

2.5 Risk Report

Opportunities and Risk Management System

Business activity as defined by the Articles of Incorporation makes risk-taking unavoidable. These risks must, however, be manageable and controllable for the management. Effective and foresighted risk management is therefore an important and value-creating component among the management instruments employed by Salzgitter AG to ensure the existence of the company, the invested capital and current jobs.

In the Salzgitter Group, risk and opportunity management are treated separately as a matter of principle. Risks are mapped and tracked in a separate reporting system. By contrast, the identification and communication of opportunities forms an integral part of the controlling system that operates between our subsidiaries and associated companies and the holding company. This also includes, for example, measures to profile our strengths and access strategic growth potential that can be derived on a focused basis from a specially developed strategy atlas and with whose help we constantly monitor our market and product environment.

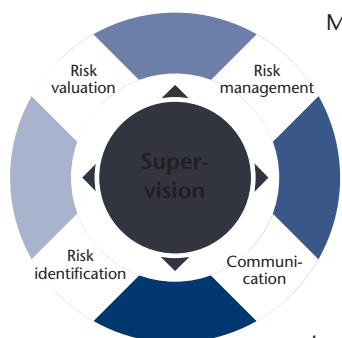
With regard to value-oriented corporate management, we weigh up risk and opportunity aspects.

The risk management incorporates all fully consolidated companies in the Steel, Trading and Services divisions – also including the non-consolidated Oswald Hydroforming GmbH & Co. KG and Telefonbau Marienfeld GmbH & Co. KG. In the Tubes Division, not only the fully consolidated companies, but also the joint venture Europipe GmbH, including Eupec PipeCoatings GmbH, are integrated into the risk management system in accordance with Salzgitter AG's guidelines.

The subsidiaries and associated companies of Salzgitter AG apply the risk management system autonomously. The management holding company specifies guidelines that constitute the basis on which to ensure adequate and uniform consideration and communication of risks within the Group. Beyond this, the system of risk management deployed by Salzgitter AG is also documented in a risk manual.

In order to improve the informative value of the groupwide risk portfolio, the risk management system is constantly being further developed and refined to meet the prevailing requirements. Based on the contents implemented in the previous financial year, principles for the continuing harmonization of damage evaluations were formulated this year in a more extensive set of guidelines.

A reporting system used by the entire Group ensures that management is provided with complete and timely information. Group companies report on the risk situation in monthly controlling reports, ad hoc and directly to the Executive Board. Almost all of the companies subject to reporting requirements use a Group database to ensure effective data handling. At Group level, the identified risks are analyzed, evaluated and meticulously tracked.



Measures to cope with and delimit risks can be introduced at an early stage and in a targeted manner as a result of the transparency gained with respect to risk-inherent developments and potential risks. At Salzgitter AG there is a clear demarcation between risk management and controlling, which are nevertheless geared to complementing each other. Actual risks can therefore be handled either through the medium of controlling (for example, by way of provisioning), or via the risk management system (by taking action to overcome the risk), or via both approaches augmenting each other.

Risks are considered an integral part of intra-year forecasting, medium-term planning and strategy discussions. To manage these risks, processes, regulations and tools are established. The aim is to avoid potential risks or to control them or to take corresponding measures while being appropriately aware of opportunities that might arise.

In terms of the likelihood of their occurrence, a distinction is drawn between improbable and probable risks. Improbable risks are events, which after careful commercial, technical and legal consideration of the circumstances, are deemed unlikely to occur and thus tend not to be expected. The conditions that must be fulfilled for this judgment to stand are documented, periodically examined and if necessary updated. Consideration of the sustained validity of the conditions set is an aspect of controlling and auditing at Salzgitter AG. The definition of probable risk means that loss or damage to the company resulting from an undesirable event can no longer be ruled out. In the interest of traceability and controllability, the quantitative extent of the calculated loss or damage is documented in the light of the relevant influencing factors.

With regard to the extent of loss or damage, a distinction is drawn between major risks in excess of € 25 million and other risks involving loss or damage of less than € 25 million. Risks must be recorded within the internal planning and controlling systems of the respective companies and communicated to Group management in accordance with the specific company reporting thresholds.

Individual Risks

Based on macroeconomic changes in the international markets, price developments in the sales and purchase markets, currency exchange rates (in particular the USD/EUR exchange rate) and developments in the price of oil are of key importance for us. In order to minimize business risks that result from these, we observe related trends and take these into account in our risk forecasts. This also applies for potential, politically conditioned restrictions in the international business, for example, due to a trade embargo.

In order to counter possible risks arising from the many fiscal, environmental, competition-related and other rules and regulations, we ensure strict observance of the respective laws and stipulations and seek extensive legal advice from our own experts and, on a case-by-case basis, from qualified external specialists. We meet risks due to changes in the sector with a decentralized Group structure and, as a result, fast decision-making processes that allow us to adapt rapidly to new market conditions.

Large value risks resulted from the price increase for important raw materials (iron ore, coal, scrap and alloys). The previous year's trend continued on an overall undiminished basis into 2005 and led to higher purchase costs compared with budget, to the extent of a mid-double digit figure in millions. We identified this at an early stage and it is reflected in the profits preview. In the financial year ended, increases in the sales of our products and the early implementation of currency hedging measures compensated for these additional expenses.

