

# Water = Life

Annual Report 2003

**WEDECO AG**  

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Water Technology

## Key figures

|                                     | 2001<br>T€ | 2002<br>T€ | 2003<br>T€ |
|-------------------------------------|------------|------------|------------|
| Revenue                             | 81,371     | 143,928    | 125,898    |
| Revenue change                      | 61.8 %     | 76.9 %     | -12.5 %    |
| EBITDA                              | 11,153     | 20,893     | -647       |
| EBITDA change                       | 44.7%      | 87.3%      | -103.1 %   |
| EBIT                                | 9,050      | 13,301     | -8,232     |
| EBIT change                         | 28.3%      | 47.0%      | -161.9 %   |
| Net result                          | 6,072      | 8,390      | -8,158     |
| Net result change                   | 32.5%      | 38.2%      | -197.2 %   |
| Net result return                   | 7.5%       | 5.8%       | -6.5 %     |
| Earnings per share                  | 0,58       | 0,77       | -0,74      |
| Earnings per share change           | 26.1%      | 32.8%      | -196.1 %   |
| Cash flow from operating activities | 3,567      | 3,334      | 94         |
| Total assets                        | 94,654     | 149,832    | 146,122    |
| Shareholders` equity                | 67,455     | 75,169     | 64,452     |
| Equity ratio                        | 71.3%      | 50.2%      | 44.1 %     |
| Capital expenditure                 | 11,479     | 56,405     | 14,644     |
| Average number of employees         | 418        | 724        | 733        |
| Revenue per employee                | 195        | 199        | 172        |

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## Important points set for the future



Christoph Dicks

Dear shareholders, business partners, customers and employees,

Since the IPO of WEDECO AG in 1999, the founder and first Chairman of the Management Board of our TecDax-listed company, Werner Klink, has used this foreword to comment on the events of the previous financial year. As it had been agreed with ITT Industries as part of the framework of the takeover negotiations, Werner Klink retired from the Company on February 6 of this year. Each of us at WEDECO – Management Board members and employees – had already adopted his [vision of a paradigm shift in water treatment](#) to provide people all over the world with healthy water as the driving principle for our own actions. Since Werner Klink has now placed WEDECO in our care, we feel this obligation to his vision even more intensely.

In addition to the operating activities in the 2003 financial year, strategic negotiations were conducted with a competitor in spring 2003 as well as with ITT Industries in autumn 2003. The Management Board and Supervisory Board are convinced that the [takeover offer made by ITT Industries German Holding GmbH, an indirect subsidiary of ITT Industries, Inc., White Plains, New York, USA](#), is the best strategic choice for the employees and shareholders of WEDECO, and for the future of WEDECO itself.

Following two earlier stages, first as a privately owned company and then as a publicly traded stock company, WEDECO is now entering the third stage of its development as a member of a large international publicly traded group.

The possibilities for continuing the development of UV disinfection and Ozone oxidation technologies within the ITT Group, and for combining them with other technologies such as filtration and biological treatment represent the best opportunity for WEDECO to fully develop its own potential. The Management Board anticipates that the integration of WEDECO AG into the ITT Group will allow the Company to increase its financial strength and operations expertise, and to leverage new business opportunities through the ITT Group's broad sales and marketing network in particular. The Management Board and the Supervisory Board feel that the compensation



offered to shareholders of EUR 18.00 in cash per share is also appropriate. The members of both bodies reported this in a joint statement and recommended shareholders to accept the public bid.

In the 2003 financial year, WEDECO recorded both a decline in revenue and a net loss. In addition to the poor state of the global economy, two key factors contributed to this disappointing result: The negotiations regarding strategic mergers with a competitor and ITT Industries caused WEDECO to incur costs of EUR 3.5 million. Secondly, due to the relocation of the two US companies WEDECO UV Technology Inc. and WEDECO Ozone Technologies Inc. to Charlotte, North Carolina, results for the North American market fell considerably short of their targets.

The Management Board implemented measures to remove the causes of this shortfall in the USA quickly and systematically, and to focus the Group on its core markets and core competencies in order to return the Company to its usual profitability in the 2004 financial year.

Positively, there is a large demand for UV disinfection and Ozone oxidation systems and equipment, which continues to grow. The technological edge of WEDECO AG in both areas is recognized by the market. Management and employees are highly motivated and eager to leverage the available business prospects in the interests of the shareholders.

The 2003 financial year was an important year for the future of WEDECO AG, a year in which the Company plotted its future course. The 2004 financial year will carry on from the Company's positive development, the main aspects of which are detailed in this Annual Report.

Düsseldorf, March 2004



Christoph Dicks  
Chairman of the Management Board



## Strategic partner



Michael Stolskij

Ladies and Gentlemen,

In line with the duties incumbent upon the Supervisory Board according to legislation, the Company's articles of association and terms of reference, the Supervisory Board of WEDECO AG implemented its tasks in seven joint meetings with the Management Board in 2003, with meetings of its committees (Personal, Audit and Corporate Governance Committees), in writing as well as in a number of conference calls. Key aspects of these talks were the issues of [the strategic alignment of the WEDECO Group](#), and, at the start of the year, particularly negotiations on the merger with a competitor in the UV-Disinfection. The Supervisory Board was convinced that the Management Board made every effort to ensure the success of this business merger. However, despite every effort taken, the merger was not implemented. In the middle of the year, ITT Industries initiated talks on the possibility of a co-operation with its water treatment division. In the course of these talks it became clear to both parties that it would be strategically preferable to integrate WEDECO into the water treatment division of the ITT Industries Group. This bundling of resources would present several advantages, particularly in the areas of international growth, the handling of increasingly larger projects with corresponding financing and risk hedging management requirements, and the possibility of combining complementary water treatment technologies. Thereupon the Management Board signed a [non-binding letter of intent](#) with the approval of the Supervisory Board.

On November 5, the key documents for a public takeover offer for the acquisition of shares in WEDECO AG by ITT Industries German Holding GmbH were presented and explained to the Supervisory Board. In this meeting, the Supervisory Board recommended that negotiations continue. On November 11, the Management Board and the Supervisory Board approved the [conclusion of the business combination agreement](#), as well as the total transaction it provided for, on the basis of the final version of contracts reached through negotiations and an independent fairness opinion. In a joint statement by both bodies it has been recommended to the outstanding shareholders to [accept the offer](#). The offer price by ITT Industries German Holding GmbH of [EUR 18.00 in cash per WEDECO share](#) was 33.9% higher than the German weighted average price of WEDECO shares during the last three months prior to the publication of the takeover offer. On December 30, ITT Industries German Holding GmbH reduced its original minimum acceptance level from 95% to 75% of WEDECO shares issued. On January 16, 2004, ITT Industries German Holding GmbH reported



that the [acceptance rate and all other conditions of the public offer had been met](#). In its first meeting of the 2004 financial year, the Supervisory Board accepted the resignation of the previous Management Board and appointed Christoph Dicks (Chairman), Till Schwarzlose (Finance), Dr. Andreas Kolch (Research and Development) and John Marrino (Sales, Marketing and Public Relations in North America) as [new members of the Management Board](#). The Supervisory Board and the staff bid farewell to the departing Chairman of the Management Board and founder of the Company, Werner Klink, at a celebration at the site of the main location of WEDECO AG in Herford, Germany. The Supervisory Board and the staff honored Werner Klink's life's work and gave him their assurances for the continuing success of the Company.



The annual financial statements of the Company and the management report prepared in line with the Handelsgesetzbuch (HGB – German Commercial Code) and the consolidated financial statements, including the consolidated management report as of December 31, 2003 prepared in line with IFRSs (International Financial Reporting Standards) were audited by the auditor chosen by the Annual General Meeting and mandated by the Supervisory Board, KPMG Deutsche Treuhand-Gesellschaft AG Wirtschaftsprüfungsgesellschaft, Düsseldorf, and [given an unqualified audit certificate](#). The audit reports were discussed in detail in a joint meeting with the Management Board and the auditor on March 18, 2004. The auditor provided supplementary information on several key areas. The Supervisory Board carefully examined the annual financial statements. There were no objections. The report of the auditor was approved by the Supervisory Board. The Supervisory Board approved the [annual financial statements and the management report for the 2003 financial year](#) prepared by the Management Board which are thus adopted and approved the consolidated financial statements and the consolidated management report for the 2003 financial year. After examination, the Supervisory Board concurs with the proposal of the Management Board on the appropriation of the result shown on the balance sheet.

Düsseldorf, March 2004

A handwritten signature in blue ink, appearing to read 'Stolskij', with a stylized flourish at the end.

Michael Stolskij  
Chairman of the Supervisory Board

## Management Board



Werner Klink  
Chairman until February 2004

- Born 1941
- Married, 2 children
- Businessman
- Self-employed entrepreneur since 1973
- Founder of the WEDECO Group
- Chairman of the WEDECO AG Management Board since 1999 until February 2004



Christoph Dicks  
Chairman since February 2004

- Born 1969
- Single
- Degree in business administration
- Head of International Controlling in the WEDECO Group from 1997 to 1999
- Vice Chairman and Chief Financial Officer on the WEDECO AG Management Board since 1999 until February 2004
- Since February 2004 Chairman of the WEDECO AG



Till Schwarzlose  
Finance

- Born 1971
- Married, 1 children
- Degree in business administration
- Since 2001 until February 2004 Head of International Controlling
- Since February 2004 Vice Chairman and Chief Financial Officer on the WEDECO AG Management Board



Dr. Andreas Kolch  
Research & Development

- Born 1965
- Married, 1 child
- Ph.D. in biology
- Head of Research and Development of the UV company in the WEDECO Group from 1994 to 1999
- WEDECO AG Management Board member with responsibility for R&D since 1999



John Marrino  
Sales North America

- Born 1966
- Married
- Bachelor of Science (Engineering)
- Various management positions in the WEDECO Group between 1990 and 1999
- WEDECO AG Management Board member with responsibility for Sales, Marketing and Public Relations in North America since 2002



## Supervisory Board



Michael Stolskij  
Chairman

- Born 1947
- Married, 3 children
- Management Consultant
- Managing Partner at LIGA Management Consultants GmbH since 1999
- Chairman of the WEDECO AG Supervisory Board since 1999



Holger Künzel  
Vice Chairman

- Born 1943
- Married
- Degree in business administration
- Managing Director at WBL Holding GmbH since 1998
- Vice Chairman of the WEDECO AG Supervisory Board since 1999



Prof. Dr. med. Martin Exner

- Born 1951
- Married, 4 children
- Full Professor and Director of the Institute for Hygiene and Public Health at the University of Bonn
- Doctor of Hygiene and Environmental Medicine
- Member of the WEDECO AG Supervisory Board since 2002



Dr. jur. Peter Hess

- Born 1948
- Married, 6 children
- Lawyer
- National Assembly member
- Co-owner of a lawyers office in Zug/Switzerland
- Member of the WEDECO AG Supervisory Board since May 9, 2002



Michael Roesen

- Born 1936
- Married, 2 children
- Lawyer
- Owner of a legal partnership in Düsseldorf since 1964
- Member of the WEDECO AG Supervisory Board since May 29, 2002



Horst Wedekamp

- Born 1938
- Married, 2 children
- Engineer
- Founder of the WEDECO Group
- Managing Director at WEDECO Gesellschaft für UV-Verfahrenstechnik mbH, 1995 until 1999
- Member of the WEDECO AG Supervisory Board since 2002

## 2003 - an eventful year for WEDECO



### January

- WEDECO shares begin the new year on the stock exchange at a price of EURO 13.15.
- WEDECO Umwelttechnologie supplies a large ozone system for a particularly innovative application at the Kalundborg waste water treatment plant in Denmark. The municipal treatment plant treats difficult pharmaceutical waste water.

### February

- The Korean subsidiary, WEDECO Co., Ltd. receives a large order for wastewater disinfection from the operator of the Goyang water treatment plant. The UV waste water system employs the new WEDECO HP lamp technology.

### March

- WEDECO acquires the French ozone company Trailgaz from Veolia Water Systems, formerly Vivendi Water Systems. Trailgaz is the third largest ozone company in the world. The company becomes a subsidiary of WEDECO Umwelttechnologie, WEDECO's ozone company.
- Financial statements for 2002 are published at the well-attended balance sheet press conference in Düsseldorf. The Chairman of the Management Board, Werner Klink, reports another successful year.
- In Turkey, WEDECO is awarded a contract to supply a large ozone system (order value: EUR 2.3 million) for the Kagithane drinking water plant in Istanbul, Turkey.

### April

- Wassergewinnung Essen GmbH orders from WEDECO for EUR 1.7 million three drinking water treatment ozone systems for the Essen Überehr waterworks.
- WEDECO receives an order to upgrade the municipal waste water treatment plants for the city of Charlotte, USA with UV disinfection systems.

### May

- Following the termination of negotiations regarding a merger with a competitor, which incur a non-recurring expense of EUR 3 million, WEDECO lowers its forecasts for 2003.
- Publication of the report on the first three months on May 13: Revenue and earnings down in the first quarter: EUR 24.8 million revenue, net loss of EUR - 3.5 million.
- At the 4th Annual General Meeting of WEDECO AG in Düsseldorf, the Management Board receives a vote of confidence from an overwhelming majority.

### June

- The US general contractor Pizzagalli orders a state-of-the-art UV waste water disinfection system for the Pelham waste water treatment plant in South Carolina, USA (order value: EUR 1.2 million).
- WEDECO is awarded a large contract in Las Vegas. Two drinking water plants will receive cutting edge ozone systems from the newest WEDECO subsidiary Trailgaz. The total order value is more than USD 5.5 million.



## July

- The Italian city of Milan places an order for the largest UV system ever installed on the European mainland for its newly built waste water treatment plant. The order volume totals EUR 1.7 million.

## August

- On August 12, WEDECO publishes its half-year results, with revenue of EUR 61.8 million. The losses of the first quarter are now reduced considerably to EUR -2.8 million.
- WEDECO UV Systems, United Kingdom, lands another major framework agreement. Southern Water, a leading UK water utilities company, will award orders worth EUR 3.4 million to upgrade waste water treatment plants with UV disinfection.

## September

- WEDECO UV Systems wins a contract from Yorkshire Water Services to supply a UV waste water disinfection system for the Withernsea water treatment plant on the east coast of England.

## October

- WEDECO AG supplies Hydrochem Pte. Ltd., one of Singapore's largest water utilities and waste companies, with three UV systems to disinfect the high-quality "gray" water produced by the Seletar water works.

- On October 24, WEDECO opens its new North American headquarters in Charlotte, North Carolina, USA with a ceremony attended by over 300 guests.

## November

- WEDECO AVP, Australia wins a contract for a large UV project from United Utilities Australia Pty Ltd. The project has an order value of EUR 1.7 million.
- On November 11, ITT Industries submits a takeover bid to shareholders for all shares in WEDECO at a price of EUR 18 per share in cash.
- On November 11, WEDECO also publishes its report on the first nine months: revenue reaches EUR 98.5 million with a consolidated loss of EUR -0.9 million.

