ALTANA AKTIENGESELLSCHAFT
Form 20-F
April 21, 2004

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 20-F

**REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934**

**OR**

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2003**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from _____ to _____**
**Commission file number:**

# ALTANA Aktiengesellschaft

**(Exact Name of Registrant as Specified in Its Charter)**

**Federal Republic of Germany**
**(Jurisdiction of Incorporation or Organization)**

**Am Pilgerrain 15**
**D-61352 Bad Homburg v. d. Höhe**
**Federal Republic of Germany**
**(Address of Principal Executive Offices)**

Securities registered or to be registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| American Depositary Shares, each representing 1 Common Share, no par value | New York Stock Exchange |
| Common Shares, no par value* | New York Stock Exchange |

* Listed, not for trading or quotation purposes, but only in connection with the listing of American Depositary Shares, pursuant to the requirements of the New York Stock Exchange.

Securities registered or to be registered pursuant to Section 12(g) of the Act: None

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act: None

The number of issued and outstanding shares of each of the issuer s classes of capital or common stock as of December 31, 2003 was 136,266,805, no par value.

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes No

Indicate by check mark which financial statement item the registrant has elected to follow.

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**FORWARD-LOOKING STATEMENTS**

This annual report contains certain forward-looking statements, *i.e.*, current expectations or estimates of future events or future results. When used in this document, the words anticipate , believe , estimate , expect , intend , plan and project , and similar expressions, as they relate t management, identify forward -looking statements. These statements are based on beliefs of our management as well as assumptions made by and information currently available to us. Such statements reflect our current views with respect to future events and are subject to various risks, uncertainties and assumptions. Many factors could cause our actual results, performance or achievements to be materially different from those which may be expressed or implied by such forward-looking statements. The accompanying information contained in this annual report, including the information under Item 3: Key Information Risk Factors , Item 4: Information on the Company and Item 5: Operating and Financial Review and Prospects identifies important factors that could cause such differences. These factors includeour ability to develop and launch new and innovative pharmaceutical and chemical products, price regulations for pharmaceuticals and budgeting decisions of local governments and health care providers, the level of our investment in pharmaceuticals -related R&D in any given period, the sales and marketing methods that we use to distribute our pharmaceuticals, the composition of our pharmaceuticals portfolio, our ability to maintain close ties with our chemicals customers, the business cycles experienced by our chemicals customers and the prices of the raw materials that we use in our chemicals business. Forward-looking statements speak only as of the date they are made. We do not intend, and do not assume any obligation, to update forward-looking statements to reflect facts, circumstances or events that have occurred or changed after such statements have been made.

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## PART I

### ITEM 1: IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not applicable.

### ITEM 2: OFFER STATISTICS AND EXPECTED TIMETABLE

Not applicable.

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## ITEM 3: KEY INFORMATION

### Selected Consolidated Financial Data

The selected consolidated financial data as of and for the years ended December 31, 1999, 2000, 2001, 2002 and 2003 set forth below are derived from our consolidated financial statements. Our consolidated financial statements as of and for the years ended December 31, 1999, 2000, 2001 and 2002 have been audited by KPMG Deutsche Treuhand-Gesellschaft AG Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, Germany ( KPMG ); our consolidated financial statements as of and for the year ended December 31, 2003 have been audited by PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt am Main, Germany ( PwC ).

We prepare our consolidated financial statements in accordance with International Financial Reporting Standards (IFRS). IFRS differ in certain significant respects from U.S. Generally Accepted Accounting Principles (U.S. GAAP). For a description of the significant differences between IFRS and U.S. GAAP and a reconciliation of net income and shareholders equity to U.S. GAAP, you should read notes 33 and 34 to our consolidated financial statements.

All share and per share data in this annual report relating to prior periods have been restated to reflect the changes to our share capital that occurred in 2001.

You should read the information below in conjunction with our consolidated financial statements and the other financial information that we have included elsewhere in this annual report. For our consolidated financial statements as of and for each of the three years ended December 31, 2003, see the discussion beginning on page F-1.

**Selected Consolidated Financial Data as of and for the Five Years Ended December 31, 2003**

The following table presents selected consolidated financial information as of and for the five years ended December 31, 2003:

| | As of and for the year ended December 31,(1) | | | | |
|---|---|---|---|---|---|
| | **1999** | **2000** | **2001** | **2002** | **2003** |
| | **(€ in millions, except per share/ADS amounts)** | | | | |
| **Selected income statement data** | | | | | |
| *Amounts in accordance with IFRS* | | | | | |
| Net sales | 1,577 | 1,928 | 2,308 | 2,609 | 2,735 |
| Gross profit | 927 | 1,144 | 1,414 | 1,681 | 1,788 |
| Research and development expenses | (171) | (219) | (285) | (369) | (412) |
| Operating income | 205 | 309 | 520(2) | 538 | 563 |
| Financial income | 18 | 21 | 24 | (12) | 17 |
| Income before taxes and minority interests | 223 | 329 | 544 | 527 | 580 |
| Net income | 118 | 181 | 328 | 324 | 345 |
| Weighted average number of shares outstanding during period (in millions) | 140.2 | 138.8 | 137.5 | 136.6 | 136.3 |
| Basic earnings per share/ADS(3) | 0.84 | 1.30 | 2.38 | 2.37 | 2.53 |
| Diluted earnings per share/ADS(4) | 0.84 | 1.30 | 2.37 | 2.36 | 2.53 |
| Dividends per share/ADS(5) | 0.35 | 0.44(6) | 0.60(7) | 0.75 | 0.83(8) |
| *Amounts in accordance with U.S.GAAP* | | | | | |
| Net income | 130 | 166 | 314 | 338 | 337 |
| Basic earnings per share/ADS(3) | 0.93 | 1.20 | 2.28 | 2.47 | 2.47 |
| Diluted earnings per share/ADS(4) | 0.92 | 1.19 | 2.26 | 2.46 | 2.47 |

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| | As of and for the year ended December 31,(1) | | | | |
|---|---|---|---|---|---|
| | 1999 | 2000 | 2001 | 2002 | 2003 |
| | (€ in millions, except per share/ADS amounts) | | | | |
| **Selected balance sheet data** | | | | | |
| *Amounts in accordance with IFRS* | | | | | |
| Property, plant & equipment | 394 | 478 | 579 | 610 | 687 |
| Cash & cash equivalents and marketable securities | 547 | 487 | 552 | 584 | 580 |
| Total assets | 1,638 | 1,812 | 2,127 | 2,269 | 2,532 |
| Debt | 126 | 100 | 127 | 117 | 96 |
| Total liabilities | 336 | 384 | 426 | 448 | 527 |
| Total provisions | 402 | 436 | 522 | 563 | 553 |
| Total shareholders equity | 881 | 984 | 1,170 | 1,250 | 1,445 |
| Number of shares outstanding at period end (in millions) | 139.5 | 138.1 | 137.2 | 136.5 | 136.3 |
| *Amounts in accordance with U.S. GAAP* | | | | | |
| Total shareholders equity | 886 | 973 | 1,159 | 1,261 | 1,470 |
| **Selected cash flow statement data** | | | | | |
| *Amounts in accordance with IFRS* | | | | | |
| Net cash flow provided by operating activities | 164 | 282 | 309 | 442 | 425 |
| Net cash flow used in investing activities | (111) | (156) | (113) | (204) | (298) |
| Net cash flow used in financing activities | (65) | (118) | (116) | (154) | (152) |

(1) Columns may not add due to rounding.
(2) Includes a one-time gain in the amount of € 110 million resulting from the sale of our interest in a joint venture and a special donation of € 15 million to a charitable endowment.
(3) Basic earnings per share is computed by dividing net income by the weighted average number of shares outstanding during the relevant period. For the year ended December 31, 2003, the weighted average number of shares includes shares issuable in connection with the legal proceedings surrounding Deutsch-Atlantische Telegraphen AG ( DAT ). See Item 4: Information on the Company-Legal Proceedings for more information on these proceedings.
(4) Diluted earnings per share is computed by dividing net income by the sum total of the weighted average number of shares outstanding during the relevant period, adjusted for shares issuable upon the exercise of options under stock option plans and, for years ended on or before December 31, 2002, shares issuable in connection with the DAT litigation.
(5) Dividends are presented in the column of the year in respect of which they are declared. Dividends are paid in the year following the year in respect of which they are declared.
(6) Does not include a one-time bonus dividend in the amount of € 0.17 per share.
(7) Does not include a one-time bonus dividend in the amount of € 0.10 per share.
(8) Management proposal to be submitted to our shareholders for approval at the annual general meeting to be held on May 5, 2004.

**Dividends**

The following table sets forth the dividends per share paid in respect of each of the five years in the period ended December 31, 2003 in euro and U.S. dollars. We declare dividends in euro. For purposes of the table below, we have converted the amounts paid as dividends into U.S. dollars using the noon buying rate on the date of the shareholders meeting at which the relevant dividends were approved. The table does not reflect the related tax credits that were available to German taxpayers in respect of dividend payments prior to 2002. Owners of our shares who are U.S. residents should be aware that they will be subject to German withholding tax on any dividends that they receive. See Item 10: Additional Information Taxation .

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| Year ended December 31, | Dividend per share | |
|---|---|---|
| | (€) | ($) |
| 1999 | 0.35 | 0.37 |
| 2000(1) | 0.44 | 0.39 |
| 2001(2) | 0.60 | 0.54 |
| 2002 | 0.75 | 0.85 |
| 2003 | 0.83(3) | – |

(1) Does not include a one-time bonus dividend in the amount of € 0.17 per share.
(2) Does not include a one-time bonus dividend in the amount of € 0.10 per share.
(3) Management proposal to be submitted to our shareholders for approval at the annual general meeting to be held on May 5, 2004.

Both net income distributable as dividends and net income subject to German tax are determined on the basis of the stand-alone unconsolidated financial statements of our holding company, ALTANA Aktiengesellschaft, prepared in accordance with German GAAP. German GAAP differ in a number of important respects from both IFRS and U.S. GAAP. In 2003, our net income calculated on an unconsolidated basis in accordance with German GAAP was € 276.0 million. In 2002, our net income calculated on an unconsolidated basis in accordance with German GAAP was € 1,113 million. This figure reflects corporate income tax-free capital gains resulting from changes to the legal organization of our group in 2002. We transferred the gains realized in connection with these changes to our holding company pursuant to various profit transfer agreements between our holding company and our two divisions. Excluding the effect of these gains, our company s net income calculated on an unconsolidated basis in accordance with German GAAP would have been € 223 million in 2002, compared with € 193 million in 2001. Because the companies that were affected by the organizational changes in 2002 are all wholly-owned subsidiaries of our holding company, the tax-free capital gains that arose in connection with these changes are not reflected in our consolidated financial statements.

**Exchange Rate Information**

We publish our consolidated financial statements in euro. As used in this annual report, euro or € means the single unified currency of the European Monetary Union. U.S. dollar , USD , U.S.$ or $ means the lawful currency of the United States of America. As used in this annual report, the term noon buying rate refers to the exchange rate for euro, expressed in U.S. dollars per euro, as announced by the Federal Reserve Bank of New York for customs purposes as the rate in the city of New York for cable transfers in foreign currencies.

To enable you to ascertain how the trends in our financial results would have appeared had they been expressed in U.S. dollars, the table below shows the average noon buying rates for U.S. dollars per euro for the five years ended December 31, 2003. The averages set forth in the table below have been computed using the noon buying rate on the last business day of each month during the periods indicated.

| Year ended December 31, | Average |
|---|---|
| 1999 | 1.0588 |
| 2000 | 0.9209 |
| 2001 | 0.8909 |
| 2002 | 0.9495 |
| 2003 | 1.1411 |

The following table shows the noon buying rates for U.S. dollars per euro for the six months ended March 31, 2004:

| Month | High | Low |
|---|---|---|
| October 2003 | 1.1833 | 1.1596 |
| November 2003 | 1.1995 | 1.1417 |
| December 2003 | 1.2597 | 1.1956 |
| January 2004 | 1.2853 | 1.2389 |
| February 2004 | 1.2848 | 1.2426 |
| March 2004 | 1.2431 | 1.2088 |

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On April 19, 2004, the noon buying rate was $ 1.2019 per € 1.00.

Since the beginning of 1999, our shares have traded on the Frankfurt Stock Exchange in euro. We expect that fluctuations in the exchange rate between the euro and the U.S. dollar will affect the U.S. dollar equivalent of the euro price of our shares on the Frankfurt Stock Exchange and as a result are likely to affect the market price of our American Depositary Shares ( ADSs ) on the New York Stock Exchange. In addition, you should note that any cash dividends that we may declare in the future will be denominated in euro. Therefore, exchange rate fluctuations between the euro and the U.S. dollar will affect the U.S. dollar amounts that the holders of our ADSs will receive upon the conversion of any cash dividends that we may pay out on the shares represented by these ADSs.

A substantial portion of our assets, liabilities, revenues and expenses are denominated in currencies other than the euro. Accordingly, fluctuations in the value of the euro relative to other currencies have had a significant effect on the translation into euro of our non-euro assets, liabilities, revenues and expenses, and may continue to do so in the future. For further information on the impact of fluctuations in exchange rates on our operations, see Risk Factors Risks Related To Each Of Our Businesses and Item 11: Quantitative and Qualitative Disclosures About Market Risk.

## Risk Factors

Our business, financial condition and results of operations may suffer material adverse effects due to any of the following risks. Additional risks not known to us or that we now consider immaterial also may adversely affect our business.

### Risks Related to Each of our Businesses

*Because the industries in which we operate are characterized by constant innovation and technological change, our success depends upon our continued ability to develop and market innovative products on a cost-effective basis. If we fail to do so, we may be unable to capture additional market share or may lose market share.*

We operate in the pharmaceuticals and the specialty chemicals industries, both of which are highly competitive and are characterized by intensive research efforts and rapid technological change. Our success is highly dependent on our ability to discover, develop and manufacture new and innovative products on a cost-effective basis and to market them successfully. In doing so, we face and will continue to face intense competition from a variety of competitors, ranging from small niche companies to large national and international conglomerates. Based on total assets and annual revenues, we are significantly smaller than many of our competitors, which often have substantially greater financial, R&D and sales and marketing resources than we do. As a result, our competitors may succeed in developing and manufacturing products that are superior to our own products or that the market perceives to be more attractive. If this happens, our products may become uncompetitive and we may be unable to capture additional market share or may lose market share. In light of the ongoing consolidation of the industries in which we operate, we expect that the competitive pressures to which we are subject will increase in the future.

*We operate in many different countries around the world. As a result, fluctuations in the exchange rates between the euro and other currencies could adversely affect our results of operations and reduce our ability to price our products competitively.*

Due to the international scope of our operations, our net sales and net income may be affected by fluctuations in exchange rates, particularly between the euro and the U.S. dollar. An increasing portion of our sales is made in markets outside the European Union by our local subsidiaries or through distribution arrangements. As a result, fluctuations between the euro and the currencies in these markets may cause our reported revenues to vary significantly from period to period. For example, the devaluation of the U.S. dollar against the euro that started in 2002 has had a negative impact on our net sales, especially our reported sales of Pantoprazole, which is currently our most important product, in the United States. Any further devaluation of the U.S. dollar against the euro would intensify this effect. At the same time, a substantial proportion of our operating costs continues to be linked to the euro. Accordingly, exchange rate fluctuations have also affected our profitability, and they may continue to do so in the future.

You should note that historically each of our subsidiaries has been responsible for managing its own foreign exchange rate exposure. In 2003 we introduced a uniform hedging strategy for our main currency exposures, especially our exposure to the U.S. dollar, by expanding the time frame for our hedging transactions and the instruments that we use in structuring them. We believe that this revised

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strategy will assist us in better forecasting our financial results as well as in limiting our exposure to volatile exchange rates. Nevertheless, future fluctuations in the exchange rates between the euro and other currencies, particularly the U.S. dollar, may significantly influence our revenues and profitability.

In addition to influencing our reported net sales and net income, exchange rate fluctuations may also impact our competitive position in countries whose currencies fluctuate against the euro. In past years, the weakness of the euro vis-à-vis the U.S. dollar and currencies linked to the U.S. dollar has afforded us greater pricing flexibility in the United States and other countries, which in turn improved our competitive position and our profitability vis-à-vis our U.S. competitors. Starting in 2002, however, the euro has strengthened significantly relative to the U.S. dollar. This development has benefited our U.S. competitors, reduced our own pricing flexibility and adversely affected our reported revenues and profitability.

*Because we depend on key management, scientific and technical personnel, our ability to compete would suffer if we were unable to hire and retain qualified employees.*

Our success depends upon the continued contributions of our key management, scientific and technical personnel, many of whom have substantial experience with our company and would be difficult to replace. Competition for qualified personnel is intense in the industries in which we operate, and particularly so in the pharmaceuticals industry, and we may be unable to attract the highly qualified employees that our business requires. If we lose the services of our key management or scientific and technical personnel or do not succeed in attracting highly qualified personnel in the future, our business may be hurt by a reduced ability to compete in the rapidly evolving markets in which we operate.

*Our business will suffer if we are unable to obtain and defend intellectual property rights or if we do not gain access to, or are accused of infringing on, the intellectual property rights of others.*

Our ability to remain competitive and to capture additional market share depends in part on our ability to obtain and defend patents, trademarks and other forms of intellectual property protection for our products, and on our development and manufacturing processes and our know-how. While we intend to prosecute patents aggressively, the process of obtaining patents is lengthy and expensive. There can be no assurance that patents will be granted in connection with any of our currently pending or future applications or that such patents will be valid and of sufficient scope and strength to provide us with meaningful legal protection or any commercial advantage. We recently received notices of applications by generic drug companies before the Food and Drug Administration Agency ( FDA ) in the United States challenging the patents for Pantoprazole with a view to manufacturing and distributing a generic version of Pantoprazole. While we believe that our U.S. patents relating to Pantoprazole are valid and enforceable and of sufficient scope and strength to prevent the entities that have made the filings and any other third party from manufacturing and distributing Pantoprazole-based generics at this time, there can be no assurance that we will be successful in defending our patents. For more information, see Item 4: Information on the Company Pharmaceuticals Intellectual Property .

In addition, intellectual property protection may be unavailable or limited in some of the countries in which we do business. Furthermore, a substantial portion of our know-how is not eligible for patent or comparable forms of intellectual property protection. To protect this type of information against access by competitors, we rely on trade secret law and frequently enter into confidentiality agreements with our employees, customers and partners. These agreements may be unenforceable, however, and the remedies available to us for breaches may be inadequate. Likewise, our competitors may gain access to our know-how by lawful means, for example, by reverse engineering or by independently developing the same know-how, which would destroy any advantage that our know-how may afford us.

Our competitive position may also suffer if competitors come up with products, development or manufacturing processes or know-how that is protected by patents, trademarks, licenses or other forms of intellectual property protection. Technologies over which our competitors hold intellectual property rights may either be unavailable to us or be available to us only on unfavorable terms. To gain access to such technologies, we sometimes enter into licensing arrangements with third parties. If our licensing partners were to terminate the licenses that we have obtained from them or if we are unable to obtain licenses on commercially favorable terms in the future, our ability to develop, manufacture and market our present and future products may be impaired.

While we seek to protect our trademarks, which include the names of many of our key products, by filing for trademark protection in most of the countries where we sell these products, you should

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note that trademark protection consists primarily of a right to sue against infringing uses of a mark and, in order to be effective, requires extensive policing. If we fail to detect instances of infringement or if we do not succeed in defending our trademarks in court, our reputation with our customers and our ability to protect our trademarks in the future may be harmed.

It may become necessary for us to seek to enforce our patents, trademarks, licenses and other forms of intellectual property protection and to protect our trade secrets by taking legal action or to engage in litigation in order to defend ourselves against claims of alleged infringement of someone else s intellectual property brought against us by third parties. For example, in 1995, AstraZeneca PLC sued us, alleging that our gastrointestinal therapeutic Pantoprazole infringed that company s omeprazole patents (which have meanwhile expired). While we successfully settled this claim in a manner favorable to us, there can be no assurance that we will also be able to settle other claims that may be brought against us by third parties in the future. If we are unable to successfully settle future claims on terms acceptable to us, we may be required to engage in costly and time-consuming litigation and may be prevented from, or experience substantial delays in, marketing our existing pharmaceuticals and launching new ones. Any of these events could require us to divert substantial financial and management resources that we would otherwise be able to devote to our business.

*Because our operations are subject to numerous environmental laws and regulations, we could become exposed to liability and be required to spend substantial amounts in connection with environmental compliance or remediation proceedings.*

Our operations are subject to numerous environmental laws and regulations in the jurisdictions in which we operate. These laws and regulations govern, among other things, air emissions, wastewater discharges, the use and handling of hazardous substances, waste disposal and the investigation and remediation of soil and groundwater contamination. As with other companies engaged in activities similar to ours, we face a risk of environmental liability inherent in our current and historical manufacturing activities. While we do not believe that any currently anticipated environmental compliance and remediation requirements are likely to have a material adverse effect on our business, financial condition or results of operations, we may be forced to incur substantial expenses in connection with future environmental compliance or remediation proceedings, in which case our results of operations and financial condition may be materially adversely affected.

*We may be faced with product liability claims, which could impair our reputation in the marketplace and hurt our profitability.*

Although we maintain a comprehensive quality assurance program, there remains a risk that defects may occur in any of our products. The occurrence of such defects could give rise to liability for damages, including consequential and punitive damages, and could, by impairing our reputation, reduce the market s acceptance of our products.

To reduce our exposure to the aforementioned risks, we maintain an insurance policy covering product liability claims. There can be no assurance, however, that our insurance policy will be adequate and sufficient to cover all product liability claims that may be brought against us or that we will be able to obtain adequate insurance coverage on commercially reasonable terms in the future. A successful product liability claim in excess of our coverage could require us to pay substantial amounts in damages. In addition, our insurance policy does not protect us against reputational harm that we may suffer if the market perceives our products as unsafe or ineffective.

*Our business may suffer as a result of volatility in different parts of the world.*

We operate on a global basis. Our business is therefore subject to a variety of risks inherent in conducting international operations, each of which could adversely affect our business and results of operations. These risks include:

Wars, terrorist attacks and other hostilities;

Instability of foreign governments;

Changes in domestic or foreign laws or policies affecting international trade and foreign investment; and

Varying practices of the regulatory, tax, judicial and administrative bodies in the jurisdictions in which we operate.

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*Fluctuations in stock prices and interest rate volatility could impair the value of our investments and adversely affect our financial position.*

We invest a considerable amount of our cash balances in marketable securities, particularly fixed-income securities. At December 31, 2003, our portfolio of marketable securities represented more than 10% of our total assets. Fluctuations in the stock prices and interest rate volatility may affect the value of our portfolio of marketable securities and thus have an adverse impact on our financial position.

**Risks Related to our Pharmaceuticals Business**

*Because we depend on the sale of a limited number of key products to generate a substantial proportion of our revenues, factors adversely affecting the sale of these products could materially harm our revenues and results of operations.*

As with other companies in the pharmaceuticals industry, our pharmaceuticals division depends on sales of certain key products that account for a substantial portion of its revenues. For example, in 2003, our net sales of Pantoprazole, a proton pump inhibitor ( PPI ) that we offer for the treatment of ulcers and reflux disease, accounted for 56.2% of the net sales of our pharmaceuticals division, or 40.7% of our overall revenues. Pantoprazole has been a key revenue driver of our pharmaceuticals division for several years, and we expect that it will continue to account for a substantial proportion of our revenues in future periods. While we plan to launch additional therapeutics over the next several years (provided we manage to obtain regulatory approval for these drug candidates), including Ciclesonide, which we intend to market under the name Alvesco®, and Roflumilast, which we intend to market under the name Daxas®, we expect to continue to depend on a limited number of key products for the foreseeable future.

As a result of our dependence on key products, particularly Pantoprazole, factors adversely affecting the sale of any of these products could materially adversely affect our revenues and results of operations. These factors include:

- Competition from other branded pharmaceuticals that may be equivalent or superior to our own products or that the market perceives to be more attractive;
- Competition from generic versions of branded pharmaceuticals once the term of patent protection for the original branded pharmaceuticals has expired;
- Technological advances;
- The marketing strategies of our competitors;
- Supply chain interruptions;
- Work stoppages;
- Changes in prescription practices;
- Changes in the reimbursement policies of third-party payers; and
- Product liability claims.

Pantoprazole, in particular, faces competition from various other branded PPIs. Most notably, these competitors include Takeda's lansoprazole-based PPI, which is the leading PPI in the world and which is marketed in the United States by TAP Pharmaceuticals under the name Prevacid, and AstraZeneca s Nexium, a PPI based on a substance called esomeprazole, which was launched in 2001 and is marketed as a next-generation PPI. If our competitors continue to invest heavily in marketing these products, the ability of Pantoprazole to capture market share or maintain its current market share could be adversely affected.

In addition, Pantoprazole faces increasing competition from generic PPIs, based on a substance called omeprazole. A variety of companies are marketing omeprazole-based generics in Europe and the United States at prices that tend to be significantly lower than the price of Pantoprazole and other branded PPIs. Further competition results from the fact that the Procter & Gamble Company ( P&G ) has recently launched an over-the-counter ( OTC ) version of omeprazole in the United States, which, unlike Pantoprazole, is available to patients without a prescription. While generic and OTC versions of omeprazole-based products have so far had a limited impact on the market for branded PPIs, including Pantoprazole, in Europe, their launch in the United States has resulted in increased competition and stronger price pressure in the U.S. market. This pressure results from the fact that generic PPIs are typically offered at higher discounts than branded PPIs, especially to managed care

organizations, which are among the most important customers of PPIs.

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While Pantoprazole s share both of new PPI prescriptions and of total prescriptions in the United States has, with temporary interruptions, grown since the drug was first introduced in the U.S. market, there can be no assurance that this trend will persist. As a result, we may experience reduced growth and potentially a decline in net sales of Pantoprazole in future periods.

*We depend on Wyeth, Inc. ( Wyeth ) for the marketing and distribution of Pantoprazole in the United States. If Wyeth were to devote insufficient resources to the marketing of Pantoprazole or if we were to lose Wyeth as a partner, our sales of Pantoprazole would be adversely affected.*

Up until June 2003, we marketed Pantoprazole in the United States exclusively through Wyeth Pharmaceuticals, the pharmaceuticals division of Wyeth, Inc. Since July 2003, our own dedicated sales force for the U.S. market has been co-promoting Pantoprazole alongside Wyeth. While this arrangement has afforded us greater influence with respect to the marketing of Pantoprazole in the United States, the revenues that we derive from this drug in the U.S. market continue to materially depend on the resources that Wyeth devotes to the marketing of this therapeutic. While our distribution arrangement with Wyeth requires Wyeth to use commercially reasonable efforts to sell Pantoprazole, there can be no assurance that Wyeth s marketing efforts will be successful. In addition, Wyeth is entitled to terminate its distribution agreement with us in certain circumstances, including when a third party commences legal action against Wyeth alleging patent infringement and, following the fifth anniversary of the date of approval by the U.S. Food and Drug Administration ( FDA ) of the first Pantoprazole-based product, without cause upon one year s prior written notice. If Wyeth terminates the contract for reasons other than because we become insolvent or commit a material breach of the agreement, it is required to transfer all of its rights pertaining to Pantoprazole and to products based on this substance, including any regulatory approvals that it has obtained, to us. See Item 10: Additional Information Material Contracts for a summary of the terms of our agreement with Wyeth. If we were to lose Wyeth as a distribution partner, we would be forced to find a suitable replacement. If we experience delays in finding such a replacement, our ability to sell Pantoprazole in the United States, which accounts for a substantial and increasing proportion of our Pantoprazole sales worldwide, would suffer, and, accordingly, our results of operations would be adversely affected.

*Due to the inherent unpredictability of the process underlying the development of new pharmaceuticals, there can be no assurance that we will be able to successfully and timely launch new drugs and other pharmaceutical products.*

A critical element of our future success is the successful and timely commercial launch of new products. To this end, we devote substantial resources to research and development and have a number of promising candidates for new therapeutics in our pipeline, including a potential next-generation drug for indications similar to those of Pantoprazole and several candidates for the treatment of asthma and other respiratory tract diseases. Because of the complexities and uncertainties associated with pharmaceutical research, however, we cannot be certain that any of these drug candidates will survive the development process and ultimately obtain the regulatory approvals needed in order to be launched commercially. While some of them are in advanced stages of clinical testing and appear to have desirable therapeutic profiles, adverse clinical and toxicological results remain possible at any time.

*We may be unable to expand into the U.S. market, or our expansion may be delayed, each of which would limit our growth opportunities.*

A key element of the growth strategy of our pharmaceuticals division is our plan to expand into the United States. The United States is the biggest pharmaceuticals market in the world and offers the greatest growth opportunities for our business. We plan to accomplish our expansion into the U.S. market with the assistance of experienced co-promotion partners and by exploiting the launch of certain of our pipeline drugs, including Alvesco® and Daxas®, two therapeutics that we are developing for the treatment of respiratory tract indications, to gradually build up our own sales and marketing organization for innovative therapeutics in the United States. This new sales and marketing organization will supplement our existing U.S. operations for facial topics and certain other types of pharmaceuticals. While we made significant further progress in this area in 2003, if either or both of Alvesco® or Daxas® fail to make it to market or to generate sufficient demand or if we were to lose our co-promotion partners for these drugs and be unable to find suitable replacements or experience delays in finding replacements, we may be unable to expand our operations in the U.S. market or may experience delays in doing so. If we do not succeed in securing a strategic position in this or

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other international markets, the growth of our business may be adversely affected. In addition, we may be unable to recover investments that we have already made in these markets.

*Because our business is subject to extensive governmental regulation, including price controls, our ability to market our products is subject to administrative constraints over which we have only limited influence.*

The development, manufacture and marketing of pharmaceuticals is subject to extensive governmental regulation. Regulatory approval is required in each jurisdiction in which we operate before any dosage form of any new pharmaceutical, including an off-patent equivalent of a previously approved pharmaceutical, may be marketed in that jurisdiction. The process for obtaining governmental approval to market pharmaceuticals is rigorous, time-consuming and costly, and it is impossible to predict the extent to which this process may be affected by legislative and regulatory developments. We currently have several drug candidates in various stages of the approval process in the United States, the European Union and Japan. If we fail to obtain, or experience delays in obtaining, regulatory clearance to market new pharmaceuticals or existing pharmaceuticals for new indications or if we experience any other regulatory impediments, our results of operations may be adversely affected. Even after a pharmaceutical has been approved, it may be subject to regulatory action based on newly discovered facts concerning its safety or efficacy. Any such regulatory action may adversely affect the marketing of our pharmaceutical products, require changes to their labeling and even force us to withdraw them from the market altogether.

In addition to the need for obtaining regulatory approval to market new products, we are subject to price controls imposed by local governments and health care providers and in some markets need to obtain special approval before patients are entitled to be reimbursed for purchasing our products. The existence of price controls can limit the revenues that we earn from our products and thus could also have an adverse effect on results of operations. The way in which price controls operate varies by country and can cause substantial disparities in the price levels prevailing in different markets. Many governments and private medical care providers, such as Health Maintenance Organizations ( HMOs ) and social security organizations, have recently introduced or are currently in the process of introducing reimbursement schemes that favor the replacement of branded pharmaceuticals by cheaper generic pharmaceuticals. Since January 1, 2003, the pharmaceutical industry in Germany had been required to grant the German social security funds (which are the main purchasers of drugs in the German health care system) discounts of 6% off the list price for most ethical therapeutics, which has had a negative impact on our pharmaceuticals sales in Germany. As part of its health care reform plans, the German government has recently increased these discounts to 16% and excluded certain OTC pharmaceuticals from the list of therapeutics that are eligible for reimbursement by the social security funds. In addition, recently adopted legislation provides a framework for the implementation of reference prices also for patent-protected pharmaceuticals, which may be introduced in 2005. As a result of these developments, we anticipate the negative impact of German regulation on our business in Germany to persist. We also expect further price regulations in various other European countries. In the United States, generic substitution statutes, which permit or require dispensing pharmacists to hand out less expensive generic drugs instead of the original ethical drug, have been enacted by virtually all states. The Medicare reform, which was adopted at the end of 2003, provides for, among other things, outpatient pharmaceutical coverage for covered beneficiaries. Demand for pharmaceuticals in the U.S. market could therefore increase significantly. However, the U.S. government could use its purchasing power to demand discounts from pharmaceutical companies, thereby creating *de facto* price controls on prescription drugs. As a result, we expect that pressures on pricing will continue, which could adversely affect our turnover and operating results.

*As part of our plans to expand our pharmaceuticals business, we expect to make substantial investments in therapeutic areas in which we have limited experience, such as oncology. If we are unable to develop new drugs in these areas, we may be unable to recoup our investments.*

Our medium- to long-term goal is to expand our pharmaceuticals business by entering markets in which we are currently not active. One such market that we may decide to enter is the oncology market, which we expect will grow substantially in the future. We have commenced basic oncological research and entered into R&D collaborations with third parties, and we intend to make further investments related to oncology over the next several years. In addition, we may decide to enter other therapeutics markets, which may require us to make similar investments. Investments of this sort frequently involve significant cash expenditures, for example in connection with hiring qualified scientists, conducting R&D projects and making desirable acquisitions. In addition, you should note that we have limited experience with respect to therapeutics that we do not currently offer. As a result, there can be no assurance that we will be successful in developing, manufacturing and

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marketing therapeutics for new markets or integrating them with our existing portfolio at all or within a time frame that will enable us to recoup our initial investments. Any of these risks may ultimately have an adverse impact on our business, financial condition and results of operations.

