

2.2 Annual Financial Statements of Salzgitter AG

The annual financial statements of Salzgitter AG (SZAG) for the financial year 2005 have been drawn up in accordance with the provisions of the German Commercial Code, taking into account the supplementary provisions of the German Stock Corporation Act, and have been approved without qualification by the auditor PricewaterhouseCoopers Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Hanover. The complete text is published in the Federal Gazette (Bundesanzeiger) and deposited under HRB 9207 at the Commercial Register of the District Court of Braunschweig.

SZAG heads up the divisions as the management holding company. Operations are conducted by the Group companies; in as much, the result of SZAG is determined by the income from its shareholdings.

The structure of the Salzgitter Group in its current form means that profits and losses posted by individual Group companies in intercompany trading and any losses carried forward can be offset for tax purposes only to a limited extent, and that the scope for central financial management in the Group is similarly restricted.

To eliminate the disadvantages, the Group intends to reorganize its internal structure under company law in such a way that SZAG will bring the shares in its material affiliated companies by way of a spin-off under the Reorganization Act (UmwG) into its wholly-owned subsidiary Salzgitter Mannesmann GmbH (SMG; formerly: Mannesmannröhren-Werke GmbH) either in their entirety (100%) or – where expedient for avoiding tax burdens – in the amount of some 99.8% or 94.9%.

In this concept, SMG has no employees and is run purely as an intermediate holding company in which the results posted by all of the material Group companies are offset against each other for tax purposes and the Group's financial management is organized centrally.

On November 17, 2005, SZAG's Extraordinary Meeting of Shareholders granted its approval to effect a spin-off to the subsidiary SMG as of December 1, 2005, in accordance with Section 123, para. 3, no. 1, German Reorganization Act (UmwG).

This resolution was legally challenged on December 19, 2005, at the Regional Court of Braunschweig. In the meantime, the Court has been provided with a statement of defense as well as an application for ascertainment that the action will not impede official entry into the Register of Companies (application for release).

Owing to the action to rescind and the entry into the Register of Companies of the spin-off and transfer agreement which has thereby been challenged, the transfer of beneficial ownership could not be ascertained at the time when the balance sheet was drawn up. For this reason, SZAG has included its holdings unchanged as per December 31, 2005, despite the spin-off and transfer agreement which

Weathering
rough seas:
Waves impacting
the bow reflect
the tremendous
forces water
can conjure up.



has been signed, in its financial assets. The resulting income/expenses from profit sharing agreements have been neutralized in terms of their impact on income by the formation of a provision which does not permit profit contributions that cannot be allocated with certainty to be used for making dividend payments.

As part of the reorganization of the Group structure, it was also agreed to implement groupwide cash and foreign currency management solely through SMG effective as of December 1, 2005. Accordingly, as of this date, SZAG transferred all receivables and liabilities vis-à-vis the Group companies, including existing financial investments, against the granting of a claim to its subsidiary SMG.

Salzgitter AG Balance Sheet (summarized)

in € mil.	31/12/2005	%	31/12/2004	%
Fixed assets	471.6	31.0	467.7	27.3
Tangible assets ¹⁾	25.7	1.7	27.1	1.6
Financial assets	445.9	29.3	440.6	25.7
Current assets	1,047.7	69.0	1,244.1	72.7
Trade receivables and other assets ²⁾	1,047.5	69.0	1,015.2	59.3
Cash and cash equivalents	0.2	0.0	228.9	13.4
Assets	1,519.3	100.0	1,711.8	100.0

in € mil.	31/12/2005	%	31/12/2004	%
Shareholders' equity	678.3	44.6	636.8	37.2
Special reserves with an equity portion	3.7	0.3	3.9	0.2
Provisions	825.5	54.3	449.0	26.2
Liabilities	11.8	0.8	622.1	36.4
due to banks	[7.9]		[8.2]	
Shareholders' equity and liabilities	1,519.3	100.0	1,711.8	100.0

