Koenig & Bauer Group

Consolidated Financial Statements 2006

At a Glance

KBA Group in Figures

€m

	2002	2003	2004	2005	**2006**
Order intake	1,084.5	1,255.8	1,459.1	1,768.9	1,649.7
Sales	1,353.8	1,231.8	1,423.0	1,621.0	1,741.9
Order backlog at 31.12.	832.9	856.9	893.0	1,040.9	948.7
Operating profit/loss	46.6	–47.0*	20.4	33.3	46.2
Earnings before taxes	43.2	–49.6	16.0	25.8	47.4
Net profit/loss	28.1	–30.0	11.8	18.5	34.3
Balance sheet total	1,240.6	1,299.4	1,344.4	1,395.1	1,394.2
Intangible assets, property, plant and equipment	283.0	260.2	275.5	270.3	293.1
Equity (without proposed dividend payment)	467.6	443.7	441.2	441.5	468.1
Investment in intangible assets, property, plant and equipment	51.7	45.3	57.6	39.5	54.3
Depreciation on intangible assets, property, plant and equipment	45.0	57.2	45.5	40.5	41.9
Payroll: annual average	7,539	7,266	7,370	7,882	8,269
Cash flows from operating activities	11.9	61.6	38.1	174.6	90.0
Dividend paid per share in €	0.50	–	0.25	0.40	0.50

* including €45.1m restructuring expenses







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In 2006 the German engineering industry enjoyed its third successive year of growth, powered by a large backlog of orders from the previous year, buoyant demand in foreign markets and an upturn in the domestic economy. Both our business divisions vigorously defended our strong position in mainstream and niche markets, and as a result Group sales climbed 7.5% to an unprecedented €1,741.9m. While a total of €1,649.7m for new bookings was a good 6% down on 2005, when they had surged 21% to a record €1.77bn, it was several hundred million euros above the corresponding figures for 2001 to 2004.

As we had announced, Group earnings before taxes (EBT) soared to €47.4m from €25.8m the year before. Although softer sales of multi-unit web presses and thus a smaller volume of customer prepayments caused the free cash flow to shrink to €37.8m from an outstanding €147.2m in 2005, Group liquidity remains strong.

But net operating margins are still below target. Despite a raft of cost-cutting initiatives that are gradually taking effect, earnings in our sheetfed division continue to cause concern. Against fierce competition from German and Japanese rivals in a global buyers' market we were unable to charge an innovation premium for our highly advanced and, for some applications, technologically superior press models. The costs associated with selling off stocks of second-hand machinery and launching new models also weighed on the segment result. However, we are confident that the current year will bring a significant improvement.

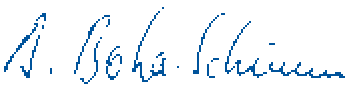
Albrecht Bolza-Schünemann,
President and CEO,
Koenig & Bauer AG

Following a 41% leap in Group sales over the past three years we anticipate no more than weak growth in 2007 due to a smaller backlog of orders for big web presses, and even this projection is based on steady demand for batch-built sheetfed and web offset presses with shorter turnaround times. Some major contracts for newspaper presses and the sale of diverse commercial web offset and rotogravure presses early this year will improve plant utilisation levels at our web press facilities. Nonetheless, we have already negotiated an agreement with staff representatives on possible changes in working hours that will allow us to respond more flexibly to fluctuations in capacity, and have substantially reduced the number of temporary workers, which in 2006 was still relatively high. Our sheetfed and security press factories in Radebeul (near Dresden), the Czech Republic and Austria will all be busy for the next few months. But order intake – and thus plant utilisation – in the second half of the year will depend in part on whether members of the print media industry decide to defer investment until the Drupa international trade fair in May 2008.

As a global enterprise we must live with developments in the commodities, energy and currency markets – and the political environment – that may impact severely on our operations. Nonetheless, based on our current knowledge I am confident that at the end of the 2007 business year we shall be able to offer you, our shareholders, earnings on a similar scale to 2006.

On behalf of the management board I would like to thank all our executives, employees and staff representatives for their dedication 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 interest you have demonstrated in our products and services, and for the invaluable feedback with which you support our activities.

Würzburg, 5 March 2007
Koenig & Bauer Management Board



Albrecht Bolza-Schünemann
President and CEO

Major Events in 2006

January:
Technology leader: statistics issued by the German Patent and Trademark Office reveal that KBA's tally of 200 patent applications in 2005 was the highest in the press manufacturing industry and ranked 22nd in the national league table

February:
A milestone in newspaper production: the *Badische Zeitung* in Freiburg becomes the first regional title to be printed on a KBA Cortina waterless mini tower press

March:
Inline finishing on the advance: more than 500 trade professionals from all over Europe attend a KBA coating seminar in Dresden

April:
Champions in print: KBA presses make a big impact at Ipex, the world's second-largest print media trade fair, in Birmingham, UK

May:
Cultural commitment: as an 80th birthday present for KBA's longstanding president and deputy chairman Dr Hans-Bernhard Bolza-Schünemann, KBA employees donate €35,000 to the Mainfranken Theatre in Würzburg

Competence counts: KBA wins the coveted Golden Cylinder Award presented by the Gravure Association of America (GAA)

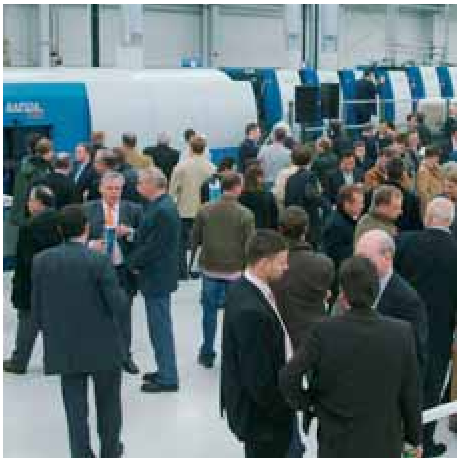
June:
Growth market China: the Zhejiang Daily in Hangzhou orders the country's first KBA Commander press line along with a KBA Comet semi-commercial press

L-r:

Milestone: last year the Badische Zeitung in Freiburg made the successful transition to waterless offset with a KBA Cortina

Inline finishing: over 500 members of the print media converged on Dresden for a KBA coating seminar

Champions in print: the World Cup was the theme on the KBA stand at Ipex 2006



July:
New subsidiary KBA-MetalPrint: the acquisition of LTG Print Systems Holding in Stuttgart by KBA subsidiary Bauer + Kunzi moves KBA up to the top slot in the market for metal-decorating presses

August:
First the biggest, then the smallest: after winning the Printing Industries of America/Graphic Arts Technical Foundation's prestigious 2005 PIA/GATF InterTech Technology Award with the world's biggest sheetfed offset press, the Rapida 205, KBA carries off the 2006 Award with the ultra-compact Genius 52UV built by KBA-Metronic

September:
Success in niche markets: a new security-press assembly hall is inaugurated at KBA-Mödling near Vienna

October:
Commitment to Würzburg: a new manufacturing hall nears completion at KBA's Würzburg headquarters. Erected around the old hall while this was still in uninterrupted use, it will streamline the large-parts production flow

November:
Extending a hand over the fence: KBA and Heidelberg join forces to promote clear standards for UV and hybrid print applications as a service to all users

December:
Engagement in eastern Europe: a new Polish subsidiary, KBA-Polska, is established in Warsaw and sales by dynamic Czech subsidiary KBA-Grafitec top the one billion koruna threshold in the first full year following the company's acquisition by KBA

L-r:
Cultural commitment: the KBA workforce donated €35,000 to the Mainfranken Theatre in Würzburg as an 80th birthday present for former company president Dr Hans-Bernhard Bolza-Schünemann

Pole position in metal decorating: the acquisition of specialist manufacturer LTG-Mailänder in Stuttgart resulted in the creation of KBA-MetalPrint

Commitment to Würzburg: a new production hall streamlined the large-parts workflow at Group headquarters

Human Resources and Welfare

Staff skills key to future success

For technology-powered German enterprises, maintaining a competitive edge in a globalised marketplace demands a correspondingly high level of staff skill, creativity and flexibility. We therefore focused once again on providing basic and further training for our specialist and executive staff.

At the end of the year there were 8,296 staff on the Group payroll (2005: 7,962), with KBA-MetalPrint in Stuttgart accounting for 293, the rest of the Group for just 41 of the additional 334.

Skills drive

In 2006 we expanded our personnel advancement programme still further, offering a broader choice of internal and external training courses to enhance staff proficiency in technology, products, methodology and foreign languages. A three-month initiative launched by our sheetfed operation to encourage the transfer of skills and know-how from one generation to the next in final assembly and service proved to be extremely effective. A new executive training programme was introduced in the autumn at our web press plants, while support committees at our various facilities continued their task of helping young department managers, junior executives and trainees to recognise and develop their full potential.

In-depth training

Staff training has ranked among our top priorities ever since Koenig & Bauer established an in-house vocational training school in Würzburg almost 140 years ago. At the end of 2006 there were 461 (2005: 487) apprentices and student trainees in the KBA Group. Despite a minor adjustment in line with current needs, this still represented 5.6% of the workforce. At present the qualifications most in demand are electromechanics, industrial and metalworking mechanics and business administration. Over and above this 16 aspiring electrical and mechanical engineers worked at KBA as part of the sandwich courses they are pursuing at vocational colleges in Mannheim, Mosbach and Riesa. 114 trainees passed their final examinations in 2006, most of them with outstanding results. Once again, KBA apprentices were among the local and regional prize winners at the final examinations set by the Chambers of Industry and Commerce.

Skills drive: maintaining a high level of staff qualifications and providing extensive customer training, eg at our dedicated training centre in Radebeul (pictured here), rank high on our list of priorities


KBA

Efforts to stimulate interest among young people in industrial and technical careers included open days at our training centres, visits to schools and participation in nationwide campaigns such as "Girls' Day". More than 400 pupils, trainees, students and external apprentices gained initial working experience at KBA through trial training courses and industrial placements. 31 students joined our ranks to write industry-related theses. We also awarded undergraduate and postgraduate grants as a means of promoting the engineering professions essential to our long-term survival.

Continuing a tradition of social welfare

Koenig & Bauer has pursued an active welfare policy for more than 150 years, during which time it has pioneered a number of social institutions including a company health insurance scheme (established in 1855) and a trust fund for the disabled and widowed (1873). Now an independent enterprise operating solely in Germany, the KBA health-insurance scheme increased membership in 2006 to 9,442 plus 3,391 dependents, and continued to promote preventive health care along with its other services.

Enabling employees to combine a career and a family is crucial to staff retention and for this reason KBA joined a regional initiative in July last year aimed at helping new parents return to work. In addition to the family-friendly options we already offer, such as part-time work ranging from job-sharing to a four-day week, we launched a monthly newsletter for Würzburg staff who are on parenting leave, and also reserved kindergarten places in the immediate vicinity. A day-care centre for employees' children was set up in October 2006 next door to our Radebeul plant. Open from 6am to 6pm, the centre is supported by KBA via a not-for-profit organisation.

Ideas cut costs

Employees at our German facilities submitted a total of 1,097 suggestions (2005: 1,732), over 70% of which attracted bonuses. Once again staff suggestions were instrumental in streamlining the production workflow and slashing costs.

Group payroll on 31 December

	2005	**2006**
Total	7,962	8,296
Salaried office staff	3,030	3,222
Wage-earning industrial staff	4,445	4,613
Apprentices / students	487	461

Ongoing investment: modern universal milling machines for ink ducts and cross bars in Würzburg

Group work and collective wage agreements

Group work, which was introduced at our various factories over a period of years, was refined still further, with the annual re-appraisal of group targets and parameters resulting in a closer alignment of earnings and expenses. At the end of the year there were 2,583 staff engaged in group work at the Parent Company. Complex, labour-intensive preparations for implementing a new harmonised pay system also continued.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Sustainability Report

Spotlight on quality and the environment

In order to maintain and continually enhance product quality, and thus promote customer satisfaction on an ongoing basis, KBA employs a holistic quality management system extending from the design phase to the end of the warranty period. At our web press plants the final pre-shipment inspection test carried out on subassemblies includes trial runs with the relevant software as a means of safeguarding product quality.

At our sheetfed facilities, internal pre-delivery inspections help maintain our rigorous quality standards. Process-integrated measuring systems and modern measuring equipment in climate-controlled rooms ensure that errors in the parts manufacturing workflow are detected and remedied at an early stage in the value-added chain. Other activities include tests on new assemblies or materials at selected customers prior to serial production, first sampling of all bought-in parts and assemblies, continuous auditing of suppliers, and goods despatch controls or staff training in quality assurance at key suppliers. Last year service and installation staff were also given extensive training in order to trim quality costs.

Greening up products and processes

As a member of Umweltpakt Bayern, an environmental initiative in Bavaria, KBA is firmly committed to protecting the environment. Many of the investments and organisational changes we made at our factories in 2006 served to diminish our ecological footprint while improving working conditions and safety. In Würzburg, new heating and ventilation systems with no-draught air exchange were brought on stream together with a new production hall, and work started on dismantling the salt-bath hardening furnaces. Equipment upgrades at the distribution hub for pre-scheduled assemblies and at various machine tools improved workflow ergonomics as well as work safety.

Sustainability plays an ever-increasing role in product development. All our Rapida sheetfed offset presses, for example, boast an "emission-tested" certificate issued by the BG (Berufsgenossenschaft Druck- und Papierverarbeitung, the German equivalent of the UK's Health and Safety Executive) that is recognised in many countries. KBA is also a pioneer of waterless offset technology, an environmentally friendly printing process that dispenses with ink keys. Unique in the global marketplace, it is incorporated in some of our sheetfed presses, special UV presses and in our ultra-compact Cortina newspaper press.

Holistic quality management: new measuring centre for large parts at our Würzburg factory

KBA Shares

Upward trend with seasonal fluctuations

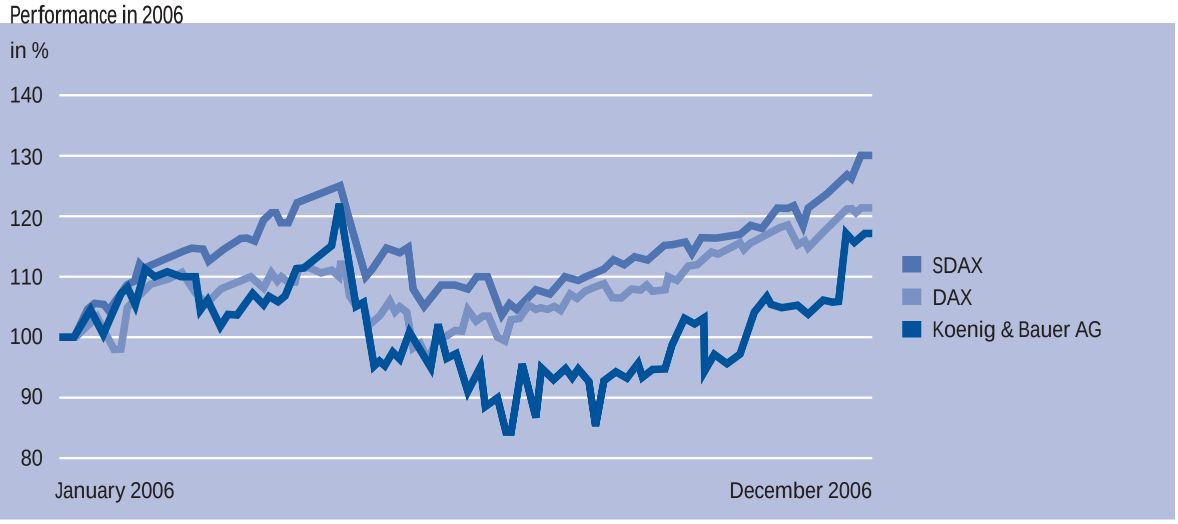
Buoyed by a favourable industry climate and brighter Group prospects, on 11 May KBA shares were quoted at €30.93, their highest level since the early 1990s. From mid-May onwards external influences brought a series of stock market corrections, and with Group figures for the first quarter falling short of many analysts' expectations, our shares failed to keep pace with the SDAX (small-caps) and DAX indices.

