Koenig & Bauer
Group

Consolidated Financial Statements **2003**

At a Glance

Koenig & Bauer Group

We manufacture and sell web offset and flexo presses for printing newspapers, commercial web offset presses for printing brochures, books and telephone directories, publication rotogravure presses for printing catalogues and magazines, conventional and digital sheetfed offset presses for printing books, stamps, magazines and packaging, security presses for printing banknotes, metal-decorating presses for printing sheet metal, flexo sheetfed presses for printing cartonboard and peripheral systems product identification, paper logistics and counterfeit protection.

KBA Group in Figures

	2003[1]	2002[1]	2001	2000	1999
Values in €m					
Order intake	1,255.8	1,084.5	1,197.9	1,375.7	1,043.4
Sales	1,231.8	1,353.8	1,304.0	1,087.4	949.8
Order level at 31.12.	856.9	832.9	1,102.2	1,252.2	963.9
Loss/profit from operations[2]	– 1.9	46.6	58.6	–	–
Restructuring expenses	– 45.1	–	–	–	–
Earnings before interest and taxes (EBIT)	– 46.1	46.3	58.8	51.3	45.4
Profit from ordinary activities	– 49.6	43.2	62.3	59.0	49.8
Net loss/profit	– 30.0	28.1	40.0	52.6	51.1
Balance-sheet total	1,299.4	1,240.6	1,334.1	751.2	685.1
Intangible assets, property, plant and equipment	260.2	283.0	257.5	159.8	137.4
Equity (without dividend payments)	443.7	467.6	437.1	322.4	280.1
Investment in intangible assets, property, plant and equipment	45.3	51.7	81.4	57.1	38.6
Depreciation on intangible assets, property, plant and equipment	57.2	45.0	38.5	33.7	31.7
Personnel: annual average	7,266	7,539	7,424	6,729	6,492
Cash flows from operating activities	61.6	11.9	– 39.8	62.7	63.7
Dividend and bonus paid per ordinary/no-par share in €	–	0.50	0.67+0.33	0.62+0.13	0.61
Dividend and bonus paid per preferred/no-par share in €	–	–	–	0.67+0.13	0.66

[1] under International Financial Reporting Standards

[2] in 2003 prior to restructuring expenses

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This is the second annual report KBA has issued since adopting International Financial Reporting Standards (IFRS). Because the balance sheet and income statement for the Parent Company, Koenig & Bauer AG, are prepared in accordance with German accounting laws (HGB), they cannot be compared on a one-to-one basis with the financial statements for the Group. At the request of some of our shareholders they have therefore been included in the Notes at the end of this report.

Sales and profitability in the 2003 financial year reflected the challenges confronting the printing industry since 2001. But though weak demand led to under-utilisation and short-time work in our web and special press division, Group sales, at €1,231.8m, were just 9% short of the previous year's all-time high of €1,353.8m, largely thanks to buoyant sales of sheetfed offset presses. This fall in sales is relatively moderate when compared with the industry as a whole. Nonetheless soft demand, and in its wake overcapacity, a buyers' market and downward pressure on prices, impacted heavily on profit margins and along with the weakening dollar and substantial restructuring costs at our web press operations resulted in a net loss for the year.

Excluding restructuring costs, the KBA Group posted an operating loss of €1.9m in the 2003 financial year. A one-off expense of €45.1m from downsizing our web press operations resulted in a loss before taxes of €49.6m (2002: profit of €43.2m). The recognition of deferred taxes reduced the net loss for the year to €30m (2002: €28.1m profit). The loss per share was €1.86.

So despite vigorous cost-cutting initiatives in 2003, KBA posted a loss for the first time since the acquisition of Planeta in 1993 and will not be paying a dividend for the first time since its stock market listing in 1985. Much to our regret, the unfavourable economic climate has had just as negative an impact on our performance as on that of our close competitors. We will continue to make every possible effort to return to an acceptable level of profit as quickly as possible.

Since the autumn, order bookings have picked up sharply, both for sheetfed offset presses, sales of which remained brisk throughout the economic downturn, and for web and special presses, which had been badly hit by two years of stagnating demand. As a result we started the 2004 business year with an order backlog for sheetfed offset presses that was almost 20% higher than twelve months previously, and with a steady stream of contracts for newspaper, commercial and gravure presses.

2004 is a significant year for KBA and the print media worldwide because Drupa, the definitive trade fair for the graphic arts industry, takes place in Düsseldorf in May. At Drupa we are planning to consolidate our already strong position among the leading industry players with a plethora of new presses and processes, and to this end have spent the past year and more working intensively on implementing advances across our entire product range. We are confident that our cutting-edge sheetfed and web presses, related workflows and process technologies will hit the mark in an industry confronted with far-reaching structural change. We are equally optimistic that this will generate additional sales both in the current year and in years to come, enabling us to expand our share of the market.

In 2004, setting aside any potential sales that Drupa may generate, resurgent doubts as to the stability and momentum of the anticipated economic recovery and the political and currency risks facing an export-intensive company like ours, we are targeting a substantial increase both in sales volumes and in Company and Group profits.

As a result I am confident that we shall be posting a much better performance long before the next annual report is due in twelve months' time.

Personally and on behalf of my colleagues on the management board I wish to thank all our executives, staff and employee representatives for their unswerving dedication and constructive collaboration in helping us implement the decisions we have had to make during the past year, which have not been easy for any of those involved.

I also wish to express my thanks to you, our shareholders and customers, for the confidence and trust you have placed in us and for the support you have shown in an adverse economic climate.

Würzburg, 31 March 2004
Koenig & Bauer AG
Management Board

Albrecht Bolza-Schünemann
President and CEO

In the 2003 fiscal year the supervisory board and its committees closely and continuously monitored the activities of the Koenig & Bauer management board, duly fulfilling the obligations and functions assigned to us by law and the statutes. Maintaining and co-ordinating our monitory and advisory functions between our plenary sessions is part of my job as chairman, with the support of the committees. Regular quarterly meetings were held at which KBA management gave the supervisory board a thorough briefing on the economic situation at Koenig & Bauer and within the Group, and also on fundamental matters of corporate management, policy and strategy. Alongside investment, the product range, risk management, market developments and personnel policy our discussions centred on rationalisation and cost-cutting measures.

The economic climate throughout the year was strongly influenced by a persistent and widespread loss of confidence in the markets. The impact on individual business activities was explained in detail to the supervisory board and published in the interim reports. Here the biggest issues were the closure of two assembly plants and the restructuring measures initiated in the web and special press division as a direct result of flagging demand.

In addition Reinhart Siewert and I, and later Albrecht Bolza-Schünemann and I, regularly discussed key executive decisions and specific business matters along with emerging trends.

The supervisory board devoted particular attention to the acquisition of two companies which are active in niche markets: Bauer+Kunzi Gesellschaft für Drucktechnik mbH, which makes metal-decorating presses, and Metronic AG, a manufacturer of small-format printing presses and product identification systems.

The Corporate Governance Code adopted at the beginning of the year was reappraised and new rules of procedure for the supervisory board approved in March. The declaration of compliance was duly amended in response to the expanded Code issued in May. The only point of deviation related to the disclosure of individual board members' remuneration. Since Koenig & Bauer offers the members of its management and supervisory boards neither share options nor other derivatives, we saw no cause to enlarge on the information contained in the annual report for 2002.

At the AGM on 26 June 2003 Reinhart Siewert formally retired as company president and was voted onto the supervisory board to succeed Josef Barth. We would like to express our appreciation of the signal contribution Reinhart Siewert has made towards shaping and directing the company's fortunes during his long years of service. We would also like to thank Mr Barth for the invaluable contribution he has made to the board's activities over the years.

The financial statements, management reports and method of accounting for the Parent and the Group to 31 December 2003 were examined by Bayerische Treuhandgesellschaft AG – the auditors appointed at the AGM – and awarded the auditor's certificate unreservedly. In my capacity as chairman of the supervisory board I attended the audit meeting between management and the auditor. The financial statements, management reports and auditors' reports for Koenig & Bauer and for the KBA Group were subsequently discussed in detail by the supervisory board's audit committee, with the auditors furnishing the results of their audit and detailing the main points. All the relevant statements and reports were distributed to the members of the supervisory board well in advance of the audit meeting. The audit committee's findings were then submitted to and approved by the supervisory board.

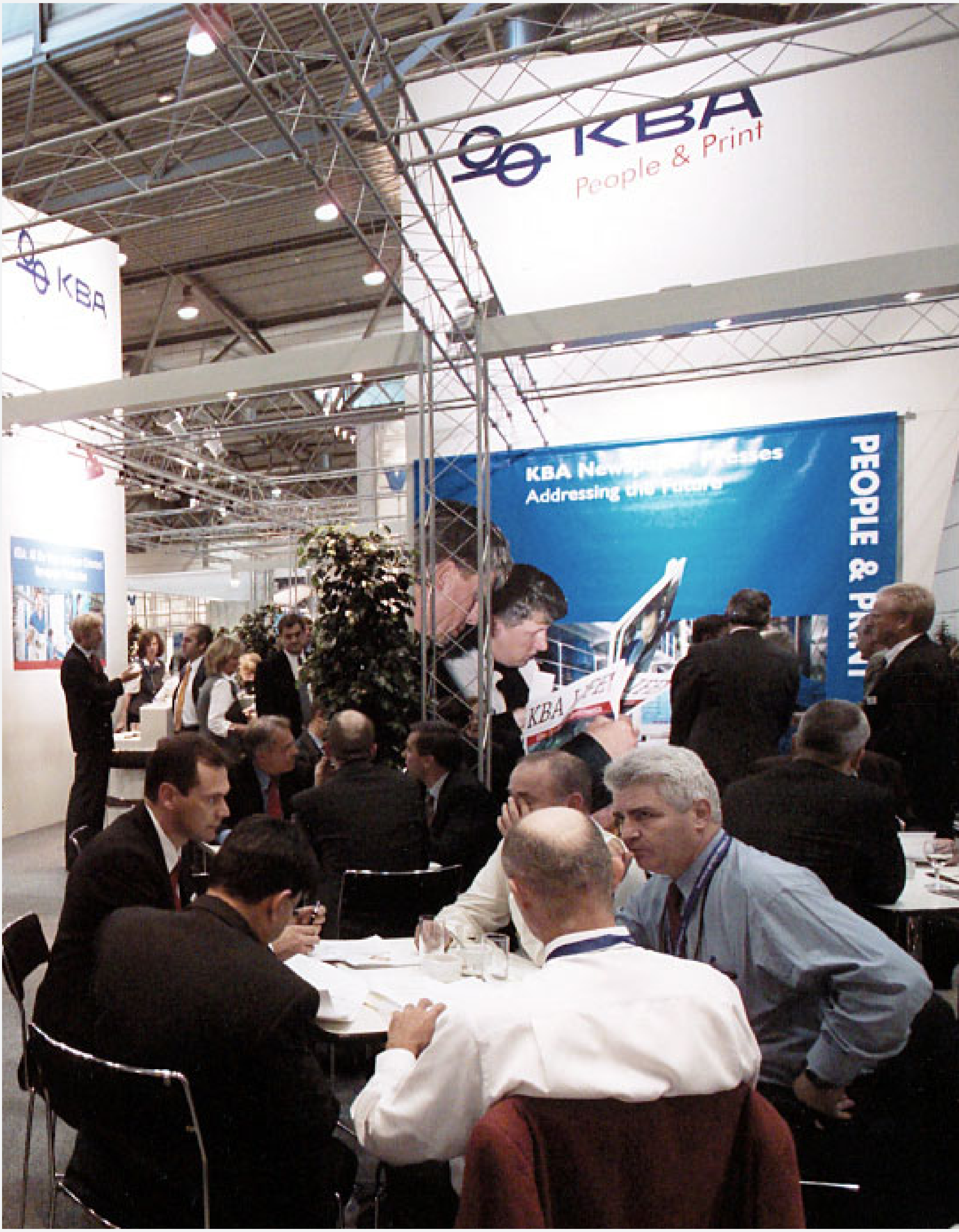
After conducting its own examination the supervisory board raised no objections to the financial statements and management report for the Parent Company, and at its meeting on 31 March 2003 officially approved the year-end financial statements submitted by the management board. The financial statements and management report for the Group were also examined and approved.

The supervisory board wishes to thank all KBA management and staff for their unflagging commitment in a critical year.

Würzburg, 31 March 2004
Koenig & Bauer AG
Supervisory Board

P. Reimpell

Peter Reimpell
Chairman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Declaration of Compliance

Essentially Koenig & Bauer is in agreement with the recommendations and proposals set out in the Corporate Governance Code, and has implemented the majority of these proposals for many years even though they were not formally documented. Some of the recommendations relating to shareholders, transparency and accounting were implemented in 2001 and 2002. The rules of procedure for the supervisory and management boards were revised in 2003 in order to comply as fully as possible with the updated Code.

The only point of deviation concerns the disclosure of individual board members' remuneration (provisions 4.2.4 and 5.4.5). Since share options and other derivatives form no part of board members' remuneration, we are of the opinion that a breakdown into fixed and variable elements for each of the two boards provides adequate information for our shareholders.

The revised declaration of compliance issued by the management and supervisory boards was published on the KBA website.

Commitment to transparent corporate culture

The initiatives launched with the Corporate Governance Code over the past two years should help to restore investors' confidence in German companies and their management. Koenig & Bauer, too, is committed to this goal. However, any new initiatives and statutory provisions should have due regard for the ability of the company and its decision-makers to respond to global competition.

Signs of an emerging recovery in the newspaper press market first became apparent at the IfraExpo trade convention in Leipzig last October

Renewed confidence on the trading floor

During the first half of 2003 the economic and political climate was overshadowed by a succession of economic setbacks and the war in Iraq. The stock markets responded with massive price falls, continuing the downward trend of 2002. In mid-March the DAX and MDAX reached new lows of 2,203 and 2,647 respectively, and Koenig & Bauer shares registered their lowest ever price of €10.

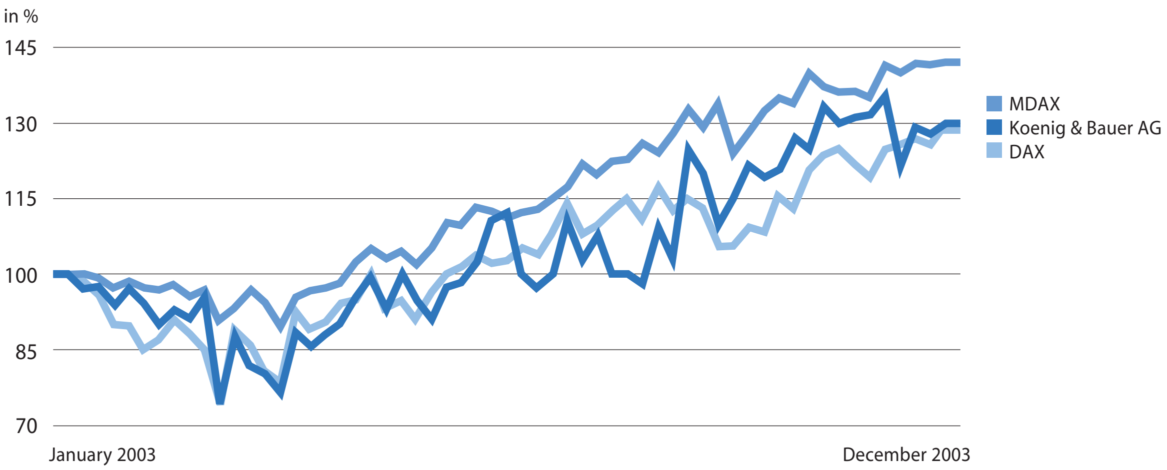
With the end of the war the situation improved, and a relatively volatile trading environment in the second half of the year saw share prices rebounding to ever higher levels in expectation of a significant economic recovery in 2004 and 2005.

Rising share price

Including dividend payments, KBA shares climbed 31.9% to close at €17.70 at year's end. Although they failed to match the performance of the DAX and MDAX indices, which rose by 37.1% and 47.8% respectively, their value on a long-term basis (SMAX listing on 26 April 1999 = 100%), allowing for scrip shares and dividend payments, rose to 127.5%, representing a mid-ranking performance on the relevant DAX and MDAX indices.

The relentless fall in the value of the dollar impacted heavily on the export-oriented German engineering industry, and thus on KBA shares. In the early weeks of the current year the dollar regained some of its value against the euro and in line with this the price of KBA shares rose to a temporary high of €20 in February. In March, with the strong euro continuing to squeeze margins and the demand for capital goods remaining sluggish, share prices became more volatile once again as the markets reacted to renewed threats from terrorism in the aftermath of the bombings in Madrid.

Performance in 2003



Continuing interest in employee share scheme

In the second year of the scheme, despite the uncertainty occasioned by short-time work and redundancies, 54% of Koenig & Bauer employees seized the opportunity to acquire up to 28 company shares. The workforce now owns around 1% of our subscribed capital, and active promotion of employee participation will continue in 2004.

