changes in capital structure and market interest rates. In order to make this calculation more realistic, we revised the method of calculation for the current financial year. We now record our cost of capital on the basis of a weighted expected return on capital; significant changes in the capital structure are therefore also reflected in the changed cost of capital. As in the past, the cost of capital is stated before taxes. This takes into account our management philosophy as well as the international, in part different tax rates.

The **value contribution** represents the difference between ROCE and the applied cost of capital. The adjustment of the calculation methodology resulted in an improvement of the value contribution.

<b>OPERATIONAL ASSETS<sup>1)</sup></b>		
Figures in € millions		
	2003/2004	2004/2005
Intangible assets + tangible assets	891	779
+ Participations	157	42
<b>= Operating fixed assets</b>	<b>1,048</b>	<b>821</b>
Inventories	963	786
+ Receivables <sup>2)</sup> + prepaid expenses	1,646	1,325
– Other provisions	481	439
– Operational liabilities <sup>3)</sup> + deferred income	743	511
<b>= Working capital (net)</b>	<b>1,385</b>	<b>1,161</b>
<b>= Operational assets (net)</b>	<b>2,433</b>	<b>1,982</b>
Average operational assets	2,593	2,208

<sup>1)</sup> Adjusted for effects from special items

<sup>2)</sup> Excluding finance and tax receivables

<sup>3)</sup> Excluding tax liabilities, including operational financial debt

<b>VALUE CONTRIBUTION<sup>1)</sup></b>		
Figures in € millions		
	2003/2004	2004/2005
Result of operating activities	79	167
+ Income from participations	– 71	– 19
<b>= EBIT</b>	<b>8</b>	<b>148</b>
ROCE in % of operational assets <sup>2)</sup>	0.3	6.7
<b>Cost of capital</b>	<b>264</b>	<b>217</b>
in % of operational assets <sup>2)</sup>	10.2	9.8
<b>Value contribution</b>	<b>– 256</b>	<b>– 69</b>
in % of operational assets <sup>2)</sup>	– 9.9	– 3.1

<sup>1)</sup> Adjusted for effects from special items

<sup>2)</sup> Annual average

### ROCE Significantly Improved – Value Contribution Still Negative

We were successful in increasing the ROCE to 6.7 percent during the financial year. This is a clear indication of a considerable improvement in the business situation. How did we achieve this? We accomplished this through the sale of the loss-generating Digital and Web Systems divisions, the lowering of our structural costs by 20 percent, and the increase of our sales in the Press Division. We described the exact effects in detail in the section ‘Net Assets, Financial Position, and Results of Operations’.

We hold operating assets to a minimum through active asset management. As can be seen in the table ‘Operational Assets’, we succeeded in considerably reducing locked up capital – even over and above the effect of the streamlining of the divisions.

We simultaneously thereby reduced our cost of capital by € 47 million. As result of this, the value contribution noticeably improved over the previous year. Although this figure was not yet a positive number this financial year, the improvement from – 9.9 percent to – 3.1 percent confirms that our decisions were correct and we are on true course.

## Strategy – Focus on Value Appreciation

- > **Top Products along the Added Value Chain**
- > **Growth in the Packaging Market**
- > **Heidelberg's Worldwide Presence**

We focus on our core business field sheetfed offset printing, in which we are the world market leader with our products, as well as on the rapidly growing packaging and label printing segment. We continue to be the internationally leading solution provider in the print media industry – no other supplier can offer the integrated workflow that Heidelberg provides. Moreover, we have the most extensive and best service and sales network in the industry. We intend to purposefully further expand these strategic competitive advantages.

### Focus on Company's Own Strengths

Heidelberg has earned a reputation as a reliable partner who ensures a high level of quality in both **production and service** – worldwide. We intend to consolidate and expand this image – to maintain first place when it comes to securing our customers' success. And we will continue to strengthen Heidelberg's position as a technological leader in the future.

We maintain the best and most extensive service and sales network in the industry throughout the world – our staff has direct contact with local printing establishments in more than 170 countries. This is an enormous advantage in reacting adequately to customers' requirements. We intend to further strengthen our presence in **emerging markets** – in the past seven years, the share of these markets in our sales grew by 16 percentage points – in order to take full advantage of the existing potential in these regions. Developments in China confirm that we are moving in the right direction. We are already represented by nearly 500 sales and service employees in that important growth market – not least for that reason we were successful in again further expanding our market shares there!

Qualified and highly motivated **employees** are the foundation of our corporate success. We intend to further intensify our specialized training programs over the next few years.

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**PRINECT**

Comprehensive workflow management system from Heidelberg, which records and optimizes overall print-specific work processes.

### Growth Sectors Spotlighted

With our focus constantly on our customers' added value, we offer **specialty tailored solutions** based on our application and process engineering. For example, we convert existing printing presses to enable printers and finishers to undertake various types of jobs at low cost. We are well prepared for the opportunities available in the rapidly growing package and label printing market. Our printing presses that were developed specially for this market segment satisfy even the widest possible range of customer requirements.

We are purposefully supporting the workflow digitization at printing establishments by means of **PRINECT** – our workflow software, which is able to measurably increase printing establishments' profitability and productivity. Since our Prinect solutions are based on a modular design, not only large printing establishments can benefit from the automation of business processes. Medium-sized and small printing establishments are also able to optimize their workflows based on specially tailored components. Worldwide, we are the only provider of universal solutions, thereby providing our customers with a clear competitive advantage.

Since the sale of our Digital Division, we have no longer been active in the development and production of digital printing presses. Depending on how this market develops, however, in the medium term sales partnerships are conceivable in the digital area.

### The Crucial Factor: the Customer's Benefit

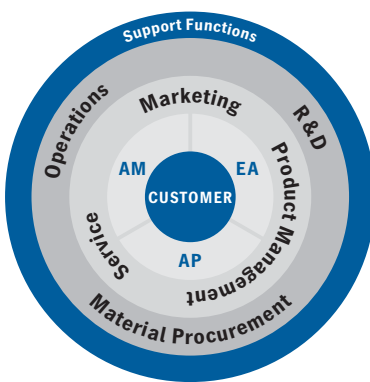
Our goal is to create added value for our customers, on the basis of which they can successfully rise above the competition. Greater flexibility, shorter production times, more automation, and enhanced differentiation – these are the requirements of our customers that we must be in a position to satisfy. We therefore offer our customers future-secure modern technology with the latest in state-of-the-art solutions along the **entire added value chain** – ranging from prepress all the way to finishing, and including workflow, service, replacement parts supply, and specialized further training programs. Our **customer financing** represents an additional major solution component.

We assist our customers with our **systems service** in order to ensure the highest level of efficiency for their printing establishments at all times. What can customers expect from us? Highly trained service technicians who are quickly available locally; an Internet-based remote service with which the problem can already often be remedied online; and a 24-hour replacement parts supply that is unrivaled regarding delivery speed.

Heidelberg's specialized and general training opportunities for printers are unique. With the help of our global **Print Media Academy Network**, our customers are able to keep up to date on the latest developments – and thereby optimize their production process.

## Organization – Focus on Functionality and Market Requirements

- > **Clear Structures**
- > **Customer Requirements Determine Processes**



Around the globe, our customers are assured of on-the-spot support from our sales and service organization. The key to success is the principle: one customer, one personal advisor. Three sales regions manage global service and sales activities worldwide. They work closely with the central functions of the Heidelberg Group.

Following the sale of the Digital and Web Systems divisions, we were able to purposefully focus our organization on our **new strategy** and on Heidelberg's core business. We are maintaining our proven principle of 'one customer, one personal advisor'. Our customers continue to be serviced extremely well. We have streamlined our structures and designed processes to function more efficiently. We have also simplified our processes – in order to achieve this, we have moved away from a division-based organization to one that is purely **functional**.

Already last year, we adapted and streamlined management structures all the way up to the level of the Management Board. We also reassigned the areas of responsibility of the members of the Management Board during the financial year. Board members have assumed both strategic and operating responsibilities, as a result of which they are more closely involved than in the past and are able to take action directly and rapidly.

We intensified local cooperation and the exchange of information with our sales and service companies. Among other things, the Group has assumed some administrative responsibilities on behalf of subsidiaries, primarily in the financial area. We also streamlined the sales management structures, which are now internally organized based on three large regions – The Americas, Asia/Pacific, and Europe.

We described and disclosed the elements and guidelines of our organization in the form of a management system. In doing so, we fulfill both the requirements of the Corporate Governance Code as well as the ISO 9001 norm – Heidelberg has been certified as a corporation.

In order to secure the quality of Heidelberg products on a long-term basis, among other things we have implemented a 'Quality Gate' process. This process systematically integrates nearly all corporate functions within the framework of product development and places the highest priority on customer requirements.

The new organizational structure leaves room for independence – namely, where it is appropriate. That is the case in the Postpress Division, for example, which retained the autonomy it requires to ensure success in pursuing its goals to the best of its ability. A common computer system ensures improved processes. Furthermore, we merged the German Postpress companies within a single legal firm.




# 40 million

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Some





square meters of paper a year – that's what Heidelberg's quickest Speedmaster achieves

## CONTACT-FREE TO PERFECTION.

**Everything all set?** Is the data from prepress OK, the printing plates fixed in place on the cylinders, and the ink and varnish reservoirs filled? Well, then, production can begin. At the touch of a button, the printer starts up the 62 metric tons heavy printing press, and immediately paper sheets are fed through the printing units by means of air-transfer-feeding – contact-free and quick as a wink. After an hour's work, thousands of printed sheets are lying neatly stacked. What's so special about the Speedmaster XL 105? A new color and moistening system ensures that each printing job, even those undertaken at top speeds, excels with a perfect result. Whether traditional printing or surface coating: in terms of productivity, profitability and quality, this printing press sets the standard for an entirely new performance category.



The new Speedmaster XL 105 can print

up to **18,000** sheets per hour.

**Did you already know** that when combined with the Prinect Workflow System, the Speedmaster XL 105 can increase productivity by up to 30 percent?

## Research and Development – Spotlight on Market-Oriented Solutions

- > **Product Offensive with Over 50 Innovations**
- > **R&D Strategy Confirmed by Customers**

In May 2004, we presented over **50 product innovations** at drupa. One focus of our attention during the financial year was to reliably bring these new products and product extensions to production startup or to series production. We also further developed our products and launched new R&D projects.

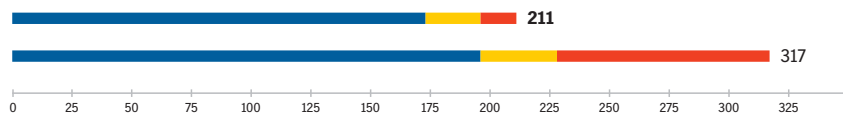
In the Reports of the Divisions, we go in detail concerning innovations as well as their market opportunities and potential. The favorable feedback from customers confirmed that we are following the correct R&D strategy and establishment of product specifications.