However, a big rise in half-year earnings and a surge in new orders for sheetfed presses in the third quarter were rewarded by the market in the autumn with a substantial lift in the share price. On 29 December KBA shares were quoted at €29.64, 17.2% above their opening price of €25.30 on 2 January 2006. Even so, their volatility throughout the year meant that they were no match for the SDAX or DAX, which climbed by around 30% and 21% respectively. In the first two months of the current year our shares remained volatile within a bandwidth of €27 to €30.

Higher dividend targeted

Group earnings per share improved perceptibly from €1.14 to €2.11. 50% of the Parent's net profit of €32.2m (2005: €6.9m) was transferred to revenue reserves to strengthen the equity base. At the annual shareholders' meeting in Würzburg on 19 June the management and supervisory boards will propose using the residue of €16.1m (2005: €6.5m) to pay a higher dividend of 50 cents (2005: 40 cents). This equates to a dividend yield of 1.7% relative to the year-end price.

Performance in 2006



Analysts verdict overwhelmingly positive

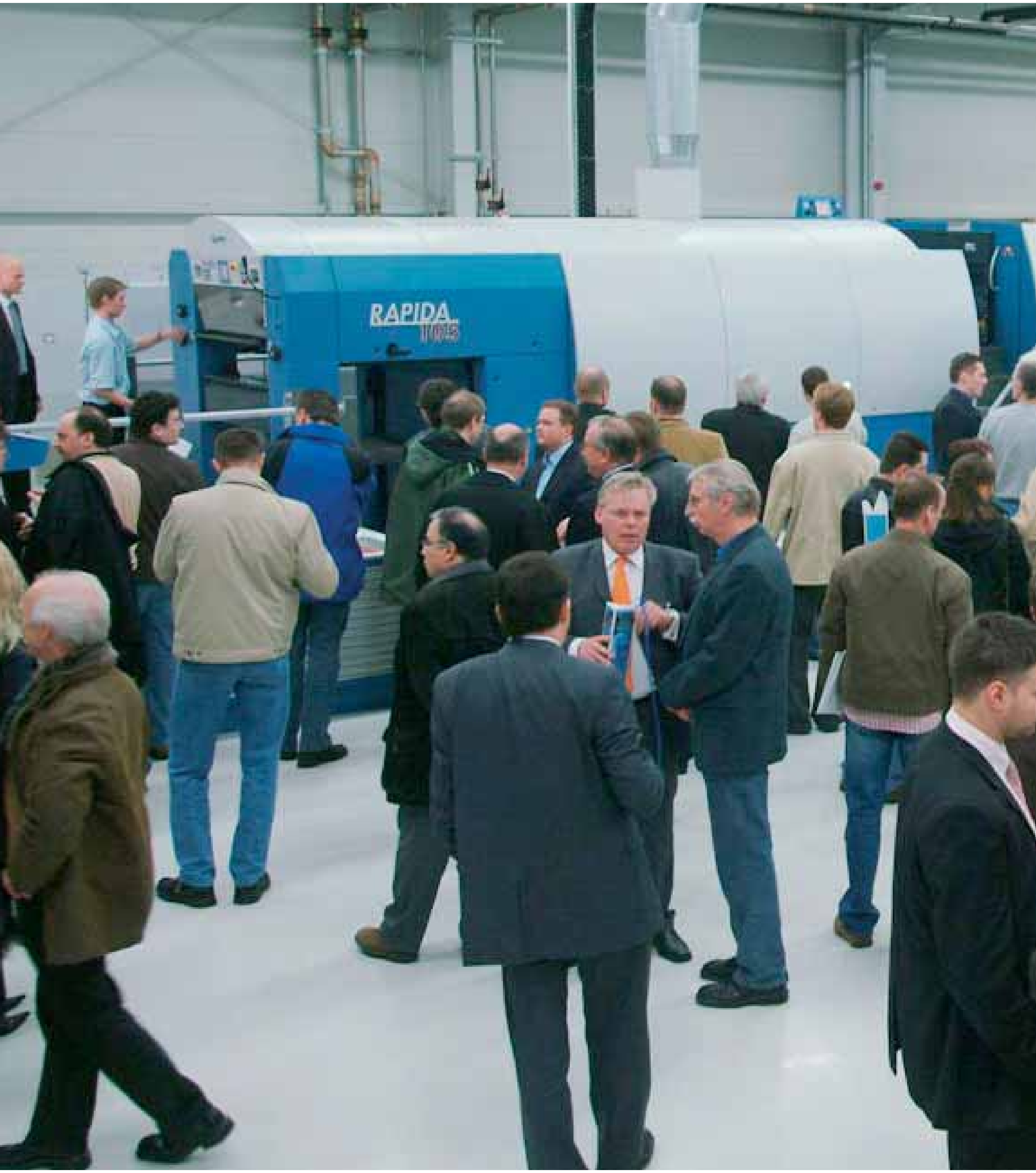
Many financial institutes have monitored Group progress for some years now and regularly publish appraisals of Group performance. In 2006 their assessments were once again largely positive and most analysts recommended buying or holding KBA shares, which are listed as a prime standard in the small-caps index.

Ongoing contact with investors

The annual shareholders' meeting in June 2006 was broadcast live on the internet up until the general debate, and 56.3% of Parent equity was represented. We also promoted the KBA Group at international investor conferences. The annual analysts' conference, which took place at the end of March at the Stuttgarter Zeitung, was equally well attended. The venue afforded participants and members of the business and trade press a chance to tour one of the most advanced printing plants in Europe, where a KBA Commander web press takes pride of place. Numerous individual interviews throughout the year with institutional and private investors, analysts and business journalists from home and abroad gave us the opportunity to elucidate Group objectives and strategies, and discuss current issues relating to the market environment in which KBA operates. Tours of our factories proved a popular option, since they underscored KBA's solid standing and enduring qualities.

Key data on Koenig & Bauer ordinary shares

	2005	**2006**
Earnings per share	€ 1.14	€ 2.11
Price-earnings ratio	21.2	14.0
Highest price	€ 25.58	€ 30.93
Lowest price	€ 15.85	€ 21.47
Closing price	€ 24.20	€ 29.64
Market capitalisation in €m	393.6	483.3
Cash flow per share	€ 10.73	€ 5.52
Dividend	€ 0.40	€ 0.50
Free float	58.4 %	58.4 %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Management Report

Share Capital, Executive Bodies and Approved Capital Initiatives

The Parent Company's share capital on 31 December 2006 was worth €42,391,440, divided among 16,304,400 bearer shares. Every no-par share conveys a voting right. The management board knows of no restrictions on voting rights, the transfer of shares or special powers. 10.29% of all voting rights are held by K&B-Holding GmbH in Würzburg, no other capital shareholding exceeds 10%.

Members of the management boards are appointed and dismissed, and amendments made to the articles of association, in accordance with statutory regulations (sections 84, 85 and 179 AktG). The supervisory board is authorised to update the articles of association subsequent to resolutions passed by the AGM relating specifically to the utilisation of the approved capital.

In accordance with the compensation system currently in force, all the members of the Koenig & Bauer management board draw a basic salary plus a bonus calculated solely on annual profit. Supervisory board remuneration is laid down in section 11 of the articles of association, which specifies a fixed lump-sum payment of €100,000 per year. Following the conclusion of the AGM, at which the utilisation of retained earnings is determined, the supervisory board receives a variable component comprising 5% of the dividend sum less 4% of equity capital. Share options and other share-based benefits form no part of board remuneration.

Approved capital used for employee shares

The shareholders' meeting on 22 June voted to raise the volume of approved capital, with the option of cancelling pre-emption rights on issues of new shares. Instances of pre-emption rights being cancelled on issues of new shares, for example to employees, are detailed in section 4 (3) of the articles of association. The management board was authorised to increase share capital to a maximum of €15.6m by 21 June 2011 through the issue of 6,000,000 new, no-par bearer shares either as a single offering or in several tranches. Of these new shares, up to 625,000 can be issued to employees. The management board will determine the conditions pertaining to the share issue pending the approval of the supervisory board. For the fifth year in succession Koenig & Bauer employees were given the option of acquiring 15 or 20 company shares at a preferential price of €21.95. 35% took advantage of this offer and on 11 October 39,640 employee shares were issued. At the end of the year approved capital amounted to €15,496,936 or 5,960,360 no-par shares. Since 2002 our employees have purchased 304,400 company shares, or 1.9% of our subscribed capital.

Preparations for a share buyback

Everything under control: the main workstation for operators of highly automated web presses is the console in the soundproofed control room

The AGM also authorised a share buyback not exceeding 10% of the equity capital of €42,288,376, with repurchasing to be completed by no later than 21 December 2007, but preferably by the end of the next AGM. No shares had been repurchased by 31 December 2006.

There are no agreements pursuant to section 315 (4) 8 and 9 HGB.

Business Environment and Activities

Strong in major core markets, successful in niche markets

Since going public in 1985 our Würzburg-based Parent, Koenig & Bauer AG, has moved up among the world's top three press manufacturers and boasts the broadest product offering in the industry, ranging from customised, multi-unit web presses for the newspaper and gravure market to batch-built sheetfed and web offset presses for printing books, packaging and commercials. KBA has established an outstanding position in virtually all high-volume markets. The biggest, taking around two-thirds of all shipments, is Europe (with Germany). This is followed by North America and Asia (including the Pacific), which each account for between 12 and 17% of output. In addition a long-term policy of organic growth and strategic acquisition has enabled us to move into lucrative niche markets with presses for banknotes and securities, metal decorating, plastic cards, data storage media and industrial coding. These now generate roughly one-quarter of Group sales and make a disproportionately substantial contribution to Group earnings.

Group statements and reports differentiate between our batch-based sheetfed division and our web and special press division, which builds large-scale mainstream and small-scale niche presses. Following double-digit growth the previous year, in 2006 both business divisions ramped up sales to contribute in roughly equal parts to a Group total that exceeded €1.7 billion for the first time in our history.

International Group Organisation and Financial Controls

Quoted enterprise with family values

Even though Koenig & Bauer went public more than twenty years ago, the company is still headed by descendants of the founders who, in 1817, established one of the first engineering production plants in Germany. Now in the sixth generation, the family retains its defining influence on our global operations, and this is evident in our long-term strategic focus, with the emphasis on healthy, sustainable growth. Alongside organic growth in what are traditionally our prime markets, such as newspaper and sheetfed offset, over the past five years we have pursued strategic acquisitions to boost earnings while at the same reducing our dependence on print markets that are more exposed to volatile advertising cycles and competition from new media. The acid test for all acquisitions is that they must be compatible with and signally enhance our core competence, printing technology.

We deploy financial control instruments at Group level to monitor the gross profit margin, the net operating margin, the order intake and the cash flow. A performance-related graduated bonus system based on individual targets for executives and collective targets for group workers ensures that management and staff are fully committed to achieving Group objectives.

Last year the spiralling cost of raw materials and energy, upward pressure on wages and persistent downward pressure on the prices of our products were exacerbated in dollar-denominated markets by the strength of the euro. Process enhancement throughout the entire value-added chain, from order reception to shipping and installation, thus remained an ongoing priority, as did an organisational realignment to address more sophisticated market demands.

Integrated logistics: automating substrate logistics for high-tech sheetfed presses delivers enormous efficiency gains when printing packaging


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Following changes on the management board, web press sales activities in Würzburg and Frankenthal were restructured, the newspaper and commercial web offset units merged and staff regrouped into four regional sales teams. A new subsidiary was set up in Poland with a view to expanding our share of the market there. Collaboration by sales, project management, development and production staff was intensified and interdepartmental committees established to align product development more closely with market demand and eliminate cost overruns by adopting target costing.

Investment activities in 2006 revolved around boosting productivity and expanding distributed manufacturing. In view of the volatility of the printing press market we have sought to reduce costs and improve plant utilisation in the production division by outsourcing non-core activities. These include the manufacture of parts that are not assigned to a specific press.

The KBA Group's corporate culture and image are summarised in guiding principles formulated in 1994 and founded on customer satisfaction, staff skills, motivation, creativity and innovation, product quality and a commitment to personnel welfare and the environment. In keeping with this philosophy we have achieved ISO 9001 quality management accreditation, are heavily engaged in in-house environmental stewardship and work safety, and offer a range of staff incentives that include basic and further training, employee shares and a company suggestion scheme. In addition our various facilities have a long tradition of promoting regional culture and economies.

For an industrial enterprise of this magnitude sickness levels are exceptionally low, while a staff churn rate of just 3% and an unusually large number of long-service employees at the Parent in 2006 (113 with 25 years of service, 68 with 40 years and 4 with 50 years) are evidence of the staff loyalty and motivation that we consider such a valuable asset in the global market environment. Conservation has historically ranked high in our corporate policy and internal processes. One example of our engagement is waterless offset technology, which we have actively advanced for many years now.

Global operations

Successful subsidiaries

Koenig & Bauer has been an international player ever since it was founded in 1817. In recent years we have steadily increased our tally of sales and service subsidiaries in Europe and overseas. At present KBA has foreign subsidiaries in eighteen countries (*see Notes, page 77*). In conjunction with our authorised agencies, many of which would also be eligible for long-service medals, they provide us with a presence in virtually every major printing press market throughout the world.

KBA presses are manufactured almost entirely in Europe, where we have eight factories – six in Germany and one each in Austria and the Czech Republic. The number of components purchased from non-European suppliers is relatively small.

A shift in market demand will result in the closure this summer of our US manufacturing and assembly plant KBA North America Inc., Web Press Division, in York, Pennsylvania, which was acquired in 1991 as Motter Printing Press Company. Sales, service and spare-parts activities were relocated at the turn of the year to KBA North America's rapidly expanding sheetfed division in Williston, Vermont. Just 50 employees remained at the York operation to complete existing contracts that brought its sales to $13.4m. Provision was made for restructuring expenses relating to the relocation.

In future KBA North America will serve the sheetfed and web press market from its headquarters in Vermont, which has approximately 170 staff. Regional branch offices and a new spare-parts and service centre near Dallas/Fort Worth airport will ensure the necessary customer proximity. In 2006 KBA North America ramped up sheetfed sales by 27% to over $200m.

A large backlog of orders for security presses and another big increase in work for our sheetfed facility in Radebeul kept production humming at our Austrian subsidiary KBA-Mödling. Sales climbed by almost 15%. The payroll swelled by 30 to 806.

In the twelve months following its acquisition by Koenig & Bauer our Czech subsidiary, KBA-Grafitec in Dobruška, posted a double-digit jump in sales of small-format Performa presses to €36.7m and expanded the payroll by 48 to 476.

Sales and earnings also improved at KBA-Metronic, one of the subsidiaries integrated in our web and special press division. Based in Veitshöchheim, not far from our Würzburg headquarters, KBA-Metronic is a niche manufacturer of ink-jet, laser and hot-stamp coding systems as well as UV offset presses for printing electronic data storage media, smart cards and plastic film. While sales climbed 19% to €43.6m, the number of employees rose by just 9 to 291.

Our Dutch subsidiary Holland Graphic Occasions (HGO) in Wieringerwerf, which addresses the market for second-hand printing equipment, underwent an extensive overhaul in 2006 following a loss the previous year, and pared its workforce from 31 to 21. As a result it moved back into the black with sales of €22.7m, up from €18.8m in 2005.

KBA-GIORI achieved a sizeable boost in sales of banknote and security presses and once again made a signal contribution to Group earnings.

KBA MetalPrint: global market leader in metal-decorating presses

The acquisition by our subsidiary Bauer + Kunzi of Stuttgart-based LTG Print Systems Holding and LTG-Mailänder in summer last year led to the creation of KBA-MetalPrint, the global market leader in metal-decorating presses. Bauer + Kunzi now functions as a holding company for KBA-MetalPrint, to which it has transferred all business operations. Following its consolidation in our sheetfed division on 1 July 2006, KBA-MetalPrint posted an operating profit on sales of €39.6m in the second half-year. In addition Bauer + Kunzi reported final sales of €22m.