Quotation on Prime Standard

The re-organisation of the German stock exchange came into effect in mid-March 2003. Koenig & Bauer applied for admission to the Prime Standard segment at the end of 2002 and thus continues to be listed on the MDAX index for selected medium-sized quoted companies. This entails a commitment to comply with international standards of transparency, which in turn conform to the key recommendations of the German Corporate Governance Code.

Capital market promotion intensified

A gradual improvement in the performance of the printing industry re-ignited interest in KBA shares among capital market investors during the second half of the year. A succession of investor conferences and individual interviews served as a platform to promote our shares, positioning and strategy in the print media market. Despite announcing a loss for the year under review, our share rating was buoyed by our success in increasing our share of high-volume markets, coupled with significantly better prospects for 2004, and as a result many analysts changed their recommendations from "hold" to "overweight".

Key Data on Koenig & Bauer Ordinary Shares

	2003	2002
Earnings per share	€ –1.86	€ 1.75
Price-earnings ratio	–	7.9
Highest price	€ 18.85	€ 27.30
Lowest price	€ 10.00	€ 11.00
Closing price	€ 17.70	€ 13.80
Market capitalisation in m	€ 286.0	€ 221.8
Cash flow per share	€ 3.81	€ 0.74
Dividend + bonus	–	€ 0.50
Free float	58.4 %	58.4 %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Upturn still on hold

After two difficult years, 2003 was once again a year of dashed hopes for the printing industry. During the first two quarters in particular, the economy's general weakness was exacerbated by investor insecurity regarding the Iraq war and the initially unpredictable impact of the SARS epidemic in the Far East. As a result even the wheels of the region's growth engine, China, slowed markedly for a while.

For the third year in succession consumption and investment were particularly weak in Germany which, though the largest economy in the European Union, was once again bottom of the table, recording a slight fall in GDP. Although advertising revenues in the newspaper industry, one of our major markets, marginally improved, advertising volumes in general remained unsatisfactory and, with a few regional exceptions, acted as a brake on new investment.

Sustained price and cost pressures

Apart from a few regional anomalies and niche markets, in 2003 the printing industry and its suppliers once again battled against inadequate capacity utilisation, massive price and cost pressures and difficulties in obtaining capital as a result of banks' increasingly restrictive loan policies. These difficulties were reflected in a growing number of insolvencies and an intensification of the mergers and acquisitions that the industry has witnessed in recent years.

The first significant signs of a noticeable and sustained economic upturn and renewed investment came in early autumn in the form of more optimistic growth forecasts and higher growth rates, most notably in the USA.

Strong euro acts as brake on sales and profits

However the euro, which is heavily overvalued against both the US dollar and Japanese yen, is increasingly acting as a brake on the export-led German press manufacturing industry's sales and profits in North America and other markets dominated by the US dollar. Despite widespread insecurity and disruptions in the political and economic environment, the outlook at the end of 2003 was better than it had been a year earlier, with signs of a steady, albeit relatively slow, upturn in the advertising industry and in the economy generally.

An open house at a major KBA customer, Hansaprint in Turku, Finland, drew web offset printers from all over Europe

Autumn brings renewed willingness to invest

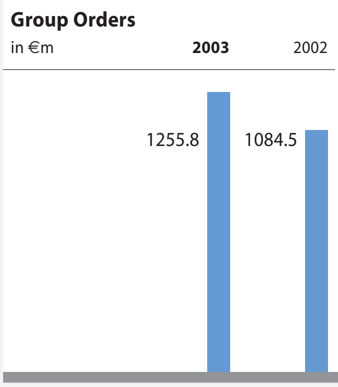
KBA experienced two very different trends in 2003, with the first six months seeing a continuation of short-time work in the web press division due to a substantial fall in sales and a widespread reluctance among industry players to invest in new kit. As the autumn approached, project activity and incoming orders increased noticeably. Capacity utilisation at our web press locations also improved in the second half of the year, but price and cost pressures continued to operate in a market still suffering from overcapacity. Although we have significantly enhanced both the level of automation and the productivity of our web presses, the current market environment has forced us to reduce the price substantially.

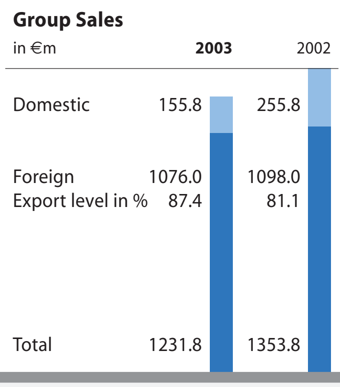
Sales of sheetfed offset presses, though more buoyant than those of large-scale web installations, were also subject to pricing pressures that squeezed margins. The strong euro seriously impacted on prices and sales in North America and other markets (Latin America, China, South East Asia, Australia), to the benefit of our Japanese competitors.

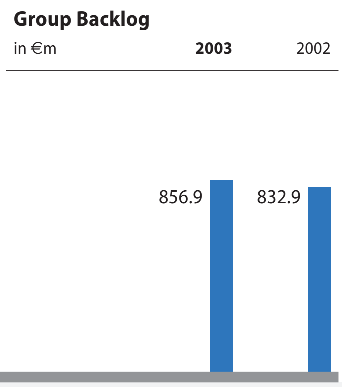
Double-digit increase in new orders

Despite the unremitting challenges posed by the market environment the KBA Group nevertheless succeeded in boosting market share, posting a 15.8% increase in new orders to €1,255.8m from €1,084.5m in 2002. The biggest order booked by the web press division came from the Rizzoli group in Italy. Our successful move into waterless newspaper offset, a technology with enormous potential, was underscored by the sale of the first Cortina press to a Dutch customer at the end of the year. Since then we have received a number of orders for 48-page versions of this press, with further contracts nearing completion.

A big increase in new order bookings for commercial web offset presses included the first sales to the ex-Soviet Union, while a contract from Maul-belser, a German media federation, for the first TR12B publication rotogravure presses for a web width of 4.32m (170") represented a new dimension in this technology.







In 2003 we underscored our pole position in waterless and keyless printing technology

We also posted a substantial increase in the volume of incoming orders for sheetfed offset presses compared to 2002, which was itself a good year. The unabated popularity of our large-format Rapida presses worldwide, in tandem with higher sales of our medium- and half-format conventional presses, the Rapida 105 and Rapida 74, and of our half-format digital offset press, the 74 Karat, boosted sales and enabled us to penetrate new markets such as Australia and North Africa.

Sales surpass target

Group turnover of €1,231.8m (previous year: €1,353.8m) was slightly above our sales forecast of spring 2003. The 9% fall compared to 2002, due entirely to reduced shipments of newspaper and publication rotogravure presses, was appreciably smaller than at rival companies.

Order backlog improves plant utilisation

The order level at the end of the year stood at €856.9m, 2.9% higher than twelve months previously (€832.9m). A double-digit jump in unfilled orders for sheetfed offset presses was offset by a smaller backlog of orders for web and special presses caused by a drop in negotiated contracts for security presses.

Results hit by restructuring and reduced plant utilisation

During 2003 Group assets and profitability were adversely affected by the pricing pressures which have been confronting the printing industry for a number of years, by prior sluggish demand for web presses and the subsequent under-utilisation of web press facilities, and by substantial restructuring costs.

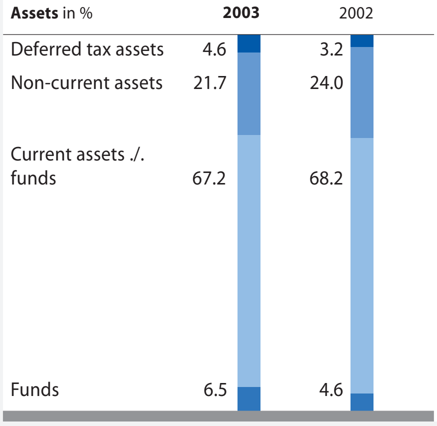
The following factors impacted severely on earnings:
- a drop of more than €120m in sales of web and special presses, resulting in smaller margins
- falling market prices and thus a deterioration in overall profitability
- the strength of the euro against the US dollar, which led to substantial currency losses despite the use of hedging devices
- a deterioration in customers' creditworthiness due to the industry downturn, which forced us to increase provisions for bad debts
- a one-off restructuring expense for our web press division.

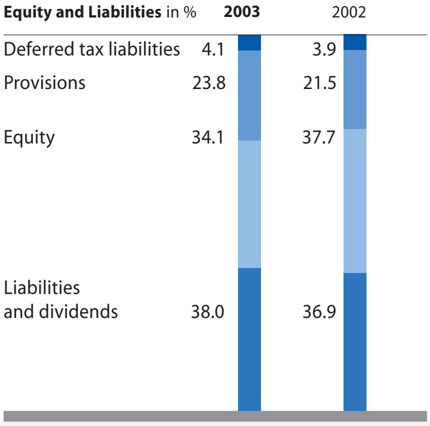
Comprehensive restructuring programme

Capacity adjustments in the web press division were initiated in summer 2002 in response to flagging demand for large web presses, and took the form of a reduction in outsourcing and the number of temporary workers, and the introduction of short-time work. At the end of the second quarter of 2003, with the print media industry's unofficial moratorium on new investment forcing down prices, further action was initiated to ensure KBA's long-term competitiveness by downsizing capacity and cutting costs.

The key elements for achieving a sustainable reduction in the Parent Company's fixed costs were to concentrate capital-intensive production processes at a single location, to sell off obsolete machinery and equipment, and to close down our Kusel assembly plant and KBA-Berlin GmbH, which primarily

Group Assets and Capital Structure





Our new 16pp commercial web offset press, the Compacta 217, was just one of the many new products we developed in preparation for the Drupa international trade fair

functions as a reelstand assembly plant. Both closures were scheduled for the end of the year, but the closure of the Berlin operation was delayed by difficult and protracted negotiations which we are now expecting to conclude this year. Numerous steps were also taken to reduce costs and increase the efficiency of production processes and operational procedures (*see chapter on production, page 30*). To implement the inevitable job cuts, redundancy schemes for 2003 and 2004 were negotiated with employee representatives at all the locations affected.

The comprehensive programme to reduce costs and increase efficiency in the web press division, coupled with the cost of the planned closure of KBA-Berlin GmbH or its sale to an external investor, led to a one-off loss of €44.2m.

Slight operating loss for first time

Thanks to brisk sales of sheetfed offset presses the fall in Group sales, at 9%, was relatively moderate compared with the industry as a whole. It was accompanied by a fall in gross profit from €301.9m in 2002 to €284.4m in 2003, with a slight improvement in the ratio of production costs. Because the fixed costs for web presses could not be adequately adjusted in the short term to match the fall in segmental sales, the operating result before non-recurring items fell as a result of higher research and development costs, increased provisions for risks and other operating costs from a €46.6m profit in 2002 to a €1.9m loss in 2003.

Net result reflects non-recurring items

The €45.1m non-recurring cost of restructuring the web press division and a €2.6m financial loss (2002: €3.4m loss) increased the pre-tax loss to €49.6m (2002: €43.2m profit).

Factoring in deferred taxes, which represent the capitalisation of anticipated tax loss carryforwards, the annual loss for 2003 totalled €30m (2002: €28.1m profit), with a loss per share of €1.86 (2002: €1.75 profit).

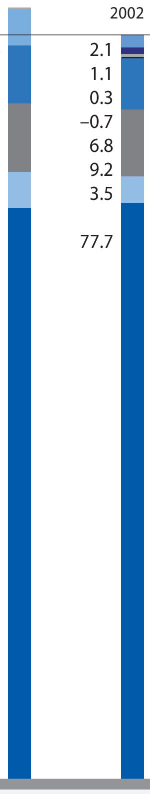
Balance sheet remains strong

The Koenig & Bauer Group's financial position remains strong despite two difficult financial years, as does the balance sheet. The balance sheet total on the accounting date of 31 December 2003 increased by 4.7% to €1,299.4m. Despite the continued modernisation of our machinery and facilities, our fixed assets fell in value by €16.1m, due among other things to extraordinary write-downs of new products following their capitalisation. The ratio of disclosed equity to long-term fixed capital was 150%.

Current assets increased by €54.2m to €956.9m, with the fall in inventories being counterbalanced by a substantial rise in other intangible and liquid assets.

During 2003 active inventory management and a reduction in semi-finished goods cut working capital by €25.9m to €407.2m. Overall, the working capital ratio (the ratio of current assets to short-term liabilities) fell from 2.1 in 2002 to 1.9 in 2003.

Income Statement



as % of sales	**2003**	2002
Net loss/profit	–2.4	2.1
Income taxes	–1.6	1.1
Financial result	0.2	0.3
Other income ./. expenses	5.2	–0.7
Administrative expenses	7.7	6.8
Distribution costs	9.3	9.2
Research and development costs	4.7	3.5
Costs of conversion	76.9	77.7

A spacious new demonstration centre for digital offset technology was inaugurated in Radebeul

Cash and cash equivalents improved substantially, with a year-end balance of €84.8m compared to €57.1m at the end of 2002.

The loss incurred in the 2003 financial year meant that shareholders' equity fell from €475.6m in 2002 to €443.7m, while the equity ratio of 34.1% (2002: 38.3%) remained above the average for a German machinery and plant manufacturer.

Other major changes related to provisions and liabilities. The €42.5m increase in provisions to €308.9m was mainly the result of restructuring costs for the web and special press division and outstanding invoices. The rise in liabilities was due to increased borrowing and the disclosure of €18.9m as liabilities from payments received on account of orders for web presses during the fourth quarter of 2003.

Improved cash flow and financial status

Despite the net annual loss, the cash flow from operating activities rose by €49.7m, from €11.9m in 2002 to €61.6m in 2003. Among the factors contributing to this improvement were an increase in customer advance payments and in provisions. Group investment activities were adjusted in response to the economic climate, with the result that the outflow of funds fell by €7.2m to €40.2m. As a consequence of this the free cash flow moved back into the black to stand at €21.4m in 2003, as against –€35.5m the previous year.

Cash inflows totalling €12.3m were generated through financing activities, and overall we look forward to a stable financial situation in 2004.

Sheetfed offset stable – web more dynamic

Although the order situation in the sheetfed offset division was very much better than in the web and special press division in 2002, the two more or less converged in 2003 and the volume of incoming orders rose substantially. The rise in orders for sheetfed offset presses meant that, for the first time, sales in 2003 exceeded those of web and special presses.

No drop in sheetfed offset sales

The volume of incoming orders, which has risen for eleven consecutive years in this high-growth division, increased by 14.5% to €659.7m (2002: €576m). Our Radebeul facility has thus further strengthened its position in the global marketplace. At €617.5m (2002: €619m), 2003 sales of sheetfed offset presses were roughly on a par with the previous year's high level, despite the negative impact of the weakening dollar on euro-based sales in the key North American market. The order backlog at the end of 2003 totalled €259.6m, a 19.4 % increase over the previous year (€217.5m), forming a sound basis for 2004 and the Drupa trade fair.

Group Business Operations: Order intake/Sales/Order backlog

in €m

	2003	2002
Order intake	1,255.8	1,084.5
Sheetfed offset presses	659.7	576.0
Web and special presses	596.1	508.5
Sales	1,231.8	1,353.8
Sheetfed offset presses	617.5	619.0
Web and special presses	614.3	734.8
Order backlog	856.9	832.9
Sheetfed offset presses	259.6	217.5
Web and special presses	597.3	615.4

The superlarge Rapida 205 launched at the end of the year is the biggest sheetfed press worldwide and offers poster, display and packaging printers a whole new perspective

This success was facilitated by the strong performance of our sheetfed offset presses in the packaging and book printing markets, both of which are less volatile, coupled with our recognised expertise in building very long and complex press configurations in all formats. KBA Radebeul has also made a name for itself in the global marketplace as a driver of innovation in process technology (hybrid coating, ecological sheetfed offset, printing on corrugated board and plastic). As a result, since Drupa 2000 we have supplied over 100 sheetfed offset presses featuring the hybrid coating technology which we are currently in the process of patenting. Although the niche digital offset market was badly hit by the economic downturn, we substantially boosted sales and incoming orders with our innovative 74 Karat digital offset press, enabling us to expand beyond Europe and North America to the Middle and Far East.

Jump in new orders for web presses

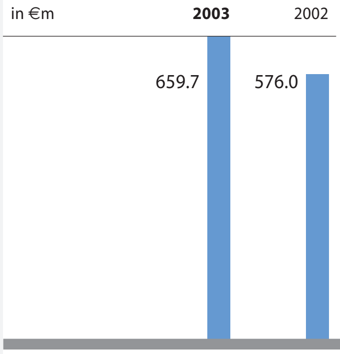
Following disappointing sales in recent years, incoming orders for web and special presses jumped 17.2% to €596.1m (2002: €508.5m), with virtually the entire product range (newspaper presses, commercial web offset presses, publication rotogravure presses) contributing to growth.

