KBA
Koenig & Bauer Group

Consolidated Financial Statements 2005

At a Glance

Koenig & Bauer Group

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

KBA Group in Figures

€m	2001	2002[1]	2003[1]	2004[1]	**2005[1]**
Order intake	1,197.9	1,084.5	1,255.8	1,459.1	1,768.9
Sales	1,304.0	1,353.8	1,231.8	1,423.0	1,621.0
Order backlog at 31.12.	1,102.2	832.9	856.9	893.0	1,040.9
Operating profit/loss	58.6	46.6	–47.0[2]	20.4	33.3
Earnings before taxes	62.3	43.2	–49.6	16.0	25.8
Net profit/loss	40.0	28.1	–30.0	11.8	18.6
Balance sheet total	1,334.1	1,240.6	1,299.4	1,344.4	1,396.2
Intangible assets, property, plant and equipment	257.5	283.0	260.2	275.5	270.3
Equity (without proposed dividend payment)	437.1	467.6	443.7	441.2	442.9
Investment in intangible assets, property, plant and equipment	81.4	51.7	45.3	57.6	39.5
Depreciation on intangible assets, property, plant and equipment	38.5	45.0	57.2	45.5	40.8
Personnel: annual average	7,424	7,539	7,266	7,370	7,882
Cash flows from operating activities	–39.8	11.9	61.6	38.1	174.6
Dividend and bonus paid per share in €	0.67+0.33	0.50	–	0.25	0.40

[1]under International Financial Reporting Standards
[2]including €45.1m restructuring expenses

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With the global economy expanding steadily at a rate of almost 5% in real terms, and above-average growth in the EU accession states, the USA, the Middle East and China, demand for printing presses finally picked up in Germany, too, following prolonged stagnation.

KBA's strong strategic position in virtually all key sectors of the print media market enabled us to reap the benefits. Thanks to an outstanding performance in the fourth quarter we surpassed by more than €120m the €1,500m sales target we had set ourselves in the spring, posting Group sales of €1,621m – a 13.9% increase on the previous year and a new record in our long history.

As we had predicted, the KBA Group made a good recovery in 2005, generating pre-tax earnings (EBT) of €25.8m (2004: €16m). The free cash flow essential for company liquidity also improved, especially in the second half-year. Even so, pre-tax profit relative to sales was below target, despite a raft of cost-cutting initiatives.

A comparison with our sales and earnings in 1997 clearly reveals the impact of the recent industry crisis and the increasing globalisation of market prices, technological specifications, shipping and financing terms. Although Group sales in 1997 (€747.7m) were less than half the level of 2005, pre-tax earnings were over one-and-a-half times the level (€39.1m). The market for printing presses is still very much a buyers' market, with all the challenges this entails for globally active players. At the same time headlong economic expansion in regions like the Far East, with their massive consumption of resources, has driven up the prices of raw materials and oil, so on the supply side we have a sellers' market in many respects.

Although Group productivity and cost-efficiency are much higher than they were nine years ago, the slide in market prices means that we must ship a far bigger volume of goods and sophisticated technology to achieve the same level of turnover. So rigorous cost management and ongoing innovation are indispensable for German machine manufacturers operating in a global marketplace. We can only hope for a moderate outcome to the current tariff negotiations in the German metalworking and electronic industries, so that they do not erode the savings we have achieved.

KBA made a good start to 2006, with last year's 20%-plus leap in new business to more than €1.75bn translating into an order backlog exceeding €1bn. Judging by the volume of contracts booked in the first quarter we anticipate a high level of plant utilisation at all our production facilities for the rest of the year. Following a vigorous performance in the past two years we are targeting a moderate lift in sales in 2006. To minimise risk and maximise earnings our focus will be on defending margins. Notwithstanding the familiar risks associated with raw materials, energy and currency exchange, we are confident that at the end of the current business year we shall be able to notify shareholders of an appreciable improvement in our financial figures.

On behalf of the management board I would like to thank all the executives, employees and staff representatives at our individual facilities for their dedication and support in helping us to attain our goals. I also wish to express my thanks to you, our shareholders, for your loyalty to Koenig & Bauer. And a big thank-you to all our customers, old and new, for the confidence and trust you have placed in our products and services, and for the invaluable feedback with which you support our operations.

Würzburg, 7 March 2006
Koenig & Bauer AG
Management Board

Albrecht Bolza-Schünemann
President and CEO

In the fiscal year under review the supervisory board and its committees closely and continuously monitored the activities of the Koenig & Bauer management board, duly fulfilling the obligations and functions assigned to us by law and the statutes.

Four meetings were held at which KBA management gave the supervisory board a thorough briefing on the economic situation at Koenig & Bauer and within the Group, on Group performance and individual business operations, and on fundamental matters of corporate policy, management and strategy. Alongside market developments and the potential these offered, the emphasis was on the product range, corporate shareholdings, the second-hand machinery business, investment, personnel policy, risk management, the performance of major subsidiaries and corporate governance.

The April meeting was largely devoted to scrutinising, discussing and approving the financial statements and examining issues relating to the integration of Grafitec, a Czech manufacturer of small-format sheetfed presses acquired at the beginning of March. Current business figures and strategic aspects were reviewed at the meeting on 23 June. In September, Group performance in the first half-year and management prognoses for 2005 were on the agenda. The November session focused on investment plans for 2006 and the supervisory board elections scheduled for the following year. The supervisory board was involved in all corporate decision-making processes of any import. Beate Grabmair, who joined the board as an employee representative on 26 June 2003, was unable to attend any of the four sessions due to ill health. We were deeply saddened to hear of her untimely death on 19 March this year.

Between the plenary sessions I continued to maintain and co-ordinate the monitory and advisory functions I fulfil in my capacity as chairman, both in meetings with the management board and in various committees. Albrecht Bolza-Schünemann gave me regular updates on all significant procedures and developments within Koenig & Bauer and the Group. In addition we discussed in detail fundamental business matters, upcoming executive decisions and emerging trends.

The Koenig & Bauer supervisory board has three committees: the human resources or executive committee, the audit committee and the mediation committee stipulated in section 27 of the Law on Codetermination. The audit and human resources committees convened several times in 2005. The financial statements, management reports and auditors' reports for Koenig & Bauer and for the KBA Group were reviewed by the supervisory board's audit committee, with the auditors furnishing the results of their audit. In my capacity as chairman of the supervisory board I attended the audit meeting between management and the auditors on 7 March 2006. Other topics on the agenda were the quarterly statements, risk assessment and tracking systems, risk reporting by the internal auditing department and the monitoring of auditor independence. The human resources committee deliberated on the extension of employment contracts for

the members of the management board, the efficiency of the management and supervisory boards and matters relating to succession. The mediation committee formed in accordance with section 27, clause 3 of the German Law on Codetermination did not convene in 2005. The supervisory board was regularly updated on the work of the committees.

The supervisory board routinely monitors compliance with the German Corporate Governance Code and its continued implementation by the Parent Company, which we found to conform as declared. The update issued on 2 June 2005 was appraised, the declaration of compliance amended and in February 2006 deviations duly disclosed. These are stated in the chapter on corporate governance (*pages 8 - 11*), which also includes management and supervisory board remuneration.

The financial statements, management reports and method of accounting for the Parent and the Group to 31 December 2005 were examined by Bayerische Treuhandgesellschaft AG – the auditors appointed at the AGM – and awarded the auditor's certificate unreservedly. The auditors further confirmed that the management board operates an effective risk management system compliant with statutory regulations. The financial statements, management reports and auditors' reports for Koenig & Bauer and for the KBA Group, as well as the proposal for the utilisation of net profit, were distributed to the members of the supervisory board well in advance of the audit meeting. The audit committee's findings were then submitted to and approved by the supervisory board.

After conducting its own review the supervisory board raised no objections to the financial statements and management report for the Parent Company, and at its meeting on 29 March 2006 officially approved the year-end financial statements submitted by the management board. The financial statements and management report for the Group were also reviewed and approved, as was the management board's proposal for the utilisation of net profit.

The supervisory board wishes to thank all KBA management and staff for their unflagging commitment to the success of the Company and the Group.

Würzburg, 29 March 2006
Koenig & Bauer AG
Supervisory Board

Peter Reimpell
Chairman

Corporate Governance

Commitment to a transparent corporate culture

Koenig & Bauer identifies with the basic recommendations and proposals set out in the internationally recognised German Corporate Governance Code of 2002, and is committed to a transparent corporate culture that promotes the confidence of shareholders, customers, employees and the general public in the management and monitoring of listed German companies. However, the time and resources required for compliance with such initiatives and any new directives must remain within reasonable bounds if global competitiveness is not to be impaired.

KBA has, with very few exceptions, implemented the Corporate Governance Code for many years, even though this was not documented in detail. The voluntary recommendations have been broadly adopted, the amendments issued in May 2003 and June 2005 implemented at the earliest opportunity and compliance monitored on an ongoing basis. The rules of procedure for the supervisory and management boards were revised in 2003 and have been updated accordingly.

Declaration of compliance

The Koenig & Bauer supervisory and management boards issued a current declaration of compliance in February 2006 pursuant to section 161 of the German Stock Corporation Act (AktG). The recommendations of the Government Commission on the German Corporate Governance Code, as revised on 2 June 2005, were adopted and will be observed with the following minor exceptions.

There is no disclosure of individual board members' remuneration (provisions 4.2.4 and 5.4.7). Since share options and other derivatives form no part of such remuneration, and there are no plans for them to do so in the future, we believe that a breakdown into fixed and variable elements for each of the two boards is perfectly adequate and, with the elucidation of the management board remuneration system at the AGM on 23 June 2005 and the rules detailed in section 11 of the company statutes for supervisory board remuneration, furnishes our shareholders with adequate information for assessing the propriety of the remuneration given.

Following a prolonged recession, the atmosphere was much brighter at the annual IfraExpo newspaper trade fair, Leipzig, in October 2005

KBA

In accordance with the compensation system currently in force, all the members of the Koenig & Bauer management board draw the same basic salary. Only the bonus entitlements awarded to the president and deputy president are slightly higher than for the other board members. The profit-oriented portion of variable compensation is calculated solely on annual profit. Management board remuneration for the 2005 business year is disclosed as fixed and variable components in the Notes on page 81.

Supervisory board remuneration was determined by the shareholders' meeting of 15 July 1999, which authorised a total fixed fee of €100,000 per year plus a variable component comprising 5% of the dividend sum less 4% of equity capital. The allocation of the fixed and variable components among the individual members is determined by the supervisory board according to the duties and committee work involved. At present 20% of the variable component is assigned to the committees (with the exception of the mediation committee in accordance with section 27 of the Law on Codetermination) and 80% to other board activities. The variable component for the 2005 business year totalled €0.2m.

Section 9 of the articles of association stipulates that in accordance with the provisions of the German Stock Corporation Act and the Law on Codetermination (MitbestG) the supervisory board chairman, the deputy chairman as defined in section 27 of the Law on Codetermination and a second deputy chairman must be elected in a single session immediately following the AGM, the conclusion of which marks the beginning of a new term of office. The session must be conducted by the oldest AGM-appointed supervisory board member until a new chairman has been elected. To ensure that no restrictions are placed on the new supervisory board in electing the chairman, the names of candidates are not disclosed to the shareholders (provision 5.4.3).

Pursuant to section 15a of the German Securities Trading Act (WpHG, Wertpapierhandelsgesetz), members of the management and supervisory boards, closely associated parties and any other parties with executive functions, routine access to insider information and decision-making powers must disclose any transactions in company securities exceeding a total of €5,000 in any one calendar year. All such transactions in KBA shares (ISIN: DE0007193500) during the 2005 business year were published without delay on the KBA website under Investor Relations/Directors' Dealings, but due to lack of space are not disclosed individually in the Corporate Governance section (provision 6.6 of the Corporate Governance Code).

Members of the management board own 5.3% of equity capital, members of the supervisory board 6.5%. The figures for individual board members (provision 6.6) have not been disclosed, since this would be of no added significance to shareholders.

Our Group financial statements for 2005 will be published within the recommended 90 days (provision 7.1.2). Only the statements for 2004 were published a few days late.

In accordance with provision 7.2.3 it was agreed that the auditors, Bayerische Treuhandgesellschaft Aktiengesellschaft, should inform the supervisory board or make a note in the audit if they detected any deviations from the declaration of compliance issued by the supervisory and management boards. The auditors discovered no errors or misrepresentations.

The revised declaration of compliance issued by the management and supervisory boards was published on the KBA website under Investor Relations/Corporate Governance.

Würzburg, 7 March 2006

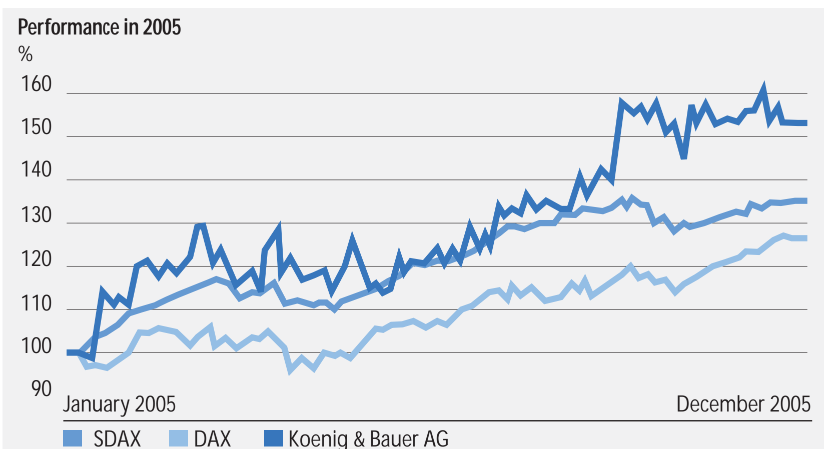
For the supervisory board:
Peter Reimpell

For the management board:
Albrecht Bolza-Schünemann

KBA Shares

Share value reflects Group prospects

A more favourable business climate in Germany and relatively buoyant demand in the global media industry led to a more optimistic assessment of the press engineering sector in financial circles. While Group news and figures played their part in boosting KBA shares, capital markets also rewarded above-average growth in order intake and sales, the expansion of market share, the strategic acquisition of Czech manufacturer Grafitec and a steady improvement in earnings. After climbing at a relatively steady rate throughout the year, KBA shares hit an annual high in December 2005 of €25.58 before easing back at the end of December to €24.20, 52.6% above their opening price of €15.86 on 3 January. Our shares thus outperformed both the small-caps index, the SDAX (+ 35.6%) and the DAX (+ 26%). The share price at the end of 2005 and in the first few months of 2006 approached the true book value more closely than at any time in recent years.



Analysts verdict overwhelmingly positive

Financial institutes publish regular appraisals of Group performance. In 2005, most analysts recommended buying or holding KBA shares. As a prime standard in the small-caps index KBA is committed to transparency.

Over 50,000 new employee shares

For the fourth year in succession Koenig & Bauer employees were given the option of acquiring 15 or 20 company shares at a preference price of €14.50. Almost half, 44.6%, took advantage of this offer and 50,290 employee shares were issued. The workforce now owns around 1.6% of our subscribed capital. The scheme will be repeated in 2006 in order to promote staff identification with the company.

Investor relations activities in 2005

We organised a series of events for analysts, business journalists, institutional and private investors to elucidate our objectives, strategies and the market environment in which KBA operates. In addition to the well-attended AGM and individual interviews with fund managers we also promoted the KBA Group at international investor conferences. Factory tours proved a popular option.