Production and Organisation

Cost reduction an ongoing task

In a fiercely competitive environment our prime objective in 2006 was to enhance our core competence and optimise the complex processes involved in press engineering and construction, from the initial offer to after-sales service. The main focus at our German production plants was on manufacturing and assembly. In view of the high level of capacity utilisation we continued to expand the distributed manufacturing system we had introduced for core components, outsourcing parts that were not specific to any one press. The foundry and standalone islands for large components and cylinders in Würzburg, for example, gradually took over manufacturing tasks for our sheetfed facility in Radebeul. This allowed us to utilise capital-intensive machining centres more efficiently by operating them in multiple shifts.

New production hall for major components in Würzburg

The erection of a new production hall some 220m long by 16m high at our Würzburg facility demanded a lot of forethought and meticulous planning, not least because the new building was erected around the old one while this was still in use, with no break in production. The completion of the new hall in the fourth quarter substantially improved working conditions, not only because it has a much bigger crane capacity but also because it houses new heavy-duty milling machines and streamlines the logistics flow.

Reorganisation in Frankenthal and Radebeul

The restructuring measures implemented in the production department at our Frankenthal facility over the past few years finally began to bear fruit. A new pre-assembly centre was set up and other measures taken to optimise the factory layout. Manufacturing, storage and assembly space for the Group-wide roller-manufacturing island was expanded to accommodate the ever-increasing quantities of rollers that must be made. Following extensive investment in new buildings at our Radebeul facility in recent years no major new additions were scheduled in 2006. However, productivity gains were delivered by a number of internal changes, among them the reorganisation of ink-trough assembly.

Information technology upgrade

For a globally active press manufacturer, information technology is vital both for internal processes and for external communication with suppliers, customers, fitters and project managers the world over. In 2006 our activities centred on upgrading various applications for job scheduling, production monitoring and materials management and on creating a service-oriented architecture. New software was developed for quotation and order-handling systems to promote a trouble-free provision of spare parts to our customers. A new NC programming system was introduced in the manufacturing division, the installation of virtualisation technology in the data processing department continued apace and the existing telecommunications systems at the individual facilities were replaced by VOIP.

Above:
In 2006 a new large-parts production hall was built at our Würzburg facility

Below:
The reorganisation of ink-duct assembly at our Radebeul plant dramatically improved productivity


KBA KOENIG & BAUER AG

Research and Development

No innovation slowdown between Drupas

Even though 2006 marked the mid-way point in the four-year cycle of Drupa international trade fairs, the traditional venue for launching new products, R&D activity at KBA was as vigorous as ever and with new customer-specific developments consumed around 6% of turnover. More than 800 of the Group's 8,300 employees are engaged in research and development work of some kind.

The successful start-up at the Badische Zeitung, Freiburg, in early February of a KBA Cortina, our compact waterless newspaper press that is unique in the global marketplace, represented a landmark in the seven-year development process. There were further installations of high-automation Cortina presses in Belgium, the Netherlands, Germany and Switzerland. One of them was the first press worldwide with the ability to print coldset newspapers on simple newsprint alongside high-quality heatset supplements and semi-commercials on coated stock, with no change of ink. None of the conventional newspaper presses on the market can match this versatility and the sales potential it offers publishers.

At the end of the year we successfully tested a Cortina printing unit that is a full six plates wide. This could deliver enormous cost savings to newspaper publishers with the appropriate product structure. At the IfraExpo newspaper trade fair in October we unveiled a second compact model, the Commander CT, which incorporates many of the Cortina's unique features but is equipped with conventional inking units and dampeners and thus targets the more conservative members of the newspaper industry. Other new advances included optimised remote maintenance via the internet and a camera-based ID system for plates.

One example of technology transfer from a traditional KBA market to a high-potential niche market is our new TR5D decorative gravure printing press, the first units of which were delivered to a customer in North Rhine-Westphalia. Converting a standard publication gravure press presented something of a challenge to our R&D engineers in Frankenthal because decorative presses operate with water-based inks and gas-fired dryers, so extensive modifications had to be made. The new press, which is primarily used to print decorative patterns for furniture and flooring manufacturers, redefines the productivity and quality benchmarks in a market that is totally new for KBA.

Sheetfed development activities at our Radebeul facility and our Czech subsidiary KBA-Grafitec basically focused on upgrades of the new-generation presses launched at Drupa 2004. Our superlarge-format Rapida 205, for example, which is mainly used to print posters and point-of-sale displays, was modified to print folding cartons. Preparations were made to convert the operating systems for our other large-format presses from OS2 to Windows. Medium-format presses with new features based on gearless direct drives – a technology that KBA has been pioneering for some years – advanced to the beta testing stage. New identification systems were developed for our QualiTronic inline sheet-inspection system along with a new inline cold-foil stamping module for our Rapida presses.

Yet another high-growth niche: KBA moved into the decorative printing market with a new gravure press, the TR5D

One of KBA-Grafitec's new developments was an automatic perfecting unit for the Performa 74. Parallel to this the R&D teams at all our sheetfed and web press plants started working on new products for launching at Drupa 2008.

Market and Industry Environment 2006

A good year for the engineering industry

Although the US economy weakened in the second half-year, the global economy grew by around 5% on the back of bullish demand in eastern Europe, China, India and many markets in the Middle and Far East. Following years of stagnation the German economy finally picked up pace again, with a 2.7% increase in gross domestic product. One of the chief beneficiaries was the export-intensive engineering industry, which boosted output and sales by 7.4% to record its fourth successive year of growth. But more dynamic activity led to capacity bottlenecks, a shortage of skilled personnel and difficulties in obtaining steel and other raw materials, which hit the different sectors to varying degrees.

Patchy growth in the industry

While the influx of new orders swelled – in some cases by double digits – at 31 of the 41 branches of the engineering industry for which the German Machinery and Plant Manufacturers' Association (VDMA) issues statistics, printing and papermaking were among the ten occupations that saw a decline in new contracts compared to the previous year's high volume. The printing press sector's formidable export level (even for an engineering enterprise) of around 80% makes it more dependent than other branches on demand from countries outside the EU. So when business is brisk in Germany and the rest of Europe, softer demand in major overseas markets will have a disproportionately bigger impact. The VDMA calculated that the volume of new orders received by press manufacturers in 2006 was 7% lower than in 2005. Corporate figures published to date reveal a similar picture. While most manufacturers' production plants were busy, bookings for new machines were slower than in 2005, especially in the fourth quarter.

Order intake falls short of prior-year record

2006 brought big fluctuations in the volume of new orders both for the web presses built in Würzburg and Frankenthal, whose sales tend to be dominated by a few major contracts, and for the sheetfed presses built in Radebeul, where serial production and numerous smaller contracts are the norm. In general, business in the niche markets served by our subsidiaries was better than expected.

The Group order intake for the first six months stood at €719.3m, 16.4% down on the previous year which had seen a record inflow following the launch of new products. In the third quarter the shortfall was almost completely made good by a higher volume of bookings than for any three-month period in Group history. But with price competition among vendors in the web press market sharpened by a slump in demand, the influx of new orders in the fourth quarter slowed perceptibly.

As a result the value of orders received by the end of the year was 6.7% lower, at €1,649.7m, than the outstanding figure of €1,768.9m for 2005. While incoming orders for sheetfed presses lifted 4.2% to €864.3m (2005: €829.5m), largely as a result of the consolidation in the second half-year of our subsidiary KBA-MetalPrint, bookings for web and special presses declined 16.4% to €785.4m (2005: €939.4m). Apart from the dearth of contracts up for tender in the newspaper press market this drop was caused by softer sales of gravure presses following heavy investment in recent years.

Smaller backlog of orders for web presses

A 7.5% increase in sales to €1,741.9m helped trim the order level to €948.7m by the end of the year (2005: €1,040.9m). The backlog of unfilled orders for sheetfed presses, which have a relative short delivery time-frame, fell 2% to €305.4m, while the volume of orders on hand for web and special presses shrank 11.8% to €643.3m.

Group business operations: order intake / sales / order backlog

in €m	2005	**2006**
Order intake	1,768.9	1,649.7
sheetfed offset presses	829.5	864.3
web and special presses	939.4	785.4
Sales	1,621.0	1,741.9
sheetfed offset presses	817.6	870.6
web and special presses	803.4	871.3
Order backlog	1,040.9	948.7
sheetfed offset presses	311.7	305.4
web and special presses	729.2	643.3

Earnings, Finances and Assets

Earnings

Good result, could be better

Firmer sales, a higher level of plant utilisation and a more profitable product mix boosted pre-tax earnings to €47.4m from just €25.8m a year earlier. While the successful restructuring and cost-cutting initiatives implemented by our web press division played a role, they were partially offset by price erosion in our core markets, a hike in the cost of raw materials and a wages settlement negotiated by the unions.

Sales up in both divisions

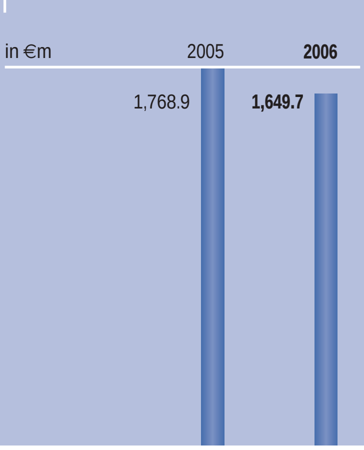
After outperforming the industry average in 2005 with a 13.9% leap in Group sales to €1,621m, last year we posted a 7.5% increase to €1,741.9m, the highest figure in our 189-year history.

Sheetfed sales climb by 6.5%

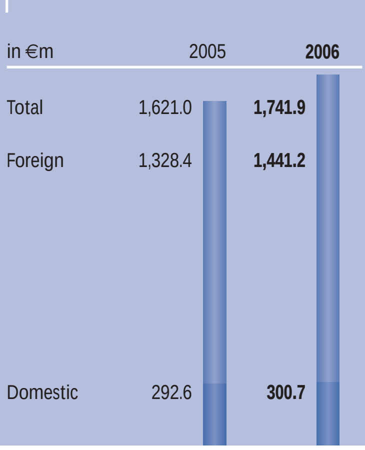
Our sheetfed division posted sales worth €870.6m, roughly half the Group total. This was a gain of 6.5% over the previous year's €817.6m. Our best-selling model, the new-generation Rapida 105 launched in 2004, is now in operation the world over printing substrates ranging from paper, cardboard and corrugated board to plastics and synthetic film, in configurations of up to fifteen units complete with inline coating and drying. It has enabled us to grow market share and consolidate our standing as one of the world's topmost manufacturers of medium-format presses. We also defended our number one slot in large format with a higher volume of sales. Europe and North America have historically accounted for the bulk of all large-format sheetfed shipments, but demand is steadily mounting in the Far East, particularly mainland China and Hong Kong. A substantial rise in sales of Performa presses strengthened our position in the small-format sector. Our share of

Print retains its appeal: even in the age of the internet there is still a demand for well designed printed products, as evidenced by countless poster hunters at graphic trade fairs like this one in Canada

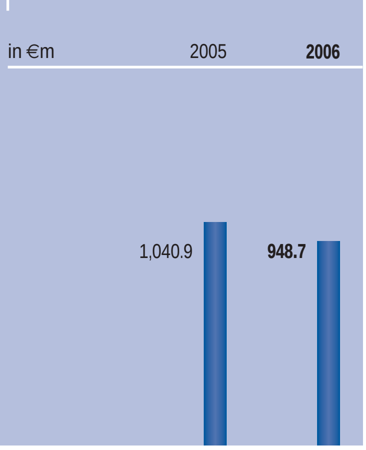
Group orders



Group sales



Group backlog



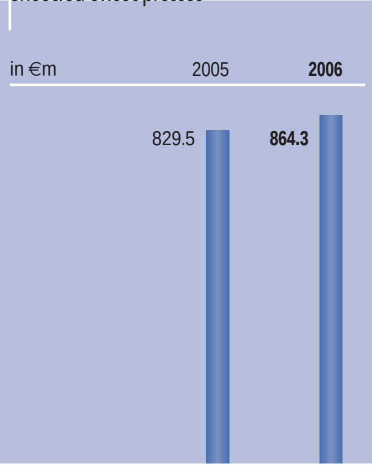

XEROX
XEROX.
700
800
KBA
Size Matters
DIGITAL WOW!
DIGITAL SPARK
Print Software Theatre
KBA

the global sheetfed press market remained steady at around 15%. The acquisition by our subsidiary Bauer + Kunzi of Stuttgart-based rival LTG-Mailänder, and the subsequent merger of their activities in KBA-MetalPrint, adds punch to our presence in the metal-decorating sector.

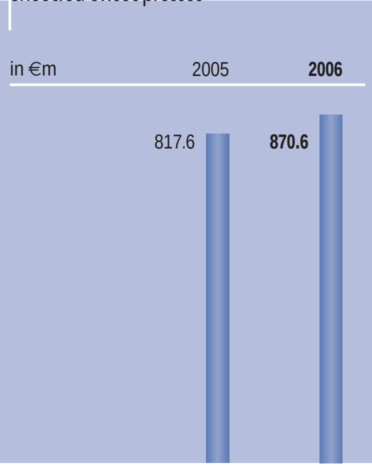
Above-average growth in sales of web and special presses

Our web and special press division bolstered sales to €871.3m, 8.5% above the prior-year figure of €803.4m. Shipments of newspaper presses included the first big Colora installation and single-width Comet for Australia. These two popular models also shipped to printers in Germany, Spain, the USA and China. Double- and triple-width versions of our flagship, the Commander, were put into operation at German, French, Italian, Spanish, UK and US newspaper printing houses. One of them, the Kansas City Star, now houses the biggest KBA press line to date in North America. Softer sales of publication rotogravure presses than in the previous year were more than balanced by a double-digit jump in sales

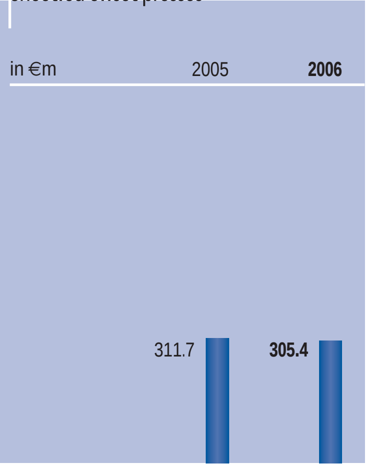
Order intake
Sheetfed offset presses



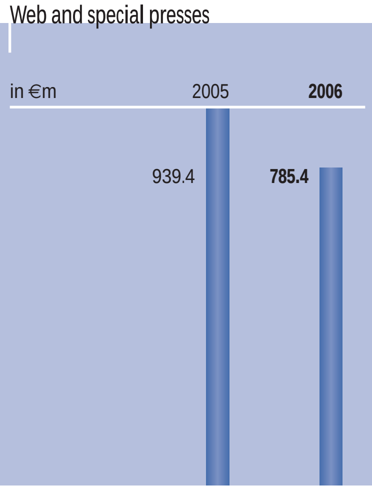
Sales
Sheetfed offset presses



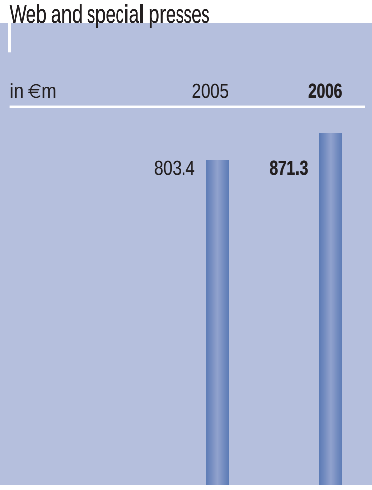
Order backlog
Sheetfed offset presses



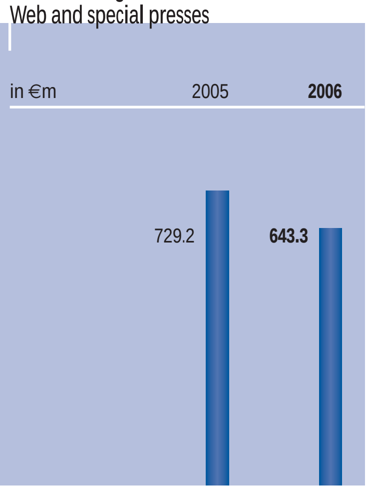
Order intake
Web and special presses



Sales
Web and special presses



Order backlog
Web and special presses



of commercial presses, among them the first 72-page press lines for Austria, Slovakia, Italy, England and Spain. Our share of new international contracts for newspaper presses was around 30% and for commercial presses approximately 10%. The KBA subsidiaries that specialise in niche applications – security and UV printing, ink-jet coding systems – also made a solid contribution to Group sales.