In the global newspaper press market, which has still to recover from the downturn, we were able to defend our position as the leading manufacturer. Alongside a major order for nine Commander and two Comet presses from Rizzoli Corriere della Sera (RCS) in Italy we booked orders for newspaper presses from the USA (including the Gannett Group, among others), China, Korea, Costa Rica, Saudi Arabia, Sweden, Estonia and Germany.

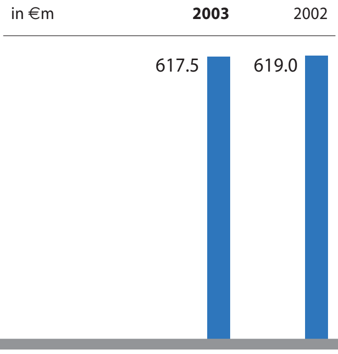
Orders for commercial web offset presses were received from France, the Benelux states, the UK, Ukraine, Estonia and Mexico. In the USA, RR Donnelly, one of the world's biggest print groups, ordered a further rotogravure press line. In Germany and Europe the ongoing shake-up in the commercial web offset market led to numerous insolvencies and mergers.

At €614.3m, sales of web presses, which have much longer production cycles, were 16.4% lower than in 2002 (€734.8m) as a result of weak demand in previous years. More specifically, fewer newspaper and publication rotogravure presses were shipped. Orders included an extension to the world's largest flexo press line at Harmsworth Quays Printing in London (printers of the *Daily Mail*), the installation of the first sections of a 6/2 Commander triple-width newspaper web offset press at Tamedia AG in Zurich, Switzerland, a large Commander press line at the *Basler Zeitung*, the first Comet presses for Australia and Russia and several Colora presses for customers in the USA, Canada and China. The key markets for our commercial and gravure presses were Finland, the Ukraine, Croatia, Switzerland, Austria, France, the UK and Germany.

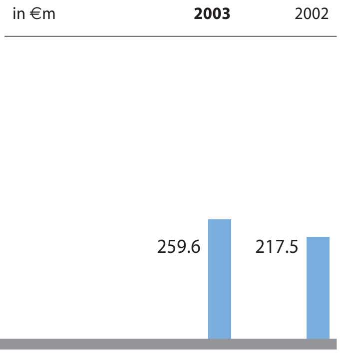
Order Intake
Sheetfed Offset Presses



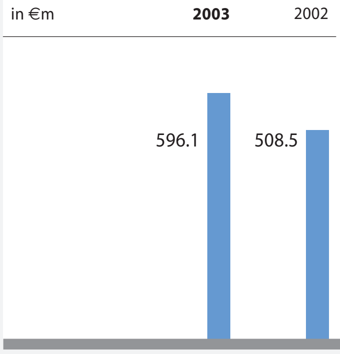
Sales
Sheetfed Offset Presses



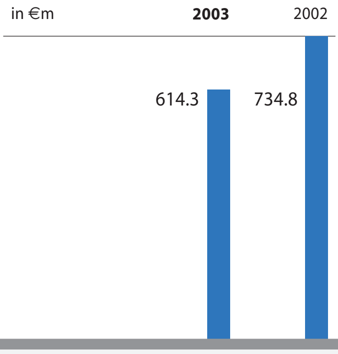
Order Backlog
Sheetfed Offset Presses



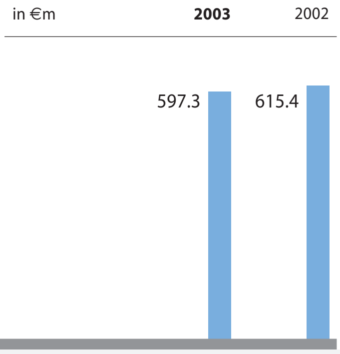
Order Intake
Web and Special Presses



Sales
Web and Special Presses



Order Backlog
Web and Special Presses



The cost savings and quality delivered by our Cortina mini tower press have hit the mark among newspaper publishers

This renewed willingness to commit capital to new equipment during the second half of 2003 brought a substantial improvement in incoming orders, and thus capacity utilisation, at our newspaper, commercial and gravure press facilities. Nevertheless, order bookings for web and special presses at the end of 2003 were 2.9% lower than the previous year (€597.3m against €615.4m in 2002). This was due to a fall in new orders for security presses.

Segmental results: sheetfed better, web press worse

The segmental results also revealed a difference between our sheetfed division and our web and special press division. Whereas the sheetfed division posted a healthy operating profit of €19.9m (2002: €17.4m), a high one-off restructuring expense resulted in an overall loss of €66.9m (2002: €29.2m profit) in the web and special press division.

KBA president Albrecht Bolza-Schünemann cutting the ribbon on a new sheetfed offset press in China

Exports hit a new high

The German economy has been stagnant since 2001, and as a result domestic investment in web presses during 2003 was extremely low. This in turn meant that KBA's 2003 export ratio reached a high of 87.4% (2002: 81.1%).

In the **domestic** market, KBA supplied presses and services totalling €155.8m (2002: €255.8m). In order to achieve our ambitious objectives and increase our market share we set up a new outlet in Neuss to expand our sheetfed sales and service network in west, southwest and northern Germany.

In line with our strategy of raising our profile by concentrating on high-growth niche markets, in early summer 2003 we acquired a specialist manufacturer of metal-decorating presses, Bauer+Kunzi Gesellschaft für Drucktechnik mbH in Ditzingen near Stuttgart, thus improving our already excellent position in packaging printing. Prior to the takeover Bauer+Kunzi had collaborated with our Radebeul plant for almost ten years. At the end of the year we announced the proposed acquisition of a majority interest in Metronic AG in Veitshöchheim near Würzburg, and this has since come to fruition with the purchase of a 73.9% holding. Metronic manufactures inkjet, hot stamping, laser and thermal transfer ID devices for industrial applications plus UV offset printing systems for CDs, CDRs, DVDs and plastic cards. It has around 300 employees and a 2004 annual sales target of around €36m. KBA entered an alliance with Metronic in 2001 to develop a small-format sheetfed offset press, the Genius 52, and we are confident that we can reap synergy benefits in other areas too.

Group sales in the **rest of Europe**, at €575.1m, were also slightly lower than in 2002 (€589.2m), itself a lacklustre year. The EU states continued to suffer from low growth rates and a slide in advertising revenues. We responded to the emerging significance of the Russian and Byelorussian markets by setting up a new subsidiary, KBA RUS GmbH, in Moscow in October 2003.

16.4% of Group sales were generated in the **USA** and **Canada**, traditionally two prime markets. The unfavourable exchange rate pushed down sales to €201.6m from €207.1m in 2002, with a drop in sales of large newspaper press lines being largely counterbalanced by higher sales of sheetfed and digital offset presses. Incoming orders for newspaper and publication rotogravure presses were impressive considering the problems created by the weak dollar.

Sales in **Latin America** jumped by a third to €48.6m from €36.8m in 2002, primarily driven by higher sales in Brazil and Mexico. However, Latin American economies as a whole were adversely affected by the economic uncertainty in the USA and by the weakness of the dollar.

Geographical Breakdown of Sales

in %	**2003**	2002
Africa	1.4	1.3
Latin America	3.9	2.7
Asia/Australia	19.0	18.3
USA/Canada	16.4	15.3
Europe	46.7	43.5
Germany	12.6	18.9

We are planning to boost sales in the corrugated market with the Corrugraph large-format sheetfed flexo press built by our US subsidiary, KBA North America, in York, Pennsylvania

With shipments worth €17.3m (2002: €16.9m), or 1.4% of total regional sales, **Africa**, more specifically South Africa and parts of North Africa, represents a small but high-potential market which we are aiming to develop further. In 2003 we booked a number of orders from Algeria and Tunisia for sheetfed offset and digital offset presses.

As in 2002, **Asia** contributed 18% of Group sales, or €221.2m (2002: €243.5m), once again putting the region ahead of North America. China remains the main growth market. In southern Asia investment in printing machinery remained sluggish, though sales of sheetfed offset presses were brisk throughout the region. In spring 2003 we expanded our sales and service network in China with a new subsidiary, KBA Printing Machinery (Shanghai) Co., Ltd., in addition to the branches that have been operating for some time in Beijing, Guangzhou and Hong Kong. China is rapidly becoming the premier KBA market for sheetfed and web presses in the Far East.

In **Australia** and **New Zealand** the establishment of KBA Australasia Pty Ltd., a sales subsidiary, in 2002 has enabled us to expand our market share. In 2003 Australian sales totalled €12.2m (2002: €4.5m) and we anticipate a further increase this year. 2003 saw the first sales in Australia of a Comet newspaper press line, a large-format Rapida press and 74 Karat digital offset presses.

A 7% training quota reflects our commitment to offering young people good career prospects

Ongoing adjustments to the payroll

The 2003 financial year placed severe demands on the flexibility of our employees. Although working hours in production-related operations during the first half of the year were primarily determined by low capacity utilisation in the web press division, a number of contracts with very short delivery time frames necessitated limited periods of overtime. Management and employee representatives therefore negotiated a flexible short-time working model based on a four-day week. In addition, for the first time in many years, we had no alternative but to announce job cuts in order to adjust capacity to changes in the business environment. The bulk of the cuts were achieved via natural attrition, voluntary redundancies and with the aid of relocation companies set up specifically for this purpose.

On 31 December 2003 the Koenig & Bauer payroll totalled 5,832 or 4.7% fewer than twelve months earlier (6,119). Similar cuts within the KBA Group as a whole meant that at the end of the year 337 fewer people were employed, giving a total of 7,054 (2002: 7,391).

Different trends in different divisions

While almost three years of weak demand continued to impact heavily on the web and special press division, market volatility left our sheetfed facility in Radebeul near Dresden more or less unscathed, enabling it to maintain a high level of employment. The 38-hour working week negotiated for the former East German states until early 2008 also had a beneficial impact on performance at our plant in Saxony.

The lack of demand for large-scale web presses forced us to close our assembly plant in Kuse (Rhineland-Palatinate) at the end of 2003 and to downsize the payrolls at our main plants in west Germany. The closure of our assembly plant in Berlin (KBA Berlin GmbH), originally scheduled for the end of 2003, is now planned for the end of 2004 unless we find an external investor in the meantime. At the end of 2003 there was a total of 88 people (2002: 115) still employed in Berlin.

Average Group Payroll

	2003	2002
Apprentices/ students	493	517
Salaried office staff	2,669	2,744
Wage-earning industrial staff	3,892	4,130
Total	7,054	7,391

We offer customers worldwide a comprehensive and intensive training programme

Performance-related remuneration scheme extended

The performance-related management remuneration scheme introduced two years ago was extended in 2003 to embrace new parameters and goals. This guarantees that corporate and departmental objectives are harmonised across the entire hierarchy and organisational structure, while annual performance reviews enable them to be adapted more easily to Group objectives for the coming year. Each individual agreement focuses on a specific sphere of activity. From the management board through middle management to all the members of each working team, most of our employees are now directly involved in achieving our common corporate goals by virtue of the variable components in their remuneration.

Further training for key tasks

To economise on resources, our training activities in 2003 focused on central issues. These included technical training to expand our service activities, customer-related training in project management, and the ongoing trainee programme for young managers which has proved an effective tool in expanding our global sales and service network.

Sophisticated electronics and integrated workflows are essential features of modern-day printing presses

Substantial savings from suggestion schemes

The response to the Group's ideas management schemes varied from location to location, with a big increase in suggestions for improvements at our Radebeul plants, but a reduction in the number of new suggestions submitted in Würzburg and Frankenthal. This was partly due to the introduction of short time work for a limited period. A total of 1,350 suggestions were submitted. Although this was 10% fewer than last year, the quality was better and the 65% that were accepted generated annual savings of over €1m. There was also an encouraging increase in the number of new patents and proprietary rights filed.

Company pension scheme maintained

Company pension provision was the subject of much public debate in 2003. Although it was generally acknowledged that demographic trends would inevitably enhance the significance of this second pillar of pension provision, there was widespread criticism of the associated costs that companies would incur. Koenig & Bauer offers its employees two pension schemes: a company-financed occupational pension fund for all employees plus the option of joining an additional scheme known as the MetallRente and deducted directly from earnings. We are heavily promoting this option at all our facilities, with the aim of demonstrating to our employees the benefits of an industry-wide pension fund.

Vocational training remains vital

Despite the unavoidable job losses, in 2003 there was very little change in the number of apprentices and student trainees within the Group, who totalled 493 (7% of the workforce), or just 24 fewer than in 2002 (517). In order to meet the social commitment laid down in our corporate principles while also safeguarding our own future, we provide thorough training not only in the classical branches of engineering but also in vocations geared to the specific needs of press manufacture, for example those of electromechanic and press operator. In the course of the year 106 university students, 64 external trainees and 68 secondary school pupils were given their first experience of a working environment through job placements, the sponsorship of dissertations and trial training courses at the Parent Company.

As in previous years, several KBA apprentices were among the local and regional prize winners at the final examinations set by the Chamber of Industry and Commerce. 104 of the 109 apprentices who passed their final examinations were offered employment contracts in 2003.

Membership of the Company health insurance scheme increased to 12,626 (2002: 12,528). Activities during 2003 focused on preventive health care and explaining the health implications of everyday working practices.

Long-service bonuses were awarded to 209 members of KBA staff: 147 for 25 years of service, 61 for 40 and one for 50 years of service.

Thank-you to all our employees

2003 was one of the most challenging years in the history of the KBA Group, but despite this our performance compared favourable with that of the industry as a whole. The management board would like to take this opportunity to thank all our employees for their dedication and commitment on behalf of the Group and its customers, and also the employee representative committees for their constructive attitude in determining and implementing some unpopular measures.

Distributed manufacturing cuts costs

Following the transition to a new plant structure in 2002, the strategic re-alignment of our production workflow continued in 2003 with each of our three web press manufacturing facilities concentrating more intensely on specific activities as part of the distributed-manufacturing model we had adopted. Our central goals were to achieve substantial reductions in production costs, to minimise inventories and to shorten delivery time frames in line with market demand.

Focus on core competence

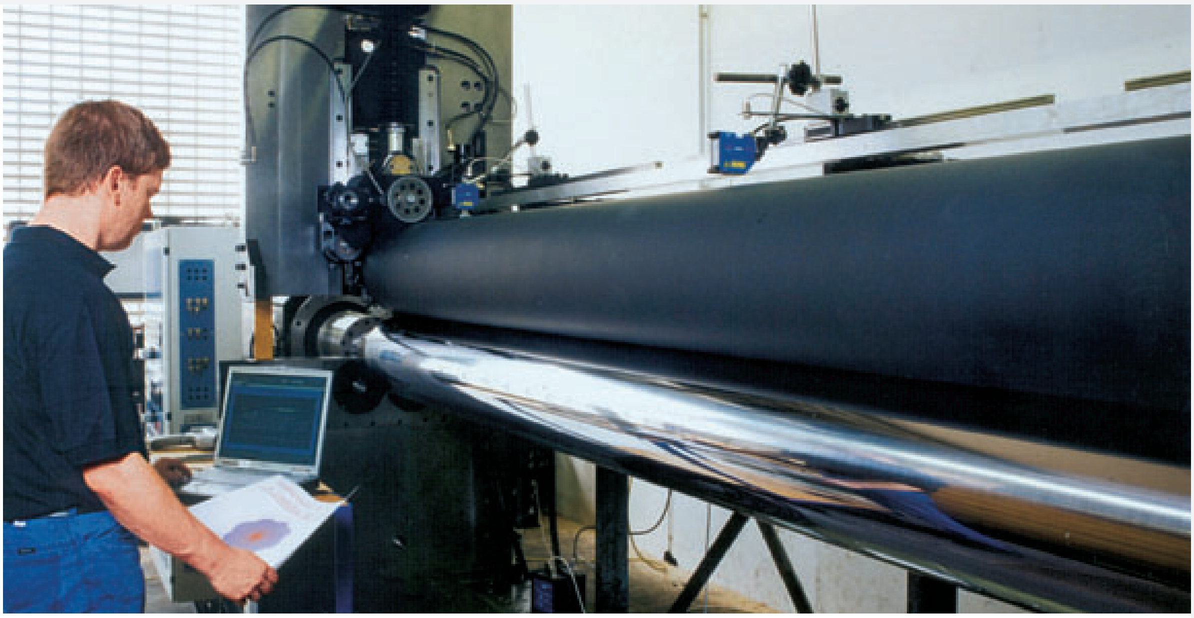
In order to focus more sharply on our core competence we outsourced more work and collaborated more closely with our authorised suppliers. This created a more streamlined and flexible workflow, while leasing agreements reduced the amount of capital tied up in plant.

Workplaces and assembly sequences were redesigned and new technologies adopted to cut production and assembly costs and reduce lead times. Initial benefits have already been felt in the final assembly line at our sheetfed offset facility in Radebeul.