We counter the potential risk of insufficient supplies, relative to demand, of important raw materials and energy (electricity, gas) by safeguarding the procurement of such raw materials from various regions and suppliers, in part by way of long-term framework contracts. We also operate an appropriate warehousing policy. On the basis of our assessment of our sources of supply, we regard the availability of these raw materials in the required quantities and qualities as largely ensured as best as can possibly be the case. This likewise applies to supplies of coal that are still sourced partly in Germany and partly on the world market. We purchase electricity on a contractually secured basis insofar as our requirements exceed our own generating capacity.

A typical risk may result from the wide fluctuations in prices and volumes in our selling markets. We counteract the possible threat to our existence this risk may represent by broadly diversifying our products, customer segments and regional selling markets, by adopting situation-related countermeasures in our operations and by maintaining a sound balance sheet and financing structure. By exploiting the compensatory opportunities offered by the differing economic developments which affect our various divisions (for example, the influence of the oil price on the automobile industry and the tube and pipe business), we are able to achieve a more balanced risk portfolio across the entire Group.

The risk of an unplanned, extended shutdown of our key plant components is counteracted by continuous plant checks, a program of preventive maintenance as well as ongoing modernization and investment. To cover possible loss or damage and the associated production stoppages, as well as other possible compensation and liabilities claims, we have concluded insurance policies which guarantee that the financial consequences of potential risks are kept within bounds, if not indeed fully excluded. The scope of this insurance cover is kept under constant review and adjusted as required.

As a matter of principle, it is only permitted to enter into financial and currency risks that are connected with our steel production and trade-typical processes and they are therefore of minor importance in comparison with operating risks.

Currency risks arising from purchase or sales transactions must on principle be secured, either by internal netting within the Group or by hedging. Provision is made for hedging interest rate exposure by means of suitable instruments. In this regard, we refer to the information provided in the Notes to the Annual Financial Statements and the Consolidated Financial Statements.

In the international trading business, open positions or financing arrangements that involve risks are not permitted. Receivables risks are limited as far as possible by providing security for loans and by having set in place a stringent system for exposure management. A part of our US dollar currency requirements is covered with currency options with a two-year duration.

The parent company monitors the liquidity situation within the Group by operating a central cash and interest management system for all of the companies that are financially integrated into the Group. This involves defining internal credit lines for the subsidiaries. Companies with their own credit lines assume responsibility for minimizing the risks that these incur.

In addition, there might be risks arising from necessary capital and liquidity measures and from associated companies which have not performed well over time. We counter this risk through a rolling financial planning process.

The recording and documenting of fiscal risks is carried out by the companies integrated into the pooling of fiscal interests, in close cooperation with the holding company's tax department. The controlling enterprise ensures that provisioning is done to take account, for instance, of the risks arising from tax audits. Companies with independent tax liability, on the other hand, are responsible for their own provisioning.

In connection with the former border area assistance, the EU Commission is demanding subsequent interest and tax payments from Salzgitter AG. The European Court of Justice decided in favor of our company in the first instance. The EU Commission, however, appealed against the judgment before the European Court of Justice. Appropriate provisioning has been carried out for the inherent risk.

Salzgitter AG actively competes on the market to attract qualified specialists and managers. The company counters the risk of fluctuation and the loss of knowledge involved with broad-based measures for developing its personnel.

The introduction of specialist career paths has laid the foundation for creating adequate career prospects for our specialists.

We deal with product and environmental protection risks by adopting a variety of quality assurance measures including, for example, certification in accordance with international standards, the ongoing modernization of our plants and the development of our products, and by comprehensive environmental management.

On January 1, 2005, we began trading with CO₂ emissions certificates. The allocation of emission allowances for the first trading period (2005 – 2007) was sufficient. We do not enter into speculative trading activities with the certificates.

We counter risks arising in the field of information technology by developing and maintaining a Group knowledge base in the form of IT services-oriented subsidiaries. This guarantees that we remain at the forefront of technological progress. The appropriate authority granted to the Group IT management in matters of general policy in this area ensures the ongoing development of our groupwide IT systems and forms the basis for the economic deployment of the required investment funds.

Risks arising in the context of joint ventures in which we do not hold a majority stake and which are therefore not under our full control are limited by way of suitable reporting and consultation structures, by participation in supervisory committees and through contractual arrangements. As a consequence, in order to ensure the transparency of the Europipe GmbH 50% joint venture, members of the Salzgitter AG Board are represented on the Supervisory Board.

The seamless tube activities of the associated company Vallourec & Mannesmann Tubes S.A. were concentrated in Vallourec at mid-year. As of the year-end, Salzgitter's participation in Vallourec amounts to 17.2%.

Overall Statement on the Risk Position

As an independent authority, the Salzgitter AG audit department examines the systems used throughout the Group in terms of adequacy, security, safety and efficiency and provides impetus for their further development as required.

In the financial year 2005 there were no risks which posed a threat to the continued existence of Salzgitter AG. Nor are there currently any concrete developments discernible which might be capable in future of having a lasting and substantially negative impact on the earnings situation, financial position and net worth of Salzgitter AG.

The auditor has checked the risk early warning system installed at Salzgitter AG in accordance with the German Stock Corporation Act. This examination verified the fact that the early warning system installed throughout the Group fulfills its tasks and fully satisfies all company law requirements.

Everything
revolves around
body shells:
State of the art
car body pro-
duction line.