Europe takes two-thirds of all shipments

Once again, the rest of Europe was our biggest market, generating €858.4m or 49.3% of Group sales, an improvement of 19.4% over 2005 (€718.8m, 44.3%). Sales in Germany came to €300.7m, up from €292.6m the previous year. The export level rose to 82.7% from 81.9% in 2005.

Asia and the Pacific well ahead of North America

Asia and the Pacific moved up into third place in the regional sales statistics, with brisker sales of sheetfed presses and some major contracts for web presses helping to boost the volume by 14% to €286.2, or 16.4% of the Group total (2005: €251.1m and 15.5%). The suspension by the Chinese authorities of customs exemption for high-performance printing presses in May 2006 put a temporary brake on incoming orders, but import restrictions are expected to be eased in spring this year.

Although sheetfed business thrived, a drop in shipments of web presses meant that the USA and Canada generated just 12% of Group sales, or €209.9m (2005:15.9% and €258.4m), well below the median trend. Installations in what continues to be a prime KBA market included the world's longest litho press, a superlarge-format Rapida 205 at National Posters in Tennessee. Rapida 105 press lines and the Genius 52UV built by KBA-Metronic are also becoming more popular in the USA.

Sales in Africa and Latin America below prior-year level

Press sales in Africa and Latin America, where volumes are generally lower, totalled €86.7m (2005: €100.1m). However, there was a welcome burgeoning of demand for sheetfed presses in Egypt and other North African markets, and a further 48-page commercial press was shipped to an existing customer in Sao Paulo, Brazil.

Geographical breakdown of sales

in %	2005	**2006**
Africa/Latin America	6.2	5.0
Asia/Pacific	15.5	16.4
North America	15.9	12.0
Rest of Europe	44.3	49.3
Germany	18.1	17.3

Rising commodity prices and wages weigh on costs of conversion

In 2006 the cost of sales came to €1,324.7m (2005: €1,239m), or 76% of total sales (2005: 76.4%). To counteract spiralling prices for steel and semi-finished castings we carried out value analyses, made technical modifications and pared material costs in areas less dependent on raw materials.

Containing material costs on a long-term basis remains a fundamental objective of our purchasing strategy. Group-wide procurement, global sourcing, electronic order handling and tracking, and the expansion of our distributed purchasing systems for consumable parts and auxiliaries play a crucial role. Long-term planning and bigger inventories at suppliers give us greater flexibility in securing a steady and timely supply of resources, even critical raw materials and parts.

Leaner structures and workflows were also instrumental in trimming manufacturing costs. However, labour costs were inflated by a pay deal negotiated in spring last year for employees in the metalworking and electrical industries, as a result of which wages and salaries for a large proportion of Group employees in Germany rose by 3% on 1 June 2006, following a lump-sum payment for the months March to May.

Gross profit increased to €417.2m, the gross profit margin to 24% (2005: €382m and 23.6%).

Other income and expenses

Research and development costs, excluding new customer-specific products and advances, came to €63.6m, €8.4m above the prior-year figure of €55.2m. A drop in commission payments helped whittle distribution costs down from €175m in 2005 to €170m. But the consolidation of KBA-MetalPrint pushed general administrative expenses up to €95.7m (2005: €89.6m). Lower earnings from property sales and higher provisions for receivables caused other operating expenses to outstrip other operating income by €41.7m (2005: €28.9m shortfall).

Group income statement

as % of sales	2005	**2006**
Cost of sales	–76.4	–76.0
Research and development costs	–3.4	–3.7
Distribution costs	–10.8	–9.7
Administrative expenses	–5.5	–5.5
Other income/expenses	–1.8	–2.4
Financial result	–0.5	0.1
Income taxes	–0.5	–0.8
Net profit	1.1	2.0

Big improvement in operating profit

Depreciation stood at €41.9m, or 2.4% (2005: 2.5%) of sales. Earnings before interest, tax, depreciation and amortisation (EBITDA) climbed to €88.4m and 5.1%, from €72.8m and 4.5% the previous year. Operating profit jumped from €33.3m in 2005 to €46.2m.

While sheetfed earnings, at €5m, were higher than twelve months earlier (€2.7m), they failed to meet management objectives. This was because the raft of cost-cutting and productivity-enhancing initiatives we implemented was largely outweighed by pervasive downward pressure on prices in our markets coupled with the substantial cost of decreasing our inventory of second-hand equipment and refining new high-tech products. Once again web and special presses made the bigger contribution to Group profit with earnings of €41.2m (2005: €30.6m).

2.7% pre-tax profit margin

A financial loss of €7.5m in 2005 was transformed into a modest profit of €1.2m. A steady supply of liquid assets allowed us to raise interest income on current investment and customer financing from €7.7m to €13.3m and shave interest expense from €14.2m to €12.4m. Pre-tax earnings (EBT) improved accordingly to €47.4m or 2.7% of sales (2005: €25.8m and 1.6%).

Group tax rate below 30%

Taxes on income and earnings, including deferred taxes, jumped from €7.3m to €13.1m. This is equivalent to an effective tax rate of 27.6%, compared to 28.3% in 2005. The effective Group tax rate is determined by the tax rate in Germany (nominally 39%) and by foreign tax rates for subsidiaries abroad, which are generally lower.

Net profit of €34.3m

We posted a net Group profit after tax of €34.3m (2005: €18.5m) and earnings per share of €2.11 (2005: €1.14).

Finances

Solid financial base

One of our prime objectives is to safeguard our corporate independence and financial flexibility by maintaining a solid capital base. Active receivables management, external customer financing and internal initiatives to reduce the volume of tied capital thus rank among our top priorities, and in 2006 these generated a cash flow from which we were able to finance all investment. A further objective is to raise our capital-to-assets ratio in keeping with our value-oriented financial management policy. To minimise currency risks, most foreign currency transactions are hedged (*see risk management report on page 45*).

Cash flow down on previous year

Cash inflows from operating activities amounted to €90m (2005: €174.6m). While profits were higher and trade receivables €65.8m lower, at €399.8m (2005: €465.6m), the processing of various major projects trimmed customer prepayments from €294.2m to €274m. Bigger inventories and a substantial drop in other financial payables reduced cash flows from operating activities. Cash outflows from investing activities climbed to €52.2m from €27.4m in 2005, primarily due to payments for new production equipment. In consequence the free cash flow ebbed to €37.8m from a record €147.2m the year before. Cash outflows from financing activities, which included the payment of dividends, came to €12.6m (2005: €64m).

By the end of the year funds had swelled to €154m (2005: €129m).

Sound capital structure and resources

Shareholders' equity increased to €476.3m (2005: €448m), the return on equity – measured against the marginally lower balance sheet total – eased up to 34.2% from the prior year's 32.1%. This was largely due to an annual surplus and the issue of employee shares. Our income-to-equity ratio improved to 7.2% from 4.1% the year before.

Current and non-current liabilities sank from €947.1m to €917.9m. While other financial payables fell, trade payables rose from €95.7m to €104.3m, primarily due to the consolidation of KBA-MetalPrint.

Heading the financial payables were bank loans to the sum of €78.8m, virtually on a par with the prior-year figure of €78.7m (*for further details see page 84*). Our net financial position strengthened from €50.3m to €75.2m, our debt-to-equity ratio dropped from 211.4% to 192.7%. Lines of credit not drawn down at the balance sheet date came to €182.8m (2005: €153.2m).

Current and non-current liabilities include a €49.8m jump in provisions from €254.4m to €304.2 m, basically due to an increase in pension provisions (€99.3m compared to €92.1m in 2005), obligations to employees and warranty claims.

Assets

Solid substance

The Group balance sheet total of €1,394.2m at year's end approached the 2005 figure of €1,395.1m.

Productivity-boosting investment

Non-current assets were valued at €384.3m (2005: €366.4m), with intangible assets accounting for €35.1m and tangible assets for €258m. The ratio of equity capital to fixed assets was thus 184.6%.

In 2006 we invested €1.8m (2005: €2.3m) in intangible assets and €52.5m (2005: €37.2m) in property, plant and equipment, with the aim of boosting productivity and product quality and expanding our manufacturing and assembly capacity. The two biggest items were a new production hall in Würzburg and a new security-press assembly hall inaugurated by our Austrian subsidiary, KBA-Mödling, in mid-September.

Investment in new machining centres at our German, Austrian and Czech factories included a large-parts measuring machine in Würzburg complete with a feed system and climate-controlled measuring room. New systems for manufacturing nylon-coated and draw rollers for the entire Group were two of the items installed in Frankenthal. At our Radebeul facility, the restructuring of the ink-duct assembly line radically reduced assembly times and inventories, while new assembly workplaces with an integrated testing field allowed us to ramp up production of our own brand of dryers for Rapida sheetfed presses, in collaboration with suppliers.

Strong balance sheet

Despite a €145.8m (2005: €116m) increase in cash and cash equivalents, current assets fell to €1,007.2m (2005: €1,028.7m). As sales climbed, active receivables management enabled us to reduce trade receivables by €65.8m to €399.8m (2005: €465.6m). Inventories swelled from €368.5m to €377.6m in preparation for a larger volume of shipments. Working capital rose from €473.9m in 2005 to €516.7m.

Group assets and capital structure

Assets in %	2005	**2006**
Non-current assets	26.3	**27.6**
Current assets less funds (including assets held for sale)	64.5	**61.4**
Funds	9.2	**11.0**

Equity and liabilities in %	2005	**2006**
Equity	32.1	**34.2**
Non-current liabilities	18.1	**18.9**
Current liabilities	49.8	**46.9**

Summary of Earnings, Finances and Assets

In 2006 KBA drove up pre-tax earnings from €25.8m to €47.4m. But the profit margin of 2.7% was well below our Group target of 5%. This is because price erosion in key markets wiped out most of the benefits accruing from the cost-cutting and efficiency-enhancing initiatives implemented at our sheetfed facility. Earnings were further impaired by the weakness of the US dollar and Japanese yen relative to the euro, which gave our foreign competitors a price advantage. Other factors impacting on the bottom line were price hikes in commodities markets and an increase in union wage rates at our German facilities. But once again we were able to finance investment from a strong cash flow. Our sound capital structure was further strengthened by a higher capital-to-assets ratio. In the long term, continued investment in innovative products, automated manufacturing technology and high-potential niche markets will help us defend the Group's standing as a leading supplier to the print media industry. In 2006 we made good progress in expanding our Group-wide distributed manufacturing system, streamlining processes and enhancing product quality. With working capital much improved and a healthy cash balance, KBA is operating from a position of financial strength.

Supplementary Statement

No events detrimental to Group earnings, finances or assets occurred after the balance sheet date.

Risk Management

Meticulous monitoring

The purpose of the Group monitoring system is to detect potential risks arising from entrepreneurial activities so that preventive action can be taken. Prudent risk management enables the Group to boost shareholder value by exploiting potential rewards.

Risks to the Group are systematically documented, assessed and reported in accordance with uniform, Group-wide procedures. Risks relating to our subsidiaries are monitored by comparing their performance reports with the targets they have been set. Management can thus identify incipient risks to our earnings, finances and assets and institute countermeasures.

The management and supervisory boards are notified of all developments and instantly alerted to any unforeseen changes in our risk exposure. The basic indicators and tools employed in risk management are determined by the board, while the risk management unit monitors the various checks and controls, and provides a systematic overview of the Group's risk status. This early warning system is monitored annually by the auditors and the supervisory board's audit committee.

Economic and industry-related risks

A major asset in the media mix: despite fierce competition from digital media, newspapers are still the prime information and advertising vehicle in many countries and have seen a worldwide increase in total circulation and the number of titles

Renewed growth in the print media industry over the past three years in the wake of an economic recovery and an upturn in advertising reflects the industry's heavy exposure to the general business climate. A lift in consumption and investment automatically drives demand for modern printing technology by increasing the volume of print. Growth is particularly strong in populous threshold economies such as China or India, since the consumption of print media and printed packaging rises with the spread of prosperity. Even so, certain sectors (eg newspapers and magazines) are losing ground to digital media in industrialised countries with a high per-capita consumption of print. In many mature economies, demand for print is being undermined by negative demographic trends and by changes in the media consumption habits of younger people. At the same time print capacity has been expanded through investment in ever more powerful technology.

We address the associated risks by expanding our presence both in regional growth markets (the Middle East, Far East, eastern Europe) and in media-neutral sectors (eg packaging). In addition KBA has a longstanding policy of diversification through acquisition in lucrative, less volatile niche markets, and as a result we have expanded into security printing, metal decorating, decorative printing, UV printing on electronic data storage media, industrial coding and air purification. In traditional markets such as commercial and newspaper printing we focus on product and process innovation in order to grow market share and maintain unique advantages over existing European and non-European competitors and, in the medium term, over low-cost competitors from the Far East.

The risks to which the engineering industry is exposed include demand-driven price hikes in raw materials and energy markets, which could diminish earnings. We seek to contain such risks through strategic, Group-wide purchasing, changes in product design and diverse cost-cutting initiatives.

Market and business risks

We devote a considerable amount of energy to defending our technology lead in core product segments and to detecting and addressing incipient trends in the market and customer demands. The technological and quality risks deriving from the development of new products are contained by rigorous quality management and pre-launch trials both in-house and at customers' premises. Feedback from the individual projects benefits our products and services on an ongoing basis. The risks associated with large-scale customised press installations are monitored by the competent project management unit.

With customers demanding more flexible forms of financing, mechanisms for minimising our exposure to risk prior to the exchange of contracts are a crucial aspect of risk management. These include minimising the risks associated with repurchase obligations and agreements relating to new and second-hand equipment.

Price erosion in key print markets and price inflation in procurement markets constitute ongoing risks that we address 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 contracts. The risks concomitant with tight margins are addressed by seeking cost savings on price-sensitive products, adopting more flexible working hours, outsourcing non-core components and activities, and promoting customer loyalty through efficient after-sales services.

Financial risks

Financial risks predominantly comprise foreign currency risks, bad debt risks, liquidity risks and risks relating to cash-flow movements. The type, scope and market value of the instruments used to contain financial risks are detailed in the Notes (*pages 84-85*).

Foreign currency risks primarily relate to dollar-denominated transactions. Risks from foreign currency transactions are actively managed by our treasury unit in close collaboration with our sales teams. 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. Our portfolio contains a limited stock of dollars because these attract a higher rate of interest.

Bad-debt risks are contained by monitoring customer accounts. A deterioration in payment records has caused us to tighten internal controls relating to financing conditions and collateral. Customer creditworthiness is regularly reviewed and collateral called in prior to shipment. Provision is made for potential bad debts.

Liquidity is managed and secured at Group level by a rolling financial-planning procedure. Liquidity movements and credit lines are monitored by the Parent, incoming payments by the competent sales department. Fluctuations in cash flows are balanced with existing credit lines and sureties.

Other risks

At present we see no incalculable risks relating to IT systems, capacity or personnel planning, the environment (including natural catastrophes) or interest management. Potential risks that are hard to quantify are managed using the standard instruments available. The Group is not engaged in any litigation that would materially impair its financial position. No commodity derivatives were held on the balance sheet date. Adequate provision has been made in the accounts for all other risks. Thanks to strong Group finances and earnings, total risk exposure is moderate. We have detected no risks that could pose an existential threat.


KBA COMMANDER CT
KBA
7
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KBA

Outlook and Opportunities

2007: potential risks and rewards in fourth year of growth

In 2007, for the fourth year in succession, the global economy is projected to grow by around 5% – more than the gross domestic product in Germany, for which some authorities have projected growth rates of 2% or more. But actual growth, and thus the outlook for manufacturers of big-ticket items, depends on a number of factors: the repercussions in Germany of the VAT increase and current wage negotiations in the metalworking and other industries; the volatility of oil and gas prices due to conflicts in the Middle East; the recent weakening of the US economy; sporadic restrictions on imports imposed by fast-growing economies such as China and India; the impact of these economies on commodity prices; and movements in stock markets, which have been twitchy of late.