As part of the restructuring programme for our web press facilities all frame production was centred on Würzburg, since this is where the relevant upstream operations – the foundry and model workshop – are located. Assembly work which had previously been handled by our plant in Kusel was transferred to our Frankenthal and Trennfeld factories following the closure of the Kusel plant towards the end of the year. We also started assembling reelstands in Würzburg to compensate for the reduction in output by our subsidiary KBA Berlin GmbH.

Organisational adjustments

Changes in the division of competences demanded corresponding adjustments to our organisational structures. Production processes were rescheduled to support process-oriented manufacture and promote a better co-ordination of group work based on the principle of autonomous control. A new parts list system for subassemblies was introduced in the web press division to enable the individual subassemblies to be scheduled more flexibly according to assembly capacities, and to be tracked with much greater precision. This perceptibly improved job scheduling and order processing in the capacity-based production control system, especially for multi-unit press lines comprising large numbers of identical subassemblies. To enhance our customer focus we also reorganised our engineering and project management departments, assigning staff to specific technologies – newspaper, commercial web offset and gravure – whereas before they had been engaged in all three.



Extending the frontiers of technology in publication rotogravure with a web width of 4.32 m (170”) demanded careful and intensive preparation

Optimising IT structures

The volume of data being managed has increased continuously in recent years following conversion to 3-D CAD plus the associated product-data management system, and the transition to SAP R/3. At the same time, demands on data security and host computer capacity have increased substantially. Outsourcing part of our data management activities to an external computing centre has furnished additional storage capacity and guaranteed the future availability of all Group applications, while integrated back-up systems have decisively improved our data security.

The continuing standardisation of workstation facilities has also improved reliability while reducing the level of technical support required.

Quality management system expanded

Guaranteeing and enhancing product quality on a sustained basis, in order to maintain customer satisfaction in the long term, is an ongoing priority here at KBA. Functional checks on the subassemblies prior to shipment include test runs on the printing units and folders using dedicated software. To eliminate the risk of faults in critical components, new methods of fault analysis and failure effect analysis were deployed by quality control units between engineering and production, resulting in faster commissioning at customer premises. In some areas this enabled us to make substantial reductions in quality control costs. In April 2003 our Radebeul facility successfully applied for a renewal of its environmental accreditation to the new ISO 9001-2000 standard.

Synchronising processes

It is precisely when demand is weak that procurement management takes centre stage. This involves locating and implementing potential savings at a time when both purchasing volumes and batch sizes are diminishing. Order-related fluctuations in capacity utilisation and the production of customised press lines demand a high level of flexibility. Production and procurement processes were synchronised by refining our electronic order processing software and introducing a document management system to support procurement controlling. As a first step the procurement of low-value mass-produced parts, otherwise known as C parts, was transferred to the internet. Additional cost reductions were achieved through value analyses, ongoing price negotiations and group-wide procurement contracts.

Developing customer-supplier relationships

Our main suppliers were encouraged to expand their capabilities and product ranges to support our production requirements, thus enabling us to reduce our supplier base still further. Bringing key suppliers to the table during the initial stages of current projects and new development initiatives helped us to reduce quality control costs. Parallel to this we stepped up our search in international procurement markets for new suppliers with the necessary expertise and experience.

Adjusting our logistic structures

The closure of our Kusel assembly plant and the transfer of inventory planning from KBA Berlin GmbH as part of the restructuring plan for our web press division necessitated changes to the logistic structures, and these were successfully completed towards the end of the year. Our logistics centres were integrated in the flow of material between and within our Würzburg and Frankenthal facilities, resulting in greater efficiency and a better organisation of internal traffic movements in pursuit of our aim to provide just-in-time delivery of parts to our assembly plants on a job-by-job basis.

Bringing our new logistics centres in Würzburg and Radebeul on line has streamlined the material flows for assembly work and spare parts

Focus on sustainability

Environmentally-friendly printing presses and processes aimed at conserving natural resources are steadily gaining ground, particularly in Europe and the USA, as a result of existing and proposed legislation to reduce emissions.

Ecology and economy united into a single concept

KBA is a pioneer of new ecological technologies and processes in sheetfed and web offset. Recent examples include our mini newspaper press, the Cortina, and our new B2 sheetfed offset press, the Rapida 74 G, both of which feature environmentally-friendly keyless inking and waterless technology.

This logical combination of technologies, which is currently offered by no other supplier in the international marketplace, minimises production waste and thus reduces the consumption of a valuable raw material, paper, delivering substantial savings to our customers. We have further improved the ecological balance sheet by eliminating environmentally sensitive fount solutions and cleaning agents.

The market response to this milestone innovation by KBA has been extremely positive and initial sales have already been made. The Rapida 74 G, which features the same keyless inking system as our 74 Karat digital offset press, has also sparked a lot interest, particularly among print providers working with expensive substrates.

Environmental protection starts with production processes

In 2003 we invested heavily in equipment and organisational measures to make our production processes more environmentally friendly. Examples include optimising burnishing and paintshop processes as well as the creation of a noise profile in the foundry as a further step towards reducing noise emissions. Improvements in workplace safety and ergonomics were achieved by installing new cylinder production equipment and adopting additional preventive measures in our manufacturing and assembly halls, for example new dermatological products. We are confident that outsourcing the cleaning and handling of fuels, lubricants and coolants to an external specialist will reduce emissions still further.

The commissioning of a new production hall for cylinder manufacturing in Würzburg was accompanied by new machine tools like the deep-hole drilling machine on the left and CNC cylinder grinding machine above

Big cut in investment budget

During 2003, stagnation in the web press market forced us to rein in our investment activities and focus on essentials in the form of rationalisation measures with short-term returns, more specifically in the roller-manufacturing line and the manufacturing island for prismatic small parts in Frankenthal. A new production hall for conveyor-belt cylinder machining was commissioned in Würzburg. Raw parts for our Würzburg and Frankenthal production plants are now supplied from the automated rod and sheet-metal store attached to the new hall.

Expansion investment was only undertaken to generate additional core expertise, for example at our Radebeul manufacturing plant, which also inaugurated a new building for project management and after-sales service, complete with a digital printing demonstration centre.

At €45.3m, total Group investment in intangible assets, property, plant and equipment was significantly lower than depreciation at €57.2m.

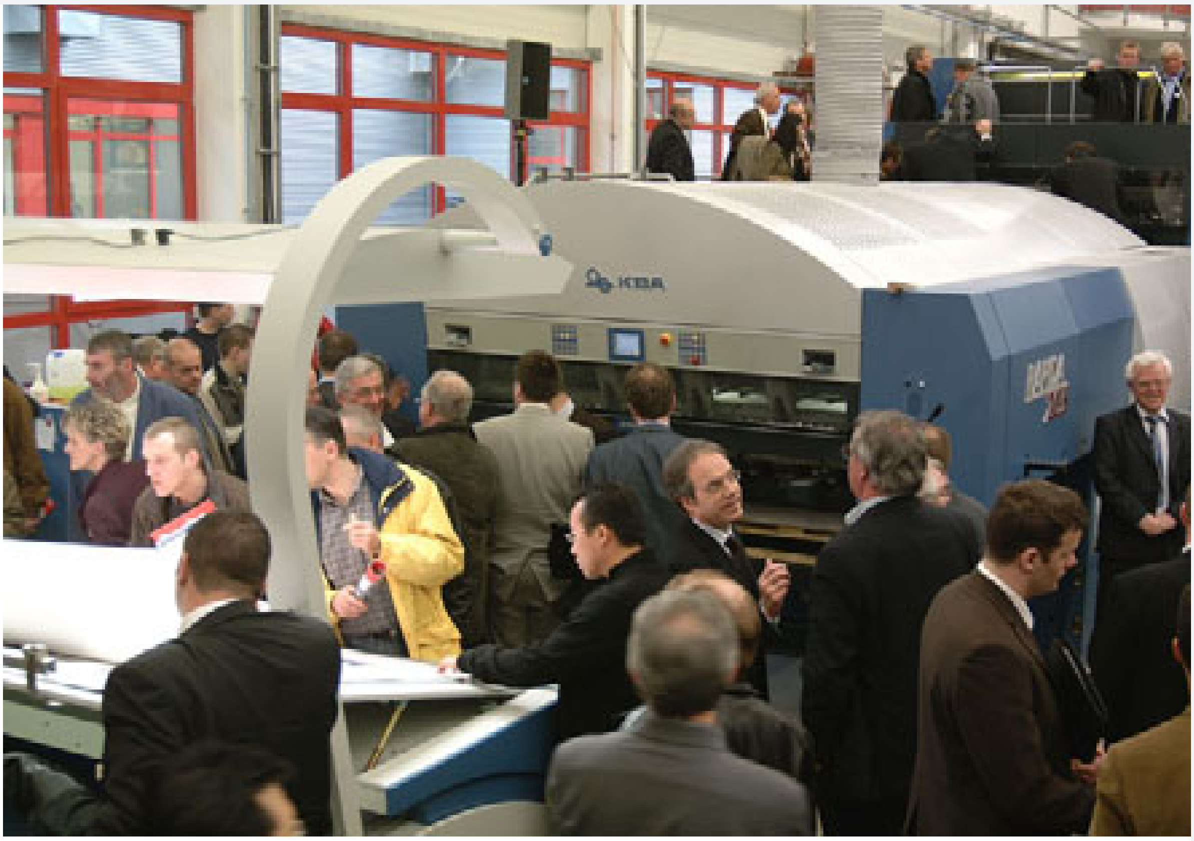
Innovation drive in the countdown to Drupa

R&D activities at the Parent Company in 2003 focused on developing new products and processes and on enhancing our existing press range in preparation for the Drupa international trade fair in Düsseldorf in May 2004. Our security-press subsidiary, KBA-GIORI S.A., developed new anti-counterfeiting, anti-wear and quality control technologies for banknotes, features which are of ever greater importance in this sensitive market. Our North American subsidiary, KBA North America Inc., developed a new large-format sheetfed flexo press, the Corrugraph, which can handle cartonboard and corrugated up to 10mm (0.4") thick. The prototype has already been sold to a printing house in Canada. The Corrugraph expands our range of sheetfed packaging presses, which were previously all offset, into the high-potential market for heavy-grade corrugated.

Overall, the KBA Group's pure R&D costs increased in 2003 by €9.8m to €57.6m. This does not include the high personnel and administrative costs typical in the plant construction industry for the continuous design and process development work associated with customised installations.

Pre-Drupa R&D activities by our web press division resulted in a new high-performance commercial press for the popular 16-page market, the Compacta 217 featuring a new pin folder plus a raft of additional automation modules. Our publication rotogravure team excelled itself with the TR12B for a web width of 4.32m (170"): a capability which represented a daunting engineering and technological challenge. The first press to leave the production line will be delivered to Maul-belser in Nuremberg this summer. Our newspaper press engineers came up with a host of new features for our triple-width 6/2 Commander (automatic roller locks, self-regulating web tension, minigaps etc), upgraded our 4/1 Prisma and brought our Cortina waterless press to market maturity. A key innovation in the pursuit of high-quality, low-cost newspaper production, the Cortina underscores our reputation for foresight and innovation in driving down costs in the newspaper industry.

R&D activities at our sheetfed offset division were just as intense, culminating in a totally new version of our medium-format Rapida. This new press, which has undergone exhaustive testing at a number of printing plants, boasts an even higher output and is even easier to operate than its six-year old predecessor. It will be just one of the many exhibits on our stand at Drupa, alongside half- and large-format Rapidas whose new, streamlined design reflects their enhanced performance and capabilities. Also making its debut at Drupa will be the



R&D activities in Radebeul culminated in a new generation of presses from B2 to SLF.
Left: The new Rapida 74G with keyless inking units
Above: The first Rapida 205 following its inauguration at Plakatfabrik Radebeul

Rapida 74 G, the world's first sheetfed offset press to combine a unit-built design with keyless and waterless technology. The Rapida 74 G features the same Gravuflow™ keyless inking system that has proven its excellence in our 74 Karat digital offset presses. The exceptionally low level of waste makes the G version of the Rapida 74 an ideal tool for print firms specialising in short-run work on expensive substrates.

In recent years we have expanded our unique range of conventional sheetfed offset presses into both larger and smaller formats to address the needs of an even broader customer base. The innovative Genius 52, which is now manufactured at our Radebeul plant, opened up the B3 market while the Rapida 205, the first press lines of which have already come on stream, targets the super-large format market. We are also the acknowledged market leaders in waterless offset technology. The range of sheetfed and digital offset presses we are exhibiting at Drupa 2004 will be more diverse, more advanced and support much greater production flexibility than that of any other exhibitor.

Active risik control

The purpose of Group risk management is to maximise potential rewards while minimising risks by employing prudence and forethought. This is an integral component of our business processes and is carefully co-ordinated with our planning, management and controlling systems.

Risk management procedures are defined in a set of principles applied throughout the Group and ensure a common and systematic approach to documenting and assessing risks. The management board is notified immediately of any unforeseen changes in the risk situation.

In addition all our subsidiaries submit regular progress reports, comparing their performance with the targets they have been set. This enables us to identify emerging risks to our assets, finances and earnings and to institute countermeasures. The efficacy of our risk management systems is monitored by our internal auditing department and its implementation confirmed by external auditors. The findings are incorporated in our risk management system.

Economic and market-related risks

The downturn in the global economy, which in some regions turned into a full-blown recession, impacted heavily on the advertising industry and thus on capacity utilisation by our web press customers, pushing prices down and costs up. Investment in new equipment virtually dried up, and as a printing press manufacturer KBA was directly affected. Although investment has perceptibly increased since autumn 2003, overcapacity in the global marketplace continues to foster intense competition on pricing, customer financing and delivery terms. To counter these risks we conduct in-depth market analyses, offer customised press configurations and focus our research and development activities on market-driven technologies and processes, some of which are unique to KBA.

Further potential risks arise from changes in information technology and the impact of the internet, which has accelerated structural change in the print media industry. We address these risks in a variety of different ways, for example by entering high-growth niche markets. Thus in 2003 we agreed to buy a specialist manufacturer of metal-decorating presses, Bauer+Kunzi Gesellschaft für Drucktechnik mbH, and early this year we acquired a majority shareholding in Metronic AG, an innovative producer of UV offset and ID systems. These acquisitions enabled us to establish a presence in markets that we had previously not addressed.

The Genius 52 addresses
the short-run colour market

Market and business risks

Economic developments in recent years have created a buyers' market. In addition to much fiercer competition on pricing new and second-hand presses this has led to an emerging demand among customers for a wider range of services and more customised investment planning. As a result the willingness of manufacturers to sell on legacy equipment following replacement, to accept contractual re-purchasing obligations and to offer customer financing has become a major selling point.

To counteract pricing pressures we have intensified our cost management procedures, enhanced our range of services to promote customer loyalty, launched new technologies to raise our product profile and entered profitable new markets.

In addition, during 2003 our web press division launched a project aiming to reduce overall costs, and this should have largely come to fruition by the end of 2004.

Financial and technical risks associated with large-scale projects are contained by project management and project controlling. Delivery time-frames have been cut by upgrading our engineering technology and capabilities, reducing lead times and by implementing a company-wide capacity and production management system.

The experience gleaned from project implementation is constantly improving the quality of our products and services. A combination of permanent monitoring and quality management reduces potential risks to quality and deadlines from external procurement processes. Continuous benchmarking for suppliers has been introduced in the purchasing department to reduce quality-related risks.

Financial risks

Financial risks mainly comprise liquidity risks, bad debt risks, currency risks and risks relating to financial instruments.

Liquidity is managed and safeguarded at Group level by a rolling financial-analysis and planning procedure. Receivables are monitored regularly and in some cases are covered by bad debt insurance where deemed appropriate in view of customer creditworthiness. This means that potential corporate financing risks are detected at an early stage.

Currency and exchange rate risks arise from increased sales activities outside the euro zone and currently relate in particular to business in the dollar zone and in regions where currencies are linked to the US dollar. However, we regard these risks as manageable since all the biggest press manufacturers are based in Europe.

Exchange rate risks from foreign currency transactions are actively managed through close co-operation between our sales units and the Koenig & Bauer treasury unit and are substantially reduced or even eliminated using hedging instruments. In addition to specifically hedging major contracts we also hedge a set proportion of small and medium-sized orders as part of a regular strategy aimed at cushioning fluctuations in exchange rates to make it easier to plan ahead.

Risks from changes in short-, medium- and long-term interest rates are constantly monitored and actively limited. Opportunities that arise from changes in interest rates are prudently exploited.

Other risks

Other risks relate to IT systems, capacity and personnel planning, the market launch of new technologies and products and potential litigation. We guard against these risks in the areas in which they arise. For example, in 2003 internal data security between Group companies was further enhanced by new encryption systems and our firewall upgraded to guard against malicious external interference.