### RESEARCH AND DEVELOPMENT COSTS

2004/2005

2003/2004

Figures in € millions



■ Press	<b>173</b>	<b>-12 %</b>
■ Postpress	<b>23</b>	<b>-28 %</b>
■ Financial Services	-	-
<b>Continuing Operations</b>	<b>196</b>	<b>-14 %</b>
■ Discontinuing Operations	<b>15</b>	<b>-83 %</b>
<b>Heidelberg Group</b>	<b>211</b>	<b>-33 %</b>

### R&D Rate of 6 Percent – Processes Further Improved

We invested a total of € 196 million (continuing operations) in research and development, which corresponds to an R&D rate of 6 percent. This rate is lower than in the previous year, when we were vigorously promoting product innovations for drupa.

Of course, we also made efforts to improve research and development processes and procedures. We therefore restructured the management of the product lines within the framework of Heidelberg's overall realignment. A body of experts from R&D, Product Management, Controlling, Manufacturing, and Service now determines the direction of future developments in advance. These experts' decisions are, among other things, based on market analyses, economic viability considerations, and our technology roadmap – the latter describes our long-term development goals that will be necessary to satisfy future customer requirements. Product models that are no longer in line with market conditions are purposefully cancelled. This approach makes it possible for us to reduce the complexity of our products – and thereby our costs as well.

## EMPLOYEE QUALIFICATIONS

Share in percent

04/05

University degree	25
Specialized college degree	25
Technical or master craftsman diploma	18
Skilled workers	26
Commercial training	6
<b>Total</b>	<b>100</b>

We undertake cooperation agreements with other companies – among others, for reasons of efficiency. We also work together with numerous banks, universities and other organizations worldwide.

### Highly Qualified Employees: Patents for 156 New Inventions Registered

At financial year-end, a total of 1,524 employees, or 8 percent of the total staff, were active in research and development. Work here focuses on mechanics, electrical engineering, software, and engineering support – the latter including such varied areas as lab work as well as work on printing technology, on documentation, in the CAD area, and on simulations of fluidic and mechanical structures.

The quality of our work stands and falls with the **qualifications of our R&D employees**. Half have university or specialized college degrees, and through training and university studies, nearly 30 percent of our engineers have qualified for two specializations.

Studies in engineering are the foundation for an ability to develop our complex products, and continuous specialized further training is the prerequisite for successful R&D projects. We consequently also continued offering our Project Manager Development Program during the financial year. This program provides participants with the capabilities and knowledge that are necessary to implement significant and strategically important product development projects.

Our R&D employees applied themselves with a high level of motivation, and with their above-average performance have maintained Heidelberg's competitive edge in technology. A clear sign of this is our announcement of 156 patents for new inventions during the financial year. Heidelberg had a total of over 5,500 pending and granted patents throughout the world as of March 31, 2005.

### Close Cooperation with Customers – Equipment Optimization

All our R&D projects **focus on the customer**. That is why we work together closely with future end-users. The goals and visions of the development, the concepts, and the qualities of the products are discussed with potential customers at an early stage. We take into consideration ideas that result from this in the development and project roadmap as well as in the performance specifications of the individual products. In the course of product development, in practical tests we process actual customer orders on the new printing presses. This approach makes it possible for us to monitor whether we are attaining the project goals while still within the development process, and to adjust further development accordingly.

In the final stage, in field tests selected customers examine our products 'with a fine-toothed comb'. The feedback from practical and field tests play a major part in the decision on whether a product is ready for the market and series production can be initiated.

### **Product Developments Offer Added Value in All Areas**

We are developing more and more cross-product functions to support our customers in boosting their **productivity**. Beginning in the reporting year, for example, plate production in the prepress area can be initiated with a single keystroke on the printing press.

We make use of our flexibility and support our customers' requirement for differentiation. During the financial year, we developed and installed numerous customer-specific printing presses. An outstanding example is the world's longest sheetfed printing press, which has 16 units – printing, varnishing and drying – and which we delivered in the US at the end of 2004.

However, we do not only offer personalized solutions on a large scale but on a small scale as well. We are developing more and more applications and process engineering solutions, with which our customers can attain greater added value using existing printing presses.

Especially in view of the shortage of skilled workers, **user-friendliness** is a condition that we must meet in all developments. Our customers have confirmed to us that so far, we have completely reached this goal.

**Minimal environmental pollution** in manufacturing and production is also one of our declared goals. For example, our new Speedmaster XL105 requires 5 to 8 percent less energy for each printed area. During the financial year, we launched EcoColor for the Printmaster PM74, which makes it possible to print without alcohol.

In order to ensure quicker service reaction times in case of an error, we further expanded our Internet-based service tool. Every one of Heidelberg's products can be linked with our Remote Service, which makes it possible for our service technicians to identify and remedy the cause of a problem by means of remote diagnosis. As a side note, we received the Technical Safety Certificate for this service from TÜViT GmbH during the financial year.

## Investments – Strategic Goals Pursued Further

- > **Product Startups Have High Priority during the Financial Year**
- > **Supporting the Future Reduction of the Cost of Manufacturing**

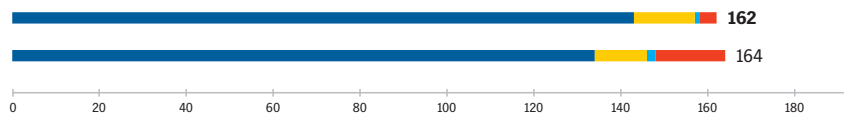
Our business picked up renewed steam during the financial year. We also increased our investments – the overall volume of investment in continuing operations rose over the previous year by 7 percent to € 158 million; our investment ratio amounted to 5 percent of sales. We primarily focus on starting up series production of new innovative products and further product developments, which we presented at drupa in May 2004. Furthermore, we assigned high priority to consolidating resources within the framework of our restructuring program and enhancing ongoing series-produced goods. Details concerning investments in the divisions and individual projects can be found on pages 55 to 63.

### INVESTMENTS

Figures in € millions

2004/2005

2003/2004



■ Press	<b>143</b>	+ 8 %
■ Postpress	<b>14</b>	+ 17 %
■ Financial Services	<b>1</b>	- 50 %
<b>Continuing Operations</b>	<b>158</b>	+ 7 %
■ Discontinuing Operations	<b>4</b>	- 76 %
<b>Heidelberg Group</b>	<b>162</b>	- 1 %

### Production Improved: Machinery Replacement and HPP Project

We generally replace machinery and technical equipment with considerably more productive installations when the optimal replacement time is reached for such installations from the technical and economic point of view. We invested approximately € 19 million during the financial year in order to replace older equipment generations. Our investment requirements in the manufacture of components was lower than the previous year, as already implemented structural streamlining resulted in optimized capacity utilization. On this basis, the manufacturing areas can develop further on an up-to-date basis in the direction of process orientation. The consequence? Both our **productivity** and flexibility are increasing while the cost of manufacturing is being reduced on a sustained basis!

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**PULL PRINCIPLE**

Demand-oriented production control.

The **High Performance Production** project (HPP 2006) has been in operation since July 2003. Here as well, increasing productivity is our most urgent goal. We are accomplishing this through the uncompromising implementation of synchronous logistics based on the **PULL PRINCIPLE** and a focus on added value activity. This strategy results in two significant advantages: on the one hand, turnaround times and inventories are thereby reduced, while on the other hand we can react more rapidly to customer requirements. We are simultaneously reorganizing procedures and systems within the process of product creation. In this manner, we lay the groundwork for even more efficiently meeting future market requirements. The HPP project will be concluded in 2006. This will require an overall volume of investment totaling some € 9 million, of which € 2 million was undertaken during the financial year. The resulting sustained cost reduction will be in the area of double-digit million euros.

**Investment Activity Optimized: Global Planning System,  
Make-or-Buy-Analyses and Leasing**

All planned investments are consolidated in our worldwide uniform planning system, which forms the basis of our focused financial management. We are continuously pursuing and monitoring planned investments – primarily in view of whether they decisively serve Heidelberg’s strategic goals. We undertake a make-or-buy analysis prior to every decision for capital goods investments. Moreover, all these decisions are examined by a team consisting of engineers and financial specialists.

In order to reduce the capital commitment and short-term outflow of funds to the greatest possible extent, we make use of **leasing** as a form of financing whenever doing so would be economically feasible. The importance of leasing is increasing, not only for the car fleet but at an especially rapid pace in the IT area – not least because innovation cycles are very short in this segment and we attach the highest priority to having the latest in communications technologies. Among other things, during the financial year we fine-tuned the structures of our data center in Wiesloch in line with the requirements of all of Heidelberg’s Internet-based applications and launched a new uniform office infrastructure worldwide. Hardware and software components accounted for 20 percent of additions to fixed assets, a considerably lower share than in the past.



## Procurement and Logistics – Long-Term Concepts

- > **Intensive Market Observation**
- > **Expansion of Electronic Order Processing**

With the upswing of our sales, our cost of materials also further increased. We thus recorded an increase in procurements for continuing operations from € 1.2 billion to € 1.4 billion. Primarily due to exchange rate effects, the increase was thereby proportionately slightly higher than the growth of the comparable total operating performance.

Steel and oil were subject to high rates of inflation during the financial year – and thereby, all oil-based products as well. Although we were also affected by the substantial price increases, we nevertheless succeeded in reacting quickly to these developments. We were able to implement necessary measures in order to limit the overall impact. Thus, the overall result was hampered by only an additional € 5 million in the past financial year.

### **Global Procurement and Close Cooperation with Suppliers**

We again benefited from the advantages of the **global procurement market** during the financial year – in particular, the opportunities resulting from the eastward expansion of the EU. Many of our systems suppliers have built up manufacturing networks in this region. Although they now take advantage of low cost regions, they are aware of our quality requirements for supplied parts and ensure that these are met.

### **Optimizing Deliveries and Inventory**

Our suppliers must meet our high technical and qualitative standards and also be in a position to realize and promptly provide product change management – even if changes in our production occur due to fluctuations in demand. We emphasize the prompt delivery of parts in order to lower inventory costs. Our **just-in-time deliveries** are subject to continuous further optimization – it is obvious that this requires very close cooperation with our suppliers as well as automation and the meshing of processes.

Our consignment warehouses serve us well. We make warehouse space available to the supplier, who fills it up based on our planning requirements. The goods remain the property of the supplier until they are removed from the warehouse due to assembly requirements. We thereby always have access

to secure supplies without the need to hold our own safety stocks. During the financial year, we therefore extended our consignment warehouse concept to larger component parts as well.