Another variable that affects the performance of the export-oriented German engineering industry are currency exchange rates. In 2006 the competitiveness of non-euro rivals received an additional boost from a slide in the dollar and the relative weakness of the yen and Swiss franc against the euro, further intensifying the fiercely competitive climate of recent years. So 2007 poses potential risks as well as rewards for the diverse branches of the industry, some of which have seen stronger growth than others over the past four years. The VDMA calculates an average real growth rate of 4%, following 7.4% in 2006.

Volume of print increasing, albeit with regional fluctuations

The demand for modern manufacturing technology will remain brisk in economies that are becoming more prosperous but are still less capital intensive than mature markets. Most of these growth markets are in the Middle and Far East and parts of eastern Europe. Russia, with its politically influenced print media industry, has so far failed to meet expectations. In general we can assume that, allowing for cyclical fluctuations and sectoral differences, the global print market will expand at a rate of 3 - 5% per year. Press manufacturers will reap the benefits, with prospects brightest for sectors that are not exposed to competition from digital media. These include packaging, label and security printing, metal decorating and coding – sectors in which KBA is already well positioned.

Compact is the route to take: following the successful launch of our waterless Cortina we unveiled a conventional counterpart, the high-automation Commander CT, at the IfraExpo 2006 newspaper trade fair in Amsterdam

Innovation a growth opportunity in a fiercely competitive environment

Despite the smaller number of large-scale projects currently up for tender in one of our traditional core markets, newspaper presses, there are growth opportunities in Europe, North America and other mature markets as well as in threshold economies, in the form of replacement technology for systems that are outdated or have limited colour capabilities. And alongside mergers and acquisitions the newspaper industry is pursuing new business models, for example outsourcing or merging print activities in big joint facilities. While this diminishes the potential customer base, it feeds a demand for technology that is more highly automated, productive and versatile, and for greater competence on the part of the vendor in planning, scheduling and implementing ambitious, complex projects. Herein lies considerable growth potential for European press manufacturers, with their sophisticated technology, over vendors in other parts of the world whose technology is less advanced and who compete almost solely on price.

In the sheetfed market, which accounts for two-thirds of global sales of professional printing systems, German manufacturers have successfully defended their formidable position in the world market through ceaseless technological and process innovation. One example is the integration of coating and finishing capabilities in the printing press to enhance product value or cut production costs and throughput times. KBA is a pioneer in this field.

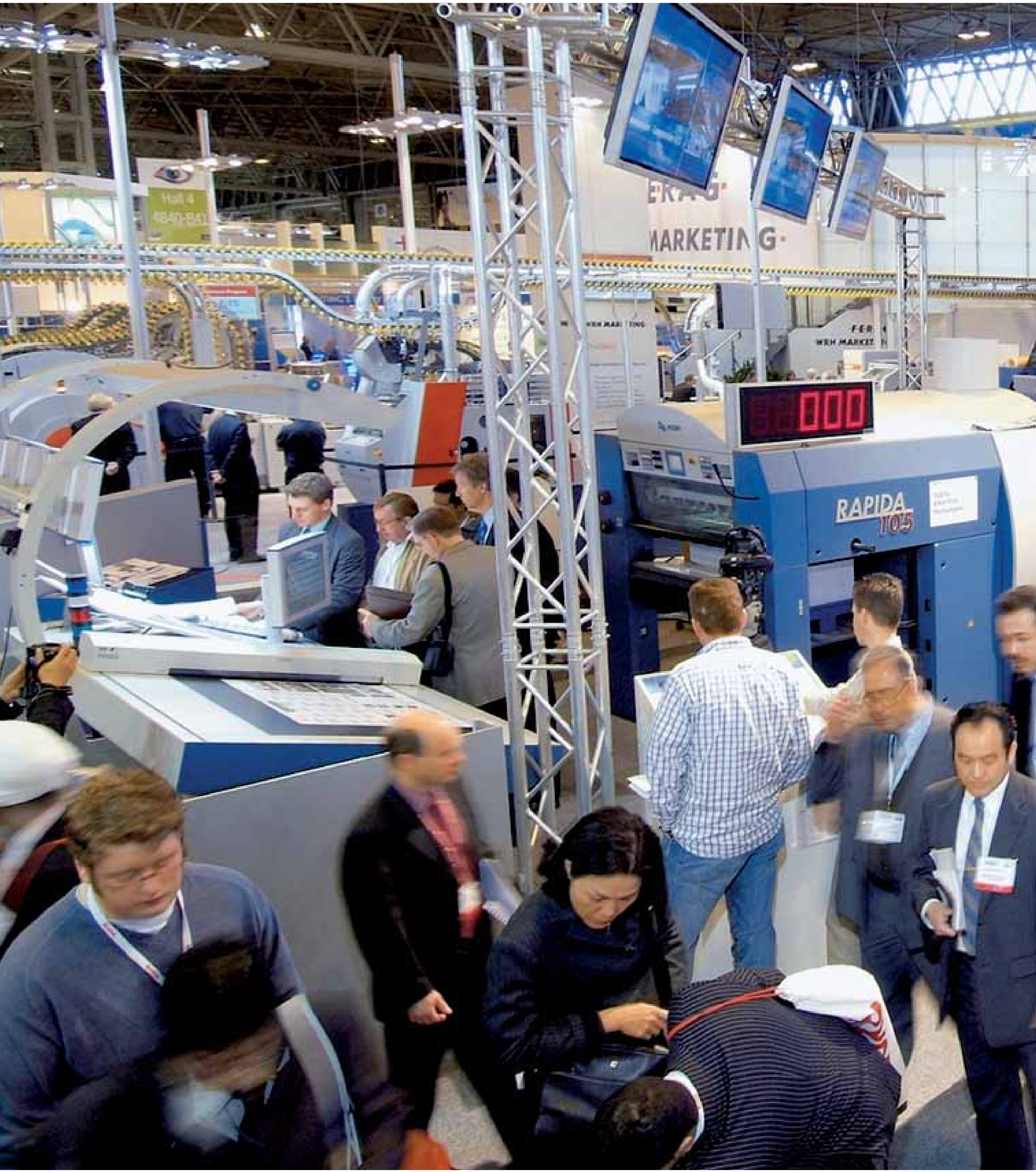
Growth impaired by lack of major contracts

The KBA Group started the new year with a smaller order backlog than twelve months earlier. The main reason for this was a slide in demand last year for multi-unit newspaper and gravure web presses in key markets such as the USA and Germany. Although contracts placed by UK, Italian, Spanish and US newspaper publishing houses in the first few months of the current year have improved the order level, lengthy turnaround times for web presses mean that plant utilisation is likely to dip in the manufacturing and assembly departments at our web press operations. In anticipation of this we downsized our temporary workforce at the turn of the year. Fluctuations in capacity utilisation are also being addressed through diverse agreements on changes in flexible working hours, the internal transfer of manufacturing tasks and the in-house production of sundry components which, for capacity reasons, were previously bought in.

We are also optimistic that the new products and processes we have developed to market maturity in recent months will enable us to increase the volume of incoming orders in the newspaper press market, where overcapacity has engendered fierce competition. These products, which incorporate some unique features, are being unveiled at customer premises in the spring.

In the sheetfed market, where lead times are much shorter, the volume of orders on hand at the beginning of the year will keep our plants in Radebeul and Dobruška (Czech Republic) busy until well into the second quarter. The order intake in the first two months was roughly on a par with the same time last year. Alongside our technologically advanced medium-format Rapida 105, which is one our best-selling models, at the Print China trade fair in April we are launching a new version of the Rapida 105 universal, modified to meet the needs of printing houses in emerging markets such as China. We are confident that this will make us more competitive in the price-sensitive market for four- or five-colour presses. Our subsidiaries, most of which address niche markets, look set to perform strongly and post a profit, which will help to offset the cyclical slide in demand for big web presses.

Even though sales of multi-unit web presses will be marginally down on the high figure for last year, we are confident that Group sales and pre-tax earnings will be roughly the same. Any changes in our cash position will largely depend on our web press business and the associated customer prepayments. If there is an increase in the proportion of new orders for batch-produced presses it will entail a higher volume of pre-financing: a scenario that the plump financial cushion we carried into the new year makes us well equipped to handle. However, in view of the unpredictability of the political and economic environment in coming months, and structural changes in the print sector, we believe 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.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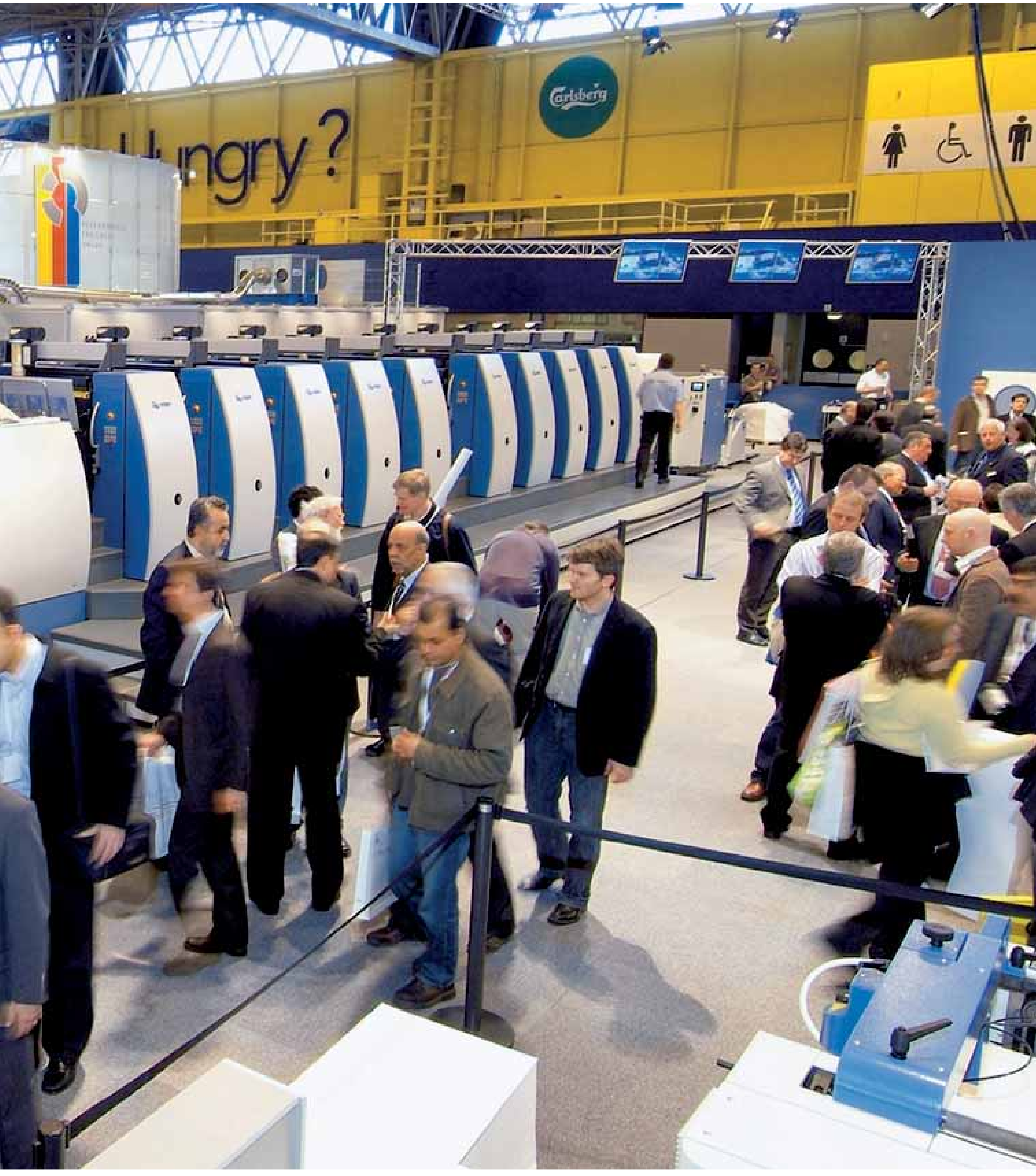
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Dieter Rampl,
Chairman,
Koenig & Bauer AG

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 it by law and the statutes. The members of the supervisory board were closely involved in all corporate decision-making processes of any import, passing the pertinent resolutions either in person at scheduled meetings or, for unscheduled issues, by written consent in lieu of a meeting.

A total of 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, acquisitions, factory locations, investment, personnel policy and the performance of major subsidiaries.

The March meeting was largely devoted to scrutinising, discussing and approving the financial statements. At the recommendation of the human resources committee, with effect from 1 May 2006 the board appointed Christoph Müller successor to Walter Schumacher as executive vice-president for web press sales. The board wishes to thank Mr Schumacher for his considerable achievements during his seven years in office. On 1 January 2007 Mr Schumacher took the helm at KBA's Sydney-based subsidiary, KBA Australasia. At committee level, discussions revolved around the acquisition by another KBA subsidiary, Bauer + Kunzi, of a rival manufacturer of metal-decorating presses, LTG-Mailänder in Stuttgart.

Current financial data and corporate strategies were reviewed at the meeting on 22 June. In September, Group performance in the first half-year and management projections for 2006 were on the agenda, as was the restructuring of KBA North America, which entailed the merger of sheetfed and web sales and service activities at the company's sheetfed facility in Williston (Vermont) and the closure of the plant in York (Pennsylvania).

The November session focused on investment plans for 2007 and on further executive changes. It was decided that on 1 August 2007 Ralf Sammeck, president and CEO of our North American subsidiary, should succeed Andreas Mössner as executive vice-president for sheetfed sales. On 1 February 2008 Mr Mössner will become managing director of KBA's Austrian subsidiary, KBA-Mödling AG. The supervisory board would like to thank Mr Sammeck and Mr Mössner for their dedication and commitment.

Between the plenary sessions it is the job of the chairman to maintain and co-ordinate the monitory and advisory functions pertaining to his position, both in meetings with the management board and in various committees. Albrecht Bolza-Schünemann provided regular updates on all significant procedures and developments within Koenig & Bauer and the Group. In addition routine transactions and emerging trends were discussed in detail.

The Koenig & Bauer supervisory board has three committees: the human resources (executive) committee, the audit committee and the mediation committee stipulated in section 27 (3) of the Law on Codetermination. The audit and human resources committees convened a number of times in 2006. The audit committee reviewed the financial statements, management reports and auditors' reports for Koenig & Bauer and for the KBA Group, 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 5 March 2007. Other topics on the agenda were the quarterly reports and the monitoring of auditor independence and efficiency. The audit committee also examined risk assessment and tracking systems. The executive committee deliberated on issues relating to personnel and corporate governance, for example the efficiency of the management and supervisory boards. The mediation committee did not convene in 2006. The supervisory board was given regular updates 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, which we found to conform as declared. The update issued on 12 June 2006 was appraised, the declaration of compliance amended and in February 2007 duly disclosed.

The financial statements, management reports and method of accounting for Koenig & Bauer and for the KBA Group to 31 December 2006 were examined by Bayerische Treuhandgesellschaft AG – the auditors appointed at the AGM – and awarded the auditor's certificate unreservedly (*see page 97*). The auditors further confirmed that the management board operates an effective risk management system compliant with statutory regulations. The statements and reports for the Parent and the Group, the auditors' reports and the proposal for the utilisation of retained earnings 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, and at its meeting on 28 March 2007 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 retained earnings.

The following changes occurred in the Koenig & Bauer supervisory board: upon the conclusion of the AGM on 22 June Dr Hans-Bernhard Bolza-Schünemann, Rupert Hatschek, Alfred Kuffler, Peter Reimpell and Werner Ring completed their terms of office and stepped down. Our thanks to them all for their longstanding commitment – in some cases spanning several decades – and for the invaluable experience and critical support with which they have enabled the Company to expand into one of the world's foremost providers to the graphic arts industry.

Our special thanks go to Peter Reimpell, who chaired the supervisory board for almost 30 years, and to Rupert Hatschek, who was a member of the board for a full 45 years and deputy chairman from 1965 to 1997.