Capacity planning and personnel risks were managed by outsourcing more work during production peaks and by providing further trainer for employees.

The risks and rewards associated with the launch of new products and processes were assessed using market analyses and customer surveys. Beta testing at selected customers helped ensure that new products attained market maturity prior to launching.

The legal risks associated with business operations were covered in each business area by specific reinsurance arrangements and the appropriate provisions.

Overall risk faced by the KBA Group

An evaluation of the overall risk potential showed that economic and competitive risks remain as high as in the previous year and that new uncertainties have arisen due to the strength of the euro. However, the measures described above represent a prudent and effective means of hedging such risks. No risks have been perceived that could endanger the continuing existence of the Koenig & Bauer Group.


KBA
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Recovery in sight despite economic instability

Despite a fragile economic climate, particularly in Germany, international growth statistics and prognoses indicate that the global economy will experience an upturn in 2004. Even in Germany, research institutes predict growth rates of around 1.5% in gross domestic product after years of stagnation. However, advertising revenues, on which much of the graphic arts industry depends, are unlikely to receive more than a modest boost from an economic recovery as European companies continue to cut costs. By way of contrast, the advertising industry in the USA, the global economy's engine room, is expected to pick up speed in the wake of the presidential election campaign.

Alongside geopolitical instability (Iraq, North Korea, the Palestinian conflict, social reforms in Germany, federal deficit in the USA), the euro-dollar and euro-yen exchange rates will continue to impact on Germany's export-driven engineering industry. The lack of any clearly detectable trend at the start of the year means that longer-term projections of currency movements are clouded in conjecture. However, demand in Europe should benefit in no small measure from the eastward expansion of the EU on 1 May, though this expansion will also bring new challenges for German industry in general and the German printing industry in particular.

The new 18,000 sph Rapida 105 we are exhibiting at Drupa will redefine the standard in medium format

Our new-generation Rapida 74 delivers an even higher output and greater production flexibility

2004, the year of the Drupa trade fair, started much more favourably for KBA than 2003. The order backlog for web presses due for delivery in 2004, and the capacity utilisation of our web press locations, are both much higher than twelve months ago. In January and February two more contracts for our innovative Cortina waterless newspaper press were signed by customers in Germany and Belgium, and a further 6/2 Commander triple-width newspaper press line was sold to a different customer in Belgium. Further orders for single und double-width newspaper presses were booked in Turkey, Spain and the Netherlands. Orders for commercial web offset and publication rotogravure presses – including a huge gravure press line for Hubert Burda Media in Offenburg – came in from Belgium, Italy, Spain, Chile and Germany.

Once again we booked a large volume of incoming orders for sheetfed offset presses during the first two months of 2004, with domestic and international orders being placed for all press formats. In addition we have won new customers among users of rival equipment. There has been no sign of a slowdown in new sheetfed sales prior to Drupa.

Turnover in both divisions and for the Group as a whole for the first two months of the year was down on 2002 levels, primarily due to the redefinition of invoicing dates. We shall be issuing our first quarter results at an analysts' conference on 17 May at Drupa in Düsseldorf. Although the signs of economic recovery are still relatively weak and are compounded by political uncertainties, the unpredictability of future exchange rates and the tense overall situation in the print media sector, we anticipate a substantial increase in Group sales during 2004 as a whole.

The new-generation sheetfed and web presses due for launch at Drupa 2004 will make a substantial contribution to sales during the second half of the year and enable us to target new markets. The acquisition of Metronic will take us into high-potential niche markets where KBA has hitherto had no presence. As well as generating additional orders for our short-term products, serially produced sheetfed offset presses, we are confident that the Drupa trade fair will help to break down psychological barriers to investment in the graphic arts industry and promote a much-needed sense of optimism among print media players in the longer term as well.

Following the high restructuring costs incurred in 2003 as a result of periodic under-utilisation of plant capacity we are aiming to return to profitable trading in the course of the current year. Due to external factors which are difficult to gauge at the present time we shall not be able to estimate the likely extent of these profits until the summer.

Financial Statements

Group Balance Sheet to 31 December 2003

Assets

in €m	Note	31.12.2003	31.12.2002
Non-current assets	**(1)**		
Intangible assets		20.9	35.4
Property, plant and equipment		239.3	247.6
Financial assets		22.1	15.4
		282.3	298.4
Current assets			
Inventories	**(2)**	371.1	388.6
Trade receivables	**(3)**	374.1	384.4
Other receivables and assets	**(3)**	126.9	72.6
Securities	**(4)**	13.2	13.1
Cash and cash equivalents	**(5)**	71.6	44.0
		956.9	902.7
Deferred tax assets	**(6)**	60.2	39.5
		1,299.4	1,240.6

Equity and liabilities

in €m	Note	31.12.2003	31.12.2002
Equity	**(7)**		
Issued capital		42.0	41.8
Capital reserve		82.2	81.5
Revenue reserves		349.5	324.2
Net loss/profit		– 30.0	28.1
		443.7	475.6
Provisions			
Pension provisions	**(8)**	86.6	82.5
Tax provisions	**(9)**	0.4	3.5
Other provisions	**(9)**	221.9	180.4
		308.9	266.4
Liabilities	**(10)**		
Bank borrowings		148.0	132.9
Payments received on account of orders		216.3	197.4
Trade payables		69.8	65.3
Other liabilities		59.3	54.3
		493.4	449.9
Deferred tax liabilities	**(6)**	53.4	48.7
		1,299.4	1,240.6

Group Income Statement for 2003

in €m	Note	2003	2002
Revenue	(13)	1,231.8	1,353.8
Costs of conversion	(14)	– 947.4	– 1,051.9
Gross profit		284.4	301.9
Research and development costs	(14)	– 57.6	– 47.8
Distribution costs	(14)	– 114.8	– 124.5
Administrative expenses	(14)	– 94.9	– 91.8
Other operating income and expenses	(16)	– 19.0	8.8
Loss/profit from operations prior to restructuring expenses		– 1.9	46.6
Restructuring expenses	(17)	– 45.1	–
Loss/profit from operations after restructuring expenses		– 47.0	46.6
Financial result	(18)	– 2.6	– 3.4
Loss/profit from ordinary activities		– 49.6	43.2
Income taxes	(19)	19.6	– 15.1
Net loss/profit for the period		– 30.0	28.1
Loss/earnings per share (in €)	(20)	– 1.86	1.75

Statement of Changes in Shareholders' Equity

in €m	Share capital	Capital reserve	Revenue reserves: Original financial instruments	Revenue reserves: Derivatives	Revenue reserves: Currency translation	Revenue reserves: Other	Net profit/ loss	**Total**
1 January 2002	41.6	80.0	1.3	–	5.0	285.1	40.0	453.0
Prior year dividend	–	–	–	–	–	–	– 16.0	– 16.0
Net profit	–	–	–	–	–	24.0	4.1	28.1
Capital increase from approved capital	0.2	1.5	–	–	–	–	–	1.7
Translation differences	–	–	–	0.1	3.2	–	–	3.3
Changes in value of financial instruments	–	–	– 1.2	6.7	–	–	–	5.5
31 December 2002	41.8	81.5	0.1	6.8	8.2	309.1	28.1	475.6
1 January 2003	41.8	81.5	0.1	6.8	8.2	309.1	28.1	475.6
Prior year dividend	–	–	–	–	–	–	– 8.0	– 8.0
Net loss	–	–	–	–	–	20.1	– 50.1	– 30.0
Capital increase from approved capital	0.2	0.7	–	–	–	–	–	0.9
Translation differences	–	–	–	– 0.2	– 5.3	–	–	– 5.5
Changes in value of financial instruments	–	–	0.2	10.5	–	–	–	10.7
31 December 2003	42.0	82.2	0.3	17.1	2.9	329.2	– 30.0	443.7

Cash Flow Statement

in €m	**2003**	2002
Loss/profit from ordinary activities	–49.6	43.2
Appreciation/depreciation on non-current assets	57.1	45.0
Foreign exchange gain/loss	– 3.1	– 0.4
Interest income/expense	1.8	– 1.7
Changes in long-term provisions	4.1	–
Loss/profit on disposal of non-current assets	– 1.8	0.3
Gross cash flow	8.5	86.4
Changes in inventories	5.8	111.0
Changes in receivables and other assets	– 29.5	– 7.0
Changes in provisions	41.1	– 6.1
Changes in liabilities	44.0	– 155.5
Interest expense	– 2.1	– 5.5
Tax expense	– 6.2	– 11.4
Cash flows from operating activities	61.6	11.9
Proceeds from disposal of intangible assets, property, plant and equipment	8.8	2.5
Payments for investment in intangible assets, property, plant and equipment	– 45.3	– 51.7
Proceeds from disposal of financial assets	0.4	0.3
Payments for investment in financial assets	– 7.1	– 1.1
Investment subsidies received	2.0	2.5
Dividends received	1.0	0.1
Cash flows from investing activities	– 40.2	– 47.4
Proceeds from capital contributions	0.9	1.7
Proceeds from borrowings	67.1	36.7
Repayment of debt	– 47.7	– 35.3
Change in minority interest	–	– 0.2
Dividends paid (previous year)	– 8.0	– 16.0
Cash flows from financing activities	12.3	– 13.1
Change in funds	33.7	– 48.6
Effect of changes in exchange rates	– 6.0	3.9
Funds at beginning of period	57.1	101.8
Funds at end of period	84.8	57.1

For further information see explanatory Note (I).

(A) Preliminary Remarks

The consolidated financial statements for the year to 31 December 2003 were prepared in accordance with the International Financial Reporting Standards (IFRS) valid on that date, as issued by the International Accounting Standards Board (IASB), London, and interpreted by the International Financial Reporting Interpretation Committee (IFRIC).

Individual items in the balance sheet and the income statement were aggregated to clarify presentation. These items are disclosed and explained separately in the notes below. For the income statement we used the cost of sales method. The Group currency is the euro. All amounts disclosed in the financial statements represent million euros (€m), unless otherwise indicated.

(B) Accounting Policies

The financial statements for Koenig & Bauer AG and its domestic and foreign subsidiaries were prepared in compliance with IAS 27 (revised 2000) using uniform accounting policies.

Intangible Assets

Purchased intangible assets were disclosed at their purchase price as per IAS 38 if it was likely that economic benefits attributable to the use of the assets would flow to the enterprise and their cost could be measured reliably. Each asset was amortised on a straight-line basis over its estimated useful life.

Development costs for new or significantly improved products were capitalised at cost if, as stipulated in IAS 38, the technical feasibility, an intention to sell and the existence of a market could be demonstrated, the attributed expenditure measured reliably, adequate development and marketing resources were available and future economic benefits probable. Compliance with the above criteria was checked by conducting product trials in the marketplace, with development costs capitalised from the date on which these trials were initiated. The straight-line method was used to allocate the depreciable amount of such products over their projected useful life, and annual impairment tests carried out. Adequate provision was made for future market trends.

Property, Plant and Equipment

Items of property, plant and equipment were disclosed at cost less depreciation based on the straight-line method and the use to which they are put. Manufacturing costs for self-constructed plant and equipment included an appropriate proportion of production overheads, material and labour costs. Under IAS 23 (revised 1993) borrowing costs were carried as an expense, not as part of the cost of an asset. Costs for maintenance and repairs were also recognised as an expense. No land or buildings were held as financial investments as defined in IAS 40.

Grants

Since government grants are classified by IAS as a reduction in the cost of assets, they were recognised as a reduced depreciation charge over the asset life.

Leases

Leases for which the KBA Group, as the lessee, assumed the basic risks and rewards incident to ownership were capitalised as finance leases under non-current assets. Leased property was measured at fair value or the lower present value of the minimum lease payments. Depreciation was calculated using the straight-line method for the shorter of the two periods (the term of the contract or the useful life of the leased property). Payment obligations arising from future lease payments were disclosed in other liabilities. Where the risks and rewards incident to ownership were not assumed, the lease was classified as an operating lease and payments carried as expenses.

Depreciation

The systematic depreciation of intangible Group assets, property, plant and equipment was based on the following useful lives:

	Years
Industrial property rights and similar rights	3 to 7
Goodwill	3 to 10
Negative goodwill	10
Product development costs	4 to 6
Buildings	5 to 40
Plant and machinery	3 to 15
Other facilities, factory and office equipment	2 to 12

In addition intangible assets, property, plant and equipment were, where applicable, tested for impairment loss on the balance sheet date as per IAS 36 and the *recoverable amount* defined as the higher of an asset's net selling price and its value in use. Where the recoverable amount was lower than the carrying amount the difference was disclosed as an impairment loss. If the reason for a write-down no longer applied, an adjustment in the allowance account was made, up to the amortised cost of acquisition or manufacture.

Financial Assets

These were measured at cost upon initial disclosure and subsequently classified in four categories under IAS 39 (68) (revised 2000): loans and receivables originated by the enterprise and not held for trading; investments held to maturity; financial assets available for sale; and financial assets held for trading. Loans originated by the enterprise and investments held to maturity were measured at their amortised cost or lower net recoverable amount. Available-for-sale financial assets were measured at fair value, with unrealised gains and losses recognised directly in equity, net of deferred taxes. Financial assets were recognised in the balance sheet on the settlement date. No financial assets were held for trading.

Investments in unconsolidated affiliates (*see Note (C)*) were measured at their amortised cost.

Inventories

Inventories were carried at the cost of purchase or conversion, with the latter including individual items, their proportionate share of total overheads and depreciation based on a normal level of plant utilisation. Borrowing costs under IAS 23 (revised 1993) were not included. The cost of inventories that could not be measured on an item-by-item basis was calculated using the weighted average cost formula.

Inventories whose net realisable value on the balance sheet date was lower than cost, for example due to damage, impaired marketability or prolonged storage, were written down to the lower value. The net realisable value is the estimated sales revenue realisable in normal business minus the estimated cost of completion and the estimated costs that would be incurred to make the sale.

Receivables and Other Assets

Receivables and other assets relate to loans and receivables originated by the enterprise, with the exception of derivatives. Under IAS 39 (revised 2000) they were stated at their amortised cost or the lower recoverable amount. Value adjustments were made for all recognisable risks, based on item-by-item risk assessments and past experience. Bill holdings, non-interest-bearing debts and low-interest debts with maturities of more than one year were discounted.

Contract Revenue and Expenses

Contract revenue and expenses were disclosed using the percentage of completion method, as per IAS 11 (revised 1993). Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and profit which can be attributed to the proportion of work completed. Contract revenue was carried under trade receivables after deducting payments received.

Marketable Securities, Cash and Cash Equivalents

These refer to available-for-sale financial instruments carried at market value on the balance sheet date, as specified in IAS 39 (revised 2000). This classification was also used for fixed-interest securities and shares, since we have no plans to hold these until final maturity. Unrealised gains or losses were recognised in equity, net of deferred taxes.

Pension Provisions

Pension provisions were measured using the projected unit credit method described in IAS 19 (revised 2000), an actuarial means of valuation that recognises the present and potential benefits known on the balance sheet date and includes an estimate of anticipated increases in salaries and pensions. Actuarial gains and losses were recognised only where they exceeded a 'corridor' of plus or minus 10% of the accrued benefits, divided by employees' average remaining years of service.

As a rule, in accordance with national and regional regulations, we offer our employees defined-benefit pension plans.

Other Provisions

These included all other corporate risks and contingent liabilities to third parties, insofar as an outflow of resources was probable and could be reliably assessed. The amounts disclosed in other provisions represent the best estimate of the expenditure needed to settle current obligations on the balance sheet date. Long-term provisions were disclosed at their present value where the interest effect was substantial.

Liabilities

Financial liabilities, with the exception of liabilities arising from finance leases, were initially disclosed at cost of purchase. In future years all liabilities, with the exception of derivatives, will be measured at the amortised cost.

Derivatives

In accordance with IAS 39 (revised 2000) all instruments such as swaps and future currency contracts were carried at market value. Changes in market value were reported in net profit or loss where no hedge accounting was used.

Where **hedge accounting** was used, changes in market value were reported either in equity or in the income statement. With a **fair value hedge**, changes in the market value of a hedging instrument and the underlying transaction were reported as a profit or loss. With a **cash flow hedge**, the portion of the gain or loss in the hedging relationship that was determined to be an effective hedge was recognised directly in equity and the ineffective portion reported in the income statement. Gains and losses were reported in the income statement as soon as the hedged transaction itself was recognised.

Derivatives in the form of marketable futures, currency and interest swaps were used to hedge against Group currency and interest risks. Where the conditions defined in IAS 39 (revised 2000) for an effective hedging relationship and its documentation were fulfilled, hedge accounting was used, more specifically cash flow hedges. Futures contracts were the prime hedging instrument against foreign currency risks for projected or existing transactions.