### **Strategic Purchasing: Making Full Use of Resources**

The purchasing process is planned meticulously at Heidelberg. We make systematic use of electronic support systems. This frees up capacities that can be utilized to pursue strategic goals – for example, to fully take advantage of savings potential and vigorously implement quality improvements.

We meanwhile transact more than two-thirds of all orders on an electronic basis – either as direct data transfers (Electronic Data Interchange) or by means of an Internet platform in the case of smaller orders. Beside traditional procurement methods, in the search for capable suppliers we also make use of Internet marketplaces.

We lowered processing times and costs by means of standardized master agreements with suppliers. Moreover, all the Group's departments can now order such standard products as IT consumables, tools, and electronic components in catalogs within the system; an authorization system ensures security.

### **Even Better Spare Parts Service through New Spare Parts Warehouse in the US**

We also pull ahead of our competitors due to our ability to more quickly supply our customers with spare parts worldwide. Over the past five years, we considerably expanded the number of various spare parts that we carry in stock, thereby substantially improving our ability to continually ensure deliveries. We successfully further increased over the previous year the share of direct shipping from our **World Logistics Center** (WLC) for Europe to the current figure of 91 percent. The overall volume of shipments from the WLC increased by 8 percent to a total of approximately 270,000 shipments. Despite the fact that the volume of shipments has grown by 26 percent in the past four years, our costs have fallen by 24 percent!

In May 2004, we launched our new Americas Logistics Center (ALC), which operates within a free trade zone situated in Indianapolis, Indiana – here, we only need to arrange customs formalities when the goods are shipped. As with the WLC, the ALC makes it possible for us to provide a highly efficient, IT integrated spare parts supply chain, which ranges from the final customer all the way to the manufacturing plant. We fill approximately 10,000 orders a month at the ALC – 99.85 percent of which are already shipped on the day the orders arrive.

## Employees – Improved Competitiveness

- > **Pact Signed to Secure the Future**
- > **Intensive Sales Training, Service Improved**
- > **Independent Learning Encouraged**

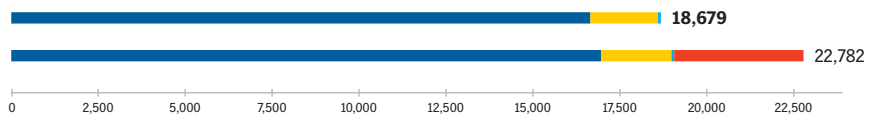
Our personal and social policies focused on highly varied areas during the financial year. Sales personnel were trained to ensure that staff could optimally present new products to our customers. We increased our investments in qualification enhancement and human resource development for members of senior management in order to enhance employees' loyalty to the Company on a long-term basis. Furthermore, over a period of several months we held negotiations with the employee representatives, with the goal of increasing flexibility in production – and most importantly, in order to maintain a competitive cost of manufacturing.

### EMPLOYEES

Number of employees

March 31, 2005

March 31, 2004



■ Press	<b>16,653</b>	- 2 %
■ Postpress	<b>1,946</b>	- 4 %
■ Financial Services	<b>80</b>	- 6 %
<b>Continuing Operations</b>	<b>18,679</b>	- 2 %
■ Discontinuing Operations	<b>0</b>	-
<b>Heidelberg Group</b>	<b>18,679</b>	- 18 %

### Number of Employees Cut Back Due to Reorientation

The number of our employees fell again considerably during the financial year. As of March 31, 2005 we only had 18,679 employees worldwide – as you can clearly see in the graph, this 18 percent decline resulted primarily from the sale of the Digital and Web Systems divisions. We have already streamlined our internal structures and adapted them to our new strategic alignment. Overall, since March 31, 2002 our staff therefore was reduced by 6,665 employees, of which some 3,700 due to the deconsolidation of discontinuing operations. That represents an overall decline of 26 percent! Of the various regions, primarily the Europe, the Middle East and Africa, and the North America regions were affected by the decline, since the deconsolidated areas had their production sites in these parts of the world.

**EMPLOYEES BY REGION<sup>1)</sup>**

Number of employees

	03/04	04/05
Europe, Middle East and Africa	16,329	14,275
Eastern Europe	750	745
North America	3,271	1,355
Latin America	393	389
Asia/Pacific	2,039	1,915
<b>Heidelberg Group</b>	<b>22,782</b>	<b>18,679</b>

<sup>1)</sup> By company plant locations; including discontinuing operations

**Agreement to Secure Competitiveness Signed**

We have already considerably reduced our structural costs – although in view of the unfavorable development of raw material prices and exchange rates, still not yet adequately. In January 2005, we therefore undertook negotiations with the employee representatives in order to also lower production costs. At the end of April, following difficult negotiations we came to agreement on a comprehensive solution package that secures jobs while taking market dynamics into consideration and which is acceptable to all the parties. This agreement basically remains in effect through March 31, 2008 and applies to the Group's German plants – 68 percent of our employees work in Germany. What are the key points of this comprehensive solution?

Working time has been lengthened by approximately 5 percent, with no change in wages or salaries. The overtime premium will in general no longer be paid, and there will be more possibilities for flexible working times. The volume of special payments by the Company has been reduced and the method of calculation revised. Additionally, key points for the introduction of a Master Compensation Agreement ('Entgeltrahmenabkommen') in 2007 were arranged. Within the framework of this agreement, increases for 2007 provided for under the collective bargaining agreement will be credited against components that go beyond standard provisions. The Management Board and the executive staff will also make a comparable contribution through reduced income.

Since in this manner we ensure our **ability to meet the challenges of the future**, we can continue to invest in our German plants. We have pledged among other things to maintain a training ratio of at least 6 percent in Germany and intensify specialized further training over the next three years. We will also forego significant shifts in production or operations-related terminations over the next three financial years.

**New Forms of Compensation and More Flexible Working Times**

On July 1, 2004 we launched the Time Offset Account – a new working time model that makes it possible to accumulate overtime on a long-term basis. In line with the slogan 'flexibility grants security', the Time Offset Account ensures that our capacities will enjoy additional flexibility. On the other hand, with this model employees can balance out economic fluctuations without a loss of income.

We preserve proven tools and instruments to enhance motivation – including our Balanced Score Card System and the annual discussion with the employee. Our employee share participation program was again quite popular during the financial year, with approximately 86 percent of eligible employees buying up to five Heidelberg shares at favorable terms.

### **Specialized Further Training for Service and Sales:**

#### **A Benefit of the Print Media Academy**

Our excellent worldwide service puts us far ahead of our competitors. Due to the launching of many new products and product range expansions in the market, the training requirements for Service and Sales were substantial during the financial year.

Through sales training programs we succeeded in expanding our business with supplies. Advising our customers in the areas of applications and process engineering also played an important part in the specialized training program during the financial year. Since the significance of business with used printing presses has increased throughout the world in recent years, we also educated and trained our sales staff especially for this market.

### **One Focus of Specialized Further Training:**

#### **Independent Learning by Employees**

The trend to independent learning has strengthened. We make increasing use of alternative learning methods in this area – for example, special e-learning programs. We also promote learning within networks. In place of costly external or internal seminars, we make it possible for employees to inform themselves about various issues and to develop common solutions within the framework of project work. The number of specialized further training days in Germany rose by 6 percent.

### **Reintroduction of Management Development Programs**

In the previous two years, in order to reduce costs in the short-term we had largely terminated the programs for developing members of senior management. However, these programs were reintroduced during the financial year. Beside the professional and personal further development of participants, the various development programs aim at enhancing the bonding of motivated employees with Heidelberg. We intend to acquire especially suitable junior executive employees for our Company in order to benefit from an extensive fund of experience that extends beyond country and regional borders.

### **Improved Compatibility of Professional and Family Life**

An equally important factor in the competition for highly qualified and motivated personnel is ensuring that professional life is compatible with family life. With this in mind, we launched a telecommuting initiative during the financial year. We also expanded the possibilities of engaging in part-time work.

### **Average Training Ratio at 6 Percent**

The Heidelberg Group had on average 780 trainees during the financial year, of which 656 were active at Heidelberger Druckmaschinen Aktiengesellschaft. This represents a training quota of 6 percent. We train young people in a total of 18 various apprenticeship-based trades and areas of study. We also offer dual education possibilities for university studies in cooperation with vocational and technical colleges.

### **Suggestion Program: Participation Attractive for Employees**

We revised our suggestion program during the financial year, creating additional incentives for our employees to become active. For example, a car was raffled off as the main prize among the 1,380 most 'inventive' participants.

Of the some 12,000 employees eligible to take part in the suggestion program, approximately 12 percent participated, submitting some 3,700 suggestions for which we disbursed premiums to employees of around € 300,000. Nearly € 3 million in cost reductions resulted from suggestions for improvement during the financial year.

### **Expression of Thanks by the Management Board**

We know that a substantial commitment was again required from our employees during the financial year. In the run-up to drupa, a considerable commitment was necessary from employees – simultaneously, the programs for working time reduction due to the collective bargaining agreement covering job protection were still in effect, and there was short-time work. The order books were full after the conclusion of drupa, as a result of which new products and various product models had to be brought to reliable series production. Simultaneously, the cost reduction measures according to which we cut back additional jobs continued to be in effect. The Digital and Web Systems divisions were sold and were excluded from the global organization.

We would like to thank our employees, who despite everything, with their commitment and high level of motivation contributed to Heidelberg's long-term success. We wish to thank in particular our staff representatives with whom we wrestled to find solutions for the reduction in manufacturing costs and who constructively assisted in introducing far-reaching human resources measures.



120,000

different

11

12



spare parts are awaiting deployment at the Wiesloch World Logistics Center

13

14



**ONE ONLY NOTICES HOW IMPORTANT A SMALL SCREW IS WHEN IT GOES MISSING.**

**It's the middle of the night.** The darkness is only interrupted by a light falling from the warehouse gates. A quiet purr can be heard now and then – a sound that reminds one more of a cat than of a storage retrieval unit. And voices, which seem to be somewhat louder in the night than in the bright sunlight. A truck approaches Warehouse 55 with sonorous motor sound, loads a package, and vanishes again towards Frankfurt Airport – and soon an urgently needed spare part for a customer in Kuala Lumpur is already on its way by air. Our service staff does not keep office hours. At most one hour following our receipt of a request, we send the spare on its way – day and night. Because speed and reliability are important, so that customers can again get their printing establishments into operation as quickly as possible.



We send out **1,100** shipments

of spare parts a day from Wiesloch – every year, we ship some 1 million spare parts to 170 countries on five continents.

**Did you already know** that since May 2004 we have been supplying our North American customers directly from our Americas Logistics Center in Indianapolis with approximately 600 spare part shipments a day?