## December

- The acceptance period for the public take over bid to the shareholders of WEDECO AG begins on December 9, 2003. The Management Board and the Supervisory Board had previously approved the transaction and advised shareholders to accept the offer.
- WEDECO shares close the year on December 31, 2003



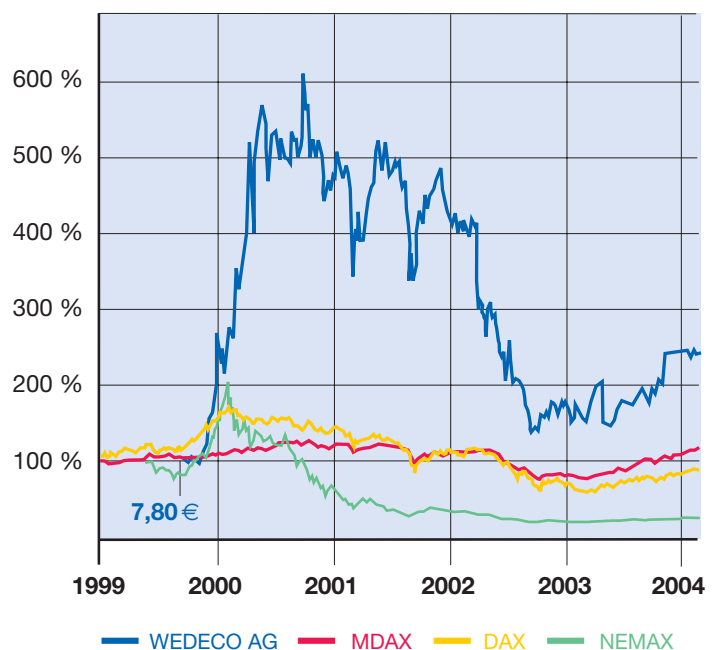
## WEDECO share



### Share data

|  |  |
|--|--|
| Securities identification number         | 514180   |
| ISIN                                     | DE 0005141808  |
| Exchange abbreviation                    | WDO  |
| Trading exchanges                        | Frankfurt, Berlin,<br>Bremen, Düsseldorf,<br>Hamburg, Munich,<br>Stuttgart |
| Trading segment                          | MDAX,<br>from March 24, 2003:<br>TecDAX                                    |
| Issue price                              | € 7.80   |
| Year high                                | € 17.87  |
| Year low                                 | € 9.80   |
| Year end closing price                   | € 17.86  |
| Average price for year                   | € 12.57  |
| Performance since IPO                    | + 129.0%   |
| Market capitalisation<br>at the year end | € 197,267,986  |
| Earnings per share                       | € 0.74   |
| Number of shares                         | 11,045,240   |

### Performance in comparison with the most important indices





Annual Meeting 2003 in Düsseldorf

In the course of 2003, WEDECO shares fluctuated within a range of EUR 9.80 to EUR 17.87 in the newly created TecDax technology index. Factors that had a material impact on the price included the profit warning in the spring 2003 following a weak first quarter, and the termination of negotiations on a possible merger with a competitor. The price then recovered and, on November 10 – one day before the announcement of the voluntary takeover bid by ITT Industries German Holding GmbH and ITT Industries, Inc., USA – the price reached EUR 13.94. ITT offered the shareholders EUR 18.00 in cash per share – almost 30 percent more – for their shares in WEDECO AG. The share then closed around this price on the last day of trading on German stock exchanges.

In the past 10 years, 490 companies went public on the German exchanges. The current market price only exceeds the issue price for 41 of these companies. Ranked at number 11 is WEDECO AG, whose shares were issued at a price of EUR 7.80 on October 26, 1999. As part of the takeover bid of November 11, shareholders who acquired their shares at the IPO and tendered their shares at a premium of over 130 percent. This corresponds to an average return on capital employed of more than 20 percent per year generated by WEDECO shares in the accounts of these shareholders.



## WEDECO - from pioneer to world market leader

The WEDECO AG Water Technology success story began 28 years ago with the formation of WEDECO Gesellschaft für Entkeimungsanlagen mbH and the establishment of the first small production facilities in Herford, Germany. From the very beginning, the company's business policy was shaped by the vision of chemical-free and environmentally friendly water treatment. In just a few years, WEDECO developed from being a pioneering operation with six employees to the European and later the world market leader for both water disinfection with UV light and water oxidation using ozone. Today WEDECO AG employs almost 800 people worldwide. The IPO in 1999 and the capital it generated opened up the path for WEDECO's global expansion.

The following chronicles are the story of the development of the company, the acquisitions made and the companies formed, highlights of product development and the acceptance vital for the attainment of procedure's success.



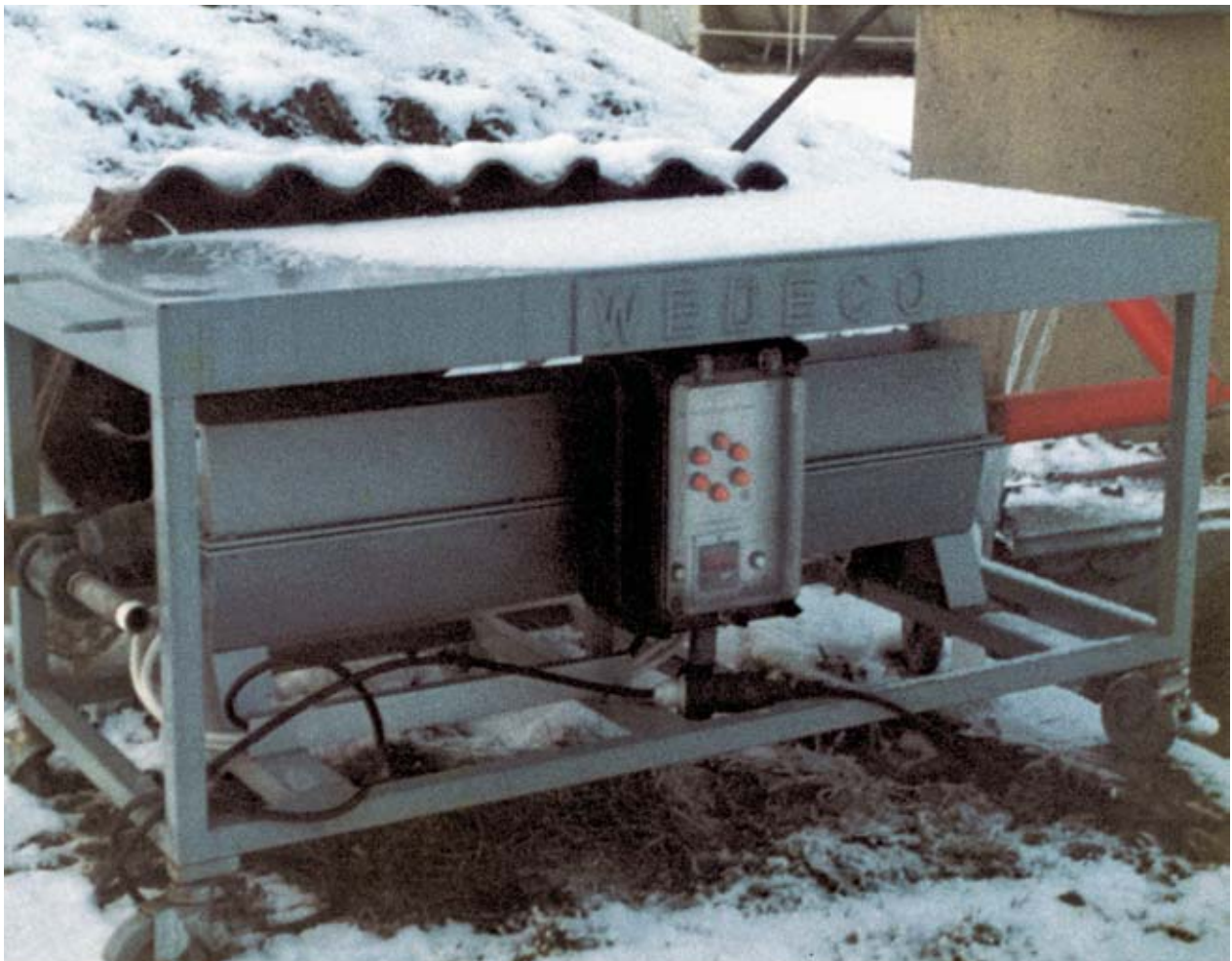
Old fashioned control device for UV disinfection system

The story of WEDECO is tied to two names, Horst Wedekamp and Werner Klink, who provided the inspiration for the company and its name WEDECO. At the start of the 1970s, Werner Klink, an experienced businessman in the electronic industry, met the technician Horst Wedekamp. At the time Horst Wedekamp had already spent several years working intensively on the use of UV light to disinfect water. At a time when the water supply industry considered chlorine to be the only acceptable disinfectant, he convinced the entrepreneur Werner Klink of the idea of disinfecting water without the use of chemicals by irradiating it with ultraviolet light. This groundbreaking method was to be the way forward.



## UV disinfection as an object of research

Since the early 1970s, various research groups were looking into the disinfection of water using UV light. In Munich, Dr. K. Scherb, the head of chemical research at the Munich-based Bavarian Biological Research Institute (Bayerische Biologische Versuchsanstalt), was investigating the use of UV technology in the disinfection of waste water at the waste water testing grounds at Grosslappen, Germany. The findings of his experiments were so promising that Dr. K. Scherb predicted a great future for UV waste water disinfection.



UV system at waste water test field Großlappen, Germany



WEDECO production  
in the year 1976



WEDECO UV disinfection system type E



1976

## WEDECO Gesellschaft für Entkeimungsanlagen mbH, Germany

Werner Klink and Horst Wedekamp had followed this research very closely. On July 14, 1976, they founded WEDECO Gesellschaft für Entkeimungsanlagen mbH. The production and marketing of the first UV water disinfection systems began on a small scale. The first E type series UV disinfection system was a small reactor with a positive geometry. The UV lamps were circular embedded around the quartz tube through which the water was piped. During these early days, working alongside Horst Wedekamp and Werner Klink, were Georg Horstmann, Gerhard Menke, Walter Berges and Günther Dammann.

## UV water disinfection for zoological parks

WEDECO systems were used in a wide variety of applications. For example, for disinfecting aquarium pool and exhibit water in zoological parks. The Duisburg Zoo, the Löbbecke Museum in Düsseldorf and later the Aquazoo as well used UV light early on to disinfect water in their aquatic exhibits.

## German "Seeberufsgenossenschaft" grants approval

In the mid-1970s, WEDECO worked together closely with the Seeberufsgenossenschaft (Professional Association of Seafarers) in Hamburg. In 1976 the organization launched an extensive investigation into UV disinfection of drinking and non-drinking water on ships. The results were positive, and WEDECO was granted the first official certificate in the company's history for the E type series UV disinfection systems.



View inside UV reactor type E:  
This picture was used for a long time  
as symbol for UV disinfection



First WEDECO building in Herford





WEDECO UV amalgam lamp



The first WEDECO UV sensor



1976

## UV sensor

To ensure sufficient disinfection, the UV dose generated by UV lamps in the water must achieve a sufficiently high level. This is monitored using UV sensors. In the late 1970s, WEDECO technicians developed a UV sensor for commercial use that was sufficiently sensitive in the wavelength range of the UV radiation generated for disinfection.

## UV amalgam lamp

The next and certainly the most important milestone in WEDECO UV technology dates back to the end of the 1970s. At this time, WEDECO began developing a special lamp for potable water supply on trains. Inspired by the positive results being achieved by UV systems on ships, the German Federal Railway launched an investigation into the possible use of UV water disinfection in trains. There was a particular problem that needed to be solved: the large fluctuations in temperature of on-board water storage tanks. The UV lamps available on the market at the time experienced a drastic deterioration in performance at temperatures of more than 40°C. A lamp that was virtually insensitive to temperature had to be developed. In close cooperation with prominent manufacturers of UV lamps, Horst Wedekamp developed a new type of UV lamp, which was later taken from prototype to production readiness by Josef Pirkel from the quartz lamp factory Dr. Ing. Felix Müller GmbH & Co. KG in Essen. This lamp was the low pressure high output (Lo-Hi) amalgam lamp, and would later form the core of all WEDECO systems under the brand name Spektrotherm®.

**1981**

## Cooperation with the Bremen Institute of Hygiene

In the early 1980s, a milestone for public acceptance of UV water disinfection of drinking water was the start of a cooperation with the Institute of Hygiene at the Hanseatic City of Bremen. At the time, Dr. Gängel, the director of the Institute, was conducting experiments in on disinfection of the water supply in the administration and laboratory building. In the past, routine investigations of the water supply had repeatedly established that the bacteria count was too high. These biological impurities were effectively removed eliminated by the use of UV systems.

**1988**

## First WEDECO ozone electrode

In 1988, WEDECO began working with ozone. It developed the unique, patented small diameter hexagonal ozone electrode, the core of which consisted of a six-sided metal rod set in a quartz borosilicate glass dielectric tube. This ozone electrode was first fitted in small ozone systems. One of the first systems for treating drinking water for the Ostheim, Germany community produced 150g/h of ozone from atmospheric oxygen.

## First current-controlled frequency converter

WEDECO ozone systems are controlled today at frequencies of up to 1,000 Hertz. At the time, converters available on the market could not generate this frequency, so WEDECO had to develop its own converter.

## First BMFT Special Research Program

UV disinfection of drinking water was already well established in some European countries, though not in Germany. The Norwegian city Stord installed a WEDECO UV system for disinfecting drinking water in 1977. In Germany, however, there was little acceptance of this new technology. As a result of many submissions and discussions initiated by prominent research institutes and UV equipment manufacturers, the German Federal Ministry for Research and Technology (BMFT) launched an ambitious



WEDECO Hexagonal Ozone Electrode

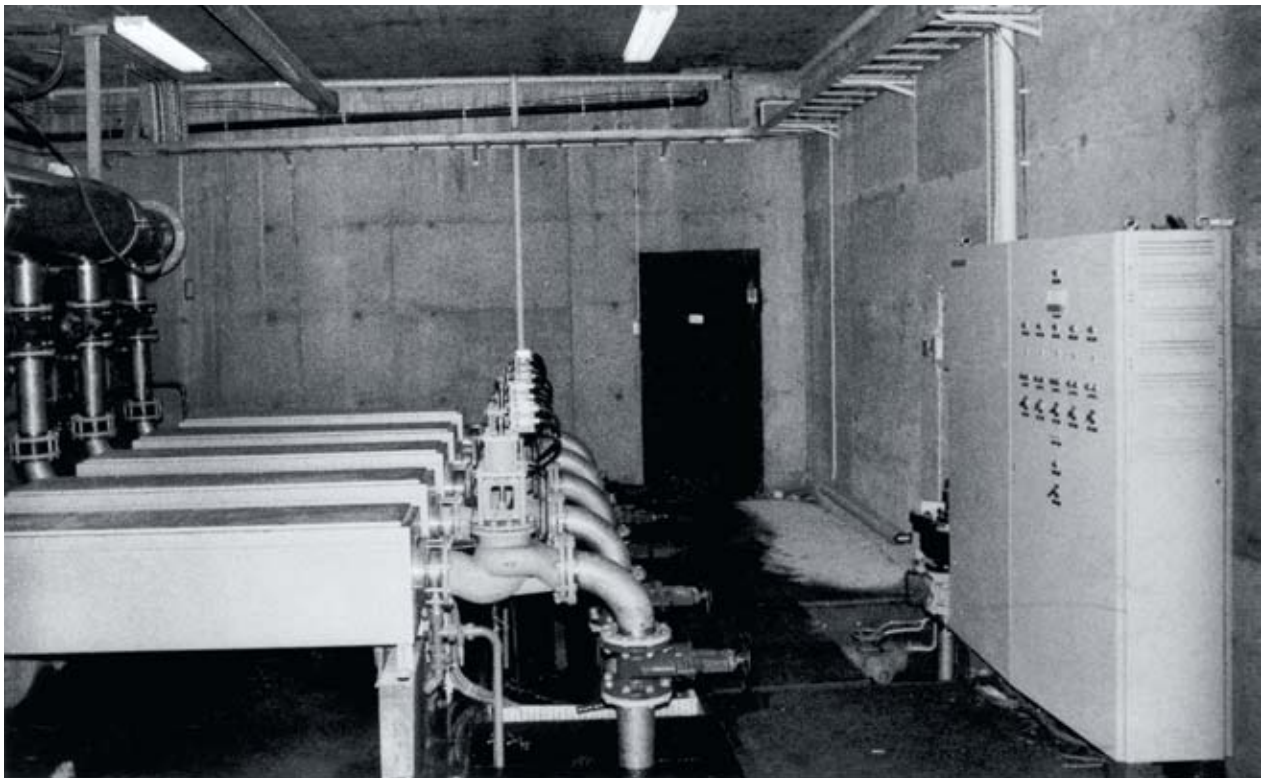


First current-controlled frequency converter from WEDECO

network research program in 1988. The objective of this was to systematically research the as yet unanswered questions regarding the use of UV light to disinfect drinking water. Presided over by Professor Heinz Bernhardt, this was the genesis of the First BMFT Research Project: "Investigation into the hygienic safety of drinking water disinfection with UV radiation". Not all the issues were dealt with conclusively, and so it was agreed to continue the investigations in a second BMFT project.