Deferred Taxes

Deferred tax assets and liabilities were recognised on temporary differences between IFRS and tax bases for Group enterprises, and in consolidation measures. Differences were calculated using the liability method specified in IAS 12 (revised 2000), and only tax-relevant temporary differences were taken into account. Deferred tax assets also included claims to future tax reductions arising from the anticipated use of existing tax loss carryforwards, where this use was probable. Adequate provision was made against the likelihood that insufficient taxable income would be generated against which a deferred tax asset could be offset. The tax rates used to calculate deferred taxes were the national rates applicable or anticipated at the time of recovery. The effect of changes in tax rates on deferred taxes was reported when such changes came into force.

(C) Consolidated Companies and Consolidation Principles

Consolidated Companies

In addition to Koenig & Bauer AG, Würzburg, the consolidated financial statements include ten (previous year: 10) subsidiaries, together with one associated enterprise from the previous year. The financial statements for the consolidated companies were prepared using uniform accounting policies.

In 2003 Koenig & Bauer agreed to take over Bauer+Kunzi GmbH in Ditzingen, near Stuttgart, and also acquired the remaining shares in Print Assist AG in Höri (Switzerland) and KBA Koenig & Bauer (Asia Pacific) Sdn. Bhd. in Kuala Lumpur. If consolidated, these companies would have accounted for just one per cent of the Group's turnover and financial result. Altogether thirteen (previous year: 7) subsidiaries were excluded from the consolidated financial statements since they were of minor significance to the Group's financial position and performance. Of these, two companies were established during the business year.

A special fund, classified under IAS 27 (revised 2000) and SIC 12 as a special purpose entity, was not included in the consolidated financial statements since it was also of minor significance to the Group's financial position and performance. Available-for-sale financial instruments were carried at market value as per IAS 39 (revised 2000).

A list of Koenig & Bauer's investment holdings was filed in the Commercial Register at the Municipal Court in Würzburg under number HBR 109.

Consolidation Principles

The capital consolidation of affiliates and the disclosure of business combinations were reported using the book-value method, offsetting the cost of acquiring shares in subsidiaries against the Parent's share of equity at the date of initial consolidation. The difference between purchase cost and the Parent's share of equity was allocated to the subsidiary's assets and liabilities where the difference resulted from undisclosed reserves or liabilities. Any excess of cost over the amounts allocated was recognised as goodwill and amortised over the estimated useful life on a straight-line basis. Negative goodwill was deducted as a separate item in intangible assets and written back over the useful life, which was calculated from the weighted average depreciation period of the intangible assets, property, plant and equipment of the consolidated company. Goodwill generated prior to 1 January 1995 remained netted against reserves as permitted by IAS 22 (revised 1998).

Associates were consolidated using the equity method, following the consolidation principles stated above.

Receivables, liabilities, income and expenses relating to transactions among consolidated companies were eliminated, as were the profits from such transactions. With the exception of goodwill, temporary tax deferrals arising from the consolidation were recognised as deferred taxes under IAS 12 (revised 2000).

(D) Foreign Currency Translation

The financial statements of consolidated companies prepared in a foreign currency were translated using their functional currency and the foreign entity method specified in IAS 21 (revised 1993).

Since foreign subsidiaries are financially, economically and organisationally autonomous their functional currency is the same as their local currency. Their assets and liabilities were therefore translated in the consolidated financial statements at the closing rate, equity items at the historic rate and income and expenses at the average exchange rate for the year. The resulting exchange differences were disclosed in equity.

Goodwill arising from the acquisition of subsidiaries, and adjustments in the carrying amounts of assets and liabilities to fair value, were translated at the closing rate on the date of acquisition.

Monetary items in foreign currency were also translated at the closing rate in the financial statements for the individual companies. The ensuing currency gains and losses were recognised directly as income or expense.

(E) Notes to § 292a of the German Commercial Code (HGB)

The conditions laid down in the German Commercial Code (HGB), paragraph 292a, for exemption from the preparation of consolidated financial statements in accordance with German accounting and reporting law, were fulfilled as stipulated with additional explanatory notes. The consolidated financial statements and management report, which must be filed with the Commercial Register and published in the Bundesanzeiger (Federal Gazette), also comply with the European Union Directive on Consolidated Financial Statements (83/349/EEC) as interpreted by German Accounting Standard No. 1, "Exempting Consolidated Financial Statements in Accordance with §292a of the German Commercial Code", issued by the German Accounting Standards Committee.

The basic differences between IAS accounting and consolidating policies and German accounting regulations are detailed in the following items.

Non-current Assets

Under IFRS, the systematic depreciation of non-current assets is calculated over their useful economic lives on a straight-line, pro-rata basis, whereas German regulations favour the declining-balance method and simplification rules, with the useful life determined by tax regulations.

The application of IAS 17 (revised 1997) led in some cases to a reclassification of operating leases as finance leases and thus to the recognition of their current market value in property, plant and equipment.

According to German accounting regulations, investment subsidies must be disclosed as special items in equity and liabilities. Under IFRS they reduce the cost price.

IFRS stipulates that, under certain conditions, internally generated intangible assets, and more specifically development costs, must be capitalised.

Inventories

IFRS writes down inventories to the lower net selling price. The prudence principle advocated by German accounting regulations, however, recognises a higher volume of provisions.

IFRS favours the percentage of completion method for disclosing contract revenue and expenses. This is not permitted under German accounting laws.

IFRS does not allow payments received to be deducted from inventories.

Other Marketable Securities and Liabilities

German accounting law states that financial instruments (securities, receivables and liabilities, derivatives) are to be carried at cost (historical cost method) and at the most prudent value (imparity method in conjunction with the highest and lowest value method). Unrealised gains must not be collected, but provision must be made for anticipated losses related to incomplete contracts. IFRS, on the other hand, stipulates that financial instruments, depending on how they are classified, must be carried at market value, at amortised cost or at the recoverable amount, and derivatives marked to market. Unrealised gains and losses must be disclosed in accordance with IAS 39 (revised 2000). With a cash flow hedge, the portion of the gain or loss in the hedging relationship that was determined to be an effective hedge was recognised directly in equity until the hedged transaction itself was recognised.

Provisions

Pension provisions were reported using the projected unit credit method as per IFRS. This differs from measurement under German accounting regulations in that it factors in projected salary, career and pension trends.

In contrast to German accounting regulations no provisions could be made for expenses.

With IFRS, provisions are measured at the current best estimate, whereas German accounting regulations specify the prudence principle, which leads to higher provisions.

Deferred Taxes

According to IFRS all deferred tax assets and liabilities must be disclosed, and deferred tax assets created for tax loss carryforwards, if future taxable income is likely to be sufficient. Tax must be calculated according to the tax rate applicable on the balance sheet date. Deferred tax liabilities may be offset against deferred tax assets only if the conditions stipulated in IAS 12 (revised 2000) are fulfilled.

German accounting regulations stipulate that deferred tax assets and liabilities need only be created on consolidated transactions. Disclosure of other deferred tax assets is optional, with the proviso that tax loss carryforwards must not be recognised. The current tax rate applies when calculating taxes.

(F) Non-current Asset Movement Schedule

in €m	01.01.2003	Additions	Translation differences	Reclassi-fications	Disposals	**31.12.2003**
						Cost
Intangible assets						
Industrial property rights and similar rights	33.4	2.5	– 0.7	–	0.4	34.8
Goodwill	22.3	0.3	–	–	0.8	21.8
Negative goodwill from capital consolidation	– 0.3	–	–	–	–	– 0.3
Product development costs	12.4	–	–	–	–	12.4
	67.8	2.8	– 0.7	–	1.2	68.7
Property, plant and equipment						
Land and buildings	173.1	8.0	– 1.2	8.3	0.5	187.7
Plant and machinery	208.0	14.7	– 3.8	2.4	13.5	207.8
Other facilities, factory and office equipment	90.8	14.1	– 0.9	1.0	10.9	94.1
Advanced payments made and assets under construction	10.6	3.7	–	– 11.7	0.1	2.5
	482.5	40.5	– 5.9	–	25.0	492.1
Financial assets						
Investments in affiliates	3.7	6.8	– 0.1	0.9	0.1	11.2
Investments in associates	0.9	–	–	– 0.9	–	–
Investment securities	2.5	–	–	–	–	2.5
Other loans	0.4	–	–	–	–	0.4
Claims from life insurance	8.6	0.3	–	–	–	8.9
	16.1	7.1	– 0.1	–	0.1	23.0
	566.4	50.4	– 6.7	–	26.3	583.8

[1] of which €1m relate to web and special presses, €3.1m to sheetfed presses
[2] of which €6.3m relate to web and special presses, €0.2m to sheetfed presses

						Depreciation		Residual value
01.01.2003	Annual depreciation	Impairments	Write-ups	Translation differences	Disposals	**31.12.2003**	01.01.2003	**31.12.2003**
18.9	6.4	–	–	– 0.4	0.4	24.5	14.5	10.3
5.2	4.7	1.1	–	–	–	11.0	17.1	10.8
– 0.1	–	–	–	–	–	– 0.1	– 0.2	– 0.2
8.4	1.0	3.0	–	–	–	12.4	4.0	–
32.4	12.1	4.1[1)]	–	– 0.4	0.4	47.8	35.4	20.9
50.2	4.6	5.1	–	– 0.6	0.1	59.2	122.9	128.5
130.9	15.7	1.0	–	– 2.8	9.7	135.1	77.1	72.7
53.8	14.2	0.4	–	– 0.7	9.2	58.5	37.0	35.6
–	–	–	–	–	–	–	10.6	2.5
234.9	34.5	6.5[2)]	–	– 4.1	19.0	252.8	247.6	239.3
0.4	–	–	–	–	– 0.3	0.7	3.3	10.5
–	–	–	–	–	–	–	0.9	–
0.3	–	–	– 0.1	–	–	0.2	2.2	2.3
–	–	–	–	–	–	–	0.4	0.4
–	–	–	–	–	–	–	8.6	8.9
0.7	–	–	– 0.1	–	– 0.3	0.9	15.4	22.1
268.0	46.6	10.6	– 0.1	– 4.5	19.1	301.5	298.4	282.3

(G) Explanatory Notes to the Balance Sheet

(1) Non-current Assets

Depreciation on intangible assets and on property, plant and equipment was carried in costs of conversion, selling costs, general administrative costs and other operating expenses, the amortisation of goodwill and income from the reversal of negative goodwill were stated in the income statement as administrative costs.

Changes and impairments in individual items of non-current assets were disclosed in the non-current asset movement schedule on page 56. The impairment of development assets was disclosed under research and development costs, of goodwill under administrative expenses and of property, plant and equipment (closure of the Kusel facility and KBA-Berlin GmbH) under restructuring expenses.

Non-current assets include €0.2m (previous year: €0.4m) for rights arising from finance leases, €1.8m for plant and machinery from the previous year and €0.4m (€0.7m) for other facilities, factory and office equipment. Further details of finance leases are given in Note (10) under sundry other obligations.

No intangible assets or items of property, plant or equipment were pledged against liabilities and there were no other restrictions on the right of free disposal.

Government grants for promoting investment reduced the carrying amounts for intangible assets by €0.3m and for property, plant and equipment by €11.3m (previous year: €0.6m and €11.6m respectively).

Development costs are detailed in note (14).

Intangible Assets

Additions to industrial rights and similar rights related to purchased software and licences.

Goodwill arising from the acquisition of KBA-GIORI S.A., Lausanne was amortised over 10 years. Goodwill to the value of €10.1m arising from the merger of Karat Digital Press GmbH, Radebeul, with Koenig & Bauer AG was amortised over three years on the straight-line basis.

Negative goodwill resulting from the purchase of shares in KBA-Mödling AG, Mödling, in previous years was carried as income over a period of 10 years as specified in IAS 22 (revised 1998).

Property, Plant and Equipment

A new production hall for cylinder machining was completed in Würzburg and a new project management and after-sales service centre, with demonstration showroom for digital printing, was inaugurated in Radebeul.

Additions to property, plant and equipment primarily related to new and replacement plant and machinery as well as other plant.

Financial Assets

Major interests held by Koenig & Bauer AG are shown in the table below. Unless otherwise indicated, the figures for equity are those disclosed in the single-entity statements audited under the pertinent national accounting laws. Statements in foreign currencies show equity translated at the balance sheet date.

Company / Seat

	Capital share in %	Equity in €m
Consolidated affiliates		
KBA-Mödling AG, Mödling, Austria	>99.9	21.4
KBA North America Inc., Wilmington, Delaware, USA	100.0	24.1
KBA-Berlin GmbH, Berlin, Germany	100.0	3.1[1]
KBA-Le Mont-sur-Lausanne SA, Lausanne, Switzerland	100.0	18.6
KBA-GIORI S.A., Lausanne, Switzerland[5]	100.0	25.5
Holland Graphic Occasions B.V., Wieringerwerf, Netherlands	100.0	– 0.2[2]
Non-consolidated affiliates		
KBA (UK) Ltd., Watford, UK	100.0	0.8
KBA-France SAS, Tremblay-en-France, France	100.0	0.5
KBA-Italia S.p.A., Milan, Italy	100.0	1.3[3]
KBA Koenig & Bauer (Asia Pacific) Sdn. Bhd., Kuala Lumpur, Malaysia	100.0	0.0
KBA (HK) Company Ltd., Hong Kong, China	51.0	0.9
KBA Australasia Pty. Ltd., Lane Cove, Australia	100.0	0.1
KBA NORDIC A/S, Herlev, Denmark	50.2	0.2
KBA Printing Machinery (Shanghai) Co., Ltd., Shanghai, China	100.0	0.2
Bauer+Kunzi GmbH, Ditzingen, Germany	100.0	3.8[3]
KBA RUS GmbH, Moscow, Russia	100.0	0.0
Print Assist AG, Höri, Switzerland[5]	100.0	1.6
Interests		
KBA Leasing GmbH, Bad Homburg, Germany	24.9	– 0.5[2] [4]
KBA-GIORI India Private Ltd., New Delhi, India[5]	50.0	0.2

[1] A profit and loss transfer agreement with KBA-Berlin exists since 8.4./9.11.1971
[2] Deficit not covered by equity
[3] Figures for 2002
[4] Preliminary figures
[5] Indirect holding via KBA-Le Mont-sur-Lausanne SA

Two new sales subsidiaries were established in 2003: KBA RUS GmbH in Moscow and KBA Printing Machinery (Shanghai) Co., Ltd. in Shanghai.

Further additions to affiliated companies arose from the acquisition of Bauer+Kunzi GmbH in Ditzingen and the remaining shares in KBA Koenig & Bauer (Asia Pacific) Sdn. Bhd. in Kuala Lumpur and Print Assist AG in Höri.

(2) Inventories

The carrying amount of inventories balanced at net realisable value was €109m (previous year: €118.1m).

in €m	**31.12.2003**	31.12.2002
Raw materials, consumables and supplies	49.9	52.5
Work in progress	292.3	312.1
Finished goods and products	2.9	1.7
Payments on account	26.0	22.3
	371.1	388.6

(3) Receivables and Other Assets

in €m	**31.12.2003**	up to 1 year	Term to maturity 1 to 5 years	more than 5 years	31.12.2002	up to 1 year	Term to maturity 1 to 5 years	more than 5 years
Trade receivables	374.1	297.7	73.5	2.9	384.4	315.4	67.9	1.1
Other receivables								
- from affiliates	34.8	34.7	0.1	–	25.9	25.9	–	–
- from associates	–	–	–	–	0.1	0.1	–	–
- from companies in which interests are held	8.3	8.3	–	–	2.9	2.9	–	–
Other assets								
- tax receivables	8.0	8.0	–	–	4.4	4.4	–	–
- receivables from employees	5.2	5.2	–	–	4.6	4.6	–	–
- sundry other assets	70.6	53.0	16.1	1.5	34.7	26.0	7.9	0.8
	126.9	109.2	16.2	1.5	72.6	63.9	7.9	0.8
	501.0	406.9	89.7	4.4	457.0	379.3	75.8	1.9

Receivables and other assets were measured at their amortised cost. The amounts recoverable in the normal course of business were the carrying amounts.

Adopting the percentage of completion method resulted in €17.8m (previous year: €54.2m) being carried in **trade receivables**.

Sundry other assets contain prepayments of €3.3m (previous year: €1.7m) and other advance payments of €3.7m (€3.2m). Assets from derivatives are detailed in Note (11).