Key data on Koenig & Bauer ordinary shares

	2004	**2005**
Earnings per share	€ 0.73	€ 1.15
Price-earnings ratio	21.8	21.0
Highest price	€ 20.95	€ 25.58
Lowest price	€ 15.00	€ 15.85
Closing price	€ 15.92	€ 24.20
Market capitalisation in €m	258.1	393.6
Cash flow per share	€ 2.35	€ 10.73
Dividend	€ 0.25	€ 0.40
Free float	58.4 %	58.4 %

Management Report

Better times for press manufacturers

The export-driven German engineering industry enjoyed its third successive year of growth, with production up by more than 4% and exports firm despite fierce competition in global markets and renewed price hikes for raw materials and energy. Demand for new presses, which tends to lag the general economy due to the print industry's heavy exposure to the advertising cycle, stabilised at a high level, albeit with the usual regional and seasonal fluctuations. Domestic demand increased by 10%.

Newspaper publishing houses, which had been struggling to regain their equilibrium ever since a slump in advertising and the spread of e-media had hit revenues, seemed to reach the conclusion that defending market share entails an organisational and technological realignment along with cost-cutting initiatives, and started to invest in new kit once again. Lower production costs and staffing levels, higher productivity and greater flexibility, enhanced quality and more customised equipment for differentiating products from price-driven commodity print work are the prime challenges facing press manufacturers today. KBA, with cutting-edge technology and the broadest product palette in the industry, is well positioned to address these user priorities.

We shall continue to pursue a business strategy founded on innovation, cost-efficiency and long-term customer loyalty. In 2005 this delivered substantial gains in sales and bookings in virtually all markets sectors, and visible success in boosting earnings.

The German engineering industry looks set to maintain its role in 2006 and beyond as a driver of exports and economic expansion, notwithstanding the uncertainties arising from the movement of the euro against the dollar, the prices of raw materials and energy, and the political situation in the Middle East. An uptick in domestic demand for industrial goods, and the popularity of German machinery in high-growth markets, should largely compensate for the slide anticipated by the German Machinery and Plant Manufacturers' Association (VDMA) in exports to traditional markets like western Europe and North America.

The control consoles for modern publication rotogravure presses like this one at Burda in Offenburg resemble the distribution centres at power stations

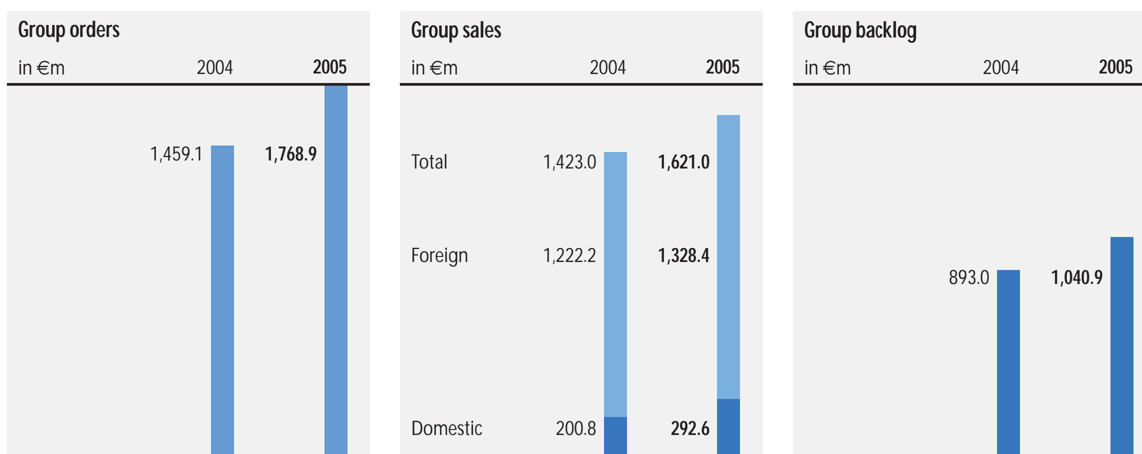
Brisk growth, bulging order books

With our production plants running at close to maximum capacity throughout the year we posted a sizeable increase in sales to €1,621m, easily surpassing our target for 2005 of €1,500m. Our web and sheetfed divisions and our consolidated subsidiaries all played their part in achieving an above-average growth rate of 13.9%.

Unrelenting pressure on margins in key markets, and the considerable expense of setting up the production lines for the models launched at Drupa 2004, were exacerbated by the added burden of higher material and energy costs and a downturn in the second-hand machinery market. Even though, like most other players in the industry, we were obliged to accept narrower margins than we had envisaged, we came close to meeting our earnings target. We shall vigorously pursue ongoing initiatives for sustaining the competitiveness of our German production plants and defending profit margins in a globalised marketplace by driving innovation. For the purposes of corporate management we track order intake and cash flow data along with profit margins.

Orders up 20 per cent

A surge in new orders in 2004 to €1,459.1m was followed by a 21.2% jump in 2005 to €1,768.9m, with a sharp rise in order bookings for commercial web offset, security and newspaper presses. As expected, bookings for webfed gravure presses softened following a prior-year boom. In the sheetfed offset



Cost-effective inline coating is an increasingly popular choice for enhancing product profile in a competitive media arena

division, which maintained its rapid rate of expansion, the inflow of new orders accelerated in the first half but slowed in the second, due in part to a capacity-related extension of delivery time-frames and a closer scrutiny of contracts with regard to earnings potential and customer financing. Even so, the total volume of new orders was almost 10% up on the previous year's outstanding figure and well above the industry average. Demand was particularly brisk for our new medium- and superlarge-format sheetfed presses.

Sales top €1.6bn

For the first time in Group history, sales of presses and peripherals alone topped the €1.6bn mark and enabled us to grow market share. As in the previous year our sheetfed offset division accounted for 50.4% of this double-digit increase. Our two-pronged approach of the past five years – driving up sales in our traditional, volume markets while pursuing a strategy of judicious acquisition in less volatile niche markets – has paid off.

Production safeguarded in 2006

Despite firmer sales, the order backlog at year's end stood at €1,040.9m, well above the figure for 2004 (€893m), and will keep our web press production plants busy for most of the year. We also anticipate a high level of capacity utilisation at our sheetfed division in Radebeul and our Austrian subsidiary, KBA-Mödling.

The entry-level Performa sheetfed presses built by our Czech subsidiary, KBA-Grafitec, have opened up new markets

Upward trajectory sustained

A double-digit increase in sales of both web and sheetfed presses was accompanied by strong growth at KBA-GIORI, which makes special presses for printing banknotes and securities, and buoyant business in key sectors by KBA-Metronic, which builds industrial ID systems (ink-jet, laser) and UV offset presses for digital data storage media. Both subsidiaries are incorporated in our web division.

Sheetfed division drives expansion with innovative products

Our sheetfed division posted its twelfth successive year of growth, surpassing its record performance in 2004 with a 9.7% lift in new orders to €829.5m (2004: €756.4m) and a 14.2% boost in sales to €817.6m (2004: €716.2m). The consolidation of our Czech subsidiary, KBA-Grafitec, which also posted higher sales, was a contributory factor.

The sheer breadth and sophistication of our product range – we manufacture cutting-edge equipment for sheet widths from less than half a metre to more than two metres – is unequalled by any competitor worldwide. In 2005 we gained market share and consolidated our position up among the leaders in the global sheetfed market. Our new-generation Rapida 105, winner of the German print industry's innovation award, is immensely popular among print entrepreneurs the world over. In the 19 months between its market launch in May 2004 and the end of 2005 we shipped well over 100 presses in a wide variety of configurations that included a 15-unit version.

The Rapida 105 high-performance sheetfed press launched at the Drupa international trade fair in May 2004 generated a high volume of sales

RAPIDA
105

In the market for large- and superlarge-format presses we successfully defended our pole position against fierce competition, with orders for the biggest press in the range, the Rapida 205, exceeding all expectations. A popular choice for printing posters and point-of-sale displays, the Rapida 205 won the 2005 InterTech Technology Award sponsored by America's Graphic Arts Technical Foundation (GATF). Superlarge format is also beginning to take off among packaging and book printers who had previously evinced little interest. At the other end of the range, our innovative small and half-size waterless offset presses, the Genius 52 and Rapida 74 G, and KBA-Grafitec's budget-priced Performa presses, also attracted customers we were unable to target just a few short years ago. The sales potential, particularly in threshold economies, is huge and we are already busy expanding our sales network.

Although shipments picked up steam, the backlog of unfilled orders for sheetfed presses at year's end grew to €311.7m (2004: €299.8m).

Web and special presses on an updraught

Our web and special press division booked orders worth €939.4m – an even bigger increase than in the sheetfed division and a healthy 33.7% above the prior-year figure of €702.7m, which was itself a substantial gain. While demand was brisk for newspaper, commercial and security presses, the volume of new orders for publication gravure presses was, as expected, lower than in the previous year, with only three European publishing houses placing contracts.

Group business operations: order intake/order backlog

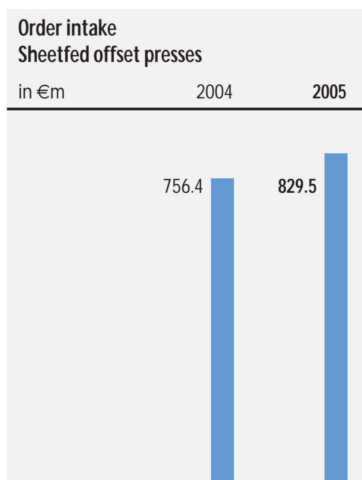
in €m	2004	2005
Order intake	1,459.1	1,768.9
sheetfed offset presses	756.4	829.5
web and special presses	702.7	939.4
Sales	1,423.0	1,621.0
sheetfed offset presses	716.2	817.6
web and special presses	706.8	803.4
Order backlog	893.0	1,040.9
sheetfed offset presses	299.8	311.7
web and special presses	593.2	729.2

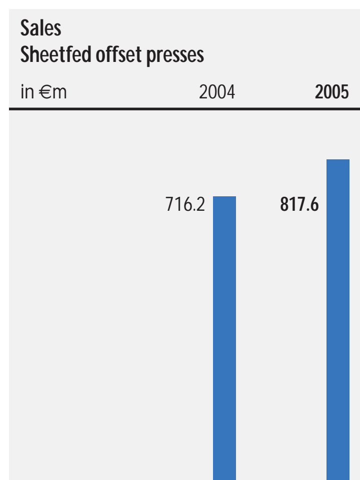
Compact and green: the delivery of the first Cortina waterless offset press in 2005 signalled a new era in high-quality newspaper production. This photo shows part of the press line at Freiburger Druck (*Badische Zeitung*)

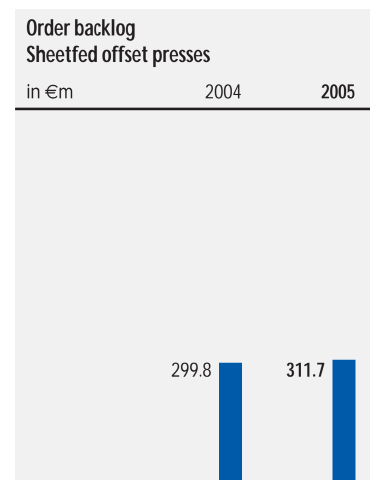
As has been the case for many years, there were significant regional variations in sales of newspaper presses. We are delighted to report that the investment climate in Germany has noticeably improved. A contract for two multi-unit parallel press lines for West Australian Newspapers and other contracts for sheetfed and commercial web presses confirmed the wisdom of intensifying our activities in the Australian market. Orders for single-width newspaper presses were booked in Turkey, China, Spain and the USA, and for double-width and triple-width Commander 6/2 press lines in Germany, France and Belgium. A Cortina contract awarded at the beginning of the year by a prominent Swiss newspaper publisher, Edipresse in Bussigny near Lausanne, was followed by the inauguration of the first major Cortina installation at Rodi Rotatiedruk in the Netherlands, and signals mounting interest among members of the trade in this innovative waterless offset press.

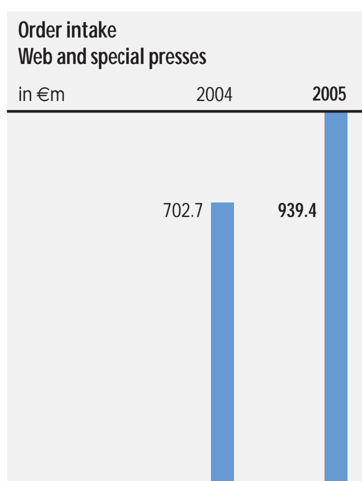
A sizeable rise in new orders for commercial web presses compared to 2004 reflects the popularity of our large-format Compacta 618 and 818 models, the first 72-page versions of which were ordered by European publishing houses. The first Compacta 215 book-printing press will soon ship to Egypt, while Vogel Druck und Medienservice in Höchberg, near Würzburg, will take delivery in summer 2006 of a new-generation 16-page Compacta 217.

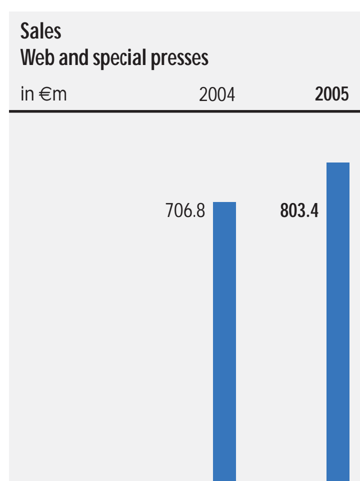
Sales of web and special presses totalled €803.4m, 13.7% up on the previous year (€706.8m). They included big Comet and Continent newspaper press lines for Spain, Italy and the USA, the completion of a major contract awarded by the Dr Ippen publishing house for multiple locations in Germany, and Commander 6/2 shipments to Switzerland and Belgium. In addition a number of gravure and commercial web presses were installed in Europe (including Germany) and the USA. At year's end the volume of orders on hand was worth €729.2m, 22.9% above the prior-year figure of €593.2m.

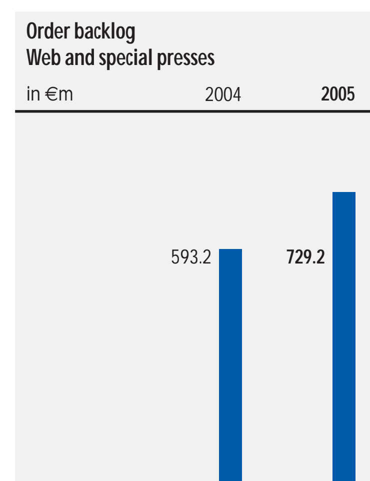












The volume of orders for Compacta commercial web presses almost doubled in 2005. A contract for a multi-unit Compacta 217 was placed by Vogel Druck und Medienservice (VDM) in Höchberg, near Würzburg. Managing director Rolf Lenertz (l) is pictured here with KBA deputy president Claus Bolza-Schünemann at our assembly plant in Trennfeld

Earnings diverge

Sustained pricing pressures and the spiralling cost of raw materials hit earnings in both divisions. Our sheetfed division bore the additional expense of establishing production lines for new models and of implementing product enhancements based on post-launch feedback – a consequence of rolling out complex capital investment goods that even exhaustive prior testing cannot completely eliminate. However, this expense will not recur in 2006. Downward pressure on the prices of new machinery inevitably impacted on the market for second-hand equipment addressed by our subsidiary Holland Graphic Occasions (HGO). As a result gross operating profit, at €2.7m, was well down on the corresponding figure for 2004 (€9.6m), which itself had been trimmed by a substantial outlay for the Drupa trade fair and product development. The situation will ease in 2006.

The savings gleaned in recent years from restructuring our web press production plants, the high level of capacity utilisation and a more profitable product mix in 2005 had a beneficial effect on web and special press earnings. Operating profit almost tripled to €30.6m (2004: €10.8m). Here, too, scheduled sales will bring a noticeable improvement in the current year.