### International expansion

Between 1989 and 1991, WEDECO established subsidiaries in the Netherlands, Hungary, Spain, France and Switzerland to tap these markets with their own sales and service personnel.



UV drinking water disinfection in Stord, Norway



1991

## Second BMFT Special Research Program

Building on the findings of the first project, the second BMFT Project provided a further scientific basis for the safe use of UV disinfection in drinking water treatment.

1994

## Digital system control for ozone production

From 1992 to 1994, decisive work was carried out to improve the performance and control of smooth ozone production. The development and launch of a digital control system guaranteed a more efficient operation of WEDECO ozone generators.

## Joint Venture in Great Britain

In order to tap the UV waste water markets in Great Britain, WEDECO entered into a joint venture with a Manchester-based company in 1994. In just a few years it became the market leader in the British UV waste water market. In 1996, WEDECO acquired its partner's shares in the joint venture.

## Daylight-blind UV sensor

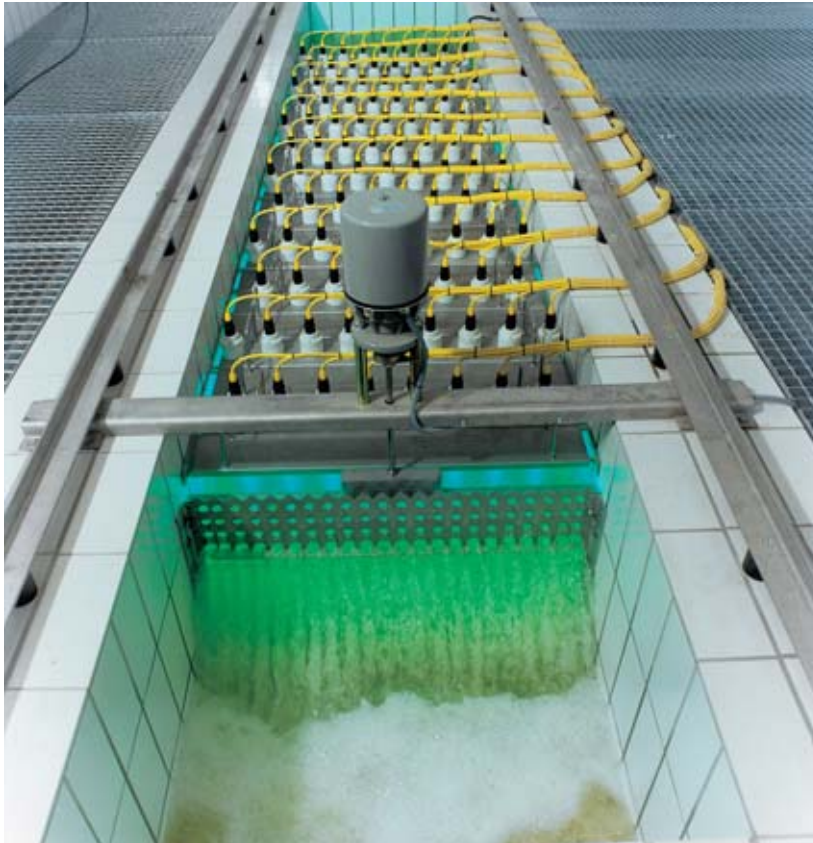
In order to use UV technology in open waste water channels, WEDECO engineers developed a daylight-blind UV sensor, which allows smooth continuous operation of UV systems in waste water without special filter technology.

## First UV waste water disinfection systems

At the beginning of the 1990s, the first WEDECO UV waste water disinfection systems were installed in the German City of Grömitz and in Baldwin, Florida, USA. Demand for WEDECO systems rose steadily in the following years; one milestone was the UV system in Tywyn, Wales, UK. Over the next few years, many large European coastal towns improved the quality of their coastal waters in line with the recently adopted European



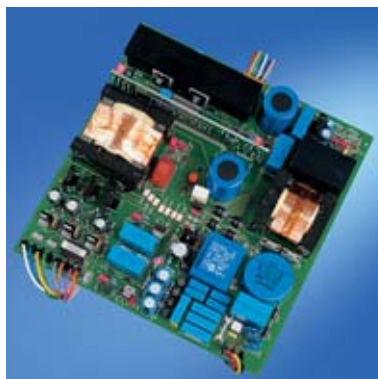
WEDECO TAK installation in Tywyn, Wales



TAK system Cismar at Grömitz, Germany



2001: WEDECO TAK waste water system in Manukau, New Zealand



Electronic ballasts ensure that the lamps operate economically and reliably

Bathing Water Directive, which had been passed by this time. Today, WEDECO supplies waste water disinfection systems in all sizes and on all continents. At the Manukau waste water treatment plant in Auckland, New Zealand, the waste water is disinfected using almost 8,000 Spektrotherm UV lamps. The plant is one of the largest in the world.

### WEDECO optimizes UV lamps with electronic power supply and control devices

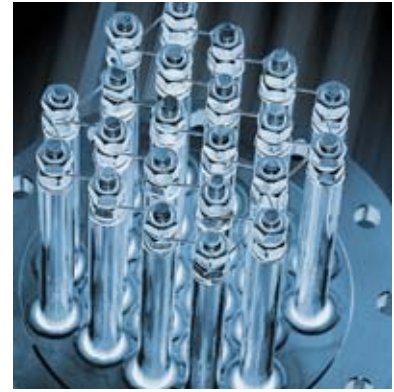
WEDECO developed an electronic power supply and control device that improves the overall performance of lamps while significantly reducing energy requirements. This reduces life cycle costs for customers, a key competitive advantage over substitute disinfection methods. WEDECO is the only manufacturer of to date to produce this specially patented control device.

## Development of EFFIZON® electrode

A milestone in the company's history was the development of a fundamentally new principle of ozone generation using the EFFIZON® electrode. This patented electrode significantly reduced the cost of ozone generation by allowing substantially higher ozone concentrations to be produced from smaller, more cost-effective ozone generators.

## First large EFFIZON® system

In September 1995, the first large system fitted with EFFIZON® electrodes was supplied to the German city Düsseldorf. These waterworks provides large parts of Düsseldorf with drinking water that was supplied from Rhine river bank filtrate. Today, all of Düsseldorf's drinking water plants are fitted with WEDECO ozone systems.



WEDECO Effizon® electrodes



Ozone system for drinking water treatment „Am Staad“, Düsseldorf, Germany





Test facility of the DVGW

1996

## DVGW certification for UV systems

WEDECO recognized early on the need to have the functionality of its UV systems documented by an internationally recognized certification. Therefore, in early 1996, WEDECO participated in the development of the German Association for Gas and Water (DVGW) certification body in Bonn, Germany, whose test standards are now recognized around the world.

## WEDECO Gesellschaft für Umwelttechnologie mbH, Germany

In 1996, the WEDECO Gesellschaft für Umwelttechnologie mbH, in which all the company's ozone activities are bundled, was formed. From its facilities in Herford it markets ozone systems of all sizes for a range of applications – and is now the world market leader in this field.



WEDECO ozone electrodes are subjected to intensive quality tests before they are used



WEDECO SMO/SMA compact ozone system with gas inflow and electronic control unit

1997

## WEDECO Technologie Ochrony Srodowiska Sp. z o.o., Poland

The formation of the Polish WEDECO subsidiary in Posen marks one of WEDECO's early first foray's into the Eastern European market.

## PCI-WEDECO, USA

Also in 1997, WEDECO acquired PCI Environmental Technologies, Inc., based in West Caldwell, New Jersey. Its product range was quickly converted to WEDECO EFFIZON® technology. Following a name change PCI-WEDECO is now the market leader in North America under the name WEDECO Ozone Technologies. In 2003, its headquarters and manufacturing facilities were relocated to Charlotte, North Carolina.



In October 2003 WEDECO inaugurated its new north american headquarter in Charlotte, North Carolina, USA

1999

## WEDECO and KATADYN merge their UV activities

In June 1999, both companies made the strategic decision to combine the UV activities of WEDECO with those of KATADYN. KATADYN companies in Switzerland, Germany and France were merged with WEDECO companies in Germany, Great Britain, Spain, Poland and Switzerland, and were supplemented by the global sales networks of both companies. Thus, the European market leader in UV disinfection was created under the parent company WEDECO AG Water Technology. KATADYN was founded in Switzerland in 1928, and had successes in drinking water treatment with methods using filtration, silver ions and UV disinfection. The merger signified the joining of Europe's two pioneers in UV water disinfection.



First trade day of the WEDECO AG at the Frankfurt Stock Exchange



## IPO of WEDECO AG Water Technology

On October 26, 1999, WEDECO AG was admitted to the SMAX segment on the Frankfurt Stock Exchange. A total of 4.5 million shares were offered on the capital market at a price of EUR 7.80 per share. Proceeds from the IPO were used to finance WEDECO's strategic acquisitions in its core markets, and to further extend its technological leadership. The first Management Board was made up of the company's founder Werner Klink (Chairman), Christoph Dicks (Finance) and Dr. Andreas Kolch (Research & Development).

### 2000

## Greater growth through acquisitions

In the first year after the IPO, WEDECO increased its market presence in the US by purchasing a UV company, Ideal Horizons, Inc., Poultney, Vermont, USA. Under its new name WEDECO UV Technologies Inc. it now employs more than 100 people and is headquartered in Charlotte, North Carolina.



In Austria VISA UV-Technologie GmbH in Seewalchen am Attersee was also acquired. It serves the market in Austria and Southern and Eastern Europe. In Great Britain – a key European market for WEDECO – the company consolidated its already strong position with the acquisition of UV Systems plc., Sudbury, now known as WEDECO UV Systems plc. By merging its operation with its second existing British subsidiary, WEDECO Ltd. in Manchester, WEDECO achieved UV market leadership in Great Britain. – one of the most important UV markets in Europe. The next acquisition took place in Spain where the Company first bought the Madrid-based Rex Ibérica S.A., which was then also merged with WEDECO's existing second Madrid-based subsidiary, Tecnologia Ambiental WEDECO S.A., to form WEDECO Rex S.A. By acquiring Puro srl., Parma, and establishing its own subsidiary Wedeco Technologie Aque srl. in Bari, WEDECO also took up a significant position at the forefront of the important Italian market. Production facilities in Parma were also expanded to become a key WEDECO manufacturing location.

## Admittance of WEDECO shares to SDAX

On March 20, 2000, WEDECO's shares were admitted to the SDAX segment, an index for Germany's top 100 listed small and medium entities.

## AWWA investigates Cryptosporidia

For decades, people in the USA trusted in drinking water disinfection using chlorine alone. It was not until the drinking water supply of Milwaukee, Wisconsin, a city with a regional population of several million, experienced a dramatic and deadly outbreak of parasites in the early 1990s. Hundreds of thousands of people were affected and several hundred died as a result of the infection and the USA also began to rethink its policy. New evidence showed that chlorination alone did not offer sufficient protection against these organisms, and the path was cleared for alternative water treatment methods. In 2000, WEDECO participated in an American Water Works Association (AWWA) sponsored program that investigated the effectiveness of several UV systems on cryptosporidia in large UV drinking water systems. The results were convincing. The subsequent public report boosted sales of UV drinking water disinfection systems in the USA.



Through its worldwide subsidiaries and representatives WEDECO is prepared to meet the increasing global demand for advanced water treatment technologies



„Cryptosporidium Parvum“ is deactivated by UV light

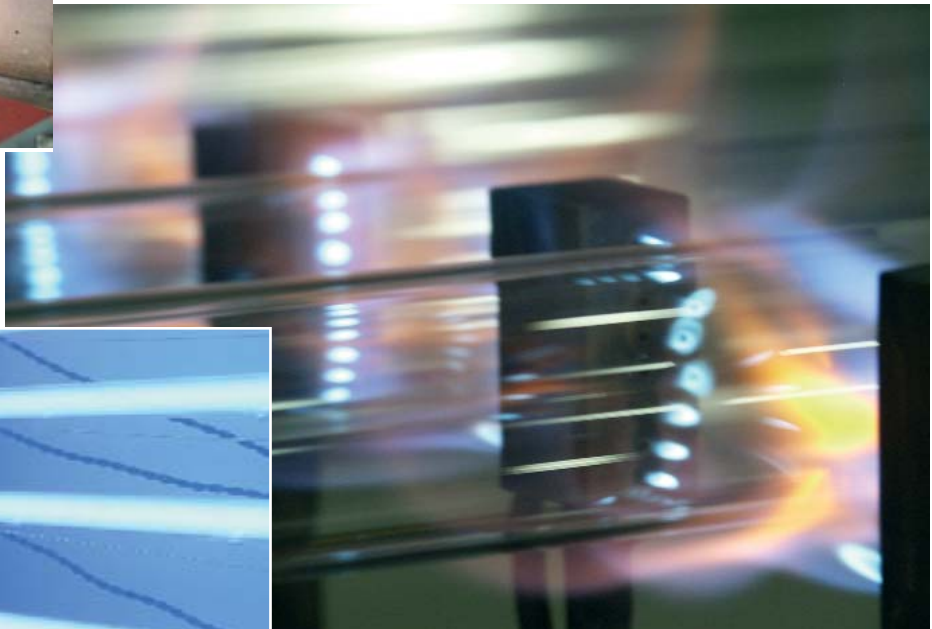
2001

## Own UV lamp development and production

On February 15, 2001, WEDECO acquired the production and development of UV lamps by purchasing the quartz lamp factory Dr. Felix Müller GmbH in Essen. WEDECO had previously enjoyed many years of exclusive cooperation with this company in the development and production of low pressure high output UV lamps. The company is today known as WEDECO UV Light GmbH. With this acquisition, WEDECO became the world's only manufacturer of UV devices with its own leading edge UV lamp production and technology development capability.

## Further acquisitions

In 2001, WEDECO focused its expansion in Asia and the Pacific. WEDECO also became the market leader in New Zealand by acquiring Water and Waste Treatment NZ Ltd. In Korea Sung Jin Entech Corporation in Seoul was purchased. The acquisition of Australian Ultra Violet Products, which today operates as WEDECO AVP Pty. Ltd., gave the company a foothold on the fifth continent.



WEDECO is worldwide the only UV manufacturer with own lamp production and development

At the second German-Chinese High Technology Dialog Forum in Peking, the company signed a declaration of intent for a joint venture with Chongqing Kangda Environmental Protection Inc. in the presence of the Chancellor of the Federal Republic of Germany. The company that was later founded, WEDECO-Kangda, provided WEDECO with access to the Chinese market for ultraviolet drinking water and waste water disinfection.

Shortly before the year end of the year, WEDECO formed a company in Sao Paulo, Brazil, which operates as the South American head office, supporting existing agents in South and Central America.

### Capital increase

In spring 2001, WEDECO performed a capital increase to finance its successful expansion strategy. A total of 995,000 shares were issued.