Interest, exchange and credit risks at the balance sheet date related to customer financing and loans to employees and agents. Interest risks are summarised in the table on the next page. Currency risks related to the conclusion of delivery contracts in foreign currencies, usually US dollars. These were hedged using derivatives (*see Note (11)*). Credit risks were contained by creating adequate provisions. Retention of title and hedging via credit insurance were used to minimise risks pertaining to sales. Provisions made in 2003 totalled €13.3m (previous year: €6.9m).

in €m	**31.12.2003** Carrying amount	Interest rate	Term to maturity in years	31.12.2002 Carrying amount	Interest rate	Term to maturity in years
Trade receivables	374.1	up to 10.2%	up to 8	384.4	up to 9.4%	up to 9
Receivables from affiliates	34.8	up to 3.7%	up to 2	25.9	up to 5.1%	up to 1
Receivables from employees	5.2	up to 6%	up to 5	4.6	up to 6%	up to 6
Other loans and assets	70.6	up to 8%	up to 10	34.7	up to 6%	up to 11
	484.7			449.6		

(4) Securities

These mainly refer to fixed-interest securities owned by the Parent and shares in a special fund combining stocks and bonds classified under IAS 39 (revised 2000) as available-for-sale financial instruments. €6.2m (previous year: €5.2m) of this special fund was pledged to employees in order to hedge phased retirement credits.

Fixed-interest securities were valued at €6.7m (2002: €6.8m).

The sale of shares in the **special fund** in 2002 resulted in a profit of €1.9m being carried in the income statement as other operating income. Previously this had been disclosed in equity. The balanced market value was €6.5m (previous year: €6.3m).

(5) Cash and Cash Equivalents

in €m	**31.12.2003**	31.12.2002
Cheques, cash in hand, balance at Bundesbank	0.2	3.7
Balances with banks	71.4	40.3
	71.6	44.0

(6) Deferred Taxes

Deferred tax assets and liabilities comprised the following:

in €m	Deferred tax assets 31.12.2003	31.12.2002	Deferred tax liabilities 31.12.2003	31.12.2002
Assets				
Non-current assets	2.4	1.4	18.0	21.9
Inventories	8.6	4.9	2.8	1.9
Receivables and other assets	3.9	6.3	17.7	6.8
Securities, cash and cash equivalents	–	–	0.6	0.1
	14.9	12.6	39.1	30.7
Equity and liabilities				
Equity	0.1	–	–	2.1
Provisions	18.8	19.9	7.1	7.8
Liabilities	7.3	3.4	7.2	8.5
	26.2	23.3	14.3	18.4
Tax loss carryforwards	19.3	4.1	–	–
Other	– 0.2	– 0.5	–	– 0.4
	60.2	39.5	53.4	48.7

Deferred taxes on equity refer to deferred taxes on the translation differences arising from consolidation procedures.

Other deferred tax assets and liabilities include offsetting as per IAS 12 (revised 2000) and provisions.

Deferred taxes totalled €11.2m (previous year: €4.5m).

(7) Equity

Changes in shareholders' equity are described in a separate schedule on page 48.

Issued Capital

At 31 December 2003 Koenig & Bauer AG had a total share issue of 16,157,860 (2002: 16,071,396) no-par shares with a par value of €2.60. The 86,464 increase over the previous year represents the issue of employee shares, using part of the €15.6m capital approved by the AGM on 22 November 2001. The remaining €15.2m was approved until 22 November 2006. Until 25 December 2004 the company is authorised to buy back shares up to a maximum of one tenth of the issued capital of €41.8m.

All bearer shares issued were paid up in full.

Capital Reserve

This included the extra charge from the issue of shares. Our capital reserve rose by €0.7m compared to the previous year, due to the issue of employee shares.

Revenue Reserves

These encompassed the accumulated net profits posted in previous years by consolidated companies (unless dividends were paid) and adjustments arising from the adoption of IFRS. Goodwill and negative goodwill acquired from capital consolidation prior to 1 January 1995 increased revenue reserves by €0.4m.

Revenue reserves also included translation differences relating to the financial statements of foreign entities and to changes in the market value of financial instruments after taxes, where these were not recognise as income or expense. The disclosure of original financial instruments raised revenue reserves by €0.3m (previous year: €0m).

The use of hedge accounting increased revenue reserves by €17m (previous year: €11.1m). During completion of the underlying transactions €6.7m (previous year: €3.8m) was recognise as income.

Deferred taxes were carried in equity, reducing revenue reserves by €6.8m (previous year: €3.6m).

(8) Pension Provisions

Pension provisions related to obligations to active and retired employees of Koenig & Bauer AG, and their survivors, from accrued and current benefits. Company pensions are based on a **defined-benefit plan**, with the company meeting all commitments to active and retired employees. Pensions are largely financed through additions to provisions and through a funded benefit system. If fund assets exceed obligations from pension commitments, the excess is capitalised in other assets as per IAS 19 (revised 2000). If fund assets do not cover obligations, net liabilities are carried in pensions provisions.

The extent of the pension obligation (defined-benefit obligation) was calculated using actuarial methods which necessarily entailed making estimates.

Calculations were based on a discount rate of 5.4% (previous year: 5.8%), or 6% (6.5%) in the USA, a salary increase of 2.7% (3.5%) and a median fluctuation rate of 3.5% (3.7%). Pension adjustments were calculated at 2% (2%).

Pension provisions constituted the following:

in €m	**31.12.2003**	31.12.2002
Present value of non-funded obligations	88.5	83.5
Present value of funded obligations	13.0	13.6
Current market value of plan assets	– 10.9	– 11.7
Current market value of obligations (offset)	90.6	85.4
Unrecognised actuarial gains/losses	– 3.9	– 1.0
Unrecognised changes due to implementation/change of plan	–	– 1.8
Currency gains/losses	– 0.1	– 0.6
Balance sheet value at 31.12.	86.6	82.0
- pension provisions	86.6	82.5
- assets	–	0.5

Net liability recognised in the balance sheet changed as follows:

in €m		**31.12.2003**		31.12.2002
Net liability recognised in the balance sheet at 01.01.		82.0		78.2
Annual expense		9.1		7.5
- current service cost	(2.7)		(2.7)	
- past service cost	(0.9)		(–)	
- interest cost	(5.5)		(5.5)	
- expected return on assets	(– 0.9)		(– 1.0)	
- recognised actuarial gain/loss	(0.9)		(–)	
- change due to implementation/change of plan	(–)		(0.3)	
Benefits paid		– 4.4		– 3.8
Translation changes		– 0.1		0.1
Net liability recognised in the balance sheet at 31.12.		86.6		82.0

The actual return on plan assets was €1.2m (previous year –€1.2m).

All pension components were disclosed in the income statement according to their function, with the exception of the interest portion, which was included in interest expense.

Expenses for **defined-contribution plans** totalled €2.5m (2002: €3m).

(9) Other Provisions

in €m	Status on 01.01.2003	Consumption	Reversal of provisions	Allocation	Translation difference	Status on 31.12.2003
Tax provisions	3.5	3.1	–	–	–	0.4
Other provisions						
- for employees	37.8	14.3	0.5	47.1	– 0.6	69.5
- for sales	61.3	8.3	5.2	16.6	– 1.2	63.2
- for sundry other purposes	81.3	54.0	0.4	63.0	– 0.7	89.2
	180.4	76.6	6.1	126.7	– 2.5	221.9
	183.9	79.7	6.1	126.7	– 2.5	222.3

Tax provisions primarily related to income taxes for prior business years.

Provisions for employees included holiday and flexitime credits, long-service expenses, credits for pre-retirement part-time plans and performance bonuses. Sales expenses covered provisions for process risks, warranty and commission obligations. Provisions for sundry other purposes primarily related to outstanding invoices.

Personnel expenses and other one-off expenses arising from current cost-cutting initiatives were disclosed in provisions for employees and for sundry other purposes *(cf. Management Report p. 16)*.

The maturity schedule for provisions is given below:

in €m	**31.12.2003**	Term to maturity up to 1 year	1 to 5 years	more than 5 years	31.12.2002	Term to maturity up to 1 year	1 to 5 years	more than 5 years
Tax provisions	0.4	0.4	–	–	3.5	3.5	–	–
Other provisions								
- for employees	69.5	39.8	28.4	1.3	37.8	18.8	14.6	4.4
- for sales	63.2	56.0	7.2	–	61.3	48.3	13.0	–
- for sundry other purposes	89.2	76.4	12.5	0.3	81.3	69.3	12.0	–
	221.9	172.2	48.1	1.6	180.4	136.4	39.6	4.4
	222.3	172.6	48.1	1.6	183.9	139.9	39.6	4.4

(10) Liabilities

in €m	**31.12.2003**	up to 1 year	Term to maturity 1 to 5 years	more than 5 years	31.12.2002	up to 1 year	Term to maturity 1 to 5 years	more than 5 years
Bank borrowings	148.0	115.9	19.6	12.5	132.9	89.5	26.2	17.2
Payments received on account	216.3	216.3	–	–	197.4	197.4	–	–
Trade payables	69.8	64.8	5.0	–	65.3	61.6	3.7	–
Other liabilities								
- to affiliates	2.2	2.2	–	–	1.5	1.5	–	–
- from taxes	8.7	8.6	0.1	–	6.7	6.7	–	–
- from social security and similar obligations	8.3	8.3	–	–	7.5	7.5	–	–
- from sundry other obligations	40.1	39.5	0.6	–	38.6	27.7	10.6	0.3
	59.3	58.6	0.7	–	54.3	43.4	10.6	0.3
	493.4	455.6	25.3	12.5	449.9	391.9	40.5	17.5

The carrying amounts of liabilities largely corresponded to their market value.

Lines of credit not drawn down by the KBA Group totalled €106.3m (previous year: €179.9m). Details of **bank borrowings** relating to existing interest risks are summarised below.

in €m	Term to maturity in years	Carrying amount	**31.12.2003** Interest rate	Carrying amount	31.12.2002 Interest rate
Loans	up to 1	61.3	up to 5.7%	72.1	up to 5.9%
	up to 5	19.6	up to 6.2%	26.2	up to 6.2%
	up to 10	12.5	up to 5.7%	9.5	up to 5.7%
	up to 12	–	–	7.7	up to 4.9%
Bank overdrafts	up to 1	54.6	up to 4.0%	17.4	up to 6.8%
		148.0		132.9	

Bank borrowings were secured by mortgages and other rights of lien to the value of €11.1m (previous year: €11.2m), and by the assignment of trade receivables totalling €7.9m (€4.9m).

Payments received included contract revenues of €126.9m (previous year: €108.7m).

Sundry other obligations included liabilities from finance leases to the sum of €6.1m (previous year: €6.6m). Sale and leaseback transactions based on customer finance models were concluded, with liabilities offset against accounts receivable to the same amount. Turnover was carried upon delivery of the machinery.

The present value of future payments for finance leases was broken down as follows:

in €m	**31.12.2003**	up to 1 year	Term to maturity 1 to 5 years	more than 5 years	31.12.2002	up to 1 year	Term to maturity 1 to 5 years	more than 5 years
Minimum lease payments	7.0	2.2	4.8	–	7.8	1.8	5.8	0.2
Interest portion	– 0.9	– 0.4	– 0.5	–	– 1.2	– 0.4	– 0.8	–
Present value of finance lease	6.1	1.8	4.3	–	6.6	1.4	5.0	0.2

The derivative items included in liabilities for sundry other purposes are explained more fully in Note (11).

(11) Derivatives

The KBA Group is exposed to numerous risks arising from its global activities.

Currency risk is the risk that the value of business transactions conducted in other currencies, particularly US dollars, will fluctuate due to changes in foreign exchange rates.

Interest rate risk is the risk that the value of variable-interest monetary investments or borrowings will fluctuate due to changes in market interest rates.

Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.

These risks are contained by a risk management system at group level. The principles laid down for the KBA Group ensure that risk is assessed and documented in accordance with systematic and uniform procedures. Further information can be found on pages 38 to 41.

Risks were hedged using standard market instruments such as future exchange transactions in tandem with interest and currency swaps.

In 2001 a currency swap with a maturity of 5 years was concluded to hedge current, fixed-term business transactions concluded in US dollars. The nominal volume at the balance sheet date 2003 was €28.5m (previous year: €45.8m), €19m (€34.4m) of this with a term to maturity of more than one year. In addition, forward contracts with a maturity of up to 3 years (3 years) were used to hedge the calculation rate of additional foreign currency trade contracts. The currencies hedged were primarily US dollars, Swiss francs and British pounds.

The nominal volumes underlying derivatives, and their market values, are listed below.

in €m	Nominal volume Total **31.12.2003**	Term to maturity more than 1 year	Market value **31.12.2003**	Nominal volume Total 31.12.2002	Term to maturity more than 1 year	Market value 31.12.2002
Forward contracts	153.1	26.4	22.9	153.5	31.5	8.5
Currency swaps	33.8	24.3	8.4	51.5	40.0	3.0
Interest swaps	30.7	20.5	– 0.7	30.7	30.7	– 1.7
	217.6	71.2	30.6	235.7	102.2	9.8

The **nominal volume** of derivatives signifies a calculated reference amount from which payments are deduced. The risk therefore lies not in the nominal volume but in changes in the related exchange and interest rates.

Market value corresponds to the gains and losses derived from a fictitious offsetting of derivatives on the balance sheet date calculated using standardised measurement procedures.

In the balance sheet the market values were carried as €46.5m (previous year: €17.7m) in other assets and €15.9m (€7.9m) in other liabilities. The effective portion of a cash flow hedging relationship was offset against equity as per IAS 39 (revised 2002) and only carried in the income statement when the underlying transaction was completed.

(12) Other Financial Commitments and Contingent Liabilities

Other financial commitments

in €m	**31.12.2003**	Term to maturity up to 1 year	1 to 5 years	more than 5 years	31.12.2002	Term to maturity up to 1 year	1 to 5 years	more than 5 years
Commitments from:								
operating leases	9.7	3.7	5.9	0.1	8.0	3.4	4.6	–
leasing and service contracts	12.2	3.5	8.2	0.5	5.6	1.6	4.0	–
delivery agreements	23.8	23.8	–	–	10.3	10.3	–	–
investment plans	4.3	4.3	–	–	8.7	8.4	0.3	–
sundry other activities	1.0	0.2	0.2	0.6	1.0	0.2	0.2	0.6
	51.0	35.5	14.3	1.2	33.6	23.9	9.1	0.6

Operating leases were mainly negotiated for IT equipment and our vehicle fleet. Leasing payments of €4.5m (previous year: €4.1m) were carried in the income statement. Commitments from operating leases were stated at the minimum lease payments.

Investment plans included commitments to invest in intangible assets to the value of €0.3m (previous year: €0.2m) and in property, plant and equipment to the value of €4m (€8.5m).

Sundry other commitments were carried at their nominal amount and included outstanding ground rent and deposits.

Contingent Liabilities

These comprised contingencies totalling €168.1m (previous year: €139.6m) from warranty agreements, and a bill commitment of €2.3m (€9m).

Contingencies from warranty agreements primarily related to repurchase guarantees to lessors and banks. The guaranteed repurchase price decreased over the term of the repurchase obligation.

No provisions were created for the contingent liabilities stated. Where existing risks were not classified as minor they were recognised in the balance sheet.

(H) Explanatory Notes to the Income Statement

(13) Revenue

Revenue was recognised in accordance with IAS 18 (revised 1993) and comprised revenue from sales and from the rendering of services relating to web presses, special presses and sheetfed offset presses. Price reductions, rebates, bonuses and bulk discounts granted to customers were deducted from revenue.

Contract revenue and expenses for big newspaper press lines were calculated using the percentage of completion method specified in IAS 11 (revised 1993). Contract revenue totalled €246.6m (previous year: €254.7m), accumulated revenue for contracts not completed by the balance sheet date came to €324.3m (€427.3m).

Further details can be found in Segment Information, Note (J).

(14) Expenses by Function

Costs of Conversion

Costs of conversion included the purchase and manufacturing costs of products sold. In addition to directly attributable material and prime costs these incorporated overheads, depreciation on production plant and inventory adjustments.

Costs of conversion also contained €0.3m in subsidies (previous year: €0.1m) for apprentice training, job promotion and project advancement.

Research and Development Costs

Research and development costs encompassed costs for original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding, and these were recognised in full in the income statement together with development costs not recognised by IAS 38. The amortisation and disposal of capitalised development projects were also disclosed under research and development costs.

Government research grants for expenses already incurred were recognised at the time of approval, reducing research and development costs by €1.2m (previous year: €0.7m). One condition for the disbursement of funds is that a complete record must be kept of all the costs incurred, and this record was submitted upon completion of the relevant project.

The €9.8m increase in expenses primarily related to research and development activities for new products and processes and the enhancement of our existing press range for the Drupa trade fair in May 2004.

IAS38 stipulates that development costs may only be capitalised if future economic benefits are expected to flow to the enterprise. The current economic climate, the massive devaluation of the US dollar and the associated increase in the prices of our products – the consequences of which are difficult to calculate – made a more reliable estimate of future benefits impossible. As a result total impairments were measured and carried at €3m.

Selling and Administrative Expenses

Wherever possible, income and expenses were attributed to their respective functions; those that could not be attributed were disclosed under other operating income and expenses.

The reduction in selling expenses was largely due to lower commissions resulting from a decrease in turnover. Administrative expenses included €5.8m (previous year: €4.6m) for the amortisation of goodwill, €1.1m of this relating to write-downs.