PRINT'05 in Chicago: last year North America accounted for some 16% of Group sales, with sheetfed business expanding apace

Domestic demand firm, exports strong

Although an upturn in domestic demand pushed the export level down to 81.9% (2004: 85.9%), a stream of foreign orders kept exports well above their historical average.

Sales in **Germany** totalled €292.6m, a leap of 45.7% compared to 2004 (€200.8m). Alongside a big increase in deliveries of sheetfed offset presses following a general upturn in demand and vigorous expansion in 2005, growth was driven by the inauguration of numerous newspaper, commercial and publication gravure presses.

Our subsidiary Bauer+ Kunzi, which specialises in presses and systems for metal decorating, posted a higher volume of sales, primarily in Europe and Asia, and again returned a profit.

KBA-Metronic, a 280-employee subsidiary consolidated in our web and special press division in 2004 and specialising in industrial ID systems (ink-jet, laser, thermal transfer) and UV offset systems for digital data storage media, film and card printing, generated healthy earnings on roughly the same volume of sales (€36.6m) as in 2004 (€36.7m), even after discontinuing a number of niche products. Sales of KBA-Metronic's small-format Genius 52 UV presses were well above target, while demand for CD/CDR/DVD printing systems was more moderate in anticipation of changes in file formats. We are aiming to boost sales still further in 2006.

As in the past, the **rest of Europe** was the premier market for KBA presses, accounting for €718.8m or 44.3% of total sales (2004: €650.3m and 45.7%). High-growth markets in eastern Europe played an increasingly central role. Sheetfed business expanded rapidly in countries such as the UK and Spain, and there was a rise in shipments of web presses to Switzerland, Italy, Spain, Belgium, the Netherlands, France and the UK. Our new Czech subsidiary, KBA-Grafitec in Dobruska, returned a profit after surpassing its targets for both sales

Geographical breakdown of sales

in %	2004	2005
Africa/Latin America	7.0	**6.2**
Asia/Australia	17.8	**15.5**
USA/Canada	15.4	**15.9**
Rest of Europe	45.7	**44.3**
Germany	14.1	**18.1**

KBA president and CEO Albrecht Bolza-Schünemann cutting the ribbon on a large-format Rapida press in China

and new orders. Our two sales and service subsidiaries in the UK and France, KBA (UK) Ltd and KBA-France SAS, were consolidated for the first time on 31 December, bringing a modest lift in order bookings and backlog. However, this had no effect on Group sales and profits.

15.9% of Group sales, or €258.4m (2004: €219m; 15.4%), was generated in the **USA and Canada**. While KBA North America's sheetfed division in Williston, Vermont, posted a big increase in shipments and new orders, its web press division in York, Pennsylvania, failed to match the high volumes of previous years. However, after a slow start, the order intake for web presses picked up towards the end of the year with a number of contracts for directory presses. Extensions were completed to newspaper presses, another Corrugraph sheetfed flexo press shipped to a manufacturer of corrugated and a number of multi-unit web presses put into operation at newspaper and gravure houses.

Shipments to **Asia and the Pacific** (including Australia and New Zealand) were worth €251.1m, roughly on a par with 2004 (€253.1m), though the percentage of total Group sales was slightly lower than in the previous year (15.5% compared to 17.8%) due to increased shipments within Germany, to the rest of Europe and North America. China remained the primary market in the region for our medium- and large-format sheetfed presses and single-width newspaper presses. Business was also good in Australia, where a multi-unit commercial web offset press line was inaugurated along with a number of long sheetfed presses. The biggest contract for newspaper presses in this region was also booked in Australia.

Increasingly, our success in this growth market is driven by the sales and service activities of our subsidiaries and outlets in China, Hong Kong, Malaysia, Singapore and Australia, and our established dealers elsewhere in Asia.

Africa and Latin **America** generated sales worth €100.1m (2004: €99.8m), or 6.2% of the Group total. Shipments included a major sheetfed installation in Algeria and a commercial web press for Mexico.

Girls' Day at Koenig & Bauer's in-house vocational school in Würzburg

Staff skill key to success

For a technology-driven enterprise at a high-wage location like Germany, maintaining a competitive edge in a globalised marketplace demands a correspondingly high level of skill among existing employees and new additions alike, and to this end we expanded our training activities still further in 2005. It also demands more flexible working hours, and in February an agreement was reached at our web press production plants similar to the one negotiated in August 2004 at our sheetfed plant in Radebeul. A skeleton agreement for a group-work bonus scheme is expected to enhance efficiency.

Diverging payroll trends at Group sites

At the end of December 2005 there were 70 more staff on the Koenig & Bauer payroll than in the previous year, raising it to 5,900 (2004: 5,830). The first-time consolidation of KBA-Grafitec (428), KBA (UK) (44) and KBA-France (35) swelled the Group payroll by 507, while 57 new hirings by the companies already consolidated pushed the total up to 7,962 (2004: 7,398). The number of employees at our German web press facilities fell by 125 following the closure of our Berlin assembly plant at the end of 2004, while the workforce at our sheetfed offset plant in Radebeul expanded by 129, most of them in production, to support vigorous growth.

Group payroll on 31 December

	2004	2005
Total	7,398	**7,962**
Salaried office staff	2,828	**3,030**
Wage-earning industrial staff	4,061	**4,445**
Apprentices/ students	509	**487**

Dedicated events, like the open house on small-format printing at our Radebeul plant, are gaining currency compared to big trade fairs

Training in tomorrow's professions

At year's end there were 487 apprentices and student trainees (2004: 509) in the KBA Group, or 6.1% of the workforce. The training curriculum is adjusted on an ongoing basis to maintain the skills required to keep pace with market trends. At present it embraces electromechanics (for which there is a big demand), industrial and metalworking mechanics, electronics, printing, media design and industrial administration. Most of the students were aspiring electrical or mechanical engineers pursuing sandwich courses at vocational colleges in Dresden, Mannheim and Mosbach. Activities to stimulate interest in industrial and technical careers included open days at our training centres, visits to schools and participation in nationwide campaigns like "Girls' Day".

104 trainees passed their final examinations in 2005, most of them with outstanding results. Once again, several of our apprentices were among the local and regional prize winners at the final examinations set by the Chambers of Industry and Commerce.

In 2005 our web press development engineers in Würzburg moved to a new, purpose-built facility complete with a 1,350m² prototype testing area

More than 500 pupils, trainees, students and external apprentices gained initial working experience at KBA through industrial placements, trial training courses, holiday jobs and industry-related theses. To promote the engineering professions essential to our continued survival we expanded our educational budget to include sponsorship of a three-year doctorate at the Institute for Print and Media Technology attached to Chemnitz Technical University, above and beyond the prizes awarded annually by our Benno Bolza foundation for outstanding theses and research papers in the field of mechanical engineering, electrical engineering and print technology.

Further training a major priority

Training and further training activities were also expanded in 2005. Alongside technical courses, IT seminars and training in social competence and methodology, our extensive personnel advancement programme placed greater emphasis on products, components and foreign languages. Support committees at our various locations continued their task of helping young department managers, junior executives and trainees to recognise and develop their full potential.

Continual process of improvement

Employees submitted a total of 1,732 suggestions (2004: 1,723), over half of which attracted bonuses. This was more than in the previous year and resulted in higher cost savings. A suggestion submitted by one of our installation technicians for modifying the infeed units on newspaper presses delivered the highest-ever annual saving with regard to web presses since the suggestion scheme was introduced.

Mounting interest in MetallRente

Koenig & Bauer continued to pursue a two-pronged approach to retirement provision: a compulsory, company-funded pension scheme for all employees and a voluntary scheme, MetallRente, run by trade unions and employers in the metalworking and electronics industry. Over one-fifth (21%) of employees in Würzburg, Frankenthal, Radebeul and Trennfeld have now joined the voluntary scheme. Once again, awareness campaigns were conducted at all our German sites.

Target-related remuneration scheme continued

The individual agreements for all executive staff and the collective targets for employees engaged in group work were re-appraised in 2005 and variable remuneration aligned with our targets for 2006.

Staff loyalty rewarded

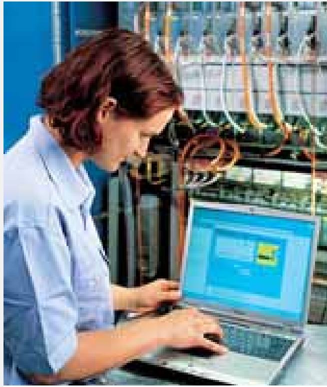
171 members of KBA staff celebrated works jubilees. 103 were awarded bonuses for 25 years of service, 67 for 40 years and one for 50 years of service.

Company health insurance fund celebrated 150th jubilee

In 2005 our company health insurance fund, BKK KBA, an independent enterprise that operates solely in Germany, celebrated its 150th jubilee with a number of promotional activities that boosted membership to 12,918 (2004: 12,826).

A big thank-you from the executive board

With a substantial increase in sales keeping our production plants busy, a raft of new products to be integrated in the workflow and market demands becoming ever more sophisticated, 2005 proved a challenging year for our executives, employees and labour representatives. The management board would like to thank all concerned for their dedication and constructive support.



Cost reduction and quality enhancement an ongoing task

Following the realignment of our web press production sites on core activities in recent years, in 2005 the production workflow was streamlined and quality-assurance activities expanded. Our primary objectives are to trim manufacturing, assembly and quality costs still further and reduce throughput times while minimising inventories.

Concentrating on core competence

Diverse projects for concentrating the production of essential press components at specific locations were completed. The final assembly of semi-finished products for our Radebeul plant was outsourced to a specialist contractor. Torch-cut parts were bought in following the closure of the heavy plate store in Würzburg and the disposal of cutting equipment to a subcontractor. Buying in non-press parts enables us to absorb fluctuations in plant utilisation more easily and achieve lasting economies.

Processes streamlined still further

If production and delivery time-frames are to remain competitive, then enhancing workplace efficiency and production sequences throughout the Group on a continuous basis is as vital as regular upgrades in manufacturing technology. Our Würzburg scheduling department, which had previously been scattered among several offices, was relocated to premises vacated by the research and development department. Changes were made in the organisation and layout of our Trennfeld plant to enlarge the assembly area while reducing the labour input and storage space required. The pre-assembly department in Frankenthal was refurbished and reorganised to cut processing times, while our Radebeul facility installed new measuring machines to accelerate quality control procedures.

Systematic upgrade of information technology

In our IT department the emphasis was on optimising external and internal communication structures, data security and operating costs. A new globally accessible service communication system and the installation of an information system for our subcontractors made communication with customers and suppliers much more efficient. Internal business procedures were streamlined by standardising and integrating software applications and by expanding document management systems. The server rooms in Würzburg, Frankenthal and Radebeul were refurbished to guarantee long-term IT security. A Group-wide software suite was installed to facilitate the in-house development and utilisation of Web-compatible programs.

Surprise inspections were just one of the steps taken to enhance the quality of final assembly at our sheetfed plant in Radebeul

Quality management expanded

For an ISO 9001-2000 accredited enterprise like KBA, total quality management is traditionally a top priority, and in 2005 all the monitoring procedures necessary for maintaining certification were successfully concluded. A raft of initiatives was implemented to safeguard our high manufacturing and assembly quality and further reduce quality costs. Special emphasis was placed on quality monitoring at the engineering phase. Fault potential was reduced by checking new parts and assemblies at an early stage, and examining alternative materials or procedures. Error analysis was stepped up to reduce the internal costs associated with rejects and reworked parts. The quality of purchased parts was improved by systematically vetting subcontractors, outgoing goods and acceptance procedures. Product quality was further enhanced by pre-shipment checks on aggregates. A second testing module in the Frankenthal folder assembly line allows more new and serially produced folders to be tested with running webs prior to dispatch. Internal product inspections ensure that the final assembly of complex machine configurations in Radebeul is completed to rigorous quality standards.

Focus on material costs and flow of goods

In 2005 our purchasing department implemented long-term strategies for guaranteeing a timely, cost-effective and more flexible source of materials in the consistently superior quality required. Procuring a substantially larger volume of goods than in 2004, and in a volatile market environment, posed something of a challenge. While long-term planning and bigger inventories at suppliers were effective at securing resources, intensive price negotiations, value analyses and technical changes failed to offset in full the impact of higher global prices for basic raw materials and energy.

Strategic alliances

Long-term procurement contracts were awarded or renewed and an alliance with a major manufacturer of control and drive systems for web presses was extended. Resource management also outsourced the production of specific non-core components.

Labour-saving electronic procurement

The implementation in recent years of an electronic support system for order placement was key to enabling the purchasing department to handle the heavier workload. In Radebeul, procurement contracts are put up for tender online. Tools, serial parts and small indirect parts are also purchased online. Hundreds of manufacturers now have a dedicated link to our scheduling system in order to cut the response time for serial parts incorporated in individual machine configurations. A document management system introduced in Würzburg and Frankenthal at the beginning of 2005 has also reduced processing times and administrative input.

Distribution hubs trim assembly times

The centralised materials logistics system implemented to great effect by our sheetfed offset plant in Radebeul a few years ago was extended to our web press sites. With this system, the scheduling department has all the subassemblies, components etc required for the next stage of assembly conveyed in advance to predesignated distribution hubs ready for just-in-time delivery when assembly personnel actuate the relevant command. This has dramatically reduced inventories, materials handling and assembly times. The implementation of an innovative, reciprocal kanban system for the automatic replenishment of indirect parts won our Radebeul plant and the subcontractor concerned the VDI's award for the best customer-supplier relationship.

Interim storage at distribution hubs like this one in Würzburg support the just-in-time delivery of components to the assembly line

Productivity, quality and environment on the agenda

Investment activities in 2005 revolved around boosting productivity and quality. Group investment in intangible assets, property, plant and equipment totalled €39.5m, well below the prior year figure of €57.6m. This was chiefly due to the fact that a number of investments scheduled for 2005 had been moved forward to 2004. Depreciation, at €40.8m, was down on the previous year (€45.5m). With our production plants running at capacity, the volume of investment is set to climb above €40m in the course of the current year.

As with process optimisation and product development, sustainability was again a major aspect.

Pioneering green technologies

Following the accreditation of our established Rapida series over a period of five years, in spring 2005 our new-generation Rapida 105, which has an output of 18,000 sheets per hour, became the first press of this calibre worldwide to be awarded an "emission tested" seal of approval by the industrial safety council for the German printing and paper processing industry. This prestigious environmental certificate, which is only issued to presses complying with stringent emission levels for ink mist, VOCs, ozone, UV radiation, powder and noise, underscores KBA's role as a pioneer of green technologies and processes.

Environmental protection is an equally high priority in our web press division. One outstanding example is our Cortina newspaper press, which dispenses with fount solution. Dampening units specifically designed for low-alcohol or alcohol-free print production reduce the consumption of environmentally sensitive additives by our commercial web offset presses. All the relevant machine parts can be cleaned with vegetable-based washes, which dramatically improves working conditions for the operators.

Active environmental and safety management

Monitoring and refining production processes on a regular basis helped limit the consumption of raw materials and the volume of waste and emissions. Energy savings were achieved by shutting down old energy-intensive plants and installing new air compressors. Progress was also made in waste disposal by reorganising disposal routes and the handling of recyclable materials. Work safety initiatives included further training in handling hazardous substances and securing cargoes. To improve work safety and reduce emissions, hazard assessments for production workplaces were captured electronically in a central database, workplace emissions measured and staff briefed on countermeasures.