WEDECO location in Herford today





WEDECO ozone generator



WEDECO K reactor as UV disinfection step at waterworks Weber Basin, Utah, USA

### First multi-barrier system

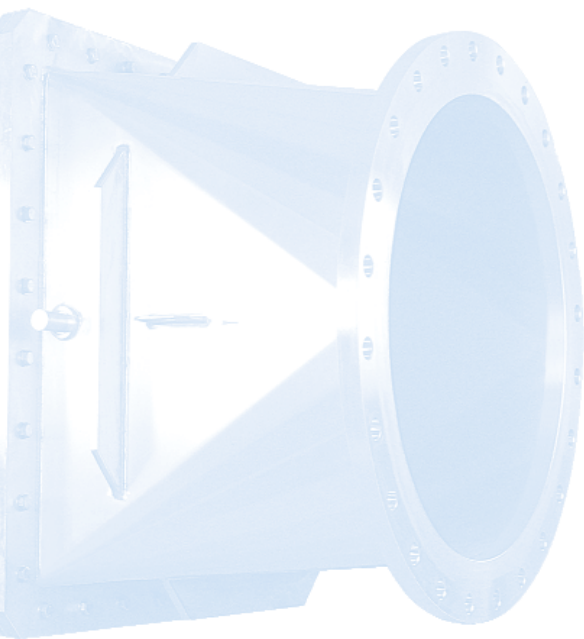
Methods combining membrane filtration, chlorination, UV disinfection and ozone oxidation are becoming increasingly important for drinking water treatment. This combination of methods, known by experts as a "multi-barrier" design, offers comprehensive, safe and economically viable drinking water treatment. WEDECO's first large system of this type was ordered by the North American Weber Basin Water Conservancy District in Utah in May 2001. A key component of this overall system is a major UV disinfection level with up-stream ozone oxidation.

### Development of EFFIZON® HP

In 2001, another leap forward in technology was achieved through the introduction of the enhanced new EFFIZON® HP ozone electrode, which allows even greater efficiency in ozone generation.

### Admission of WEDECO shares to the MDAX

One year after being listed on the SDAX, WEDECO shares are admitted to the MDAX on September 18, 2001.



2002

## New generation of UV lamps

In October 2002, WEDECO launched the new Spektrotherm® HP lamp on the market. This low pressure high output lamp is the culmination result of many years of development, with the aim of further reducing the total cost of UV disinfection.

2003

## Trailigaz, France

In spring 2003, Veolia Water Systems, formerly Vivendi Water Systems, contributed its subsidiary Trailigaz to WEDECO's ozone division. In return, Veolia received a 15.2% interest in WEDECO's ozone division. Trailigaz is the world's third-largest manufacturer of ozone systems. Many ozone systems for the drinking water treatment systems of major cities are supplied by Trailigaz, such as Paris, London, Madrid, Prague, Moscow, Tokyo, Sydney, San Francisco and Singapore.

## Admission of WEDECO shares to TecDAX

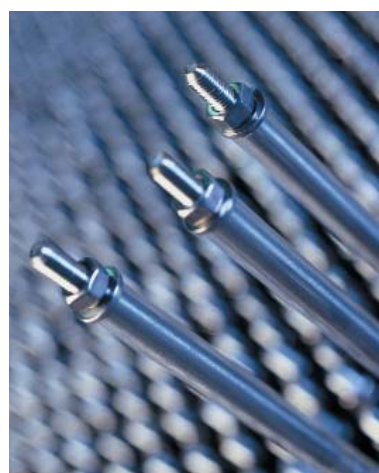
Following the restructuring of German share indices on March 24, 2003, WEDECO AG shares have been listed in the TecDAX technology segment.

## ITT Industries makes takeover offer

On December 9, ITT Industries initiated the public offer for WEDECO it had announced on November 11 through its wholly owned subsidiary ITT Industries German Holding GmbH. ITT offered WEDECO shareholders EUR 18 in cash for each WEDECO share.



The new Spektrotherm® HP lamps in WEDECO TAK system



WEDECO Effizon® HP ozone electrodes





## Auditor's Opinion

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 the WEDECO AG Water Technology for the business year from January 1, 2003 to December 31, 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 is examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by 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 WEDECO 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 January 1, 2003 to December 31, 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 January 1, 2003 to December 31, 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.

Düsseldorf, March 17, 2004

KPMG Deutsche Treuhand-Gesellschaft  
Aktiengesellschaft  
Wirtschaftsprüfungsgesellschaft

|                   |                   |
|-------------------|-------------------|
| Moesta            | Hemker            |
| Wirtschaftsprüfer | Wirtschaftsprüfer |

# Consolidated Balance Sheet

| <b>Assets</b>                               |           |                      |                      |
|---|-----------|----------------------|----------------------|
|   | Notes     | 31 Dec. 2003<br>€000 | 31 Dec. 2002<br>€000 |
| <b>Non current assets</b>                   |           |                      |                      |
| Intangible assets                           | (5, 7)    | 10,965               | 10,997               |
| Goodwill                                    | (5, 7)    | 47,554               | 51,220               |
| Property, plant and equipment               | (5, 7)    | 6,256                | 6,903                |
| Shares in affiliated companies              | (5, 7)    | 316                  | 0                    |
| Deferred tax assets                         | (5, 7, 8) | 6,137                | 2,314                |
|   |           | <b>71,228</b>        | <b>71,434</b>        |
| <b>Current assets</b>                       |           |                      |                      |
| Inventories                                 |           |                      |                      |
| Raw materials and supplies                  | (5, 9)    | 12,779               | 11,296               |
| Work in progress                            | (5, 9)    | 21,479               | 22,120               |
| Finished goods and merchandise              | (5, 9)    | 3,892                | 3,267                |
| Advance payments                            | (5, 9)    | 440                  | 81                   |
|   |           | <b>38,590</b>        | <b>36,764</b>        |
| Receivables and other assets                | (5, 10)   | 34,519               | 34,333               |
| Cash and cash equivalents                   | (33)      | 1,785                | 7,301                |
|   |           | <b>74,894</b>        | <b>78,398</b>        |
|   |           | <b>146,122</b>       | <b>149,832</b>       |
| <b>Shareholder's equity and liabilities</b> |           |                      |                      |
| <b>Shareholder's equity</b>                 |           |                      |                      |
| Capital stock                               | (12)      | 11,045               | 10,995               |
| Capital reserves                            | (13)      | 43,413               | 44,856               |
| Other comprehensive income                  | (14)      | -795                 | -562                 |
| Retained earnings                           |           | 10,789               | 19,880               |
|   |           | <b>64,452</b>        | <b>75,169</b>        |
| <b>Minority Interest</b>                    | (15)      | <b>1,669</b>         | <b>657</b>           |
| <b>Non current liabilities</b>              |           |                      |                      |
| Financial liabilities                       | (5, 16)   | 24,961               | 25,977               |
| Pension provisions                          | (5, 17)   | 525                  | 495                  |
| Other liabilities                           | (5, 16)   | 613                  | 1,064                |
| Deferred taxes                              | (5, 18)   | 2,810                | 2,757                |
|   |           | <b>28,909</b>        | <b>30,293</b>        |
| <b>Current liabilities</b>                  |           |                      |                      |
| Advance payments from customers             |           | 2,095                | 865                  |
| Trade account payables                      | (5)       | 16,471               | 12,396               |
| Liabilities due to affiliated companies     |           | 12                   | 0                    |
| Financial liabilities                       | (5, 19)   | 15,988               | 3,099                |
| Tax accruals                                | (20)      | 3,178                | 3,988                |
| Other accruals and provisions               | (5, 20)   | 8,668                | 8,118                |
| Other liabilities                           | (5, 19)   | 4,680                | 15,247               |
|   |           | <b>51,092</b>        | <b>43,713</b>        |
|   |           | <b>146,122</b>       | <b>149,832</b>       |

## Consolidated Profit and Loss Account

|   | Notes       | 2003<br>€000   | 2002<br>€000  |
|---|-------------|----------------|---------------|
| Revenue   | (5, 21)     | 125,898        | 143,928       |
| Cost of sales                                       | (5, 22)     | -91,269        | - 93,523      |
| <b>Gross profit</b>                                 |             | <b>34,629</b>  | <b>50,405</b> |
| Selling expenses                                    | (23)        | -20,267        | - 18,282      |
| General and administrative expenses                 | (24)        | -12,916        | - 10,355      |
| Research and development expenses                   | (25)        | -6,720         | - 6,059       |
| Other operating income                              | (26)        | 5,499          | 5,699         |
| Other operating expenses                            | (27)        | -8,457         | - 11,297      |
| Profit from the disposal of discontinued operations | (35)        | 0              | 3,190         |
| <b>Operating result (EBIT)</b>                      |             | <b>-8,232</b>  | <b>13,301</b> |
| Interest and similiar income                        |             | 159            | 1,239         |
| Interest and similiar expenses                      |             | -3,299         | - 2,195       |
| Income from affiliated companies                    |             | 17             | 0             |
| <b>Net interest</b>                                 |             | <b>-3,123</b>  | <b>-956</b>   |
| <b>Result from ordinary activities</b>              |             | <b>-11,355</b> | <b>12,345</b> |
| Taxes on income                                     | (28)        | 3,002          | -3,970        |
| <b>Net result before minority interest</b>          |             | <b>-8,353</b>  | <b>8,375</b>  |
| Minority interest                                   |             | 195            | 15            |
| <b>Net result attributable to the group</b>         |             | <b>-8,158</b>  | <b>8,390</b>  |
|   |             |                |               |
| <b>Basic earnings per share in €</b>                | <b>(29)</b> | <b>-0.74</b>   | <b>0.77</b>   |
| <b>Diluted earnings per share in €</b>              | <b>(29)</b> | <b>-0.73</b>   | <b>0.76</b>   |
| <b>EBITDA in €000</b>                               | <b>(30)</b> | <b>-647</b>    | <b>20,893</b> |



## Consolidated Cash Flow Statement

|  | 2003<br>€000  | 2002<br>€000   |
|--|---------------|----------------|
| Net result attributable to the group   | -8,158        | 8,390          |
| Amortization of positive goodwill  | 3,737         | 3,799          |
| Disposal of negative goodwill  | -196          | -202           |
| Depreciation on other intangible assets and property, plant and equipment    | 4,046         | 3,995          |
| Taxes paid   | -1,710        | -3,830         |
| Interest paid  | -3,020        | -949           |
| Exchange rate losses   | -1,362        | -300           |
| Change of accruals and provisions  | -444          | 3,780          |
| Result from discontinued operations  | 0             | -3,190         |
| Result from disposal of subsidiaries   | -633          | -1,207         |
| Result on disposal of non current assets                                     | -1            | -3             |
| Change of deferred tax assets  | -3,393        | 900            |
| Change of inventories, receivables and other assets                          | 1,776         | -6,331         |
| Change of trade accounts payable and other liabilities                       | 9,452         | -1,518         |
| <b>Cash flow from operating activities</b>                                   | <b>94</b>     | <b>3,334</b>   |
| Acquisition of subsidiaries, net of cash acquired                            | -83           | -35,542        |
| Disposal of subsidiaries, net of cash disposed                               | -32           | 4,129          |
| Cash proceeds on disposal of non current assets                              | 1,463         | 982            |
| Cash payments to acquire property, plant and equipment and intangible assets | -6,229        | -7,303         |
| <b>Cash flow from investing activities</b>                                   | <b>-4,881</b> | <b>-37,734</b> |
| Increase of capital from stock options                                       | 522           | 0              |
| Change of capital reserves   | -1,915        | -1,000         |
| Change in treasury shares  | 0             | 886            |
| Change of other assets from disposal of business                             | 4,763         | -4,763         |
| Change of liabilities for acquisitions                                       | -16,000       | 16,000         |
| Change in financial liabilities  | 11,901        | 7,463          |
| <b>Cash flow from financing activities</b>                                   | <b>-729</b>   | <b>18,586</b>  |
| <b>Change in cash funds</b>  | <b>-5,516</b> | <b>-15,814</b> |
| <b>Cash and cash equivalents at January 1</b>                                | <b>7,301</b>  | <b>23,115</b>  |
| <b>Cash and cash equivalents at December 31</b>                              | <b>1,785</b>  | <b>7,301</b>   |

# Consolidated Statement of Changes in Shareholders' Equity

|                                     | Capital stock<br>€000 | Capital<br>reserves<br>€000 | Other<br>comprehensive<br>income<br>Exchange<br>rate<br>differences<br>€000 | Treasury<br>shares<br>€000 | Retained<br>Earnings<br>€000 | Total<br>€000 |
|-------------------------------------|-----------------------|-----------------------------|---|----------------------------|------------------------------|---------------|
| <b>December 31, 2001</b>            | <b>10,995</b>         | <b>45,856</b>               | <b>0</b>  | <b>-886</b>                | <b>11,490</b>                | <b>67,455</b> |
| Loss on treasury shares             | -                     | -152                        | -   | -                          | -                            | -152          |
| Sale of treasury shares             | -                     | -                           | -   | 886                        | -                            | 886           |
| Share price guarantees              | -                     | -848                        | -   | -                          | -                            | -848          |
| Exchange rate differences           | -                     | -                           | -562  | -                          | -                            | -562          |
| Net result for the year             | -                     | -                           | -   | -                          | 8,390                        | 8,390         |
| <i>Recognized gains and losses</i>  | <i>0</i>              | <i>0</i>                    | <i>-562</i>   | <i>0</i>                   | <i>8,390</i>                 | <i>7,828</i>  |
| <b>December 31, 2002</b>            | <b>10,995</b>         | <b>44,856</b>               | <b>-562</b>   | <b>0</b>                   | <b>19,880</b>                | <b>75,169</b> |
| Capital increase from Stock options | 50                    | 472                         | -   | -                          | -                            | 522           |
| Share price guarantees              | -                     | -1,915                      | -   | -                          | -                            | -1,915        |
| Changes in consolidated companies   | -                     | -                           | -   | -                          | -933                         | -933          |
| Exchange rate differences           | -                     | -                           | -233  | -                          | -                            | -233          |
| Net result for the year             | -                     | -                           | -   | -                          | -8,158                       | -8,158        |
| <i>Recognized gains and losses</i>  | <i>0</i>              | <i>0</i>                    | <i>-233</i>   | <i>0</i>                   | <i>-8,158</i>                | <i>-8,391</i> |
| <b>December 31, 2003</b>            | <b>11,045</b>         | <b>43,413</b>               | <b>-795</b>   | <b>0</b>                   | <b>10,789</b>                | <b>64,452</b> |

# Notes to the Consolidated Financial Statements for fiscal year 2003

The consolidated financial statements of the WEDECO Group presented by the parent company, WEDECO AG Water Technology (hereafter referred to as WEDECO AG), have been drawn up using uniform accounting policies in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB).

In applying International Financial Reporting Standards (IFRS), the parent company is taking advantage of the provisions available under German commercial law which allow it to prepare consolidated financial statements in accordance with a recognised set of international accounting principles.

These consolidated financial statements, together with the group management report, fulfil the exemption requirements contained in § 292a HGB as interpreted by the German Accounting Standards Committee (GASC). The consolidated financial statements of WEDECO AG for the year ended 31 December 2003 are not included in any higher level consolidated financial statements.

The consolidated profit and loss account is presented using the cost of sales format.

## Accounting policies and principles

### (1) Underlying accounting principles

The consolidated financial statements have been drawn up in accordance with IFRS and differ therefore in a number of respects from consolidated financial statements prepared in accordance with German commercial law. The main differences, which are described in detail in the relevant notes to the consolidated financial statements, are as follows:

#### - Percentage of completion method (IAS 11)

In contrast to financial statements prepared in accordance with HGB, IAS requires that profits are

realised on long-term construction contracts (work in progress) in the period in which they are earned. This is reflected in the level of revenue and cost of sales recognised.

#### - Deferred taxes (IAS 12)

Deferred tax assets and liabilities arise from differences between the carrying values of the individual assets and liabilities in the IFRS financial statements and their tax base as well as from tax loss carry-forwards.

#### - Derivative financial instruments (IAS 39)

In contrast to German accounting rules, derivative financial instruments are measured under IAS at their fair value.

#### - Pension provisions (IAS 19)

Pension provisions are measured in accordance with the requirements of IAS 19 which take into account future increase in salaries and a common market interest rate.

#### - Intangible assets (IAS 38)

In contrast to German accounting rules, product development costs which fulfil the requirements of IAS 38 are capitalised.

#### - Stock options

Under IFRS the company recognises compensation costs related to stock options when the options are exercised. Under German accounting rules these costs are not recognised.

The consolidation methods applied in these consolidated financial statements for IFRS purposes are the same as those used in German consolidated financial statements.