*Our R&D strategy involves creating and maintaining alliances and other collaborative arrangements with third parties, and any inability to find suitable collaborators may adversely affect our ability to develop new pharmaceuticals.*

Our continued success will in part depend on our ability to establish new and to maintain existing collaborations, alliances and licensing arrangements with third parties, especially with biotech companies. Collaborations with companies and other entities that have expertise in biotechnology and genetic research are of particular importance to our plans to supplement the existing franchises of our pharmaceuticals business with therapeutics for oncological indications. We may not be able, however, to establish such collaborations on terms that are acceptable to us or at all. Moreover, in view of the ongoing consolidation of the biotech industry, we may experience greater difficulty finding suitable partners in the future, as a number of smaller companies, which would be candidates for collaborations, become part of larger conglomerates that compete with us and that may be unwilling to grant us access to attractive technologies on commercially favorable terms or at all. In addition, we have no control over the amount and timing of resources that our partners devote to our programs. If we are unable to form or maintain alliances or our partners fail to assist us with our R&D efforts, our business may be harmed and our results of operations may be adversely affected.

**Risks Related to our Chemicals Business**

*Demand for our products could suffer as result of periodic downturns.*

Because the specialty chemicals that we offer are used in a wide variety of downstream industries served directly or indirectly by us, including the automotive, construction, electrical appliances and packaging industries, our results are affected by the business cycles experienced by these industries. While we seek to reduce our exposure to these cycles by focusing on complementary geographic and product markets, there is no assurance that we will be successful in insulating our chemicals business from downturns experienced by the industries that it serves. In addition, we are not immune to negative economic developments affecting more than one of these industries, such as the continuing difficult economic environment in 2003, which has negatively affected our business by dampening our net sales growth. Economic downturns can lead to overcapacity, oversupply, price pressure, reduced growth and lower margins, each of which could adversely affect our business and results of operations.

*Our results may suffer if we are unable to offset increases in raw material prices or pass them on to our customers.*

Raw material costs account for a significant portion of the cost of sales of our chemicals business. The prices and availability of the raw materials that we use in our chemicals business vary with market conditions and can be highly volatile. If we are unable to compensate for increasing raw material prices by achieving cost savings in other areas or to pass such increases on to our customers, or if the prices for our products decrease faster than raw material prices, our profitability may be hurt. In 2003, we continued to experience high raw material prices, which we were able to offset by substituting cheaper raw materials for more expensive ones. Nevertheless, there have been periods in the past during which we have been unable to offset rising raw material prices, and we expect that similar situations may arise in the future. Therefore, you should be aware that any movements in the level of the raw material prices that we use in our chemicals business may have a material impact on our business, results of operations and financial condition.

*Our growth depends in part on our ability to acquire and successfully integrate companies into our existing organization.*

A key element of the growth strategy of our chemicals division is to supplement our internal growth with strategic acquisitions of businesses and technologies that we consider capable of complementing or enhancing our existing products or of providing us with access to new markets. As a result, if we are unable to identify suitable acquisition targets, our growth prospects may suffer. In addition, in pursuing acquisitions, we may face competition from other companies operating in the specialty chemicals and related industries. Our ability to make acquisitions may be limited also by applicable antitrust, anti-takeover and other regulations in the United States, the European Union and any of the other jurisdictions in which we do business. If any of these risks materialize, we may be

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unable to make desirable acquisitions or to complete them on terms attractive to us. If that occurs, our ability to grow in certain of our business areas may be adversely affected.

To the extent that we are successful in making acquisitions, we may have to expend substantial amounts of cash, incur debt, assume loss-making business units and incur other types of expenses. We may also face difficulties in successfully integrating targets into our existing organization. Each of these risks may have an adverse effect on our business, financial condition and results of operations.

**Risks Related to Investments in our Company**

*Because we and our directors and officers are located in Germany, it may be difficult for you to sue these persons in the United States or to enforce judgments by U.S. courts against them.*

We are a corporation organized under the laws of the Federal Republic of Germany, and certain of our directors and executive officers are residents of Germany. In addition, a substantial portion of the assets owned by us and the aforesaid individuals is located outside the United States. As a result, it may be difficult or impossible for you to effect service of process upon us or any of the aforesaid persons within the United States with respect to matters arising under the U.S. federal securities laws or to enforce against us or any of such persons judgments of U.S. courts predicated upon the civil liability provisions of the U.S. federal securities laws. We have been advised by counsel that it is doubtful as to whether original actions of liabilities predicated on the U.S. federal securities laws may be enforced in Germany and that in Germany both recognition and enforcement of court judgments with respect to the civil liability provisions of the U.S. federal securities laws are solely governed by the provisions of the German Civil Procedure Code (*Zivilprozessordnung* or *ZPO*). In some cases, especially when the relevant statutory provisions of German law do not recognize the international jurisdiction of a U.S. court or the judgment conflicts with certain basic principles of German law (*e.g.*, the prohibition of punitive damages and limited pre-trial discovery), a U.S. judgment might not be recognized by a German court. Service of process in U.S. proceedings on persons in Germany, however, is regulated by a multilateral treaty guaranteeing service of writs and other legal documents in civil cases if the current address of the defendant is known.

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## ITEM 4: INFORMATION ON THE COMPANY

### Introduction

We are a globally operating company that develops, manufactures and markets innovative pharmaceutical and chemical products for a range of targeted, highly specialized applications. In 2003, we reported net sales of € 2,735 million, 82% of which were generated outside of our home market Germany, and operating income of € 563 million.

Over the last five years, our business has on average experienced double-digit annual revenue growth. During the same period, our operating income has grown substantially faster than our net sales, leading to a profit margin (operating income as a percentage of net sales) of 20.6% in 2003. We believe that this development is a result of our strategic focus on the pharmaceuticals and specialty chemicals markets and the international expansion of our business. In recent years, much of this development has been driven by Pantoprazole, our main therapeutic, which we offer for the treatment of reflux disease as well as gastric and duodenal ulcers. Given the market position that Pantoprazole has achieved to date, we expect the growth of Pantoprazole to slow in the future. The following table provides a breakdown of our net sales and shows our operating income for the three years ended December 31, 2003:

**Results of Operations**

| | 2001 | 2002 | 2003 | CAGR(1) |
|---|---|---|---|---|
| | (€ in millions, except %) | | | ( % ) |
| Net sales | | | | |
| Pharmaceuticals | 1,591 | 1,861 | 1,980 | 16.2 |
| Chemicals | 717 | 748 | 755 | 4.3 |
| Total | 2,308 | 2,609 | 2,735 | 12.4 |
| Operating income | 520(2) | 538 | 563 | 22.2 |
| As % of net sales | 22.5(3) | 20.6 | 20.6 | |

(1) The Compound Annual Growth Rate ( CAGR ) measures the average annual growth of a line item over the period for which data is shown in the table.
(2) Includes a one-time gain in the amount of € 110 million resulting from the sale of our interest in a joint venture and a special donation of € 15 million to a charitable endowment. Excluding these items, our operating income in 2001 would have been € 424 million.
(3) Excluding the items described in note (2) above, our operating income, expressed as a percentage of net sales, would have been 18.4% in 2001.

For a description of our principal capital expenditures over the last three years, see Item 5: Operating and Financial Review and Prospects Liquidity and Capital Resources .

Our pharmaceuticals division is committed to developing innovative therapeutics for the global pharmaceuticals markets with a strategic focus on unmet medical needs in the gastrointestinal and respiratory tract areas. Our pharmaceuticals business is currently mainly driven by Pantoprazole. We market Pantoprazole in virtually all regions of the world with the exception of Japan. The main markets for the drug are the United States and Europe. Pantoprazole has been chiefly responsible for the growth of our pharmaceuticals division in recent periods, and we expect that it will continue to be a key revenue driver in the coming year. In addition, our R&D pipeline contains two promising candidates for the treatment of asthma and other respiratory tract diseases, Alvesco® (Ciclesonide) and Daxas® (Roflumilast). Both drug candidates are in advanced stages of clinical development. We filed an application for regulatory approval of Alvesco® in the United Kingdom, Australia, Canada and Switzerland in May 2002, in the United States at the end of 2003 and in Japan in January 2004. At the end of February 2004, the Australian Health Agency granted marketing approval for Alvesco® in Australia. We expect that Alvesco® will next be approved in the United Kingdom in the first half of 2004, with approvals in other member states of the European Union based on the U.K. approval to follow. We filed an application for EU-wide regulatory approval of Daxas® with the European Agency for the Evaluation of Medicinal Products ( EMEA ) in February 2004. In addition to our portfolio of prescription therapeutics, we offer imaging reagents and an assortment of over-the-counter ( OTC ) drugs, which are drugs that are available to patients without prescription.

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Our chemicals division offers a portfolio of innovative high quality specialty chemicals, including additives and measuring instruments, can and coil coatings and sealing compounds, and electrical insulation coatings for use in a wide range of downstream applications. In light of the highly application-specific nature of the specialty chemicals that we offer, we maintain close contact with our customers and constantly aim to develop, manufacture and market products that respond to their specific requirements. We believe that our customer-oriented approach has enabled us to achieve leading positions in the niche markets that we serve as well as revenue growth and margins above the average of our peers.

At December 31, 2003, we had operating subsidiaries in over 25 countries, which marketed our products on a worldwide basis. At that date we employed 10,402 people, of whom 19.2% worked in research and development. We believe that our commitment to the international expansion of our business and to R&D will enable us to capture future growth opportunities in the pharmaceuticals and specialty chemicals industries in our various targeted markets.

We are incorporated as a stock corporation under the laws of the Federal Republic of Germany and began operations as a separate legal entity in 1977 following our spin-off by VARTA AG. The legal name of our company is ALTANA Aktiengesellschaft. Our principal executive offices are located at Am Pilgerrain 15, D-61352 Bad Homburg v. d. Höhe, Germany, and our telephone number is ++49 (0) 6172-1712-0.

**Strategy**

Our group mission, which serves as a guiding principle for both our divisions, is to increase shareholder value through sustained profitable growth by developing, manufacturing and marketing innovative products in selected high-margin areas and expanding our operations internationally. We are committed to fully exploiting the opportunities of emerging technologies by investing a substantial amount of our annual earnings in R&D and to enlarging our presence in all important international markets, particularly the United States.

We measure our success in creating shareholder value by reference to sustained levels of growth in earnings, annual dividends and market capitalization. To focus our efforts on these criteria, we have sought to align the interests of our management and employees with those of our shareholders by implementing stock-based compensation programs. Accordingly, we operate annual stock option plans that are open to our management board, senior executives and other key and high-potential employees. We also offer an annual share ownership plan for those of our employees who are not eligible to participate in our stock option plans. For more information on these plans, see Item 6: Directors, Senior Management and Employees Stock Option Plans and ALTANA Investment Program.

In addition to our overall group strategy, we have also formulated more detailed strategies for each of our two divisions.

In our pharmaceuticals division, our strategy is to:

*Develop innovative therapeutics in high-growth areas.* To capitalize on opportunities in the worldwide pharmaceuticals markets, we concentrate our efforts on the discovery and development of innovative therapeutics in those areas that we believe offer the highest growth potential. Our current focus is on expanding our successful gastrointestinal franchise by exploiting the expertise that we have gained through the development of Pantoprazole, while strengthening our respiratory tract franchise. To this end, we are actively developing next-generation therapeutics for the treatment of ulcers and acid reflux disease, including Soraprazan, which is an acid pump antagonist ( APA ) in Phase II clinical development, and are in the process of finalizing the development of two innovative drugs for the treatment of asthma and other diseases of the respiratory tract, Alvesco® and Daxas®. Our medium- to long-term goal is to supplement our existing franchises by entering the oncology market, which we expect will grow substantially in the future. Consistent with our strategy to concentrate on those segments of the pharmaceuticals markets that offer the greatest growth potential, we have disposed of most of our diagnostics business.

*Expand our business internationally, particularly in the United States, to capture growth opportunities in the global pharmaceuticals markets.* International markets already account for more than 80% of the net sales of our pharmaceuticals division. We consider the further internationalization of our business a key element of our growth strategy. The strong market position of our gastrointestinal drug Pantoprazole in the United States has enabled us to

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achieve substantial sales increases over the past years. In 2003, our U.S. pharmaceutical sales amounted to € 638 million, representing 32.2% of the total net sales of our pharmaceutical division in this period. To solidify and expand our position in this and other important international markets, we aim to increase our visibility by entering into co-promotion arrangements with partners that have established marketing and sales organizations and by exploiting the launch of our pipeline drugs to gradually build our own sales and marketing organizations for innovative pharmaceuticals in the U.S. and other overseas markets. In addition, we plan to create and expand our own research, clinical development and regulatory affairs facilities in overseas locations, especially in the United States and Japan.

*Focus on R&D.* We believe that the foundation of our long-term growth strategy is our continued emphasis on R&D with a special focus on therapeutics, the strategic core of our pharmaceuticals business. In addition, we intend to expand the depth and scope of our R&D activities by entering into strategic collaborations with third parties active in biotechnology and molecular science with a view to enhancing our R&D efforts in the areas of genomics and proteomics. To fully exploit the fruits of our research, we complement our own efforts by entering into co-development arrangements with third parties. We also develop drugs on the basis of technologies licensed from third parties. See Pharmaceuticals Research and Development R&D strategy for more information on our R&D strategy.

In our chemicals division, we seek to:

*Market comprehensive customer-oriented solutions.* In our chemicals business, we provide our customers with comprehensive solutions that combine specialized chemical products with technical advice and assistance regarding their adaptation and integration into our customers manufacturing processes. To this end, we typically market our products on a decentralized basis and maintain customer service facilities in proximity to our customers premises. We believe that this strategy enables us to add substantial value to our customers products and their manufacturing efforts. Our customer-driven philosophy has enabled us to achieve leading positions in terms of innovation, quality and service in a number of selected markets. In addition, because our customers pay us primarily for the performance of our products, rather than the chemical substances of which they consist, our ability to offer comprehensive solutions has allowed us to attain higher profit margins than many of our peers.

*Maintain an innovative portfolio of technologically superior products.* We believe that our focus on developing innovative products has earned us an industry-wide reputation as a supplier of technologically advanced specialty chemicals. We intend to build upon this reputation by continuing to spend substantial resources on R&D. To ensure that our R&D efforts are at all times geared towards improving the performance of our products, all our R&D projects are carried out in close cooperation with our sales and service organization. This approach, which we believe distinguishes us from our competitors, enables us to collaborate with our customers and to constantly adapt the focus of our efforts in response to their needs.

*Focus on selected niche markets.* We seek to achieve a leading position in each of our targeted markets through innovation, quality and service. A key element of our strategy is to focus on markets that are too small to form a core business of our larger competitors and yet too complex to be serviced by smaller companies, which typically have insufficient resources to meet the market s expectations in terms of R&D and international scope. In selecting markets to enter, we aim to maintain a strategic portfolio of downstream markets that allows us to supply a wide array of complementary industries. We believe that this approach enables us to diversify our risk by reducing our exposure to the business cycles of individual markets.

*Supplement organic growth with acquisitions of selected targets.* In furtherance of our strategic goal to maintain and expand our leading position in selected markets of the specialty chemicals industry, we have historically relied on a combination of organic growth and selective acquisitions, and we intend to continue to pursue this strategy in the future. In selecting acquisition targets, we focus on the potential for synergies, the availability of experienced and competent management and the willingness and ability of the target to accept our corporate culture and our focus on serving our customers.

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**Pharmaceuticals**

**Overview**

We develop, manufacture and market a wide range of pharmaceutical products, with a focus on innovative therapeutics. In addition, we offer imaging reagents and OTC drugs. We benefit from an extensive product portfolio, with particular strengths in the area of gastrointestinal therapies, and market our pharmaceuticals internationally, mainly in the United States, Germany and other countries in Europe, as well as in Latin America. The strength of our portfolio has enabled our pharmaceuticals division to increase its net sales substantially in recent years.

In 2003, our pharmaceuticals division generated net sales of € 1,980 million, an increase of 6.4% compared with 2002. The chart below provides a breakdown of our pharmaceuticals net sales by geographic region for the three years ended December 31, 2003:

A substantial portion of the North American growth of our business derives from the successful marketing of, and the steady growth in demand for, Pantoprazole since it was launched in the United States in May 2000, despite an increasingly adverse exchange rate situation over the past two years. We expect the proportion of our net sales accounted for by sales to North America to continue to increase in future years due to Pantoprazole and new pharmaceuticals currently under development. This growth may, however, be less substantial than it has been in the past. The increase in our pharmaceuticals net sales in Europe mainly reflects the continued success of Pantoprazole in the European markets. The decrease in Latin America is due primarily to the continuing difficult economic conditions in Argentina and Brazil as well as to currency exchange rate effects, especially in Mexico. As a result of the international dimension of our business, our results of operations are materially affected by exchange rate fluctuations in any given period, especially by changes in the exchange rate between the euro on the one hand, and the U.S. dollar and currencies linked to the U.S. dollar on the other hand. See Item 3: Key Information Risk Factors Risks Related To Each Of Our Businesses and Item 11: Quantitative and Qualitative Disclosure About Market Risk for more information on our exchange rate exposure. In 2003, our pharmaceuticals division comprised three principal business areas:

- Therapeutics, comprising prescription drugs for gastrointestinal, respiratory tract and cardiovascular indications as well as a variety of other therapeutics;
- OTC, comprising drugs, tonics, vitamins and medical accessories that patients may purchase over-the-counter without the need to obtain a prescription; and
- Imaging, comprising diagnostic reagents, such as contrast media, for in vivo applications.

In addition, we generate limited revenues from other sources, mainly from contract manufacturing on behalf of third parties.

At the end of 2002, we sold a substantial part of our former diagnostics business to DiaSorin s.r.l., while retaining certain diagnostic technologies that are directly relevant to our pharmaceuticals research. Accordingly, effective January 1, 2003, we changed the presentation of our pharmaceuticals

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business to reflect four business areas: therapeutics, OTC, imaging and other. Diagnostic revenues generated prior to the sale of our diagnostics business in 2002 are now presented within other.

The following chart provides a breakdown of our pharmaceutical net sales by business area for the three years ended December 31, 2003:

The growth of our pharmaceuticals division is driven primarily by our therapeutics business and especially by our acid suppressant Pantoprazole, which continued to be the primary growth driver for the division, accounting for 56.2% of its net sales in 2003.

The following table shows the targeted applications and revenues generated by the five most important revenue contributors of our pharmaceuticals division in 2003:

**Principal Products and Applications**

| Product/product group | Application | Revenues generated in 2003 |
|---|---|---|
| | | (€ in millions) |
| Pantoprazole | Gastrointestinal therapeutic for the treatment of reflux disease and ulcers | 1,113 |
| Imaging reagents(1) | Imaging reagents used for in vivo diagnostic applications | 106 |
| Ebrantil® | Cardiovascular therapeutic for the treatment of hypertension | 66 |
| Riopan® | Drug for the treatment of heartburn | 30 |
| Crofab | Drug for the treatment of snake bites | 29 |

(1) Our imaging reagents portfolio includes Imeron® and related reagents.

**Products**

*Therapeutics*

In our therapeutics business, we develop, manufacture and market prescription drugs, commonly referred to as ethical therapeutics, primarily for gastrointestinal and respiratory tract indications. In addition, we market therapeutics for cardiovascular and a variety of other indications. In 2003, our therapeutics business generated net sales of € 1,724 million. In prior periods, we presented our therapeutics business on the basis of four franchises: our gastrointestinal franchise, our respiratory tract franchise, our cardiovascular franchise and our other therapeutics franchise. Effective January 1, 2003, we changed this presentation by reclassifying our cardiovascular net sales as part of our other therapeutics category. As a result, we now present our therapeutics business on the basis of three franchises instead of four.

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The following table shows a breakdown of our therapeutics net sales by franchise for the three years ended December 31, 2003:

| | Therapeutics Net Sales by Franchise | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| | | (€ in millions) | |
| Gastrointestinal | 795 | 1,083 | 1,241 |
| Respiratory tract | 53 | 57 | 59 |
| Other(1) | 427 | 425 | 424 |
| Total | 1,275 | 1,565 | 1,724 |

(1) This franchise includes net sales of our cardiovascular business, which was formerly presented as a separate franchise.

In the medium- to long-term, we intend to expand our therapeutics business by entering the oncology market. We have already commenced basic research related to oncology and entered into a number of collaborations with biotech companies through which we seek to enhance our R&D expertise in this area. See Research and Development R&D strategy for more information on our R&D strategy.

*Gastrointestinal franchise.* In our gastrointestinal franchise, we market drugs for the treatment of diseases affecting the human esophagus, stomach and intestine. In 2003, our gastrointestinal business achieved net sales of € 1,241 million. We originally gained a foothold in the market for gastrointestinal indications through Riopan®, a drug for treating ulcers that is capable of neutralizing acidity. While we sell Riopan as an ethical drug in a small number of markets, we market it primarily as an OTC drug. See OTC for more information on Riopan.

The most important product in our gastrointestinal portfolio is our patent-protected therapeutic Pantoprazole. In 2003, Pantoprazole accounted for net sales of € 1,113 million, or 89.6%, of the revenues of our gastrointestinal franchise. Pantoprazole enjoys patent protection in Europe until June 2005 and in the United States until July 2010. In addition, the drug benefits from supplementary protection in the majority of European countries until the end of May 2009. Recently, applications for approval of generic versions of Pantoprazole were submitted to the FDA. We are convinced that our U.S. patents relating to Pantoprazole are valid and enforceable and of sufficient scope and strength to prevent the applicants or any other third party from manufacturing and distributing Pantoprazole-based generics during the remaining life of these patents. For more information, see Intellectual Property , - Regulation - United States and Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business .

Pantoprazole is an acid suppressant drug that belongs to the family of so-called proton pump inhibitors ( PPIs ). Over the past decade, the worldwide market for PPIs has experienced rapid growth, and the number of PPIs and their labeled indications have continuously expanded. Doctors typically use Pantoprazole for the short- and long-term treatment of patients with gastroesophageal reflux disease ( GERD ), including patients with erosive esophagitis, which is a more serious form of GERD, a chronic condition caused by the reflux of stomach acid into the esophagus. Medscape estimates that more than 40% of adults experience GERD symptoms at least twice a week. If left untreated, esophageal damage caused by GERD can lead to even more serious complications, including a precancerous condition known as Barrett s esophagus and esophageal cancer. Pantoprazole blocks the enzyme responsible for producing acid in the gastric mucosa, thereby restricting the flow of acid into the stomach. Pantoprazole has also received approval in the United States and Europe for the long-term treatment of GERD, which has significantly expanded its therapeutic profile. In addition, Pantoprazole has also received regulatory approval in many countries outside the United States for the treatment of gastric and duodenal ulcers. Ulcers result from the digestive action of the gastric juice on the mucous membrane when the latter is rendered susceptible to its action, for example, by certain drugs or local factors, including the Helicobacter pylori infection. Helicobacter pylori, which is widespread in industrialized countries, is the bacterium chiefly responsible for peptic ulcers. In addition, Pantoprazole received approval in the United States and in Europe for application in an intravenous formulation. Pantoprazole intravenous has important therapeutic benefits for the treatment of patients who are unable to receive a PPI by other routes and who need an intravenous ( IV ) agent for the short term. In some countries, we also offer Pantoprazole in combination with two antibiotics for the eradication of Helicobacter pylori.

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We believe that Pantoprazole enjoys therapeutic advantages vis-à-vis its competitors. First, clinical studies we have conducted on Pantoprazole suggest that Pantoprazole has less clinically relevant potential for metabolic interaction with other drugs. This feature distinguishes Pantoprazole from competing PPIs. Our studies have also shown that Pantoprazole has a higher bioavailability than other PPIs. Bioavailability is a measure for the degree and rate at which a substance is absorbed into the body. Finally, Pantoprazole is the only PPI currently available in the United States as both an oral and an IV preparation and the only PPI that enables patients to switch easily from IV to oral application without complications. However, we are expecting competition from IV preparations of Prevacid and Nexium in the very near future.

We have offered Pantoprazole in our home market, Germany, under the name Pantozol® since 1994 and launched it in the United States in May 2000 under the name Protonix®. As a result, we currently offer the drug in virtually all regions of the world with the exception of Japan. According to our internal records and data provided to us by our co-marketing partners, co-promotion partners and licensees, global market sales of Pantoprazole amounted to € 2,350 million in 2003Market sales include our own direct sales to the market as well as the sales of our licensees and co-marketing and co-promotion partners. See Sales and Marketing for a description of our sales and marketing organization.

Pantoprazole has experienced rapid growth in almost every market in which it has been launched. Based on data available to us, total market sales of Pantoprazole in 2003 totaled € 1,456 million in North America, € 193 million in Germany, € 558 million in Europe excluding Germany, € 46 million in Latin America, and € 97 million elsewhere. These figures yield total market sales of Pantoprazole of € 2,350 million in 2003, compared with € 2,007 million in 2002 and € 1,326 million in 2001. The growth in total market sales of Pantoprazole in each of the three years reflects the product s strong growth in the U.S market.

Our launch of Pantoprazole in the United States benefited from our marketing collaboration with Wyeth Pharmaceuticals, the pharmaceuticals division of Wyeth, Inc. ( Wyeth ). According to IMS Health, as of the week ending April 2, 2004, Pantoprazole s share of new U.S. prescriptions for PPIs was 22.6%, while our total prescription share amounted to 21.3%.

We expect Pantoprazole to continue to be a key revenue driver for our business for at least the next several years although we expect the growth rate to slow given that the drug has already achieved a substantial position in all markets in which it has been launched and as a result of the impact of increasing competition. Pantoprazole faces competition from various other branded PPIs. Most notably, these include Takeda s lansoprazole-based PPI, which is the leading PPI in the world and which is marketed in the United States by TAP Pharmaceuticals under the name Prevacid, and AstraZeneca s Nexium, a PPI based on a substance called esomeprazole, which was launched in 2001 and is marketed as a next-generation PPI. If our competitors continue to invest heavily in marketing these products, the ability of Pantoprazole to capture market share or maintain its current market share could be adversely affected. In addition, Pantoprazole faces increasing competition from generic PPIs based on a substance called omeprazole, for which patent protection has expired. A variety of companies, including Schwarz Pharma AG, Mylan Laboratories Inc., Novartis AG and most recently Torpharm, are marketing omeprazole-based generics in Europe and the United States at prices that tend to be lower than the price of Pantoprazole and other branded PPIs. Further competition results from the fact that the Procter & Gamble Company ( P&G ) has recently launched an OTC version of omeprazole in the United States, which, unlike Pantoprazole, is available to patients without a prescription. While generic and OTC versions of omeprazole-based PPIs have so far had a limited impact on the market for branded PPIs, including Pantoprazole, in Europe, their launch in the United States has resulted in increased competition and stronger price pressure in the U.S. market. This pressure results from the fact that generic PPIs are typically offered at higher discounts than branded PPIs, especially to managed care organizations, which are among the most important customers of PPIs.

Factors that we believe should limit Pantoprazole s ongoing exposure to competition include the facts that Pantoprazole is priced at a substantial discount to Nexium and that Wyeth s branding experience should enable us to continue to convey the therapeutic benefits of Pantoprazole to the market. However, there can be no assurance that we will be able to raise or maintain Pantoprazole s market share in future periods. See Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business and Competition for more information on the competitors of Pantoprazole.

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Our continued commitment to the development of innovative gastrointestinal therapeutics has yielded a potential next-generation drug for indications similar to those of Pantoprazole. We refer to this drug candidate as Soraprazan and have applied to the World Health Organization ( WHO ) for recognition of that name as a proposed International Nonproprietary Name ( INN ). INNs identify pharmaceutical substances or active pharmaceutical ingredients. After a review of our application, the WHO has given the name Soraprazan proposed INN status and published it for comment. Soraprazan is currently in Phase II clinical development. See Research and Development Pipeline for more information on Soraprazan and its therapeutic profile and on our R&D efforts in the area of gastrointestinal therapeutics generally.

*Respiratory tract franchise.* In our respiratory tract franchise, we offer drugs to treat chronic obstructive lung diseases, such as asthma and chronic obstructive pulmonary disease ( COPD ), and recurrent respiratory tract infections. Asthma is a chronic inflammation of the airways, often of allergic origin, that is marked by continuous labored breathing accompanied by wheezing, breathlessness, a sense of constriction in the chest, and often by attacks of coughing or gasping. COPD is a pulmonary disease that is characterized by chronic, typically irreversible airway obstruction resulting in a slowed rate of exhalation. The airflow limitation is typically associated with an abnormal inflammatory response of the lungs to noxious particles or gases. COPD is often, though not always, caused by smoking. Over time, greater airway damage occurs, and patients eventually die due to lung failure. Our respiratory tract business generated net sales of € 59 million in 2003 and has been relatively stable over the past few years.

Currently, the principal drug of our respiratory tract franchise is Euphyllin®, a drug based on a substance called theophyllin. Euphyllin® is used for the treatment of asthma and COPD. The drug was among the very first products developed, manufactured and marketed by our pharmaceuticals division. The most advanced drug of our Euphyllin product line is Euphylong®, a therapeutic that we designed to be administered only once daily.

Recently, our strategic focus in the respiratory tract area has shifted to two innovative drug candidates that are in advanced stages of clinical trials contained in our R&D pipeline, Alvesco® and Daxas®. We filed an application for regulatory approval of Alvesco® in the United Kingdom, Australia, Canada and Switzerland in May 2002, in the United States at the end of 2003 and in Japan in January 2004. At the end of February 2004, the Australian Health Agency granted us approval to market Alvesco® in Australia. We expect that Alvesco® will be approved in the United Kingdom in the first half of 2004 with approvals in other EU countries following. We submitted the registration dossier for Daxas® to the EMEA in February 2004 to obtain approval to market this drug in the European Union. We have not yet determined when we will submit an application for regulatory approval in the United States. If we are able to obtain regulatory approval for the commercial launch of these drugs, we expect our respiratory tract business to grow substantially in the future. See Research and Development Pipeline for more information on our R&D pipeline in the respiratory tract area and Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business for risks associated with the regulatory approval of pharmaceuticals under development.

For respiratory tract indications, we also offer Broncho-Vaxom®, an oral drug used principally for the treatment of recurrent respiratory tract infections. Broncho-Vaxom consists of fractions of eight different strains of bacteria whose application stimulates the natural defenses of the body. As a result, the drug can reduce the severity of symptoms and help patients develop a greater resistance to respiratory tract infections, thereby reducing the incidence and duration of such infections in adults and children. We license Broncho-Vaxom from OM PHARMA SA, a company located in Switzerland.

*Other therapeutics.* In our other therapeutics business, we market a variety of therapeutics for indications outside of our other two franchises, including therapeutics to treat cardiovascular diseases. In 2003, our other therapeutics business had net sales of € 424 million.

Our main product offerings in the cardiovascular area are Ebrantil®, a drug based on a substance called urapidil, which is available as both an oral and an IV formulation, and Querto®, a therapeutic based on a substance called carvedilol. Ebrantil and Querto are used for the treatment of hypertension. Hypertension is characterized by an increase in blood pressure above normal levels over a prolonged period of time. The condition can cause damage to the heart and blood vessels, creating an increased risk of heart attack, heart failure and stroke. While the IV formulation of Ebrantil is used primarily to treat hypertensive emergencies and postoperative hypertension, Querto is also used for the treatment of coronary heart disease and chronic heart failure. Ebrantil is a so-called selective alpha-1 receptor antagonist with central anti-hypertensive action, whereas Querto is a beta blocker.

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Alpha and beta receptors are cellular entities that exist on the surfaces of cells and are stimulated by the sympathetic nervous system. Both alpha receptor antagonists and beta blockers reduce stress symptoms by inhibiting the effects of the sympathetic nervous system, thereby preventing cardiovascular damage. While Ebrantil is a result of our own cardiovascular R&D efforts, we have licensed Querto from F. Hoffmann-La Roche Ltd. Querto s patent in Germany will expire in 2004; we thus expect a decline of our Querto sales. However, we do not expect this decline to have a significant negative impact on our overall pharmaceutical sales. In the second quarter of 2003, we completed the disposal of two product lines (Chromagen and StrongStart) in the cardiovascular area for $ 27 million. In 2002, these product lines generated revenues of € 16 million.

Apart from cardiovascular products, our main products in this area are drugs for the treatment of rheumatism and for urological and gynecological indications, as well as iron supplements and facial topicals.

*OTC*

In our OTC business, we market a variety of non-prescription brands directly to the consumer. Our portfolio includes gastrointestinal drugs, circulatory remedies, tonics and vitamins. Unlike ethical therapeutics, patients may purchase OTC drugs without a prescription. The OTC market has grown considerably in importance in recent years, as health insurance companies have become more cost-sensitive and refuse to refund the costs of certain categories of therapeutics (especially drugs used to treat trivial complaints). Therefore, we have switched several products from prescription to self-medication in the recent past. We achieve approximately half of the revenues of our OTC business in Germany, which we served through our Hamburg-based subsidiary ALTANA Consumer Health GmbH until the end of 2003. In January 2004, we integrated our German OTC business into our main marketing and sales organization, ALTANA Pharma Deutschland GmbH. We also distribute OTC drugs through our subsidiaries in a number of other regions of the world, most notably in other parts of Western Europe and in Latin America. In December 2003, we paid $ 33 million to acquire certain OTC-related trademarks in Brazil. In 2003, our OTC business generated net sales of € 104 million.

The most important products in our comprehensive OTC portfolio are Riopan®, Buerlecithin® and Sanostol®. Riopan is an antacid for the treatment of GERD, duodenal and gastric ulcers, and stress-related mucosal damage. Antacids are agents that neutralize acidity and are used as an adjunct to other drugs to relieve ulcer pain and as self-medication against acid indigestion, heartburn, dyspepsia and sour stomach. The therapeutic importance of antacids has been declining in recent years in view of the better clinical efficacy of PPIs, such as Pantoprazole. We currently market Riopan as an ethical therapeutic in some markets but mainly offer it as an OTC drug. Buerlecithin is a tonic based on lecithin, a substance found in soy plants, and is used to increase mental productivity. Sanostol is a widely recognized vitamin preparation for children in Germany and many other countries.