The CNC machining centres at the individual production plants (in this case Radebeul) are networked with computers in manufacture and tool management as part of a company-wide CIM system

Investment in plant and buildings

In preparation for the renovation of a big production hall at our Würzburg plant in 2006, parts of the mechanical manufacturing department were relocated to new premises and the manufacture of round parts and gearwheels completely reorganised. The new distribution hubs in Würzburg and Frankenthal were equipped with high-bay racks and new materials-handling equipment. In addition to CNC machining centres for prismatic parts, Frankenthal installed a new sand-blasting plant to enhance efficiency in the rilsan roller production line. CNC machining centres for small prismatic parts, a CNC profile grinding machine for gear wheels and a special machine for manufacturing gripper pads were added in Radebeul. Networking the CNC machines with manufacturing computers and tool management systems delivered considerable savings in makeready times.

New test centres in Radebeul and Würzburg

A dedicated press room was set up in Radebeul to allow products in the pipeline to be tested for prolonged periods of time in a real working environment. The purpose of this investment, which is on a major scale and includes two multi-unit Rapida 105 medium-format presses with a host of new features, is to enable products to be developed to serial maturity faster and more cost-effectively. At our Würzburg factory, staff engaged in printing and measuring technology and CTP pre-press were relocated to new premises with a web press testing centre attached, enabling basic tasks, prototype tests, technical investigations and press demonstrations for customers to be carried out in direct proximity to R&D.

One example of user-driven innovation in 2005 was a new bearing system, NipTronic, which for the first time in the history of offset enables printing pressure to be set remotely from the console. NipTronic was developed in association with Bosch Rexroth and bearing specialist Ina

Raft of product and process innovations

A key aspect of activities in our web press division was the optimisation in a pressroom environment of the technology and consumables developed for our compact Cortina, the first waterless offset newspaper press on the market. These activities culminated in the delivery to Dutch and German printing plants of press lines which have since come on stream, heralding a new era in newspaper production. In the autumn we unveiled a new bearing system which, for the first time in the history of offset, allows the pressure between the plate and blanket cylinders to be set instantly and with absolute precision. Developed in association with engineers at Bosch Rexroth (hydraulics) and Ina (bearings), this new system, which is currently being patented, will be a standard feature of the Cortina. It not only reduces maintenance work at the press but also delivers major time and quality benefits where the production schedule entails frequent changes of stock.

Other R&D activities included closed-loop controls for newspaper presses, to reduce operator workload and stabilise print quality, and an automation concept for web presses, based on a new-generation data bus system. Working conditions for our Würzburg R&D department improved when it was relocated to a new, dedicated facility complete with a 1,350m² prototype testing area (*see chapter on investment*).

The infrastructure for testing new technologies and processes at our sheetfed offset works in Radebeul was substantially expanded with the inauguration of a new purpose-built centre for long-term press trials. Development activities in Radebeul primarily focused on integrating new technologies, applications and consumables in our new-generation presses. These included a dryer for more flexible print finishing and a video-based scanning system for inline quality control.

A new purpose-built press room at our sheetfed facility in Radebeul allows products in the development pipeline to be tested for prolonged periods of time in a real working environment prior to their market launch

In Radebeul the focus was on replacing mechanical drive systems (transmissions, clutches) with dedicated AC drives to facilitate automation and handling, cut makeready times and enhance flexibility. KBA Radebeul pioneered this technology some years ago with the creation of a shaftless sheet feeder – still unique in the global marketplace – and another world first, a no-sidelay infeed with AC drives.

Statistics issued by the German Patent and Trademark Office (DPMA) reveal that German press manufacturers traditionally rank high in the league table and that KBA's tally of 200 applications in 2005 was an industry best.

Improved operating result and pre-tax profit

Gross profit increased by 14% to €382m (2004: €335m), partly thanks to firmer sales. The gross profit margin, at 23.6%, was on a par with the previous year (23.5%). However, the cost of launching new products, the weakness of the dollar in the first six months, higher prices for steel and energy, and unsatisfactory market rates for new and second-hand machinery all had a detrimental impact on the bottom line. Though successful, the cost-cutting initiatives we implemented could not offset in full external factors such as these, over which we had limited influence.

Developing new products to serial maturity raised R&D costs to €55.2m, roughly the same as the previous year's level (€54.7m), which itself had been inflated by preparations for the Drupa trade fair. A substantially higher volume of shipments drove distribution costs up to €175m (2004: €140.8m). General administrative expenses stood at €89.6 m (2004: €87.6m). Applying the current rate method for foreign currency translation and derivatives increased other operating income to €37.7m (2004: €22m) and other operating expense to €66.6m (€53.5m). Operating profit jumped from €20.4m in 2004 to €33.3m.

Although a reduction in bank loans cut our interest expense, the amount of interest accrued also diminished following a switch to leasing as a means of customer financing. As a result we made a financial loss of €7.5m (2004: –€4.4m). Even so, pre-tax profit (EBT), at €25.8m, exceeded the figure for 2004 (€16m). Taxes on income and earnings, including deferred taxes, came to €7.2m (2004: €4.2m), resulting in a net profit of €18.6m (2004: €11.8m) and earnings per share of €1.15 (2004: 73 cents).

Income statement

as % of sales	2004	**2005**
Cost of sales	–76.5	–76.4
Research and development costs	–3.8	–3.4
Distribution costs	–9.9	–10.8
Administrative expenses	–6.2	–5.5
Other income/expenses	–2.2	–1.8
Financial result	–0.3	–0.5
Income taxes	–0.3	–0.4
Net profit	+0.8	+1.2

Fierce competition in major sectors of the print market such as web offset impact on the prices of new and used machinery

Solid capital structure and financial position

One of our prime objectives is to safeguard our corporate independence and financial flexibility by maintaining a solid capital base. Internal initiatives to reduce the volume of tied capital and external activities to secure customer financing are thus a major priority, and in 2005 these delivered a big increase in the free cash flow.

Cash inflows from operating activities were up €136.5m at €174.6m (2004: €38.1m). Though sales picked up, active receivables management shaved €18.4m off total trade receivables, bringing them down to €465.6m (2004: €484m). The higher pre-tax profit and a €46.3m rise in customer down payments to €294.2m (2004: €247.9m) also contributed to the higher cash flow. Cash outflows from investing activities mostly related to property, plant and equipment and the acquisition of Grafitec. In 2005 they dropped €20.5m to €27.4m (2004: €47.9m) because a major project was moved forward to 2004. In consequence the free cash flow swelled to €147.2m, following a €9.8m loss the previous year. Cash outflows from financing activities, some of which related to the repayment of debt and the payment of dividends, totalled €64m (2004: €26.3m).

Shareholders' equity was worth €449.4m (2004: €445.3m). However, a higher balance sheet total meant that the return on equity was slightly lower (32.2%, against 33.1% in 2004).

Non-current liabilities eased down to €252.6m (2004: €257.9m). Long-term provisions sank €6.3m to €135.6m (2004: €141.9m). This was largely attributable to a drop in provisions for employees, though pension provisions were up.

Current liabilities climbed from €641.2m to €694.2m following a €43.3m rise in customer prepayments and the marking to market of derivatives, which pushed the total of other liabilities up to €298.4m (2004: €247.6m). Trade payables fell to €95.7m by the end of the year (2004: €100.4m).

The exceptionally high free cash flow enabled bank borrowings to be reduced by €58.4m to €78.7m (2004: €137.1m), transforming a net debt of €91m in 2004 into a €50.3m surplus.

Healthy balance sheet

The Group balance sheet total of €1,396.2m at year's end was €51.8m above the prior-year figure of €1,344.4m, thanks in part to the first-time consolidation of KBA (UK), KBA-Grafitec and KBA-France.

Non-current assets were valued at €367.4m (2004: €368m), tangible assets at €250.3m (€253.1m). The sound financial structure was reflected in a capital-to-assets ratio of 179.5%.

Group assets and capital structure

Assets in %	2004	**2005**
Non-current assets	27.4	**26.3**
Current assets/funds	69.2	**64.5**
Funds	3.4	**9.2**

Equity and liabilities in %	2004	**2005**
Equity	33.1	**32.2**
Non-current liabilities	19.2	**18.1**
Current liabilities	47.7	**49.7**

Inline processing saves time and money, and press lengths are growing as more and more capabilities are added. A new record was set in 2005 by a Rapida 142 for Anzpac Services in Sydney, Australia, which measures over 40 metres in length

The €83.8m increase in cash and cash equivalents caused current assets to rise to €1,028.8m (2004: €976.4m). Rigorous warehouse management shrank inventories from €374.1m in 2004 to €368.5m even though our order books were full. A systematic reduction in trade receivables to €465.6m (2004: €484m) and the adoption of the current rate method for derivatives led to a decline in other financial liabilities from €37.2m to €26m. The working capital ratio was 1.8 (2004: 2.0).

Further information on the composition and scheduling of debt and provisions, details of receivables and other intangible assets, eg maturity, interest rates etc, can be found in the Notes.

Supplementary statement

No events impacting on Group earnings, finances or assets occurred after the balance sheet date.

Systematic risk control

The purpose of the Group monitoring system is to flag potential risks arising from entrepreneurial activities. Measures and rules have been implemented to guarantee prudent risk management.

Risks to the Group are systematically documented, assessed and reported in accordance with uniform, Group-wide procedures. All our subsidiaries submit regular progress reports comparing their performance with the targets they have been set. This enables us to identify incipient risks to our earnings, finances and assets and to institute countermeasures.

The management and supervisory boards are notified of all developments and instantly alerted to any unforeseen changes in our risk exposure. The early warning system is monitored by our internal auditing department and the supervisory board. While no risks have been perceived that could endanger the continuing existence of the Group, it is impossible to allow for every contingency.

Economic and industrial risks

Although print sectors that depend heavily on advertising revenue are losing ground to digital media, the overall volume of print worldwide will continue to expand. As business and advertising have picked up, so too has investment in new equipment, initially among publishers in the dynamic threshold economies of the Far East and eastern Europe and, more recently, among publishers in Germany and western Europe. The risks associated with this shift in media focus are addressed by closely observing market trends and developing appropriate products, with the emphasis on targeting sectors with broader margins.

The demand-driven price hikes in global resources and energy markets inflate the cost of purchased materials for the engineering industry and could therefore diminish earnings. We seek to contain such risks through strategic purchasing, changes in product design and diverse cost-cutting initiatives.

The 4.32m-wide web runs through our giant TR 12B gravure press at a speed of 55 kilometres per hour – and with a registration accuracy on both sides of the web measured in tenths of a millimetre

Market and business risks

A buyers' market for presses, coupled with banks' restrictive lending practices, has boosted demand for customer financing, and with it our exposure to risk. This is therefore a fundamental parameter monitored by our early-warning system to protect cash flows. In 2005 our Radebeul facility established an independent unit to manage the risks associated with repurchasing obligations and the purchase of second-hand machinery.

Severe pricing pressures have sharpened competition among press manufacturers. KBA addresses the attendant risks by carefully screening prospective contracts and pricing them according to the complexity and degree of customisation involved. Adequate provision is made for obligations from unprofitable orders. The risks concomitant with tight margins are addressed by negotiating cost savings on price-sensitive products, adopting more flexible working hours, outsourcing non-core components and activities, creating unique features, developing profitable niche markets and promoting customer loyalty with efficient investment planning and after-sales services.

The technological and quality risks deriving from the development of new products are contained by rigorous quality management and pre-launch trials in our in-house printing plant. Quality enhancements made when processing individual customer projects are systematically incorporated in all other projects, benefiting our products and services on an ongoing basis. The risks associated with large-scale press installations are monitored by the competent project management unit.

Financial risks

Financial risks predominantly comprise foreign currency risks, bad debt risks, liquidity risks and risks relating to cash-flow movements. Financial instruments are used solely as a safeguard, not for speculative purposes. The type, scope and market value of the instruments used to contain financial risks are detailed in the Notes.

Foreign currency risks basically relate to dollar-denominated transactions. Risks from foreign currency transactions are actively managed by our treasury unit in close collaboration with our sales units. In addition to hedging major contracts we also hedge a fixed proportion of small and medium-sized orders as part of an established strategy aimed at counteracting fluctuations in exchange rates, thus making it easier to plan ahead.

Bad-debt risks are contained by monitoring customer accounts down to individual project level. A deterioration in payment records has caused us to tighten up customer financing conditions and the hedging policy implemented by our financial divisions. Customer creditworthiness is regularly reviewed and provision made for potential bad debts. Fluctuations in cash flow are balanced with existing credit lines and sureties.

Liquidity is managed and safeguarded at Group level by a rolling financial-analysis and planning procedure. This means that potential corporate financing risks are detected at an early stage.

Other risks

At present we see no uncontrollable risks relating to IT systems, capacity or personnel planning, the environment or interest management. Individual risks that are hard to calculate are managed using the standard instruments available. The Group is not engaged in any litigation that would materially impact on our financial position. Adequate provision has been made in the accounts for all other risks.

Quality-oriented growth for higher yields

On the whole, demand for printing presses in most of the markets we serve remained brisk well into the current year. The German print media industry has benefited not only from a domestic upturn in consumption, investment and advertising but also from a boost in print production and advertising generated by the World Cup, which Germany hosts this summer. The 2 to 3% real increase in sales predicted for 2006 by the BVDM, Germany's Printing and Media Industries Federation, looks like being exceeded. And as the dollar has perked up, so have export prospects for the German engineering industry in dollar-denominated markets against non-European competitors.

However, there is still no end in sight to the price erosion that has afflicted the global print media market in recent years, and which depresses the price of printing equipment. Fierce competition among existing vendors is now being exacerbated by the appearance of new players from rapidly expanding economies like China or India, who are using pricing as a tool to ramp up exports of products that are technologically less advanced than those of German or European origin. Global competition is likely to intensify in the medium term.

In response we have implemented a raft of strategies and initiatives in recent years. The restructuring of our web press production sites, more flexible working hours at our German factories and the adoption and optimisation of a Group-wide distributed-manufacturing model have diminished our cost base and honed efficiency. Our product spectrum, which targets the mid-range and high end of the market, is broader, technologically more advanced and supports a wider range of applications than that of any other manufacture in the industry. The addition of the entry-level presses built by our Czech subsidiary, KBA-Grafitec, has opened up more price-sensitive markets. A strong presence in high-volume sectors like publication rotogravure and less ad-dependent markets like packaging and security printing helps diversify risks. This will enable us to sustain our long-term competitiveness against both cheaper vendors from Asia and the new media.

Print is expanding at a rate of 3 to 5% per annum, despite competition from e-media. However, the primary centres of growth have shifted to densely populated threshold countries like China, India and Brazil

Our subsidiary KBA-Metronic specialises in the production of UV presses for printing cardboard and plastic cards

With Group order books bulging and production plants humming, our prospects for the current financial year are good. We anticipate a further moderate lift in Group sales and a substantial improvement in pre-tax profit. However, the unpredictability of the external factors impacting on the global market for industrial goods persuades us that it would be premature to issue a detailed prognosis at this moment in time. We shall therefore postpone our assessment until a later date, when interim figures are available.

We are confident that print will withstand the challenge from electronic media in traditional print markets and that the total volume of print produced worldwide will grow by around 5% both in 2007 and in 2008, when the next Drupa is scheduled. Technological advances and the need for print enterprises to take on board high-performance production equipment in order to maintain their competitive edge in a ruthless market environment will lead to a steady demand for new presses and the associated peripherals. In the medium term, the fastest rates of growth in the printing industry will be found in populous countries like China, India and Brazil, whose economies are expanding rapidly, and, if political conditions improve, in Russia, since the consumption of print automatically rises along with prosperity. Demographic trends and market saturation in western Europe, North America, Japan and other developed economies will put a brake on growth, as a result of which investment by printers will largely be confined to replacements and efficiency-enhancing technology.