## Press – Solutions that Are in Demand

- > **Product Offensive at drupa**
- > **Series Production of the Speedmaster XL 105 Launched**
- > **Despite the Costs of drupa: Earnings Exceed Previous Year's Figure**

<b>PRESS</b>		
Figures in € millions		
	03/04	04/05
<b>Incoming orders</b>	2,807	3,087
<b>Net sales</b>	2,670	2,797
<b>Order backlog</b>	680	966
<b>Number of employees</b>	16,957	16,653
<b>Investments</b>	133	143
<b>Research and development costs</b>	196	173
<b>Result of operating activities<sup>1)</sup></b>	151	183

<sup>1)</sup> Before special items

The Press Division, our important core business area, includes all the components, products and solutions for Prepress as well as sheetfed offset, packaging, and flexo printing. We are the world market leader in sheetfed offset printing presses. We are continually further expanding our position in package printing – a segment that remains relatively untouched by cyclical fluctuations.

### Product Innovations Enhance Heidelberg's Number One Market Position

We were represented at drupa at the beginning of the financial year with a true product offensive – with success! The favorable reaction of customers shows that our new products and product models came to market at exactly the right time.

We have again set new standards for industrial offset printing in terms of productivity, quality and profitability. As the first printing press in a completely new performance category, the **Speedmaster XL 105** is ideal for package printing with long print runs due to its high degree of automation, its large print format of 74 × 105 centimeters, and its ease of use. Based on our innovative system for the contact-free sheet transport and innovations in the area of coating application, printing establishments can boost their productivity by up to 30 percent. Additional innovative solutions such as 'Autoplate Advanced' for easy and register-accurate plate changes additionally enhance profitability.

With our **Speedmaster CD 74-P**, which is outfitted with a perfecting device, end-users achieve a 15 to 25 percent boost in productivity compared with conventional medium-format straight and perfecting printing machines. This model makes it possible to quickly switch between paper and cardboard printing as well as between straight printing and perfecting printing. The target group for this printing press comprises commercial printing establishments with a broad range of print stock as well as label and package printing establishments that also print packaging on both sides – for example, in the cosmetics industry.



All our printing presses are based on modular designs – an advantage in that we can also use the features of higher-quality printing presses – for example, of our innovative feeders and cantilevers – together with other solutions.

#### **Integrated Workflow – An Important Stand-Alone Feature**

In addition to printing presses, finely tuned and integrated solutions are becoming ever more attractive for our customers. Our customers are increasingly concerned with remaining ahead of their competitors – and it is precisely here that we offer solutions that measurably increase the productivity and profitability of printing establishments. None of our competitors can offer the quality of integrated workflow that we do! Heidelberg is unique in providing this solution.

During the financial year, our drupa presence as well as many of our corporate trade shows focused on the innovations of Prinect Systemhaus. The immense interest shown by our customers confirms that this approach was correct. Our ‘Prinect Experience Tour’, during which participants could progressively follow the creation of a virtual printing job through to final production, was highly popular.

Since **Prinect** – as well as our printing presses – is based on modular designs, even small and medium-sized printing establishments can arrange for an appropriate and profitable solution, which in case of need can be subsequently expanded.

### Financial Year 2004/2005 in Figures

The print media industry as a whole recovered somewhat during the financial year – and we were present with our product offensive at just the right time! This was reflected in the outstanding volume of **incoming orders**, which adjusted for foreign currency changes reached € 3,087 million in the financial year – 12 percent higher than the previous year's figure. Over the year as a whole, we were highly successful, among others, with our Printmaster series, with which we precisely satisfied our customers' requirements for superb and reliable print quality on a limited investment budget.

After adjusting for foreign currency changes, **sales** of € 2,797 million were 7 percent higher than the previous year's figure. These figures also include the sales of the Gallus corporate group as well as our remaining web offset sales.

In sheetfed offset, our 70 × 100 format developed especially favorably – demand for this format category was especially strong in Asia.

drupa also had an enormous impact on our **order backlog**. As of financial year-end, the order backlog amounted to € 966 million – a substantial 42 percent increase over the previous year. This ensures a high level of capacity utilization for the first few months of the financial year.

We continued implementing our efficiency-boosting measures, as a result of which the number of **employees** in this division fell to 16,653.

**Investments** in this division of € 143 million slightly exceeded the previous year's level. As is discussed on page 44, we had to lay the foundation for launching series production of the new products. In addition, we replaced older generations of machinery in the production process. For example, in Amstetten we replaced the old production facility for the preprocessing of large cast cylinders. The total investment volume of this first stage amounted to approximately € 20 million, with € 8 million incurred during the financial year.

During the previous year, our **research and development costs** were very high due to the preparation for drupa. These expenses also reached a high level of € 173 million during the financial year.

We were successful in increasing the **result of operating activities before special items** to € 183 million, reaching a return on sales of 6.5 percent – despite the fact that the financial year includes all the considerable costs for drupa and that the underlying conditions for this division were not without complications. The figure also shows that our measures to reduce structural costs were effective.

## Postpress – New Product Generation

- > **Postpress an Important Factor for Differentiation**
- > **New Developments Meet Customer Requirements**
- > **Result Improves from € –18 Million to € –2 Million**

<b>POSTPRESS</b>		
Figures in € millions		
	03/04	04/05
<b>Incoming orders</b>	355	359
<b>Net sales</b>	359	348
<b>Order backlog</b>	69	80
<b>Number of employees</b>	2,022	1,946
<b>Investments</b>	12	14
<b>Research and development costs</b>	32	23
<b>Result of operating activities<sup>1)</sup></b>	–18	–2

<sup>1)</sup> Before special items

High quality finishing is becoming an increasingly important factor for the added value of printing establishments. Production measures that follow the actual printing process lend the print product its final form as well as its ultimate, often crucial finish. Printed products overall are becoming increasingly lavish in order to attract attention. Packaging makes an important contribution to brand name establishment, for example. The competitive position of our customers accordingly improves if they are able to offer product differentiation combined with top quality and reasonable prices.

### New Products Extremely Well Received

We introduced a completely new product generation at drupa in May 2004, thereby precisely meeting the requirements of the market. Our new product developments ensure top quality, they are highly efficient, and they permit a wide variety of applications.

Series production of our new folding machine generation **Stahlfolder TH/KH** was launched in September 2004. Thanks to their numerous variations, these folding machines are appropriate for printing establishments of all sizes as well as for finishing specialists. Customers also thereby have more opportunities for differentiation and specialization.

In November 2004, series production of the **Stitchmaster ST 350** was also launched – an economic and flexible gatherer-stitcher for printing establishments and finishing specialists. This model is especially attractive due to its outstanding production capacity; it ensures high processing quality and reliability with distinctive ease of use.

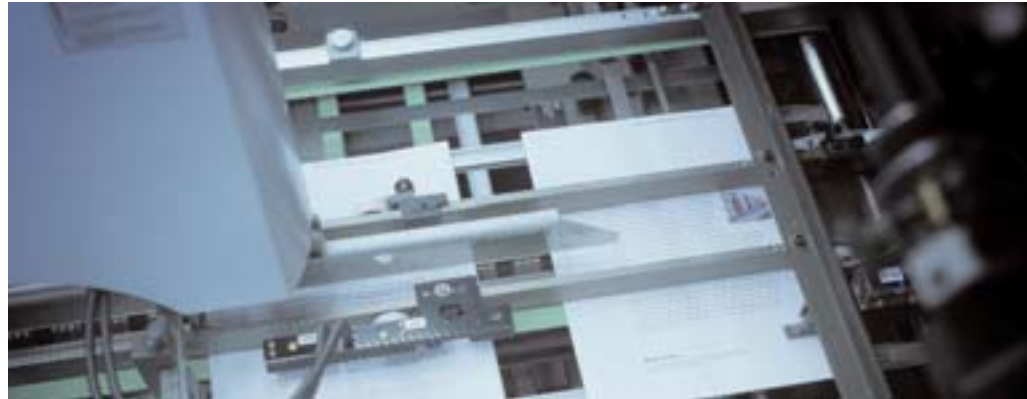
Not only our offerings at drupa were well received. The prototype of our new generation of highly automated adhesive binders was enthusiastically received by customers. We introduced this product for the first time at the corporate trade show ‘Postpress-Inforum’ in Leipzig. In view of the increasing numbers of printed products that require high-quality binding, the market opportunities of the **Eurobind 4000** are obvious.

### Networking: A ‘Must’ in Finishing

One significant competitive advantage of our new products is that – via **JDF** – they can be fully integrated into the workflow. Our customers must fill orders at an increasingly rapid pace – in other words, they must work more and more

#### JOB DEFINITION FORMAT (JDF)

Makes possible the uninterrupted, manufacturer-independent integration of all order-related and computer-supported processes.



efficiently. Print-runs are decreasing – while resetting efforts are increasing. Final customers expect their product to attract attention – the more flexibly our customers can utilize their machinery, the better. Complete networking is indispensable if this is to be realized while at the same time generating appropriate margins. Networking ensures trouble-free processing with simultaneous cost transparency.

#### Financial Year 2004/2005 in Figures

Overall, during the financial year the market did not develop as strongly as had originally been projected. This was largely attributable, among other things, to the weak US dollar. The United States is a principal market for finishing products. Our products' prices rose in that country due to exchange rate effects. We nevertheless generated more orders in the US market than in the previous year – which confirms that our products precisely meet the needs of our customers. However, **incoming orders** of € 359 million were only slightly higher than the previous year's figure.

**Sales** reached € 348 million – after adjusting for foreign currency changes, approximately the previous year's figure. This development was primarily due to the modest decline in packaging printing presses and mailroom systems. Overall, this resulted in a larger **order backlog** of € 80 million.

Our **research and development costs** were very high in the previous year due to our extensive preparations for drupa. During the financial year, the R&D rate was again nearly 7 percent. **Investments** amounted to € 14 million. The number of **employees** fell by a further 76 due to our plant consolidations.

The **result of operating activities before special items** of € –2 million represents considerable improvement – a clear success of our measures to enhance efficiency.

## Financial Services – An Important Sales Instrument

- > **Worldwide Presence with Print Finance Companies**
- > **High Financing Volume Outsourced Again**
- > **Interest Income Declines, But Result Continues to be Positive**



Global locations of the Print Finance Companies.

We merged our customer financing activities within their own division for the first time during the financial year – although Heidelberg has already had over 15 years of experience in this area.

Why did we redefine this area of business activity? On the one hand, the decision rested on the conviction that by showing our customer financing separately, we can considerably increase the transparency of reporting. On the other hand, our ‘Customer Financing’ solution component is more and more often proving to be a crucial **competitive advantage**. In rapidly growing emerging markets, financing for medium-sized firms is frequently not available at all or only insufficiently available. And in numerous industrialized countries, new overall conditions – for example, Basel II – have resulted in a more restrictive financing policy by banks in recent years.