*Imaging*

In our imaging business, we offer a variety of in vivo diagnostic applications, which are applications for diagnosing medical conditions in the living body of a human. Imaging is a term that covers a range of diagnostic techniques for creating images of parts of the human body. Our portfolio comprises contrast media for both x-ray imaging and magnetic resonance imaging ( MRI ) and ultrasonic imaging. MRI is an increasingly important noninvasive diagnostic technique that produces computerized images of internal body tissues and is based on nuclear magnetic resonance of atoms within the body induced by applying radio waves. In 2003, our imaging business generated net sales of € 106 million. We offer our imaging portfolio in cooperation with Bracco S.p.A., an Italian company active in contrast media. Under the terms of our collaboration with Bracco, we manufacture a variety of contrast media developed by Bracco and market them in Germany and in parts of Central Europe. We believe that as a result of our collaboration with Bracco, we are among the leading providers of contrast media in Europe.

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**Research and Development**

*R&D strategy*

We consider R&D to be the foundation of the long-term growth of our pharmaceutical division and are committed to maintaining a high level of investment in R&D in the future. The table below provides information regarding our pharmaceutical R&D expenditures for the three years ended December 31, 2003:

| | R&D Expenditures | | |
|---|---|---|---|
| | 2001 | 2002 | 2003 |
| | (€ in millions, except %) | | |
| R&D expenditures | 252 | 335 | 376 |
| % of pharmaceuticals net sales | 15.8 | 18.0 | 19.0 |
| % of therapeutics net sales | 19.8 | 21.4 | 21.8 |

We believe that our current level of R&D expenditures positions us well vis-à-vis our peers. Our goal is to continue to spend approximately 20% of our therapeutics net sales on R&D in the future. We intend to allocate approximately 20% of our R&D expenditures in any given year to basic research and drug discovery.

The main focus of our R&D expenditures in recent years has been therapeutics, which is the single most important contributor to our pharmaceuticals revenues and which we expect to increase in importance in the future. Within therapeutics, we concentrate on the development of innovative drugs for gastrointestinal and respiratory tract indications. We have identified oncology as a further focal point of our R&D efforts. To this end, we have commenced basic oncological research and entered into a variety of collaborations with biotech companies. In addition, we also conduct R&D related to molecular diagnostics.

Our current R&D facilities are located in Constance, Germany; Hamburg, Germany; Bromma, Sweden; Florham Park, New Jersey; and Boston, Massachusetts. To support the international expansion of our operations, we are in the process of expanding our R&D facilities in overseas locations. In light of the relative size and importance of the U.S. market, we focus our international R&D activities outside of Germany primarily on the United States. To this end, we formed the ALTANA Research Institute, a genomics-oriented research center based in Waltham near Boston, Massachusetts, in May 2002, which was officially opened in June 2003. The unit is equipped with a variety of technology, including technology licensed from GPC Biotech AG ( GPC ), and specializes in functional genomics and proteomics, target identification and target validation. Its aim is to assist us in decoding complex cell functions and detecting genetically steered cell malfunctions. To conduct clinical studies on, and to assist us with obtaining regulatory approval for, new therapeutics in the United States, we primarily rely on our late-stage U.S. development and marketing facility in Florham Park, New Jersey, which we created in September 2002. In addition, we intend to enhance our research capacity in the field of medicinal chemistry by building a research institute in Mumbai, India. We expect that this institute will significantly increase our ability to synthesize new chemical compounds in our core indication areas.

In addition to carrying out R&D projects internally, we continuously seek to enhance the scope and depth of our research portfolio by obtaining access to outside knowledge, mainly through collaborations with companies in the biotech field. Our immediate goal is to intensify our activities in the areas of genomics, proteomics and high-throughput screening ( HTS ) by acquiring equity holdings in biotech companies, sponsoring research projects and facilitating collaborations that we believe will yield results which may assist us with the development of innovative new therapeutics. For example, in 2001, we acquired a strategic 8.3% stake in GPC, a biotech company with facilities in the United States and Germany with which we have a longstanding relationship. In addition to collaborating with third parties in the area of basic research, we also enter into co-development arrangements with third parties. By supplementing our own development efforts with the resources of third parties, we believe that we can enhance the commercial potential of our research results.

We believe that our scientific staff is a key to our success. At December 31, 2003, 1,514 of our employees about 20% of the workforce of our pharmaceuticals division worked in our pharmaceutical R&D laboratories. Our goal is to attract and retain the best-qualified scientists for our R&D activities. To this end, we offer our employees a competitive compensation package, which includes the ability to participate in our various employee incentive plans. See Item 6: Directors,

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Senior Management and Employees Stock Option Plans for additional information on our stock option plans.

*Pipeline*

*Overview.* We currently have several therapeutics in various stages of our R&D pipeline. For each project, we are required to conduct a number of pre-clinical and clinical studies. In the pre-clinical project phase, we typically conduct a number of in vitro and in vivo studies on animals to test the molecular and physiological effects of a drug candidate on cellular systems and its mechanisms of action. If these tests yield positive results, we then conduct Phase I, Phase II and Phase III clinical studies on humans to test the safety and clinical efficacy of the drug candidate. For more information on the regulatory approval process, see Pharmaceuticals Regulation .

While regulators in the United States and the European Union require that we conduct comprehensive pre-clinical and clinical studies before applying for authorization to market a drug, we typically need not conduct all requisite studies in each of the two jurisdictions. Instead, we are usually able to apply to the regulator of one jurisdiction to give us credit for studies conducted in other jurisdictions. Sometimes, a regulator will require us to supplement our existing studies with additional trials in order to satisfy all applicable requirements. As a result, we often manage to use, for example, the results of Phase I trials conducted in the European Union in order to qualify for Phase II trials in the United States and vice versa. Historically, we used to first test our drug candidates in the European Union and subsequently transfer the results of these tests to the United States, subject to any additional testing required by the U.S. Food and Drug Administration ( FDA ). More recently, in connection with the international expansion of our business, we started to conduct trials in the European Union and United States in parallel. In doing so, we rely partly on our own resources and partly on collaborations with third parties.

Consistent with our R&D strategy, we focus our development efforts on innovative drug candidates for gastrointestinal and respiratory tract indications.

*Gastrointestinal franchise.* In the gastrointestinal area, we focus our R&D efforts on a new class of therapeutics known as Acid Pump Antagonists (APA). Our main drug candidate in this area is Soraprazan, which we are developing for the treatment of GERD. APAs are widely considered the next generation of acid suppressants. Like PPIs, APAs restrict the flow of acid into the stomach. They differ from PPIs, however, in the way they operate. Whereas PPIs bind to active proton pumps, thereby inhibiting them irreversibly, APAs reversibly inhibit the ability of such pumps to produce acid. As a result of this difference, we believe that Soraprazan should have significant therapeutic benefits compared with currently available treatments for GERD and ulcers, such as a faster onset of action, which may result in a better symptom relief. This characteristic should make Soraprazan more suitable for treating the symptoms of various gastrointestinal diseases. We have completed ten Phase I studies with respect to Soraprazan, and the project is currently in Phase II development. Initial data from early Phase II studies indicate that Soraprazan is efficacious and well-tolerated.

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*Respiratory tract franchise.* Our pipeline for respiratory tract indications contains a series of innovative drug candidates for the treatment of asthma, COPD and rhinitis. Rhinitis is a disease that causes inflammation of the mucous membrane of the nose. The table below provides an overview of our respiratory tract pipeline along with the respective development stages of each drug:

**Respiratory Tract Pipeline**

| Drug candidate | Indication | Current project phase | (Expected) filing date of NDA/MAA(1) | |
|---|---|---|---|---|
| | | | US | EU |
| Ciclesonide metered dose inhaler ( MDI")(2) | Asthma | Phase III(3) | 2003 | 2002 |
| Ciclesonide dry powder inhaler ( DPI ) | Asthma | Phase I | N/A(4) | N/A(4) |
| Ciclesonide nasal | Rhinitis | Phase II/III | N/A(4) | N/A(4) |
| Ciclesonide combined with formoterol(5) | Asthma | Phase I/II | N/A(4) | N/A(4) |
| Roflumilast oral | Asthma | Phase III(6) | 2004/2005 | 2004 |
| Roflumilast oral | COPD | Phase III(6) | 2004/2005 | 2004 |

(1) As part of the regulatory approval process, a New Drug Application, or NDA, must be submitted to the Food and Drug Administration in the United States. In the European Union, a Marketing Authorization Application, or MAA, has to be submitted to the EMEA. For more information on the regulatory approval process, see Pharmaceuticals Regulation . In light of the inherent unpredictability of the regulatory process, you should be aware that there can be no assurance that an MAA or NDA with respect to any of the drug candidates listed in the table above will be filed by the time indicated or at all.
(2) At the end of February 2004, the Australian Health Agency granted marketing approval for Alvesco® in Australia.
(3) In conducting Phase III studies with respect to this project in the United States, we collaborate with Aventis S.A.
(4) To be determined.
(5) Formoterol is a long-acting beta agonist, which is a compound acting as an acute bronchodilator.
(6) In conducting clinical studies with respect to this project, we collaborate with Pfizer, Inc.

Ciclesonide, which we intend to market under the name Alvesco®, is an inhaled steroid for the treatment of asthma. Because asthma is a global and widespread disease, there is a substantial need for further effective therapeutics in addition to those which are already on the market. Steroids are powerful anti-inflammatory drugs that prevent asthma attacks by reducing airway hyper-responsiveness and inflammatory reactions, such as mucous edema and secretion. Inhaled steroids are considered the current drug of choice for the treatment of asthma, as they offer the best overall therapeutic profile. The inhaled steroids currently available on the market, however, have two main side effects. First, when administered via inhalers, portions of the drugs active ingredients are deposited not only in the lung but also in the mouth and throat, which can cause local side effects such as hoarseness and fungal infections. Second, once spread throughout the body following absorption and distribution via the blood, the systemic availability of these ingredients can lead to serious systemic effects. Of these systemic effects, diabetes, osteoporosis and slowed growth in children are the most important. In contrast, Ciclesonide is activated predominantly at the site of its action, in this case the lung. The activation is caused by special enzymes known as esterases. This feature of Ciclesonide should reduce the systemic effects that characterize existing inhaled steroids and may provide the drug with a significant therapeutic advantage over present treatments.

We are developing Ciclesonide for use in connection with metered dose inhalers ( MDIs ), dry powder inhalers ( DPIs ), nasal applicators and in combination with formoterol, which is a compound acting as an acute bronchodilator. With respect to the MDI version of Ciclesonide, for which we use a CFC-free environmentally friendly device, we are currently conducting a number of Phase III studies in the United States and other countries. Several of the studies that we are conducting in the European Union have yielded satisfactory results and have already been published. We filed an application for regulatory approval of Ciclesonide in the United Kingdom, Australia, Canada and Switzerland in May 2002. At the end of February 2004, the Australian Health Agency granted marketing approval for Alvesco®. We expect that Alvesco® will next be approved in the United Kingdom in the first half of 2004, with approvals in other member states of the European Union based on the U.K. approval to follow. At the end of 2003, Aventis S.A submitted a new drug

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application (NDA) for the MDI version of Ciclesonide to the FDA. In January 2004, Teijin Ltd., our partner for the Japanese market, submitted an application for regulatory approval in Japan. With respect to the DPI version of Ciclesonide, we have completed one Phase I study. This study is in addition to a large number of Phase I studies that we have conducted with respect to Ciclesonide in various trials since 1995. Because these studies have established the pharmacological and toxicological characteristics of Ciclesonide, we expect to be able to use the results of these studies not just in connection with the MDI version of Ciclesonide but also as the basis of future Phase II studies of the DPI version. With respect to the nasal application version, we are currently in the process of performing an extensive Phase II/III program involving more than 2,000 adult and pediatric patients. These studies are being performed mainly in the United States.

Roflumilast, which we intend to market under the name Daxas®, is a selective phosphodiesterase ( PDE ) 4 inhibitor for the treatment of asthma and COPD. In the United States COPD is second only to cardiovascular disease as a cause of disability, according to U.S. Social Security statistics, which speaks to the substantial need for an effective treatment. PDE 4 inhibitors are substances that have anti-inflammatory and immuno-modulatory effects and are effective against various inflammatory diseases. We refer to Roflumilast as a selective PDE 4 inhibitor because it selectively inhibits one form of the PDE enzyme family, namely the PDE 4 enzyme. As a result of its special molecular interaction with this enzyme, we expect that Roflumilast will have an improved side-effect profile compared with other PDE 4 inhibitors. Unlike most existing therapies, Roflumilast can be administered orally.

For both the asthma and the COPD indications of Roflumilast, we have completed a number of Phase III studies in the European Union and are currently in the process of conducting several additional studies in the European Union, the United States and other geographic regions.

In February 2004, we submitted the registration dossier for Daxas® for European approval to the EMEA. Despite certain similarities in their indications, our various pipeline drugs in the respiratory tract area are targeted at complementary markets. While Ciclesonide and Roflumilast are both aimed at the treatment of asthma, they have different therapeutic profiles as a result of differences in their mode of action and the manner in which they are administered. In addition, unlike Ciclesonide, Roflumilast is being developed also for the treatment of COPD.

While clinical trials of the various pipeline drugs described above have so far shown promising results, given the nature of the drug development process, there can be no assurance that any of these drugs will reach the market. There is always a significant possibility that adverse results with respect to a drug will become apparent in the future, which may result in substantial delays in the launch of the drug and possibly force us to abandon the drug altogether.

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*R&D collaborations*

The table below provides an overview of some of our more important current R&D collaborations, including a brief description of the scope and objectives of each:

**R&D Collaborations**

| Partner | Scope |
|---|---|
| *Research collaborations* | |
| GeneData AG | Bioinformatics and genomics information management and analysis systems |
| | Data storage and analysis of high-throughput screening assays |
| GPC Biotech AG | Validation of tumor-specific targets |
| | Creation of a functional genomics/proteomics research unit in Waltham, near Boston, Massachusetts |
| | Collaboration in the area of pathway mapping and kinases |
| Atugen AG | Antisense target validation, *i.e.*, validation of drug targets by using a complementary sequence to a given segment of genetic material |
| Pharmacopeia Inc. | Screening for new chemical compounds with special biological properties in the field of inflammation research |
| Evotec OAI AG | Technical collaboration in the field of confocal laser detection in high throughput screening |
| Proteros Biostructures GmbH | Crystallization and X-ray analysis of drug target complexes in order to obtain three-dimensional information on the binding geometry of drug molecules and their biological target |
| Xerion Pharmaceuticals AG | Functional proteomics and target validation |
| *Development collaborations* | |
| Aventis S.A. | Co-development and co-promotion of Alvesco® in the United States |
| Teijin Ltd. | Development and marketing of Alvesco® in Japan; co-development of the nasal application of Alvesco® |

| | |
|---|---|
| Pfizer Inc. | Co-development and co-promotion of Daxas® in the United States, Europe and other markets |
| Tanabe Seiyaku Co. Ltd. | Co-development and co-promotion of Daxas® in Japan |

*Research collaborations.* In 2000, we entered into an alliance with GeneData AG, a Swiss company that is a leading provider of bioinformatics and genomics information management and analysis systems used in various genomic R&D applications. Our collaboration with GeneData has put us in a position to manage the huge amounts of data involved in functional genome analysis, thereby significantly enhancing our capabilities in this important area of pharmaceutical R&D. In 2002, we expanded the scope of our collaboration with GeneData to develop a high-throughput screening ( HTS ) data storage and analysis system. High-throughput screening is an automated process that is used to select the best drug candidate from among hundreds of thousands of candidate molecules.

In December 2000, we entered into a five-year research alliance with GPC Biotech AG in the area of tumor research. The alliance replaced our earlier collaboration with GPC, under which we worked together to investigate new genomic targets for the control of infections caused by microorganisms causing or capable of causing disease. Under the terms of this agreement, we collaborate in the identification of tumor-specific targets, that is, targets whose inhibition selectively eradicates cancer

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cells (but not normal cells). Most current chemotherapeutics for tumors show poor efficacy and safety profiles because they are unable to specifically target tumor cells. As a result, we believe that our collaboration with GPC will benefit our oncological research efforts. In addition to research, we are also entitled to have target validation, assay development and screening carried out by GPC. In 2001, we entered into an agreement with GPC, pursuant to which the company provides us with technology for our research unit in Waltham near Boston, Massachusetts, which specializes in functional genomics and proteomics. In addition, under the terms of the agreement, we collaborate with GPC in the area of pathway mapping and kinases. Kinases are enzymes that catalyze the transfer of phosphate groups and play an important role in the cell cycle and for the regulation of biochemical pathways in living cells.

In July 2001, we entered into a three-year arrangement with Atugen AG pursuant to which Atugen will carry out target validation for us, including the validation of tumor-specific targets. Target validation constitutes an essential step in the process of turning new target proposals identified with genomic technologies (which is the subject-matter of our agreement with GPC) into new drugs. The agreement will help us determine whether a target is critically involved in a disease process and whether drugs that modulate the target are likely to have a beneficial therapeutic effect.

In December 2003, we entered into a research collaboration with Pharmacopeia Inc. The goal of this collaboration is to search and identify new lead compounds for a biological target that we have identified in our inflammation research area. A lead compound is a chemical molecule that has been shown to bind to, inhibit or activate a target. Lead compounds are usually put through a process of modification and re-testing called optimization before a drug candidate is found. Under our agreement with Pharmacopeia Inc., we will screen Pharmacopeia s large chemical library for compounds that influence the biological behavior of the target. Upon successful completion of defined preclinical and clinical milestones, Pharmacopeia will receive milestone payments. We believe that this agreement will enable us to improve the number and quality of relevant lead compounds.

Since 2001, we are collaborating with Evotec OAI in the field of HTS technologies. As part of this collaboration, Evotec develops specialized equipment for the detection of fluorescence signals in cellular HTS assays, which constitutes a core capability for the high content screening of bioactive compounds and which we believe will provide us with a competitive advantage. The collaboration entitles us to a non-exclusive license to this technology.

In October 2001, we entered into a collaboration with Proteros AG, a company specializing in X-Ray crystallography of proteins. Under this collaboration, Proteros develops crystallization protocols for target proteins, 3D-structure elucidation of these proteins as well as protein-ligand complexes that permit the further optimization of our lead structures. The collaboration gives us an exclusive right to use the data generated by Proteros in our own R&D efforts, for example, in connection with the development of biological targets and bioactive compounds.

In June 2003, we completed our collaboration with Xerion Pharmaceuticals AG, Munich, which focused on the evaluation of antibody-based target validation technologies. We are entitled to use the results of this collaboration in our own R&D programs.

*Development collaborations.* We are currently party to four development collaborations. In 2001, we entered into an agreement with Aventis Pharmaceuticals Inc., the U.S. pharmaceuticals subsidiary of Aventis S.A., pursuant to which we cooperate with Aventis in connection with the ongoing Phase III clinical trials for Alvesco® carried out in the United States and share the costs of these trials. In addition, we agreed with Aventis that if we obtain regulatory approval to launch Alvesco® in the United States, we will distribute the drug in the U.S. market in collaboration with Aventis. In 1998, we entered into a contract in relation to the same drug with Teijin Ltd., a Japanese conglomerate, pursuant to which we granted Teijin the right to develop and market Alvesco® in Japan. Our collaboration with Teijin will enable us to gain access to the Japanese market, which operates substantially differently from the U.S. and EU markets, through an experienced partner. In addition, we agreed with Teijin to collaborate in the development of the nasal application of Alvesco®.

In 2002, we entered into an agreement with Pharmacia Corporation, now Pfizer, to co-develop and, provided we receive regulatory approval, market Daxas® in the United States, Europe and other important markets. While we coordinate the development of the drug in the European Union, Pfizer does so in the United States. The agreement provides that, following the receipt of regulatory approval in the relevant jurisdictions, we and Pfizer will jointly launch and promote Daxas® in the United States, Europe and other markets. Under the agreement, we received an upfront payment in the amount of $ 30 million in the second quarter of 2002 and a milestone payment in the amount of

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$ 30 million in the first quarter of 2003. We may receive additional payments based on the achievement of certain milestones in the future. On April 16, 2003, Pharmacia merged with Pfizer, Inc. We believe that this merger, which has created the largest pharmaceutical company in the world in terms of net sales, has significantly enhanced our distribution capabilities for Daxas®. In 2002, we also entered into a separate agreement with Tanabe Seiyaku Co. Ltd., a Japanese company, for the co-development and co-promotion of Daxas® in Japan.

**Supplies and Raw Materials**

We purchase our supplies and raw materials on a worldwide basis from a number of third-party providers. In those instances where there is only a single supplier, we seek to reduce our dependence on that supplier by accumulating and maintaining strategic reserves of the supplies and raw materials that we need for the manufacture of our products, qualify new suppliers, and, to the extent feasible, develop production processes in our own facilities. We typically attempt to secure strategic materials through medium- and long-term supply contracts and to ensure that in case of an outage, alternative sources would be readily available to us without undue expense and delay. We have not experienced significant difficulties in obtaining sufficient amounts of supplies and raw materials in recent years, and we do not expect to encounter such difficulties in the foreseeable future.

We have several sources for the most important raw materials of Pantoprazole, i.e., the active ingredient of the drug and a dry frozen IV formulation. We source the active ingredient of Pantoprazole from our Singen facility and from two suppliers, one of which has received FDA approval. The IV formulation is sourced internally from our Singen facility and from two external contract manufacturers as back-up sources.

**Production**

In the area of production, our goal is to ensure consistent quality and to minimize costs by creating facilities that specialize in discrete manufacturing tasks. We concentrate the manufacture of most of our products for the supply of the worldwide pharmaceuticals markets in Europe. Our manufacturing facility in Singen, Germany, has sole responsibility for all sterile application forms of therapeutics, including Pantoprazole IV, and also produces non-sterile semi-solid and liquid application forms as well as active pharmaceutical ingredients, predominantly Pantoprazole. Our facility in Oranienburg, Germany, which we are in the course of expanding in order to facilitate the large-scale production of Roflumilast, is engaged in the production of solid dosage forms, primarily Pantoprazole tablets. Our facility in Lyskowice, Poland, specializes in solid and liquid formulations. We started construction of a new manufacturing facility for Pantoprazole and Roflumilast tablets in County Cork, Ireland, during the fourth quarter of 2003. In Latin America, we are in the process of concentrating our activities for the Mercosur area in our facility in Jaguariuna, Brazil. As part of this program, we recently ceased all manufacturing activities at our site in Buenos Aires, Argentina, which has been shut down. All of our sites comply with current good manufacturing practice (cGMP) standards, which are a set of officially recognized scientifically sound methods, practices and principles for the development and manufacture of pharmaceuticals. In addition, certain of our sites, including Singen, have been inspected and have received approvals by the FDA and the relevant EU authorities.

We currently operate ten production facilities around the world. We source the active ingredient for Pantoprazole principally from our manufacturing facility located in Singen, Germany, and Isochem S.A., a French company that performs contract manufacturing for us. Pantoprazole tablets are manufactured at our facilities in Oranienburg, Germany, and Jaguariuna, Brazil. While we procure key starting materials for Pantoprazole from our facility in Mumbai, India, we also use external sources. For the construction of our Mumbai facility we have entered into a 50% joint venture with a third party. We otherwise own all of our principal production facilities and substantially all of the land on which they are located.

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The following table shows selected key information with respect to our principal current manufacturing facilities as well as our facilities under construction:

**Production Facilities**

| Location | Function | Size (m2) |
|---|---|---|
| Singen, Germany | Pharma (sterile, solid and semi-solid dosage forms and active pharmaceutical ingredients) | 167,000 |
| Oranienburg, Germany | Pharma (solid dosage forms) | 64,300 |
| Lyskowice, Poland | Pharma (solid and liquid dosage forms) | 25,000 |
| Melville, New York | Pharma (semi-solid and liquid dosage forms) | 52,000 |
| Hicksville, New York | Pharma (semi-solid dosage forms) | 23,200 |
| Mexico City, Mexico | Pharma (solid, semi-solid and liquid dosage forms) | 11,900 |
| Jaguariuna, Brazil | Pharma (solid, semi-solid and liquid dosage forms) | 214,000 |
| Mumbai, India | Key starting materials for Pantoprazole | 25,100 |
| Carrigtwohill, Ireland (1) | Under construction; Pharma (solid dosage forms) | 14,000 |
| Bromma, Sweden | Diagnostics | 2,785 |

(1) Leased.

**Sales and Marketing**

We use the ALTANA brand to market products of our pharmaceuticals division on a worldwide basis. In doing so, we use sales and marketing methods customary in the pharmaceuticals industry. In addition to advertising our drugs, we maintain a network of sales representatives, collaborate with third parties and use our company s website to provide information about our pharmaceuticals. We also grant discounts to our customers. Our discounting practices vary widely among the countries in which we are active, depending on the respective country s regulatory framework and our position in the relevant market. The amount of control that we have over the sales mix used by our partners in any given market depends on the distribution arrangements we use in that market.

We have sales and marketing organizations in most European pharmaceuticals markets. As with other pharmaceuticals companies, however, we do not distribute our products exclusively through our own sales and marketing organization but also use collaborations with third parties. For example, while we supply a number of hospitals directly, we frequently rely on wholesalers to distribute our products to retailers, such as pharmacies.

In July 2003, we established a second sales force in the United States with approximately 300 representatives, which markets Pantoprazole in the U.S. market under the name Protonix® alongside Wyeth. Our sales force in the United States now comprises approximately 600 members, which we believe constitutes an important step towards establishing a fully integrated U.S. organization. To support our efforts in building a sales and marketing organization in the United States, we entered into an agreement with Ventiv Health, Inc., a provider of outsourced marketing and sales solutions, in October 2002. Under this agreement, Ventiv provides us with a nationwide sales force and related services, including recruitment, training and operational support services. We expect that our U.S. sales organization will assume a significant role in the distribution of Alvesco® and Daxas® if and when these drugs are launched in the U.S. market. In the meantime, our staff co-promote Pantoprazole and several drugs of Pfizer in the United States.

In Japan, where we currently have no sales and marketing organization of our own, we expect that our agreement with Tanabe Seiyaku Co. Ltd., pursuant to which we will collaborate in the marketing of Daxas® in the Japanese market, will allow us to establish our own presence in that market in the mid- to long- term. Furthermore, with respect to Pantoprazole, we have found it desirable to supplement our internal sales and marketing efforts with the branding experience and marketing capabilities of external partners, particularly in the United States.

Among our third-party partners, we make a distinction between licensees, co-marketing partners and co-promotion partners. Licensees are partners that we typically use in markets that we do not

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serve ourselves. By contrast, co-marketing and co-promotion partners are distributors that we use in markets where we have a sales and marketing organization of our own. We use co-marketing partners when we decide to sell a product under more than one brand in the same market. Although we typically coordinate our efforts with our co-marketing partners, particularly in terms of dealing with regulators and drug safety, we and our co-marketing partners each manage a separate brand and use distinct distribution channels. To generate revenue, we charge our co-marketing partners a fee in an amount tied to the price that they charge their customers. By contrast, when we use co-promotion partners to sell a product under a single brand, either we or our co-promotion partners take sole responsibility for distributing the product, although we cooperate with our co-promotion partners in promoting the brand under which the product is marketed.

The type of arrangement we use in any given situation depends on the particular product and the features of the targeted market. An example of a licensing arrangement is our agreement with Wyeth to distribute Pantoprazole in the United States, where we have only recently begun to build a sales and marketing organization of our own. Pursuant to our agreement with Wyeth, Wyeth is required to use commercially reasonable efforts to distribute Pantoprazole in the U.S. market and to bill its customers for the drug directly. Wyeth is free to set the retail price at its discretion, which affords it the flexibility necessary to adapt its distribution strategy to the prevailing market conditions. In return, Wyeth is required to pay us a fixed percentage of its net sales, subject to a minimum price. While we market Pantoprazole in the United States through a licensing arrangement, we currently use co-marketing partners for the distribution of Pantoprazole in Germany, most other European countries and Latin America. In Australia and Canada, we distribute Pantoprazole in collaboration with a co-promotion partner.

Going forward, we intend to use licensees primarily in markets that we do not consider a strategic focus or where we believe that the costs of building and maintaining the necessary infrastructure and expertise outweighs the benefits of having a sales and marketing organization of our own. In strategically important markets that offer a substantial growth potential for our pharmaceuticals business, especially the United States, our goal is to rely less on licensees and instead to use experienced local companies as co-marketing and co-promotion partners. We believe that this approach will enable us to gradually build our own sales forces in these markets and to reduce our dependence on partners. We have already entered into a co-promotion agreement with Aventis for the distribution of our pipeline drug Alvesco® in the United States and have entered into a similar agreement with Pfizer with respect to Daxas®.

At December 31, 2003, Wyeth, the U.S. company through which we distribute Pantoprazole in the United States, accounted for 6.4% of our accounts receivable, compared with 7.6% at December 31, 2002. In 2003 and 2002, Wyeth accounted for 15.3% and 14.1% of our net sales, respectively.

**Competition**

For the most part, our pharmaceuticals division operates in markets characterized by intense competition. Our competitors include a wide variety of companies, ranging from small pharmaceutical companies to large national and international pharmaceuticals groups and from off-patent manufacturers of generic pharmaceuticals to owners of preeminent brands.

The global therapeutics markets are highly competitive and are targeted both by large companies and by small niche players. The main competitive factors include product efficacy and safety and distribution capabilities. In addition, price has become increasingly important, particularly in Europe and Latin America. Our main competitors for drugs in the gastrointestinal area are Takeda, whose lansoprazole-based PPI is marketed in the United States through TAP Pharmaceuticals under the brand name Prevacid, and AstraZeneca, which markets Nexium, a PPI based on a substance called esomeprazole. Another company offering a branded PPI is Eisai. In addition, a variety of companies, including Schwarz Pharma, Mylan Laboratories, Novartis and most recently Torpharm, offer generic omeprazole-based PPIs in the United States and Europe, at prices that tend to be significantly lower than the price of Pantoprazole. In September 2003, Procter & Gamble launched an OTC version of omeprazole in the United States, which, unlike Pantoprazole, is available to patients without a prescription. While generic and OTC versions of omeprazole have so far had a limited impact on the market for branded PPIs, including Pantoprazole, in Europe, the launch of these products in the United States has resulted in increased competition in the U.S. market and led to stronger price pressure due to the fact that these PPIs are offered at higher discounts than branded PPIs, especially to managed care organizations, which are among the most important customers of PPIs. See Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business for a

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discussion of the risks resulting from competition by other PPI brands, generic and OTC versions of omeprazole-based PPIs and Therapeutics for more information on Pantoprazole. In the respiratory tract area, we compete primarily with AstraZeneca, GlaxosmithKline, Merck & Co. and Boehringer-Ingelheim.

In the OTC area, the key competitive factors are price and branding. The OTC market is highly fragmented, and we face competition not only from other pharmaceuticals companies but also from distributors of homeopathic remedies and medical accessories.

The imaging markets are highly competitive. The key competitive factors include price (especially with respect to x-ray contrast media), product efficacy, safety, and sales and marketing capabilities. As far as new diagnosing techniques are concerned, technological innovation is also an important factor. Our competitors include Schering AG, Tyco Inc. and Amersham plc.

**Intellectual Property**

Intellectual property and especially patent protection are of critical importance to our pharmaceuticals business. At December 31, 2003, we held 102 U.S., 57 European and 22 Japanese patents for various pharmaceutical inventions. In addition, we have 72 patent applications pending at the U.S. Patent and Trademark Office, 172 at the European Patent Office and 122 in Japan. Our most important patents are those covering Pantoprazole as well as the patents for which we have applied and which have been granted in connection with our various pipeline drugs.

Pantoprazole enjoys patent protection in Europe until June 2005 and, by virtue of an extension granted by the U.S. Patent and Trademark Office in July 2003, in the United States until July 2010. In addition, however, Pantoprazole benefits from supplementary protection certificates, which have an effect similar to that of an extension of original patents, in the majority of European countries until the end of May 2009.

In February 2004, generic drug companies submitted applications known as an Abbreviated New Drug Applications ( ANDA ) including paragraph IV certifications in respect of Pantoprazole to the FDA. For more information on ANDAs, see Regulation United States .

Drug companies are required to include a certification in their ANDA filings when they intend to manufacture and distribute a generic version of a patent-protected drug listed in the Orange Book, which is a list of proprietary drugs together with pertinent patent information maintained by the FDA. Inclusion of a paragraph IV certification in an ANDA implies that the applicant is asserting that the patents listed in the Orange Book are either invalid or unenforceable or will not be infringed by the manufacture and distribution of a generic version of that drug. The applicant is required to notify the innovator company that it has filed an ANDA with the FDA, and must describe the reasons it believes the listed patents will not be infringed or are invalid or unenforceable. Once the innovator drug company has received notice that a generic application has been filed and its patent is being challenged, it may file a lawsuit claiming patent infringement based on its review of the generic drug company s notice. If a lawsuit is brought within 45 days of receiving the applicant's notice, the FDA s approval is stayed for 30 months. The 30-month period starts five years after the approval of the drug. If the patent court determines that the patent is valid, enforceable and would be infringed by the product proposed in the ANDA, the FDA will not approve the application until the patent expires. If the court decides that the patent will not be infringed or is invalid or unenforceable, the FDA may approve the generic application when that decision occurs. The FDA may approve the application at the end of the 30-month period, even if the litigation is ongoing. A generic applicant who is the first to challenge a listed patent using a paragraph IV certification is granted a 180-day exclusivity period with respect to other generic applicants. This exclusivity period provides generic applicants with an incentive to challenge listed patent for innovative drug products.