Some of the niche markets addressed by KBA offer considerable potential for growth and profitability. However, major web press markets will see growth slow in 2007 and 2008, and this will hit sales of newspaper and commercial presses. The higher productivity of modern web presses has already led to overcapacity in western Europe and to a string of mergers and acquisitions in the commercial market, while in the European newspaper industry the transition to full-colour production has been more or less completed.

Thanks to our broad product palette we are well positioned to sustain growth in a market environment which, though in a state of transition, is generally favourable.

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Balance Sheet to 31 December 2005

Assets in €m	Note	31.12.2004	31.12.2005
Non-current assets			
Intangible assets	(1)	22.4	20.0
Property, plant and equipment	(1)	253.1	250.3
Investments and other financial receivables	(2)	30.9	20.9
Deferred tax assets	(6)	61.6	76.2
		368.0	**367.4**
Current assets			
Inventories	(3)	374.1	368.5
Trade receivables	(2)	484.0	465.6
Other financial receivables	(2)	37.2	26.0
Other assets	(2)	34.5	39.3
Current tax assets		0.5	0.4
Securities	(4)	13.9	13.0
Cash and cash equivalents	(5)	32.2	116.0
		976.4	**1,028.8**
		1,344.4	**1,396.2**

Equity and liabilities in €m	Note	31.12.2004	31.12.2005
Equity	(7)		
Share capital		42.2	42.3
Share premium		83.1	84.0
Reserves		320.0	323.1
Capital attributable to equity holders of the Parent		**445.3**	**449.4**
Liabilities			
Non-current liabilities			
Pension provisions	(8)	88.4	92.1
Other provisions	(9)	53.5	43.5
Bank loans and other financial payables	(10)	47.2	35.5
Other liabilities	(10)	15.3	18.2
Deferred tax liabilities	(6)	53.5	63.3
		257.9	**252.6**
Current liabilities			
Other provisions	(9)	130.0	118.8
Trade payables	(10)	100.4	95.7
Bank loans and other financial payables	(10)	163.2	181.1
Other liabilities	(10)	247.6	298.4
Current tax liabilities		–	0.2
		641.2	**694.2**
		1,344.4	**1,396.2**

Income Statement for 2005

in €m

	Note	2004	2005
Revenue	**(14)**	1,423.0	1,621.0
Cost of sales	**(15)**	–1,088.0	–1,239.0
Gross profit		**335.0**	**382.0**
Research and development costs	**(15)**	–54.7	–55.2
Distribution costs	**(15)**	–140.8	–175.0
Administrative expenses	**(15)**	–87.6	–89.6
Other operating income	**(17)**	22.0	37.7
Other operating expenses	**(17)**	–53.5	–66.6
Operating profit		**20.4**	**33.3**
Other financial results		–	–1.0
Interest income		10.2	7.7
Interest expense		–14.6	–14.2
Financial result	**(18)**	**–4.4**	**–7.5**
Earnings before taxes		**16.0**	**25.8**
Income tax expense	**(19)**	–4.2	–7.2
Profit for the period attributable to equity holders of the Parent		**11.8**	**18.6**
Earnings per share (in €, basic*)	**(20)**	**0.73**	**1.15**

* no dilutive effects apply

Statement of Changes in Shareholders' Equity

in €m			Reserves		
	Share capital	Share premium	Recognised in equity	Other	**Total**
31 December 2003	**42.0**	**82.2**	**20.3**	**299.2**	**443.7**
Changes under IAS 8	–	–	–	–3.5	–3.5
1 January 2004	**42.0**	**82.2**	**20.3**	**295.7**	**440.2**
Total net profit					
Profit for the period	–	–	–	11.8	11.8
Primary financial instruments	–	–	0.8	–	0.8
Derivatives	–	–	–4.5	–	–4.5
Exchange differences	–	–	–4.3	–	–4.3
	–	**–**	**–8.0**	**11.8**	**3.8**
Other changes					
Capital increase from approved capital	0.2	0.9	–	–	1.1
Sundry other changes	–	–	–	0.2	0.2
31 December 2004	**42.2**	**83.1**	**12.3**	**307.7**	**445.3**
1 January 2005	**42.2**	**83.1**	**12.3**	**307.7**	**445.3**
Total net profit					
Profit for the period	–	–	–	18.6	18.6
Primary financial instruments	–	–	0.4	–	0.4
Derivatives	–	–	–12.1	–	–12.1
Exchange differences	–	–	2.0	–	2.0
	–	**–**	**–9.7**	**18.6**	**8.9**
Other changes					
Capital increase from approved capital	0.1	0.9	–	–	1.0
Dividend	–	–	–	–4.1	–4.1
Sundry other changes	–	–	–	–1.7	–1.7
31 December 2005	**42.3**	**84.0**	**2.6**	**320.5**	**449.4**

For further information see explanatory Note (7).

Cash Flow Statement

in €m	2004	2005
Earnings before taxes	16.0	25.8
Depreciation on intangible assets, property, plant and equipment	45.5	40.5
Foreign exchange gain/loss	0.5	12.1
Interest income/expense	3.1	2.0
Changes in non-current provisions	1.8	2.0
Other income/expenses	–4.2	–4.0
Gross cash flow	**62.7**	**78.4**
Changes in inventories	–10.5	12.3
Changes in receivables and other assets	–39.9	48.0
Changes in current provisions	–11.5	–24.1
Changes in payables and other liabilities	42.6	64.8
Interest received	6.8	4.5
Interest paid	–8.7	–9.5
Income tax paid	–3.4	0.2
Cash flows from operating activities	**38.1**	**174.6**
Proceeds from disposal of intangible assets, property, plant and equipment	3.6	10.0
Payments for investment in intangible assets, property, plant and equipment	–57.6	–39.5
Proceeds from disposal of investments	0.8	0.7
Payments for investments	–0.1	–2.0
Proceeds for/proceeds from acquisition of consolidated enterprises	1.0	–1.0
Investment subsidies received	4.4	3.0
Dividends received	–	1.4
Cash flows from investing activities	**–47.9**	**–27.4**
Proceeds from capital contributions	1.0	1.0
Proceeds from loans	12.5	5.3
Repayment of loans	–40.0	–66.2
Other changes in equity	0.2	–
Dividends paid (previous year)	–	–4.1
Cash flows from financing activities	**–26.3**	**–64.0**
Change in funds	**–36.1**	**83.2**
Effect of changes in exchange rates	–2.6	–0.3
Funds at beginning of period	84.8	46.1
Funds at end of period	**46.1**	**129.0**

For further information see explanatory Note (J).

(A) Preliminary Remarks

The KBA Group is a global manufacturer of sheetfed, web and special printing presses. The Parent, Koenig & Bauer AG based in Würzburg, Germany, is a public limited company under German law. The consolidated financial statements include the Parent, consolidated affiliates and all jointly controlled holdings.

The Parent prepared consolidated financial statements and a Group management report to 31 December 2005 in accordance with section 315a of the HGB (German Commercial Law). The statements and report were filed in the Commercial Register at the Municipal Court in Würzburg under number HRB 109.

The consolidated financial statements for the year to 31 December 2005 were prepared in accordance with the International Financial Reporting Standards (IFRS) valid on that date, as issued by the International Accounting Standards Board (IASB), London, and interpreted by the International Financial Reporting Interpretation Committee (IFRIC), with due regard for EU directives.

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

On 7 March 2006 the Koenig & Bauer management board authorised the submission of the Group financial statements to the supervisory board for scrutiny and approval.

(B) New and Amended Standards and Interpretations

The financial statements for 2005 were prepared in accordance with the International Financial Reporting Standards that are required to be applied for annual periods beginning on or after 1 January 2005. Of these standards, the following are pertinent to the KBA Group:

IAS 1 Presentation of Financial Statements
IAS 2 Inventories
IAS 8 Accounting Policies. Changes in Accounting Estimates and Errors
IAS 10 Events after the Balance Sheet Date
IAS 16 Property, Plant and Equipment
IAS 17 Leases
IAS 21 The Effects of Changes in Foreign Exchange Rates
IAS 24 Related Party Disclosures
IAS 27 Consolidated and Separate Financial Statements
IAS 32 Financial Instruments: Disclosure and Presentation
IAS 33 Earnings per Share
IAS 36 Impairment of Assets
IAS 38 Intangible Assets
IAS 39 Financial Instruments: Recognition and Measurement

The above standards were applied in compliance with the relevant transitional provisions. Where appropriate, amendments were made retrospectively, ie as if the new accounting policies had always applied. The comparative prior-year figures were amended accordingly.

The effects on the periods of time specified in the consolidated financial statements are described below.

IAS 1 Presentation of Financial Statements

The Group financial statements must distinguish between current and non-current assets and liabilities. Current items are those that are expected to be realised or settled within the ordinary operating cycles typical of our industry or within 12 months of the balance sheet date.

IAS 16 Property, Plant and Equipment

According to the amended standard, every item of property, plant and equipment must be written down separately, and by a significant purchase value relative to the total value of the asset. Subsequent costs associated with the addition or replacement of an item of property, plant or equipment were capitalised and written down over the individual useful life. Further information on the effects of the initial application of IAS 16 can be found in Note (F).

IAS 21 The Effects of Changes in Foreign Exchange Rates

The functional currency of the entities included in the consolidated financial statements is the currency of the primary economic environment. No changes affected the entities included in the statements.

Any goodwill and any fair value adjustments of assets and liabilities arising on the acquisition of a foreign entity were disclosed in the functional currency of that entity and translated into the reporting currency on the balance sheet date. This standard was applied prospectively to all acquisitions after 1 January 2005 as per IAS 21.59. Goodwill and negative goodwill arising on the acquisition of an entity prior to 1 January 2005 were carried as if acquired in the reporting currency.

IAS 32 Financial Instruments: Disclosure and Presentation

The revised version of IAS 32 substantially expands disclosure requirements.

The other standards applicable since 1 January 2005 had no fundamental effect on the Group.

The KBA Group did not apply in advance the IASB standards, interpretations and amendments to existing standards that are not yet mandatory:

IFRS 6 Exploration for and Evaluation of Mineral Resources
IFRS 7 Financial Instruments: Disclosures
IFRIC 4 Determining whether an Arrangement contains a Lease
IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds
IFRIC 6 Liabilities Arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment
IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
IFRIC 8 Scope of IFRS 2
IAS 1 Presentation of Financial Statements (amendments to disclosure of capital)
IAS 19 Employee Benefits (amendments to recognition of actuarial gains and losses, multi-employer plans and explanatory notes)
IAS 39 Financial Instruments: Recognition and Measurement (amendments to cash flow hedges for future internal group transactions)
IAS 39 Financial Instruments: Recognition and Measurement (revisions limiting the use of fair value options)
IAS 39 Financial Instruments: Recognition and Measurement, and IFRS 4 Insurance Contracts (amendments to financial guarantees)
IFRS 1 First-time Adoption of International Financial Reporting Standards, and IFRS 6 Exploration and Evaluation of Mineral Resources (amendments)

The application at some future date of IFRS 6, IFRIC 4, IFRIC 5, IFRIC 6, IFRIC 7, IFRIC 8 and amendments to IFRS 1 will have no effect on the consolidated financial statements because they are of no relevance to the business activities of the entities included in the statements.

IFRS 7 Financial Instruments: Disclosures

This standard amends and expands the disclosures previously regulated in IAS 30 and IAS 32, and is required to be applied for annual periods beginning on or after 1 January 2007. IFRS 7 will give rise to additional disclosures relating to financial instruments.

IAS 1 Presentation of Financial Statements (amendments to disclosure of capital)

The consolidated financial statements for annual periods beginning on or after 1 January 2007 must disclose information on capital management objectives, methods and processes. This will entail additional explanatory Notes to the Group accounts for the 2007 business year and beyond.

IAS 19 Employee Benefits (amendments to recognition of actuarial gains and losses, multi-employer plans and explanatory notes)

Amendments to IAS 19 relate to additional methods for recognising actuarial gains and losses, an obligation to recognise defined-benefit multi-employer plans, the presentation of such plans and changes in the explanatory notes to defined-benefit pension plans. The initial adoption of this amendment in the 2006 business year will probably lead to changes only in the Notes on defined-benefit pension plans. There are no plans at present to switch from the recognition of actuarial gains and losses using a ‘corridor’ to their recognition in equity capital. The KBA Group does not participate in any multi-employer plans.

IAS 39 Financial Instruments: Recognition and Measurement

This applies to cash flow hedges for future internal Group transactions. It allows the currency risk from a highly probable forecast internal group transaction to be defined in the consolidated financial statements as an underlying transaction in a cash flow hedging relationship, if the currency risk affects Group profit. From the current perspective, adopting this standard for the 2006 business year is not expected to have any affect on the KBA Group.

(C) Accounting Policies

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

Measurement basis and judgements

The measurement of assets and liabilities is based on the historical or amortised cost, with the exception of available-for-sale financial assets, derivative assets and derivative liabilities, which are measured at fair value. In the process of applying the entity's accounting policies management makes various judgements, basically on the classification of investments held to maturity.

Estimates and assumptions

Future assumptions may give rise to a risk on the balance sheet date, necessitating an adjustment in the subsequent business year to the assets and liabilities disclosed. The estimate of assets and provisions was based on past experience or current knowledge.

Earnings

Earnings were recognised at the fair value of the consideration received or claimed. Revenues from the sale of goods were recognised at the transfer of ownership or passage of risk. Earnings from services were recognised on the balance sheet date using the effort-expended method, provided the amount of earnings and costs could be reliably estimated. Interest was recognised as profit if the amount could be measured reliably and there was a reasonable likelihood of future economic benefit. Dividends were balanced with the origination of a legal claim to payment.

Intangible assets

Purchased intangible assets were disclosed at their purchase price if it was likely that economic benefits attributable to the use of the assets would flow to the enterprise and their cost could be measured reliably. Each asset was amortised on a straight-line basis over its estimated useful life. Intangible assets (goodwill) with an unlimited useful life were tested for impairment loss at least once a year.

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

Property, plant and equipment

Items of property, plant and equipment were disclosed at cost less depreciation, based on the use to which they are put. Each item with a significant value relative to the total asset value was treated as a separate depreciable asset (component recognition). Manufacturing costs for self-constructed plant and equipment included an appropriate proportion of production overheads, material and labour costs. Pursuant to IAS 23 borrowing costs were carried as an expense, not as part of the cost of an asset. Subsequent costs associated with the acquisition or replacement of an item of property, plant or equipment were capitalised and written down over the individual useful life. Replaced items were derecognised accordingly. Costs for maintenance and repairs were also recognised as an expense. No land or buildings were held as financial investments as defined in IAS 40.

Grants

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

Leases

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

Depreciation

The systematic straight-line depreciation of intangible Group assets, property, plant and equipment was based on their useful lives as shown in the chart.

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

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

Financial assets

These were measured at fair value where contractual claims existed and subsequently assigned to one of four categories under IAS 39: financial assets recognised at fair value through profit or loss; held-to-maturity investments; loans and receivables; and available-for-sale financial assets. Held-to-maturity investments, and also loans and receivables, were stated at their amortised cost using the effective interest method, and were tested for impairment loss on the balance sheet date. Available-for-sale financial assets were measured at fair value, with unrealised gains and losses recognised directly in equity, net of deferred taxes. Financial assets were recognised in the balance sheet on the settlement date. Value adjustments were made for all recognisable risks based on item-by-item risk assessments and past experience.

Interests in affiliated, non-consolidated entities were reported under **investments** and classified as available for sale. Since they represent financial investments in equity instruments for which no price is quoted in an active market, and whose fair value cannot be reliably determined, they were carried at cost of purchase. Other loans were grouped under loans and receivables.

Other financial receivables included derivatives and held-to-maturity investments.

Trade receivables related to commercial loans and receivables. Non-interest-bearing claims and low-interest claims with maturities of more than one year were discounted.