### Principles Underlying Customer Financing at Heidelberg

Heidelberg adheres to three principles in customer financing:

- > We see ourselves primarily as intermediaries between financial providers and customers. With our financing expertise, we support our customers in an advisory capacity. We only provide financing if no other sources are available to the customer – for example, because the credit market in the respective country is in the process of being created or banks are very restrictive in lending to our medium-sized customers.
- > The credit standing of the customer and the customer’s financing structure must reflect a reasonable risk.
- > We outsource financing to the greatest possible extent. With this in mind, we are continually expanding our cooperative agreements with German and international partners.

### Focus on Risk Minimization

Financial arrangements are associated with particular longer-term risks, especially in economically or politically uncertain environments. We therefore systematically monitor foreign currency and default risks.

Our global network of print finance companies is unique in the industry. As can be seen from the graph on page 60, we cover various foreign currency zones with this service, and can thus provide financing that ensures neutral foreign currency risk. We largely transact financing in the major trading currencies (see also the outline on page 39 in 'The Figures').

Our industry expertise and close customer relationships put us in a position to competently assess risks of default. In addition to cash flow, our approach is to also take into account the printing establishments' specific key factors for success, such as the workflow and the quality of the management. Our risks are manageable, since as a matter of principle we retain ownership of the machinery as collateral and additionally operate an international network for the resale of used printing presses.

We have also created and implemented worldwide a comprehensive risk assessment system. We discuss this issue in more detail in the Corporate Risks section starting on page 71.

### Financial Year 2004/2005 in Figures

In order to design our reporting in a transparent manner, all components of this segment are shown in the operating result. Accordingly, interest revenues are included under net sales, with refinancing costs set off as cost of materials. The previous year's figures were accordingly restated.

The goal of our customer financing business is to generate equipment sales – as well as to simultaneously create **sustainable risk structures** in the credit portfolio. This includes the earning of income out of financing transactions to cover possible defaults.

Although some 30 percent of our sales volume during the financial year arose from the arranging of credit and the provision of own financial arrangements, we were able to again considerably reduce our **accounts receivable from customer financing** by 27 percent. This was possible due to the close cooperation with our partners and the sale of a portion of the portfolio.



## Financial Services

## FINANCIAL SERVICES

Figures in € millions

	03/04	04/05
<b>Sales (interest revenue)</b>	85	62
<b>Cost of materials (interest expense)</b>	25	17
<b>Gross profit (net interest)</b>	60	45
<b>Other costs/income</b>	19	19
<b>Result of operating activities<sup>1)</sup></b>	41	26
<b>Number of employees</b>	85	80
<b>Investments</b>	2	1
<b>Accounts receivable from customer financing</b>	769	565
<b>Provision for risks</b>	183	142
<b>Acquired counter- liabilities</b>	286	309

<sup>1)</sup> Before special items

By contrast, during the reporting period **acquired counter-liabilities** rose by only 8 percent to € 309 million. As a further helpful sales promotion instrument, we increasingly arrange financing for our customers with banks under government export credit insurance. We were again highly successful in this area during the financial year – not least thanks to outstanding cooperation with responsible officials of the German Federal Government. We thus completed a master cooperation agreement with banks for Russia, which is covered by the export guarantee firm EulerHermes Kreditversicherungs AG.

We generated **interest income** (classified as **sales**) of € 62 million – 27 percent less than the previous year and a direct consequence of the above-mentioned outplacement measures. Together with decreased **interest expense** (classified as **cost of materials**), this resulted in a **gross profit** of € 45 million – 25 percent lower than the previous year. This division generated a gratifying overall **result of operating activities before special items** of € 26 million.

Due to the slight decline in the portfolio risks and the falling volume of credit, our **provision for risks** was reduced by 22 percent to € 142 million.

A total of 80 **employees** are active in the Financial Services Division worldwide.

## Discontinuing Operations – Loss-Makers Divested

- > **Digital and Web Systems Divisions Divested**
- > **No Future Burden on the Operating Result**

<b>DISCONTINUING OPERATIONS</b>		
Figures in € millions		
	03/04	04/05
<b>Incoming orders</b>	605	192
<b>Net sales</b>	632	153
<b>Order backlog</b>	204	–
<b>Number of employees</b>	3,718	–
<b>Investments</b>	17	4
<b>Research and development costs</b>	89	15
<b>Result of operating activities<sup>1)2)</sup></b>	–95	–40

<sup>1)</sup> Before extraordinary measures

<sup>2)</sup> Additionally, a pro-rata loss of € 8 million (previous year: € 68 million) was realized on the NexPress joint venture during the financial year, which is included in the financial result.

In connection with the Heidelberg Group's strategic reorientation, in the previous year we came to the decision to divest the Digital and Web Systems divisions. We completed the sale during the financial year as follows:

- > The contract with the Eastman Kodak Corporation covering the sale of the Digital Division went into effect on May 1, 2004. This agreement covers the production, service, and sales of digital printing presses. We arranged for a performance-based purchase price under the contract. Since demand in the digital printing segment continued to be restrained, we did not book any payment during the financial year. We anticipate a payment of a maximum of 75 million US dollars for 2005.
- > The contract with Goss International Corporation covering the sale of Web Systems went into effect on August 6, 2004. This transaction, whose financial details the two parties agreed not to disclose, includes the Commercial Web and Newspaper Printing Press business areas as well as processing installations for web printing presses in the US. We hold a 15 percent share in Goss International Corporation. Moreover, in some countries we continue to maintain sales and service operations for web printing presses. Sales proceeds and earnings from this business segment are included under the Press Division shown on page 55.

We continued to be active in the divested areas right up to the time the contracts went into effect, thereby generating **incoming orders** of € 192 million and **sales** of € 153 million. **Investments** as well as **research and development costs** were already relatively low. Digital and Web Systems were a burden on the Group for the last time, generating a loss of € 40 million, compared with € 95 million the previous year. The extent to which the sale of the two divisions improved our consolidated result can be clearly seen when the pro-rata loss of the NexPress joint venture of € 68 million, which was included in the financial result the previous year, is also taken into account.

## Regions – Developments Largely Favorable

- > **Systemservice Concept Launched Worldwide**
- > **Print Media Industry Recovers Modestly in Industrialized Countries**
- > **Incoming Orders Increased in All Regions**

<b>SALES AND MARKETING SPECIALISTS BY REGION<sup>1)</sup></b>		
Number of employees		
	03/04	04/05
Europe, Middle East and Africa	3,625	3,369
Eastern Europe	745	745
North America	1,263	1,263
Latin America	362	389
Asia/Pacific	1,889	1,915
<b>Heidelberg Group</b>	<b>7,884</b>	<b>7,681</b>

<sup>1)</sup> Continuing operations

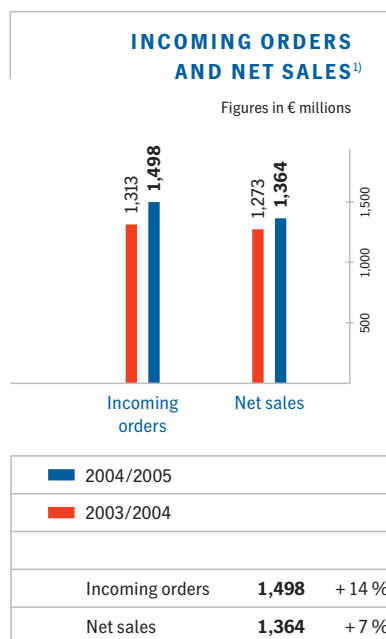
We streamlined our sales management structures during the financial year, bundling our activities – in terms of their organization – into three large regions. In order to continue clearly showing individual developments and retain our transparency, as in the past we continue to report on developments in the five regions.

As a result of our streamlining processes, boosting efficiency, and merging regions, we were able to reduce the number of administrative employees working in the individual sales and service companies while simultaneously retaining the high quality of our customer support. We reduced the number of employees mainly in the Europe, Middle East and Africa region. On the other hand, we increased our presence particularly in China and India.

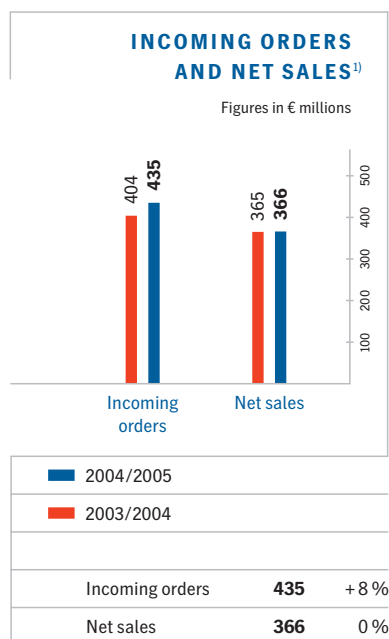
Service is becoming increasingly important as a competitive factor in the industry. Printing establishments are able to better differentiate themselves from their competitors if they are extensively advised and receive customer support. That makes it possible for them to optimally and fully utilize all available technical opportunities – and prevent costly machinery breakdowns. We support this trend with our **systemservice concept**, which we launched in nearly all areas during the financial year. This concept includes all life cycle phases of our solutions, among others: printing establishment planning, training measures, service inspections, overnight repair services, remote service, and print color management.

### > **Europe, Middle East and Africa: Renewed Upswing**

This region experienced an upswing again for the first time in the past three years. In particular the beginning of the financial year was exceptional. Incoming orders at the drupa trade fair surpassed our expectations, particularly business from France and Germany – this was especially pleasing for us following the market downturn of recent years. However, after the first quarter, which was very strong due to drupa, orders from this region declined again to the previous year's level. Overall incoming orders rose by 14 percent and this region's sales increased by approximately 7 percent, with the order backlog growing accordingly as well.



<sup>1)</sup> Continuing operations



<sup>1)</sup> Continuing operations

Developments in Switzerland were especially conspicuous. In recent years, whereas the print media industry in many other European countries experienced its worst crisis ever, sales in Switzerland showed a moderate upward trend. The market weakened during the financial year – with a time lag of two and a half years. By contrast, the other countries experienced a slow recovery. Overall, however, the printing establishments in the region continue to be subject to substantial pressure on costs and strong competition.

Like **Germany**, Spain and France in particular posted a good year as well. In Spain, business already picked up considerably in the previous year. In France, our sales and service company is on solid footing in the market following comprehensive restructuring measures over the past three years. Although we were compelled to reduce our staff here, customer processes were nevertheless optimized.

The Middle East also developed better than had been expected. The economic situation recovered surprisingly rapidly from the effects of the war in Iraq, with the countries of this region returning rapidly to normality – at least as far as business is concerned.