The new members elected by the AGM on 22 June were Matthias Hatschek, Dr Hermann Jung and Baldwin Knauf. The supervisory board subsequently appointed me, Dieter Rampl, the new chairman, with Gottfried Weippert and Reinhart Siewert as deputy chairmen. The members of the various committees were also elected. Günter Hoetzl, Walther Mann and Jochen Walther had already been voted in as the new staff representatives on 30 May.

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, 28 March 2007
Koenig & Bauer AG
Supervisory Board

Dieter Rampl
Chairman

Corporate Governance Report

Commitment to the principles of the code

The aim of the German Corporate Governance Code, which came into force in 2002 and has since been amended several times, is to inspire confidence in the management and monitoring of listed companies. Koenig & Bauer has long been committed to a transparent corporate culture that engenders such confidence, and therefore implements with virtually no exceptions the recommendations and principles embedded in the Code.

Declaration of compliance

In February 2007 the Koenig & Bauer supervisory and management boards issued a current declaration of compliance pursuant to section 161 of the German Stock Corporation Act (AktG). It was published on the Group website under Investor Relations/Corporate Governance, where other information, including the articles of association, may also be found.

The recommendations of the Government Commission on the German Corporate Governance Code, as revised on 12 June 2006, were and will be observed with the following justifiable exceptions.

According to the law on the disclosure of board compensation and section 286 (5) of the German Commercial Code (HGB), the annual shareholders' meeting may resolve, by a three-quarter majority of the voting capital, to forego the disclosure of individual board members' compensation and the details required in section 314 (1) 6a articles 5 to 9 of the HGB. At the Koenig & Bauer AGM on 22 June 2006 a resolution was passed, with a majority of 86.1% of the votes cast, to the effect that the specified particulars need not be disclosed for a period of five years.

Similarly, there is no disclosure of individual board members' remuneration (provision 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 furnishes our shareholders with sufficient information for assessing the propriety of the remuneration given.

Quality is our strength: the KBA Cortina combines economic and environmental benefits with the high print quality typical of the waterless process


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Board compensation

The compensation system is detailed on page 21. Management board remuneration in 2006 is disclosed in the Notes on page 93, together with pension provisions for active and retired members of the board. Compensation for the supervisory board totalled €0.4m (2005: €0.3m), of which €0.3m was variable (2005: €0.2m).

Supervisory board elections

In accordance with section 8 (2) of the articles of association, the shareholders' meeting on 22 June elected representatives to the supervisory board for a term of office that expires with the conclusion of the 2011 AGM. The names of candidates for chairman were not disclosed to the shareholders (provision 5.4.3).

Directors' Dealings

Pursuant to section 15a of the German Securities Trading Act (WpHG), all directors' dealings in KBA shares (ISIN: DE0007193500) during the 2006 business year were published without delay on the KBA website under Investor Relations/ Directors_Dealings, but for lack of space are not disclosed individually in the Corporate Governance section (provision 6.6 of the Corporate Governance Code).

Management and supervisory board shareholdings

At the end of December 2006 members of the management board owned 5.3% of equity capital, members of the supervisory board 2.3%. The figures for individual board members (provision 6.6) have not been disclosed.

Audit agreement

In accordance with provision 7.2.3 of the Code 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.

Würzburg, 5 March 2007

For the supervisory board:
Dieter Rampl

For the management board:
Albrecht Bolza-Schünemann

Financial Statements for the KBA Group

Balance Sheet to 31 December 2006

Assets in €m	Note	31.12.2005	31.12.2006
Non-current assets			
Intangible assets	(1)	20.0	35.1
Property, plant and equipment	(1)	250.3	258.0
Investments and other financial receivables	(2)	20.9	25.5
Deferred tax assets	(6)	75.2	65.7
		366.4	**384.3**
Current assets			
Inventories	(3)	368.5	377.6
Trade receivables	(2)	465.6	399.8
Other financial receivables	(2)	26.0	17.8
Other assets	(2)	39.3	56.4
Current tax assets		0.3	1.6
Securities	(4)	13.0	8.2
Cash and cash equivalents	(5)	116.0	145.8
		1,028.7	**1,007.2**
Assets held for sale		–	**2.7**
		1,395.1	**1,394.2**

Equity and liabilities in €m	Note	31.12.2005	31.12.2006
Equity	(7)		
Share capital		42.3	42.4
Share premium		84.0	84.9
Reserves		321.7	349.0
Capital attributable to equity holders of the Parent		**448.0**	**476.3**
Liabilities			
Non-current liabilities			
Pension provisions	(8)	92.1	99.3
Other provisions	(9)	43.5	66.2
Bank loans and other financial payables	(10)	35.5	39.9
Other liabilities	(10)	18.2	0.6
Deferred tax liabilities	(6)	63.3	57.2
		252.6	**263.2**
Current liabilities			
Other provisions	(9)	118.8	138.7
Trade payables	(10)	95.7	104.3
Bank loans and other financial payables	(10)	181.1	108.9
Other liabilities	(10)	298.4	294.3
Current tax liabilities		0.5	8.5
		694.5	**654.7**
		1,395.1	**1,394.2**

Income Statement for 2006

in €m

	Note	2005	2006
Revenue	(14)	1,621.0	1,741.9
Cost of sales	(15)	–1,239.0	–1,324.7
Gross profit		**382.0**	**417.2**
Research and development costs	(15)	–55.2	–63.6
Distribution costs	(15)	–175.0	–170.0
Administrative expenses	(15)	–89.6	–95.7
Other operating income	(17)	37.7	36.5
Other operating expenses	(17)	–66.6	–78.2
Operating profit		**33.3**	**46.2**
Other financial results		–1.0	0.3
Interest income		7.7	13.3
Interest expense		–14.2	–12.4
Financial result	(18)	**–7.5**	**1.2**
Earnings before taxes		**25.8**	**47.4**
Income tax expense	(19)	–7.3	–13.1
Profit for the period attributable to equity holders of the Parent		**18.5**	**34.3**
Earnings per share (in €, basic/dilutive)	(20)	**1.14**	**2.11**

Statement of Changes in Shareholders' Equity

in €m	Share capital	Share premium	Reserves: Recognised in equity	Reserves: Other	**Total**
31 December 2004	**42.2**	**83.1**	**12.3**	**307.7**	**445.3**
Changes under IAS 8	–	–	–	–1.3	–1.3
1 January 2005	**42.2**	**83.1**	**12.3**	**306.4**	**444.0**
Total net profit					
Profit for the period	–	–	–	18.5	18.5
Primary financial instruments	–	–	0.4	–	0.4
Derivatives	–	–	–12.1	–	–12.1
Exchange differences	–	–	2.0	–	2.0
	–	**–**	**–9.7**	**18.5**	**8.8**
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**	**319.1**	**448.0**
1 January 2006	**42.3**	**84.0**	**2.6**	**319.1**	**448.0**
Total net profit					
Profit for the period	–	–	–	34.3	34.3
Primary financial instruments	–	–	–0.1	–	–0.1
Derivatives	–	–	1.0	–	1.0
Exchange differences	–	–	–1.4	–	–1.4
	–	**–**	**–0.5**	**34.3**	**33.8**
Other changes					
Capital increase from approved capital	0.1	0.9	–	–	1.0
Dividend	–	–	–	–6.5	–6.5
31 December 2006	**42.4**	**84.9**	**2.1**	**346.9**	**476.3**

For further information see explanatory Note (7).

Cash Flow Statement

in €m	2005	**2006**
Earnings before taxes	25.8	47.4
Depreciation on intangible assets, property, plant and equipment	40.5	41.9
Foreign exchange gain/loss	12.1	–5.3
Interest income/expense	2.0	–0.9
Changes in non-current provisions	2.0	4.8
Other income/expenses	–4.0	–1.3
Gross cash flow	**78.4**	**86.6**
Changes in inventories	12.3	–12.5
Changes in receivables and other assets	48.0	68.2
Changes in current provisions	–24.1	36.6
Changes in payables and other liabilities	64.8	–85.7
Interest received	4.5	9.7
Interest paid	–9.5	–9.7
Income tax paid	0.2	–3.2
Cash flows from operating activities	**174.6**	**90.0**
Proceeds from disposal of intangible assets, property, plant and equipment	10.0	6.5
Payments for investment in intangible assets, property, plant and equipment	–39.5	–54.3
Proceeds from disposal of investments	0.7	0.1
Payments for investments	–2.0	–0.1
Payments for acquisition of consolidated enterprises	–1.0	–5.4
Investment subsidies received	3.0	0.9
Dividends received	1.4	0.1
Cash flows from investing activities	**–27.4**	**–52.2**
Free cash flow	**147.2**	**37.8**
Proceeds from capital contributions	1.0	1.0
Proceeds from loans	5.3	6.9
Repayment of loans	–66.2	–14.0
Dividends paid (previous year)	–4.1	–6.5
Cash flows from financing activities	**–64.0**	**–12.6**
Change in funds	**83.2**	**25.2**
Effect of changes in exchange rates	–0.3	–0.2
Funds at beginning of period	46.1	129.0
Funds at end of period	**129.0**	**154.0**

For further information see explanatory Note (J).

(A) Preliminary Remarks

The KBA Group is a global manufacturer of sheetfed, web and special printing presses for all current processes. 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.

Consolidated financial statements for the Parent and a Group management report to 31 December 2006 were prepared in accordance with section 315a of the HGB (German Commercial Law) and published online in the *Bundesanzeiger* (Federal Gazette).

The consolidated financial statements 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 5 March 2007 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 2006 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 2006. Of these standards, the following are pertinent to the KBA Group:

IAS 19	Employee Benefits: 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, revisions limiting the use of fair value options, recognition and measurement of insurance contracts (financial guarantees)
IFRIC 4	Determining whether an Arrangement contains a Lease.

The above standards were applied in compliance with the relevant transitional provisions. Where appropriate, amendments were made retrospectively, i.e. 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 19 Employee Benefits: 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 on defined-benefit pension plans. The adoption of this amendment in 2006 led to changes 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.

Adopting this standard for the 2006 business year caused no changes within the KBA Group.

The other standards applicable since 1 January 2006 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:

IAS 1	Presentation of Financial Statements (amendments to disclosure of capital)
IFRS 7	Financial Instruments: Disclosures
IFRS 8	Amendments to IAS 14: Segment Reporting
IFRIC 7	Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
IFRIC 8	Scope of IFRS 2
IFRIC 9	Reassessment of Embedded Derivatives
IFRIC 10	Interim Financial Reporting and Impairment (loss on goodwill and certain financial assets)
IFRIC 11	IFRS 2 – Group and Treasury Share Transactions
IFRIC 12	Service Concession Arrangements (accounting by operators for public-to-private service concession arrangements).

The standards specified in IFRIC 7, IFRIC 8, IFRIC 9, IFRIC 11 and IFRIC 12 are irrelevant to the business activities of the entities included in the statements.

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.

IFRS 7 Financial Instruments: Disclosures

This standard amends and expands the disclosures 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 for the 2007 business year and beyond.

IFRS 8 Amendments to IAS 14: Segment Reporting

This replaced IAS 14 and applies to entities in capital markets. It requires identification of operating segments on the basis of internal reports that are regularly reviewed by the entity's chief operating decision maker. An entity must apply this IFRS for annual periods beginning on or after 1 January 2009. For KBA, this approach will result in no changes other than additional Notes.

IFRIC 10 Interim Financial Reporting and Impairment

This stipulates that, with effect from 1 November 2006, an entity may not reverse an impairment loss recognised in a previous interim period in respect of goodwill (IAS 36) or an investment in either an equity instrument or a financial asset carried at cost (IAS 39). If impairment losses are recognised in interim accounts this will result in adjustments to accounting policies.

(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.

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

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 with a limited useful life was amortised on a straight-line basis over its estimated useful life.

Development costs for new or significantly improved products were capitalised at cost if 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

Government grants are classified by IAS as a reduction in the cost of assets and 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 an impairment no longer applied, an adjustment in the allowance account was made, up to the amortised cost of acquisition or manufacture.

Depreciation on and impairments in intangible assets, property, plant and equipment were disclosed under the individual functions. When goodwill was tested for impairment as per IAS 36 it was 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.

Individual items, depreciation and impairments under IAS 36 were disclosed under “Changes in Intangible Assets, Property, Plant and Equipment” (G).

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 as soon as 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.

Construction contracts

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, based on actuarial reports that recognised the present and potential benefits known on the balance sheet date and included 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.

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.

Other provisions

These included all other corporate risks and uncertain 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 on 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, and ranged from 11% to 40%.

The effect of changes in tax rates on deferred taxes was reported when such changes came into force.

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".

Non-current assets held for sale

A non-current asset is classified as being held for sale if management is committed to a plan to sell the asset and it is highly probable that the sale will be completed within one year from the date of classification. The asset is valued at the lower of its carrying amount and fair value less costs to sell. Such an asset will no longer be written down.

(D) Consolidated Companies and Consolidation Principles

Consolidated companies

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

In 2006 Koenig & Bauer acquired a 100% interest in LTG Print Systems Holding GmbH, Stuttgart, changing the name to KBA-MetalPrint GmbH. Altogether 13 (prior year: 15) 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. It was carried at fair value as an available-for-sale financial instrument in accordance with 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. Hidded 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 was netted against reserves.

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 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 date 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

In 2006 it was established that certain operational expenses were not tax-deductible. Adjustments were made in compliance with IAS 8 and prior periods adjusted accordingly.

Effects on Group balance sheet

in €m	01.01.2005 Adjustment	**31.12.2005** Adjustment
Deferred tax assets	–1.0	–1.0
Current tax assets		–0.1
Reserves	–1.3	–1.3
Profit for the period		–0.1
Current tax liabilities	0.3	0.3
Earnings per share (in €, basic/dilutive)		–0.01

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

in €m	Cost						
	01.01.	Group additions	Additions	Translation differences	Reclassifications[1]	Disposals	**31.12.**
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**
2006							
Intangible assets							
Industrial property rights and similar rights	42.7	14.0	1.8	–0.2	–	2.2	56.1
Goodwill	14.2	9.2	–	–	–	3.4	20.0
Product development costs	16.4	–	–	–	–	11.0	5.4
	73.3	**23.2**	**1.8**	**–0.2**	**–**	**16.6**	**81.5**
Property, plant and equipment							
Land and buildings	206.9	0.1	12.0	–0.4	0.4	1.1	217.9
Plant and machinery	228.8	5.0	19.0	–1.4	–8.6	10.0	232.8
Other facilities, factory and office equipment	103.9	8.5	14.6	–0.3	–1.2	12.2	113.3
	539.6	**13.6**	**45.6**	**–2.1**	**–9.4**	**23.3**	**564.0**
	612.9	**36.8**	**47.4**	**–2.3**	**–9.4**	**39.9**	**645.5**

[1] including reclassifications of assets held for sale
[2] impairment in sheetfed division

Depreciation									Residual value	
01.01.	Group additions	Annual depreciation	Impairments	Write-ups	Translation differences	Reclassifi-cations[1]	Disposals	**31.12.**	01.01.	**31.12.**
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**
36.8	4.7	4.3	–	–	–0.1	–0.1	2.1	43.5	5.9	12.6
3.4	–	–	–	–	–	–	3.4	–	10.8	20.0
13.1	–	0.8	–	–	–	–	11.0	2.9	3.3	2.5
53.3	**4.7**	**5.1**	**–**	**–**	**–0.1**	**–0.1**	**16.5**	**46.4**	**20.0**	**35.1**
65.8	0.1	5.5	–	–	–0.2	–1.9	1.0	68.3	141.1	149.6
159.6	4.9	13.9	–	–	–1.2	–8.2	7.3	161.7	69.2	71.1
63.9	8.1	17.1	0.3[2]	–	–0.2	–1.3	11.9	76.0	40.0	37.3
289.3	**13.1**	**36.5**	**0.3**	**–**	**–1.6**	**–11.4**	**20.2**	**306.0**	**250.3**	**258.0**
342.6	**17.8**	**41.6**	**0.3**	**–**	**–1.7**	**–11.5**	**36.7**	**352.4**	**270.3**	**293.1**

(H) Explanatory Notes to the Balance Sheet

(1) Intangible assets, property, plant and equipment

The total includes €0.1m (previous year: €0.2m) for rights arising from finance leases, €4.3m for plant and machinery (€0.5m) and €1.8m (€0.8m) 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 in 2005 and for property, plant and equipment by €12.4m in 2006 (2005: €15.7m).