No IAS Standards or Interpretations which have been released but which are not yet mandatory have been adopted early.



## (2) Consolidated companies

All affiliated enterprises are consolidated in which WEDECO AG, either directly or indirectly, holds a majority of the shares. The group reporting entity therefore consists of four domestic (including parent company) and 20 foreign companies.

During 2003, the following changes to the group structure occurred:

On 17 March 2003, WEDECO AG and WEDECO Gesellschaft für Umwelttechnologie mbH agreed with Trailigaz Compagnie Generale De L'Ozone S.A. to merge their activities in the Ozone division. On effect of this agreement, Trailigaz Compagnie Generale De L'Ozone contributed its wholly-owned subsidiary Trailigaz Ozone S.A.S., Garges-lès-Gonesse, France into WEDECO Gesellschaft für Umwelttechnologie mbH in return for a 15.2% interest in WEDECO Gesellschaft für Umwelttechnologie mbH with a value of € 7.0 Mio. Trailigaz Compagnie Generale De L'Ozone had the contractual right to increase its share holding by 9.8% until the end of 2003. This option was not exercised. Furthermore, Trailigaz Compagnie Generale De L'Ozone has the contractual right to increase its share holding by 24.9% in 2006 or to decrease its share holding by 7.6% in 2008.

WEDECO Kft., Hungary, which had been fully consolidated until 30 June 2003, has been consolidated "at equity" from 1 July 2003 onwards due to the fact that the consolidated shareholding decreased from 51% to 43.2%.

OZOMATIC Wasseraufbereitungsgeräte GmbH was merged into its parent company, WEDECO Gesellschaft für Umwelttechnologie mbH, during the financial year 2003. This did not have an impact on the consolidated financial statements.

The changes to the group structure outlined above resulted in an increase of group revenue by € 4,467 thousand (31 Dec. 2002: € 62,960 thousand). The effect on the group result before eliminations amounts to € 602 thousand (31 Dec. 2002: € 3,592 thousand).

Further details on consolidated subsidiaries are included in note (38).

## (3) Consolidation principles

Subsidiaries are consolidated in accordance with the purchase method. The difference between the cost of investment and net assets acquired is based on values at the date of acquisition. Minority interests are calculated based on the book value method.

In accordance with IAS 22, both negative and positive goodwill are presented under non-current assets. Negative goodwill is recognised as income over the period in which the tax loss carry-forward which gave rise to the negative goodwill is being utilised. Positive goodwill is amortised on a straight-line basis over 15 years.

Associated companies with a direct or indirect WEDECO shareholding of 20% to 50% for which significant influence is exercised are consolidated at equity.

Receivables and payables between group companies are eliminated. Similarly, income and expenses relating to inter-company transactions are also eliminated.

#### (4) Foreign currency translation

All assets including goodwill and liabilities in the financial statements of group companies with a functional currency other than Euros are translated using closing exchange rates. Income and expenses are translated using the average exchange rates. Differences arising from this translation are recorded directly in the balance sheet as a separate component of equity.

Foreign currency receivables and payables are translated at the closing rate and the relevant gains or losses are recorded in profit and loss account.

#### (5) Accounting policies

**Intangible assets** are stated at purchase cost less accumulated scheduled amortisation. Intangible assets are amortised based on the following useful lives:

|                           |                                   |
|---------------------------|-----------------------------------|
| Software                  | 3 to 4 years                      |
| Certification costs       | 5 years                           |
| Product development costs | 5 years                           |
| Patents                   | based on the patent's useful life |

Capitalized product development costs include external development costs as well as directly attributable internal development costs.

Positive goodwill is amortised on a straight-line basis over 15 years. Negative goodwill was recognised as income until 31 Dec. 2003 over the period in which the tax loss carry-forward which gave rise to the negative goodwill is being utilised.

**Property, plant and equipment** are stated at purchase or manufacturing cost less accumulated scheduled amortisation. In the case of equipment manufactured by a Group company, cost includes a proportion of production

overheads. Tangible assets are depreciated on a straight-line basis. Depreciation is based on the following estimated useful lives:

|   |               |
|---|---------------|
| Leasehold improvements                  | 8 years       |
| Warehousing equipment                   | 15 years      |
| Motor vehicles                          | 4 years       |
| Office equipment, fixtures and fittings | 3 to 10 years |

**Deferred tax assets** are recognised in accordance with IAS 12 (Income Taxes) on tax loss carry-forwards existing at the balance sheet date to the extent that future benefits are probable.

**Raw materials and supplies** are stated at purchase cost and taking into account the usability of the inventories at the reporting date. **Work in progress and finished goods** are valued at the lower of cost or net realisable value.

Manufacturing cost includes all direct production costs as well as production and material overheads. The percentage of completion method is applied to long-term construction contracts, in which case work in progress is measured at manufacturing cost plus realisable profit margin. Identified risks for slow-moving and obsolete items are recognised through inventory write-downs.

**Receivables and other assets** are stated at their nominal value. Specific allowances are recorded to cover identifiable recoverability risks.

All assets, with the exception of inventories and deferred tax assets, are subject to an **impairment** review at each reporting date in accordance with IAS 36 to identify any losses in value.

**Accruals and provisions** are recognised to cover all identifiable risks and all liabilities of uncertain amount. The amounts are measured on the basis of management's assessment of the probability of incurrence.

Short-term **liabilities** are stated at their repayment amount. Non-current liabilities, excluding costs of debt acquisition, are stated at their repayment amount and, to the extent that they do not bear interest, are discounted to their net present value.

In the case of small equipment and spare parts, **revenue** is recognised on delivery of goods to the customer, i.e. after transfer of economic ownership. In the case of services, revenue is recognised after services have been performed. The Group applies the percentage of completion method to long-term construction contracts. Revenue is recognised in accordance with the stage of completion of each long-term contract at the reporting date as measured by the number of working hours completed for each contract. Final invoicing takes place after the contract has been completed.

#### **(6) Events after the balance sheet date**

On 13 February 2004, ITT Industries German Holding GmbH, Frankfurt, an indirect subsidiary of ITT Industries Inc., White Plains, USA, publicly announced and informed WEDECO AG in accordance with §§ 21, 22 German share trade legislation (WpHG) that it holds 91.91% of the shares of WEDECO AG. ITT Industries German Holding GmbH had announced its public offer to acquire shares of WEDECO AG for a purchase price of € 18.00 per share on 9 December 2003.

The Supervisory Board meeting on 6 February 2004 resolved the resignation of the chairman of the Management Board, Werner Klink, as a result of the takeover of WEDECO AG by ITT Industries. Former Deputy chairman and Chief Financial Officer Christoph Dicks was appointed new chairman of the Management Board of WEDECO AG. Till Schwarzlose was appointed new Deputy chairman and Chief Financial Officer. The Management Board members Dr. Andreas Kolch (research and development) and John Marrino (Sales, Marketing and Public Relations North America) were approved.

On 17 February 2004, the German stock exchange announced that WEDECO AG shares will cease to trade on the TecDax and the NEMAX 50 stock exchange effective 22 March 2004.

## **Notes to the consolidated balance sheet**

#### **(7) Non current assets**

The following table shows the movements during the year of the individual captions included in non current assets based on gross purchase and manufacturing cost.



|   | Balance<br>1 Jan. 2003<br>€000 | Additions<br>€000 | Acquisition<br>€000 | Transfer<br>€000 | Disposals<br>€000 | Exchange<br>rate<br>differences<br>€000 | Balance<br>31 Dec. 2003<br>€000 |
|---|--------------------------------|-------------------|---------------------|------------------|-------------------|---|---------------------------------|
| <b>Acquisition and manufacturing cost</b>                       |                                |                   |                     |                  |                   |   |                                 |
| <b>Intangible assets</b>  |                                |                   |                     |                  |                   |   |                                 |
| Licences to industrial property rights and other similar rights | 10,849                         | 616               | 406                 | 521              | 1,022             | -34                                     | 11,336                          |
| Product development   | 2,492                          | 1,546             | 0                   | 0                | 0                 | -1                                      | 4,037                           |
|   | 13,341                         | 2,162             | 406                 | 521              | 1,022             | -35                                     | 15,373                          |
| <b>Goodwill</b>   | 56,817                         | 5,725             | 0                   | 0                | 6,322             | -78                                     | 56,142                          |
| <b>Property, plant and equipment</b>                            |                                |                   |                     |                  |                   |   |                                 |
| Leasehold improvements  | 687                            | 163               | 0                   | 0                | 345               | -56                                     | 449                             |
| Plant and equipment   | 3,514                          | 594               | 2,170               | -345             | 437               | -409                                    | 5,087                           |
| Office equipment, fittings and fixtures                         | 6,846                          | 1,775             | 1,167               | 345              | 506               | -316                                    | 9,311                           |
| Advance payment to suppliers                                    | 381                            | 163               | 3                   | -521             | 3                 | 0                                       | 23                              |
|   | 11,428                         | 2,695             | 3,340               | -521             | 1,291             | -781                                    | 14,870                          |
| <b>Financial assets</b>   |                                |                   |                     |                  |                   |   |                                 |
| Shares in affiliated companies                                  | 0                              | 316               | 0                   | 0                | 0                 | 0                                       | 316                             |
| <b>Deferred taxes</b>   | 2,314                          | 5,187             | 235                 | 0                | 1,392             | -207                                    | 6,137                           |
|   | <b>83,900</b>                  | <b>16,085</b>     | <b>3,981</b>        | <b>0</b>         | <b>10,027</b>     | <b>-1,101</b>                           | <b>92,838</b>                   |
| <b>Depreciation and amortisation</b>                            |                                |                   |                     |                  |                   |   |                                 |
| <b>Intangible assets</b>  |                                |                   |                     |                  |                   |   |                                 |
| Licences to industrial property rights and other similar rights | 2,235                          | 1,425             | 403                 | 0                | 307               | -19                                     | 3,737                           |
| Product development   | 109                            | 562               | 0                   | 0                | 0                 | 0                                       | 671                             |
|   | 2,344                          | 1,987             | 403                 | 0                | 307               | -19                                     | 4,408                           |
| <b>Goodwill</b>   | 5,597                          | 3,541             | 0                   | 0                | 545               | -5                                      | 8,588                           |
| <b>Property, plant and equipment</b>                            |                                |                   |                     |                  |                   |   |                                 |
| Leasehold improvements  | 262                            | 34                | 0                   | 0                | 175               | -22                                     | 99                              |
| Plant and equipment   | 1,188                          | 581               | 1,992               | -114             | 249               | -176                                    | 3,222                           |
| Office equipment, fittings and fixtures                         | 3,075                          | 1,442             | 1,133               | 114              | 308               | -163                                    | 5,293                           |
|   | 4,525                          | 2,057             | 3,125               | 0                | 732               | -361                                    | 8,614                           |
|   | <b>12,466</b>                  | <b>7,585</b>      | <b>3,528</b>        | <b>0</b>         | <b>1,584</b>      | <b>-385</b>                             | <b>21,610</b>                   |
| <b>Net book values</b>  |                                |                   |                     |                  |                   |   |                                 |
| <b>Intangible assets</b>  |                                |                   |                     |                  |                   |   |                                 |
| Licences to industrial property rights and other similar rights | 8,614                          |                   |                     |                  |                   |   | 7,599                           |
| Product development   | 2,383                          |                   |                     |                  |                   |   | 3,366                           |
|   | 10,997                         |                   |                     |                  |                   |   | 10,965                          |
| <b>Goodwill</b>   | 51,220                         |                   |                     |                  |                   |   | 47,554                          |
| <b>Property, plant and equipment</b>                            |                                |                   |                     |                  |                   |   |                                 |
| Leasehold improvements  | 425                            |                   |                     |                  |                   |   | 350                             |
| Plant and equipment   | 2,326                          |                   |                     |                  |                   |   | 1,865                           |
| Office equipment, fittings and fixtures                         | 3,771                          |                   |                     |                  |                   |   | 4,018                           |
| Advance payments to supplies                                    | 381                            |                   |                     |                  |                   |   | 23                              |
|   | 6,903                          |                   |                     |                  |                   |   | 6,256                           |
| <b>Financial assets</b>   |                                |                   |                     |                  |                   |   |                                 |
| Shares in affiliated companies                                  | 0                              |                   |                     |                  |                   |   | 316                             |
| <b>Deferred taxes</b>   | 2,314                          |                   |                     |                  |                   |   | 6,137                           |
|   | <b>71,434</b>                  |                   |                     |                  |                   |   | <b>71,228</b>                   |

At 31 December 2003, no negative goodwill (31 Dec. 2002: € 196 thousand) has been deducted from the goodwill balance. The negative goodwill of the prior year related to tax loss carry-forwards and future additional tax deductible depreciation available under Swiss tax law. The negative goodwill balance was released to income on a time-apportioned basis as the tax benefits were utilised up until the end of 2003. In the year 2003 an amount of € 196 thousand (2002: € 202 thousand) was released to income.

#### (8) Deferred tax assets

The deferred tax assets are computed in accordance with IAS 12 (Income Taxes). They relate mainly to tax loss carry-forwards amounting to € 6,614 thousand (31 Dec. 2002: € 1,215 thousand) partly set-off by future reduced tax deductible depreciation amounting to € 648 thousand and future additional tax deductible depreciation amounting to € 7 thousand; (31 Dec. 2002: € 1,047 thousand). Prior year future additional tax deductible depreciation mainly related to restructuring costs for the relocation of a subsidiary in the USA amounting to € 1,005 thousand.

Tax loss carry-forwards amounting to € 1,297 thousand (31 Dec. 2002: € 0 thousand) have been provided for.

#### (9) Inventories

Work in progress includes profits resulting from the application of the percentage of completion method (IAS 11) amounting to €1,842 thousand (31 Dec. 2002: € 7,601 thousand). In connection with € 0 thousand (31 Dec. 2002: € 201 thousand) of this recognised profit, advance payments have been received from customers amounting to € 0 thousand (31 Dec. 2002: € 82 thousand).

#### (10) Receivables and other assets

|                   | 31 Dec. 2003<br>€000 | 31 Dec. 2002<br>€000 |
|-------------------|----------------------|----------------------|
| Trade receivables | 30,334               | 25,168               |
| Other assets      | 3,478                | 8,637                |
| Prepaid expenses  | 707                  | 528                  |
|                   | <b>34,519</b>        | <b>34,333</b>        |

The management in each of the WEDECO Group enterprises monitors the inherent **credit risk** relating to the **trade accounts receivable** of the Group and takes appropriate measures to mitigate this risk in line with defined corporate instructions. Firstly, a large portion of receivables is due from local government operators, using WEDECO equipment in the various countries. For these, once a contract reaches a specified limit, progress advance payments based on the degree of contract completeness are obligatory. Secondly, receivables with identified collectibility risks are generally secured with export letters of credits.

Other assets include mainly receivables relating to income tax and VAT amounting to € 2,721 thousand (31 Dec. 2002: € 456 thousand). Prior year amounts included sales price receivables of € 4,706 thousand and loans receivables of € 1,890 thousand.

Other assets include € 0 thousand (31 Dec. 2002: € 1,261 thousand) which falls due in one to five years. All other receivables and other assets are of a short-term nature.

#### (11) Derivative financial instruments

Derivative financial instruments are used to minimise the currency risk from operating activities. They are accounted for at their fair value at the balance sheet date in accordance with the principles of hedge accounting. The derivative financial instruments employed by the Group relate exclusively to forward currency sales (futures) intended to hedge the currency risk on U.S. dollars. In the past the forward contracts have been matched with the timing of the anticipated transactions.

Depending of their intended usage, the futures are classified in accordance with IAS 39 into fair value and cash flow hedges. Whereas fair value hedges relate to existing assets denominated in foreign currencies, cash flow hedges relate to future cash flows. All of the conditions required to apply hedge accounting have been met.

No forward currency contracts (31 Dec. 2002: USD 400 thousand) were in place throughout the group at the balance sheet date as a hedge of existing assets.