Africa reached the previous year’s level. Some printing establishments, particularly in South Africa, are benefiting from the low levels of wages and infrastructure costs in producing for the European and US markets.

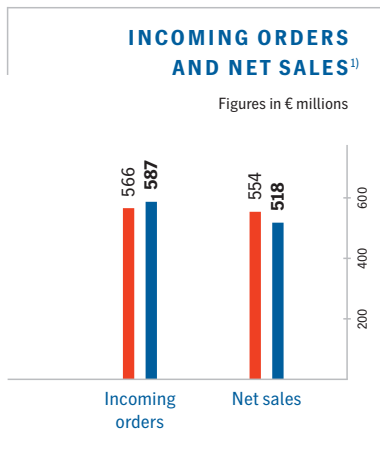
In order to further reduce structural costs in the region, we launched a corresponding program that has been in operation since the beginning of the financial year.

> **Eastern Europe: Lower Growth Rates for the First Time in Some Years**

Whereas this region was always able to generate above-average increases in recent years, and in general grew at a more rapid pace than other regions, our expectations were just barely met during the year under report. Incoming orders rose by 8 percent while sales remained at the previous year’s level – sales fell short of expectations primarily during the second half of the year.

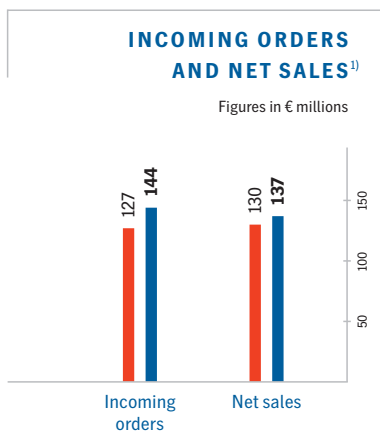
What caused this development? The growth effects arising from the joining of the EU of some countries were already anticipated in the past. As result, there was no crucial impetus during the financial year. In recent years, printing establishments in the region had heavily invested in highly efficient printing presses. We were successful in increasing our sales volume in the region by approximately 150 percent during the period 1998 – 2004!

Companies in Russia were noticeably restrained with their investments, as a result of which no large-scale projects were undertaken. This resulted in a decline of our incoming orders and sales.



	2004/2005	2003/2004
Incoming orders	<b>587</b>	+ 4 %
Net sales	<b>518</b>	- 6 %
currency adjusted:		
Incoming orders	<b>621</b>	+ 10 %
Net sales	<b>545</b>	- 2 %

<sup>1)</sup> Continuing operations



	2004/2005	2003/2004
Incoming orders	<b>144</b>	+ 13 %
Net sales	<b>137</b>	+ 5 %

<sup>1)</sup> Continuing operations

Our strategy of also maintaining a local presence in difficult markets has paid off. We set up a training center and opened a branch this past year in Afghanistan. We established a further branch in Albania during the financial year as well.

#### > North America: Dollar's Decline Hampers Sales

The economic upswing in the region had an impact on business developments in the print media industry during the financial year. US printers reported a growing volume of business, and their business expectations are becoming increasingly favorable.

In the United States, we contended with the decline in value of the US dollar and the strong euro. Japanese competitors were able to benefit from their considerable foreign currency advantage in the US market.

We were nevertheless able to improve the volume of incoming orders over the previous year. The successful course of drupa and **GraphExpo**, where we obtained orders totaling 105 million US dollars, contributed considerably to this development. Nevertheless, after adjusting for foreign currency changes, sales fell slightly short of the previous year's figure – although in the second half of the year we were successful in growing by more than 50 percent over the first half of the year.

We also again implemented significant aspects of the package of measures to enhance efficiency during the financial year. All centralized operations are now bundled in a single building in Kennesaw, Georgia. We also completed the new central demonstration center, where we can now present to regional customers Heidelberg's entire product range, including the workflow, at a single location.

In May 2004, we inaugurated our new Americas Logistics Center (ALC) in Indianapolis, Indiana. Our US customers now benefit from an even more rapid supply of spare parts, since we supply all parts from this location.

#### > Latin America: Growth Following Crises in Recent Years

After years of serious political and economic crises, the situation in the region continued to stabilize. Business further improved and the economy grew by over 5 percent. Nevertheless, the high price of oil, the devaluation of the dollar, and high inflation rates caused uncertainty.

We were able to generate growth in incoming orders primarily in Mexico. Overall growth in the region over the previous year amounted to 13 percent, with sales also surpassing the previous year's level. Some of the outstanding orders will only be delivered during the current financial year.

Customer financing is still a key factor for success, especially in Brazil and Mexico. A credit squeeze, extremely high interest rates, and the strong euro continued to hamper our customers' financing opportunities during the financial year.

The measures to reduce structural costs in the region remain in effect. For example, the sales and service company in Mexico moved to a lower-cost building.

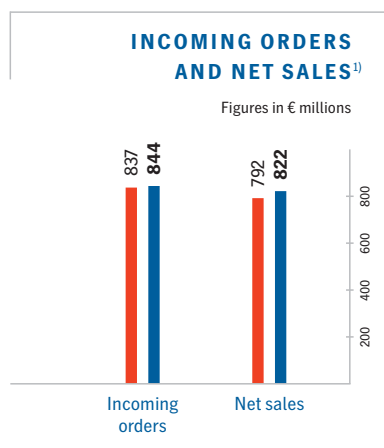
#### > Asia/Pacific: Stable Growth

The increasing significance of the Asia/Pacific region was clearly reflected by drupa 2004. A full 20 percent of visitors came from the Asian region, compared with approximately 9 percent four years ago. The incoming orders received from this region at the trade fair – over € 250 million – were accordingly high. The economies in the countries of this region remained stable. Despite the relatively enormous strengthening of the euro, Heidelberg was again able to gain additional market shares – primarily in **China**, but in Australia and Indonesia as well. At least during the financial year, the increasing credit crunch did not yet have any perceptible impact on our business in China. One reason for this is our broadly based and highly trained service and sales team – one of our crucial competitive advantages.

After adjusting for foreign currency changes, incoming orders in the region grew by 5 percent over the previous year and sales by 8 percent.

The region remained the most important market for our A1 format. Demand for our Speedmaster CD 102 continues to be strong, particularly in China. We realized rapid growth in business with supplies in the entire area.

No employees of the Heidelberg Group or their family members in this region were affected by the tragic tsunami in December 2004. However, some employees from Germany who were in Asia at this point in time were involved in the calamity. Both the Management Board as well as regional agencies spontaneously made funds available for relief organizations.




	2004/2005	2003/2004
Incoming orders	<b>844</b>	+ 1 %
Net sales	<b>822</b>	+ 4 %
currency adjusted:		
Incoming orders	<b>881</b>	+ 5 %
Net sales	<b>856</b>	+ 8 %

<sup>1)</sup> Continuing operations



58,000

visitors

A low-angle, upward-looking shot of a massive, curved metallic structure, likely a printing press component. The structure is composed of several large, curved panels that reflect the sky and the surrounding industrial environment. The background is filled with a dense network of pipes, scaffolding, and structural beams, creating a complex, industrial scene. The lighting is bright, suggesting an outdoor or well-lit indoor setting.

each year at the Print Media Academy in Heidelberg



**PRINT PRODUCTS ARE AS COLORFUL AND VARIED AS PEOPLE.**

**Atlanta, Cairo, Kuala Lumpur, Moscow, São Paulo, Shenzhen, Sydney, Tokyo or Heidelberg:** In our Print Media Academy network, everything revolves around the latest products in the print and media industry. Here, knowledge is conveyed, ideas arise, contacts are made, and lively discussions on printing and the media are held in various forms. What is it that everywhere in the world, it's exciting to push material and printing press to the limit? One reason is surely the fact that print simply 'feels' good. The paper, its surface, and the ink – and as you know, printed materials even have their own individual smell ... In addition, Heidelberg also offers a noteworthy experience in the form of the Print Media Academy. Already with the first steps into the light-flooded building of glass and steel, with its living play of water, happy anticipation grows for the extraordinary architecture and for the people who meet here. Not only experts enjoy visiting us – lectures and vernissages that are regularly held here, as well as the top-quality restaurant high above with its view over the city, make the Print Media Academy a special meeting place.



With its **7,000** seminars

and training programs the Print Media Academy in Heidelberg attracted thousands of print experts from all over the world during the financial year – as well as innumerable visitors who admired the building from the outside ...

**Did you already know** that the two stainless steel-covered cylinders symbolize the impression cylinders of a printing press?

## Corporate Risks – Purposeful Response

- > **Fewer Strategic Risks**
- > **Increased Integration of Risk Management in Corporate Management**

Corporate activities always entail risks. One of the key aspects of corporate management is to keep risks as low as possible or to ensure that the risks of an undertaking are reasonable in relation to profit expectations.

### **Methodology Adapted to New Organizational Structure**

We have adapted our methodology for determining individual and overall risk to the structures of our new organizational form. Among other things, we took into account the even greater significance of customer financing.

We **optimized corporate risk reporting** in connection with the organizational changes. For example, reporting of the 30 greatest individual risks of the Group is now presented in even greater detail and monitored. On a quarterly basis, we determine whether risk assessments have changed and what measures need to be taken in view of circumstances.

We retain proven processes and procedures. Our risk management procedures are uniformly applicable throughout the Group and integral components of five-year planning. To ensure that our requirements are followed, we have published an organizational directive and documented procedures as part of a corporate guideline. This approach makes it possible for us to systematically and purposefully undertake countermeasures against risks – including those resulting from our corporate strategy.

All operating units and divisions are solidly embedded within the risk management process, under which information on risks is collected locally and subsequently summarized. The responsibility for the appropriate assessment and adequate handling of risks lies with each unit's highest management level. To aid in this assessment, several key parameters are quantified on the basis of instruction manuals, guidelines, and other documentation, including the probability of occurrence, the amount of the loss upon an occurrence, and the expected course of a risk over the next five years.

The average profit generated per annum serves as the basis for the ranking of risk categories. Reporting thresholds for the Group's risk management are defined uniformly throughout the Group. Since the divisions assess the potential damage to the operating result for which they are responsible, we are able to closely link the recording of risk with the process of operational controlling.

The effectiveness of our risk management process is periodically examined by our internal auditors. The auditors additionally undertake a systems examination within the framework of the annual audit. We coordinated our risk management system in detail with our auditors at the time of introduction. This system meets the legal requirements of the Corporation Control and Transparency Law and was favorably appraised by the auditors.

### Overall Risk Down Considerably

Heidelberg's strategic reorientation in the previous year paved the way to a considerable reduction in the risks of the Group. Our overall risk has been substantially reduced since our divestiture of the loss-generating Digital and Web Systems operations. We significantly diminished our cost base while simultaneously providing for greater certainty in the planning process for our traditional sheetfed offset printing segment.