Intangible assets

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

Goodwill

in €m	31.12.2005	**31.12.2006**
Bauer+Kunzi GmbH, Ditzingen, Germany	3.4	3.4
KBA-GIORI S.A., Lausanne, Switzerland	7.3	7.3
KBA-MetalPrint GmbH, Stuttgart, Germany	–	9.2
Other	0.1	0.1
	10.8	**20.0**

Goodwill was tested for impairment on the balance sheet date in accordance with IAS 36. The recoverable amount exceeded the carrying amount (including goodwill) of the relevant cash-generating units.

Property, plant and equipment

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

Assets held for sale were reclassified following the decision to close down KBA North America Inc., Web Press Division in York.

(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-Metronic AG, Veitshöchheim, Germany	100.0	10.8
Bauer+Kunzi GmbH, Ditzingen, Germany	100.0	0.1
KBA-MetalPrint GmbH, Stuttgart, Germany[1]	100.0	4.7
KBA-France SAS, Tremblay-en-France, France	100.0	1.3
KBA (UK) Ltd., Watford, UK	100.0	–0.4[2]
Holland Graphic Occasions B.V., Wieringerwerf, Netherlands	100.0	–1.1[2]
KBA-Mödling AG, Mödling, Austria	>99.9	29.1
KBA-Le Mont-sur-Lausanne SA, Lausanne, Switzerland	100.0	42.4
KBA-GIORI S.A., Lausanne, Switzerland[1]	100.0	34.3
KBA-Grafitec s.r.o., Dobruška, Czech Republic	100.0	9.9
KBA North America Inc., Wilmington, Delaware, USA	100.0	15.6
Non-consolidated affiliates		
KBA Australasia Pty. Ltd., Lane Cove, Australia	100.0	–0.7[2]
KBA NORDIC A/S, Herlev, Denmark	100.0	–0.5[2]
KBA-Italia S.p.A., Milan, Italy	100.0	1.7
KBA Koenig & Bauer (Asia Pacific) Sdn. Bhd., Kuala Lumpur, Malaysia	100.0	0.4
KBA-Polska Sp. z o.o., Warsaw, Poland	100.0	0[3]
KBA RUS GmbH, Moscow, Russia	100.0	0[3]
Print Assist AG, Höri, Switzerland[1]	100.0	2.4
KBA (HK) Company Ltd., Hong Kong, China	51.0	1.1
KBA Printing Machinery (Shanghai) Co., Ltd., Shanghai, China	100.0	0.4
Interests		
KBA Leasing GmbH, Bad Homburg, Germany	24.9	0.8
KBA-GIORI India Private Ltd., New Delhi/India[1]	50.0	0.2

[1] Indirect holding
[2] Deficit not covered by equity
[3] Preliminary figures

The acquisition by our subsidiary Bauer + Kunzi GmbH of Stuttgart-based LTG Print Systems Holding GmbH and LTG-Mailänder GmbH & Co. KG on 1 July 2006, was followed by their merger to form KBA-MetalPrint, the global market leader in metal-decorating presses. The new subsidiary and its 293 employees posted an operating profit of €0.9m on sales of €39.6m.

In the second half of the year a new full subsidiary, KBA-Polska Sp. z o.o., was established in Poland.

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

in €m	31.12.2005	Term to maturity up to 1 year	Term to maturity more than 1 year	31.12.2006	Term to maturity up to 1 year	Term to maturity more than 1 year
Trade receivables						
- from affiliates	8.9	6.4	2.5	4.7	3.1	1.6
- from companies in which interests are held	5.1	5.1	–	6.5	6.5	–
- from third parties	451.6	368.7	82.9	388.6	321.1	67.5
	465.6	**380.2**	**85.4**	**399.8**	**330.7**	**69.1**
Investments	5.5	–	5.5	5.4	–	5.4
Other financial receivables						
- from affiliates	–	–	–	1.1	1.1	–
- derivatives	6.8	6.8	–	2.1	2.0	0.1
- sundry other financial receivables	34.6	19.2	15.4	34.7	14.7	20.0
	46.9	**26.0**	**20.9**	**43.3**	**17.8**	**25.5**
Other assets						
- payments for inventories	24.5	24.5	–	35.3	35.3	–
- payments for intangible assets, property, plant and equipment	6.0	6.0	–	5.4	5.4	–
- tax receivables	4.2	4.2	–	9.5	9.5	–
- prepayments	4.6	4.6	–	6.2	6.2	–
	39.3	**39.3**	**–**	**56.4**	**56.4**	**–**
	551.8	**445.5**	**106.3**	**499.5**	**404.9**	**94.6**

Adopting the percentage of completion method resulted in €16.3m (previous year: €32.9m) being carried in trade receivables.

Included above are sundry other financial receivables of €4.2m (previous year: €4.9m) held under finance leases totalling €4.7m (previous year: €5.6m) and an interest share of €0.5m (previous year: €0.7m), with those due in less than one year representing €0.6m (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 receivables from derivatives are detailed in Note (11).

Interest, exchange and credit risks at the balance sheet date related to customer financing and loans to employees and agents. Interest-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 2006 totalled €24.7m (previous year: €10.3m).

in €m	31.12.2005 Carrying amount	Interest rate	Term to maturity in years	**31.12.2006** Carrying amount	Interest rate	Term to maturity in years
Trade receivables						
- from affiliates	2.7	max. 5.5%	up to 5	1.7	max. 5.5%	up to 4
- from third parties	241.2	max. 10.2%	up to 7	223.9	max. 9.4%	up to 7
Other financial receivables	1.7	max. 6.0%	up to 4	11.4	max 7.0%	up to 6
	245.6			**237.0**		

(3) Inventories

in €m	31.12.2005	**31.12.2006**
Raw materials, consumables and supplies	53.4	63.1
Work in progress	307.9	288.2
Finished goods and products	7.2	26.3
	368.5	**377.6**

The carrying amount of inventories balanced at net realisable value was €121.4m (previous year: €66.9m). Impairments of €0.4m (previous year: €2.5m) were recognised as an expense.

(4) Securities

These mainly refer to fixed-interest securities and shares in a special fund combining stocks and bonds. €7.5m (previous year: €4.1m) of this special fund was pledged to employees in order to hedge phased retirement credits.

Fixed-interest securities were valued at €0.7m (previous year: €5.5m).

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

(5) Cash and cash equivalents

in €m	31.12.2005	**31.12.2006**
Cheques, cash in hand	0.2	0.2
Balances with banks	115.8	145.6
	116.0	**145.8**

(6) Deferred taxes

Deferred tax assets and liabilities comprised the following:

in €m	Deferred tax assets		Deferred tax liabilities	
	31.12.2005	**31.12.2006**	31.12.2005	**31.12.2006**
Assets				
Intangible assets, property, plant and equipment	2.2	2.1	21.0	24.3
Inventories	22.3	20.0	3.9	3.2
Financial receivables and other assets	2.2	6.8	3.3	1.3
Securities, cash and cash equivalents	–	–	1.0	0.9
	26.7	**28.9**	**29.2**	**29.7**
Equity and liabilities				
Equity	–	0.2	0.7	–
Provisions	18.4	22.6	1.9	2.6
Financial payables and other liabilities	12.2	3.3	31.5	24.9
	30.6	**26.1**	**34.1**	**27.5**
Tax loss carryforwards	18.1	12.3	–	–
Other	–0.2	–1.6	–	–
	75.2	**65.7**	**63.3**	**57.2**

Deferred taxes disclosed under equity related to the translation differences carried in equity that arose from consolidation procedures. Deferred taxes totalled €1.7m (previous year: €2m).

Loss carryforwards for which no deferred taxes were disclosed totalled €9.3m at the end of the year.

(7) Equity

Changes in shareholders' equity are described in a separate schedule on page 64.

Share capital

The Parent's share capital at 31 December 2006 totalled 16,304,400 (2005: 16,264,760) no-par shares with a par value of €2.60. The 39,640 increase over the previous year represents the issue of employee shares, using part of the €15.6m capital approved by the shareholders' meeting on 22 June 2006. The remaining €15.5m was approved until 21 June 2011. Koenig & Bauer was further authorised to continue buying back shares up to a maximum of one tenth of the issued capital of €42.3m, with repurchasing to be completed by no later than 21 December 2007, but preferably by the end of the next AGM.

All bearer shares issued were paid up in full and convey attendance and voting rights at shareholder meetings plus full dividend entitlement. In 2006 a dividend of 40 cents per share was paid for the previous year.

Share premium

This included the extra charge from the issue of shares, and is subject to the limitations imposed by section 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 diminished reserves by €0.2m (previous year: €0.6m increase).

The use of hedge accounting swelled reserves by €5.2m (previous year: €7.4m decrease). During completion of the underlying transactions €3.6m (previous year: €12.4m) was recognised as income.

Deferred taxes increased reserves by €0.4m (previous year: €6.8m), with primary financial instruments accounting for €0.1m (compared to –€0.2m the previous year), derivatives –€0.6m (€7.7m) and foreign currency translation €0.9m (–€0.7m).

(8) 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 4.3% (previous year: 4.2%) in Germany and 5.2% (4.8%) in the UK, a salary increase of 2.3% (2.3%) and a fluctuation rate of 2.6% (2.9%). Pension adjustments were calculated at 1.6% (1.2%). All figures are weighted averages of the assumptions contained in the pension plans.

Pension provisions constituted the following:

in €m	31.12.2005	**31.12.2006**
Present value of non-funded obligations	108.9	115.9
Present value of funded obligations	21.3	11.1
Present value of obligations	130.2	127.0
Current market value of plan assets	–17.3	–8.8
Current market value of obligations (offset)	**112.9**	**118.2**
Unrecognised actuarial gains/losses	–20.6	–18.5
Currency gains/losses and other	–0.2	–0.4
Balance sheet value at 31.12.	**92.1**	**99.3**
- pension provisions	**92.1**	**99.3**

The present value of obligations and the current market value of plan assets changed as follows:

in €m	Present value of obligations		Current market value of plan assets	
	31.12.2005	**31.12.2006**	31.12.2005	**31.12.2006**
Status on 01.01.	**104.5**	**130.2**	**–10.3**	**–17.3**
Current service cost	2.7	5.0	–	–
Interest cost	5.0	5.6	–	–
Recognised actuarial gain/loss	0.1	0.8	–	–
Expected return on plan assets	–	–	–0.9	–1.0
Cost (+)/return (-) for the year	**7.8**	**11.4**	**–0.9**	**–1.0**
Contributions	–	–	–0.2	–0.2
Benefits paid	–5.0	–5.2	0.5	0.6
Unrecognised actuarial gain/loss	14.3	1.3	0.5	–0.1
Change in scope of consolidated financial statements	6.3	2.3	–4.7	–
Settlements and plan asset changes	–	–12.5	–	8.8
Foreign currency exchange rate changes/other changes	2.3	–0.5	–2.2	0.4
Status at 31.12.	**130.2**	**127.0**	**–17.3**	**–8.8**

Plan assets comprised €3.3m (previous year: €3.2m) from life insurance for pension schemes, €2.6m (previous year: €6.5m) from shares and equity securities, €2m (€0.5m) from loans and €0.9m (€7.1m) from other assets.

The actual return on plan assets was €1.1m (previous year: €0.4m). The anticipated rate of return is 9.3% (previous year: 5.2%).

Net liability resulted from the present value of obligations less the current market value of plan assets, and during the past four years changed as follows:

in €m	31.12.2003	31.12.2004	31.12.2005	**31.12.2006**
Present value of obligations	101.5	104.5	130.2	127.0
Current market value of plan assets	–10.9	–10.3	–17.3	–8.8
Net liability	**90.6**	**94.2**	**112.9**	**118.2**

Expenses for defined-contribution plans totalled €33.3m (previous year: €29.9m).

(9) Other provisions

in €m	Status on 01.01.2006	Group additions	Con-sumption	Reversal of provisions	Allocation	Unwind of discount	Translation difference*	**Status on 31.12.2006**
Other provisions								
- for employees	30.2	4.1	4.3	0.1	12.2	0.7	–0.1	42.7
- for sales	89.8	2.2	16.7	5.5	51.6	–	–0.1	121.3
- for sundry other purposes	42.3	0.4	35.7	0.5	34.7	–	–0.3	40.9
	162.3	**6.7**	**56.7**	**6.1**	**98.5**	**0.7**	**–0.5**	**204.9**
of which								
- long-term provisions	43.5							66.2
- short-term provisions	118.8							138.7
	162.3							**204.9**

* including reclassifications

Provisions for employees included 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	31.12.2005	Term to maturity up to 1 year	Term to maturity more than 1 year	**31.12.2006**	Term to maturity up to 1 year	Term to maturity more than 1 year
Trade payables						
- to affiliates	1.0	1.0	–	2.0	2.0	–
- to others	94.7	94.7	–	102.3	102.3	–
	95.7	**95.7**	**–**	**104.3**	**104.3**	**–**
Bank loans	78.7	53.3	25.4	78.8	49.0	29.8
Other financial payables						
- from derivatives	16.2	16.1	0.1	0.7	0.7	–
- sundry other financial payables	121.7	111.7	10.0	69.3	59.2	10.1
	216.6	**181.1**	**35.5**	**148.8**	**108.9**	**39.9**
Other liabilities						
- from payments received	294.2	276.7	17.5	274.0	273.4	0.6
- from taxes	16.9	16.2	0.7	14.5	14.5	–
- sundry other liabilities	5.5	5.5	–	6.4	6.4	–
	316.6	**298.4**	**18.2**	**294.9**	**294.3**	**0.6**
	628.9	**575.2**	**53.7**	**548.0**	**507.5**	**40.5**

Bank loans were secured by mortgages to the value of €11.2m (previous year: €16.4m), the pledging of securities worth €1.3m (previous year: €1.6m) and the assignment of trade receivables totalling €12.4m (€12.4m). The carrying amounts of secured items of property, plant and equipment came to €10.5m (previous year: €10.4m) and of pledged securities (other financial receivables) €2m (€2.1m).

Of trade payables, €0.1m is attributable to the percentage of completion method.

Lines of credit not drawn down by the KBA Group at the balance sheet date totalled €182.8m (previous year: €153.2m). Details of **bank loans** relating to existing interest rate risks are summarised below.

in €m	Term to maturity in years	Carrying amount	31.12.2005 Interest rate	Term to maturity in years	Carrying amount	**31.12.2006** Interest rate
Loans	up to 1	29.5	max. 6.7%	up to 1	28.7	max. 7.0%
	1 to 5	15.3	max. 6.7%	1 to 5	21.9	max. 7.0%
	5 to 8	10.1	max. 5.7%	5 to 7	7.9	max. 4.9%
Bank overdrafts	up to 1	23.8	max. 9.0%	up to 1	20.3	max. 7.9%
		78.7			**78.8**	

Sundry other financial payables included finance leases to the sum of €10.8m (previous year: €8.3m). Standard market conditions apply to renewal and purchase options. Sale and leaseback transactions based on customer financing models were concluded, with liabilities offset against accounts receivable to the same amount. Turnover was carried upon delivery of the machinery.

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

in €m	31.12.2005	Term to maturity			**31.12.2006**	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	9.2	3.7	5.5	–	12.1	5.0	7.1	–
Interest portion	–0.9	–0.5	–0.4	–	–1.3	–0.4	–0.9	–
Present value of finance lease	**8.3**	**3.2**	**5.1**	–	**10.8**	**4.6**	**6.2**	–

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

Other liabilities include total payments received of €53.6m (previous year: €106.9m) for construction 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 page 45.

Risks are hedged using standard market instruments such as interest and currency swaps.

Forward contracts hedged the calculation rate of individual foreign currency trade contracts, while currency swaps and options hedged current, fixed-term business transactions denominated in foreign currency. Interest swaps were generally used to contain interest risk related to long-term loans.

A currency swap with a maturity of 5 years, concluded in 2001 to hedge business transactions denominated in US dollars, expired on the balance sheet date (nominal amount the previous year: €12.6m).

In 2006 a currency option with a maturity of 3 years was concluded to hedge a foreign subsidiary's current, fixed-term business transactions denominated in euros. The nominal amount at the balance sheet date was €7.2m, of which €3.6m 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.