#### **(12) Share capital**

Share capital comprises 11,045,240 (31 Dec. 2002: 10,995,000) non-par bearer ordinary shares each with a (computed) nominal value of € 1 per share.

The parent company has a contingent share capital with a nominal value of € 268,750 ([contingent share capital I](#)) and a contingent share capital with a nominal value of € 300,000 ([contingent share capital II](#)). The contingent share capital increases will only be issued in conjunction with the exercise of stock options granted under the WEDECO 1999 and 2001 stock option plans, where such stock options can neither be transferred nor sold. Up to 268,750 and 300,000 new shares respectively, each made out to bearer and each equivalent to a nominal value of € 1 may be issued. The new shares participate in profits from the beginning of the financial year in which they are issued.

In accordance with the authority granted to it and, with the approval of the Supervisory Board, the Management Board issued 268,750 stock options in connection with the 1999 stock option plan. The stock options run for a maximum period of up to five and a half years. The stock options relating to the 1999 stock option plan may be exercised at the earliest in 2003 and only as a result of reaching certain agreed targets. In 2003 a total of 50,240 stock options were exercised.

The Management Board is authorised, with the approval of the Supervisory Board, to issue 300,000 stock options relating to the 2001 stock option plan, either in one or several steps, until 29 May 2006, comprising up to 100,000 to members of the Management Board of the parent company, up to 75,000 to members of the executive boards of subsidiaries, up to 75,000 to employees of the parent company and up to 50,000 to employees of subsidiaries. In 2003 the Management Board issued 119,800 stock options (31 Dec. 2002: 0 stock options issued). The stock options run for a maximum period of five years, commencing at the grant date. The stock options relating to the 2001 stock option plan can be exercised at the earliest two years after the grant date and only on a condition that certain agreed targets have been reached.

In addition, the Management Board is authorised, with the approval of the Supervisory Board, to increase the share capital of the parent company until 20 May 2008 by issuance of new ordinary shares and/or non-voting preference shares in return for cash, either in one or several steps, up to a total amount of € 2,748,750 ([authorised share capital I](#)). A subscription right is to be granted to existing shareholders. The Management Board is authorised, however, with the approval of the Supervisory Board, to exclude fractional amounts from the subscription rights of the shareholders.

The Management Board is also authorised, with the approval of the Supervisory Board, to increase the share capital of the parent company up to 30 May 2008 by issuance of new ordinary shares and/or non-voting preference shares in return for cash or a contribution in kind, either in one or several steps, up to a total amount of € 2,748,750 ([authorised share capital II](#)). Existing shareholders may be excluded from the subscription right.



**(13) Capital reserves**

The capital reserves comprise the share premium arising on the company's flotation in 1999 and the share capital increase in 2001. Costs associated with the flotation and share capital increases (net of related income taxes) have been set off against capital reserves.

In addition, an amount of € 1,915 thousand (31 Dec. 2002: € 848 thousand) has been deducted from capital reserves in connection with share price guarantees in accordance with IAS 22.70. These guarantees were given in conjunction with prior acquisitions of various subsidiaries. Income taxes attributable to these guarantees amounted to € 547 thousand (31 Dec. 2002: € 203 thousand).

Furthermore, capital reserves increased by € 472 thousand (31 Dec. 2002: € 0 thousand) due to the exercise of stock options.

**(14) Other comprehensive income**

Other comprehensive income include translation differences of € 795 thousand (31 Dec. 2002: € 562 thousand) relating to the translation of the financial statements of consolidated foreign subsidiaries prepared in foreign currency.

**(15) Minority interests**

Minority interests relate to shareholdings of third parties of 49% in Chongqing WEDECO-Kangda Water Technology Co. Ltd., Chongqing, China and of 15.2% in WEDECO Gesellschaft für Umwelttechnologie mbH, Düsseldorf, Germany, and its subsidiaries WEDECO Ozone Technologies Inc., Charlotte, USA, WEDECO Ozotech Ltd., Burgees Hill, Great Britain and Trailigaz Ozone S.A.S., Garges-lès-Gonesse, France.

**(16) Non current liabilities**

Financial liabilities comprise mainly two long-term loans received in 2002 for € 15 million and € 10 million which are subject to interest rates of 5.60% and 5.88% p.a., respectively. Repayment commences in 2004 and ends in 2009. The conditions of the aforementioned long-term loans are subject to certain financial key ratios. If one financial ratio is not fulfilled, the interest rate is increased. If more than one financial ratio is not fulfilled, the loan grantor has a unilateral right of notice. Other financial liabilities relate to other bank liabilities which are subject to interest rates of between 3.8% and 7.25% p. a. as well as long-term leasing liabilities subject to an interest rate of 8% p.a.

|                       | 31 Dec. 2003  |  |                              | 31 Dec. 2002  |  |                              |
|-----------------------|---------------|--|------------------------------|---------------|--|------------------------------|
|                       | Total<br>€000 | Thereof with<br>a maturity of<br>1 to 5<br>years<br>€000 | more than<br>5 years<br>€000 | Total<br>€000 | Thereof with<br>a maturity of<br>1 to 5<br>years<br>€000 | more than<br>5 years<br>€000 |
| Financial liabilities | 24,961        | 2,594  | 22,367                       | 25,977        | 17,131   | 8,846                        |
| Other liabilities     | 613           | 462  | 151                          | 1,064         | 1,015  | 49                           |
|                       | <b>25,574</b> | <b>3,056</b>   | <b>22,518</b>                | <b>27,041</b> | <b>18,146</b>  | <b>8,895</b>                 |

Other non-current liabilities include mainly residual purchase price payables due in connection with business acquisitions amounting to € 244 thousand (31 Dec. 2002: € 723 thousand).

#### **(17) Pension provisions**

The present value of the four (31 Dec. 2002: four) pension commitments (including widows' pension entitlements) to individuals with fixed pension payments was computed in accordance with IAS 19 using a discount rate of 5.25% (31 Dec. 2002: 5.75%). The provision at 31 December 2003 amounting to € 525 thousand (31 Dec. 2002: € 495 thousand) corresponds to the present value of the obligation net of unrecognised actuarial losses of € 29 thousand (31 Dec. 2002: € 36 thousand). The net pension expense for 2003 amounted to € 53 thousand (31 Dec. 2002: € 53 thousand) and pension payments in 2003 amounted to € 23 thousand (2002: € 23 thousand). Pension expenses were recorded as general administrative expenses in the profit and loss statement.

#### **(18) Deferred taxes**

The amount disclosed under this caption relates to deferred tax liabilities in accordance with IAS 12 (Income Taxes). It comprises mainly divergent accounting and tax bases for investments of € 768 thousand (31 Dec. 2002: € 819 thousand) and for intangible assets of € 1,641 thousand (31 Dec. 2002: € 1,811 thousand) arising on initial consolidation in conjunction with purchase accounting in accordance with IAS 22.

#### **(19) Current liabilities**

Financial liabilities comprises short-term loans and bank overdrafts amounting to € 15,988 thousand (31 Dec. 2002: € 3,099 thousand) which are subject to common market interest rates.

Other liabilities include residual purchase price amounts due in connection with business acquisitions amounting to € 865 thousand (31 Dec. 2002: € 12,993 thousand); liabilities from social security of € 1,746 thousand (31 Dec. 2002: € 861) as well as taxes payable of € 1,121 (31 Dec. 2002: € 644 thousand).

**(20) Accruals and provisions**

Tax accruals and other accruals and provisions comprise the following:

|                                      | 1 Jan. 2003<br>€000 | Acquisitions/<br>Disposals<br>€000 | Utilisation<br>€000 | Release<br>€000 | Allocation<br>€000 | 31 Dec. 2003<br>€000 |
|--------------------------------------|---------------------|------------------------------------|---------------------|-----------------|--------------------|----------------------|
| <b>Taxes on income</b>               | <b>3,988</b>        | <b>16</b>                          | <b>1,520</b>        | <b>228</b>      | <b>922</b>         | <b>3,178</b>         |
| Warranty                             | 1,338               | 103                                | 529                 | 77              | 688                | 1,523                |
| Consulting                           | 300                 | 0                                  | 298                 | 0               | 1,540              | 1,542                |
| Outstanding invoices                 | 2,550               | 0                                  | 2,049               | 1               | 1,058              | 1,558                |
| Personnel                            | 2,007               | 4                                  | 1,302               | 3               | 1,162              | 1,868                |
| Shareholders' meeting                | 178                 | 0                                  | 178                 | 0               | 63                 | 63                   |
| Other                                | 1,745               | 1,576                              | 1,584               | 161             | 538                | 2,114                |
| <b>Other accruals and provisions</b> | <b>8,118</b>        | <b>1,683</b>                       | <b>5,940</b>        | <b>242</b>      | <b>5,049</b>       | <b>8,668</b>         |

Accruals and provisions cover all identifiable risks of the Group to third parties. They are measured at a full cost basis.

## Notes to the consolidated profit and loss account

**(21) Revenues**

Revenue by country (based on the location of the registered office of the customer) is as follows:

|                          | 2003<br>€000   | 2002<br>€000   |
|--------------------------|----------------|----------------|
| Europe                   | 78,868         | 85,891         |
| North- and South America | 29,711         | 41,771         |
| Asia/Pacific             | 17,004         | 15,839         |
| Africa                   | 315            | 427            |
|                          | <b>125,898</b> | <b>143,928</b> |

Revenue by product and services is as follows:

|                      | 2003<br>€000   | 2002<br>€000   |
|----------------------|----------------|----------------|
| Product sales        | 91,845         | 113,918        |
| After sales services | 34,053         | 30,010         |
|                      | <b>125,898</b> | <b>143,928</b> |

Revenue includes an amount of € 14,387 thousand (2002: € 28,709 thousand) recognised on uncompleted projects in accordance with the percentage of completion method.

**(22) Cost of sales**

Cost of sales comprises the costs incurred to manufacture products sold as well as the purchase cost of merchandise sold. In compliance with IAS 2, it includes all directly attributable costs such as material and personnel expenses and a proportion of overheads including depreciation on plant and equipment used in the production process. Cost of sales includes € 12,545 thousand (2002: € 21,108 thousand) relating to projects which are still in progress at year end.

**(23) Selling costs**

Selling expenses comprise costs of the sales departments and sales force of the group companies as well as costs for advertising and logistics.

**(24) General and administrative expenses**

This caption includes the personnel and overhead costs of management and administrative cost centres.

**(25) Research and development expenses**

Product development costs of € 1,546 thousand (2002: € 2,492 thousand) are recognised in accordance with IAS 38 as intangible assets and are being amortized over a period of five years.

Other research and development expenses incurred principally to improve existing products and processes which do not meet the asset recognition criteria of IAS 38 are recorded as expenses.

**(26) Other operating income**

Other operating income comprises mainly foreign exchange gains of € 2,959 thousand (2002: € 3,321 thousand), gains on the disposal of investments amounting to € 633 thousand (2002: € 1,207 thousand) and the release of a negative goodwill balance amounting to € 196 thousand (31 Dec. 2002: € 202 thousand). The caption also includes gains on the sale of property, plant and equipment and income from the release of accruals and provisions.

**(27) Other operating expenses**

Other operating expenses comprise mainly foreign exchange losses amounting to € 4,088 thousand (2002: € 3,915 thousand), and amortisation of goodwill amounting to € 3,737 thousand (2002: € 3,799 thousand).

**(28) Taxes on income**

|                      | 2003<br>€000 | 2002<br>€000  |
|----------------------|--------------|---------------|
| Current tax expense  | -1,204       | -4,344        |
| Deferred tax expense | 4,206        | 374           |
|                      | <b>3,002</b> | <b>-3,970</b> |

Corporation tax for 2003 in Germany is 26.5% plus a solidarity surcharge of 5.5% on the corporation tax liability itself. Together with municipal trade tax, the effective tax rate on profits arising in Germany for the year 2003 results in 40.3% (2002: 38.8%). The following table provides an explanation of the relationship between

the actual tax expense and the notional tax expense derived from applying applicable tax rates to the IAS accounting profit before taxes. The effective tax rate for the Group in the year under report is -26.4% (2002: 32.2%).

|   | 2003<br>€000   | 2002<br>€000  |
|---|----------------|---------------|
| <b>Result before taxes</b>  | <b>-11,355</b> | <b>12,345</b> |
| Notional tax expense derived from applying applicable tax rates to the accounting result before tax | 4,576          | -4,790        |
| Effect of different tax rates in foreign subsidiaries   | 948            | 498           |
| Change in tax rates   | -28            | -2            |
| Permanent differences   | -1,121         | 418           |
| Prior year taxes  | 0              | -49           |
| Valuation on retained earnings  | -1,297         | 0             |
| Other   | -76            | -45           |
| <b>Disclosed taxes on income</b>  | <b>3,002</b>   | <b>-3,970</b> |

The corporation tax rate for the year 2004 is 25% (for the fiscal year 2003: 26.5%). For temporary differences between IFRS carrying values and tax bases, therefore a rate of 38.8% (31 Dec. 2003: 40.3%) has been applied.

Other taxes not on income are included in the appropriate expense line by function.

**(29) Earnings per share**

Basic earnings per share were computed on the basis of 11,003,065 shares, the average number of shares outstanding during the year. For the purposes of computing diluted earnings per share, the number of shares was increased by 105,262 shares bringing the total to 11,108,327 to take account for issued stock options.



**(30) EBITDA**

EBITDA is defined as the operating profit (EBIT) adjusted for amortisation and depreciation on intangible assets, goodwill and property, plant and equipment and the income from the release of negative goodwill.

**(31) Personnel expenses and employees**

|                                    | 2003<br>€000  | 2002<br>€000  |
|------------------------------------|---------------|---------------|
| Wages and salaries                 | 30,627        | 27,805        |
| Social security expenses           | 5,754         | 4,753         |
| Pension costs                      | 413           | 390           |
| <b>Personnel expenses</b>          | <b>36,794</b> | <b>32,948</b> |
|                                    | Employees     | Employees     |
| Production, engineering, service   | 441           | 444           |
| Administration                     | 112           | 106           |
| Selling                            | 147           | 142           |
| Research and development           | 33            | 32            |
| <b>Average number of employees</b> | <b>733</b>    | <b>724</b>    |

**Other disclosures****(32) Related Parties (IAS 24)**

IAS 24 requires disclosure of all relationships with related parties (individuals and enterprises).

The Chairman of the Management Board of the parent company, who had the right to represent the company on his own until 6 February 2004, was the controlling shareholder of GFS Finance GmbH, Düsseldorf, Germany, which in turn owned 27.24 % of the shares in WEDECO AG. For this reason, GFS Finance GmbH and companies in which this company holds a majority of the shares were considered to be related parties as defined by IAS 24 for the year 2003.

At 31 December 2003, the Group had payables to related parties amounting to € 5 thousand (31 Dec. 2002: € 13,217 thousand). The prior year's liabilities comprised mainly a remaining purchase price payable in connection with the acquisition of WEDECO Gesellschaft für Umwelttechnologie mbH. Sales to related parties in 2003 amounted to € 66 thousand (31 Dec. 2002: € 2,787 thousand) and purchases of goods and services from related parties amounted to € 1,358 thousand (2002: € 41,066 thousand). The prior year figure for purchases of goods and services includes the acquisition of WEDECO Gesellschaft für Umwelttechnologie mbH for a consideration of € 39,000 thousand. The pricing of sales to and purchases from related parties is based on arm's length principles.

**(33) Notes to the cash flow statement**

Cash and cash equivalents include balances with banks and cash on hand. The amounts disclosed are not subject to any access restrictions.