We received notice of the above-mentioned filings and the challenging of our patents in April 2004. We believe our patents are valid and enforceable. We intend to vigorously defend our patent rights and undertake all appropriate measures in the best interest of our company.

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Other patents and pending patent applications that are material to our business include those set forth in the table below:

| | Patent Expiration Year | | |
|---|---|---|---|
| | **Europe (1)** | **United States** | **Japan** |
| Ciclesonide (substance) | 2011(2) | 2013(2) | 2011(2) |
| Ciclesonide (key intermediate) | 2014 | 2015 | 2014 |
| Ciclesonide (purification process) | 2017 | 2017 | 2017 |
| Ciclesonide (aerosol) | 2018 | 2018 | 2018 |
| Ciclesonide (nasal formulation) | 2020 | 2020 | 2020 |
| Roflumilast (substance) | 2014(2) | 2015(2) | 2014(2) |
| Roflumilast (formulation) | 2021 | 2021 | 2021 |
| Soraprazan (substance) | 2019(2) | 2019(2) | 2019(2) |

(1) Includes European patents or national patents in major European countries.
(2) Does not reflect a possible extension of the term of patent protection or the grant of supplementary protection certificates for up to five additional years.

We rely on intellectual property that we obtain through cross-licensing arrangements with third parties to develop, manufacture and market pharmaceuticals. For example, we have entered into licensing arrangements with Hoffmann-La Roche and Invitrogen to obtain access to technologies that we consider critical to the R&D projects carried out in our molecular diagnostics unit. If we are unable to obtain licenses on commercially reasonable terms in the future, we may be limited in our ability to develop, manufacture and market new products.

We depend on our ability to obtain and, if challenged, successfully defend our patents, trademarks, trade secrets, licenses and other forms of intellectual property protection. Although we intend to continue to prosecute patent applications aggressively, we may not be able to obtain patents for all our inventions. In addition, the process of seeking patent protection is lengthy and expensive, and the issuance of a patent is conclusive neither of its validity nor of its scope. Therefore, there is no assurance that our currently pending or future patent applications will result in patents being granted or that, if patents are issued, they will be valid or of sufficient scope or strength to provide us with meaningful legal protection or a commercial advantage in the marketplace. In addition, if our competitors develop technologies that are themselves protected by patents, licenses or other forms of intellectual property protection, the underlying technologies may be unavailable to us or available to us only on unfavorable terms.

A significant part of our intellectual property consists of registered trademarks. We are continuously engaged in developing brand names for new products, securing trademark protection for our new brand names, policing our existing trademarks and enforcing our legal entitlements in situations where third parties infringe upon any of these rights. Before we start to advertise and sell a product under a new brand name, we seek to minimize the risks of infringing upon the trademark rights of others by filing for trademark protection and by conducting trade and service mark searches and other inquiries.

As with other pharmaceuticals companies, a portion of our know-how is not patent-protected. To protect this information, we rely on trade secret law and frequently enter into confidentiality agreements with our employees, customers and partners. These agreements may be unenforceable, however, and the remedies that are available to us for breaches may be inadequate. Likewise, our competitors may gain access to our know-how by lawful means, for example, by reverse engineering, or may independently develop the same know-how, which may destroy any competitive edge that we may have.

As a result of the key role that intellectual property plays in the pharmaceuticals industry, we may from time to time become involved in litigation as either plaintiff or defendant. For example, in 1995, AstraZeneca sued us alleging that our gastrointestinal therapeutic Pantoprazole infringes AstraZeneca s omeprazole patents. While we successfully settled this claim on terms favorable to us, there can be no assurance that we will also be able to settle other claims brought against us by third parties in the future. If we are unable to successfully settle future claims on terms acceptable to us, we may be required to engage in costly and time-consuming litigation and may be prevented from, or experience substantial delays in, marketing our existing pharmaceuticals and launching new ones. Each of these events could materially adversely affect our business, financial condition or results of

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operations or halt the sales of our existing products. For more information concerning the types of litigation that we face in our business, see Legal Proceedings and Item 3: Key Information Risk Factors Risks Related To Each Of Our Businesses .

**Regulation**

All companies developing, manufacturing and marketing pharmaceuticals are subject to extensive, complex and evolving regulations in the United States, Europe and Japan. Several years ago, the regulators and industry bodies in the United States, the European Union and Japan launched the International Conference on Harmonization, a collaborative effort with the goal of streamlining the development and registration of medicinal products by harmonizing the applicable procedures in the three regions. For the foreseeable future, however, we will have to seek separate approval in each region.

*United States*

The principal U.S. regulators relevant to the business of our pharmaceuticals division are the U.S. Food and Drug Administration ( FDA ) and to a lesser extent the U.S. Drug Enforcement Agency ( DEA ) and state government agencies. The Federal Food, Drug and Cosmetic Act, the Controlled Substances Act and other federal statutes and regulations all govern or influence the development, testing, manufacture, packaging, labeling, storage, record keeping, safety, approval, advertising, promotion, marketing, sale and distribution of our pharmaceuticals.

FDA approval is required before any dosage form of any new pharmaceutical, including any off-patent equivalent of a previously approved pharmaceutical, may be marketed. The process for obtaining governmental approval to market pharmaceuticals in the United States is rigorous, time-consuming and costly, and it is difficult to predict the extent to which this process may be affected by legislative and regulatory developments. Like all pharmaceutical companies, we are dependent on receiving FDA and other types of governmental approvals prior to producing and marketing virtually all of our new pharmaceuticals in the United States. Consequently, there is always a chance that the FDA or any other applicable agency will not approve our new pharmaceuticals, or that the rate, timing and cost of such approvals will adversely affect our launch plans and ultimately our results of operations. See Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business for a discussion of these risks.

All applications for FDA approval are required to contain information relating to formulation, raw materials, stability, manufacturing, packaging, labeling and quality control. There are two types of applications for FDA approval:

*New Drug Application ( NDA )* An NDA is filed whenever approval is sought for drugs with active ingredients and/or with dosage strengths, dosage forms, delivery systems or pharmacokinetic profiles that have not previously been approved by the FDA. A drug s pharmacokinetic profile relates to the characteristic interactions of the drug with the human body in terms of absorption, distribution, metabolism, and excretion. NDAs are typically filed for newly developed branded pharmaceuticals as well as for new dosage forms of existing drugs that have been approved previously.

*Abbreviated New Drug Application ( ANDA )* An ANDA is filed whenever approval is sought for generic equivalents of previously approved drugs or unapproved dosage forms of such drugs. The FDA will accept the filing of an ANDA before the expiration of the exclusivity period of the relevant patent only if the applicant simultaneously challenges that patent. For a description of the recent ANDA filings challenging the patents' underlying Pantoprazole, see Intellectual Property.

The process mandated by the FDA before a previously unapproved pharmaceutical may be marketed in the United States essentially involves the following steps:

Preclinical laboratory and animal tests;

Submission of an investigational new drug application ( IND ), which must become effective before clinical trials may begin;

Adequate and well-controlled human clinical trials to establish the safety and efficacy of the proposed drug for its intended use;

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Submission of an NDA containing the results of the preclinical and clinical trials establishing the quality, safety and efficacy of the proposed drug for its intended use; and

FDA approval of the NDA.

Preclinical tests encompass the laboratory evaluation of a new pharmaceutical, its chemistry, formulation and stability, as well as animal studies to assess its potential safety and efficacy. Following the conclusion of preclinical tests, the results of these studies, which have to demonstrate that the pharmaceutical delivers sufficient quantities of the drug to the bloodstream to create the desired therapeutic results, are submitted to the FDA as part of an IND, which must become effective before human clinical trials may begin. The IND automatically becomes effective 30 days after receipt by the FDA unless the FDA, during that 30-day period, raises concerns or questions about the conduct of the trials as outlined in the IND. In such cases, the IND sponsor and the FDA must resolve any outstanding concerns before clinical trials can begin. In addition, an independent Institutional Review Board at the medical center that proposes to conduct the clinical trials must review and approve any clinical study before it commences.

Human clinical trials are typically conducted in three sequential phases:

*Phase I.* During this phase, the drug is initially introduced into a relatively small number of healthy humans or patients and is tested for safety, dosage tolerance, absorption, metabolism, distribution and excretion.

*Phase II.* This phase involves studies in a limited patient population to identify possible adverse effects and safety risks, to determine the efficacy of the drug for specific targeted diseases or conditions, and to determine dosage tolerance and optimal dosage.

*Phase III.* When Phase II evaluations demonstrate that a dosage range of the drug is effective and has an acceptable safety profile, Phase III trials are undertaken to further evaluate dosage, clinical efficacy and test for safety in an expanded patient population at geographically dispersed clinical sites.

Following completion of these trials, the results of the internal development processes and the mandatory preclinical and clinical studies along with documentation evidencing compliance with applicable Chemistry, Manufacturing and Controls ( CMC ) requirements as part of an NDA are submitted to the FDA. The drug development and NDA approval process averages approximately eight to twelve years.

FDA approval of an ANDA is required before a generic equivalent of a drug that previously has been approved under an NDA or a previously unapproved dosage form of a drug that has been approved under an NDA may be marketed. The ANDA approval process differs from the NDA approval process in that it does not require new preclinical and clinical studies; instead, it relies on the clinical studies establishing safety and efficacy conducted for the previously approved drug. The ANDA process, however, requires the generation of data that show that the ANDA drug is bioequivalent (that is, therapeutically equivalent) to the previously approved drug. Bioequivalence compares the bioavailability of one drug with another and, if established, indicates that the rate and extent of absorption of an off-patent drug in the body are substantially equivalent to the previously approved drug. Bioavailability establishes the rate and extent of absorption, as determined by the time-dependent concentrations of a drug in the bloodstream needed to produce a therapeutic effect. Supplemental NDAs or ANDAs are required for, among other things, approval to transfer products from one development site to another. Such applications may be under review by the FDA for a year or more. In addition, certain drugs may be approved for transfer only once new bioequivalence studies have been conducted or other certain requirements have been satisfied.

To obtain FDA approval of both NDAs and ANDAs, a pharmaceutical company s procedures and operations must conform to FDA quality system and control requirements generally referred to as current Good Manufacturing Practices ( GMP ), as defined in Title 21 of the U.S. Code of Federal Regulations. These regulations cover all aspects of the development, manufacturing and marketing process from receipt and qualification of components to distribution procedures for finished products. Since they are evolving standards, we have to continue to expend time, money and effort in all production and quality control areas to maintain compliance. The evolving and complex nature of regulatory requirements, the broad authority and discretion of the FDA, and the high level of regulatory oversight results in the continuing possibility that we may be adversely affected by regulatory actions despite our efforts to maintain compliance with the applicable regulatory

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requirements. See Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business for a discussion of these risks.

In addition, we are subject to periodic inspections of our facilities, procedures and operations and/or the testing of our pharmaceuticals by the FDA, the DEA and certain other authorities that conduct periodic inspections to assess our compliance with applicable regulations. The FDA also conducts pre-approval and post-approval reviews and plant inspections in connection with its review of our applications for new products to determine whether our systems and processes comply with GMP and other applicable FDA regulations. If the FDA determines that deficiencies have occurred at any of our facilities, it may, among other things, withhold approval of any NDAs, ANDAs or other applications that we have submitted. Our vendors that provide us with finished products or components used to manufacture, package and label pharmaceuticals are subject to similar regulations and periodic inspections. Following its inspections, the FDA may issue notices on Form 483 and Warning Letters that may cause us to modify certain activities identified during the inspection. A Form 483 notice is typically issued at the conclusion of an FDA inspection and lists conditions that the FDA investigators believe may violate GMP or other FDA regulations. FDA guidelines specify that a Warning Letter be issued only for violations of regulatory significance for which the failure to adequately and promptly achieve correction may be expected to result in an enforcement action.

Failure to comply with FDA and other governmental regulations may result in fines, unanticipated compliance expenditures, recall or seizure of pharmaceuticals, total or partial suspension of production and/or distribution, suspension of the FDA s review of NDAs, ANDAs or other applications, enforcement actions, injunctions and criminal prosecution. Under certain circumstances, the FDA also has the authority to revoke previously granted approvals. Although we have internal compliance programs, if these programs do not meet the applicable standards or if our compliance is deemed deficient in any significant way, our business may be materially adversely affected.

See Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business for a further discussion of risks in connection with FDA regulations.

The Generic Drug Enforcement Act of 1992 established penalties for wrongdoing in connection with the development or submission of ANDAs. Under this act, the FDA has the authority to permanently or temporarily bar companies or individuals from submitting or assisting in the submission of ANDAs and to temporarily deny approval and suspend applications to market off-patent drugs. The FDA may also suspend the distribution of all drugs approved or developed in connection with certain wrongful conduct and/or withdraw approval of ANDAs and seek civil penalties. The FDA may also significantly delay the approval of any pending NDA, ANDA or other regulatory applications under the Fraud, Untrue Statements of Material Facts, Bribery and Illegal Gratuities Policy Act.

In recent years, there has been enhanced political attention and governmental scrutiny at the federal and state levels of the prices paid or reimbursed for pharmaceuticals under Medicaid, Medicare and similar programs. The U.S. Federal Trade Commission ( FTC ) has recently announced its intention to conduct a study of whether brand-name and generic drug providers have entered into agreements, or have used other strategies, to delay competition from generic versions of patent-protected drugs. The FTC s announcement could affect the manner in which generic drug providers resolve intellectual property litigation with branded pharmaceutical companies, and may result in an increase in private-party litigation against pharmaceutical companies. See Item 3: Key Information Risk Factors Risks Related To Our Pharmaceuticals Business for a discussion of government regulation in connection with third-party reimbursement programs.

*European Union*

Much of what has been said with respect to the approval process applicable to new drugs in the United States also applies to the European Union. In the European Union, however, two different basic procedures are available: a centralized approval procedure and one based on the Mutual Recognition Procedure. The London-based European Agency for the Evaluation of Medicinal Products ( EMEA ) governs the centralized drug registration and approval process. The respective scientific committees, the committee for proprietary medicinal products ( CPMP ) and the committee for veterinary medicinal products ( CVMP ), make recommendations based on reviews by appointed rapporteurs and co-rapporteurs, who are part of the CPMP/CVMP. Following the committee s recommendation, the European Commission issues a formal decision, which is valid throughout the entire European Union. Upon completion of the approval process, the drug may be marketed within all member states. An alternative procedure is the Mutual Recognition Procedure. Pursuant to this

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procedure, one member state carries out the primary evaluation. The other member states then have 90 days to decide whether they accept or reject the decision made by that member state. If a member state does not follow the decision of the reference country, then the issue is referred to the CPMP for arbitration. Based on the CPMP s determination, a formal decision is made by the European Commission.

*Japan*

In Japan, two issues make the approval process difficult for drugs developed outside of that country. First, the Japanese approval agency recognizes only a limited number of the documents used in registration procedures in other countries. Second, the Japanese approval agency requires that tests to determine appropriate dosages for Japanese patients be conducted on Japanese subjects and patients. As a result of these issues, parts of Phase II and Phase III clinical trials carried out in the United States or Europe typically need to be repeated in Japan. These regulatory requirements may cause delays of two to three years in introducing drugs developed outside of Japan to the Japanese market.

**Chemicals**

**Overview**

We develop, manufacture and market a wide range of specialty chemicals targeted at selected niche markets. Specialty chemicals are high value-added products used in the manufacture of a wide array of applications. Compared with commodity chemicals, specialty chemicals are typically made in smaller volumes. We offer our specialty chemicals together with support and comprehensive customer service regarding the use of our products and their adaptation to the specific manufacturing requirements of individual customers. The highly application-specific nature of specialty chemicals impedes product substitution, which fosters close relationships between suppliers and customers.

In 2003, our chemicals division generated net sales of € 755 million, an increase of 0.9% compared with 2002. The chart below provides a breakdown of our chemicals net sales by geographic region for the three years ended December 31, 2003:

In 2003, some of our customers transferred their production facilities from North America to Asia, which led to a decline of our sales in the North American region and caused our sales in the Far East to rise. The results for both regions suffered due to strong negative currency effects in 2003. In Europe and Asia, our chemicals division achieved single digit growth rates despite the weak economic situation throughout the year. As a result of the international dimension of our business, our results of operations are materially affected by exchange rate fluctuations in any given period, especially by changes in the exchange rate between the euro on the one hand and the U.S. dollar and the Japanese yen on the other hand. See Item 3: Key Information Risk Factors Risks Related

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To Each Of Our Businesses and Item 11: Quantitative and Qualitative Disclosure About Market Risk for more information on our exchange rate exposure.

Our chemicals division comprises three business areas:

- Additives & Instruments, which comprises paint additives, plastic additives and wax additives as well as paint testing instruments, including gloss and color meters;
- Coatings & Sealants, which comprises can and coil coatings for packaging and general industry applications as well as sealing compounds for cans and closures; and
- Electrical Insulation, which comprises electrical insulation coatings for copper and aluminum wires, electrical insulation systems for use in electrical and electronic components, and compounds for a variety of other applications.

Our chemicals division has grown steadily over the past several years both organically and as a result of strategic acquisitions. We expect to continue to rely on a combination of organic growth and acquisitions for the expansion of our operations in the future. In identifying suitable targets for acquisitions, we seek majority interests in companies that present a clear strategic fit, have potential for net income contribution and whose management is both experienced and competent.

The chart below provides a breakdown of our chemicals net sales by business area for the three years ended December 31, 2003:

Because chemicals are used in a variety of industries, manufacturers of specialty chemical products are typically affected by the business cycles experienced by the industries that they serve. By targeting selected niche markets in complementary industries all over the world, we seek to diversify our risk and reduce our exposure to these cycles.

**Products**

*Additives & Instruments*

We provide a wide range of innovative, high-quality additives and related measuring and testing instruments. In 2003 net sales generated by our Additives & Instruments business totaled € 308 million.

We offer a comprehensive portfolio of paint additives, plastic additives and wax additives, which we develop for the specific requirements of our customers in the coatings, plastics and printing ink industries and which we market under our global brand BYK-Chemie. Additives are substances that have essentially two applications: first, they facilitate manufacturing processes, for example, by reducing viscosities and shortening processing times, and second, they substantially improve the quality of products, especially their mechanical properties and

appearance. Because additives can achieve effects that otherwise would not be possible, additives have become an integral and indispensable part

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of modern paint and plastics formulations. Due to their high effectiveness, they are usually applied in small dosages.

Our additives portfolio comprises wetting and dispersing additives for pigments and fillers, additives to improve surface properties, defoamers and air release agents, rheological additives, wax emulsions, dispersions and micronized waxes. Our additives are used in a variety of downstream applications, such as architectural and industrial coatings, automotive finishes, wood, can and coil coatings, printing inks, vinyl floorings, polyester, epoxy or acrylic resin systems and polishes.

As a complement to our additives portfolio, we also offer measuring and testing instruments that may be used to measure the surface characteristics of plastics and paints, including their color and gloss attributes. We market our instruments under our global brand BYK-Gardner. By enabling our customers to adjust their selection and dosage of additives based on the surface characteristics of the raw materials that they use, our instruments portfolio naturally complements our additives offering. We believe that our ability to offer complete solutions consisting of additives and instruments affords us a competitive edge.

We manage our additives business from the headquarters of our chemicals division, which are located in Wesel, Germany, and which are responsible for our worldwide R&D, manufacturing and marketing efforts. In contrast, sales and customer service are the responsibility of our local operating companies, which operate in proximity to our customers. We believe that this dual approach enables us to achieve operational synergies, while staying in touch with our customers.

Our Additives & Instruments business has expanded continuously over the past several years, almost entirely as a result of organic growth.

*Coatings & Sealants*

In the area of Coatings & Sealants, we offer can and coil coatings as well as compounds and sealants. In 2003, our Coatings & Sealants business generated net sales of € 222 million. Our can and coil coatings are used, among other things, to coat steel and aluminum sheets and coils. An important downstream application of our coatings portfolio are packaging materials that are used in the food industry, including cans, drums and closures as well as aluminum, plastic and paper foils for flexible packages. In addition, our coil coatings are also used for other applications, such as facade claddings, roller shutters, blinds and furniture. Our compounds and sealants portfolio comprises sealing compounds for use in food and beverage cans, bottle closures and jar lids.

We believe that we offer a comprehensive portfolio of coatings and sealants. This is especially true of packaging applications, for which we are able to provide our customers with complete solutions. Our position in the coatings market is particularly strong in Europe. In the area of closure compounds and can sealants, we consider ourselves to be among the leading providers worldwide. Our declared goal is to be the best in class with respect to every type of product that we offer and every market that we are active in.

*Electrical Insulation*

In our Electrical Insulation business, we offer a comprehensive range of wire enamels, impregnating resins, coatings and other compounds used for electrical insulation in a variety of applications. All of the products in our Electrical Insulation portfolio are formulated to fulfill various performance requirements in addition to electrical insulation, such as mechanical and chemical resistance and thermal endurance even under severe operating conditions. Our Electrical Insulation portfolio comprises:

- Enamels for the electrical insulation of copper and aluminum wires used in a variety of electrical applications, including electrical motors, transformers, household appliances and consumer electronics;
- Resins for the impregnation of electrical windings in motors, generators and other coils;
- Compounds for the potting, encapsulation and embedding of electrical and electronic components such as transformers, printed circuit boards and capacitors; and
- Coatings and compounds for specialized applications, including tooling, rapid prototyping and magnetic materials.

In 2003, our Electrical Insulation business generated net sales of € 225 million.

As with Coatings & Sealants, part of our growth strategy in our Electrical Insulation business area is to expand our market position by making selective acquisitions of innovative companies with

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strong positions in the markets in which they operate. In August 2003, we completed the acquisition of the global electrical insulation business of Schenectady International, Inc. As part of the transaction, we acquired 100% of the shares of Schenectady Europe GmbH (now Beck Electrical Insulation GmbH), Hamburg, Germany, and 83% of the shares of Schenectady Beck India Ltd. (now Beck India Limited), Pune, India, a company listed on the Indian stock exchange. In addition, we acquired Schenectady s electrical insulation business operations in the United States, the United Kingdom, South Africa, Brazil, Mexico, Canada and Australia, and integrated them in our existing subsidiaries. In 2002, Schenectady s electrical insulation business had revenues of $ 91 million. In January 2004, we acquired the electrical insulation business of Ranbar Electrical Materials Inc., comprising impregnating resins, varnishes and potting compounds for the secondary insulation of electrical equipment. In 2002, this business had revenues of approximately $ 11 million.

**Research and Development**

We consider the development of innovative specialty chemicals that are capable of satisfying our customers needs a key prerequisite for the success of our business. The overarching goal of our R&D efforts is to create customized solutions that add value to our customers manufacturing processes and the products that they market. In doing so, we seek to distinguish ourselves from our competitors in terms of quality and innovation. In order to be in a position to employ state-of-the-art technology in all aspects of our dealings with customers, we supplement our development processes with basic research in selected areas.

In our Additives & Instruments business, we manage most aspects of our R&D efforts on a centralized basis. Virtually all research related to additives is carried out at the headquarters of our chemicals division, which are located in Wesel, Germany. While we also maintain laboratories for these products in close proximity to our customers in all major markets, none of them is engaged in research activities. Instead, the function of these laboratories is to provide our customers with technical assistance and to solve their problems on-site. In our Electrical Insulation business, we carry out basic research projects at our facilities in Wesel, particularly in the area of wire enamels. In addition, we maintain R&D laboratories at selected local manufacturing sites. These laboratories develop and produce region-specific formulations in close contact with our customers and provide them with technical service and support. In our Coatings & Sealants business, we manage our entire R&D process on a decentralized basis, with our R&D laboratories being located at our local plants. To avoid overlaps and redundancies, our management promotes close collaboration and the mutual exchange of information between R&D facilities within each of our business areas.

As far as new technologies are concerned, such as UV-curing and nano technologies, which we expect to play an increasingly important role in the specialty chemicals industry, each of our business areas conducts its own R&D efforts. In addition, we recently acquired a 7% stake in, and entered into a cooperation and development agreement with, Nanophase Technologies Corporation, a company active in nano materials, to jointly identify and develop products for use in the manufacture of paints, coatings and plastics. Because the value of new technologies to our business is highly application-specific, our management considers this approach preferable to concentrating all R&D in one location. To ensure that know-how built up in one business area becomes available to other business areas, we actively manage cooperation between our various R&D facilities involved in similar technology projects.

As of December 31, 2003, 486 people worldwide 18.5% of the workforce of our chemicals division were employed in our laboratories. Our R&D expenditures in this division totaled € 36 million in 2003, representing 4.7% of total sales.

**Supplies and Raw Materials**

We purchase our supplies and raw materials from third parties and typically seek to diversify our sources so as to minimize the risk of supply chain outages. We do not believe that the loss of any one of our providers would have a material adverse effect on our business. In addition, we believe that alternative sources for all supplies and raw materials that we need in our business would be readily available to us without undue expense and delay. We have not experienced significant difficulties in obtaining supplies and raw materials of sufficient amounts and quality in recent years, and we do not expect to encounter such difficulties in the foreseeable future.

Like other companies in the chemicals industry, we are exposed to raw material price increases. While we have historically been able to pass such increases on to our customers, we have experienced difficulties in doing so in the past two business years, which has created pressure on our margins. To

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reduce this pressure, we attempt to secure important raw materials by entering into long-term contracts. In 2003, we were able to achieve savings by streamlining our procurement processes.

**Production**

Our production strategy is to minimize costs by streamlining our manufacturing processes and by creating facilities that specialize in discrete product groups, thereby achieving economies of scale. In implementing this strategy, we focus on capacity and process improvements with respect to our existing facilities. To the extent necessary, we also construct new facilities. As a rule, we seek to promote close collaboration between our production facilities and our sales and service organizations so as to be able to adapt our manufacturing processes according to our customers needs. We consider this approach especially important in the areas of Coatings & Sealants and Electrical Insulation.

We own substantially all of our manufacturing facilities and substantially all of the land on which they are located. Our most important production facility in the chemical division is located in Wesel, Germany, where we manufacture the majority of the products of o ur additives business area. We operate our facility located in Pittsburgh, Pennsylvania, in a joint venture with the legal owner of the land and lease our facilities in Montataire, France, Collecchio, Italy, and Fort Wayne, Indiana.

The following table shows selected key information with respect to our current manufacturing facilities as well as our facilities under construction:

**Production Facilities**

| Location | Function | Size (m2) |
|---|---|---|
| Wesel, Germany | Additives | 98,810 |
| Kempen, Germany | Wire enamels, impregnating resins and compounds | 36,713 |
| Hamburg, Germany | Impregnating resins | 34,711 |
| Grevenbroich, Germany | Coatings | 25,219 |
| Bremen, Germany | Closure compounds | 13,719 |
| Lehrte, Germany | Coatings | 24,719(1) |
| Geretsried, Germany | Measuring and testing instruments | 10,323 |
| Vienna, Austria | Coatings | 28,508 |
| Sedan, France | Coatings | 20,000 |
| Montataire, France | Coatings | 4,342 |
| Quattordio, Italy | Wire enamels, impregnating resins | 40,096(2) |
| Ascoli Piceno, Italy | Wire enamels, impregnating resins | 17,499 |
| Burago, Italy | Coatings | 12,323 |
| Collecchio, Italy | Compounds | 8,000 |
| Deventer, Netherlands | Additives | 18,850 |
| Vigo, Spain | Can sealants | 20,637 |
| Manchester, United Kingdom | Impregnating resins | 8,500 |
| St. Louis, Missouri | Wire enamels, impregnating resins and compounds | 70,000 |
| Wallingford, Connecticut | Additives | 75,366 |
| Pittsburgh, Pennsylvania | Coatings and sealants | 5,060 |
| Fort Wayne, Indiana | Wire enamels | 3,345 |
| Pune, India | Impregnating resins | 213,191 |
| Tongling City, China | Additives and wire enamels | 19,634 |
| Shunde, China | Coatings | 9,754 |

(1) 14,104 m2 owned and 10,615 m2 leased.

(2) 26,030 m2 owned and 14,066 m2 leased.

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**Customers, Sales and Marketing**

We sell our specialty chemical products in more than 100 countries worldwide. Our customer focus and our commitment to quality and service have enabled us to achieve leading market positions. We seek to maintain close links between our manufacturing facilities and our sales and marketing organization in order to be able to respond to our customers changing needs quickly. In addition, this approach enables us to ship products directly from our manufacturing facilities to our customers, which reduces both our and their inventories.

Each of the specialty chemicals business areas has its own centralized management, which coordinates the business area s sales and marketing strategy and which is responsible for dealing with its key customers. The actual sales and marketing, however, is carried out at the local level by our operating companies. In addition, to the extent that we do not serve a particular market through our own local organization, it is carried out either by way of direct sales made by us or through external agents, whom we remunerate on a commission basis.

Our main customers in the area of Additives & Instruments are in the paint and plastics industry. We offer our Additives & Instruments portfolio worldwide under our global brands BYK-Chemie and BYK-Gardner. Our marketing efforts are coordinated by our headquarters in Wesel, Germany, and are supported by our global sales and marketing organization, which consists of marketing companies in the United States, France and Japan and sales offices in Korea, Singapore and China. In those areas of the world where it does not make sense for us to maintain sales and marketing organizations of our own, we rely on distributors with which we have long-term relationships and whom we typically remunerate on a commission basis. We do not depend on any one of our distributors, and none accounts for a material portion of our revenues. In addition, we employ technical consultants who provide technical advice and service to our customers in all major markets.

In the area of Coatings & Sealants, our customers comprise a small number of globally operating companies in the packaging and certain other industries, and we rely on our own sales and marketing organizations in Germany, most other major European markets, the United States and China.

The principal customers of our Electrical Insulation business are large manufacturers of magnet wires and various producers of electrical and electronic components. Because electrical and electronic devices are used in a wide variety of applications of everyday life, our customer base for impregnating resins and compounds is large and diverse. As far as Electrical Insulation is concerned, we use our own sales operations in all major markets worldwide.

**Competition**

Because specialty chemicals are frequently critical components of the manufacturing processes or end products in which they are used, they are typically offered together with support and customer service regarding their use and adaptation to the manufacturing requirements of individual customers. Therefore, the key competitive factors in all our business areas are the ability to respond to customers needs and the commitment to constantly introducing new products and providing consistent quality and service.

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The specialty chemicals industry is a highly fragmented industry, and there is no company that competes with us across all our business areas. The following table provides an overview of our principal competitors by business area:

| | **Competitors** |
|---|---|
| Additives & Instruments | Borchers (a subsidiary of Bayer AG), Ciba Specialty Chemicals, Cognis, Degussa-Tego, Lubrizol and UCB |
| Electrical Insulation | |
| Wire enamels | Du Pont, Nexans, Fupao Chemical and Hitachi |
| Impregnating resins and compounds | Vantico, Du Pont, Hitachi and Von Roll Isola |
| Coatings & Sealants | |
| Can coatings | ICI, PPG and Valspar |
| Coil coatings | Akzo Nobel Nippon Paint, BASF, Becker Industrial Coatings, Sigma-Kalon and Tikkurila |
| Can sealants and closure compounds | W.R. Grace |

**Regulation**

The development, manufacture and marketing of chemical substances is regulated by national and international laws. Almost every country has its own legal procedures for manufacturing, registration and import. Of all countries, the laws and regulations of the European Union, the United States and Japan, however, are those which are most significant to our business. These regulations include the European inventory of existing commercial chemical substances, the European list of notified chemical substances, the United States Toxic Substances Control Act and the chemicals list of the Japanese Ministry of Trade and Industry. Chemicals that are contained in one or more of these lists can usually be registered and imported without additional testing into any other country, although additional administrative requirements may exist.

**Employees**

See Item 6: Directors, Senior Management and Employees for information on our employees.

**Environmental Matters**

Our operations are subject to a number of environmental laws and regulations in each of the jurisdictions in which we operate governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater contamination, as well as employee health and safety. Environmental compliance obligations and liability risks are inherent in many of our manufacturing activities. In the United States, certain environmental remediation laws, such as the federal Superfund law, can impose joint and several liability for site cleanup, regardless of fault, upon certain statutory categories of parties, including companies that sent waste to a site. We are subject to potential liability at a number of owned and third party sites in the United States.

We believe that our operations are currently in material compliance with all applicable environmental laws and regulations. In many jurisdictions, environmental requirements may be expected to become more stringent in the future, which could affect our ability to obtain or maintain necessary authorizations and approvals and result in increased environmental compliance costs.

While our management does not believe that environmental compliance or remedial requirements are likely to have a material effect on us, there is no assurance that future material environmental compliance or remedial obligations will not arise in connection with our operations or facilities or that such obligations will not have a material adverse effect on our business, financial condition or results of operations.

We have established and continue to establish accruals for environmental remediation liabilities where the amount of such liability can be reasonably estimated. As a rule, investigations into potential contamination and subsequent cleanup are required only when a site is closed and the existing production facilities dismantled. Accordingly, it is not possible to reasonably estimate the ultimate liability for investigation and

cleanup at sites that are still in operation. Likewise, given the

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uncertainty inherent in such estimates, any accruals that we have established may be subject to change.