We have lessened our past dependence on the economic trends of individual markets as a result of our expansion to the emerging markets; the share of sales in these emerging markets is continually growing. The greater our regional risk diversification, the less our overall risk. We minimize country risks, especially risks resulting from economic or political instability, by purposefully monitoring current developments on-the-spot. This allows us to undertake countermeasures in case of need at an early stage.

We systematically reduced our structural and manufacturing costs, resulting in a further weakening of the impact of cyclical fluctuations on the Group's earnings position. Since the break-even point is lower, we are less dependent on fluctuations in customer orders and are able to benefit from greater flexibility in the production process. Moreover, we again expanded our position in the relatively non-cyclical package printing segment during the financial year.

As in the past, there is no recognizable risk that could threaten the existence of the Heidelberg Group – either currently or for the foreseeable future. This applies to both the results of the economic activity that we have completed as well as for operations that we are planning or have already started up.

### Individual Risks: High Weighting for Currency Risks

The development of the Heidelberg Group depends heavily on the **development of the overall economy**. Economic forecasts envision modestly favorable global economic developments for the coming years – although the development of crude oil prices and the dollar exchange rate are having a dampening effect. There are currently no grounds for fearing that the world economic situation might be directly negatively influenced by capital market or interest

rate developments or by changes in underlying legal or tax conditions or other legal regulations. However, a failure of the expected economic upswing to continue in the current growth regions would have a negative impact on our business development.

A further unfavorable **development of the exchange rates** due to a weak US dollar represents a risk for us in the US market. Unfavorable foreign currency rates could hinder our sales opportunities here because our products would go up in price for customers. This is a risk not only for the Heidelberg Group, but for our major competitors as well, since these are also located in Germany. However, the position of our Japanese competitors would be strengthened because the Japanese yen has declined in value against the euro. We counter general currency risks in part through appropriate foreign currency hedging. Our new manufacturing facility in China represents a completely new approach for us. The startup of local production reduces the risks that we would face in the Chinese market due to an ongoing strengthening of the euro against the Japanese yen.

We are currently taking on a slightly increased **sector risk**. A trend towards consolidation is evident in the print media industry in the industrialized countries. Nevertheless, the upward trend of the industry, discussed in the section Underlying Conditions, counters this risk.

Various markets are subject to **sales risks** due to underlying cyclical and political conditions. Changes in customs regulations or more restrictive import regulations could have a regional impact on business developments. We closely follow these developments and have already undertaken counter-measures wherever necessary.

Our **research and development** work consistently and systematically focuses on market needs – a policy that was clearly reflected in the success of our new products and product extensions at the last drupa. Our firmly established Quality Gate process makes a substantial contribution to reducing the sales risk from undesirable developments.

On pages 46 to 47, we describe how we – successfully – minimize **risks from the procurement** of supplied parts and raw materials. The risk from production standstills arising from problems with the delivery of significant components is relatively minor. A further shortage and thereby increase in raw material prices, especially for steel, could burden our production costs. Nevertheless, our current planning provides for a very realistic and conservative scenario of the development of raw material prices. We therefore do not foresee any significant risk for us in this area.

**Employee turnover** and problems finding highly qualified employees could represent an overall risk to the operating process in some years. On pages 48 to 51 we discuss how we counteract this problem.

In view of our strict and systematic investment management, we do not envision any significant risks for other operational areas of responsibility such as **investments**.

We also undertake systematic countermeasures against **risks from customer financing**. We regularly monitor larger commitments in particular. In doing so, we take into consideration not only the development of the economic environment and the financial performance of the borrower, but the maintenance of the value of collateral as well. We form adequate provisions for risks. Our policy for risk provisions is generally conservative – an appropriate provision for risks is formed at an early stage to cover recognizable risks.

Since the customer financing portfolio is largely carried in currencies other than euros, the future development of the portfolio will continue to be strongly influenced by exchange rate fluctuations. We counteract risks arising from **interest and exchange rate changes** by monitoring them through a central currency management unit and managing them with the aid of derivative financial instruments. Detailed information on this topic is presented in the Notes to the Financial Statements.

We minimized **liquidity and financing risks** throughout the Group at an early stage – through centrally managed cash concentration as well as Group-wide payment and settlement management. In addition, we ensure liquidity and thereby overall flexibility based on tightly organized receivables management at the operating unit level. Furthermore, our monthly rolling annual consolidated liquidity planning makes it possible for us to recognize potential trend discrepancies at an early stage. Through the placement of a convertible bond with a face value totaling € 280 million and a term to maturity of seven years, in February 2005 we laid the foundation for repaying a portion of our bank loans and overdrafts – a move that will secure our independence and financing flexibility on a long-term basis.

With the conclusion of the sale of the Digital and Web Systems divisions, the **legal risks** declined further from the previous year. We systematically protect our interests in the area of patents and licenses. We reduce risks arising from individual contracts by relying on standardized master contracts wherever possible.

Due to effective IT management and the latest in technology, we do not envision any significant risks in the **IT area**. For example, we are prepared for a potential breakdown of our systems due to a catastrophe at our biggest computer center. Copies of data are stored externally daily, so that a loss of one day's data is the worst that could occur. We minimize the economic threat of viruses and worms through comprehensive security measures.

We already undertake countermeasures against **environmental risks** through an efficient environmental management system – both in product design as well as in the manufacturing process.

As a matter of course, through insurance coverage we strive – to the greatest feasible extent – to minimize such **other risks** as the effect of natural catastrophes. However, insurance companies have considerably reduced or even completely excluded insurance against the risks of terrorism in certain regions.

## Outlook – Increase in Corporate Value

- > **Industry Expected to Further Recover**
- > **Net Profit up This Year**
- > **Investment in New Manufacturing Facility in China**

During the financial year, we were successful in considerably improving the operating result over the previous year – although the print media industry only slowly recovered from its serious crisis and the costs of drupa burdened the income statement.

We have established ambitious goals for ourselves for the coming years as well. We intend to considerably increase the **corporate value** of the Heidelberg Group. We are being helped here by the stable world economic situation, the rapid growth of the emerging markets, and the growing production volumes of printing establishments in the industrialized countries. A further substantial upward trend of the euro against the US dollar and the Japanese yen could have a slowing effect – we do not anticipate any strengthening of the dollar for the coming years. Our forecasts are based on an assumed euro exchange rate of 1.30 US dollars or 135 Japanese yen on average for the year.

### Further Stable Growth of the Global Economy

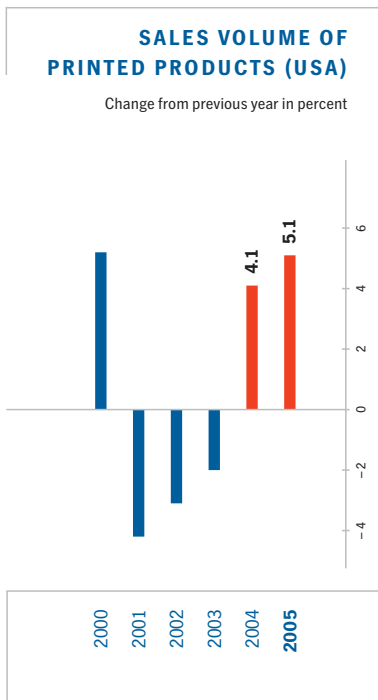
The global economy experienced a boom during the financial year, with the highest growth for quite some time reached in 2004. Somewhat weaker growth rates are anticipated for the coming years. Relevant indicators have continued to be strong up to now. This indicates that the generally favorable economic developments will continue and that the global economy will grow further at an average pace in 2005 and 2006. China and the US are expected to remain the most important supports for the world economy in these years.

An overview over the expected growth rates in the regions and countries that are important to Heidelberg is presented in the table on the left. **US** corporate earnings will remain strong and make possible additional expenditures for investments and new staff hirings. Despite higher key interest rates and a considerably lower fiscal-policy impetus, the gross national product (GDP) is expected to continue growing by nearly 4 percent in the United States.

<b>GROSS DOMESTIC PRODUCT</b>			
Change from previous year in percent			
	2003	2004	2005
<b>World</b>	3.9	4.9	4.2
USA	3.0	4.4	3.8
EU	0.5	1.8	1.6
Germany	-0.1	1.0	0.7
Asia <sup>1)</sup>	8.5	8.0	7.1
China	11.6	10.6	9.6
Japan	1.4	2.6	1.6
Latin America	1.7	5.4	4.1
Brazil	-0.2	5.2	4.3
Eastern Europe	5.8	6.2	5.9
Russia	7.3	7.1	7.0

Source: UBS Warburg, March 2005; spring survey German economic research institutes

<sup>1)</sup> Excluding Japan



Source: NAPL (estimate)

The modest economic upswing should continue in Europe. Nevertheless, in view of the strong world economic situation the growth rates – a mere 1 to 2 percent – remain disappointing. Developments in **Germany** are expected to be especially unfavorable again. The impetus from exports – currently the most important engine for growth – is expected to be weaker than during the financial year. Nevertheless, investment demand could strengthen in view of the more favorable profitability as well as the pent-up need to modernize. GDP is expected to grow by only 0.7 percent.

The economic situation in **Japan** cooled off during the last quarters of the financial year. Following 2.6 percent growth, an increase in GDP of only 1.6 percent is projected for the current year.

By contrast, the emerging markets will continue growing at a disproportionately rapid pace of 4 to 10 percent. Growth in **China** is estimated at 9.6 percent for 2005. **Russia** will achieve an increase of approximately 7.0 percent, while in **Brazil** growth will weaken somewhat to 4.3 percent.

#### Boost in Production Volumes of Printed Products

The print media industry of the **industrialized countries** is again slowly recovering after three years of crisis. In the US, the production volume of printed products will rise further this year as well. Following growth of 4.1 percent in 2004, the National Association for Printing Leadership (NAPL) is projecting 5.1 percent growth for 2005. We also expect an increase in volume for the other industrialized countries, although not in the same order of magnitude.

In recent years, because of the uncertain outlook, on average printing establishments invested only to a minor extent. The pressure to modernize is therefore considerable, and demand for printing presses is expected to increase further. The largely non-cyclical package printing segment is expected to post strong growth. Packaging, which is becoming increasingly important in product marketing, is consequently being more and more lavishly designed.