Securities, cash and cash equivalents refer to available-for-sale financial assets carried at fair value on the balance sheet date. This classification was also used for fixed-interest securities and shares, since we have no plans to hold these until final maturity.

Derivatives

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

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

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

Inventories

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

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

Contract revenue and expenses

Contract revenue and expenses were disclosed using the percentage of completion method, as per IAS 11. Under this method, contract revenue is proportionate to the contract costs incurred in reaching the stage of completion, i.e. the revenue, expenses and profit disclosed are those attributable to the proportion of work completed. Contract revenue was carried under trade receivables after deducting payments received.

Pension provisions

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

As a rule, in accordance with national and regional regulations, we offer our employees defined-benefit pension plans, with benefits determined by the length of service and employee compensation.

Other provisions

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

Financial payables

A financial payable was recognised on the balance sheet as soon as contractual obligations arose from a financial instrument. Financial payables were initially recognised at fair value and reported on the settlement date.

Bank loans and **trade payables** will subsequently be carried at their amortised cost.

Of **other financial payables**, derivatives with a negative market value were carried at fair value. Payables arising on finance leases were carried at present value. All other financial payables will subsequently be carried at their amortised cost.

Deferred taxes

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

(D) Consolidated Companies and Consolidation Principles

Consolidated companies

In addition to Koenig & Bauer AG, Würzburg, the consolidated financial statements include 14 (previous year: 12) subsidiaries.

In 2005 Koenig & Bauer acquired a 100% interest in Grafitec spol. s r.o., a Czech press manufacturer based in Dobruška. Our UK subsidiary, KBA (UK) Ltd in Watford, and our French subsidiary, KBA-France SAS in Tremblay-en-France, were included in the consolidated accounts for the first time on 31 December 2005. Altogether 15 (prior year: 17) subsidiaries were excluded from the consolidated financial statements since they were of minor significance to the Group's financial position and performance.

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

Consolidation principles

The capital consolidation of affiliates and the disclosure of business combinations entailed offsetting the cost of acquiring shares in subsidiaries against the Parent's share of equity at the date of initial consolidation. Undisclosed reserves or liabilities were allocated to the subsidiary's assets and liabilities. Contingent liabilities were offset against equity, and any excess of cost over the amounts allocated was recognised as goodwill. Goodwill generated prior to 1 January 1995 remained netted against reserves as permitted by IAS 22.

Following the prospective adoption of IFRS 3, systematic depreciation no longer applied to goodwill generated after 1 January 2004. Negative goodwill was immediately disclosed as an expense item under administrative expenses and the residual carrying amount on 1 January 2004 netted against reserves.

Goodwill was tested for impairment as per IAS 36 and attributed to the smallest identifiable group of assets (creation of cash-generating units, as a rule the legal entities). The future cash flows (prior to interest and taxes) generated by such units were determined using three-year planning schedules. Cash flow growth was not extrapolated beyond this time-frame. The free cash flows thus determined were discounted at a pre-tax interest rate of 14.1%. The discounted free cash flow is the amount recoverable for the unit and corresponds to the value in use. Where the recoverable amount exceeded the carrying amount (goodwill included) of the cash-generating unit, the unit was defined as unimpaired. Where the carrying amount exceeded the recoverable amount, an impairment adjustment to the lower market value was made by deducting the impairment loss from goodwill and distributing the difference among the unit assets.

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

(E) Foreign Currency Translation

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

Since foreign subsidiaries are financially, economically and organisationally autonomous, their functional currency is the same as their local currency. In the consolidated financial statements their assets and liabilities were therefore translated into the reporting currency at the closing rate, income and expenses at the average exchange rate for the year. The resulting exchange differences were disclosed in equity. The financial statements for subsidiaries consolidated for the first time were translated at the closing rate on the date of the initial consolidation.

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

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

(F) Adjustments under IAS 8

Property, plant and equipment (IAS 16)

Under IAS 16, which in its revised form became operative for the financial statements beginning 1 January 2005, units of property, plant and equipment with a significant value relative to the total asset value must be treated as a separate depreciable asset (component recognition). Subsequent expenditure must be capitalised and written off on an item-by-item basis.

Prior-period errors

IAS 20 states that government grants for assets must either be recognised in the balance sheet as deferred income or deducted from the carrying amount of the assets. Government subsidies were always deducted from investments in accordance with IAS 20.

Government subsidies for corporate assets were previously recognised as earnings under the German Investment Subsidy Law (InvZulG), as amended in 1999. The adoption of IAS 8 resulted in an adjustment in 2005. Prior periods were adjusted retrospectively by reducing the values of additions (adjustment on 1 January 2004: property, plant and equipment –€3.5m, reserves –€3.5m).

Effects on Group balance sheet:

in €m		31.12.2004		31.12.2005
	Adjustment under IAS 16	Correction to investment subsidy	Total	Adjustment under IAS 16
Property, plant and equipment	0.3	–3.8	–3.5	0.5
Reserves	–	–3.5	–3.5	0.2
Profit for the period	0.2	–0.3	–0.1	0.1
Deferred tax liabilities	0.1	–	0.1	0.2
Basic/diluted earnings per share in €	0.01	–0.02	–0.01	0.01

(G) Changes in Intangible Assets, Property, Plant and Equipment

in €m	Cost						
	01.01.	Group additions	Additions	Translation differences	Reclassi-fications	Disposals	**31.12.**
2004							
Intangible assets							
Industrial property rights and similar rights	34.8	1.8	2.3	0.1	–	0.5	38.5
Goodwill	21.8	3.7	–	–	–	11.0	14.5
Negative goodwill from capital consolidation	–0.3	–	–	–	–	–0.3	–
Product development costs	12.4	–	3.3	–	–	–	15.7
	68.7	**5.5**	**5.6**	**0.1**	**–**	**11.2**	**68.7**
Property, plant and equipment							
Land and buildings	187.2	14.0	6.1	–0.3	0.1	0.8	206.3
Plant and machinery	204.7	2.4	22.0	–0.5	1.6	8.7	221.5
Other facilities, factory and office equipment	91.3	3.5	17.3	–0.2	0.4	15.2	97.1
	483.2	**19.9**	**45.4**	**–1.0**	**2.1**	**24.7**	**524.9**
	551.9	**25.4**	**51.0**	**–0.9**	**2.1**	**35.9**	**593.6**
2005							
Intangible assets							
Industrial property rights and similar rights	38.5	4.1	1.6	–	–	1.5	42.7
Goodwill	14.5	–	–	–	–	0.3	14.2
Product development costs	15.7	–	0.7	–	–	–	16.4
	68.7	**4.1**	**2.3**	**–**	**–**	**1.8**	**73.3**
Property, plant and equipment							
Land and buildings	206.3	8.0	4.8	0.9	0.2	13.3	206.9
Plant and machinery	221.5	11.1	4.7	1.5	1.4	11.4	228.8
Other facilities, factory and office equipment	97.1	2.0	19.0	0.4	0.5	15.1	103.9
	524.9	**21.1**	**28.5**	**2.8**	**2.1**	**39.8**	**539.6**
	593.6	**25.2**	**30.8**	**2.8**	**2.1**	**41.6**	**612.9**

[1] impairment in sheetfed division as per IAS 36 €3.4m

Depreciation								Residual value	
01.01.	Group additions	Annual depreciation	Impairments	Write-ups	Translation differences	Disposals	**31.12.**	01.01.	**31.12.**
24.5	0.5	6.0	–	–	–	0.5	30.5	10.3	8.0
11.0	–	–	3.4 [1]	–	–	11.0	3.4	10.8	11.1
–0.1	–	–	–	–	–	–0.1	–	–0.2	–
12.4	–	–	–	–	–	–	12.4	–	3.3
47.8	**0.5**	**6.0**	**3.4**	**–**	**–**	**11.4**	**46.3**	**20.9**	**22.4**
59.1	3.4	5.1	–	–	–0.2	0.5	66.9	128.1	139.4
133.9	1.9	15.9	–	–	–0.5	7.8	143.4	70.8	78.1
56.9	2.4	15.1	–	–	–0.1	12.8	61.5	34.4	35.6
249.9	**7.7**	**36.1**	**–**	**–**	**–0.8**	**21.1**	**271.8**	**233.3**	**253.1**
297.7	**8.2**	**42.1**	**3.4**	**–**	**–0.8**	**32.5**	**318.1**	**254.2**	**275.5**
30.5	3.0	4.8	–	–	–	1.5	36.8	8.0	5.9
3.4	–	–	–	–	–	–	3.4	11.1	10.8
12.4	–	0.7	–	–	–	–	13.1	3.3	3.3
46.3	**3.0**	**5.5**	**–**	**–**	**–**	**1.5**	**53.3**	**22.4**	**20.0**
66.9	3.7	5.3	–	0.3	0.5	10.3	65.8	139.4	141.1
143.4	9.4	16.2	–	–	1.3	10.7	159.6	78.1	69.2
61.5	1.6	13.8	–	–	0.3	13.3	63.9	35.6	40.0
271.8	**14.7**	**35.3**	**–**	**0.3**	**2.1**	**34.3**	**289.3**	**253.1**	**250.3**
318.1	**17.7**	**40.8**	**–**	**0.3**	**2.1**	**35.8**	**342.6**	**275.5**	**270.3**

(H) Explanatory Notes to the Balance Sheet

(1) Intangible assets, property, plant and equipment

Depreciation on intangible assets and on property, plant and equipment was carried in cost of sales, distribution costs, administrative and other operating expenses.

Changes and impairments in individual items are shown on page 62. The impairment of development assets was disclosed under research and development costs, of goodwill under administrative expenses and of property, plant and equipment under the relevant functions.

The total includes €0.2m (previous year: €0.4m) for rights arising from finance leases, €0.5m for plant and machinery (€0.1m) and €0.8m (€0.2m) for other facilities, factory and office equipment. Further details of finance leases are given in Note (10) under sundry other financial payables.

Government grants for promoting investment reduced the carrying amounts for intangible assets by €0.1m and for property, plant and equipment by €15.7m (previous year: €0.3m and €16.4m respectively).

Intangible assets

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

Goodwill was tested for impairment on the balance sheet date in accordance with IAS 36.

The recoverable amount for KBA-GIORI S.A., Lausanne (goodwill on 31 December 2005: €7.3m), and for Bauer+ Kunzi GmbH (acquired in 2003, goodwill on 31 December 2005: €3.4m) exceeded the carrying amount (including goodwill) of the cash-generating unit. A subsequent price adjustment reduced Bauer+ Kunzi's goodwill by €0.2m. The residual goodwill of €3.4m arising from the business combination with Karat Digital Press GmbH, Radebeul, in 2002 was amortised in full the previous year. This was largely due to continued sluggish growth in the advertising industry, which impacted on the market for short-run colour and thus on Karat sales, despite the launch of new applications.
Development costs are detailed in note (15).

Property, plant and equipment

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

(2) Financial and other assets

Investments

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

Company, location	Capital share in %	Equity in €m
Consolidated affiliates		
KBA-Berlin GmbH, Berlin, Germany	100.0	3.1[1]
KBA-Metronic AG, Veitshöchheim, Germany	100.0	9.7
Bauer+Kunzi GmbH, Ditzingen, Germany	100.0	1.0
KBA (UK) Ltd., Watford, UK	100.0	–0.4[2]
KBA-France SAS, Tremblay-en-France, France	100.0	1.3
Holland Graphic Occasions B.V., Wieringerwerf, Netherlands	100.0	–1.8[2]
KBA-Mödling AG, Mödling, Austria	>99.9	24.0
KBA-Le Mont-sur-Lausanne SA, Lausanne, Switzerland	100.0	34.1
KBA-GIORI S.A., Lausanne, Switzerland[4]	100.0	23.3
KBA-Grafitec s.r.o., Dobruška, Czech Republic	100.0	13.8
KBA North America Inc., Wilmington, Delaware, USA	100.0	23.2
Non-consolidated affiliates		
KBA Australasia Pty. Ltd., Lane Cove, Australia	100.0	–0.2[2]
KBA NORDIC A/S, Herlev, Denmark	100.0	–0.5[2,3]
KBA-Italia S.p.A., Milan, Italy	100.0	1.2
KBA Koenig & Bauer (Asia Pacific) Sdn. Bhd., Kuala Lumpur, Malaysia	100.0	0.3
KBA RUS GmbH, Moscow, Russia	100.0	0.1
Print Assist AG, Höri, Switzerland[4]	100.0	2.1
KBA (HK) Company Ltd., Hong Kong, China	51.0	0.9
KBA Printing Machinery (Shanghai) Co., Ltd., Shanghai, China	100.0	0.4
Interests		
KBA Leasing GmbH, Bad Homburg, Germany	24.9	0.7
KBA-GIORI India Private Ltd., New Delhi, India[4]	50.0	0.2

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

In March 2005 Koenig & Bauer AG acquired Grafitec, spol. s r.o., a Czech press manufacturer based in Dobruška, near Hradec Králové. The purpose of this strategic acquisition is to expand market share in small-format sheetfed offset. Renamed KBA-Grafitec s.r.o., the new subsidiary has around 420 employees who in 2005 generated sales worth €25.8m and a net profit of €0.7m.

Koenig & Bauer also acquired the remaining 49.8% interest it did not already hold in KBA NORDIC A/S, founded in 2002.

The terms to maturity of financial and other assets are shown below:

in €m	31.12.2004	Term to maturity		31.12.2005	Term to maturity	
		up to 1 year	more than 1 year		up to 1 year	more than 1 year
Trade receivables						
- from affiliates	39.7	38.6	1.1	8.9	6.4	2.5
- from companies in which interests are held	2.2	2.2	–	5.1	5.1	–
- from third parties	442.1	378.6	63.5	451.6	368.7	82.9
	484.0	**419.4**	**64.6**	**465.6**	**380.2**	**85.4**
Investments	6.2	–	6.2	5.5	–	5.5
Other financial receivables						
- derivatives	26.3	21.0	5.3	6.8	6.8	–
- sundry other financial receivables	35.6	16.2	19.4	34.6	19.2	15.4
	68.1	**37.2**	**30.9**	**46.9**	**26.0**	**20.9**
Other assets						
- payments for inventories	18.3	18.3	–	24.5	24.5	–
- payments for intangible assets, property, plant and equipment	2.6	2.6	–	6.0	6.0	–
- tax receivables	10.8	10.8	–	4.2	4.2	–
- sundry other assets	2.8	2.8	–	4.6	4.6	–
	34.5	**34.5**	**–**	**39.3**	**39.3**	**–**
	586.6	**491.1**	**95.5**	**551.8**	**445.5**	**106.3**

Adopting the percentage of completion method resulted in €32.9m (previous year: €58m) being carried in **trade receivables**.

Included above are **sundry other financial receivables** of €4.9m (previous year: €4.8m) held under finance leases totalling €5.6m (previous year: €5.6m) and an interest share of €0.7m (previous year: €0.8m), with those due in less than one year representing €0.5m (previous year: €0.5m) of a total of €0.8m (previous year: €0.8m). The terms to maturity of the remainder were more than one year but less than five. Other financial receivables from derivatives are detailed in Note (11).

Sundry other assets contain prepayments of €4.6m (previous year: €2.8m).