Business acquisitions and disposals by the Group had the following effects on the Group's assets and liabilities:

|  | 2003      |              | 2002         |               |
|--|-----------|--------------|--------------|---------------|
|  | €000      | €000         | €000         | €000          |
|  | Disposals | Acquisitions | Disposals    | Acquisitions  |
| Non-current assets   | 362       | 218          | 444          | 10,830        |
| Current assets   | 482       | 9,373        | 13,270       | 27,897        |
| Cash and cash equivalents  | 32        | 67           | 634          | 3,574         |
| Non current liabilities  | -59       | -244         | -4,097       | -414          |
| Current liabilities  | -138      | -7,216       | -9,885       | -39,047       |
| Net assets   | 679       | 2,198        | 366          | 2,840         |
| Purchased goodwill   |           |              | -            | 36,276        |
|  |           |              |              | 39,116        |
| Selling price  |           |              | 4,763        | -             |
| Cash and cash equivalents acquired/disposed                        |           |              | 634          | 3,574         |
| <b>Outflows/proceeds in connection with acquisitions/disposals</b> |           |              | <b>4,129</b> | <b>35,542</b> |

All business acquisitions and disposals during 2003 relate to non-cash transactions. Expenses and income related to these disposals and acquisitions are not significant and are disclosed in the cash flow statement.

### (34) Segment information

Segment information has the objective of providing users of the financial statements with financial information on the performance, growth and risks of individual operating and geographical segments, based on the internal reporting structures of the enterprise.

The three segments Water UV, Water Ozone and Solar (primary segments) are defined as follows:

### Water UV

Research and development, production and sale of water treatment equipment based on UV light technology.

### Water Ozone

Research and development, production and sale of water and air treatment equipment based on ozone technology.

### Solar (until 31 Dec. 2002)

Development, production and sale of products involving cosmetic and medical use of UV light.

| <b>2003</b>                   | Water UV<br>€000 | Water Ozone<br>€000 | Solar<br>€000 | Total<br>€000 |
|-------------------------------|------------------|---------------------|---------------|---------------|
| Revenue                       | 72,081           | 53,817              | 0             | 125,898       |
| thereof Equipment             | 47,401           | 44,444              | 0             | 91,845        |
| thereof After sales           | 24,680           | 9,373               | 0             | 34,053        |
| EBIT                          | -5,440           | -2,792              | 0             | -8,232        |
| Assets                        | 73,734           | 72,388              | 0             | 146,122       |
| thereof Goodwill              | 16,220           | 31,334              | 0             | 47,554        |
| Liabilities/provisions        | 52,928           | 27,073              | 0             | 80,001        |
| Capital expenditure           | 4,782            | 6,116               | 0             | 10,898        |
| Depreciation and amortisation | 3,269            | 4,316               | 0             | 7,585         |
| thereof Goodwill              | 1,205            | 2,336               | 0             | 3,541         |

| <b>2002</b>                   | Water UV<br>€000 | Water Ozone<br>€000 | Solar<br>€000 | Total<br>€000 |
|-------------------------------|------------------|---------------------|---------------|---------------|
| Revenue                       | 70,910           | 63,512              | 9,506         | 143,928       |
| thereof Equipment             | 52,086           | 53,318              | 8,514         | 113,918       |
| thereof After sales           | 18,824           | 10,194              | 992           | 30,010        |
| EBIT                          | 4,964            | 4,655               | 3,682         | 13,301        |
| Assets                        | 81,514           | 68,318              | 0             | 149,832       |
| thereof Goodwill              | 17,883           | 33,337              | 0             | 51,220        |
| Liabilities/provisions        | 55,827           | 18,179              | 0             | 74,006        |
| Capital expenditure           | 7,590            | 35,989              | 0             | 43,579        |
| Depreciation and amortisation | 3,023            | 4,388               | 181           | 7,592         |
| thereof Goodwill              | 1,202            | 2,395               | 0             | 3,597         |

Segment information by geographical regions (secondary segments):

| <b>2003</b>                                   | Europe<br>€000 | North-/<br>South<br>America<br>€000 | Asia/<br>Pacific<br>€000 | Africa<br>€000 | Total<br>€000 |
|---|----------------|-------------------------------------|--------------------------|----------------|---------------|
| <b>Revenue</b>                                |                |                                     |                          |                |               |
| Water UV                                      | 45,991         | 13,808                              | 12,042                   | 240            | 72,081        |
| Water Ozone                                   | 32,877         | 15,903                              | 4,962                    | 75             | 53,817        |
| Solar   | 0              | 0                                   | 0                        | 0              | 0             |
| Total   | 78,868         | 29,711                              | 17,004                   | 315            | 125,898       |
| <b>Assets excluding Goodwill</b>              |                |                                     |                          |                |               |
| Water UV                                      | 40,624         | 11,224                              | 5,666                    | 0              | 57,514        |
| Water Ozone                                   | 26,428         | 14,607                              | 19                       | 0              | 41,054        |
| Solar   | 0              | 0                                   | 0                        | 0              | 0             |
| Total   | 67,052         | 25,831                              | 5,685                    | 0              | 98,568        |
| <b>Capital expenditure excluding Goodwill</b> |                |                                     |                          |                |               |
| Water UV                                      | 3,006          | 1,265                               | 103                      | 0              | 4,374         |
| Water Ozone                                   | 665            | 134                                 | 0                        | 0              | 799           |
| Solar   | 0              | 0                                   | 0                        | 0              | 0             |
| Total   | 3,671          | 1,399                               | 103                      | 0              | 5,173         |
| <b>Depreciation excluding Goodwill</b>        |                |                                     |                          |                |               |
| Water UV                                      | 1,728          | 259                                 | 77                       | 0              | 2,064         |
| Water Ozone                                   | 1,793          | 187                                 | 0                        | 0              | 1,980         |
| Solar   | 0              | 0                                   | 0                        | 0              | 0             |
| Total   | 3,521          | 446                                 | 77                       | 0              | 4,044         |

**2002**

|   | Europe<br>€000 | North-/<br>South<br>America<br>€000 | Asia/<br>Pacific<br>€000 | Africa<br>€000 | Total<br>€000  |
|---|----------------|-------------------------------------|--------------------------|----------------|----------------|
| <b>Revenue</b>                                    |                |                                     |                          |                |                |
| Water UV  | 47,736         | 14,713                              | 8,166                    | 296            | 70,911         |
| Water Ozon  | 32,705         | 23,698                              | 6,977                    | 131            | 63,511         |
| Solar   | 5,450          | 3,360                               | 696                      | 0              | 9,506          |
| <b>Total</b>                                      | <b>85,891</b>  | <b>41,771</b>                       | <b>15,839</b>            | <b>427</b>     | <b>143,928</b> |
| <b>Assets excluding Goodwill</b>                  |                |                                     |                          |                |                |
| Water UV  | 46,383         | 13,698                              | 3,550                    | 0              | 63,631         |
| Water Ozon  | 21,016         | 13,937                              | 28                       | 0              | 34,981         |
| Solar   | 0              | 0                                   | 0                        | 0              | 0              |
| <b>Total</b>                                      | <b>67,399</b>  | <b>27,635</b>                       | <b>3,578</b>             | <b>0</b>       | <b>98,612</b>  |
| <b>Capital expenditure<br/>excluding Goodwill</b> |                |                                     |                          |                |                |
| Water UV  | 1,225          | 565                                 | 0                        | 0              | 1,790          |
| Water Ozon  | 4,798          | 551                                 | 164                      | 0              | 5,513          |
| Solar   | 0              | 0                                   | 0                        | 0              | 0              |
| <b>Total</b>                                      | <b>6,023</b>   | <b>1,116</b>                        | <b>164</b>               | <b>0</b>       | <b>7,303</b>   |
| <b>Depreciation excluding Goodwill</b>            |                |                                     |                          |                |                |
| Water UV  | 1,511          | 241                                 | 69                       | 0              | 1,821          |
| Water Ozon  | 1,746          | 247                                 | 0                        | 0              | 1,993          |
| Solar   | 181            | 0                                   | 0                        | 0              | 181            |
| <b>Total</b>                                      | <b>3,438</b>   | <b>488</b>                          | <b>69</b>                | <b>0</b>       | <b>3,995</b>   |

The disclosures are based on the location of the registered office of Group companies, except in the case of revenue, which is analysed by reference to the location of the customer.

**(35) Income and expenses from discontinued operations**

In accordance with IAS 35, the prior year note showed the results of the Solar line of business which was sold at the end of 2002. The Solar line of business corresponds to the Solar segment presented above as part of the segment disclosures, in other words the development, production and sale of products involving cosmetic and medical use of UV light. The prior year disposal resulted in a net gain of € 3,190 thousand.

Further details are summarized as follows:



|                   | 2002<br>€000 |
|-------------------|--------------|
| Revenue           | 9,506        |
| Expenses          | -9,085       |
| Profit before tax | 421          |
| Income taxes      | -257         |
| <b>Result</b>     | <b>164</b>   |
| Assets            | 4,190        |
| Liabilities       | 4,356        |
| Cash flow         |              |
| • operating       | -95          |
| • investing       | -2,904       |
| • financing       | 3,600        |

### (36) Contingent liabilities and other financial commitments

|   | due 2004<br>€000 | due 2005<br>to 2008<br>€000 | due 2009<br>and afterwards<br>€000 | Total<br>€000 |
|---|------------------|-----------------------------|------------------------------------|---------------|
| Rental expenses                         | 2,640            | 9,629                       | 4,189                              | 16,458        |
| Vehicle and machinery<br>lease expenses | 1,319            | 1,700                       | 0                                  | 3,019         |
| Other                                   | 1,299            | 1,273                       | 4                                  | 2,576         |
|   | <b>5,258</b>     | <b>12,602</b>               | <b>4,193</b>                       | <b>22,053</b> |

At 31 December 2003 all trade accounts receivable of WEDECO AG were pledged as collateral in return for a credit guarantee facility from a commercial bank totalling € 10,226 thousand (31 December 2002: € 17,895 thousand). At the balance sheet date the credit facility drawn down by the parent company (for bank guarantees only) amounted to € 7,705 thousand (31 Dec. 2002: € 8,304 thousand).

Purchase commitments for capital expenditure and inventories amounted to € 15,035 thousand (31 Dec. 2002: € 13,752 thousand).

### (37) Leasing (IAS 17)

The Group has entered into leasing arrangements for production machinery, motor vehicles and office equipment which qualify as finance leases under IAS 17. The carrying amount of leased assets at 31 December 2003 amounts to € 2,093 thousand (31 Dec. 2002: € 1,682 thousand) and is included in property, plant and equipment at the balance sheet date. Total minimum lease obligations at 31 December 2003 amounted to € 2,296 thousand (31 Dec. 2002: € 2,089 thousand).

The net present value of minimum lease obligations, using an incremental borrowing rate of 8%, is € 2,080 thousand (31 Dec. 2002: € 1,436 thousand), of which € 877 thousand have a remaining period of under one year and € 1,203 thousand have a remaining period between 1 and 5 years.

Expenditure on operating leases in the year amounted to € 1,715 thousand (2002: € 1,314 thousand).

**(38) Consolidated companies**

The following subsidiaries are fully consolidated in the consolidated financial statements of WEDECO AG:

| Company  | Registered Office   | Shareholding      |                   |
|--|---|-------------------|-------------------|
|  |   | 31 Dec. 2003<br>% | 31 Dec. 2002<br>% |
| WEDECO KATADYN AG  | Wallisellen, Switzerland  | 100               | 100               |
| WEDECO Ltd.  | Manchester, Great Britain   | 100               | 100               |
| WEDECO Technologie Ochrony Srodowiska sp.z.o.o.  | Posen, Poland   | 100               | 100               |
| WEDECO KATADYN GmbH  | Düsseldorf, Germany   | 100               | 100               |
| WEDECO KATADYN France S.A.   | Garges-lès-Gonesse (formerly: Roissy-en-Brie), France                     | 100               | 100               |
| WEDECO UV Technologies Inc. (formerly: WEDECO Ideal Horizons Inc.)                       | Charlotte, North Carolina, USA  | 100               | 100               |
| WEDECO VISA Water Technology GmbH  | Seewalchen, Austria   | 100               | 100               |
| WEDECO UV Systems plc.   | Sudbury, Great Britain  | 100               | 100               |
| WEDECO Rex S.A.  | Madrid, Spain   | 100               | 100               |
| WEDECO Puro srl.   | Bannone di Traversetolo, Italy  | 100               | 100               |
| WEDECO Technologie Acque srl.  | Bari, Italy   | 100               | 100               |
| Advanced UV Light GmbH   | Essen, Germany  | -                 | 100               |
| WEDECO Co. Ltd. Water Technology (formerly: WEDECO Sung Jin Co. Ltd. Water Technologies) | Seoul, Korea  | 100               | 100               |
| WEDECO Water Technology Pte. Ltd.  | Singapore   | 100               | 100               |
| WEDECO Water Technology Ltd.   | Auckland, New Zealand   | 100               | 100               |
| WEDECO B.V.  | Helmond, Netherlands  | 100               | 100               |
| WEDECO Tecnologica de Aguas Ltda.  | Sao Paulo, Brazil   | -                 | 100               |
| WEDECO AVP Pty. Ltd.   | Sydney, Australia   | 100               | 100               |
| Chongqing WEDECO-Kangda Water Technology Co. Ltd   | Chongqing, China  | 51                | 51                |
| WEDECO Gesellschaft für Umwelttechnologie mbH  | Düsseldorf, Germany   | 84.8              | 100               |
| WEDECO UV Technologies Inc. (formerly: PCI WEDECO Environmental Technologies Inc. )      | Charlotte, North Carolina, USA (formerly: West Caldwell, New Jersey, USA) | 84.8              | 100               |
| OZOMATIC Wasseraufbereitungsgeräte GmbH <sup>1)</sup>                                    | Düsseldorf, Germany   | -                 | 100               |
| WEDECO Ozotech Ltd.  | Burgees Hill, Great Britain   | 84.8              | 100               |
| WEDECO UV Light GmbH   | Düsseldorf, Germany   | 100               | 100               |
| WEDECO Ltda.   | Sao Paulo, Brazil   | 100               | 100               |
| Trailigaz Ozone S.A.S.   | Garges-lès-Gonesse, France  | 84.8              | -                 |

<sup>1)</sup> merged with WEDECO Gesellschaft für Umwelttechnologie mbH

WEDECO Kft. Víz-és Környezetvédelmi Technológiák, Vac, Hungary represents an associated subsidiary with a shareholding of 43.2%, which is consolidated at equity

effective 1 July 2003. Until 30 June 2003, the subsidiary was fully consolidated as the shareholding amounted to 51%.

**(39) Corporate Governance**

During the first quarter 2003 the Management Board and the Supervisory Board have announced their compliance with the recommendations of the German Corporate Governance Codex issued by the Government Commission and made this permanently accessible to the shareholders.

**(40) Representative bodies**

The Management Board of WEDECO AG comprises:

Werner Klink, Businessman

(Chairman, until 6 February 2004);

Christoph Dicks, Graduate in business administration

(Chairman from 6 February 2004, prior: Deputy Chairman);

Till Schwarzlose, Graduate in business administration

(member of the Management Board and Deputy chairman from 6 February 2004)

Dr. Andreas Kolch, Biologist;

John Marrino, Engineer.

Werner Klink and Christoph Dicks are entitled to represent the company individually. They are exempt from the restrictions contained in § 181 of the German Civil Code (BGB).

At the balance sheet date the members of the Management Board held no (31 Dec. 2002: € 9,700) WEDECO shares.

The Supervisory Board consisted of the following members during the year:

Michael Stolskij, Businessman (Chairman);

Holger Künzel, Graduate in business administration (Deputy Chairman);

Dr. Peter Hess, Attorney and Public Notary;

Michael Roesen, Attorney;

Horst Wedekamp, Businessman;

Prof. Dr. med. Martin Exner, Scientist (Professor);

At the balance sheet date members of the Supervisory Board held 70,880 WEDECO shares (31 Dec. 2002: 75,930).

**(41) Remuneration of the representative bodies**

Total remuneration of the members of the Management Board in 2003 amounted to € 863 thousand (2002: € 1,239 thousand). As at 31 December 2003 128,760 (2002: 122,500) stock options had been granted to members of the Management Board; 15,000 (2002: zero) of these were granted in 2003.

Total remuneration of the members of the Supervisory Board in 2003 amounted to € 122 thousand (2002: € 79 thousand).