Short-term currency options in US dollars ($8m) and sterling (£0.9m) that were taken up the previous year to hedge trade contracts expired in 2006.

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

in €m	Nominal amount			Nominal amount		
	Total 31.12.2005	Term to maturity more than 1 year	Market value 31.12.2005	Total **31.12.2006**	Term to maturity more than 1 year	Market value **31.12.2006**
Forward contracts	260.7	5.3	–11.5	76.8	1.0	1.2
Currency options	7.6	–	–0.3	7.2	3.6	0.2
Currency swaps	19.4	1.5	2.4	1.5	–	–
	287.7	**6.8**	**–9.4**	**85.5**	**4.6**	**1.4**

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 €0.3m (previous year: €2m) of assets and €0.7m (previous year: €15.2m) of liabilities from ineffective hedging relationships.

(12) Fair values

in €m	31.12.2005 Carrying amount	31.12.2005 Fair value	31.12.2006 Carrying amount	31.12.2006 Fair value
Assets				
Investments and other financial receivables				
- interests in affiliates	5.3	–	5.2	–
- other loans	0.2	0.2	0.2	0.2
- other financial receivables from derivatives	6.8	6.8	2.1	2.1
- sundry other receivables	34.6	34.6	35.8	35.8
	46.9	**41.6**	**43.3**	**38.1**
Trade receivables	465.6	465.6	399.8	399.8
Securities, cash and cash equivalents	129.0	129.0	154.0	154.0
	641.5	**636.2**	**597.1**	**591.9**
Liabilities				
Financial payables				
- bank loans	78.7	78.7	78.8	78.8
- other financial payables from finance leases	8.3	8.6	10.8	11.1
- other financial payables from derivatives	16.2	16.2	0.7	0.7
- sundry other payables	113.4	113.4	58.5	58.5
	216.6	**216.9**	**148.8**	**149.1**
Trade payables	95.7	95.7	104.3	104.3
	312.3	**312.6**	**253.1**	**253.4**

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	31.12.2005	Term to maturity up to 1 year	Term to maturity 1 to 5 years	Term to maturity more than 5 years	**31.12.2006**	Term to maturity up to 1 year	Term to maturity 1 to 5 years	Term to maturity more than 5 years
Commitments from:								
operating leases	13.0	5.5	7.5	–	10.6	5.7	4.9	–
leasing and service contracts	12.6	4.1	7.5	1.0	22.9	5.8	12.0	5.1
investment plans	12.2	11.3	0.9	–	13.7	7.3	6.4	–
sundry other activities	0.1	0.1	–	–	0.1	0.1	–	–
	37.9	**21.0**	**15.9**	**1.0**	**47.3**	**18.9**	**23.3**	**5.1**

Operating leases were mainly negotiated for IT equipment and our vehicle fleet, with renewal options at prevailing market conditions. Leasing payments of €6.5m (previous year: €5.6m) 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 €0.8m (previous year: €0.1m) and in property, plant and equipment to the value of €12.9m (€12.1m).

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

Contingent liabilities

These comprised contingencies totalling €285.6m (previous year: €313.9m) from warranty agreements.

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

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

(I) Explanatory Notes to the Income Statement

(14) 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 €257.4m (previous year: €234.8m), accumulated revenue for contracts not completed by the balance sheet date came to €596.3m (€414.6m).

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

(15) Expenses by function

Cost of sales

Cost of sales included the purchase and conversion 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 €0.3m in subsidies (previous year: €0.2m) for apprentice training, job promotion and research projects.

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 €0.4m (previous year: €0.1m). 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 €6.1m increase in administrative expenses primarily related to the consolidation of KBA-MetalPrint GmbH.

(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	2005	**2006**
Cost of raw materials, consumables, supplies and purchased goods	709.8	755.3
Cost of purchased services	166.1	176.2
	875.9	**931.5**

Personnel costs (classified by nature)

in €m	2005	**2006**
Wages and salaries	370.5	375.0
Social security and other benefits	67.5	73.7
Pensions	3.7	10.0
	441.7	**458.7**
Average payroll		
- wage-earning industrial staff	4,434	4,589
- salaried office staff	3,006	3,268
- apprentices/students	442	412
	7,882	**8,269**

(17) Other operating income and expenses

in €m	2005	**2006**
Other operating income		
Gains from the disposal of intangible assets, property, plant and equipment	5.5	3.3
Foreign currency gains	0.3	0.3
Currency measurement	15.2	15.5
Reversal of write-downs and provisions	11.9	8.3
Sundry other operating income	4.8	9.1
	37.7	**36.5**
Other operating expenses		
Losses from the disposal of intangible assets, property, plant and equipment	–1.6	–1.8
Foreign currency losses	–4.0	–7.3
Currency measurement	–27.3	–10.2
Creation of write-downs and provisions	–9.0	–26.1
Sundry other operating expenses	–24.7	–32.8
	–66.6	**–78.2**
Other operating income and expenses	**–28.9**	**–41.7**

Sundry other operating income included insurance and compensation claims and other refunds.

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

(18) Financial result

in €m	2005	2006
Other financial results		
Income from interests in affiliates	0.3	0.1
Gains/impairments in securities	–1.3	0.2
	–1.0	**0.3**
Interest income/expense		
Other interest and similar income	7.7	13.3
- from affiliates	(0.2)	(–)
Other interest and similar expense	–14.2	–12.4
- from affiliates	(–0.5)	(–)
	–6.5	**0.9**
Financial result	**–7.5**	**1.2**

(19) Income taxes

Tax expense mainly comprised the following:

in €m	2005	2006
Actual tax expense	–2.6	–8.6
Deferred taxes from loss carryforwards	0.1	–5.8
Deferred tax expense/income from temporary differences	–4.8	1.3
	–7.3	**–13.1**

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 €0.9m (previous year: €0.4m) in income tax rebates unrelated to the accounting period, and €0.6m from the utilisation of adjusted loss carryforwards.

in €m	2005	2006
Earnings before taxes	**25.8**	**47.4**
Group tax rate	39.0 %	39.0 %
Expected taxes	**–10.1**	**–18.5**
Tax effects from		
- variances due to different tax rates	1.9	8.0
- adjustments	–	–4.2
- decreases and increases	0.8	–0.1
- changes under IAS 8	–0.1	–
- other	0.2	1.7
Income tax expense	**–7.3**	**–13.1**
Overall tax ratio in %	28.3 %	27.6 %

(20) Earnings per share

	2005	**2006**
Profit for the period in €m	18.5	34.3
Weighted average of ordinary shares issued	16,223,288	16,273,557
Earnings per share in €	**1.14**	**2.11**

The total number of ordinary shares issued was 39,640 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 €154m (previous year: €129m) comprised cash and cash equivalents worth €145.8m (previous year: €116m) and securities worth €8.2m (previous year: €13m).

Acquisition costs totalled €6.6m (previous year: €5.2m) and were paid in full. They were set against cash and cash equivalents worth €1.2m (previous year: €0.1m) and a prior-year sum of €3.8m from the consolidation of additional enterprises. Non-current assets worth €14.8m (previous year: €7.7m), current assets worth €21.3m (€8.3m), non-current liabilities totalling €5.8m (€0.3m), current liabilities worth €34m (€10.9m) and prior-year contingent liabilities (other provisions) of €0.9m were included in the consolidated financial statements.

Tax expense embraced tax payments of €3.2m (previous year: €1.6m) and prior-year tax refunds of €1.8m.

(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 UV 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 procedures 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.

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 financial assets and liabilities, and consolidation between segments.

Business segments

in €m	Web and special presses 2005	Web and special presses 2006	Sheet offset presses 2005	Sheet offset presses 2006	Consolidation/ reconciliation 2005	Consolidation/ reconciliation 2006	Group 2005	Group 2006
External turnover	**803.4**	**871.3**	**817.6**	**870.6**	**–**	**–**	**1,621.0**	**1,741.9**
Operating profit	30.6	41.2	2.7	5.0	–	–	33.3	46.2
Depreciation	25.5	24.8	15.3	16.8	–	–	40.8	41.6
Significant non-cash expenses	41.0	70.4	15.5	28.8	–	–	56.5	99.2
Capital investments	20.9	28.2	15.6	25.2	–	–	36.5	53.4
Assets	502.9	453.4	662.9	690.2	229.3	250.6	1,395.1	1,394.2
Liabilities (with payments received)	524.5	462.5	161.6	186.2	261.0	269.2	947.1	917.9

The geographical areas were defined according to their significance for Group income.

Geographical segments

in €m	External turnover 2005	External turnover 2006	Capital investments 2005	Capital investments 2006	Assets 2005	Assets 2006
Germany	292.6	300.7	23.8	35.3	833.2	821.5
Rest of Europe	718.8	858.4	11.5	15.9	264.6	260.3
North America	258.4	209.9	1.2	2.2	68.0	61.8
Asia/Pacific	251.1	286.2	–	–	–	–
Africa/Latin America	100.1	86.7	–	–	–	–
Consolidation/reconciliation	–	–	–	–	229.3	250.6
Group	**1,621.0**	**1,741.9**	**36.5**	**53.4**	**1,395.1**	**1,394.2**

(L) Notes to section 285 no. 17 HGB

The auditors were remunerated as follows:

in €m	2005	**2006**
Audits	0.3	0.3
Other reporting and valuation services	0.1	0.2
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	2005	**2006**
Trade receivables at 31.12.	8.9	4.7
Trade payables at 31.12.	1.0	2.0
Revenue	95.4	16.7

Remuneration for members of management totalled €3m (previous year: €2.7m), with fixed remuneration representing €1.1m (previous year: €1.1m) and variable remuneration €1.9m (previous year: €1.6m). Performance-related variable remuneration was based on net profit. Provisions for pension obligations were increased by €0.1m. Remuneration for former members and their survivors stood at €1m (€1m). Supervisory board remuneration totalled €0.4m (€0.3m), €0.3m of which was variable (previous year: €0.2m).

€12.6m (previous year: €12.7m) was set aside for pension claims by active and retired members of the management board, and their survivors.

At 31 December 2006 members of the management board held 5.3% and members of the supervisory board 2.3% of Koenig & Bauer's share capital, giving a total of 7.6%.

Supervisory Board

Dieter Rampl
Chairman (since 22 June 2006)
Banker
Munich

Peter Reimpell
Chairman (until 22 June 2006)
Banker
Munich

Gottfried Weippert*
Deputy chairman
Technician
Eibelstadt

Reinhart Siewert
Deputy chairman (since 22 June 2006)
Business economist
Würzburg

Dr Hans-Bernhard Bolza-Schünemann
Deputy chairman (until 22 June 2006)
Engineer and physicist
Würzburg

Beate Grabmair* († March 2006)
Translator
Frankenthal

Peter Hanzelka*
Milling machine operator
Coswig

Matthias Hatschek (since 22 June 2006)
Entrepreneur
Blindenmarkt, Austria

Rupert Hatschek (until 22 June 2006)
Investment manager
Vienna, Austria

Günter Hoetzl* (since 22 June 2006)
Representative of IG Metall
Hofheim

Dr Hermann Jung (since 22 June 2006)
Member of the management board, Voith AG
Heidenheim

Baldwin Knauf (since 22 June 2006)
General partner, Knauf Gips KG
Iphofen

Alfred Kuffler* (until 22 June 2006)
Representative of IG Metall
Frankenthal

Walther Mann* (since 22 June 2006)
Representative of IG Metall
Würzburg

Werner Ring* (until 22 June 2006)
Representative of IG Metall
Würzburg

Klaus Schmidt*
Director Corporate Communications, KBA
Hettstadt

Jochen Walther* (since 22 June 2006)
Instructor
Grossriedesheim

Professor Horst Peter Wölfel
Professor of structural dynamics
Technical University Darmstadt
Höchberg

* elected by the workforce

Committees

Mediation committee as per section 27(3) of the Law on Codetermination
Dieter Rampl
Klaus Schmidt
Gottfried Weippert
Professor Horst Peter Wölfel

Human Resources Committee
Dieter Rampl
Reinhart Siewert
Gottfried Weippert

Financial Audit Committee
Reinhart Siewert
Peter Hanzelka
Dieter Rampl
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

Christoph Müller (since May 2006)
Würzburg

Walter Schumacher (until April 2006)
Gerbrunn

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

	Member of the supervisory board at:
Dieter Rampl Chairman	Babcock & Brown, Sydney, Australia Bayerische Börse AG, Munich, Germany Bode Grabner Beye AG & Co. KG, Grünwald, Germany FC Bayern München AG, Munich, Germany Mediobanca, Milan, Italy UniCredit, Milan, Italy
Reinhart Siewert Deputy chairman	Winkler + Dünnebier AG, Neuwied, Germany KBA-GIORI S.A., Lausanne, Switzerland KBA-Mödling AG, Mödling, Austria KBA-Metronic AG, Veitshöchheim, Germany
Matthias Hatschek	Eternit UK Ltd, Meldreth, UK
Dr Hermann Jung	Putzmeister AG, Aichtal, Germany
Baldwin Knauf	Lindner AG, Arnstorf, Germany
Klaus Schmidt	KBA-Metronic AG, Veitshöchheim, Germany

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/corporate_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 law. 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 €16,085,000 as follows:

Payment of a dividend of 50 cents per ordinary share on 16,304,400 no-par shares	€8,152,200
Transfer to other revenue reserves	€7,932,800

(O) Events after the Balance Sheet Date

There were no significant events after the balance sheet date.

Würzburg, 5 March 2007
Management Board

Albrecht Bolza-Schünemann
President and CEO

Claus Bolza-Schünemann
Deputy president

Dr Frank Junker

Andreas Mössner

Christoph Müller

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 2006. 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 section 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 section 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 section 315(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, 9 March 2007

Bayerische Treuhandgesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Dr Grottel
Auditor

Mühlhuber
Auditor

Balance Sheet for Koenig & Bauer AG to 31 December 2006

under German Commercial Code (HGB)

Assets in €m	31.12.2005	**31.12.2006**
Non-current assets		
Intangible assets	2.9	2.0
Property, plant and equipment	156.7	160.6
Financial assets	58.8	58.6
	218.4	**221.2**
Current assets		
Inventories less payments received	3.2	75.0
Trade receivables	301.4	253.5
Other receivables and assets	118.2	122.8
Securities	10.5	5.9
Cash and cash equivalents	85.7	85.7
	519.0	**542.9**
Prepayments	**2.9**	**4.8**
	740.3	**768.9**

Equity and liabilities in €m	31.12.2005	**31.12.2006**
Equity		
Share capital	42.3	42.4
Share premium	84.0	84.9
Reserves	210.6	226.6
Retained earnings	6.5	16.1
	343.4	**370.0**
Special items with equity portion	**9.7**	**7.7**
Provisions		
Pension provisions	62.0	64.7
Tax provisions	0.2	3.4
Other provisions	170.5	195.0
	232.7	**263.1**
Liabilities		
Bank loans	32.2	20.2
Trade payables	65.0	66.8
Other liabilities	57.3	41.1
	154.5	**128.1**
	740.3	**768.9**

Income Statement for Koenig & Bauer AG for 2006

under German Commercial Code (HGB)

in €m	2005	2006
Revenue	1,342.0	1,449.6
Cost of sales	–1,124.3	–1,199.7
Gross profit	**217.7**	**249.9**
Distribution costs	–117.5	–106.2
Administrative expenses	–44.8	–49.1
Other operating income	25.0	18.0
Other operating expenses	–67.9	–80.7
Profit from operations	**12.5**	**31.9**
Financial result	–4.4	2.5
Profit from ordinary activities	**8.1**	**34.4**
Extraordinary profit	–	3.1
Earnings before taxes (EBT)	**8.1**	**37.5**
Income taxes	–0.2	–4.1
Other taxes	–1.0	–1.2
Net profit	**6.9**	**32.2**

Key Financial Dates

Interim report on 1st quarter 2007
15 May 2007

Koenig & Bauer Annual General Meeting
19 June 2007
Congress Centrum Würzburg

Interim report on 2nd quarter 2007
14 August 2007

Interim report on 3rd quarter 2007
15 November 2007

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Consolidated Financial Statements

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