Interest, exchange and credit risks at the balance sheet date related to customer financing and loans to employees and agents. Interest-related cash flow risks are summarised in the table on the next page. Currency risks related to the conclusion of delivery contracts in foreign currencies, usually US dollars. These were hedged using derivatives (*see Note (11)*). Credit risks were contained by creating adequate provisions. Retention of title and hedging via credit insurance were used to minimise risks pertaining to sales. Write-downs in 2005 totalled €10.3m (previous year: €19.3m).

in €m	31.12.2004 Carrying amount	Interest rate	Term to maturity in years	**31.12.2005** Carrying amount	Interest rate	Term to maturity in years
Trade receivables						
- from affiliates	7.7	max. 5.5%	up to 2	2.7	max. 5.5%	up to 5
- from third paties	296.2	max. 10.2%	up to 7	241.2	max. 10.2%	up to 7
Other financial receivables	2.8	max. 6.0%	up to 5	1.7	max 6.0%	up to 4
	306.7			**245.6**		

(3) Inventories

in €m	31.12.2004	**31.12.2005**
Raw materials, consumables and supplies	54.6	53.4
Work in progress	314.7	307.9
Finished goods and products	4.8	7.2
	374.1	**368.5**

The carrying amount of inventories balanced at net realisable value was €66.9m (previous year: €106.9m). Impairments of €2.5m (previous year: €8.9m) were recognised as an expense.

(4) Securities

These mainly refer to fixed-interest securities owned by the Parent, and shares in a special fund combining stocks and bonds classified under IAS 39 as available-for-sale financial instruments. €4.1m (previous year: €5.1m) of this special fund was pledged to employees in order to hedge phased retirement credits.

Fixed-interest securities were valued at €5.5m (2004: €7m).

The balanced market value of the **special fund** was €7.5m (previous year: €6.9m).

(5) Cash and cash equivalents

in €m	31.12.2004	**31.12.2005**
Cheques, cash in hand, balance at Bundesbank	0.2	0.2
Balances with banks	32.0	115.8
	32.2	**116.0**

(6) Deferred taxes

Deferred tax assets and liabilities comprised the following:

in €m	Deferred tax assets		Deferred tax liabilities	
	31.12.2004	**31.12.2005**	31.12.2004	**31.12.2005**
Assets				
Intangible assets, property, plant and equipment	1.8	2.2	20.3	21.0
Inventories	12.6	22.3	2.8	3.9
Financial receivables and other assets	5.6	2.2	10.3	3.3
Securities, cash and cash equivalents	–	–	0.8	1.0
	20.0	**26.7**	**34.2**	**29.2**
Equity and liabilities				
Equity	0.6	–	–	0.7
Provisions	21.0	18.4	1.2	1.9
Financial payables and other liabilities	1.2	12.2	18.1	31.5
	22.8	**30.6**	**19.3**	**34.1**
Tax loss carryforwards	19.0	19.1	–	–
Other	–0.2	–0.2	–	–
	61.6	**76.2**	**53.5**	**63.3**

Deferred taxes disclosed under equity related to the translation differences arising from consolidation procedures. Deferred taxes totalled €2m (previous year: €8.3m).

Other deferred tax assets and liabilities include offsetting as per IAS 12, and impairments and loss carryforwards totalling €0.3m (previous year: €0.2m).

(7) Equity

Changes in shareholders' equity are described in a separate schedule on page 52.

Share capital

The Parent's share capital at 31 December 2005 totalled 16,264,760 (2004: 16,214,470) no-par shares with a par value of €2.60. The 50,290 increase over the previous year represents the issue of employee shares, using part of the €15.6m capital approved by the extraordinary shareholders' meeting on 22 November 2001. The remaining €14.9m was approved until 22 November 2006. Koenig & Bauer is further authorised to continue buying back shares until 22 December 2006, up to a maximum of one tenth of the issued capital of €42.2m.

All bearer shares issued were paid up in full and convey the right to attend and vote at shareholder meetings and receive any dividend payments that are approved. In 2005 a dividend of 25 cents per share was paid for the previous year.

Share premium

This includes the extra charge from the issue of shares, and is subject to the limitations imposed by §150 of German Company Law. Our share premium rose by €0.9m compared to the previous year, due to the issue of employee shares.

Reserves

These encompassed the net profits posted and retained in previous years by consolidated companies, and adjustments arising from the adoption of IFRS. Goodwill and negative goodwill acquired from capital consolidation prior to 1 January 1995 increased reserves by €0.4m, €0.2m of which resulted from netting negative goodwill against reserves in 2004 as per IFRS 3.

Reserves also included translation differences relating to the financial statements of foreign entities and to changes in the market value of financial instruments after taxes, where these were not recognised as income or expense. The disclosure of original financial instruments raised reserves by €0.6m (previous year: €1.3m).

The use of hedge accounting decreased reserves by €7.4m (previous year: increase of €3.5m). During completion of the underlying transactions €12.4m (previous year: €10.9m) was recognised as income.

Deferred taxes increased reserves by €6.8m (previous year: €2.9m), with primary financial instruments accounting for –€0.2m (compared to –€0.5m the previous year), derivatives €7.7m (€2.9m) and foreign currency translation –€0.7m (€0.5m).

(8) Pension provisions

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

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

Calculations were based on a discount rate of 4.2% (previous year: 4.8%) in Germany and 5.5% (5.8%) in the USA, a salary increase of 2.3% (2.2%) and a fluctuation rate of 2.9% (3.2%). Pension adjustments were calculated at 1.2% (1%). All figures are weighted averages of the assumptions contained in the pension plans.

Pension provisions constituted the following:

in €m	31.12.2004	**31.12.2005**
Present value of non-funded obligations	92.7	108.9
Present value of funded obligations	11.8	21.3
Current market value of plan assets	–10.3	–17.3
Current market value of obligations (offset)	**94.2**	**112.9**
Unrecognised actuarial gains/losses	–5.8	–20.6
Currency gains/losses	–	–0.2
Balance sheet value at 31.12.	**88.4**	**92.1**
- pension provisions	**88.4**	**92.1**

Net liability recognised in the balance sheet changed as follows:

in €m		31.12.2004		**31.12.2005**
Net liability recognised in the balance sheet at 01.01.		**86.6**		**88.4**
Annual expense		6.1		6.9
- current service cost	(2.6)		(2.7)	
- interest cost	(5.4)		(5.0)	
- expected return on assets	(–0.9)		(–0.9)	
- recognised actuarial gain/loss	(–)		(0.1)	
- change due to implementation/change of plan	(–1.0)		(–)	
Benefits paid		– 4.3		–4.7
Change in scope of consolidated financial statements		–		1.6
Other changes		–		–0.1
Net liability recognised in the balance sheet at 31.12.		**88.4**		**92.1**

The actual return on plan assets was €0.4m (previous year €0.5m). The anticipated rate of return was 5.2% (previous year: 7.4%).

Expenses for defined-contribution plans totalled €29.9m (previous year: €29.6m).

(9) Other provisions

in €m	Status on 01.01.2005	Group additions	Con-sumption	Reversal of provisions	Allocation	Unwind of discount	Translation difference*	Status on 31.12.2005
Other provisions								
- for employees	40.0	0.2	5.4	11.2	5.9	0.8	–0.1	30.2
- for sales	99.3	0.3	20,2	4.4	19.8	–	–5.0	89.8
- for sundry other purposes	44.2	0.5	35.5	1.9	30.0	–	5.0	42.3
	183.5	**1.0**	**61.1**	**17.5**	**55.7**	**0.8**	**–0.1**	**162.3**
of which								
- long-term provisions	53.5							43.5
- short-term provisions	130.0							118.8
	183.5							**162.3**

* including reclassifications

Provisions for employees included holiday and flexitime credits, long-service expenses, credits for phased retirement plans and performance bonuses. Sales expenses covered provisions for process risks, warranty and commission obligations. Provisions for sundry other purposes primarily related to liability insurance premiums, auditing and similar obligations.

(10) Financial and other liabilities

in €m	31.12.2004	Term to maturity up to 1 year	Term to maturity more than 1 year	31.12.2005	Term to maturity up to 1 year	Term to maturity more than 1 year
Trade payables						
- to affiliates	0.3	0.3	–	1.0	1.0	–
- to others	100.1	99.9	0.2	94.7	94.7	–
	100.4	**100.2**	**0.2**	**95.7**	**95.7**	**–**
Bank loans	137.1	101.7	35.4	78.7	53.3	25.4
Other financial payables						
- from derivatives	1.8	1.4	0.4	16.2	16.1	0.1
- sundry other financial payables	71.5	60.1	11.4	121.7	111.7	10.0
	210.4	**163.2**	**47.2**	**216.6**	**181.1**	**35.5**
Other liabilities						
- from payments received	247.9	233.4	14.5	294.2	276.7	17.5
- from taxes	12.5	11.7	0.8	16.9	16.2	0.7
- sundry other liabilities	2.5	2.5	–	5.5	5.5	–
	262.9	**247.6**	**15.3**	**316.6**	**298.4**	**18.2**
	573.7	**511.0**	**62.7**	**628.9**	**575.2**	**53.7**

Bank loans were secured by mortgages to the value of €16.4m (previous year: €18.1m), the pledging of securities worth €1.6m (previous year: €1.3m) and the assignment of trade receivables totalling €12.4m (€13.8m). The carrying amounts of secured items of property, plant and equipment came to €10.4m (previous year: €10.9m) and of pledged securities (other financial receivables) €2.1m (€2.1m).

Lines of credit not drawn down by the KBA Group totalled €153.2m (previous year: €109.7m). Details of **bank loans** relating to existing interest rate risks are summarised below.

in €m	Term to maturity in years	Carrying amount	31.12.2004 Interest rate	Term to maturity in years	Carrying amount	31.12.2005 Interest rate
Loans	up to 1	55.1	max. 6,7%	up to 1	29.5	max. 6,7%
	1 to 5	22.2	max. 6,7%	1 to 5	15.3	max. 6,7%
	5 to 9	13.2	max. 6,7%	5 to 8	10.1	max. 5,7%
Bank overdrafts	up to 1	46.6	max. 9,0%	up to 1	23.8	max. 9,0%
		137.1			**78.7**	

Sundry other financial payables included finance leases to the sum of €8.3m (previous year: €10.6m). Standard market conditions apply to renewal and purchase options. Sale and leaseback transactions based on customer financing models were concluded, with payables offset against accounts receivable to the same amount. Turnover was carried upon delivery of the machinery.

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

in €m	31.12.2004	Term to maturity			**31.12.2005**	Term to maturity		
		up to 1 year	1 to 5 years	more than 5 years		up to 1 year	1 to 5 years	more than 5 years
Minimum lease payments	12.2	3.8	8.4	–	9.2	3.7	5.5	–
Interest portion	–1.6	–0.7	–0.9	–	–0.9	–0.5	–0.4	–
Present value of finance lease	**10.6**	**3.1**	**7.5**	–	**8.3**	**3.2**	**5.1**	–

The derivative items included in other financial payables are explained more fully in Note (11).

Other liabilities include total payments received of €106.9m (previous year: €115.1m) for contracts.

(11) Derivatives

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

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

Interest-related cash-flow risk is the risk that future cash flows will fluctuate following changes in market interest rates.

Interest rate risk is the risk that the interest on deposits or loans will fluctuate as a result of changes in market interest rates.

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

These risks are contained by a risk management system at Group level. The principles laid down for the KBA Group ensure that risk is assessed and documented in accordance with systematic and uniform procedures. Further information can be found on pages 44 to 45.

Forward contracts hedged the calculation rate of foreign currency trade contracts. The same purpose was served by a currency swap concluded in 2001. Here it was not individual, existing contracts that were hedged, but current, fixed-term business transactions denominated in foreign currency. Interest swaps were generally used to contain interest risk relating to long-term loans.

In 2001 a currency swap with a maturity of 5 years was concluded to hedge current, fixed-term business transactions denominated in US dollars. The nominal amount at the balance sheet date was €12.6m (previous year: €25.2m, of which €12.6m had a term to maturity of more than one year). In addition forward contracts with a maturity of up to 2 years (previous year: 2 years) were used to hedge the calculation rate of other foreign currency trade contracts. The currencies hedged were primarily US dollars.

Trade contracts worth $8m (previous year: $30m) were hedged via a short-term currency option in conjunction with a double bonus option: if the exchange rate moves outside a specified range prior to the expiry date there is an additional bonus. £0.9m were hedged by a currency option, which triggers conversion into a forward contract if the currency falls to or below a specified floor.

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

in €m	Nominal amount			Nominal amount		
	Total	Term to maturity more than 1 year	Market value	Total	Term to maturity more than 1 year	Market value
	31.12.2004		31.12.2004	**31.12.2005**		**31.12.2005**
Forward contracts	132.4	6.0	16.5	260.7	5.3	–11.5
Currency options	73.5	–	0.6	7.6	–	–0.3
Currency swaps	32.0	17.9	7.4	19.4	1.5	2.4
Interest swaps	2.0	–	–	–	–	–
	239.9	**23.9**	**24.5**	**287.7**	**6.8**	**–9.4**

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

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

The balance sheet included €2m of assets and €15.2m of liabilities from ineffective hedging relationships.

(12) Fair values

in €m	31.12.2004		31.12.2005	
	Carrying amount	Fair value	Carrying amount	Fair value
Assets				
Investments and other financial receivables				
- interests in affiliates	6.0	–	5.3	–
- other loans	0.2	0.2	0.2	0.2
- other financial receivables from derivatives	26.3	26.3	6.8	6.8
- sundry other receivables	35.6	35.6	34.6	34.6
	68.1	**62.1**	**46.9**	**41.6**
Trade receivables	484.0	484.0	465.6	465.6
Securities, cash and cash equivalents	46.1	46.1	129.0	129.0
	598.2	**592.2**	**641.5**	**636.2**
Liabilities				
Financial payables				
- bank loans	137.1	137.1	78.7	78.7
- other financial payables from finance leases	10.6	11.1	8.3	8.6
- other financial payables from derivatives	1.8	1.8	16.2	16.2
- sundry other payables	60.9	60.9	113.4	113.4
	210.4	**210.9**	**216.6**	**216.9**
Trade payables	100.4	100.4	95.7	95.7
	310.8	**311.3**	**312.3**	**312.6**

The fair value of **interests in affiliates** could not be calculated since no prices were quoted in an active market.

The fair value of **other financial receivables/payables from derivatives** was the market value. The figures disclosed for **securities, cash and cash equivalents** were the quoted market prices.

Other financial payables from finance leases refer to payment obligations discounted at the market interest rate.

The fair values of **other loans** and **sundry other financial receivables/payables** were basically the carrying amounts recognised
at amortised cost.

(13) Other financial commitments and contingent liabilities

Other financial commitments

in €m	31.12.2004	Term to maturity			**31.12.2005**	Term to maturity		
		up to 1 year	1 to 5 years	more than 5 years		up to 1 year	1 to 5 years	more than 5 years
Commitments from:								
operating leases	14.3	5.2	9.1	–	13.0	5.5	7.5	–
leasing and service contracts	13.3	3.7	8.2	1.4	12.6	4.1	7.5	1.0
investment plans	3.4	3.4	–	–	12.2	11.3	0.9	–
sundry other activities	0.9	0.2	0.2	0.5	0.1	0.1	–	–
	31.9	**12.5**	**17.5**	**1.9**	**37.9**	**21.0**	**15.9**	**1.0**

Operating leases were mainly negotiated for IT equipment and our vehicle fleet, with renewal options at prevailing market conditions. Leasing payments of €5.6m (previous year: €4.7m) were carried in the income statement. Commitments from operating leases were stated at the minimum lease payments.

Investment plans included commitments to invest in intangible assets to the value of €0.1m (previous year: €0.8m) and in property, plant and equipment to the value of €12.1m (€2.6m).

Sundry other commitments were carried at their nominal amount and included outstanding contributions.

Contingent liabilities

These comprised contingencies totalling €313.9m (previous year: €248m) from warranty agreements.

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

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

(I) Explanatory Notes to the Income Statement

(14) Revenue

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

Contract revenue and expenses for big newspaper press lines were calculated using the percentage of completion method specified in IAS 11. Contract revenue totalled €234.8m (previous year: €257.1m), accumulated revenue for contracts not completed by the balance sheet date came to €414.6m (€379m).