**Organizational Structure**

We have subsidiaries that operate in a number of countries throughout the world. The following table provides information as of December 31, 2003, with respect to our current significant subsidiaries:

**Significant Subsidiaries**

| Corporate name, location and country of incorporation | Field of activity | Equity(1) | Ownership interest(2) |
|---|---|---|---|
| | | (€ in millions) | (%) |
| **Pharmaceuticals** | | | |
| ALTANA Pharma AG, Constance, Germany | Administration, R&D, Production, Distribution | 59 | 100 |
| ALTANA Pharma Deutschland GmbH, Constance, Germany | Distribution | 2 | 100 |
| ALTANA Pharma Consumer Health GmbH, Hamburg, Germany | Distribution | 0 | 100 |
| ALTANA Pharma B.V., Hoofddorp, The Netherlands | Distribution | 28 | 100 |
| ALTANA Pharma N.V. /S.A., Diegem, Belgium | Distribution | 5 | 100 |
| ALTANA Pharma S.A.S., Le Mée-sur-Seine, France | Distribution | 20 | 100 |
| ALTANA Pharma GmbH, Vienna, Austria | Distribution | 20 | 100 |
| ALTANA Pharma S.p.A., Milan, Italy | Distribution | 28 | 100 |
| ALTANA Pharma S.A., Madrid, Spain | Distribution | 12 | 100 |
| ALTANA Pharma Sp.z.o.o., Warsaw, Poland | Distribution | 16 | 100 |
| ALTANA Inc., Melville, New York | Production, Distribution | 40 | 100 |
| ALTANA Pharma Inc., Oakville, Canada | Distribution | 31 | 100 |
| ALTANA Pharma S.A. de C.V., Mexico City, Mexico | Production, Distribution | 57 | 100 |
| ALTANA Pharma Ltda., São Paulo, Brazil | Production, Distribution | 43 | 100 |
| ALTANA Pharma AG, Kreuzlingen, Switzerland | Distribution | 12 | 100 |
| ALTANA Madaus (Pty.), Midrand, South Africa | Distribution | 7 | 50 |
| ALTANA Pharma Ltd., Marlow, Great Britain | Distribution | 1 | 100 |
| **Chemicals** | | | |
| ALTANA Chemie AG, Wesel, Germany | Administration | 865 | 100 |
| BYK-Chemie GmbH, Wesel, Germany | Production, Distribution | 106 | 100 |
| Rhenania Coatings GmbH, Grevenbroich, Germany | Production, Distribution | 9 | 100 |
| DS-Chemie GmbH, Bremen, Germany | Production, Distribution | 7 | 100 |
| Terra Lacke GmbH, Lehrte, Germany | Production, Distribution | 6 | 100 |
| Wiedeking GmbH Elektroisoliersysteme, Kempen, Germany | Production, Distribution | 5 | 100 |
| BYK-Cera B.V., Deventer, The Netherlands | Production, Distribution | 20 | 100 |
| Rembrandtin Lack Ges. mbH, Vienna, Austria | Production, Distribution | 18 | 100 |
| Deatech s.r.l., Ascoli Piceno, Italy | Production, Distribution | 24 | 100 |
| Salchi-Rhenacoat s.r.l., Burago Molgora, Italy | Production, Distribution | 7 | 51 |
| The P.D. George Company Inc., St. Louis, Missouri | Production, Distribution | 18 | 100 |
| BYK-Chemie USA, Wallingford, Connecticut | Production, Distribution | 53 | 100 |
| BYK-Chemie Japan KK, Osaka, Japan | Distribution | 5 | 100 |
| Tongling SIVA Insulating Materials Co. Ltd., Tongling City, People s Republic of China | Production, Distribution | 15 | 100 |

**Other subsidiaries**

| | | | |
|---|---|---|---|
| ALTANA Technology Projects GmbH, Bad Homburg v.d.H., Germany | Investments in and collaborations with biotech companies | 62 | 100 |

(1) Figures calculated in accordance with International Financial Reporting Standards ( IFRS ).
(2) Portion of ownership interest equals portion of voting power held.

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**Property, Plants and Equipment**

We own approximately 2.0 million square meters of property at our production, distribution and administrative facilities around the world and nearly all of the land that they occupy. See Pharmaceuticals Production and Chemicals Production for more information on our production facilities. Virtually all of our facilities are either owned by us or available to us under long-term leases. We believe that our current facilities and those of our consolidated subsidiaries are in good condition and adequate to meet the requirements of our present and foreseeable future operations.

**Legal Proceedings**

As is the case with many companies in the pharmaceuticals and specialty chemicals industry, we are and may from time to time become a party to claims and lawsuits incidental to the ordinary course of our business. We are not currently involved in any legal or arbitration proceedings that we expect to have a material adverse effect on our financial position, and, to our knowledge, no such legal or arbitration proceedings are currently threatened.

In 1988, we held 91% of Deutsch-Atlantische Telegraphen AG ( DAT ). In connection with the execution of a profit transfer and control agreement with DAT, which provided that all of DAT s profits and losses had to be transferred to us, we made a mandatory exchange offer to the minority shareholders offering them 1.3 shares of our company for each DAT share held by them. The offer was based on a valuation of DAT. Subsequently, several minority shareholders applied to the competent court for relief, alleging that our compensation offer was inadequate. After raising our stake in DAT and integrating it into our company in 1990, we submitted a new compensation offer based on an exchange ratio of 1.4. After protracted litigation, in which lower courts confirmed the adequacy of our offers, the German Federal Constitutional Co urt (*Bundesverfassungsgericht*) reversed and remanded. The court held that the compensation offered by us should have been based on the market price of the shares, which would have led to a higher compensation to the DAT shareholders. On March 12, 2001, the German Federal Supreme Court (*Bundesgerichtshof*) decided that the exchange ratio had to be based on the average share price during the three months preceding the shareholders meeting that approved the profit transfer and control agreement. The case was subsequently remanded to a district court, which in its decision dated January 15, 2003 set the exchange ratio at 3.45 shares of our company for one DAT share (not taking into account the various stock splits that have occurred in the meantime). We appealed that decision and on July 4, 2003, the appellate court (*Oberlandesgericht Düsseldorf*) confirmed the district court s decision. Based on the final court ruling, our total liability amounted to € 19.3 million. As at December 31, 2002 we had already accrued € 16.1 million. Accordingly, we recorded an expense of € 3.2 million as other operating expenses in 2003. Our obligation must be settled in cash and shares. The obligation has been calculated based on the stock price of our shares on the day of the court ruling. In 2003, we transferred 207,036 of our treasury shares to former DAT shareholders and paid € 0.9 million in cash. At December 31, 2003, we recorded the outstanding obligation in the amount of € 8.0 million under other liabilities.

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## ITEM 5: OPERATING AND FINANCIAL REVIEW AND PROSPECTS

*The following discussion includes forward-looking statements based on assumptions about our future business. Our actual results could differ materially from those contained in the forward-looking statements.*

*You should read the following discussion of our financial condition and results of operations in conjunction with our consolidated financial statements, including the related notes, and the other financial information that we have included elsewhere in this annual report. For our consolidated financial statements as of and for the three years ended December 31, 2003, see the discussion beginning on page F-1. We have prepared our consolidated financial statements in accordance with IFRS, which differ in certain significant respects from U.S. GAAP. For a description of the significant differences between IFRS and U.S. GAAP and a reconciliation of net income and shareholders equity to U.S. GAAP, you should read note 33 to our consolidated financial statements.*

### Overview

We are a globally operating company that develops, manufactures and markets innovative pharmaceutical and specialty chemical products for a range of targeted, highly specialized applications. Over the past five years, we have on average achieved double-digit revenue growth and steady increases in our operating income. We believe that this development is a result of our strategic focus on the pharmaceuticals and specialty chemicals markets and the continuous international expansion of our business. In recent years, much of this development has been driven by Pantoprazole. The following table indicates the growth of our business in recent years in terms of our net sales and our operating income for each of the last five years:

| | 1999 | 2000 | 2001 | 2002 | 2003 |
|---|---|---|---|---|---|
| | | | (€ in millions) | | |
| Net sales | 1,577 | 1,928 | 2,308 | 2,609 | 2,735 |
| Operating income | 205 | 309 | 520(1) | 538 | 563 |
| Net income | 118 | 181 | 328 | 324 | 345 |

(1) Includes a one-time gain in the amount of € 110 million resulting from the sale of our interest in a joint venture with H. Lundbeck A/S, a Danish company active in the treatment of diseases of the central nervous system ( CNS ) and a special donation of € 15 million to the Herbert Quandt endowment. Excluding these items, our operating income in 2001 would have been € 424 million.

The following discussion highlights the main factors driving the revenues and results of operations of each of our two divisions from 2001 to 2003.

*Pharmaceuticals.* The net sales of our pharmaceuticals division rose by 24.4%, from € 1,591 million in 2001 to € 1,861 million in 2002 and € 1,980 million in 2003. During the same period, the division s operating income grew by 39.3%, from € 363 million in 2001 to € 471 million in 2002 and € 506 million in 2003. The 2001 figure has been adjusted for a one-time gain in the amount of € 110 million resulting from the sale of our interest in a joint venture and a one-time expense due to our donation of € 15 million to a charitable endowment, of which we booked € 7.5 million in our pharmaceuticals division. The results of operations of our pharmaceuticals division are driven by:

*Our ability to develop and launch new and innovative therapeutics.* Our pharmaceuticals division derives most of its revenues from the sale of therapeutic drugs, and its ability to develop and launch new and innovative drugs materially influences its results of operations. The launch of new drugs, however, requires the successful completion of a regulatory approval process that is complex and burdensome and whose outcome is uncertain. Currently, the main revenue driver of our pharmaceuticals division is our gastrointestinal therapeutic Pantoprazole, whose net sales have risen by 63.6% over the past three years, from € 680 million in 2001 to € 966 million in 2002 and further to € 1,113 million in 2003. Pantoprazole accounted for 56.2% of our pharmaceuticals net sales in 2003, compared with a contribution of 51.9% in 2002 and 42.8% in 2001. In 2003, Pantoprazole continued to be the primary growth driver of the division s net sales. However, increasing competition in the U.S. market, our most important market, by other branded PPIs, in particular Takeda s lansoprazole-based PPI and AstraZeneca s Nexium, by various generic PPIs based on omeprazole as well as by an OTC version of an omeprazole-based PPI recently launched by Procter & Gamble has led to increased pressure on Pantoprazole, which may result in

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reduced growth and potentially even a decline in our Pantoprazole net sales in future periods. To reduce our reliance on sales and earnings of Pantoprazole, we are in the process of developing several respiratory tract drugs, including Alvesco® and Daxas®, which we plan to launch over the next several years and which we hope will become revenue drivers of our pharmaceuticals division in the future. Recently, we received the first regulatory approval for the marketing of Alvesco® in Australia.

*Price regulations and budgeting decisions of local governments and health care providers.* The sale of pharmaceuticals is subject to extensive price controls, which not only limit the amount of revenues that we can earn from our products but which also influence the purchasing patterns of hospitals, doctors and patients. For example, after a period in which health care providers in Germany were afforded greater flexibility in their budgeting decisions and during which we were able to increase our sales of ethical therapeutics in the German market, recent legislation providing a framework for the introduction of reference prices for certain patent-protected drugs is likely to have the opposite effect. Since January 1, 2003, the pharmaceutical industry in Germany has been required to grant German social security funds discounts of 6% off the list price for most ethical products, which has had a negative impact on our pharmaceuticals sales in Germany during the past period. At the beginning of 2004 the German government increased these discounts to 16%. Accordingly, we expect this negative impact to continue.

*The level of our investment in R&D in any given period.* The development of new and innovative therapeutics involves substantial investments in R&D. Thus, the level of our R&D spending in any given period has a material impact on the results of operations of our pharmaceuticals division in that period. To maintain our high level of innovation, we seek to invest approximately 20% of the annual revenues of our therapeutics business in R&D. Basic research and the initial development, manufacture and launch of a new therapeutic typically require high levels of cash expenditures, whereas the marginal cost of producing additional units of the therapeutic is low. As a result, our ability to recover our R&D expenditures and to generate a profit from our drugs depends on our ability to obtain patent and other forms of intellectual property protection for these drugs to shield us from competition by manufacturers of generic equivalents.

*The sales and marketing methods we use for our therapeutics.* The results of operations of our pharmaceuticals division depend substantially on the selling and distribution expenses that we incur in marketing our therapeutics. The amount of selling and distribution expenses incurred with respect to any given drug depends on a variety of factors. One principal factor is the stage of the drug s life cycle. When we launch a new therapeutic, we typically incur substantial selling and distribution expenses to support its introduction to the worldwide pharmaceuticals markets. As the drug becomes established in its markets, these costs decline.

Another key factor influencing the level of selling and distribution expenses of our therapeutics and the revenues generated by them is the method that we use to distribute them. While we record selling and distribution expenses in markets where we sell our drugs directly, we at times use arrangements under which a local distributor purchases therapeutics from us at a price specified in the relevant distribution agreement and then assumes sole responsibility for selling and distributing these drugs in its local market. All expenses incurred in connection with the sale and distribution of the drugs are the distributor s responsibility. An example of this type of distribution arrangement is our agreement with Wyeth Pharmaceuticals, the pharmaceuticals division of Wyeth, Inc., ( Wyeth ) to distribute Pantoprazole in the United States. See Item 10: Additional Information Material Contracts for a summary of the material terms of our distribution arrangement with Wyeth.

*The composition of our portfolio of pharmaceuticals.* The manufacturing costs of the various products sold by our pharmaceuticals division vary considerably relative to their prices. Therefore, the results of operations of our pharmaceuticals division depend in part on the mix of pharmaceuticals that we ship in any given period. For example, because Pantoprazole has lower manufacturing costs relative to its price than many other products in our portfolio, our cost of sales as a percentage of net sales are lower in periods in which we ship higher volumes of Pantoprazole.

*Chemicals.* The net sales of our chemicals division increased by 5.2% from € 717 million in 2001 to € 748 million in 2002 and € 755 million in 2003. Over the same period, its operating income

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fluctuated from € 98 million in 2001 to € 104 million in 2002 and € 92 million in 2003. The results of operations of our chemicals division are driven by:

*Our ability to consistently launch new and innovative products.* The longer a successful product is on the market, the more time competitors have to develop products with similar features, leading to increased competition and downward price pressure. As a result, a key driver of the revenues and results of operations of our chemicals division is our ability to consistently develop, manufacture and sell new and innovative specialty chemical products with advanced technical features and to ensure that such products account for a substantial share of our product portfolio.

*Our ability to maintain close ties with our customers.* In the specialty chemicals industry, it is important to be able to offer customers complete solutions consisting not only of products but also of comprehensive technical advice and service in connection with these products. Because the relationship aspect is an integral part of our product offering, our ability to maintain close ties with our customers affects the prices that our customers are willing to pay us and ultimately our revenues and results of operations.

*The business cycles experienced by our customers.* Although our products are targeted at specialized applications, our chemicals division is subject to the business cycles experienced by our customers. While we find it difficult to insulate our business from the impact of economic downturns that affect all of our customers, such as the global downturn that began in the fourth quarter of 2000 and continued to have a negative impact on the economic climate throughout 2003, we attempt to reduce our exposure to the business cycles of the industries that we serve by focusing on complementary industry segments and discrete geographic regions.

*The level of raw material prices.* Another driver of the results of operations of our chemicals division is the level of raw material prices prevailing at any given point. Historically, we have at times found it difficult to pass such increases on to our customers, and we may experience similar difficulties in the future. In each of the last several years, the results of operations of our chemicals division were materially influenced by rising raw material prices. We continued to be exposed to high raw material prices in 2003 but were able to limit their impact on our business by substituting cheaper raw materials for more expensive ones.

Each of our two divisions results of operations have been and continue to be materially influenced by exchange rate movements, particularly between the euro and each of the U.S. dollar, the Japanese Yen, the Chinese Renminbi Yuan and the Mexican Peso. For example, net sales of our pharmaceuticals division were reduced by seven percentage points due to the unfavorable exchange rate movements of the euro vis-à-vis the U.S. dollar and currencies linked to the U.S. dollar. Similarly, exchange rate effects resulted in a reduction of the net sales of our chemicals division by five percentage points. To promote comparability across reporting periods, the following discussion of our results of operations breaks out acquisition and foreign exchange rate effects.

In addition, the revenues of each of our two divisions may be materially influenced by acquisitions made by that division during any given period. This is particularly true of our chemicals division, whose growth strategy contemplates the acquisition of suitable targets. For example, in August 2003 we acquired the electrical insulation business of Schenectady International, Inc., which contributed € 27 million to our revenues in 2003.

We present segment information in accordance with IAS 14. The basis for our segment reporting is our two divisions: pharmaceuticals and specialty chemicals. This reporting system reflects the management structure of our organization, pursuant to which our holding company is responsible for making strategic decisions with respect to our two divisions, whereas the implementation of these decisions at the division level is the responsibility of the heads of the respective divisions, who manage them on a day-to-day basis. The reporting system also reflects our internal financial reporting and the predominant sources of risks and returns in our business. During the periods under review, there have not been significant sales between our pharmaceuticals and our chemicals segments.

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**Critical Accounting Polices**

**Revenue Recognition**

As described in note 2 to our consolidated financial statements, we recognize revenue if the revenue can be reliably measured, it is probable that we will realize the economic benefits of the underlying transaction, and all costs to be incurred in connection with the transaction can be measured reliably. Accordingly, we recognize revenue in connection with the sale of a product at the moment the product is shipped and title passes to the customer.

We make provisions for discounts and rebates to customers in the same period in which we recognize the related revenue, using a consistent methodology. We believe that our current provisions appropriately reflect our exposure to discount and rebate payments. Historically, discounts and rebates have not materially impacted our net sales.

We generate a substantial portion of our revenues from licensing agreements under which we grant third parties rights to certain of our products and technologies. We record non-refundable upfront payments received under these agreements as deferred revenue and recognize them in income over the estimated performance period stipulated in the agreement. An example of such a licensing agreement is our contract with Wyeth to distribute Pantoprazole in the United States. See Item 10: Additional Information Material Contracts for more information on this contract. Currently, Wyeth is our single largest customer. Under our agreement with Wyeth related to the distribution of Pantoprazole, we have granted Wyeth an exclusive license to sell Pantoprazole-based products in the U.S. market. Under the agreement, Wyeth pays us a specified percentage of its Pantoprazole-related net sales, subject to a minimum price. Because our net sales from this arrangement are directly dependent on the price that Wyeth charges to the final consumer, our revenue from products that we have delivered to Wyeth but that have not been sold to the final consumer as of the balance sheet date are accounted for at the minimum price. We use what we believe is a reasonable system for estimating the number of unsold products held by Wyeth as of each relevant balance sheet date. The difference between the minimum price and the price invoiced by us to Wyeth is treated as deferred income until such time as the product is actually sold to the final consumer.

We also generate revenues from our collaborative research and development arrangements. Examples of such arrangements include our agreement with Pharmacia Corporation, now Pfizer, to co-develop and co-promote Roflumilast, which we intend to market under the name Daxas®, and our agreement with Aventis with respect to the co-development of Ciclesonide, which we intend to market under the name of Alvesco®. See Item 4: Information on the Company Pharmaceuticals Research and Development for more information on these arrangements. We enter into co-development and co-promotion agreements to enhance the scope and depth of our research portfolio. Such agreements consist of multiple elements and provide for varying consideration terms, such as upfront, milestone and similar payments, which are complex and require significant analysis by management in order to determine the most appropriate method of revenue recognition. In 2003, we reviewed our various collaborative arrangements to determine if the multiple elements can be divided into separate units of accounting and how the arrangement consideration should be recognized. Where an arrangement can be divided into separate units, the arrangement consideration is recognized amongst those varying units and recognized over the respective performance period. Where the arrangement cannot be divided into separate units, the total arrangement consideration is allocated on a straight-line basis over the estimated collaboration period. Such determinations require us to make certain assumptions and judgments.

With respect to the agreements we have entered into to date, upfront payments and other similar non-refundable payments received that relate to the sale or licensing of products or technologies are reported as deferred income and recognized as other income over the collaboration periods on a straight-line basis. In previous years, non-refundable up-front payments received in connection with a development agreement were normally recognized as revenue on a straight-line basis over the expected development period through final regulatory approval. Non-refundable milestone payments which represented the achievement of a significant technical/regulatory hurdle in the research and development process, pursuant to collaborative agreements, were recognized as revenue upon the achievement of the specified milestone. The revised method is appropriate for recognizing revenue under our existing agreements and has not resulted in a material impact on our prior-year consolidated balance sheets, income statements or cash flows.

Under our arrangement with Pfizer, which is currently the most important of our development collaborations, we received upfront payments in 2002 of € 33.4 million. Initially, € 22.3 million of the

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upfront payment was recognized on a straight-line basis and deferred over the expected research and development period. Following the review of our accounting for our various collaborative arrangements in 2003, the upfront payment is now deferred over the entire collaboration period. The balance of € 11.1 million is refundable in the event that we fail to obtain regulatory approval for Daxas® and is therefore deferred in full through final regulatory approval. If and when we obtain regulatory approval, the € 11.1 million will also be deferred over the remaining collaboration period. In addition, in the first quarter of 2003, we received a milestone payment of € 28.1 million, which is being deferred over the collaboration period.

It is important to emphasize that given the complex nature of our development projects, our collaborative arrangements and the uncertainties inherent in the research and development and regulatory approval processes, any estimate of dates on which we expect to advance further in research and development or obtain regulatory approval involves uncertainty and the exercise of significant management judgment. Any change in any of these dates has an impact on the corresponding collaboration periods. For each new drug candidate, we establish a detailed timetable in close consultation with our partners. We base these timetables on, among other things, our past experience. We believe that our current estimates are based on sound assumptions and are realistic.

**Employee Incentive Plans**

As described in greater detail elsewhere in this annual report and in notes 2 and 13 to our consolidated financial statements, we offer various share-based employee incentive plans. See Item 6: Directors, Senior Management & Employees Share Ownership Stock Option Plans and Item 6: Directors, Senior Management & Employees Share Ownership Altana Investment Program for additional information on these plans. To enable us to satisfy our obligations under these plans, we may from time to time purchase shares of our company in the open market. Under International Financial Reporting Standards ( IFRS ), we amortize the excess of the average price at which we acquire these shares over the exercise price of the options over the applicable vesting period. U.S. GAAP currently permits companies to choose whether to apply the intrinsic value accounting provided by Accounting Principles Board ( APB ) Opinion No. 25 Accounting for Stock Issued to Employees ( APB 25 ) or the fair value method as set forth in the Financial Accounting Standards Board s ( FASB s ) Standard of Financial Accounting Standards ( SFAS ) No. 123 Accounting for Stock Based Compensation 123 . We currently apply APB 25 to our U.S. GAAP reporting. U.S. GAAP makes a distinction between fixed plans and variable plans. Generally, a plan is deemed to be fixed if both the option exercise price and the number options that the participant will receive are known at the date of grant. Conversely, plans under which options are granted or become exercisable only upon the achievement of performance hurdles are normally variable. Special rules apply to plans that require cash settlement or permit participants to choose between cash and stock settlement. These plans invariably require variable accounting. Most of our employee incentive plans are variable plans. The only plan offered by us that is a fixed plan is our stock option plan for key members of our management launched in 2002. In the case of our variable plans, we calculate the excess of the market value of the shares over the exercise price at each annual balance sheet date and, if we consider it probable that the exercise condition will be satisfied, record the vested portion of the difference as an expense. With respect to our only fixed plan, we have so far not recorded any compensation cost, as the options granted under that plan have been out of the money since the date of grant. The primary aspect of our accounting for employee incentive plans that involves uncertainty and the exercise of management judgment is the determination of the likelihood that the exercise conditions under our variable plans will be satisfied.

As a result of the issuance of IFRS 2, which takes effect on January 1, 2005, our accounting for employee incentive plans will change in future periods. We are currently assessing the impact that IFRS 2 will have on our consolidated financial statements. The new standard introduces a fair-value based model for the accounting for share-based compensation. It requires us to record the fair value of an option as an expense. For equity-settled plans, the fair value is measured at the grant date and for cash-settled plans at each balance sheet date using a valuation technique consistent with generally accepted valuation methodologies. Vesting conditions are not taken into account when estimating the fair value, unless these conditions are market-based. Instead, the total expense incurred is adjusted for the number of options that eventually vest. In the case of equity- and cash-settled plans, the expense is deferred over the vesting period. However, for cash-settled plans the amount of the expense is adjusted to the fair value of the options on each balance sheet date. The compensation costs that we expect to record under this fair-value based model will differ from the compensation costs that we record using our current accounting policy.

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The level of compensation costs that we have historically recorded under IFRS and U.S. GAAP is not necessarily indicative of the level of compensation costs that we may record in the future. Furthermore, fair value measurements are frequently based on estimates that involve significant management judgment, including estimates of the expected dividend yield and future share price volatility.

**Pension Plans**

We provide various pension plans and other retirement benefit plans for our employees both in Germany and abroad. While some of these plans are funded by separate plan assets, most of them are not. We value our exposure under each of these plans using the projected unit credit method set forth in IAS 19 (revised 2000). In performing valuations, we rely on the advice of actuarial consultants. The methodologies used by us require that we make estimates for some parameters, including the expected discount rate, the expected rate of compensation increase, the expected rate of pension increase and, in the case of plans covered by plan assets, the expected return on these assets. Although we believe that the actuarial assumptions used by us are appropriate, the relevant parameters may develop materially differently, which in turn may have a material impact on the level of our net periodic pension costs in any given period. We reflect all such changes in actuarial losses (gains), subject to the corridor approach.

**Research and Development**

We invest significant financial resources in our research and development activities on an ongoing basis. This is necessary to maintain continued success in the highly competitive and research/technology intensive markets in which we are active. In addition to our in-house research and development activities, we maintain various research and development collaborations and alliances with third parties, under which we are required to fund costs and/or pay for the achievement of performance milestones. For accounting purposes, research expenses are defined as costs incurred for original and planned investigations undertaken to gain new scientific or technical knowledge and understanding. Development expenses are defined as costs incurred to achieve technical and commercial feasibility of products under development. Our research and development expenses typically consist of salaries and benefits, allocated overhead costs, occupancy costs, clinical trial and related manufacturing costs, as well as milestone-based payments, contract manufacturing and other outside costs.

We expense all research costs as incurred. Further, given the regulatory approval process and other uncertain ties inherent in the development of our products, the conditions set forth in IAS 38 for capitalizing development costs are not satisfied, therefore, development costs are also expensed as incurred. Significant management judgment is required when assessing the possible outcome of development activities.

In the case of collaborations and alliances with third parties, considerable judgment can be involved in assessing whether milestone based payments simply reflect the funding of research, in which case expensing would always be required, or whether, by making a milestone payment, we acquire an asset which has alternative uses in our own ongoing research efforts and which may therefore be expensed over one or more future periods.

**Impairment**

*Tangible and intangible assets.* A significant percentage of our assets is comprised of long-lived assets. We record long-lived assets at cost and amortize or depreciate them, as the case may be, on a straight-line basis over the shorter of the term of the underlying contract, if applicable, or their estimated useful lives. As shown in note 5 to our consolidated financial statements, we hold various intangible assets. The useful life of an intangible asset, which is the period over which the asset is expected to contribute directly or indirectly to future cash flows, can be influenced by various factors, including legal, regulatory, contractual, competitive, economic and other factors. While many of our intangibles have a known contractual or legal life, determining the impact of other factors can involve considerable uncertainty and therefore require management to exercise significant judgment in estimating the period over which the cost of an asset should be expensed. Similar estimates are required for our tangible fixed assets.

The carrying value of all long-lived assets is subject to possible impairment. If facts and circumstances indicate that the carrying amount of an asset may not be recoverable in full, we estimate the value of the asset by discounting the expected future cash flows generated by it during its

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remaining estimated useful life plus any salvage value at the end of that period. If the estimated value of the asset is lower than its carrying amount, we take an impairment charge and adjust the carrying amount accordingly. Fair value estimates involve uncertainty and often require the exercise of significant management judgment. Although our management is confident that its estimates rest on sound assumptions, the actual cash flows generated by an asset in any given period and its actual salvage value could be materially different than that estimated, which could require us to record an unexpected impairment charge.

*Marketable securities and certain long-term investments.* We hold marketable securities and certain long-term investments classified as available-for-sale and, therefore, carried at fair value with unrealized gains and losses recorded in equity (revaluation reserve), net of tax. These securities are tested for impairment at each balance sheet date. Our policy to determine if an impairment of a security exists is based on a two-step approach, which takes into account both the fact whether the difference between the fair market value of the security and its book value is significant as well as for how long this difference exists. Impairment losses are recognized in other financial expenses when realized and are determined on a security-by-security basis. If there is an indication that the consideration that led to the impairment no longer exists, we would consider the need to reverse all or a portion of the impairment charge. Because market prices are available for most of the securities we hold in our portfolio, there is no need for estimates to determine the fair market value. Our management monitors our securities portfolio closely and believes the impairment procedures set out above as well as our procedures for assessing the need to make reversals are adequate to determine whether an impairment or reversal is necessary with respect to a particular security. However, there might be market effects which cannot be anticipated by management and would therefore cause unexpected impairment charges.

## Results of Operations

### Group

The following table sets forth selected items of our consolidated income statement for the three years ended December 31, 2003 both in absolute terms and as percentages of net sales:

**Results of Operations (1)**

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2001 | | 2002 | | 2003 | |
| | (€ in millions) | (% of net sales) | (€ in millions) | (% of net sales) | (€ in millions) | (% of net sales) |
| *Amounts in accordance with IFRS* | | | | | | |
| Net sales | 2,308 | 100.0 | 2,609 | 100.0 | 2,735 | 100.0 |
| Cost of sales | (894) | (38.7) | (928) | (35.6) | (947) | (34.6) |
| Gross profit | 1,414 | 61.3 | 1,681 | 64.4 | 1,788 | 65.4 |
| Selling and distribution expenses | (576) | (24.9) | (649) | (24.9) | (710) | (26.0) |
| Research and development expenses | (285) | (12.3) | (369) | (14.2) | (412) | (15.1) |
| General administrative expenses | (105) | (4.6) | (128) | (4.9) | (120) | (4.4) |
| Other operating income | 39 | 1.7 | 79 | 3.0 | 91 | 3.3 |
| Other operating expenses | (63) | (2.7) | (76) | (2.9) | (74) | (2.7) |
| Donation Herbert Quandt Foundation | (15) | (0.6) | 0 | 0.0 | 0 | 0.0 |
| Gain on sale of Lundbeck | 110 | 4.8 | 0 | 0.0 | 0 | 0.0 |
| Operating income | 520 | 22.5 | 538 | 20.6 | 563 | 20.6 |
| Financial income (expense) | 24 | 1.0 | (12) | (0.5) | 17 | 0.6 |
| Income before taxes and minority interests | 544 | 23.6 | 527 | 20.2 | 580 | 21.2 |
| Income tax expense | (216) | (9.4) | (202) | (7.7) | (235) | (8.6) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Income before minority interests | 328 | 14.2 | 324 | 12.4 | 345 | 12.6 |
| Minority interests | 0 | 0.0 | 0 | 0.0 | 0 | 0.0 |
| Net income | 328 | 14.2 | 324 | 12.4 | 345 | 12.6 |
| *Amounts in accordance with U.S.GAAP* | | | | | | |
| Net income | 314 | 13.6 | 338 | 12.9 | 337 | 12.3 |

(1) Columns may not add due to rounding.

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*2003 compared with 2002*

*Net sales.* Net sales increased by 4.8%, from € 2,609 million in 2002 to € 2,735 million in 2003. As in prior periods, the main growth driver in 2003 was once again our pharmaceuticals segment, with net sales rising by 6.4%, primarily due to revenue growth in the segment s therapeutics business. Therapeutics net sales increased particularly as a result of the continued growth of Pantoprazole in the United States and, to a lesser extent, Canada and Europe. Given the market position that Pantoprazole has achieved to date, we expect the growth of the drug to slow in the future. The positive operational development of our pharmaceuticals division was partially offset by unfavorable exchange rate movements, the effect of divestitures of certain product lines, especially those relating to our former diagnostics business, and unfavorable regulatory developments, particularly in Germany. Excluding these effects, the net sales of our pharmaceuticals segment would have risen by approximately 15%. Net sales of our chemicals segment rose by 0.9%, on account of slight revenue growth in all of the segment s business areas. Adjusted for acquisition and currency effects, net sales of our chemicals segment would have risen by 3%.

*Cost of sales.* Cost of sales comprises the manufacturing costs of products sold. In addition to directly attributable costs, such as material costs, staff costs and energy costs, the line item also covers indirect costs, including directly attributable depreciation charges. Cost of sales increased by 2.1%, from € 928 million in 2002 to € 947 million in 2003. As a percentage of net sales, cost of sales decreased slightly from 35.6% to 34.6% during the same period. The slight absolute increase in cost of sales was primarily driven by our chemicals segment, which continued to suffer from price pressures on raw materials. The slight decrease in cost of sales as a percentage of sales is entirely attributable to our pharmaceuticals segment, reflecting higher shipped volumes of Pantoprazole and the divestiture of certain product lines that have low margins compared with Pantoprazole.

*Selling and distribution expenses.* Selling and distribution expenses comprise the costs incurred by our sales and marketing organization as well as advertising and logistics costs. In absolute terms, the increase in our selling and distribution expenses amounted to 9.5%, from € 649 million in 2002 to € 710 million in 2003. As a percentage of net sales, selling and distribution expenses increased from 24.9% to 26.0% during the same period. This development was driven by an increase in selling and distribution expenses in our pharmaceuticals segment, which more than offset a decrease in selling and distribution expenses in our chemicals segment.

*Research and development expenses.* Research expenses are costs incurred for original and planned investigations undertaken to gain new scientific or technical knowledge and understanding. Development expenses comprise costs incurred to achieve technical and commercial feasibility of products under development. Our research and development expenses typically consist of salaries and benefits, allocated overhead costs, occupancy costs, clinical trial and related manufacturing costs, as well as milestone payments and other outside costs.

Research and development expenses increased by 11.6%, from € 369 million in 2002 to € 412 million in 2003, which led to an increase in research and development expenses as a percentage of net sales, from 14.2% to 15.1%. In both absolute and relative terms, the development was primarily driven by our pharmaceuticals segment, mainly reflecting expenses linked to clinical trials in connection with Alvesco® and Daxas®.