¹⁾ Including intangible assets

²⁾ Including prepaid expenses and own shares

The main consequence of the transfer of cash and foreign currency management was that the balance sheet total contracted by € 193 million (–11.2%) to € 1,519 million. This was offset by receivables from profit sharing agreements, as well as the corresponding provisions for profits generated on behalf of third parties disclosed in the balance sheet. The share of equity in the lower balance sheet total came to 44.6% (2004: 37.2%). In accordance with the resolution passed at the General Meeting of Shareholders held on April 23, 1998, provision was made for contingent capital of up to € 5.1 million to cover the issuing of warrant-linked bonds. These warrant-linked bonds comprise a 5% Salzgitter AG bond (term: 1998 to 2005) combined with option rights that entitle the holder to subscribe to Salzgitter AG shares if certain conditions are met. In the financial year 2005, this occurred on a number of occasions and, accordingly, option rights to the subscription of 280,000 shares were exercised by

those entitled. The exercising of these options, due to expire on September 28, 2005, served to repay the bond in the amount of € 0.7 million and raised subscribed capital by the same amount.

The greatly improved profit trend of the subsidiaries resulted in another notable increase in income from shareholdings in comparison with 2004. Owing to the pending, invalid spin-off and transfer agreement, a corresponding correction item was disclosed under the position "result generated on behalf of third parties".

Salzgitter AG Income Statement (summarized)

in € mil.	FY 2005	FY 2004
Other operating income	142.4	10.5
Personnel expenses	81.2	14.8
Depreciation and amortization ¹⁾	11.0	27.7
Other operating expenses	58.9	135.0
Income from shareholdings	410.6	253.9
Net interest result	5.3	-3.7
Profit on ordinary activities	407.2	83.2
Taxes	-5.6	-38.3
Result generated on behalf of third parties	338.7	0.0
Net profit for the year	62.9	44.9

¹⁾Including unscheduled write-downs on financial assets and marketable securities