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

(15) Expenses by function

Cost of sales

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

Cost of sales also contained €0.2m in subsidies (previous year: €0.7m) for apprentice training, job promotion and EU-funded regional subsidies.

Research and development costs

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

Government research grants for expenses already incurred were recognised at the time of approval, reducing research and development costs by €0.1m (previous year: €0.9m). One condition for the disbursement of funds is that a complete record must be kept of all the costs incurred, and this record was submitted upon completion of the relevant project.

Distribution costs and administrative expenses

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

The €34.2m increase in distribution costs primarily related to higher commissions arising from an increase in turnover.

Administrative expenses in 2004 included €3.4m for the impairment of goodwill.

Negative goodwill of €0.1m resulted from the consolidation of KBA-Grafitec s.r.o.

(16) Expenses by nature

In order to maintain transparency in key items when classifying expenses by function, basic expenses are summarised below according to their nature.

Material costs

in €m	2004	2005
Cost of raw materials, consumables, supplies and purchased goods	618.5	709.8
Cost of purchased services	148.4	166.1
	766.9	**875.9**

Personnel costs (classified by function)

in €m	2004	2005
Wages and salaries	333.1	370.5
Social security and other benefits	65.0	67.5
Pensions	3.3	3.7
	401.4	**441.7**
Average payroll:		
wage-earning industrial staff	4,053	4,434
salaried office staff	2,847	3,006
apprentices/students	470	442
	7,370	**7,882**

(17) Other operating income and expenses

in €m	2004	2005
Other operating income		
Gains from the disposal of intangible assets, property, plant and equipment	1.1	5.5
Foreign currency gains	1.2	0.3
Currency measurement	9.0	15.2
Reversal of write-downs and provisions	6.7	11.9
Sundry other operating income	4.0	4.8
	22.0	**37.7**
Other operating expenses		
Losses from the disposal of intangible assets, property, plant and equipment	–1.2	–1.6
Foreign currency losses	–9.2	–4.0
Currency measurement	–9.5	–27.3
Creation of write-downs and provisions	–19.3	–9.0
Sundry other operating expenses	–14.3	–24.7
	–53.5	**–66.6**
Other operating income and expenses	**–31.5**	**–28.9**

Sundry other operating income included insurance and compensation claims and other refunds. Prior-year subsidies for job promotion amounted to €0.1m.

Sundry other operating expenses included the loss of receivables outstanding, customer credit notes and warranty claims.

(18) Financial result

in €m	2004	2005
Other financial results		
Income from interests in affiliates	–	0.3
Impairment of securities	–	–1.3
	–	**–1.0**
Interest income/expense		
Other interest and similar income	10.2	7.7
- from affiliates	(0.2)	(0.2)
Other interest and similar expense	–14.6	–14.2
- from affiliates	(–0.1)	(–0.5)
	–4.4	**–6.5**
Financial result	**–4.4**	**–7.5**

(19) Income taxes

Tax expense mainly comprised the following:

in €m	2004	2005
Actual tax expense	–1.2	–2.5
Deferred taxes from loss carryforwards	–0.3	0.1
Deferred tax expense from temporary differences	–2.7	–4.8
	–4.2	**–7.2**

in €m	2004	2005
Earnings before taxes	**16.0**	**25.8**
Group tax rate	39.0 %	39.0 %
Expected taxes	**–6.2**	**–10.1**
Tax effects from		
- variances due to different tax rates	5.5	1.9
- tax-free income	3.8	0.8
- amortisation of goodwill	–1.3	–
- tax decreases and increases	–7.5	0.3
- changes under IAS 8	–0.2	–0.1
- other	1.7	–
Income tax expense	**–4.2**	**–7.2**
Overall tax ratio in %	26.3 %	27.9 %

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

Deferred taxes were calculated at the relevant national tax rates, which in 2005 ranged from 11% to 40%.

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

The accumulated impact arising from the disclosure of hidden reserves during initial consolidation and adjustments following external audits was of minor significance. Other tax effects included €0.4m (previous year: €0.9m) in income tax rebates unrelated to the accounting period.

(20) Earnings per share

	2004	2005
Profit for the period in €m	11.8	18.6
Weighted average of ordinary shares issued	16,174,101	16,223,288
Earnings per share in €	**0.73**	**1.15**

The total number of ordinary shares issued was 50,290 higher than in the previous year due to the issue of employee shares in the fourth quarter. There was no dilution of earnings per share.

(J) Explanatory Notes to the Cash Flow Statement

The cash flow statement as per IAS 7 shows how Group funds changed as a result of cash inflows and outflows from operating, investing and financing activities.

Cash flows from operating activities were adjusted for currency translation effects and changes in the number of consolidated companies. Funds totalling €129m (previous year: €46.1m) comprised cash and cash equivalents worth €116m (previous year: €32.2m) and securities worth €13m (previous year: €13.9m).

Acquisition costs totalled €5.2m (prior-year: €4.2m) and were paid in full. They were set against cash and cash equivalents worth €0.1m (previous year: €3.3m) and €3.8m from the consolidation of additional enterprises (previous year: €1.9m). Non-current assets worth €7.7m (previous year: €15m), current assets worth €8.3m (€15m), non-current liabilities totalling €0.3m (€6.4m), current liabilities worth €10.9m (€18.8m) and contingent liabilities (other provisions) of €0.9m (€0.6m) were included in the consolidated financial statements.

Tax expense embraced tax refunds of €1.8m (previous year: €1.1m) and tax payments of €1.6m (€4.5m).

(K) Segment Information

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

The business segment web and special presses encompasses newspaper, commercial, gravure, directory and security presses, industrial ID systems and presses for printing electronic data storage media.

The business segment sheetfed offset presses constitutes commercial, book, packaging, metal-decorating and digitally integrated presses.

Segment information was based on the same accounting and consolidation policies as the consolidated financial statements. Internal Group transactions contained in the segment result (operating profit) were classed as arm's length transactions.

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

Reconciliation related to assets, liabilities and consolidation between segments.

Business segments

in €m	Web and special presses		Sheet offset presses		Consolidation/ reconciliation		Group	
	2004	**2005**	2004	**2005**	2004	**2005**	2004	**2005**
External turnover	**706.8**	**803.4**	**716.2**	**817.6**	**–**	**–**	**1,423.0**	**1,621.0**
Operating profit	10.8	30.6	9.6	2.7	–	–	20.4	33.3
Depreciation	28.4	25.5	13.7	15.3	–	–	42.1	40.8
Significant non-cash expenses	44.9	41.0	14.7	15.5	–	–	59.6	56.5
Capital investments	21.7	20.9	31.5	15.6	–	–	53.2	36.5
Assets	437.8	502.9	765.7	662.9	140.9	230.4	1,344.4	1,396.2
Liabilities (with payments received)	436.0	524.5	159.6	161.6	303.5	260.7	899.1	946.8

In accordance with IAS 36 the prior-year segment result for sheetfed presses showed impairments of €3.4m.

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

Geographical segments

in €m	External turnover		Capital investments		Assets	
	2004	**2005**	2004	**2005**	2004	**2005**
Germany	200.8	292.6	41.3	23.8	980.2	833.2
Rest of Europe	650.3	718.8	11.3	11.5	170.3	264.6
North America	219.0	258.4	0.6	1.2	53.0	68.0
Other regions	352.9	351.2	–	–	–	–
Consolidation/reconciliation	–	–	–	–	140.9	230.4
Group	**1,423.0**	**1,621.0**	**53.2**	**36.5**	**1,344.4**	**1,396.2**

(L) Notes to §285 no. 17 HGB

The auditors were remunerated as follows:

in €m	**2005**
Audits	0.3
Other reporting and valuation services	0.1
Other services	0.1

(M) Related Party Disclosures

Related parties as defined by IAS 24 are all affiliated, non-consolidated entities (*see Note H2*) and members of the management and supervisory boards.

Business transactions with related entities resulted essentially from deliveries to and services for our sales and service subsidiaries, which as intermediaries disclosed receivables and revenue of roughly the same amount from customers. The same conditions applied as for arm's length transactions.

in €m	2004	**2005**
Trade receivables at 31.12.	39.7	8.9
Trade payables at 31.12.	0.3	1.0
Revenue	69.9	95.4

Remuneration for members of management totalled €2.7m (previous year: €2.5m), with fixed remuneration representing €1.1m (previous year: €1.2m) and variable remuneration €1.6m (previous year: €1.3m). Performance-related variable remuneration was based on net profit. Remuneration for former members and their survivors stood at €1m (€2.2m). Supervisory board remuneration totalled €0.3m (€0.2m), €0.2m of which was variable (previous year: €0.1m).

€12.7m (previous year: €13.1m) was set aside for pension claims by active and retired members of the management board, and their survivors.

At 31 December 2005 members of the management board held 5.3% and members of the supervisory board 6.5% of Koenig & Bauer share capital, giving a total of 11.8%.

There were no other transactions with related parties.

Supervisor Board

Peter Reimpell
Chairman
Banker
Munich

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

Gottfried Weippert*
Deputy chairman
Technician
Eibelstadt

Beate Grabmair*†
Translator
Frankenthal

Peter Hanzelka*
Milling machine operator
Coswig

Rupert Hatschek
Investment manager
Vienna, Austria

Alfred Kuffler*
Representative of IG Metall
Frankenthal

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

Werner Ring*
Representative of IG Metall
Würzburg

Klaus Schmidt*
Director Corporate Communications
Hettstadt

Reinhart Siewert
Industrial economist
Würzburg

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

* employee representative

Committees

Mediation committee as per §27(3) of the Law on Codetermination
Peter Reimpell
Rupert Hatschek
Klaus Schmidt
Gottfried Weippert

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

Financial Audit Committee
Reinhart Siewert
Peter Reimpell
Peter Hanzelka
Gottfried Weippert

Management Board

Albrecht Bolza-Schünemann
President and CEO
Radebeul/Würzburg

Claus Bolza-Schünemann
Deputy president
Würzburg

Dr Frank Junker
Radebeul

Andreas Mössner
Radebeul

Walter Schumacher
Gerbrunn

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

	Member of the supervisory board at:
Dr Hans-Bernhard Bolza-Schünemann Deputy chairman	Körber AG, Hamburg (until May 2005)
Rupert Hatschek	Wienerberger AG, Vienna KBA-Mödling AG, Mödling
Dieter Rampl	Babcock & Brown, Sydney Bayerische Börse AG, Munich Bode Grabner Beye AG & Co. KG, Grünwald FC Bayern München AG, Munich Bavaria Film GmbH, Munich (until September 2005) Bavaria Filmkunst GmbH, Munich (until June 2005)
Klaus Schmidt	KBA-Metronic AG, Veitshöchheim (from March 2005)
Reinhart Siewert	KBA-GIORI S.A., Lausanne KBA-Mödling AG, Mödling KBA-Metronic AG, Veitshöchheim

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

(N) Proposal for the Utilisation of Retained Earnings

The single-entity statements for Koenig & Bauer AG were prepared under German accounting and reporting laws.
The dividend payable to shareholders was based on retained earnings disclosed in the financial statements for Koenig & Bauer AG, in compliance with German Company Law. With the approval of the supervisory board a proposal will be submitted to the AGM to utilise retained earnings totalling €6,505,904 as follows:

Payment of a dividend of 40 cents per ordinary share on 16,264,760 no-par shares	€6,505,904

(O) Events after the Balance Sheet Date

There were no significant events after the balance sheet date.

Würzburg, 7 March 2006
Management Board

Albrecht Bolza-Schünemann
President and CEO

Claus Bolza-Schünemann
Deputy president

Dr Frank Junker

Andreas Mössner

Walter Schumacher

Auditor's Opinion

We have audited the consolidated financial statements prepared by Koenig & Bauer Aktiengesellschaft, Würzburg, comprising the balance sheet, the income statement, statement of changes in equity, cash flow statement and the notes to the consolidated financial statements, together with the group management report for the business year from 1 January to 31 December 2005. The preparation of the consolidated financial statements and the group management report in accordance with IFRSs, as adopted by the EU, and the additional requirements of German commercial law pursuant to §315a(1) HGB are the responsibility of the parent company's management. Our responsibility is to express an opinion on the consolidated financial statements and on the group management report based on our audit.

We conducted our audit of the consolidated financial statements in accordance with §317 HGB 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 misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with the applicable financial reporting framework and in the group management report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Group and expectations as to possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the accounting-related internal control system and the evidence supporting the disclosures in the consolidated financial statements and the group management report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of those entities included in consolidation, the determination of entities to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and group management report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRSs, as adopted by the EU, the additional requirements of German commercial law pursuant to §315a(1) HGB and give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with these requirements. The group management report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, 7 March 2005

Bayerische Treuhandgesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr Grottel
Auditor

Mühlhuber
Auditor

Balance Sheet for Koenig & Bauer AG to 31 December 2005

under German commercial law (HGB)

Assets in €m	31.12.2004	31.12.2005
Non-current assets		
Intangible assets	3.9	2.9
Property, plant and equipment	165.1	156.7
Financial assets	53.6	58.8
	222.6	**218.4**
Current assets		
Inventories less payments received	61.1	3.2
Trade receivables	370.9	301.4
Other receivables and assets	114.7	118.2
Securities	11.9	10.5
Cash and cash equivalents	15.7	85.7
	574.3	**519.0**
Prepayments	**1.4**	**2.9**
	798.3	**740.3**

Equity and liabilities in €m	31.12.2004	31.12.2005
Equity		
Share capital	42.2	42.3
Share premium	83.1	84.0
Reserves	209.2	210.6
Retained earnings	5.1	6.5
	339.6	**343.4**
Special items with equity portion	**11.5**	**9.7**
Provisions		
Pension provisions	61.6	62.0
Tax provisions	0.2	0.2
Other provisions	163.2	170.5
	225.0	**232.7**
Liabilities		
Bank loans	91.6	32.2
Trade payables	84.8	65.0
Other liabilities	45.8	57.3
	222.2	**154.5**
	798.3	**740.3**

Income Statement for Koenig & Bauer AG for 2005

under German commercial law (HGB)

in €m	2004	2005
Revenue	1,230.3	1,342.0
Cost of sales	–1,006.2	–1,124.3
Gross profit	**224.1**	**217.7**
Distribution costs	–106.9	–117.5
Administrative expenses	–48.9	–44.8
Other operating income	12.7	25.0
Other operating expenses	–73.8	–67.9
Profit from operations	**7.2**	**12.5**
Financial result	–1.1	–4.4
Earnings before taxes	**6.1**	**8.1**
Income taxes	0.2	–0.2
Other taxes	–1.2	–1.0
Net profit	**5.1**	**6.9**

Key Financial Dates

Interim report on 1st quarter 2006
15 May 2006

Koenig & Bauer Annual General Meeting
22 June 2006
Congress Centrum Würzburg

Interim report on 2nd quarter 2006
11 August 2006

Interim report on 3rd quarter 2006
15 November 2006

Contacts

Investor Relations
Dr Bernd Heusinger
Tel: (+ 49) 931 909-4835
Fax: (+ 49) 931 909-6015
E-mail: bernd.heusinger@kba-print.de

Corporate Communications
Klaus Schmidt (director)
Tel: (+ 49) 931 909-4290
Fax: (+ 49) 931 909-6015
E-mail: klaus.schmidt@kba-print.de

Internet
www.kba-print.com

KBA Consolidated Financial Statements

Issued by:
Koenig & Bauer AG
Postfach 60 60
97010 Würzburg
Germany
Tel: (+49) 931 909-0
Fax: (+49) 931 909-4101
E-mail: kba-wuerzburg@kba-print.de
www.kba-print.com

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