*General administrative expenses.* General administrative expenses consist of overhead, administrative expenses and personnel and non-personnel costs incurred by management to the extent that they are not charged to other cost centers. General administrative expenses decreased by 6.3%, from € 128 million in 2002 to € 120 million in 2003. As a percentage of net sales, they decreased slightly from 4.9% to 4.4%. This decrease mainly reflects the non-recurrence of certain expenses incurred in 2002 in connection with the renaming of our two divisions and a related marketing campaign, as well as our listing on the New York Stock Exchange, Inc. (the NYSE ) on May 22, 2002.

*Other operating income.* Other operating income mainly comprises income from milestone payments, income from licensees and co-marketing partners, gains realized on the sale of assets and the release of accruals. Other operating income increased by 14.9%, from € 79 million in 2002 to € 91 million in 2003. This increase primarily reflects increased earnings from our pharmaceuticals segment attributable to higher levels of income from milestone payments, the release of accruals and the disposal of certain product lines, the effects of which were offset by a decrease in income from the sale of property, plant and equipment.

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*Other operating expenses.* Other operating expenses consist of goodwill amortization, foreign currency losses and expenses that are not allocable to any of the expense items discussed above. Other operating expenses decreased slightly by 2.5%, from € 76 million in 2002 to € 74 million in 2003. This decrease reflects lower levels of goodwill amortization, mainly attributable to our pharmaceuticals segment, the effects of which were partially offset by higher levels of foreign currency losses in both segments.

*Financial income (loss).* In 2003, we had financial income of € 17 million, compared with a loss of € 12 million in 2002. Our financial income in 2003 mainly comprised net interest income of € 13 million as well as the reversal of an impairment charge we had taken with respect to our investment in a company to reflect the increased market price of that investment at December 31, 2003, compared with December 31, 2002, due to the announcement of several positive results achieved by that company in connection with two of its R&D projects.

*Income tax expense.* Income tax expense consists of corporate income and trade taxes, similar foreign taxes and deferred taxes, each calculated on the basis of the income of our company and its subsidiaries. Income tax expense increased by 16.3%, from € 202 million in 2002 to € 235 million in 2003. Our effective tax rate increased from 38.4% to 40.5%. This increase reflects the impact of the German Flood Victim Solidarity Act of 2002, which resulted in a 1.5% increase in the German corporate income tax rate in 2003 and the absence in 2003 of a one-time tax credit that we had received in 2002 in connection with certain dividend payments.

*Minority interests.* Minority interests consist of that portion of the earnings and losses of less-than-wholly-owned consolidated subsidiaries (excluding joint ventures that are consolidated according to the proportional consolidation method) that is attributable to the other shareholders of these subsidiaries. In 2003, the share of minority shareholders in the earnings of our consolidated subsidiaries had no material impact on our net income.

*2002 compared with 2001*

*Net sales.* Net sales increased by 13.0%, from € 2,308 million in 2001 to € 2,609 million in 2002. The increase was driven primarily by our pharmaceuticals segment, whose net sales rose by 17.0% , mainly due to revenue growth in the segment s therapeutics business and particularly as a result of the continued growth of Pantoprazole sales in Europe, Latin America, Canada and, especially, the United States. The impact of Pantoprazole on our pharmaceuticals sales was partially offset by unfavorable exchange rate movements. Excluding these effects, the net sales of our pharmaceuticals segment would have risen by approximately 21%. Net sales of our chemicals segment rose by 4.3%, primarily on account of revenue growth in the segment s additives business. Unfavorable exchange rate movements were offset by the effects of acquisitions. On a group-wide basis, acquisitions contributed one percentage point to the growth of our net sales in 2002, whereas exchange rate effects resulted in a reduction of four percentage points. Leaving these effects aside, our overall net sales would have grown at a rate of approximately 16% during the period under review.

*Cost of sales.* Cost of sales increased by 3.7%, from € 894 million in 2001 to € 928 million in 2002. As a percentage of net sales, cost of sales decreased from 38.7% to 35.6% during the same period. This decrease was caused by a relative decline in the cost of sales of both of our segments. In our pharmaceuticals segment, the decline was mainly attributable to a positive contribution resulting from higher volumes of Pantoprazole, whereas in our chemicals segment it primarily reflects the success of our efforts to streamline our procurement processes.

*Selling and distribution expenses.* While selling and distribution expenses increased by 12.7%, from € 576 million in 2001 to € 649 million in 2002 in absolute terms, as a percentage of net sales, they remained level at 24.9%. The absolute increase was mainly driven by our pharmaceuticals segment, reflecting increasing sales and marketing expenses in anticipation of the planned launch of our pipeline drugs Alvesco® and Daxas® and increases in our sales and marketing efforts to support Pantoprazole.

*Research and development expenses.* Research and development expenses increased by 29.7%, from € 285 million in 2001 to € 369 million in 2002, which translates into an increase as a percentage of net sales from 12.3% to 14.2%. In both absolute and relative terms, the rise in research and development expenses was mostly attributable to our pharmaceuticals segment, where it reflects expenses incurred in connection with clinical trials on Alvesco® and Daxas® as well as our formation of the ALTANA Research Institute in May 2002.

*General administrative expenses.* General administrative expenses increased by 21.1%, from € 105 million in 2001 to € 128 million in 2002, primarily reflecting expenses incurred in connection with the

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renaming of our two divisions and a related marketing campaign as well as our listing on the NYSE. To a lesser extent, the increase reflects a rise in the general administrative expenses of our chemicals segment. As a percentage of net sales, however, general administrative expenses experienced only a modest increase from 4.6% to 4.9%.

*Other operating income.* Other operating income rose substantially by 102.4%, from € 39 million in 2001 to € 79 million in 2002. This rise reflects above all the sale by our pharmaceuticals segment of its diagnostics business to DiaSorin at the end of December 2002 and various upfront, milestone and cost reimbursement payments, mainly from Pharmacia and Aventis.

*Other operating expenses.* Other operating expenses rose by 21.3%, from € 63 million in 2001 to € 76 million in 2002. This development was primarily attributable to our pharmaceuticals segment, reflecting higher levels of customs duties and losses realized in connection with the sale of fixed assets.

*Operating income.* Our operating income increased by 3.6%, from € 520 million in 2001 to € 538 million in 2002. The 2001 figure includes a one-time gain that we realized in connection with the sale of our interest in a joint venture and a special charitable donation we made in that period. Excluding these one-time factors, our operating income would have increased by 26.9%, from € 424 million in 2001 to € 538 million in 2002. This increase reflects the continuing growth of our pharmaceuticals segment, and especially the growth of Pantoprazole sales in the United States.

*Financial income (expense).* Financial income declined from € 24 million in 2001 to a loss of € 12 million in 2002. This development primarily reflects losses realized in connection with the disposal of marketable securities and an impairment charge incurred in connection with a long-term investment.

*Income tax expense.* Income tax expense declined by 6.4%, from € 216 million in 2001 to € 202 million in 2002. Our effective tax rate declined from 39.7% to 38.4%. This decrease primarily reflects the fact that we utilized tax credits available in Germany and had slightly increased levels of tax-free income in 2002.

*Minority interests.* In 2002, the share of minority shareholders in the earnings of our consolidated subsidiaries had no material impact on our net income.

*Net income.* Our net income decreased by 1.1%, from € 328 million in 2001 to € 324 million in 2002, reflecting the various factors described above. Excluding the gain we recognized in connection with the sale of our interest in a joint venture and the special donation discussed above, our net income would have increased by 26.5%, from € 256 million in 2001 to € 324 million in 2002.

**Pharmaceuticals**

The following table sets forth selected information for our pharmaceuticals segment for the three years ended December 31, 2003:

**Pharmaceuticals Results of Operations(1)**

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2001 | | 2002 | | 2003 | |
| | (€ in millions) | (% of net sales) | (€ in millions) | (% of net sales) | (€ in millions) | (% of net sales) |
| Net sales | 1,591 | 100.0 | 1,861 | 100.0 | 1,980 | 100.0 |
| Cost of sales | (458) | (28.8) | (479) | (25.7) | (487) | (24.6) |
| Gross profit | 1,132 | 71.2 | 1,382 | 74.3 | 1,493 | 75.4 |
| Selling and distribution expenses | (467) | (29.3) | (534) | (28.7) | (597) | (30.2) |
| Research and development expenses | (252) | (15.8) | (335) | (18.0) | (376) | (19.0) |
| General administrative expenses | (46) | (2.9) | (48) | (2.6) | (47) | (2.4) |
| Other operating income | 33 | 2.1 | 62 | 3.4 | 84 | 4.2 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other operating expenses | (37) | (2.3) | (57) | (3.0) | (51) | (2.6) |
| Donation Herbert Quandt Foundation | (7.5) | (0.5) | 0 | 0.0 | 0 | 0.0 |
| Gain on sale of Lundbeck | 110 | 6.9 | 0 | 0.0 | 0 | 0.0 |
| Operating income | 466 | 29.3 | 471 | 25.3 | 506 | 25.5 |

(1) Columns may not add due to rounding.

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*2003 compared with 2002*

Net Sales

Overall net sales of our pharmaceuticals segment increased by 6.4%, from € 1,861 million in 2002 to € 1,980 million in 2003. As in prior years, the single most important driver of this development was a significant increase in the net sales of Pantoprazole. In the period under review, net sales of Pantoprazole increased by 15.2%, from € 966 million in 2002 to € 1,113 million in 2003, which corresponds to a revenue contribution of 56.2% to the net sales of our pharmaceuticals segment in 2003, compared with a revenue contribution of 51.9% in 2002. In 2003, Pantoprazole achieved double-digit net sales growth in most parts of the world except for Latin America, where our net sales of this drug experienced a single-digit decline due to a weak economic environment and unfavorable currency effects. The increase in net sales of our pharmaceuticals segment was partially offset by a decrease caused by adverse regulatory changes, particularly in Europe. In addition, our pharmaceuticals net sales suffered from unfavorable exchange rate movements of the euro vis-à-vis the U.S. dollar and currencies linked to the U.S. dollar, which reduced the segment s net sales by seven percentage points, and the effect of divestitures of certain product lines, especially product lines relating to our former diagnostics business, which led to a reduction of two percentage points. Excluding these effects, the net sales of our pharmaceuticals segment would have grown by approximately 15% in 2003.

The following table breaks down the net sales of our pharmaceuticals segment by geographic region for the two years ended December 31, 2002 and 2003:

**Net Sales by Geographic Region(1)(2)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2002** | **2003** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Germany | 390 | 375 | (3.8) |
| Europe (excl. Germany) | 542 | 597 | 10.1 |
| U.S.A. | 547 | 638 | 16.6 |
| North America (excl. U.S.A.) | 86 | 94 | 10.1 |
| Latin America | 236 | 213 | (10.0) |
| Other | 60 | 63 | 5.1 |
| Total | 1,861 | 1,980 | 6.4 |

(1) By location of customers.
(2) Columns may not add due to rounding.

In 2003, net sales of our pharmaceuticals segment increased in most geographic regions in which we are active. The exceptions were Latin America, where our sales were hurt by significant adverse exchange rate movements of the euro vis-à-vis the U.S. dollar and U.S. dollar-related currencies, and Germany, where net sales were adversely affected by mandatory discounts imposed by the German government on the list prices of most ethical therapeutics. In addition, net sales suffered from the divestiture of a substantial portion of our diagnostics business in December 2002. As in prior years, we experienced the strongest growth in North America and Europe, primarily due to the continued success of Pantoprazole in these markets.

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The following table breaks down the net sales of our pharmaceuticals segment by business area for the two years ended December 31, 2002 and 2003:

**Net Sales by Business Area(1)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2002** | **2003** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Therapeutics | 1,565 | 1,724 | 10.2 |
| OTC | 110 | 104 | (5.2) |
| Imaging | 100 | 106 | 5.9 |
| Other | 86 | 46 | (46.7) |
| Total | 1,861 | 1,980 | 6.4 |

(1) Columns may not add due to rounding.

In prior periods, we discussed our therapeutics business on the basis of four franchises: our gastrointestinal franchise, our respiratory tract franchise, our cardiovascular franchise and our other therapeutics franchise. Effective January 1, 2003, we changed this presentation by reclassifying our cardiovascular net sales as part of our other therapeutics category. As a result, we now present three franchises instead of four. In 2003, our therapeutics net sales increased significantly, mainly as a result of the growth our gastrointestinal franchise, which grew by 15% and accounted for 72% of our overall therapeutics revenues in 2003. The main growth driver within our gastrointestinal franchise was once again Pantoprazole, whose contribution to total therapeutics net sales rose by 15%, from € 966 million in 2002 to € 1,113 million, or 64.5% of therapeutics net sales, in 2003. Although Pantoprazole faces competition from a variety of other PPIs, both branded and generic, and recently has become subject to competition from an OTC version of an omeprazole-based PPI in the United States, its share of prescriptions of the U.S. PPI market continued to rise in 2003. Given that Pantoprazole has meanwhile achieved a significant position in most markets, we expect the growth of our net sales of this drug to slow in the future. Our respiratory tract net sale increased from € 57 million to € 59 million. Net sales from other therapeutics, which mainly comprises cardiovascular therapeutics, remained flat at € 424 million.

Net sales of our OTC business declined by 5.2% as a result of our tightening the range of products we offer and the weakness of the Mexican peso.

Our imaging net sales continued to increase in 2003, due primarily to the more widespread use of imaging technologies in the area of computer tomography as well as growth in demand for other magnetic resonance contrast media.

The decline of our other pharmaceuticals net sales reflects the divestiture of a substantial portion of our diagnostics business in December 2002. Excluding the net sales of the divested portion of our diagnostics business, our other pharmaceuticals net sales would have grown at a rate of 2.2%.

Operating income

*Cost of sales.* In our pharmaceuticals segment, cost of sales increased by 1.7%, from € 479 million in 2002 to € 487 million in 2003. As a percentage of net sales, cost of sales decreased, from 25.7% to 24.6% over the same period. The relative decline in cost of sales was due primarily to the fact that we shipped higher volumes of Pantoprazole, which has lower manufacturing costs relative to its selling price than most products in our portfolio, and the divestiture of certain product lines that have low margins compared with Pantoprazole.

*Selling and distribution expenses.* Selling and distribution expenses of our pharmaceuticals segment increased by 11.8%, from € 534 million in 2002 to € 597 million in 2003. As a percentage of net sales, selling and distribution expenses increased from 28.7% to 30.2% over the same period. The increase in both absolute and relative terms mainly reflects increased selling and distribution expenses incurred in connection with preparations for the expected launch of our pipeline drugs Alvesco® and Daxas®.

*Research and development expenses.* Research and development expenses of our pharmaceuticals segment increased by 12.4%, from € 335 million in 2002 to € 376 million in 2003. As a percentage of pharmaceuticals net sales, research and development expenses increased from 18.0% to 19.0% during

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the period under review. Expressed as a percentage of therapeutics net sales, research and development expenses increased slightly from 21.4% to 21.8% in the same period, which is in line with our strategy to allocate approximately 20% of our therapeutics net sales in any given year to R&D projects. The majority of our research and development expenses in 2003 was accounted for by R&D activities related to clinical trials and regulatory filings in connection with the expected launch of Alvesco® and Daxas®. In 2003, we allocated approximately 20% of our research and development expenses to basic research and drug discovery and spent approximately 80% on development.

*General administrative expenses.* General administrative expenses of our pharmaceuticals segment decreased by 1.6%, from € 48 million in 2002 to € 47 million in 2003. As a percentage of net sales, general administrative expenses decreased from 2.6% to 2.4% over the same period.

*Other operating income and expenses.* Other operating income of our pharmaceuticals segment increased significantly by 34.1% , from € 62 million in 2002 to € 84 million in 2003. This increase primarily reflects higher income from milestone payments, which led to other operating income € 20 million in the period under review, corresponding to a rise of € 12 million compared with 2002. In addition, it reflects gains of € 20 million realized on the sale of certain product lines, corresponding to an increase of € 7 million compared with 2002. Other operating income also includes income from the release of accruals. Other operating expenses decreased by 10.2%, from € 57 million in 2002 to € 51 million in 2003, primarily reflecting lower levels of goodwill amortization.

*2002 compared with 2001*

Net sales

Net sales of our pharmaceuticals segment increased by 17.0%, from € 1,591 million in 2001 to € 1,861 million in 2002. The development was almost exclusively driven by a substantial increase in the net sales of Pantoprazole. In the period under review, net sales of Pantoprazole rose by 41.9%, from € 680 million in 2001 to € 966 million in 2002, which corresponds to a revenue contribution of 51.9% to the net sales of our pharmaceuticals segment in 2002, compared with a revenue contribution of 42.8% in 2001. The aforesaid factors were to a limited extent offset by a decline in our pharmaceuticals net sales in Latin America, especially in Argentina, where our net sales suffered from the local economic crisis. Unfavorable exchange rate effect movements of the euro vis-à-vis the U.S. dollar and currencies linked to the U.S. dollar, especially the currencies of various Latin American countries, resulted in a reduction of our pharmaceuticals net sales by four percentage points. Excluding foreign currency effects, the net sales of our pharmaceuticals segment would have grown by approximately 21% over the course of 2002.

The following table breaks down the net sales of our pharmaceuticals segment by geographic region for the two years ended December 31, 2001 and 2002:

**Net Sales by Geographic Region(1)(2)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2001** | **2002** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Germany | 377 | 390 | 3.3 |
| Europe (excl. Germany) | 483 | 542 | 12.4 |
| U.S.A. | 352 | 547 | 55.4 |
| North America (excl. U.S.A.) | 66 | 86 | 29.1 |
| Latin America | 260 | 236 | (9.0) |
| Other | 53 | 60 | 14.0 |
| Total | 1,591 | 1,861 | 17.0 |

(1) By location of customers.
(2) Columns may not add due to rounding.

In 2002, net sales of our pharmaceuticals segment increased in most geographic regions in which we are active. The only exception was Latin America, where our net sales generally suffered from the economic crisis in Argentina and its impact on various other Latin American countries,

especially Brazil. Contrary to this development, our Latin American sales in Mexico, continued to rise substantially. In North America, we once again experienced strong growth, thanks mainly to

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Pantoprazole. In Europe, we were able to raise our net sales in a difficult market environment characterized by tightening government regulation. In Germany, our net sales benefited from our strategic decision to merge our sales and marketing activities and organize them in a separate operating unit in July 2002.

The following table breaks down the net sales of our pharmaceuticals segment by business area for the two years ended December 31, 2001 and 2002:

**Net Sales by Business Area(1)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2001** | **2002** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Therapeutics | 1,275 | 1,565 | 22.8 |
| OTC | 129 | 110 | (15.0) |
| Imaging | 91 | 100 | 9.8 |
| Diagnostics | 43 | 48 | 11.4 |
| Other | 53 | 38 | (27.4) |
| Total | 1,591 | 1,861 | 17.0 |

(1) Columns may not add due to rounding.

As in prior periods, our therapeutics business continued to be the fastest-growing area of our pharmaceuticals segment. Although the increase in our therapeutics net sales was less dramatic in 2002 than it was in 2001, our therapeutics revenues continued to increase substantially, mainly thanks to our gastrointestinal franchise, whose net sales rose by 36.4% and accounted for 69.2% of our overall therapeutics revenues in 2002. The main growth driver within our gastrointestinal franchise was Pantoprazole, whose contribution to our total therapeutics net sales rose by 41.9%, from € 680 million in 2001 to € 966 million, or 61.7% of our therapeutics net sales, in 2002. Notwithstanding the fact that Pantoprazole had recently begun to face competition from generic omeprazole and AstraZeneca s introduction of Nexium, the successor to AstraZeneca s omeprazole-based PPI, in the United States, it continued to benefit from the continued strong demand for PPIs in the U.S. market in 2002 generally. Net sales of our respiratory tract franchise rose by 6.9%. Net sales of our other therapeutics business declined by 0.5%, as a modest decline in net sales of our cardiovascular business was only partially offset by a slight rise in net sales in other areas.

The decline in the net sales of our OTC business primarily reflects the sale of one of our business lines, which had revenues of approximately € 8 million in 2001, effective December 31, 2001 and the economic crisis in Argentina, where our OTC net sales declined by approximately € 5 million.

Our imaging net sales continued to increase in 2002, primarily because of continued strong demand for our range of magnetic resonance imaging ( MRI ) contrast media. The net sales of our diagnostics business, of which we sold a substantial portion to DiaSorin at the end of December 2002, also experienced a substantial increase in 2002.

The decline of our other pharmaceuticals net sales reflects the fact that we discontinued various product lines of our other pharmaceuticals business that we did not consider part of our core business.

Operating income

*Cost of sales.* In our pharmaceuticals segment, cost of sales increased by 4.4%, from € 458 million in 2001 to € 479 million in 2002. As a percentage of net sales, cost of sales decreased from 28.8% to 25.7% over the same period. The relative decline in cost of sales was due primarily to the fact that, as in prior periods, we shipped more Pantoprazole.

*Selling and distribution expenses.* Selling and distribution expenses of our pharmaceuticals segment increased by 14.4%, from € 467 million in 2001 to € 534 million in 2002. In contrast, as a percentage of net sales, selling and distribution expenses decreased from 29.3% to 28.7% over the

same period. The absolute increase in our selling and distribution expenses is due primarily to expenses incurred to support the planned launch of our pipeline drugs Alvesco® and Daxas®. In addition, it reflects the fact that we increased our sales and marketing support for Pantoprazole. As in prior periods, the relative decrease in selling and distribution expenses is due primarily to the fact that we

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do not incur selling and distribution expenses in connection with the distribution of Pantoprazole in the United States. All such expenses are instead incurred by Wyeth, our U.S. distribution partner for that drug.

*Research and development expenses.* Research and development expenses of our pharmaceuticals segment increased by 32.8% from € 252 million in 2001 to € 335 million in 2002. As a percentage of pharmaceuticals net sales, research and development expenses increased significantly from 15.8% to 18.0% during the period under review. Expressed as a percentage of therapeutics net sales, research and development expenses increased from 19.8% to 21.4% in the same period. The rising level of investment in R&D over the past several years reflects our strategic decision to allocate approximately 20% of our therapeutics net sales in any given year to R&D projects. In 2002, we exceeded this threshold. The increase in total R&D expenditure in 2002 reflects the fact that we incurred substantial expenses in connection with clinical trials on Alvesco® and Daxas®, for which we have applied or are about to apply for regulatory approval in various jurisdictions, and that we formed the ALTANA Research Institute, a genomics-oriented research center based in Waltham near Boston, Massachusetts, in May 2002. In 2002, we allocated approximately 20% of our total research and development expenses to basic research and drug discovery and approximately 80% to development.

*General administrative expenses.* General administrative expenses of our pharmaceuticals segment increased by 3.4%, from € 46 million in 2001 to € 48 million in 2002. As a percentage of net sales, general administrative expenses decreased from 2.9% to 2.6% over the same period.

*Other operating income and expenses.* Other operating income of our pharmaceuticals segment rose by 86.9%, from € 33 million in 2001 to € 62 million in 2002. This development primarily reflects the sale of a substantial portion of our diagnostics business to DiaSorin at the end of December 2002, which resulted in a gain of € 13 million, as well as milestone and cost reimbursement payments that we received from our development partners, the effects of which were partially offset by the absence in 2002 of the one-time gain that we generated in 2001 from the sale of one of our OTC business lines. Other operating expenses rose by 51.6%, from € 37 million in 2001 to € 57 million in 2002, primarily reflecting increased customs duty expenses and losses realized in connection with the sale of fixed assets.

*Operating income.* As a result of the factors described above, the operating income of our pharmaceuticals segment rose by 1.2%, from € 466 million in 2001 to € 471 million in 2002. The modest growth of the operating income of our pharmaceuticals segment in 2002 reflects the fact that the operating income of our pharmaceuticals segment in 2001 included a one-time gain in connection with the sale of our interest in a joint venture. The operating income of our pharmaceuticals segment in 2001 also reflects a special charitable donation, of which we booked a portion in our pharmaceuticals segment. Neither of these effects was repeated in 2002. Excluding these factors, the operating income of our pharmaceuticals segment in the period under review would have grown by 29.9%, from € 363 million in 2001 to € 471 million in 2002.

**Chemicals**

The following table sets forth selected information for our chemicals segment for the three years ended December 31, 2003:

**Chemicals Results of Operations(1)**

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2001 | | 2002 | | 2003 | |
| | (€ in millions) | (% of net sales) | (€ in millions) | (% of net sales) | (€ in millions) | (% of net sales) |
| Net sales | 717 | 100.0 | 748 | 100.0 | 755 | 100.0 |
| Cost of sales | (436) | (60.7) | (449) | (60.0) | (461) | (61.1) |
| Gross profit | 282 | 39.3 | 299 | 40.0 | 294 | 38.9 |
| Selling and distribution expenses | (109) | (15.2) | (115) | (15.3) | (113) | (14.9) |
| Research and development expenses | (33) | (4.6) | (34) | (4.6) | (36) | (4.7) |
| General administrative expenses | (34) | (4.8) | (41) | (5.4) | (41) | (5.4) |
| Other operating income | 5 | 0.7 | 11 | 1.4 | 5 | 0.7 |
| Other operating expenses | (13) | (1.8) | (16) | (2.1) | (18) | (2.4) |
| Operating income | 98 | 13.7 | 104 | 13.9 | 92 | 12.2 |

(1) Columns may not add due to rounding.

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*2003 compared with 2002*

Net sales

Net sales of our chemicals segment in 2003 were consistent with our net sales in 2002, increasing by only 0.9%, from € 748 million in 2002 to € 755 million in 2003. The slight increase in our chemicals net sales reflects organic growth of our business as well as the effect of acquisitions. We achieved this increase in the face of unfavorable exchange rate movements resulting from a significant strengthening of the euro vis-à-vis the U.S. dollar and other currencies such as the Chinese Remnimbi Yuan and the Japanese Yen and the continuing difficult economic environment. Exchange rate effects resulted in a reduction of the segment s net sales by five percentage points. Acquisition effects contributed three percentage points. Excluding these effects, our chemicals net sales would have increased by 3%.

The following table breaks down the net sales of our chemicals segment by geographic region for the two years ended December 31, 2002 and 2003:

**Net Sales by Geographic Region(1)(2)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2002** | **2003** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Germany | 100 | 107 | 6.8 |
| Europe (excl. Germany) | 292 | 306 | 5.1 |
| U.S.A. | 137 | 117 | (14.6) |
| North America (excl. U.S.A.) | 9 | 8 | (16.8) |
| Asia | 141 | 154 | 9.4 |
| Other | 69 | 63 | (9.2) |
| Total | 748 | 755 | 0.9 |

(1) By location of customers.
(2) Columns may not add due to rounding.

The increase in net sales to customers located in Europe (including Germany) is predominantly attributable to the net sales generated by a business that we acquired in 2003. The strongest growth was accounted for by net sales in Asia, which was due in part to a shift of chemicals sales from North America, where net sales declined as a result. Our sales outside Europe suffered from the increasing strength of the euro vis-à-vis most major currencies.

The following table sets forth the net sales of our chemicals segment by business area for the two years ended December 31, 2002 and 2003:

**Net Sales by Business Area(1)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2002** | **2003** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Additives & Instruments | 304 | 308 | 1.3 |
| Coatings & Sealants | 221 | 222 | 0.4 |
| Electrical Insulation | 223 | 225 | 0.9 |

| | | | |
|---|---|---|---|
| Total | 748 | 755 | 0.9 |

(1) Columns may not add due to rounding.

All business areas of our chemicals segment showed only nominal growth due to unfavorable exchange rate effects in 2003 and the continuing difficult economic environment in the markets in which we operate. The growth of our Electrical Insulation business area also reflects the effects of an acquisition, which contributed sales of € 27 million in 2003. Excluding this acquisition, our Electrical Insulation business area would have suffered a decline in sales of 11%.

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Operating income

*Cost of sales.* Cost of sales of our chemicals segment increased by 2.7%, from € 449 million in 2002 to € 461 million in 2003. As a percentage of net sales, cost of sales experienced an increase from 60.0% to 61.1% during the same period. The increase in cost of sales is due mainly to an acquisition, which had a twofold effect. On the one hand, it led to a shift in our product mix to products with higher cost of sales. On the other hand, it forced us to temporarily switch to toll manufacturing to continue to serve some of the markets where we integrated the acquired operations into our existing subsidiaries.

*Selling and distribution expenses.* Selling and distribution expenses of our chemicals segment decreased by 1.7% from € 115 million in 2002 to € 113 million in 2003. In relative terms, selling and distribution expenses showed a modest decrease from 15.3% to 14.9%. The decrease in selling and distribution expenses resulted from efficiency gains realized by streamlining the sales and marketing program of our chemicals segment.

*Research and development expenses.* The level of research and development expenses incurred by our chemicals segment is determined by the requirements of our customers and is, in any year, typically around 5% of the segment s net sales. As a percentage of net sales, research and development expenses increased slightly from 4.6% to 4.7% in the same period.

*General administrative expenses.* General administrative expenses of our chemicals segment remained stable in both absolute and relative terms at € 41 million during 2003, or 5.4% of net sales.

*Other operating income and expenses.* Other operating income of our chemicals segment decreased from € 11 million in 2002 to € 5 million in 2003, whereas other operating expenses increased from € 16 million in 2002 to € 18 million in 2003, mainly as a result of higher levels of foreign currency exchange losses.

*2002 compared with 2001*

Net sales

Net sales of our chemicals segment increased by 4.3%, from € 717 million in 2001 to € 748 million in 2002. This development primarily reflects the growth of our additives sales and the favorable development of our chemicals business in Asia. Unfavorable exchange rate movements resulting from the strengthening of the euro relative to the U.S. dollar and currencies linked to the U.S. dollar resulting in a reduction of our chemicals net sales by two percentage points were offset by acquisitions, which added two percentage points to the overall development.

The following table breaks down the net sales of our chemicals segment by geographic region for the two years ended December 31, 2001 and 2002:

**Net Sales by Geographic Region(1)(2)**

| | **Year ended December 31,** | | |
|---|---|---|---|
| | **2001** | **2002** | **Increase (decrease)** |
| | **(€ in millions)** | | **(%)** |
| Germany | 101 | 100 | (1.1) |
| Europe (excl. Germany) | 274 | 292 | 6.3 |
| U.S.A. | 142 | 137 | (3.5) |
| North America (excl. U.S.A.) | 10 | 9 | (3.6) |
| Asia | 124 | 141 | 13.7 |
| Other | 66 | 69 | 4.2 |
| Total | 717 | 748 | 4.3 |

(1) By location of customers.
(2) Columns may not add due to rounding.

While our chemicals net sales in Germany decreased in 2002, due principally to sluggish demand for our coatings and sealants, they increased in the rest of Europe, especially in the United Kingdom and Spain. The continued weak economic environment in the United States had a dampening effect on our net sales in the U.S. market. By contrast, net sales to customers located in Asia developed favorably, almost exclusively due to the organic growth of our Asian business, in particular in China.

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The following table sets forth the net sales of our chemicals segment by business area for the two years ended December 31, 2001 and 2002:

**Net Sales by Business Area(1)**

| | Year ended December 31, | | |
|---|---|---|---|
| | 2001 | 2002 | Increase (decrease) |
| | (€ in millions) | | (%) |
| Additives & Instruments | 283 | 304 | 7.2 |
| Coatings & Sealants | 218 | 221 | 1.7 |
| Electrical Insulation | 216 | 223 | 3.0 |
| Total | 717 | 748 | 4.3 |

(1) Columns may not add due to rounding.

Our additives sales benefited from the economic growth in Asia, especially China, whereas our sales of instruments continued to suffer from the weak economic environment in the United States. The net sales of our Coatings & Sealants business and our Electrical Insulation business both rose primarily as a result of acquired businesses.

Operating income

*Cost of sales.* Cost of sales of our chemicals segment increased by 3.1%, from € 436 million in 2001 to € 449 million in 2002. As a percentage of net sales, cost of sales experienced a slight decrease from 60.7% to 60.0% during the same period. The absolute increase is mainly the result of the organic growth of our chemicals segment. The decrease in the cost of sales of our chemicals segment relative to its net sales reflects the fact that an increasing portion of our product portfolio is accounted for by additives, which have lower cost of sales relative to net sales than many of our other products, as well as the success of our efforts to streamline our procurement processes.

*Selling and distribution expenses.* Selling and distribution expenses of our chemicals segment increased by 5.3%, from € 109 million in 2001 to € 115 million in 2002. In relative terms, selling and distribution expenses remained virtually stable, increasing only slightly from 15.2% to 15.3% over the same period.

*Research and development expenses.* In 2002, research and development expenses rose by 5.4%, from € 33 million in 2001 to € 34 million in 2002. As a percentage of net sales, research and development expenses remained stable in the period under review.

*General administrative expenses.* General administrative expenses of our chemicals segment increased by 18.6%, from € 34 million in 2001 to € 41 million in 2002, reflecting, among other things, consulting fees paid in connection with a project to improve administrative processes within our company, and the organizational changes that we made to our group structure in 2002. As a percentage of net sales, however, general administrative expenses increased from 4.8% to 5.4% during the period under review for the same reason.

*Other operating income and expenses.* Other operating income of our chemicals segment rose by 100.7%, from € 5 million in 2001 to € 11 million in 2002, reflecting, among other things, miscellaneous insurance and other reimbursement payments. Other operating expenses rose by 20.5%, from € 13 million in 2001 to € 16 million in 2002, reflecting higher levels of amortization of goodwill resulting from acquired businesses.

**Shareholders Equity**

At the annual general meeting of our shareholders held on May 3, 2001, our shareholders approved the following transactions proposed to them by our management board.