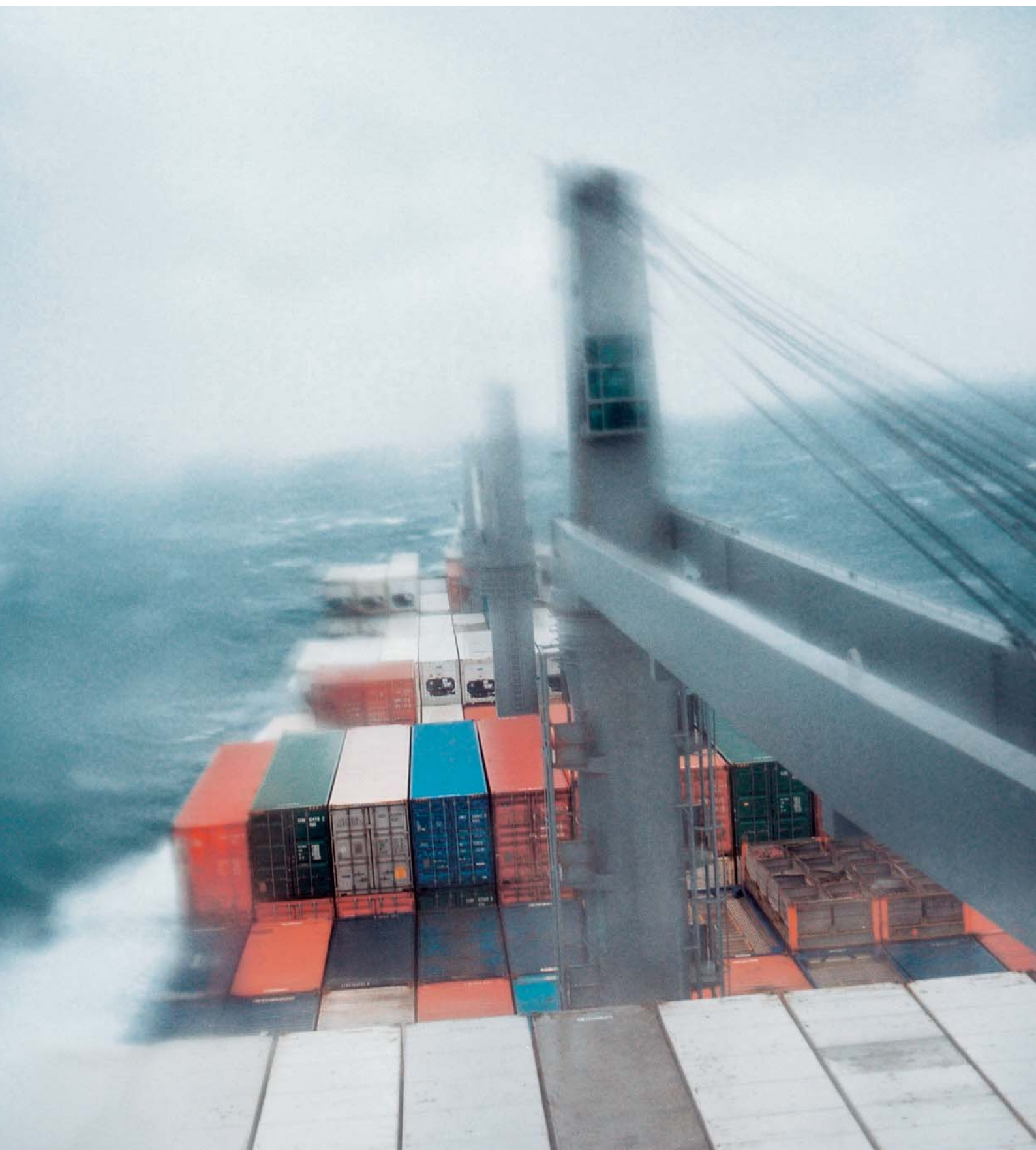
The profit of SZAG, the holding company, will be decisively impacted by the dividend of € 70 million of its SMG subsidiary. Proceeds of € 94 million from the sale of the shares of Vallourec S.A. are included under other operating earnings. Moreover, for the first time a management fee was paid by the domestic subsidiaries. The management fee of € 24 million was calculated by the application of the formula "50% sales/50% value added".

The significant increase in personnel expenses is mainly attributable to a change in the actuarial rate for pension provisions (from 6% to 4%) for the appropriate disclosure of pension liabilities.

Write-downs of financial assets were carried out this year for one of the companies belonging to the Services Division.

Much lower other operating expenses were attributable to precautionary measures in comparison with 2004 which still related to two companies, one in the Steel Division and one in the Services Division.

The improvement in interest income is mainly the result of a lower portion of interest on transfers to pension provisions arising from the adjustment of the actuarial rate. Moreover, the transfer of group-wide cash management to SMG, effective December 1, 2005, had an impact on interest income.



The development of the tax burden can be explained mainly through the fact that a significantly higher income from shareholdings was generated owing to the outstanding development of companies with profit sharing agreements in the steel and trading segments. Due to the still invalid and pending spin-off and transfer agreement these earnings in their full amount were considered as profit generated on behalf of third parties, i.e. accruing to the contracting party (legal entity). As a result, the tax expenses pertaining to these earnings were not disclosed at SZAG.

Appropriation of Earnings at Salzgitter AG

For the financial year 2005 Salzgitter AG reported a net income of € 62.9 million. Taking into account the unappropriated profit brought forward (€ 1.6 million) the profit shown on the balance sheet came to € 64.5 million.

The Executive Board and the Supervisory Board will propose to the General Meeting of Shareholders that this profit (€ 64.5 million) be used to fund payment of a basic dividend of € 0.50 per share, plus a bonus dividend of € 0.50 per share (based on the capital stock of € 161.6 million divided into 63,218,400 shares) and that the remaining amount be carried forward to new account.

The proposed appropriation of earnings will be adapted accordingly in line with the company's holding of own shares on the day of the General Meeting of Shareholders, as these shares are not eligible for dividend.