(15) Expenses by Nature

In order to maintain transparency in key items during conversion to the classification of expenses by function, basic expenses are summarised below according to their nature.

Material costs

in €m	**2003**	2002
Cost of raw materials, consumables, supplies and purchased goods	543.4	589.1
Cost of purchased services	92.0	121.3
	635.4	710.4

The lower level of plant utilisation at our web press facilities reduced the volume of purchased services by €29.3m (previous year: €15.5m).

Personnel costs (classified by nature)

in €m	**2003**	2002
Wages and salaries	303.4	312.4
Social security and other benefits	61.8	60.7
Pensions	5.3	5.6
	370.5	378.7

Average payroll	**2003**	2002
Wage-earning industrial staff	4,085	4,309
Salaried office staff	2,724	2,766
Apprentices/students	457	464
	7,266	7,539

(16) Other Operating Income and Expenses

in €m	**2003**	2002
Other operating income		
Gains from the disposal of non-current assets	4.1	0.5
Foreign currency gains	1.0	1.6
Currency measurement	4.4	9.7
Reversal of write-downs and provisions	6.6	17.3
Income from the disposal of marketable securities	–	1.4
Sundry other operating income	11.2	10.7
	27.3	41.2
Other operating expenses		
Losses from the disposal of non-current assets	2.3	0.8
Currency losses	12.9	0.5
Currency measurement	1.3	9.3
Creation of write-downs and provisions	11.1	6.9
Sundry other operating expenses	18.7	14.9
	46.3	32.4
Other operating income and expenses	– 19.0	8.8

Other operating income included insurance and compensation claims and other refunds. Government subsidies provided under the German Investment Subsidy Law of 1999 amounted to €1.1m (previous year: €2.1m) and subsidies for job promotion €1.3m (€1.5m).

Sundry other operating expenses included the loss of receivables outstanding and the payment of compensation and warranty claims.

(17) Restructuring Expenses

Asset impairments totalling €6.3m arose from the closure of our Kusel assembly works and KBA-Berlin GmbH and from the relocation of web press production activities from Mödling to Würzburg. Restructuring expenses also included personnel expenses and other one-off expenses *(for further details please turn to page 16)*.

(18) Financial Result

in €m	**2003**	2002
Investment income		
Income from investments in affiliates	0.9	–
	0.9	–
Interest income/expense		
Write-downs on marketable securities	–	– 0.3
Income from other securities and non-current loans	0.6	0.7
Other interest and similar income	10.9	12.8
- from affiliated companies	(0.1)	(0.2)
Other interest and similar expense	– 15.0	– 16.6
	– 3.5	– 3.4
Financial result	– 2.6	– 3.4

(19) Income Taxes

Tax expense mainly comprised the following:

in €m	**2003**	2002
Actual tax expense	– 1.6	– 4.8
Deferred taxes from loss carryforwards	15.1	– 5.9
Deferred tax income/expense from temporary differences	6.1	– 4.4
	19.6	– 15.1

Deferred taxes resulted from temporary differences between the commercial balance sheet and the tax balance sheet, and from differences arising from standard Group measurement and consolidation. Deferred taxes on loss carryforwards were capitalised where there was a likelihood that future taxable income would be sufficient to permit it.

Deferred taxes were calculated at the relevant national tax rates, which in 2003 ranged from 10.5% to 40%. Changes in tax rates on the balance sheet date were included. The higher corporation tax rate of 26.5% levied in, and limited to, 2003 to finance compensation for victims of the floods which occurred in 2002 was disregarded, since the expense of calculating it would have been disproportionately high and a loss was posted for the year in Germany.

in €m	**2003**	2002
Pre-tax loss/profit	– 49.6	43.2
Group tax rate	39.0%	39.0%
Expected taxes	19.3	–16.8
Tax effects from		
- variances due to different tax rates	8.4	5.6
- tax-free income	1.1	3.2
- amortisation of goodwill	– 2.2	– 1.7
- tax decreases and increases	–7.0	– 5.7
- other	–	0.3
Taxes on income	19.6	– 15.1
Overall tax ratio in %	39.5%	– 34.9%

The Group tax rate was the same as the domestic tax rate, since more than 80% of Group pre-tax profit was generated in the domestic market. The difference arising from calculations based on national tax rates was disclosed separately under "variances due to different tax rates".

The impact of income tax rebates unrelated to the accounting period, accumulated assets arising from the disclosure of hidden reserves during initial consolidation, adjustments following external audits and the use of loss carryforwards not previously taken into account was of minor significance.

(20) Earnings per Share

The total number of ordinary shares issued was 86,464 higher than in the previous year due to the issue of employee shares in the second quarter. There was no dilution of earnings per share. In accordance with IAS 33 (revised 1997) earnings per share for the previous year were adjusted retrospectively.

	2003	2002
Net loss/profit for the year in €m	– 30.0	28.1
Weighted average of ordinary shares issued	16,110,009	16,045,380
Loss/earnings per share	– 1.86	1.75

(I) Explanatory Notes to the Cash Flow Statement

The cash flow statement as per IAS 7 (revised 1992) shows how Group financial resources changed as a result of cash inflows and outflows from operating, investing and financing activities.

Cash flows from operating activities were adjusted for currency translation effects and changes in the number of consolidated companies. Financial resources comprised cash and cash equivalents and securities.

Acquisition costs totalled €6.8m (previous year: €0.1m), with both sums paid in full in the relevant business year. They were set against cash and cash equivalents worth €4.2m (€0.1m).

Non-current assets worth €2.1m (previous year: €15.1m), current assets worth €4.4m (€27.7m) and liabilities totalling €4.7m (€52.9m) were included in the consolidated financial statements.

Interest expense comprised €8.3m (previous year: €5.7m) in interest received and €10.4m (€11.2m) in interest paid. Tax expense embraced tax refunds of €1.7m (previous year: €0.0m) and payments of €7.9m (€11.4m).

(J) Segment Information

In accordance with the rules contained in IAS 14 (revised 1997), segment information for the KBA Group was broken down into business segments (web and special presses, sheetfed offset presses) as the primary reporting format and geographical segments as the secondary format. The distinction reflects internal reporting structures.

The business segment **web and special presses** encompasses newspaper, commercial, gravure, directory and security presses.

The business segment **sheetfed offset presses** constitutes commercial, book, packaging and digital presses.

Segment information was based on the same accounting and consolidation policies as the consolidated financial statements. Intragroup transactions contained in the segment result (operating profit) were priced to market.

There were no inter-segment sales. Non-cash expenses included changes in provisions and the impairment of current assets. Segment assets and liabilities included all assets and liabilities that had contributed to the operating profit generated in the business segment concerned. Segment assets primarily related to intangible assets, property, plant and equipment, inventories, trade receivables, receivables from affiliates and other assets. Segment liabilities basically included other provisions, payments received, trade payables and other liabilities.

Reconciliation covered assets, debts and consolidation between segments.

Business segments

	Web and special presses		Sheet offset presses		Consolidation/ reconciliation		Group	
in €m	**2003**	2002	**2003**	2002	**2003**	2002	**2003**	2002
External turnover	614.3	734.8	617.5	619.0	–	–	1,231.8	1,353.8
Operating profit prior to restructuring expenses	– 21.8	29.2	19.9	17.4	–	–	– 1.9	46.6
Operating profit after restructuring expenses	– 66.9	29.2	19.9	17.4	–	–	– 47.0	46.6
Depreciation	27.4	26.5	19.2	18.5	–	–	46.6	45.0
Significant non-cash expenses	102.9	73.6	32.1	38.4	–	–	135.0	112.0
Capital expenditure	27.5	31.0	15.8	18.2	–	–	43.3	49.2
Assets	508.9	533.0	615.2	591.2	175.3	116.4	1,299.4	1,240.6
Liabilities (with payments received)	418.4	344.4	139.5	143.8	297.8	276.8	855.7	765.0

The geographical areas were defined according to their significance for Group income. Other regions encompass Asia, central and south America, Africa and Australia.

In accordance with IAS 36 the segment result for 2003 contains impairments of €7.3m for web and special presses and €3.3m for sheetfed presses.

Geographical segments

	External turnover		Capital expenditure		Assets	
in €m	**2003**	2002	**2003**	2002	**2003**	2002
Germany	155.7	255.8	29.8	43.4	892.5	871.7
Rest of Europe	575.1	589.3	13.2	3.3	160.1	163.4
North America	201.6	207.1	0.3	2.5	71.5	89.1
Other regions	299.4	301.6	–	–	–	–
Consolidation/reconciliation	–	–	–	–	175.3	116.4
Group	1,231.8	1,353.8	43.3	49.2	1,299.4	1,240.6

(K) Related Party Relationships

Related party relationships as defined by IAS 24 (reformatted 1994) exist between the members of the management board and supervisory board.

Remuneration for active members of the management totalled €1.3m (previous year: €3.6m), with the entire sum representing fixed remuneration (previous year: €1.4m fixed remuneration, €2.2m variable remuneration). Remuneration for retired members and their survivors stood at €0.9m (€0.8m). Supervisory board remuneration totalled €0.1m (€0.4m).

€13.4m (previous year: €13.7m) was set aside for pension claims by active and retired members of the management board, and their survivors.

At 31 December 2003 members of the management board held 3.3% and members of the supervisory board 6.5% of Koenig & Bauer share capital, giving a total of 9.8%.

There were no other transactions with related parties.

Other information

A declaration of compliance was issued in accordance with §161 of German Company Law and made permanently accessible under www.kba-print.de/en/investor/corporate_governance.html

(L) Supervisory and Management Boards

Supervisory Board

Peter Reimpell
Chairman
Banker
Munich

Dr Hans-Bernhard Bolza-Schünemann
Deputy chairman
Engineer and physicist
Würzburg

Gottfried Weippert*
Deputy chairman
Technician
Eibelstadt

Josef M. Barth (until 26 June 2003)
Tax consultant
Stuttgart

Reinhart Siewert (from 26 June 2003)
Industrial economist
Würzburg

Peter Hanzelka*
Milling machine operator
Coswig

Rupert Hatschek
Investment manager
Vienna, Austria

Alfred Kuffler*
Representative of IG Metall
Frankenthal

Philipp Pöhlert* (until 26 June 2003)
Machinist
Worms

Beate Grabmair** (from 26 June 2003)
Translator
Frankenthal

Dieter Rampl
Spokesman for the management board
Bayerische Hypo- und Vereinsbank AG
Munich

Werner Ring*
Representative of IG Metall
Würzburg

Klaus Schmidt*
Director
Hettstadt

Prof Horst Peter Wölfel
Professor of engineering dynamics
Technical University Darmstadt
Höchberg

* elected by the workforce
** court-appointed successor to Philipp Pöhlert

Committees

Mediation committee as per § 27 (3) of the Law on Codetermination

Peter Reimpell
Rupert Hatschek
Klaus Schmidt
Gottfried Weippert

Human Resources Committee

Peter Reimpell
Rupert Hatschek
Dr Hans-Bernhard Bolza-Schünemann
Gottfried Weippert

Financial Audit Committee

Dr Hans-Bernhard Bolza-Schünemann
Peter Reimpell
Peter Hanzelka
Philipp Pöhlert (until 26 June 2003)
Gottfried Weippert (from 26 June 2003)

Management Board

Reinhart Siewert
President (until 26 June 2003)
Würzburg

Albrecht Bolza-Schünemann
President (from 26 June 2003)
Radebeul/Würzburg

Claus Bolza-Schünemann
Deputy president (from 26 June 2003)
Würzburg

Dr Frank Junker
Radebeul

Peter Marr
Waldbüttelbrunn

Andreas Mössner
Radebeul

Walter Schumacher
Gerbrunn

Other positions held by members of the Koenig & Bauer AG supervisory board

	Member of the supervisory board at:
Dr Hans-Bernhard Bolza-Schünemann Deputy chairman	Körber AG, Hamburg
Rupert Hatschek	Wienerberger AG, Vienna KBA-Mödling AG, Mödling
Dieter Rampl	Brau und Brunnen AG, Dortmund Vereins- und Westbank AG, Hamburg Bode Grabner Beye AG & Co. KG, Grünwald Bavaria Film GmbH, Munich Bavaria Filmkunst GmbH, Munich FC Bayern München AG, Munich (from May 2003) Bayerische Börse AG, Munich (from June 2003) Odeon Film AG, Munich (until January 2003) MAHAG - Münchener Automobil-Handel Haberl GmbH & Co. KG, Munich (until February 2003) Bank Austria AG, Vienna (until March 2003) Pension Consult GmbH, Munich (until March 2003) HVB Consult GmbH, Munich (until May 2003) HVB Asset Management GmbH, Munich (until July 2003)
Reinhart Siewert	KBA-GIORI S.A., Lausanne KBA-Mödling AG, Mödling Print Assist AG, Höri

(M) Events after the Balance Sheet Date

The acquisition of Metronic AG, Veitshöchheim, announced at the end of 2003 was completed in early 2004 with the purchase of a 73.9% shareholding. The initial consolidation took place in January. The company's projected annual turnover of approximately €36m represents just under 3% of Group turnover. The financial statements for Metronic AG are currently being prepared in accordance with Group accounting policies. Until completion no further information as per IAS 22 (revised 1998) can be disclosed.

Würzburg, 16 March 2004
Management Board

Reinhart Siewert
President (until 26 June 2003)

Albrecht Bolza-Schünemann
President (from 26 June 2003)

Claus Bolza-Schünemann
Deputy president (from 26 June 2003)

Dr Frank Junker

Peter Marr

Andreas Mössner

Walter Schumacher

(N) Auditors' Report

We have audited the consolidated financial statements, comprising the balance sheet, the income statement and the statements of changes in shareholders' equity and cash flows as well as the notes to the financial statements prepared by Koenig & Bauer Aktiengesellschaft, Würzburg, for the business year from 1 January to 31 December 2003. The preparation and the content of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements are examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, 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 International Financial Reporting Standards.

Our audit, which also extends to the Group management report prepared by the Company's management for the business year from 1 January to 31 December 2003, has not led to any reservations. In our opinion, on the whole the Group management report provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the Group management report for the business year from 1 January to 31 December 2003 satisfy the conditions required for the Company's exemption from its duty to prepare consolidated financial statements and the Group management report in accordance with German law.

Munich, 16 March 2004

Bayerische Treuhandgesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft
Auditors and Tax Consultants

Wiegand
Auditor

Dr Grottel
Auditor

Balance Sheet for Koenig & Bauer AG to 31 December 2003

under German Commercial Code (HGB)

Assets

in €m	**31.12.2003**	31.12.2002
Non-current assets		
Intangible assets	6.9	9.9
Property, plant and equipment	156.7	158.8
Financial assets	50.2	49.6
	213.8	218.3
Current assets		
Inventories less payments received	110.7	153.4
Trade receivables	326.0	321.5
Other receivables and assets	116.9	78.4
Securities	11.7	12.7
Cash and cash equivalents	29.5	19.0
	594.8	585.0
Prepayments	1.2	0.4
	809.8	803.7

Equity and liabilities

in €m	**31.12.2003**	31.12.2002
Equity		
Issued capital	42.0	41.8
Capital reserve	82.2	81.5
Revenue reserves	247.9	247.9
Net loss/profit	– 38.7	9.0
	333.4	380.2
Special items with equity portion	10.9	11.2
Provisions	59.9	58.5
Pension provisions	0.2	2.6
Tax provisions	190.4	163.4
Other provisions	250.5	224.5
Liabilities		
Bank borrowings	105.3	83.1
Trade payables	52.9	52.0
Other liabilities	56.8	52.7
	215.0	187.8
	809.8	803.7

Income Statement for Koenig & Bauer AG for 2003

under German Commercial Code (HGB)

in €m	**2003**	2002
Revenue	1,104.6	1,201.7
Costs of conversion	– 901.0	– 983.6
Gross profit	203.6	218.1
Distribution costs	– 88.8	– 99.6
Administrative expenses	– 47.6	– 49.9
Other operating income	16.4	27.4
Other operating expenses	– 78.2	– 59.7
Profit from operations prior to restructuring expenses	5.4	36.3
Restructuring expenses	– 32.1	–
Loss/profit from operations after restructuring expenses	– 26.7	36.3
Financial result	– 12.0	4.4
Loss/profit from ordinary activities	– 38.7	40.7
Extraordinary loss	–	– 20.2
Earnings before taxes (EBT)	– 38.7	20.5
Income taxes	–	– 2.0
Other taxes	– 0.9	– 0.6
Net loss/profit for the period	– 39.6	17.9

The basic differences between HGB and IFRS are elucidated in (E) Notes to §292a of the German Commercial Code.

Key Financial Dates

Interim report on 1st quarter 2004
15 May 2004

Koenig & Bauer Annual General Meeting
26 June 2004
Congress Centrum Würzburg

Interim report on 2nd quarter 2004
14 August 2004

Interim report on 3rd quarter 2004
14 November 2004

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