The transfer of an amount equal to € 19,968,000 from our retained earnings to our stated share capital and in connection therewith the issuance to each of our shareholders of one additional share for every five shares held by them, resulting in the issuance of a total of 7,800,000 shares and an increase of our share capital to € 119,808,000, or 46,800,000 shares;

The transfer of an amount equal to € 20,592,000 from our additional paid-in capital to our stated share capital, resulting in a further increase of our share capital to € 140,400,000; and

A share split at a ratio of one to three.

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Effective January 1, 2001, we adopted IAS 39. In accordance with this accounting standard, we classify all of our marketable securities as available for sale and carry them at their fair value, recording unrealized gains and losses in a special revaluation reserve net of tax. We have not restated our financial statements for prior periods to reflect our adoption of this standard. Instead, we recorded the difference between the carrying amount of our marketable securities and their fair value as of January 1, 2001 as an adjustment to equity in the revaluation reserve. We determine gains and losses for each of our marketable securities separately and recognize them in income when realized. On January 1, 2001, we recorded a positive revaluation reserve of € 5.2 million, net of tax of € 3.2 million. At December 31, 2001 and 2002, the revaluation reserve amounted to a negative € 5.6 million and € 14.1 million, respectively, primarily reflecting a decline in the fair value of our marketable securities portfolio through the respective dates. At December 31, 2003, the reserve had changed to a positive € 12.0 million, reflecting the net effect of gains and losses from disposals, purchases and write-ups of marketable securities that were formerly accounted as part of the revaluation reserve and increases in the fair values of certain derivative financial instruments.

In 2003, we purchased a total of 1,423,950 shares at an average price of € 53.12. We resold 613,588 shares in the open market in connection with the exercise of options granted under our stock option plans for cash and as a result of the forfeiture of options that had not been exercised. We transferred 406,833 shares to our employees in connection with the exercise of options for shares. During 2003, the DAT lawsuit (see note 30 to our consolidated financial statements) was settled. As of December 31, 2003, we had issued 207,036 shares to former DAT shareholders. Together with the 3,936,702 treasury shares that we repurchased in prior years, we held a total of 4,133,195 treasury shares at December 31, 2003, representing € 4.1 million, or 2.9%, of our share capital. We intend to use 4,041,431 of these shares to meet our obligations under our various employee incentive plans and 91,764 for issuance to former DAT shareholders. See Item 4: Information on the Company Legal Proceedings for more information on this litigation.

**U.S. GAAP Reconciliation**

We prepare our financial statements in accordance with IFRS, which differ in certain respects from U.S. GAAP. See note 33 to our consolidated financial statements for a reconciliation of our net income for the three years ended December 31, 2003 and shareholders equity as of December 31, 2002 and 2003 from IFRS to U.S. GAAP.

The following table sets forth our net income and shareholders equity under IFRS and provides the corresponding U.S. GAAP amounts for the periods presented:

**IFRS to U.S. GAAP Reconciliation**

**As of and for the year ended December 31,**

| | 2001 | 2002 | 2003 |
|---|---|---|---|
| | (€ in millions) | | |
| **Net income** | | | |
| IFRS | 328 | 324 | 345 |
| U.S. GAAP | 314 | 338 | 337 |
| **Shareholders equity (at year-end)** | | | |
| IFRS | 1,170 | 1,250 | 1,445 |
| U.S. GAAP | 1,159 | 1,261 | 1,470 |

The reconciliation of our net income for 2003 primarily reflects: (i) differences in the accounting treatment under IFRS and U.S. GAAP of goodwill arising upon business combinations both pre-1995 (for which U.S. GAAP prescribed amortization but the relevant rules under the predecessor of IFRS did not) and following the July 1, 2001 adoption of SFAS 141 Business Combinations (as a result of which U.S. GAAP no longer permits the amortization of such goodwill, while IFRS requires it), which together resulted in income in the amount of € 17 million; (ii) the different treatment under IFRS and U.S. GAAP of employee incentive plans, which gave rise to an expense in the amount of € 8 million; and (iii) the fact that under U.S. GAAP impairment charges taken on long-term investments cannot be reversed in subsequent periods, which led to an expense in the amount of € 8 million. In addition, the reconciliation reflects a € 3 million tax expense in respect of the reconciliation items discussed above.

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The reconciliation of our shareholders equity as of December 31, 2003 is principally the result of: (i) the different treatment under IFRS and U.S. GAAP of the assumption of deferred tax liabilities in connection with the acquisition of intangible assets, which resulted in an increase in equity in the amount of € 8 million and an additional equity increase of € 40 million relating to a reclassification of goodwill to intangible assets; (ii) differences between IFRS and U.S. GAAP with respect to the accounting for income taxes, which resulted in a decrease in equity in the amount of € 19 million; (iii) differences in the accounting under IFRS and U.S. GAAP for voluntary termination benefits, which resulted in an increase in equity in the amount of € 16 million; and (iv) the deferral of an upfront payment under U.S. GAAP that we recognized immediately under IFRS, which led to a decrease in equity in the amount of € 15 million.

The reconciliation of our net income for 2002 primarily reflects: (i) differences in the accounting treatment under IFRS and U.S. GAAP of goodwill arising upon business combinations both pre-1995 (for which U.S. GAAP prescribed amortization but IFRS predecessor rules did not) and following the July 1, 2001 adoption of SFAS 141 Business Combinations (as a result of which U.S. GAAP no longer permits the amortization of such goodwill, while IFRS requires it), which together resulted in income of € 17 million; and (ii) the different treatment under IFRS and U.S. GAAP of employee incentive plans, which gave rise to income of € 9 million; as well as the combined tax effects of the various reconciliation items.

The reconciliation of our shareholders equity as of December 31, 2002 is principally the result of the different treatment under IFRS and U.S. GAAP of: (i) the amortization of goodwill, as discussed in the previous paragraph, which led to an increase in equity of € 17 million; (ii) employee incentive plans, which gave rise to a decrease in equity of € 17 million; (iii) revenue recognition, which led to a decrease in equity of € 16 million; (iv) voluntary termination benefits, which resulted in an increase in equity of € 14 million; and (v) differences concerning the assumption of deferred tax liabilities in connection with the acquisition of intangible assets, which resulted in an increase in equity of € 10 million.

The reconciliation of our net income for 2001 primarily reflects: (i) the different treatment under IFRS and U.S. GAAP of employee incentive plans, which gave rise to an expense of € 35 million; and (ii) the different valuation under IFRS and U.S. GAAP of our portfolio of marketable securities, which caused an expense of € 8 million in connection with the sales of some of these securities; as well as the combined tax effects of the various reconciliation items.

The reconciliation of our shareholders equity as of December 31, 2001 is principally the result of the different treatment under IFRS and U.S. GAAP of: (i) employee incentive plans, which gave rise to a decrease in equity of € 37 million; (ii) revenue recognition, which led to a decrease in equity of € 18 million; (iii) differences concerning the assumption of deferred tax liabilities in connection with the acquisition of intangible assets, which resulted in an increase in equity of € 12 million; and (iv) voluntary termination benefits, which resulted in an increase in equity of € 11 million.

## Liquidity and Capital Resources

### Cash Flow

The following table highlights selected cash flow data for each of the three years ended December 31, 2003:

**Cash Flow(1)**

| | Year ended December 31, | | |
|---|---|---|---|
| | **2001** | **2002** | **2003** |
| | **(€ in millions)** | | |
| Net cash flow provided by operating activities | 309 | 442 | 425 |
| Net cash flow used in investing activities | (113) | (204) | (298) |
| Net cash flow used in financing activities | (116) | (154) | (152) |
| Cash and cash equivalents, year end(2) | 254 | 323 | 288 |

(1) Columns may not add due to rounding.
(2) Excluding marketable securities.

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*2003 compared with 2002*

*Net cash flow provided by operating activities.* Net cash flow provided by operating activities decreased by 3.9%, from € 442 million in 2002 to € 425 million in 2003. The decrease was due mainly to changes in our working capital, including, among other items:

A € 78 million cash decrease caused by an increase in trade accounts receivable, other receivables and prepaid expenses, mainly attributable to higher levels of net sales.

A € 65 million cash increase resulting from an increase in trade accounts payables, due mainly to a higher number of goods and services received but not paid at the end of 2003.

A € 30 million cash decrease attributable to higher levels of inventories, reflecting higher levels of semi-finished and finished products and merchandise.

*Net cash flow used in investing activities.* Net cash used in investing activities increased by 46.1%, from € 204 million in 2002 to € 298 million in 2003. The 2003 figure primarily reflects the net cash effect of:

A € 306 million cash decrease primarily reflecting investments in property, plant and equipment and intangible assets and the purchase price paid for businesses acquired by our chemicals segment. A substantial portion of the assets received as a result of this acquisition, especially existing customer relationships, was accounted for as goodwill.

A € 38 million cash increase stemming from the sale of fixed assets and certain product lines.

A € 25 million cash decrease reflecting the net effect of a € 299 million cash increase resulting from sales of marketable securities and € 324 million cash decrease due to purchases of marketable securities.

The following table sets forth our capital expenditures (excluding goodwill) for the years ended December 31, 2002 and 2003:

**Capital Expenditures**

| | **Year ended December 31,** | |
|---|---|---|
| | **2002** | **2003** |
| | **(€ in millions)** | |
| Pharmaceuticals | 147 | 141 |
| Chemicals | 65 | 86 |
| Holding Company | 13 | 10 |
| Total | 225 | 237 |

*Net cash flow used in financing activities.* Net cash used in financing activities decreased by 1.1%, from € 154 million in 2002 to € 152 million in 2003. This decrease reflects the net cash effect of, among other things:

A € 102 million cash decrease reflecting the payment of a dividend in the amount of € 0.75 per share in respect of 2002.

A € 76 million cash decrease resulting from the purchase of treasury shares, primarily in connection with our stock option plans, which was partially offset by a € 39 million cash increase resulting from the sale of treasury shares.

A € 20 million cash decrease mainly attributable to the repayment of long-term debt related to our pharmaceutical segment, the effect of which was partially offset by the receipt of cash proceeds from the incurrence of long-term debt in the amount of € 12 million.

In 2003, unfavorable exchange rate movements resulted in a € 10 million cash decrease.

*Net financial position.* At December 31, 2003, we had cash and cash equivalents that is, cash on hand and in bank accounts as well as highly liquid investments with original maturities of three months or less in the amount of € 288 million at December 31, 2003, compared with cash and cash equivalents of € 323 million at December 31, 2002, corresponding to a decrease of € 35 million during the period under review. The decrease in cash and cash equivalents at December 31, 2003 compared with December 31, 2002 mainly reflects the increase in our net cash flow used in financing activities during the period under review.

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At December 31, 2003, we had marketable securities in the amount of € 292 million, compared with marketable securities of € 261 million at December 31, 2002, corresponding to an increase of € 31 million during the period under review. The increase in marketable securities at December 31, 2003 compared with December 31, 2002 primarily reflects the recovery of the worldwide stock markets in 2003 and investments of parts of our cash and cash equivalents in marketable securities.

We had debt in the amount of € 96 million at December 31, 2003, compared with debt of € 117 million at December 31, 2002, corresponding to a decline of € 21 million during the period under review. The decline in debt was mainly attributable to repayments of financial debt by our pharmaceutical segment. For the years ended December 31, 2003 and 2002, weighted average interest rates for borrowings from banks were 6.5% and 6.1%, respectively.

*2002 compared with 2001*

*Net cash flow provided by operating activities.* Net cash flow provided by operating activities increased by 43.0%, from € 309 million in 2001 to € 442 million in 2002, despite a slight decline in the level of our net income year-on-year. The increase in operating cash flow mainly reflects the fact that in 2002 we achieved a higher net income net of one-time effects and recorded higher levels of depreciation and amortization. These factors more than offset the cash effect of changes in our working capital, including, among other items:

- A € 77 million cash decrease caused by an increase in trade accounts receivable and prepaid expenses attributable to higher levels of sales.
- A € 58 million cash decrease attributable to higher levels of inventories, mainly of raw materials and semi-finished products relating to Pantoprazole, which we built up in order to gain flexibility in responding to demand for this drug.
- A € 54 million cash increase resulting from higher levels of provisions, mainly for sales and marketing expenses.
- A € 53 million cash increase that resulted mainly from the fact that we received higher revenues under our arrangement with Wyeth to distribute Pantoprazole in the United States, a portion of which we recognize on a deferred basis.

*Net cash flow used in investing activities.* Net cash used in investing activities increased by 80.0%, from € 113 million in 2001 to € 204 million in 2002, reflecting mainly the non-recurrence in 2002 of a one-time cash inflow resulting from the sale of our interest in a joint venture in 2001. The 2002 figure primarily reflects the net cash effect of:

- A € 225 million cash decrease caused primarily by investments in property, plant and equipment, mainly ongoing construction projects in each of our two segments, the construction of a new building for our group headquarters, and our purchase of a license to distribute a therapeutic in Mexico.
- A € 16 million cash increase reflecting the net effect of € 389 million cash in sales of marketable securities and € 373 million cash in purchases of marketable securities.
- A € 13 million cash increase stemming from the sale of fixed assets.

The following table sets forth our capital expenditures for the years ended December 31, 2001 and 2002:

**Capital Expenditures**

| | **Year ended December 31,** | |
|---|---|---|
| | **2001** | **2002** |
| | **(€ in millions)** | |
| Pharmaceuticals | 150 | 147 |
| Chemicals | 49 | 65 |
| Holding Company | 7 | 13 |
| Total | 206 | 225 |

*Net cash flow used in financing activities.* Net cash used in financing activities increased by 32.2%, from € 116 million in 2001 to € 154 million in 2002. This increase reflects the net cash effect of, among other things:

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A € 96 million cash decrease reflecting the payment of a dividend in respect of 2001 in the amount of€ 0.60 per share and a special dividend in the amount of € 0.10 per share.

A € 78 million cash decrease resulting from our purchase of treasury shares, primarily in connection with our stock option plans, which was partially offset by subsequent issuances of treasury shares of € 21 million.

A € 18 million cash decrease attributable to the repayment of long-term debt, the effect of which was partially offset by the receipt of cash proceeds from the incurrence of long-term debt in the amount of € 12 million.

In 2002, unfavorable exchange rate movements resulted in a € 16 million cash decrease.

*Net financial position.* We had cash and cash equivalents that is, cash on hand and in bank accounts as well as highly liquid investments with original maturities of three months or less in the amount of € 323 million at December 31, 2002, compared with cash and cash equivalents of € 254 million at December 31, 2001, corresponding to an increase of € 69 million during the period under review. The increase in cash and cash equivalents at December 31, 2002 compared with December 31, 2001 reflects the increase in cash generated from operating activities during the period under review.

We had marketable securities in the amount of € 261 million at December 31, 2002, compared with marketable securities of € 298 million at December 31, 2001, amounting to a decrease of € 37 million during the period under review. The decrease in marketable securities at December 31, 2002 compared with December 31, 2001 primarily reflects the continuing slump of the worldwide stock markets in 2002 and our sale of a portion of our portfolio of marketable securities.

We had debt in the amount of € 117 million at December 31, 2002, compared with debt of € 127 million at December 31, 2001, corresponding to a decline of € 10 million during the period under review. For the years ended December 31, 2002 and 2001, weighted average interest rates for borrowings from banks were 6.1% and 4.9%, respectively.

**Liquidity Commitments and Capital Requirements**

Special purpose entities, irrespectively of their legal structure, are included in our consolidated financial statements when we have the power to govern their financial and operating policies. We have no special purpose entities that are not consolidated in our financial statements. Moreover, we have no material off-balance sheet arrangements that are reasonably likely to have a material effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

The following table provides a maturity analysis of our contractual obligations as of December 31, 2003:

**Contractual Obligations(1)**
**As of December 31, 2003**

| | | Payments due by period | | | |
|---|---|---|---|---|---|
| | **Total** | **< 1 year** | **1-3 years** | **4-5 years** | **> 5 years** |
| | | | **(€ in millions)** | | |
| Debt | 92 | 60 | 2 | 26 | 5 |
| Capital leases | 5 | 1 | 1 | 1 | 3 |
| Operating leases | 54 | 11 | 22 | 21 | 0 |
| R&D obligations(2) | 124 | 54 | 59 | 11 | 0 |

(1) Columns may not add due to rounding.
(2) Includes minimum and estimated milestone payments under our various R&D agreements.

As of December 31, 2003, we had commitments for investments in property, plant and equipment in the amount of € 72 million, most of which expire in the short term, guarantees for pension commitments in the amount of € 15 million and other commercial commitments in the amount of € 8 million. See note 27 to our consolidated financial statements for additional information on our commitments and contingencies as of December 31, 2003.

We typically fund our capital expenditures with our cash flow from operations and, if such funds are not sufficient, liquid funds, including cash, cash equivalents and marketable securities.

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On May 6, 2003, our shareholders meeting approved a proposal by our management and supervisory boards to pay a dividend of € 0.75 per no-par value share in respect of 2002, with the amount attributable to treasury shares to be allocated to retained earnings.

We believe that cash flows from operating activities along with available cash and cash equivalents and marketable securities will be sufficient to fund all of our anticipated operating needs in the coming 18 months, including capital expenditures, research and development projects and dividends.

**Changes in Accounting Policies**

Under IAS 8, changes in accounting policies may be performed either using the benchmark treatment or the allowed alternative treatment, unless one method is prohibited by a new accounting standard. We use the allowed alternative treatment unless otherwise required by the specific accounting standard.

**New Accounting Standards**

For a discussion of new IFRS and U.S. GAAP accounting standards, see notes 2 and 34 of our consolidated financial statements.

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## ITEM 6: DIRECTORS, SENIOR MANAGEMENT & EMPLOYEES

### Directors and Management

**Overview**

As required by the German Stock Corporation Act (*Aktiengesetz*), we have a management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*). The two boards are entirely separate, and, subject to a limited exception not currently applicable to us, no individual may simultaneously be a member of both boards. Our management board is responsible for managing our business in accordance with applicable laws, our Articles of Association and its rules of procedure. In addition, it represents us in our dealings with third parties. Our supervisory board appoints and removes the members of our management board and oversees their management of our company but does not make management decisions itself.

In carrying out their duties, the members of our management and our supervisory boards are required to exercise the standard of care of a prudent and diligent businessperson. If they fail to observe the appropriate standard of care, they may become liable to us. In carrying out their duties, both boards have to take into account a broad range of considerations, including our company s interests as well as the interests of our shareholders, employees, creditors and, to some extent, the public interest. Our management board is also required to respect the rights of our shareholders to be treated on equal terms. In addition, it is responsible for implementing an internal monitoring system.

Our supervisory board has comprehensive oversight responsibilities. To ensure that our supervisory board can carry out these functions properly, our management board must, among other things, regularly submit reports to our supervisory board in relation to the current state of our company s business and future business planning. In addition, our supervisory board is entitled to request s pecial reports at any time.

Under German law, our shareholders have no direct recourse against the members of our management board or the members of our supervisory board in the event of a breach of duty. Apart from insolvency and other special circumstances, only we have the right to claim damages from the members of our two boards. We may waive or settle claims only if at least three years have passed since any violation of a duty occurred and only if our shareholders approve the waiver or settlement at a shareholders meeting with a simple majority of the votes cast, provided that no shareholders who in the aggregate hold one-tenth or more of our share capital oppose the waiver and have their opposition formally recorded in the minutes.

**Supervisory Board**

As required by applicable German law and our Articles of Association, our supervisory board consists of twelve members. Six of these members were elected by our shareholders and six were elected by our German employees. One of the employee representatives is member of the management staff (*leitende Angestellte*) and two are elected pursuant to proposals of unions.

Our shareholders may remove any member of our supervisory board whom they have elected by adopting a resolution at a general meeting with a simple majority of the votes cast. Our German employees may remove any supervisory board member whom they have elected by adopting a resolution with a majority of three quarters of the votes cast. Our supervisory board elects a chairman and at least one deputy chairman from among its members. The election of the chairman and the first deputy chairman requires a two-thirds majority vote of the full supervisory board. If no candidate for chairman or first deputy chairman receives the required two-thirds majority, the shareholder representatives elect the chairman and the employee representatives elect the first deputy chairman. If our supervisory board chooses to elect a second deputy chairman, it does so by a simple majority of the votes cast. Resolutions of our supervisory board require a simple majority of the votes cast unless the law requires otherwise, with the chairman having a deciding vote in the event of a deadlock.

Our supervisory board meets at least twice every half year. In 2003, our supervisory board met four times. The main functions of our supervisory board are:

- To monitor and oversee the management of our company;
- To appoint and remove members of our management board;
- To represent our company in matters concerning our management board;
- To enter into contracts with independent auditors on behalf of our company; and

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To approve matters that the Articles of Association or the supervisory board have made subject to such approval.

Each member of our supervisory board is elected for a maximum term of five years. A supervisory board member s term of office expires at the end of the general meeting of our shareholders at which our shareholders discharge the respective member for the fourth fiscal year following the fiscal year in which that member was elected.

Our supervisory board has established a number of committees, including a remuneration committee (*Personalausschuss*) and an audit committee (*Prüfungsausschuss*). The remuneration committee is responsible for reviewing and approving the terms of contracts between us and the members of our management board. The audit committee is responsible for engaging the auditor and determining the audit fee following the appointment of the auditor by our shareholders meeting. The audit committee also determines the areas on which the auditor should put the emphasis when auditing our financial statements, monitors the auditor s independence and reviews our financial statements before they are presented to our supervisory board. In addition, the audit committee oversees the operation of the risk management system that has been implemented by our management board.

The following table sets forth the names and functions of the current members of our supervisory board, their ages at December 31, 2003, the year in which their current terms expire and their principal business activities outside of our company.

**Supervisory Board Members**

| **Name** | **Age** | **Term expires** | **Principal business activities outside of our company** |
|---|---|---|---|
| **Shareholder Representatives:** | | | |
| Justus Mische(1)<br>*Chairman* | 65 | 2004 | Member of the supervisory boards of B. Braun Melsungen AG (chairman), Software AG, Hoechst AG (chairman) |
| Susanne Klatten(1)<br>*Deputy chairwoman* | 41 | 2008 | Member of the supervisory boards of Bayerische Motoren Werke AG, ALTANA Pharma AG, UnternehmerTUM GmbH |
| Dr. Uwe-Ernst Bufe(2) | 59 | 2006 | Member of the supervisory boards of AirLiquide AG, Frankfurter Versicherungs-AG, Rütgers AG, UBS Warburg AG (chairman), Cognis Verwaltungs-GmbH, Solvay S.A., Akzo Nobel N.V. |
| Prof. Dr. Dr. h.c. mult. Wolfgang A. Herrmann | 55 | 2008 | President of the Technische Universität München; member of the supervisory boards of Degussa AG, Gen Pharm Tox AG |
| Prof. Dr. Heinz Riesenhuber | 68 | 2006 | Member of the supervisory boards of Evotec BioSystems AG (chairman), Frankfurter Allgemeine Zeitung GmbH, HBM BioVentures AG, Henkel KGaA, Osram GmbH, Vodafone GmbH, InSynCo AG, VfW AG |
| Dr. Klaus-Jürgen Schmieder(2) | 55 | 2006 | Chairman of the management board of Messer Griesheim GmbH; member of the supervisory board of Messer Nippon Sanso GmbH & Co. KG (chairman); chairman of the boards of directors of Messer Griesheim Industries, Inc., Messer Group, Inc. |
| Employee Representatives: | | | |
| Marcel Becker(1) | 55 | 2008 | Full time member of works council; chairman of Groups Works Council |

*Deputy chairman*

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| Name | Age | Term expires | Principal business activities outside of our company |
|---|---|---|---|
| Yvonne D Alpaos-Götz(2) | 50 | 2008 | Full-time member of works council; chairwoman of works council of ALTANA Pharma AG, member of the supervisory board of ALTANA Pharma AG |
| Dr. Rango Dietrich (3) | 52 | 2008 | None |
| Ulrich Gajewiak(1) (3) | 40 | 2008 | None |
| Ralf Giesen(2) | 40 | 2008 | Employee of IG Bergbau, Chemie, Energie; member of the supervisory boards of Vattenfall Europe Mining AG, BUL Brandenburg GmbH |
| Dr. Thomas Martin (3) | 39 | 2008 | None |

(1) Member of the remuneration committee.
(2) Member of the audit committee.
(3) These persons became members of our supervisory board on May 6, 2003.

The business address of the members of our supervisory board is the same as our business address: Am Pilgerrain 15, D-61352 Bad Homburg v. d. Höhe, Germany.

**Management Board**

Pursuant to our Articles of Association, our supervisory board determines the size of our management board, subject to the condition that our management board has at least two members. Our management board currently consists of four members. Under German law, our management board is responsible for the management of our company, including the following matters:

The preparation of the annual financial statements;

The calling of shareholders meetings and the preparation and execution of shareholders resolutions; and

The submission of reports to our supervisory board.

Our management board has adopted rules of procedure that govern the conduct of its affairs. Pursuant to the currently applicable rules of procedure of our management board, while each board member is responsible for a discrete business area, certain matters enumerated in the rules of procedure have to be managed jointly. The rules of procedure also provide that our management board should make all decisions by consensus. In the event of a deadlock, the chairman of our management board casts the deciding vote.

Our supervisory board appoints the members of our management board for a maximum term of five years. Members may be re-appointed. Our supervisory board may remove any member of our management board prior to the expiration of his or her term for cause.

The table below gives an overview of the present members of our management board, their ages at December 31, 2003, the year in which their current terms expire and their positions within our company:

**Management Board Members**

| Name | Age | Term expires | Position |
|---|---|---|---|
| Dr. Nikolaus Schweickart | 60 | 2005 | Chairman and Chief Executive Officer |
| Dr. Hermann Küllmer | 60 | 2005 | Chief Financial Officer |
| Dr. Hans-Joachim Lohrisch | 54 | 2007 | Head of Pharmaceuticals |
| Dr. Matthias L. Wolfgruber | 49 | 2005 | Head of Chemicals |

The business address of the members of our management board is the same as our business address: Am Pilgerrain 15, D-61352 Bad Homburg v. d. Höhe, Germany.

*Dr. Nikolaus Schweickart* has been a member of our management board since 1987. In 1990, he was appointed chairman of our management board and chief executive officer of our company. Prior to serving on our management board, Dr. Schweickart worked as a personal assistant to Dr. Herbert

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Quandt and as a general representative of our company. Dr. Schweickart holds a law degree and an honorary doctor title.

*Dr. Hermann Küllmer* has been a member of our management board and the chief financial officer of our company since 1990. Until 1990, he served in various finance and general management positions within our company and its predecessor entity, where he began to work in 1975. Dr. Küllmer holds a Ph.D. in economics.

*Dr. Hans-Joachim Lohrisch* has been a member of our management board since 1999 and also serves as the head of our pharmaceuticals division. Before joining our company, Dr. Lohrisch held various executive positions in the areas of therapeutics and generic drugs within Merck KGaA, where he became the head of the company s worldwide ethical pharmaceuticals business in 1998. Dr. Lohrisch holds a Ph.D. in chemistry.

*Dr. Matthias L. Wolfgruber* has been a member of our management board since July 1, 2002 and, since October 1, 2002, also serves as the head of our chemicals division. Before joining our company, Dr. Wolfgruber held a variety of marketing, production, R&D and general management positions within the Wacker group, a multinational chemicals company. Dr. Wolfgruber holds a Ph.D. in chemistry.

**Compensation**

The members of our supervisory board receive annual compensation in an amount that is determined by our Articles of Association. In 2003, the annual general meeting changed the way our supervisory board members are compensated. Their compensation now consists of a fixed portion of € 20,000, € 10,000 of which is payable in shares, and a variable portion the amount of which depends on the relationship that our annual dividend bears to our share capital. The chairman of the supervisory board receives twice this amount and the deputy chairman one and a half times this amount. In addition, our supervisory board members are entitled to be reimbursed for their out-of-pocket expenses. Members and chairpersons of supervisory board committees receive additional payments. Accordingly, the chairpersons of the remuneration and the audit committee each receive an additional € 40,000 per year, while ordinary members of these committees receive an additional € 20,000 per year. Provided that the proposal regarding the dividend to be distributed in respect of 2003 is approved at the annual shareholders meeting, the compensation paid to our supervisory board members in respect of 2003 totals € 1.3 million, of which € 0.8 million is variable and € 0.2 million is remuneration for supervisory board committee work.

The table below provides a breakdown of the compensation paid to each member of our supervisory board for 2003:

**Supervisory Board Compensation**

**For the year ended December 31, 2003**

| | Fixed(1) | Variable | Committee | Total |
|---|---|---|---|---|
| | | (€ in thousands) | | |
| Justus Mische | 40 | 111 | 40 | 191 |
| Marcel Becker | 30 | 83 | 20 | 133 |
| Susanne Klatten | 30 | 83 | 20 | 133 |
| Dr. Uwe-Ernst Bufe | 20 | 55 | 20 | 95 |
| Yvonne D Alpaos-Götz | 20 | 55 | 20 | 95 |
| Dr. Rango Dietrich (as of May 6, 2003) | 13 | 37 | 0 | 50 |
| Wolfgang Eichhorn (until May 6, 2003) | 7 | 19 | 7 | 33 |
| Ulrich Gajewiak (as of May 6, 2003) | 13 | 37 | 13 | 63 |
| Ralf Giesen | 20 | 55 | 20 | 95 |
| Prof. Dr. Dr. h.c. mult. Wolfgang A. Herrmann | 20 | 55 | 0 | 75 |
| Dr. Uwe Krüger (until May 6, 2003) | 7 | 19 | 0 | 26 |
| Dr. Thomas Martin (as of May 6, 2003) | 13 | 37 | 0 | 50 |
| Prof. Dr. Heinz Riesenhuber | 20 | 55 | 0 | 75 |
| Dr. Klaus-Jürgen Schmieder | 20 | 55 | 40 | 115 |
| Dr. Jörg Senn-Bilfinger (until May 6, 2003) | 7 | 19 | 0 | 26 |

| | | | | |
|---|---|---|---|---|
| Total | 280 | 775 | 200 | 1,255 |

(1) 50% of this amount was paid in shares of our company at the closing price of € 47.65 on Xetra on December 30, 2003.

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For 2003, the four members of our management board received aggregate compensation in the amount of € 4.7 million. € 1.5 million of the amount that we paid in respect of services performed in 2003 was fixed, and € 3.1 million of this amount was variable. The amount of the variable compensation received by active members of our management board is based on our operating income before interest, taxes and amortization ( EBITA ) and our return on capital employed ( ROCE ).

The table below provides a breakdown of the compensation paid to each of the members of our management board for 2003:

**Management Board Compensation**

**For the year ended December 31, 2003**

| | Fixed | Variable | Total |
|---|---|---|---|
| | (€ in thousands) | | |
| Dr. Nikolaus Schweickart | 505 | 1,190 | 1,695 |
| Dr. Hermann Küllmer | 345 | 663 | 1,008 |
| Dr. Hans-Joachim Lohrisch | 378 | 888 | 1,266 |
| Dr. Matthias L. Wolfgruber | 310 | 399 | 709 |
| Total | 1,538 | 3,140 | 4,678 |

In addition, as participants in our stock option plans, the members of our management board received options to subscribe for our shares. In 2003, we granted our management board members a total of 130,000 options under these plans, each option being exercisable for one share at an exercise price of € 54.65. For more information on our stock option plans, see Stock Option Plans below.

The table below sets forth the number of options granted to each member of the management board under the 2003 stock option plan and their value at the date of grant and at December 31, 2003:

| | Option plan 2003 |
|---|---|
| | (€ in thousands) |
| Dr. Nikolaus Schweickart | 40,000 options |
| Fair value on date of grant (1) | 547 |
| Value at December 31, 2003 (2) | 0 |
| Dr. Hermann Küllmer | 30,000 options |
| Fair value on date of grant (1) | 410 |
| Value at December 31, 2003 (2) | 0 |
| Dr. Hans-Joachim Lohrisch | 30,000 options |
| Fair value on date of grant (1) | 410 |
| Value at December 31, 2003 (2) | 0 |
| Dr. Matthias L. Wolfgruber | 30,000 options |

| | |
|---|---|
| Fair value on date of grant (1) | 410 |
| Value at December 31, 2003 (2) | 0 |

(1) The fair value of the options at the date of grant is calculated based on the Black Scholes / Binominal option pricing model.

(2) The value of the options as of December 31, 2003 is calculated as the difference of the share price on that date and the exercise price.
At December 31, 2003, the total amount that we had accrued for the payment of pensions to the members of our management board equaled € 3.7 million, and the total amount that we had accrued for former management board members and their surviving dependents amounted to € 6.8 million.

We have provided and will continue to provide insurance for the indemnification of our directors and officers against any general civil liability they may incur in connection with their activities on our behalf as well as against liabilities under the Securities Act.

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**Employees**

At December 31, 2003, we employed 10,402 people, compared with 9,853 employees in 2002 and 9,122 employees in 2001.

The following table provides a breakdown of the number of our employees by main category of activity and location for each of the three years ended December 31, 2001, 2002 and 2003, respectively:

**Employees by Main Category of Activity and Location**

| | As of December 31, | | |
|---|---|---|---|
| | **2001** | **2002** | **2003** |
| **By division** | | | |
| Pharmaceuticals | 6,867 | 7,504 | 7,702 |
| Chemicals | 2,217 | 2,299 | 2,634 |
| Holding company | 38 | 50 | 66 |
| **By main category of activity** | | | |
| R&D | 1,484 | 1,741 | 2,000 |
| Production and logistics | 3,269 | 3,479 | 3,651 |
| Marketing and distribution | 3,059 | 3,244 | 3,377 |
| Administration | 1,310 | 1,389 | 1,374 |
| **By location** | | | |
| Germany | 4,080 | 4,478 | 4,816 |
| Europe (excl. Germany) | 2,224 | 2,405 | 2,363 |
| North America | 1,068 | 1,209 | 1,332 |
| Latin America | 1,432 | 1,399 | 1,300 |
| Other | 318 | 362 | 591 |
| Total | 9,122 | 9,853 | 10,402 |

A significant percentage of our employees, especially those located in Germany, are covered by collective bargaining agreements that determine such matters as compensation, working hours and other conditions of employment, and some of our employees are represented by works councils. Works councils are employee-elected bodies, which exist in our company both at the group level for our German employees (*Konzernbetriebsrat*) and in certain of our subsidiaries. Works councils have a number of notification and codetermination rights in personnel, social and economic matters. Under the German Works Constitution Act (*Betriebsverfassungsgesetz*), they are entitled to receive advance notification of any proposed termination of an employee, to confirm hirings, relocations and similar matters, and to codetermine a variety of so-called social matters, such as work schedules and rules of conduct. Our management considers itself to be on good terms with the works councils of our company.