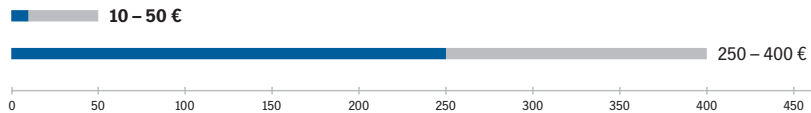
Since the economies of the **emerging markets** will continue to grow at a disproportionately rapid pace, demand for printed products in these regions will increase vigorously as well. As the graph on the following page shows, the degree of saturation of printed products is still very small. Printing establishments in these countries have a high propensity to invest. They are frequently insufficiently equipped or they could benefit enormously from more productive printing presses. In many cases, a complete lack of, or overpriced financing opportunities form an investment obstacle.



## PER-CAPITA SALES OF PRINTED PRODUCTS

Emerging markets  
Industrialized countries

Figures in €



Source: Heidelberg (estimate)

### Exchange Rate Developments Entail Risks for European Equipment Suppliers

Will exchange rate developments also have a perceptible impact on the business developments of equipment suppliers in the print media industry in the near future? Everything points in this direction. The high budgetary and current account deficit of the US represents a serious risk for international financial market stability in the medium term as well – primarily because many Asian countries have so far not allowed any significant strengthening of their currencies. As we discussed in the Underlying Conditions section on page 19, Japanese equipment suppliers continue to benefit from this situation – they have a price advantage in the US market over Heidelberg and the other German suppliers due to the exchange rate structures.

### The Right Solutions for Various Customers and Regions

We will benefit from both the continued turnaround of our sector in the industrialized countries as well as from the rapid growth seen in the emerging markets:

- > Our strategy in the industrialized countries of offering integrated solutions will continue to work out. Our innovative products, which we describe in the Reports of the Divisions, correspond precisely to the needs of our customers. We will also continue to grow in the service segment through our improved offerings. Nevertheless, we continue to face strong Japanese competition, especially in the US market.
- > In the emerging markets, we will score points particularly with our excellent service and sales network. We are already serving the premium segment in these markets, and in China, we intend to realize additional growth potential with lower priced products developed especially for this market.

Our solution component ‘Financing’ together with its professional management will continue to be an important competitive advantage, with which we will generate an increasing market share.

### Further Growth in Sales and Earnings

We are projecting a moderate **growth in sales** on a comparable basis for the current financial year, for which our high order backlog will form a solid foundation in the first half of the year. Furthermore, the investment backlog that accumulated during the crisis of the print media industry will result in a boost in demand for our products. Since the economic upswing in the emerging markets will continue – albeit at a more modest pace – we will be able to generate additional sales thanks to our very well positioned sales and service organization in these countries.

Our goal is to further expand our market shares. We will implement strategic growth projects to reach this goal, including our intention of further penetrating the Chinese market. We will also continue pursuing, with even more vigor, our proven solution provider approach, which is increasingly gaining market acceptance. An important component of this approach is not least the large number of our new products. We also give our customers substantial competitive advantages through our specially tailored solutions.

Since the above-mentioned trends are expected to continue in the following years, from today's vantage point one may assume that following the current financial year our sales will continue to grow at approximately the same pace.

During the current financial year, our **result of operating activities** will surpass the figure for the financial year under review of € 167 million as well as the after-tax result of € 61 million. We will benefit in full from our measures for boosting efficiency as well as our divestiture and deconsolidation of the loss-generating Digital and Web Systems operations. We will further boost the earnings capacity of the Press and Postpress divisions due to the sales increases. Furthermore, some of the reduction in staff costs that we negotiated with the works council will already go into effect during the current financial year. Our earnings will also reflect our continuing pursuit of reducing our structural costs. Nevertheless, the development of exchange rates and raw material prices could have a dampening effect on earnings.

The Postpress Division will reach the break-even point this year and subsequently contribute to the consolidated profit with a growing profit contribution. We are budgeting a slight decline in earnings for the Financial Services Division as a result of our sustained reduction of the volume of receivables from customer financing through outplacement measures during the financial year.

In the following years, it is our goal to return to our old earnings power. In this respect, our projects to enhance our corporate value will increasingly take effect: The reduction in staff costs will attain an annual volume of approximately € 100 million beginning in financial year 2007/2008. We will thereby also be in a position to compensate for unfavorable underlying conditions – for example, in the foreign currency or raw material sectors.

Of course, our shareholders will benefit from the increase in net profit. We will continue to orient our dividend payments on the interests of the capital market in the future.

#### **Strong Internal Financing Secures High Free Cash Flow**

Beside the lowering of structural costs, the reduction in the commitment of funds forms a central component of the Group for increasing corporate value. In addition to our concrete projects for cutting back on operating assets, we maintain a proven range of instruments for securing and optimizing our liquidity. These instruments include not least our centrally managed cash concentration operation as well as our Groupwide payment, settlement and receivables management.

As a key indicator of our financial strength, free cash flow will continue to be maintained at a high level during the current financial year, when it will reach approximately 3 percent of the sales.

#### **Cost of Capital Returned in Financial Year 2005/2006**

Our goal is to return our cost of capital during the current financial year, and in subsequent years generate a yield that is higher than the weighted cost of capital of approximately 10 percent. We will realize these value contributions through a sustained improvement in the result, as we discussed above. Additionally, we will further reduce the capital commitment and will increase working capital turnover.

#### **Measures for Securing the Future of the Heidelberg Group**

We came to agreement with the staff representatives at the end of April on a package of measures to secure our competitiveness. Additional details are provided in the Employees section.

#### **Production in China to Start up This Year**

We will establish a production site in China – primarily in order to better penetrate the Chinese market and thereby benefit from the enormous growth rates of that market even more. We already generated sales of nearly € 300 million

in that market during the financial year. In an initial stage, we will manufacture folding machines at the new location, which are relatively simple to produce. A small-format sheetfed offset printing press will then follow in a second stage. Investments for this project will total approximately € 10 million over the first few years.

### **Purposeful Investment Projects**

We will invest more than € 500 million within the next three years throughout the Group. The focus of attention will be on investments for the trouble-free startup of new product manufacture, replacement capital investments, and investments in sales and information technologies. Moreover, this year we will begin expanding the Print Media Center in Wiesloch.

We will invest in the production process over the next three years to a similar degree as we did during the financial year. We will again introduce new generations of machinery in manufacturing this year and replace the equipment for the finishing of large cast cylinders. This approach makes it possible for us to engage in manufacturing on a process-oriented basis and with improved productivity. We simultaneously achieve greater flexibility with new and better adapted products and are able to sustainably reduce the cost of manufacturing.

Within the framework of the impending replacement cycles, we rely on machinery that permits greater flexibility in changing components. This supports our strategy of acquiring a leading role in the market for customizing. Our High Performance Production project makes it possible to increase flexibility in selecting variations and volume with increasing productivity. More information on this topic can be found on page 45.

### **Research and Development: Closer Cooperation with Our Customers**

More than € 600 million will flow into our research and development over the next three years. These activities focused entirely on drupa in the past two years. This resulted in relatively high R&D rates and an emphasis on development and advanced product development. We plan R&D rates of approximately 6 percent for the coming years. In the future, the share of the R&D costs allocated to basic research will again total approximately 10 percent. Nevertheless, the focus of our work will not change in the foreseeable future. We will maintain our proven processes and retain our employees. But we will include customers in processes to an even greater extent and even earlier, thereby further accelerating our pace of innovation.

### **Procurement: Raw Material Prices Continue to Be an Issue**

Steel and raw material prices will be an increased burden in procurement this year as well. We strive to counter price increases by optimizing the purchasing processes. For example, we formed value analysis teams to focus on potential which, due to the time pressures during the launch of series production, could not yet be fully utilized. We are working on purposefully expanding the electronic flow of documentation within the supply-chain process. Our purchasing information system, which is integrated within SAP, forms the basis for this approach.

### **No Significant Changes Planned**

Heidelberg's reorientation has been accompanied by considerable change. We do not plan any change in our organization or strategy for the coming years – we will also retain our legal form. Furthermore, we will not shift any of our production facilities over the medium term. Apart from the above-mentioned investments, our global office network is currently not in need of expansion. Our existing production sites in Germany have adequate capacity to meet all our requirements. No significant acquisitions are planned at present.

As we explained in the Employees section, at the end of April we came to agreement with the staff representatives on a package of measures to secure our competitiveness. No further significant events occurred following the financial year-end.



## Glossary

### **Asset management**

Asset management serves to systematically optimize operating assets and liabilities. The goal is to generally reduce tied capital and efficiently distribute existing financial means. Asset management improves both free cash flow and value contribution.

### **Balanced Score Card System**

Concept of corporate management, according to which in addition to monetary goals, the customer's point of view, the perspective of internal business processes, and the learning and development perspective are also taken into account. Heidelberg uses this instrument for the overall Group and at all organizational levels.

### **Cash concentration**

The Group's cash and cash equivalents are managed on a centralized basis. The goal is to make efficient use of liquidity and utilize surpluses for the repayment of liabilities to banks. This ensures optimal liquidity for the Group with a minimum of interest and administrative expense.

### **Convertible bond/exchangeable bond**

The bearer of a convertible bond may exchange it for shares at a predetermined relationship prior to maturity. If the conversion right has not been exercised, the bond is repaid at maturity. Whereas the conversion right of a convertible bond

refers to shares of the issuing company, the conversion right of an exchangeable bond refers to shares of another company.

### **Flexo printing**

Flexo printing is especially used for the printing of packaging and multicolor labels. This relief printing process makes use of ink with very low viscosity. Printing is effected by means of soft, elastic, and raised printing elements.

### **Mailroom systems**

After the newspaper printing is completed, finishing and preparation for shipping are handled by means of mailroom systems.

### **Postpress / finishing**

All manufacturing steps after the printing process, up to and including the finished product – for example, cutting, folding, stitching, binding, and packaging.

### **Prepress**

The following steps must be taken before the actual printing process begins: the preparation of text, of graphic elements, and of images, ranging from the basic design concept all the way to the production of the printing plate.

### **Quality Gate**

The Quality Gate process systematically brings nearly all corporate functions together within the product development process and places the principal focus on the customer's requirements. It con-

tributes substantially to a reduction in the sales risk arising from undesirable developments.

### **Remote service**

This Heidelberg service comprises the analysis, diagnosis, and service inspection of printing presses via a data link. Heidelberg specialists can implement this service with printing presses that are linked to the remote service. To ensure prompt reaction times, it is also made available by Heidelberg's local service organization.

### **Sheetfed offset printing**

Offset printing is based on the principle that oil and water repel each other. The printing and non-printing areas are at nearly the same level. The printing elements accept the ink and repel the water; the non-image areas act in reverse. The sheetfed offset process prints individual sheets.

### **Technology roadmap**

Technology roadmaps visualize measures that are necessary for the development of all forms of technological expertise in connection with future products. In order to prepare and implement strategies, such roadmaps represent future goals as well as the resulting operations in a manner that is easy to understand.

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