**(42) Mandates of the members of the Management and Supervisory Boards**

The member of the Supervisory Board Holger Künzel is Chairman of the Supervisory Board of Realeyes AG, Munich. Other members of the Management Board and Supervisory Board do not hold any other mandates in German statutory Supervisory Boards or in comparable bodies.

Düsseldorf, 17 March 2004

WEDECO AG Water Technology

The Management Board

Ch. Dicks   T. Schwarzlose   Dr. A. Kolch   J. Marrino

# Group Management Report 2003

## Overview

Reduced revenues resulting in a consolidated net loss as well as negotiations to merge with other companies were the key developments for the business year 2003.

Significant increases in the after sales business did not manage to compensate the reduction in revenue experienced in the business with systems and equipment in Europe and North America. Together with the effects of the relocation of the activities in North America, this resulted in a net loss for the financial year.

The lack of dynamism in the global economy impacted on the demand for modern water treatment technology during the current financial year. We consider this to be just a short-term impact on a long-term stable growth trend. The global demand for UV and Ozone water treatment equipment promises a long-term growth which WEDECO, as in the past, will successfully and actively participate in.

Following the withdrawal from negotiations to merge with a competitor at the beginning of the financial year, a business combination agreement was closed with ITT Industries German Holding GmbH, Frankfurt, Germany, and ITT Industries Inc., White Plains, USA, in November 2003. ITT Industries then announced a public take over offer to the shareholders of WEDECO, which was accepted by the majority of the shareholders. This strategic alliance grants WEDECO access to business opportunities specifically with regards to the extension of distribution channels and the combination of the UV- and Ozone technologies with other water treatment technologies.

During the second quarter of the financial year, WEDECO acquired the Ozone division of Veolia Water Systems (formerly: Vivendi Water Systems) in return for shares of WEDECO Gesellschaft für Umwelttechnologie mbH, Düsseldorf, Germany. This strengthened the global position of WEDECO in the Ozone market. The integration process has been successfully completed.

## Business trends

Veolia Water Systems contributed its Ozone subsidiary Trailigaz Ozone S.A.S., Garges-lès-Gonesse, France ("Trailigaz"), to the Ozone division of WEDECO in return for a 15.2% interest in WEDECO Ozone group in June 2003. This alliance of WEDECO - the global market leader for ozone technology - with Trailigaz - the global number three in the Ozone market - formed an even stronger partnership for customers all over the world.

The new North American site located in Charlotte, North Carolina was opened in October 2003. Production sites for UV equipment in Vermont as well as Ozone systems in New Jersey had been previously relocated to the new site. The relocation as well as necessary changes to the majority of the staff interfered with the operating business more than planned. In the meantime, action has been taken to resolve these interferences quickly.



## Revenues and business development

### Overview

WEDECO AG recorded revenues of € 125.9 million for the financial year 2003. This is a reduction in revenue by 12.5% compared to the previous year's figure of € 143.9 million. It is the first year with a decrease in revenue. While after sales revenue grew by 13.7% to € 34.1 million as planned, revenue generated from business with equipment and systems declined by 19.4% from € 113.9 million to € 91.8 million.

Revenues in the Asia and Pacific region grew by 7.6% to constitute a portion of 13.5% of total revenue.

The decline in revenues for Europe and America was disappointing. European revenues decreased by 8.2% from € 85.9 million in the previous year to € 78.9 million in the current financial year. The drop in revenues in America by 28.9% to € 29.7 million was particularly significant and was partly related to the effects of the relocation of production sites in the USA.

### UV segment

Revenues generated in the UV segment went up marginally from € 70.9 million to € 72.1 million. The segment therefore accounts for 57.3% of total revenues. While revenues in Europe and America declined, revenues in the Asia/Pacific region increased by 46.3% to € 12.0 million. 63.8% of revenue is generated in Europe, 19.1% in America and 16.6% in the Asia/Pacific region.

With revenues increasing by 31.4% to € 24.7 million, the After sales business was exceptionally successful. In contrast to this, the order volume for equipment and plants placed by the public sector in Europe and

America declined in addition to the continuously weak demand by industrial customers. As a result of the weak global economy, a significant amount of orders was postponed or deferred, respectively.

In addition to various small and medium sized equipment, major plants were produced for customers in North America during the financial year. A framework agreement of € 3.4 million was contracted with the water supplier Southern Water in Great Britain. Major projects in Italy and Australia indicate that water disinfection with UV is increasingly preferred to the use of chemical treatment throughout the world.

### Ozone segment

Revenues for the Ozone segment declined by 15.3% from € 63.5 million to € 53.8 million. It should be noted, that 2003 revenues include € 5.6 million attributable to the first-time consolidation of Trailigaz. While revenues in Europe remained stable, revenue decreased in America by € 7.8 million and in the Asia Pacific Region by € 2.0 million. 61.2% of the revenues were generated in Europe, 29.6% in America and 9.2% in the Asia Pacific Region. The decline was mainly related to equipment business.

As a result of the high proportion of large projects and less after sales business, the Ozone division tends to be more volatile than the UV division. In addition to large projects in Turkey, Denmark, Germany and the USA, achievements were noted for pulp and paper bleaching with Ozone. In addition to a large project in Slovakia, the first large plant for pulp bleaching was sold in North America. The economic and ecological advantages of Ozone treatment may also lead to a breakthrough of this technology in North America.

#### Solar segment

This segment contributed revenues of € 9.5 million to group revenues in the previous year. It was sold by the end of the financial year 2002.

#### Order backlog

At year end, the order backlog of the UV segment of € 20.7 million and the Ozone segment of € 35.7 million add up to a total of € 56.4 million. This order volume is 19.7% above that at the end of the previous year, which is a good starting position for a successful business year 2004. The significant increase is also attributable to projects that had not been finalised during 2003 as planned.

### Cost of sales and gross profit

As a percentage of revenue, cost of sales went up by 7.5%. The decline in revenues, a high portion of fixed costs and a margin decrease in the North American UV market are the main contributors to this deterioration in the cost of sales ratio and the reduction in gross margin by € 15.8 million.

### Sales and marketing

WEDECO establishes its own sales force in the major regional markets to ensure the provision of competent advice to the customer and the regulatory authorities of the water industry as well as the establishment of a reliable after sales-service. This leads to a high market share and the ability to act efficiently to changes in customer demand. WEDECO is the regional market leader for both UV disinfection and Ozone oxidation for all countries it operates in – except for the UV market in the USA. We will continue to follow this successful concept in the future and will further develop our sales efforts in the North American UV market.

Selling costs increased from € 18.3 million by 10.9% to € 20.3 million. An amount of € 0.5 million is attributable to the consolidation of Trailigaz in the second half of the financial year. As a result of the decline in revenues, the portion of selling cost in relation to revenues increased significantly from 12.7% to 16.1%.

## Administration and controlling

General and administrative expenses went up from € 10.4 million to € 12.9 million in 2003. This includes costs of € 3.5 million related to negotiations to merge with a competitor at the beginning of the financial year, as well as the negotiations with ITT Industries. Taking into account the aforementioned expenses, the portion of general and administrative expenses decreased by 9.6% to € 9.4 million, resulting in a portion of 7.5% compared to 7.2% in the previous year. Due to rationalization effects supported by the ERP-software Navision, the cost associated with the administration processes and structures could be reduced.

The participation in and preparation for the negotiations as well as the due diligence process had a significant impact on the workload of the group controlling department. These effects will not reoccur in 2004. To a lesser extent, however, an additional workload is expected in relation to the integration into the ITT Industries group.

## Research and development

Research and development expenses amounted to € 6.7 million, which is 5.3% of revenues. This represents an increase of 9.8% to the previous year's expense of € 6.1 million, which was mainly attributable to the extension of pilot projects. The number of employees working in the research and development department remained stable at an average of 33 for the year.

Research and development represents a core competency for WEDECO. The main focus is a reduction of life cycle costs for UV and Ozone processes. This strengthens the group's position in the market against competitors using the same or substitutional technology and promotes the spread of UV and Ozone processes. In addition to this main focus, the development of further applications of these technologies is experiencing growing importance. Especially the decomposition of endocrine-effective substances in water is the main long-term focus.

The research and development strategy is long-term and only to a limited extent subject to short-term variations in business trends. These expenses are understood to be an investment into the group's future.

## Other operating income

Other operating income amounted to € 5.5 million during the financial year compared to € 5.7 million in the previous year. It mainly comprises exchange gains of € 3.0 million, which correspond to exchange losses of € 4.1 million disclosed under other operating expenses.

## Other operating expenses

Other operating expenses amounted to € 8.5 million (2002: € 11.3 million) which include the amortization of goodwill amounting to € 3.7 million. € 4.1 million of exchange losses are mainly a result of the weak US-dollar.

## Financial result

The financial result declined from € -1.0 million in the previous year to € -3.1 million in the current financial year. This is mainly a result of the financing of purchase prices for Ozone companies during the previous year as well as the additional financial debt assumed for the group.

## Results of operations

WEDECO recorded a negative operating result (EBIT) of € -8.2 million compared to an operating profit of € 13.3 million in the previous year. The significant decline is related to the reduction in revenues by € 18.0 million as well as the additional expenses incurred during the negotiations with a competitor and ITT Industries of € 3.5 million.

Before amortization of € 3.7 million on positive goodwill (2002: € 3.8 million), disposal of negative goodwill of € 0.2 million (2002: € 0.2 million) and depreciation of € 4.0 million on other non-current assets (2002: € 4.0 million) a negative EBITDA amounting to € -0.7 million is recorded compared to a positive EBITDA of € 20.9 million in the previous year.

The current year loss from ordinary activities of € -11.4 million is significantly below the prior year amount of € 12.3 million. In addition to the negative EBITDA, this is a result of the decline in the financial result by € 2.1 million compared to the previous year.

After current and deferred income tax, a consolidated net loss for the year of € -8.2 million after a consolidated net profit of € 8.4 million in the previous year is recorded.

Undiluted earnings per share amounted to € -0.74 compared to € 0.77 in the previous year.

## Cash flow

As a result of the consolidated net loss, cash flow from operating activities amounted to € 0.1 million only. Investing activities were limited to capital expenditure for property plant and equipment assets and intangibles of € 6.2 million as no major acquisitions were performed during the financial year. Cash of € 16.0 million was paid for the remaining purchase price of the Ozone companies financed by additional debt of € 11.9 million and a reduction in cash funds on hand.

## Personnel

The workforce of the WEDECO Group on average for the year increased slightly from 724 to 733 employees. This figure includes 67 employees of Trailigaz for the second half of the year. As the Hungarian joint venture has been fully consolidated for the first half of the year only, the 57 employees of this company are not included for the second half of the year in the total headcount. The apportionment through the business functions remained almost stable with 60.2% of employees (2002: 61.3%) working in production, technology and service and 20.1% (2002: 19,6%) in sales.

With a total of eight apprentices most of which are offered a job contract at the end of their apprenticeship, WEDECO contributes to the development of young talent. The careers of former apprentices in the company demonstrate that this is a successful model for both employee and company. This develops a qualified workforce and leads to a long-term identification of the employee with the company.



## Balance sheet

The 2003 WEDECO consolidated financial statements include 24 fully consolidated companies from 17 countries. The Hungarian joint venture has been accounted for as an associated subsidiary effective July 1, 2003.

With respect to non-current assets, the reduction of goodwill from € 51.2 million to € 47.6 million due to the current year amortisation was compensated by an increase of deferred tax assets to € 6.1 million mainly resulting from the recognition of tax losses carried forward. Inventories increased slightly by € 1.8 million to € 38.6 million.

Net equity decreased by € 10.7 million to € 64.5 million or 44.1% (2002: 50.2%) of total assets, respectively, mainly as a result of the consolidated net loss. Current financial liabilities went up to € 16.0 million (2002: € 3.1 million) due to the payment of the remaining purchase price for the Ozone companies.

## Risks of future business development

WEDECO group uses its risk management system as an instrument to evaluate the risks associated with the individual companies as well as the whole group on a qualitative and a quantitative basis. The main objective of this system is to identify risks early in order to develop appropriate counter measures. Regarding the development in the USA, the indications of the system did not lead to the appropriate measures in time.

The risk manager reports directly to the Management Board. He is in charge of the application and development of the systems in all business areas. The group planning is compared to the monthly actuals and current forecasts. The Supervisory Board, which addresses the issues of risk management in accordance with number 5.3.2. of the German Corporate Governance Code, also receives the Risk Report.

The business with industrial and public sector customers is subject to the risk of the overall economy. As WEDECO is a globally operating group with an anticipated increased portion of international business, regional differences need to be incorporated into the risk management system.

The group meets the competition with substitutional technologies as well as competitors in the UV- and Ozone technologies with intensive research and development in order to continually reduce life cycle costs for UV- and Ozone applications for the customers and to extend its competitiveness in the market.

Large projects, allocated differently to both regions and segments, continue to represent a major portion of total revenue. This portion of revenue will remain a key area of focus as these projects may lead to significant variations in business. Despite a well trained workforce and the use of appropriate controlling instruments, the effects of this structure can only be controlled to a limited extent.

Both the independent auditors as well as the Audit Committee of the Supervisory Board concluded that the Risk management system meets the requirements of § 91 (2) German Stock Corporation Act (AktG) from a system perspective.

## Corporate Governance

The Management and Supervisory Boards have declared in accordance with § 161 of the German Stock Corporation Act (AktG) that they have complied with the recommendations of the German Government Corporate Governance Code Commission in the first quarter 2003 and have granted permanent access to this declaration to the shareholders of the group. Following the recommendations of the government commission, the Annual General Meeting resolved to adjust the Supervisory Board compensation in May 2003.

## Events after the balance sheet date

On February 12, 2004, ITT Industries German Holding GmbH, Frankfurt, a subsidiary of ITT Industries Inc., publicly announced that it holds 91.91% of the shares of WEDECO AG.

In the Supervisory Board meeting on February 6, 2004, the Management Board resigned in accordance with the terms of the business combination agreement with ITT Industries. The Supervisory Board appointed Christoph Dicks – hitherto Chief Financial Officer and Deputy Chairman - new Chairman of the Management Board, Till Schwarzlose – hitherto Group Finance Director - Chief Financial Officer and Deputy Chairman. The Management Board members Dr. Andreas Kolch (Research and Development) and John Marrino (Sales, Marketing and Public Relations North America) were approved. The founder of the company and former Chairman of the Management Board Werner Klink resigned.

Due to non-compliance with key financial ratios outlined in the loan agreements with IKB Deutsche Industriefinanzbank AG and Bayerische Versicherungsbank AG, a subsidiary of Allianz AG, these financial institutions have an exceptional right of notice of € 25 million for the loans granted. Based on negotiations with these banks, we are confident that these loans will continue, even though the conditions may be subject to changes.

The Management Board of the German stock exchange decided that WEDECO AG shares will cease to trade on the TecDax and the NEMAX 50 stock exchange effective March 22, 2004, as, due to the acquisition of the majority of the shares by ITT Industries German Holding GmbH, market capitalisation and trade volume of the share, based on the reduced free float, were not sufficient to meet the criteria to continue trading in these indices.

There were no other events of major significance after the balance sheet date.


## Prospects

WEDECO will focus on its key markets and core competencies. Profitability will be given priority over sales growth. On this basis, all business activities will be analysed for their contribution to the group result. Improvements in North America will be the main focus.

WEDECO participates in a market of long-term growth potential which, however, remains vulnerable to the overall economic development. By extending its technological lead, WEDECO will further develop its competitive advantages over direct competitors and substitutional technologies. This is planned to result in an increased market share and growing sales and profits.

Düsseldorf, March 17, 2004

WEDECO AG Water Technology  
The Management Board



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Annual Reports, Quaterly Statements and other information are also available on our homepage under <http://www.wedecoag.com>.

This Annual Report is also available in German.

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# We care for healthy water. Worldwide.

*"When the well's dry,  
we know the worth of water"*  
(Benjamin Franklin)



**WEDECO AG**  
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