We offer our German employees a special investment program called *Altersvorsorge Aktiv mit ALTANA* ( AAA ) . Participating employees may designate a defined amount of their gross salary or wages to be deposited in investment funds, subject to a minimum interest rate guaranteed by us.

During the last three years, we have not experienced any material labor disputes resulting in work stoppages.

**Share Ownership**

At April 14, 2004, Ms. Klatten owned 70,332,326 shares or 50.1% of our issued share capital. The shares and options held by the other members of our supervisory board and our management board members represent less than 1% of our issued share capital. See Item 7: Major Shareholders

and Related Party Transactions .

In order to better align the interests of our employees and our management board members with those of our shareholders, we have implemented a number of plans to involve our employees and the members of our management board in the capital of our company. These plans include various stock option plans, first introduced in 1999, in which our management board members, senior executives and certain other key employees may participate, and the ALTANA Investment Program, an annual share ownership plan that we launched for the first time in 2000 in which most of our employees are eligible to participate.

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To be able to meet our obligations under our various stock option plans, we maintain approximately the same number of shares in treasury as we grant in options under our plans, including the ALTANA Investment Program. Each year, we determine the number of additional treasury shares required to be purchased and make the necessary adjustments.

In connection with the acquisition of treasury shares for delivery upon exercise of options under our various employee incentive plans, we recognize compensation expense over the vesting period in an amount equal to the difference between the exercise price of the options and the average price of the treasury shares purchased. See note 13 to our consolidated financial statements for additional information.

**Stock Option Plans**

With our stock option plans, we aim to align the interests of our key employees and employees who we believe have a high potential with those of our company.

In 1999, we launched for the first time a stock option plan, which was open to the members of our management board, senior executives and certain other key employees. In July 2000 and July 2001, we launched similar plans. Starting with the 2001 plan, we extended the eligibility criteria to include other employees that we consider to have high potential. In 2002, we offered two different plans. One of them ( Plan A ) was open to the members of our management board and certain executives of our two divisions, whereas the other plan ( Plan B ) was open to other key members of management. In order to participate in the various stock option plans that we launched in the past, our employees were required to make an initial investment in the share capital of our company. The minimum investment required of an employee depends on his or her position in our company. Once an employee had made an initial investment under one plan, he or she was not required to purchase additional shares to participate in plans launched subsequently. In 2002, we modified this requirement. Under Plan A, which is one of the stock option plans that we launched in 2002, our management board members and other participating executives were each required to make initial investments of € 150,000 and € 50,000, respectively. By contrast, no initial investment was required of participants in our Plan B.

In 2003, we adopted a new stock option plan for the members of our management board, the top management of our divisions, the managing directors and certain senior executives of certain of our subsidiaries and certain junior executives. The plan provides that the remuneration committee may cap the gains realizable upon the exercise of the options granted to our management board members if unforeseen extraordinary developments lead to a disproportionate increase in the price of our shares.

Under the 2003 plan, participants were required to make an initial investment in our shares in an amount between € 5,000 and € 150,000, depending on their position in our group. Half of this initial investment had to be paid up immediately. The other half could be paid through future profits realized upon the exercise of options. We are planning to grant participants options to subscribe for shares in the amount of approximately 2.0% of our share capital in 2004 and 2005. The number of options to be granted to a participant will be determined by our management board or, to the extent options will be granted to members of our management board, our supervisory board.

Under our various stock option plans, each option granted is exercisable for one share of our company at an exercise price that we determined on the basis of the average closing prices of our shares, as reported on the Xetra trading system of the Frankfurt stock exchange, during a 20-trading day reference period prior to the date on which each plan was launched. Options granted cannot be exercised until the expiry of a two-year lockup period from the date of the grant.

Options granted under the 2000 plan are exercisable only if the average of our earnings per share in both the year when the options were granted and the succeeding year exceeded the average of our earnings per share during the two years preceding the date of grant by at least 20%. The corresponding condition under our 2001 plan is that our earnings per share in 2002 exceed our earnings per share in 2000 by at least 20%. Likewise, options granted under our 2002 Plan A become exercisable if our earnings per share in 2003 exceed our earnings per share in 2001 by at least 20%. There are no performance hurdles under Plan B. To create appropriate incentives, we have set the exercise price for Plan B at a level that is 10% above the exercise price for Plan A. Options granted under our 2003 plan vest if our earnings per share in 2004 are 20% higher than in 2002. The conditions under the 2000, 2001 and 2002 plans have been satisfied.

Under the 2000 plan, upon exercise of any options granted, participants have the right to receive either shares or cash in an amount equal to the difference between the market price of the shares that

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they are entitled to receive and the exercise price of the options. Options granted under the 2001, 2002 and 2003 plans are exercisable only for shares.

Options under the 2000 plan expire four years after the date of grant, options granted under the 2001 and 2003 plans expire five years after the date on which they were granted, and options granted under the 2002 plan expire ten years after the grant date.

Under the 2001 and 2003 plans, the members of our management board and executive officers are entitled to receive additional options if they make an additional investment in our shares. The 2001, 2002 and 2003 plans also envisage the grant of additional options, taking into account their roles and responsibilities in our company. Our supervisory board is responsible for making such grants with respect to members of our management board, and our management board is responsible for making such grants to other eligible participants.

The following table provides details regarding the options outstanding under our various stock option plans:

**Stock Option Plans**

| Name | Title of securities issuable upon exercise of options | Number of options outstanding as of December 31, 2003 | Date on which options become or became exercisable | Date on which options expire | Exercise price |
|---|---|---|---|---|---|
| 2000 plan | Shares | 185,600 | July 1, 2002 | June 30, 2004 | € 22.97 |
| 2001 plan | Shares | 816,750 | July 1, 2003 | June 30, 2006 | € 42.41 |
| 2002 plan | | | | | |
| Executives | Shares | 255,000 | July 1, 2004 | June 30, 2012 | € 51.58 |
| Key management | Shares | 961,750 | July 1, 2004 | June 30, 2012 | € 56.74 |
| 2003 plan | Shares | 1,179,600 | July 1, 2005 | June 30, 2008 | € 54.65 |

**ALTANA Investment Program**

The ALTANA Investment Program is an employee share ownership plan that we first launched in 2000. In 2001, 2002 and 2003, we launched new editions of the plan, and we expect to offer similar plans in the future. Participation in the plan is open to employees who are not eligible to participate in any of our stock option plans, subject to certain conditions. Each plan consists of two components. The first component entitles participants to purchase a specific number of shares based on their salary or wages at a fixed price per share that corresponds to the lowest market price of our shares on the Frankfurt Stock Exchange on the date at which our management board approves the relevant plan edition. Plan participants are entitled to a discount on a portion of the shares that they purchase. Employees who are unable to receive shares for reasons of statutory law are paid the cash equivalent of the benefit that they would otherwise have received. Under the second component, participants receive one stock appreciation right ( SAR ) for each share that they purchase. The SARs become exercisable two years after the date of grant and entitle their holders to receive cash in an amount equal to the difference between a predetermined exercise price and the market price of our shares on the date on which the SARs are exercised. The SARs expire two years after the date they first become exercisable and, if not previously exercised and in the money, are deemed exercised on such date. If a participant sells shares purchased under the plan during the lock-up period, he or she must repay the subsidy and forfeits the SARs received. At December 31, 2003, 536,533 SARs had been granted under the four share ownership plans, of which 250,161 SARs were exercisable.

**Profit-sharing Certificates**

From 1980 to 2000, we issued profit-sharing certificates (*Genussscheine*) to our German employees. Holders of these certificates are entitled to receive interest at a rate equal to the higher of the dividend rate on our shares in any given year and 7% of the certificates face value. At December 31, 2003, the nominal value of all outstanding profit sharing certificates was € 8 million.

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## ITEM 7: MAJOR SHAREHOLDERS AND RELATED PARTY TRANSACTIONS

### Major Shareholders

The table below identifies all persons who, to our knowledge, beneficially owned more than 5% of our shares as of March 31, 2004. Under German law, our shareholders are required to notify us in case their holdings reach or fall below certain thresholds, and the information presented in the table is based on notifications that we have received. Since our shares are in bearer form, however, we are unable to determine precisely how many shareholders we have at any given point and how many shares a particular shareholder owns. For more information on these notification requirements, see Item 10: Additional Information Articles of Incorporation and Relevant Provisions of German Law .

| Name | Number of shares owned | Ownership interest |
|---|---|---|
| | | (%) |
| Susanne Klatten | 70,332,326 | 50.1% |

Except as set forth in the table, we are not aware of any holders of more than 5% of our shares. Nor are we aware of any significant changes in the percentage ownership of our major shareholder over the course of the past three years. To our knowledge, no arrangements are currently in place that could lead to a change of control of our company.

Ms. Klatten is the beneficial owner of the majority of our share capital. Ms. Klatten s share ownership could discourage third parties from initiating merger, takeover or other change of control transactions. As the owner of the majority of our shares, Ms. Klatten has the ability to control the outcome of all matters requiring the approval of a majority of our shareholders, including the election and removal of members of our supervisory board.

### Related Party Transactions

The Herbert Quandt Foundation is a not-for-profit charitable endowment established in 1980. The endowment promotes scientific and cultural research activities and supports civic responsibility projects. Ms. Klatten, the deputy chairwoman of our supervisory board, is chairwoman of the board of counselors of the endowment, and Dr. Nikolaus Schweickart, the chairman of our management board and chief executive officer of our company, serves as the chairman of the endowment s management board. In 2001, we made a special contribution in the amount of € 15 million to the capital of the endowment. The foundation in turn deposited the funds with us. The deposit bears interest at a rate equal to the Base Rate (*Basiszinssatz*), which is the rate specified in § 247 of the German Civil Code, of the German Central Bank (*Bundesbank* ) plus 2.5%.

Ms. Klatten is also a shareholder and member of the supervisory board of Bayerische Motoren Werke AG ( BMW ). From time to time, we purchase company cars from BMW. These transactions are immaterial both to us and to BMW and are carried out at normal third party terms and conditions.

For information on balances between us and our affiliated and associated companies and participating interests as of December 31, 2003, see note 28 to our consolidated financial statements.

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## ITEM 8: FINANCIAL INFORMATION

**Consolidated Financial Statements and Other Financial Information**

See Item 18: Financial Statements.

**Legal Proceedings**

See Item 4: Information on the Company Legal Proceedings .

**Dividend Policy**

Our management and supervisory boards may, based on our annual financial statements, propose the payment of dividends to our shareholders. Our shareholders vote on these proposals at the annual shareholders meeting, which is usually convened during the second quarter of each year. See Item 10: Additional Information Dividend Rights for further information. We expect to continue to pay dividends in the future, although there can be no assurance as to the exact amounts, if any, that we may pay in any given period. The payment of future dividends will depend on our results of operations and financial condition. See Item 5: Operating and Financial Review and Prospects. Our management board intends to submit a proposal for a dividend of € 0.83 for 2003 to the annual general meeting to be held on May 5, 2004.

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## ITEM 9: THE OFFER AND LISTING

Our ordinary shares are in bearer form and have no par value. Each of our ordinary shares has a notional value of € 1.00. The principal trading market for our ordinary shares is the Frankfurt Stock Exchange. In addition, our ordinary shares are traded on the stock exchanges of Berlin, Bremen, Düsseldorf, Hamburg, Hannover, Munich and Stuttgart. Our American Depositary Shares ( ADSs ), each representing one ordinary share, are listed on the New York Stock Exchange ( NYSE ). For more information on our shares, see Item 10: Additional Information Share Capital .

Based on turnover statistics supplied by Bloomberg and adjusted for the changes to our share capital that occurred in 2001, the average daily volume of our shares traded on the Frankfurt Stock Exchange was 200,337 in 2001, 371,056 in 2002 and 616,318 in 2003.

**Market Price Information**

The tables below set forth, for the periods indicated, the high and low closing sales prices for our shares on the Frankfurt Stock Exchange.

**Trading on the Frankfurt Stock Exchange**

| Year | High | Low |
|---|---|---|
| | (€) | |
| 1999 | 20.36 | 14.44 |
| 2000 | 46.64 | 15.98 |
| 2001 | 58.99 | 34.36 |
| 2002 | 64.60 | 36.66 |
| 2003 | 59.39 | 35.49 |

| Year | High | Low |
|---|---|---|
| | (€) | |
| **2002** | | |
| January through March | 61.75 | 52.60 |
| April through June | 64.60 | 47.95 |
| July through September | 55.30 | 36.66 |
| October through December | 50.00 | 37.80 |
| **2003** | | |
| January through March | 45.69 | 35.49 |
| April through June | 59.39 | 43.00 |
| July through September | 56.54 | 45.85 |
| October through December | 55.45 | 47.00 |
| **2004** | | |
| January through March | 53.30 | 45.18 |

| Month | High | Low |
|---|---|---|
| | (€) | |
| October 2003 | 54.84 | 51.20 |

| | | |
|---|---|---|
| November 2003 | 55.45 | 50.20 |
| December 2003 | 50.10 | 47.00 |
| January 2004 | 48.55 | 45.18 |
| February 2004 | 49.55 | 46.15 |
| March 2004 | 53.30 | 49.20 |

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Official trading of our ADSs commenced on May 22, 2002. The tables below set forth, for the periods indicated, the high and low closing sale prices for our ADSs on the New York Stock Exchange:

**Trading on the New York Stock Exchange**

| Year | High | Low |
|---|---|---|
| | ($) | |
| 2002 | 54.92 | 37.09 |
| 2003 | 69.95 | 28.75 |

| Year | High | Low |
|---|---|---|
| | ($) | |
| **2002** | | |
| May 22 through June | 54.92 | 46.00 |
| July through September | 53.46 | 37.20 |
| October through December | 50.10 | 37.09 |
| **2003** | | |
| January through March | 47.99 | 38.75 |
| April through June | 69.65 | 47.50 |
| July through September | 65.00 | 50.21 |
| October through December | 63.45 | 57.30 |
| **2004** | | |
| January through March | 65.90 | 56.70 |

| Month | High | Low |
|---|---|---|
| | ($) | |
| October 2003 | 63.35 | 59.89 |
| November 2003 | 63.45 | 57.65 |
| December 2003 | 60.42 | 57.30 |
| January 2004 | 61.99 | 56.70 |
| February 2004 | 61.80 | 57.07 |
| March 2004 | 65.90 | 60.20 |

**Trading on the Frankfurt Stock Exchange**

The Frankfurt Stock Exchange, which is operated by the Deutsche Börse AG, is the most significant of the eight German stock exchanges. The Frankfurt Stock Exchange, including the Xetra trading system described below, accounted for approximately 90% of the turnover in exchange-traded shares in Germany in 2003. As of December 31, 2003, the shares of 5,730 companies traded on the official, regulated and unregulated markets of the Frankfurt Stock Exchange. Of these, 829 were German companies and 4,901 were foreign companies.

Trading on the floor of the Frankfurt Stock Exchange begins every business day at 9:00 a.m. and ends at 8:00 p.m., Central European Time. Securities listed on the Frankfurt Stock Exchange are generally traded in the auction market, but also change hands in interbank dealer markets. Prices are noted by publicly commissioned stockbrokers who are members of the Frankfurt Stock Exchange but who do not as a rule deal with the public. The prices of actively traded securities, including the shares of large corporations, are continuously quoted during trading hours. For all securities, a fixed price is established around midday on each day on which the Frankfurt Stock Exchange is open for business. Deutsche Börse publishes an official daily list of quotations (*Amtliches Kursblatt*) containing the fixed prices (*Einheitskurse*) as well as the yearly high and low prices for all traded securities. The list is available on the Internet at http://www.exchange.de under the heading Market Data .

Our shares are traded on Xetra (Exchange Electronic Trading) in addition to being traded on the auction market. Xetra is available daily from 9:00 a.m. to 5:30 p.m. Central European Time to brokers and banks that have been admitted to Xetra by the Frankfurt Stock Exchange. Securities traded by this system include liquid stocks, warrants and bonds traded on the floor of the Frankfurt Stock Exchange. There have been no significant trading suspensions with respect to our shares in the past three years.

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Transactions on the Frankfurt Stock Exchange (including transactions through the Xetra system) are settled on the second business day following the day on which the trade takes place. Transactions off the Frankfurt Stock Exchange (which may occur for large trades or if one of the parties is foreign) are generally also settled on the second business day following the trade, although a different period may be agreed by the parties. Under standard terms and conditions for securities transactions employed by German banks, customers orders for listed securities must be executed on a stock exchange unless the customer gives specific instructions to the contrary.

Trading activities on the German stock exchanges are monitored by the Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*). A quotation can be suspended by the Frankfurt Stock Exchange if orderly trading is temporarily endangered or a suspension is deemed to be necessary to protect the public.

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## ITEM 10: ADDITIONAL INFORMATION

### Articles of Association and Relevant Provisions of German Law

This section summarizes the material provisions of our Articles of Association and German law to the extent that they affect the rights of our shareholders. The information set forth below is only a summary and does not provide a complete description of all relevant provisions.

**Organization**

We are a stock corporation organized in the Federal Republic of Germany under the German Stock Corporation Act (*Aktiengesetz*). We are registered in the Commercial Register (*Handelsregister*) maintained by the local court (*Amtsgericht*) in Bad Homburg, Germany, under the docket number HRB 1933. Copies of our Articles of Association may be obtained from the Commercial Register. In addition, an English translation is available from the U.S. Securities and Exchange Commission.

**Corporate Governance**

*Overview of the corporate governance system in Germany*

In contrast to corporations organized under the laws of the United States, German stock corporations are governed by three separate bodies: the shareholders meeting, the supervisory board and the management board. Their respective roles and responsibilities are defined by German law and the corporation s Articles of Association (*Satzung*) and may be summarized as follows:

A corporation s shareholders meeting discharges the actions of the corporation s supervisory and management boards. It decides the amount of the annual dividend, the appointment of an independent auditor and certain significant corporate transactions. It also elects the members of the supervisory board. Under the concept of co-determination (*unternehmerische Mitbestimmung*), in corporations with more than 2,000 German employees, the shareholders and employees based in Germany elect an equal number of members of the supervisory board. The law requires that an annual general meeting of shareholders be held during the first eight months of a fiscal year.

The supervisory board appoints and removes the members of the management board and oversees the management of the corporation. Although prior approval by the supervisory board may be required in connection with certain corporate matters, the law normally does not entitle the supervisory board to make management decisions.

The management board manages the business of the corporation and represents it in dealings with third parties. The management board regularly submits reports to the supervisory board about the corporation s operations and business strategies, and prepares special reports upon request. Nobody may serve simultaneously on the management and supervisory boards of the same corporation, subject to a limited exception not currently applicable to us.

In February 2002, a commission appointed by the government of the Federal Republic of Germany promulgated the German Corporate Governance Code, which contains a set of best-practice guidelines of corporate governance for companies listed on a stock exchange in Germany, which are referred to below as covered companies. The full text of the German Corporate Governance Code, including an English convenience translation, is available at http://www.corporate-governance-code.de. In addition to restating provisions of the German Stock Corporation Act, the German Corporate Governance Code contains approximately 60 recommendations that reflect widely recognized and well-established standards of corporate governance and approximately 15 suggestions for sound and responsible management and supervision.

Topics covered by the recommendations and suggestions include

- Responsibilities of the shareholders meeting;
- Responsibilities, composition and compensation of the management board, as well as procedures for the handling of conflicts of interest;
- Responsibilities, composition and compensation of the supervisory board and its chairman, responsibilities and composition of committees, as well as procedures for the handling of conflicts of interest;
- Relationship between the management board and the supervisory board;

Transparency and disclosure in periodic reports; and

Reporting and auditing of annual financial statements.

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Compliance with the German Corporate Governance Code is voluntary. Section 161 of the German Stock Corporation Act, as amended by the German Transparency and Disclosure Law (*Transparenz- und Publizitätsgesetz*) of July 19, 2002, however, requires that the management board and supervisory board of any covered company annually declare that the recommendations set forth in the German Corporate Governance Code have been adopted or which recommendations have not been adopted. On November 19, 2003, our management board and supervisory board have declared that we fully comply with the recommendations set forth in the German Corporate Governance Code. Our management board and supervisory board are not required to declare whether we also comply with the suggestions contained in the German Corporate Governance Code. However, we follow most of these suggestions voluntarily. For example, we have implemented long-term incentive plans for the members of our management board. Furthermore, each new member of our management board is initially appointed for a term of less than five years. Finally, the chairman of our supervisory board is not the same person as the chairman of the audit committee.

*Summary of significant differences between German corporate governance practices and the New York Stock Exchange, Inc. s ( NYSE s ) corporate governance standards*

The following paragraphs provide a brief, general summary of significant differences between the corporate governance practices followed by us as a German company, and those required by the listing standards of the NYSE of U.S. companies that have common stock listed on the NYSE. The NYSE listing standards are available on the NYSE s website at http://www.nyse.com.

*Composition of Board of Directors; Independence; Conflicts of Interest.* The NYSE listing standards provide that the board of directors of a U.S. listed company must consist of a majority of independent directors and that certain committees must consist solely of independent directors. A director qualifies as independent only if the board affirmatively determines that the director has no material relationship with the company, either directly or indirectly. In addition, the listing standards enumerate a number of relationships that preclude independence. The listing standards do not specifically deal with the avoidance of conflicts of interest and related party transactions. These matters are typically governed by the laws of the state in which the listed company is incorporated. Moreover, the absence of such rules reflects the NYSE s belief that the oversight of related party transactions is best left to the company s discretion.

Although German law does not explicitly require that our management or supervisory board members must be independent, a certain degree of independence of our supervisory board members is assured by the fact that generally no person may concurrently serve on the management board and the supervisory board of the same company. See Item 6: Directors, Senior Management and Employees Overview and Supervisory Board for more information on our practice. In addition, the German Corporate Governance Code recommends that proposals for the election of supervisory board members of covered companies make sure that, at any time, the supervisory board as a whole is composed of members who are sufficiently independent .

Furthermore, German law and the German Corporate Governance Code establish a number of principles of general applicability designed to strengthen the independence of board members, to avoid conflicts of interests and to establish procedures and standards for related party transactions. Specifically, German law subjects loans from the company to members of the management board or supervisory board and their close family members to the supervisory board s approval. In addition, the German Corporate Governance Code recommends that:

- The members of the management board should not, during the term of their office (1) compete with the company, (2) in connection with their office, demand or accept special benefits or grant unjustified benefits to third parties, or (3) when making business decisions for the company, pursue personal interests or exploit business opportunities that belong to the company;

- The members of the management board and the supervisory board should disclose conflicts of interest;

- All transactions between the company on the one hand and the members of the management board and persons and companies closely related to them on the other hand should be entered into on market terms and conditions;

- The members of the management board should not engage in side-line activities outside the company, including the assumption of seats on the governing bodies of other companies, without the supervisory board s approval;

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The supervisory board should not include more than two former members of the management board;

No supervisory board member should serve on a governing body of, or provide consulting services to, a major competitor of the company;

When making business decisions for the company, the supervisory board members may not pursue personal interests or exploit business opportunities that belong to the company; and

Advisory and other service contracts between the company and members of the supervisory board should be entered into only with the supervisory board s approval.

*Committees.* The NYSE listing standards require that a U.S. listed company must have an audit committee, a nominating/corporate governance committee and a compensation committee. Each of these committees must consist solely of independent directors and must have a written charter that addresses certain matters specified in the listing standards.

Under German law, the only committee required by law is the mediation committee, which is a supervisory board committee that must be formed in all companies subject to the principle of co-determination. The mediation committee consists of the chairman of the supervisory board, the deputy chairman, one shareholder representative and one employee representative. The committee convenes when the supervisory board as a whole is unable to reach the required supermajority of votes for the appointment or removal of members of the management board.

In addition, the German Corporate Governance Code recommends that covered companies form additional committees at the supervisory board level depending on, among other things, the number of supervisory board members. Specifically, the German Corporate Governance Code recommends that covered companies should have an audit committee. In addition, it suggests that specific issues, such as the company s strategy, the remuneration of the members of the management board and investment and financing questions, may be delegated to committees.

The NYSE listing standards contain detailed requirements for the audit committees of U.S. listed companies. Starting on July 31, 2005, some but not all of these requirements, will also apply to non-U.S. listed companies, such as ourselves. For the time being, however, the NYSE listing standards do not require that non-U.S. listed companies, such as ourselves, have an audit committee.

German law currently does not require that companies have an audit committee. However, the German Corporate Governance Code recommends that covered companies form an audit committee that is responsible for, among other things, questions of accounting and risk management, ensuring the independence of the company s auditor, engaging the auditor for the audit of the company s financial statements, determining the focus of the audit, and agreeing the audit fees. Although the audit committee related provisions of the German Corporate Governance Code are less detailed than those contained in the NYSE listing standards, the NYSE listing standards and the German Corporate Governance Code share the goal of establishing a system for overseeing the company s accounting that is independent from management and of ensuring the auditor s independence. As a result, they address similar topics, and there is some overlap.

One structural difference between the legal status of the audit committee of a U.S. listed company and that of a German company concerns the degree of the committee s involvement in managing the relationship between the company and its auditor. While the NYSE listing standards require that the audit committee of a U.S. listed company must have direct responsibility for the appointment, compensation, retention, and oversight of the work of the auditor, under German law, this responsibility is shared between the shareholders meeting and the supervisory board. The shareholders meeting is responsible for electing and dismissing the auditor (in doing so, it may rely on proposals submitted to it by the supervisory board and, if an audit committee exists, the audit committee). The supervisory board, in turn, is responsible for engaging the auditor, setting the terms of the engagement and administering the engagement on a day-to-day basis.

We are in compliance with the committee requirements under German law. For more information, see Overview of the corporate governance system in Germany and Item 6: Directors, Senior Management and Employees Supervisory Board.

*Disclosure regarding corporate governance.* The NYSE listing standards require U.S. listed companies to adopt, and post on their websites, a set of corporate governance guidelines. The guidelines must address, among other things: director qualification standards, director responsibilities, director access to management and independent advisers, director compensation, director orientation and continuing education, management succession, and the board s annual performance evaluation of

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itself. In addition, the CEO of a U.S. listed company must certify to the NYSE annually that he or she is not aware of any violations by the company of the NYSE s corporate governance listing standards. The certification must be disclosed in the company s annual report to shareholders.

Under German law, as discussed, our management and supervisory boards are required to declare annually either that they have complied, and do comply, with the recommendations set forth in the German Corporate Governance Code or, alternatively, which recommendations they have not complied, or do not comply, with. For more information on our compliance with the German Corporate Governance Code, see Overview of the corporate governance system in Germany.

*Code of Business Conduct and Ethics.* The NYSE listing standards require each U.S. listed company to adopt, and post on its website, a code of business conduct and ethics for its directors, officers and employees. There is no similar requirement under German law or the German Corporate Governance Code. However, under the SEC s rules and regulations, all companies required to submit periodic reports to the SEC, including ourselves, must disclose in their annual reports whether they have adopted a code of ethics for their senior financial officers. In addition, they must file a copy of the code with the SEC, post the text of the code on their website or undertake to provide a copy upon request to any person without charge. There is significant, though not complete, overlap between the code of ethics required by the NYSE listing standards and the code of ethics for senior financial officers required by the SEC s rules. See Item 16A: Code of Ethics for information on our code of ethics.

**Objects and Purposes**

The objects and purposes of our company are to found or to acquire and to hold directly or indirectly equity interests in commercial enterprises, particularly enterprises that are active in the manufacture and marketing of pharmaceutical, dietetic or chemical products and reagents as well as testing and measuring instruments. Our Articles of Association authorize us to take all measures incident to these purposes.

**Directors**

The members of our management and supervisory boards owe duties of loyalty and care to our company. Pursuant to these duties, each of our board members is required to act in our company s best interest. In fulfilling their duties, our board members are required to exercise the standard of care of a prudent and diligent businessperson and, if their actions are contested, bear the burden of proof that they have done so. The relevant standard is not customary but necessary diligence, which is an objective test that does not depend on the subjective knowledge and abilities of any particular board member. In fulfilling their duties, both boards are required to observe the interests of our shareholders, employees, creditors and, to some extent, the public interest. Board members who violate their duties are jointly and severally liable to our company for any monetary damage that their violations have caused unless they acted pursuant to a lawful resolution of our shareholders meeting passed with a simple majority of the votes cast. As a general rule, only we, but not individual shareholders, may bring an action against a board member who defaults on his or her fiduciary duties. In special circumstances, however, our shareholders may appeal to the court for assistance. See Rights, Preferences and Restrictions Attaching to Our Shares for more information on individual shareholders ability to institute a legal action against our board members.

Board members may typically not vote on matters in which they have an interest.

There is no mandatory legal retirement age and no share ownership requirement for the members of either of our boards. However, the rules of procedure of our supervisory board provide that the term of office of a supervisory board member ends at the latest upon the close of the first shareholders meeting following that member s 70th birthday. Historically, the members of our management board have retired on or before their 65th birthday.

See Item 6: Directors, Senior Management and Employees for additional information about the members of our supervisory and management boards.

**Rights, Preferences and Restrictions Attaching to our Shares**

*Information rights*

The principal means by which our shareholders may obtain information on our company is through our audited annual financial statements (*Jahresabschluss*), a report prepared by our management board discussing these financial statements, certain risk factors and business trends

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(*Lagebericht*), a report by our supervisory board and a recommendation by our management board regarding the distribution of our earnings. We are required to make these materials available for inspection at our principal offices starting on the date when the annual shareholders meeting is convened. In addition, each shareholder is entitled to receive a copy of the aforesaid materials upon request.

Furthermore, each shareholder attending a shareholders meeting is entitled to ask questions, which members of our management board, who are required to attend the meeting, are obliged to answer. The questions may cover any economic or financial matters necessary to properly evaluate the items on the agenda of the relevant shareholders meeting. By contrast, our shareholders have no right to inspect the books and records of our company.

*Voting rights*

Our shareholders vote at shareholders meetings. By contrast, German corporate law does not allow shareholders to approve matters by written consent. A shareholders meeting may be called by either our management board or our supervisory board. The annual general meeting of our shareholders is required to take place within the first eight months of each fiscal year. In addition, shareholders who in the aggregate hold 5% or more of our share capital may require our management board to call an extraordinary meeting. Shareholders holding shares with an aggregate nominal value of at least € 500,000 may require that particular items be placed on the agenda of the meeting.

Under German law, we are required to publish a notice of each ordinary or extraordinary meeting of our shareholders in the electronic Federal Gazette (*Bundesanzeiger*) at least one month prior to the registration deadline set by such notice. In order to be entitled to participate in, and to vote at, shareholders meetings, shareholders have to deposit their shares no later than the seventh day prior to the date of the meeting with a securities clearing or other bank. The shares have to remain at the depositary until the conclusion of the meeting. Our Articles of Association provide that our shareholders are no longer entitled to receive share certificates.

At our shareholders meetings, each share carries one vote. In certain cases, a shareholder s right to cast a vote is excluded. This rule applies, for example, to waivers or if we assert claims against one of our shareholders. Resolutions are normally passed with a simple majority of the votes cast at the meeting. Under the German Stock Corporation Act, a number of significant resolutions requires a vote with a majority of at least 75% of the share capital present at the meeting. This 75% majority requirement applies in the following instances:

- Amendments to our Articles of Association (except amendments that would change the rights and obligations attaching to our shares, which in addition require the approval of all shareholders concerned);
- Capital increases and decreases;
- Exclusion of preemptive rights in connection with a capital increase;
- The creation of authorized or conditional capital and the issue of convertible bonds and bonds with warrants attached;
- The dissolution of our company;
- Mergers or consolidations of our company with another company and certain other corporate transformations;
- Transfers of all or virtually all of our assets; and
- The approval of domination, profit and loss transfer or similar intercompany agreements.

*Dividend rights*

We may declare and pay dividends only from our annual net income, as they are shown on our balance sheet. Our shareholders participate in profit distributions in proportion to the number of shares that they hold. The payment of dividends requires a proposal by our management board and the approval of that proposal by our supervisory board and our shareholders meeting. We may not allocate more than half of our company s annual surplus to reserves. In determining the amount of profit to be distributed as dividends, however, our shareholders may allocate additional amounts to reserves and may even decide to carry forward our annual net income in part or in full.

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*Liquidation rights*

In case we are liquidated, any liquidation proceeds remaining after our liabilities have been paid off are distributed among our shareholders in proportion to the number of shares held by them.

*Preemptive rights*

Under the German Stock Corporation Act, our shareholders have preemptive rights. Preemptive rights are preferential rights to subscribe for issues of new shares in proportion to the number of shares already held by the relevant shareholder. These rights do not apply to shares issued out of our conditional capital or if a capital increase has occurred and our shareholders have waived their preemptive rights in connection with that increase. Preemptive rights also apply to securities other than shares if they may be converted into shares, such as options, securities with warrants, profit-sharing certificates and securities with dividend rights. The German Stock Corporation Act allows exclusions or restrictions of preemptive rights in connection with capital increases only in limited circumstances and only in the same shareholders resolution that authorizes the capital increase: At least 75% of the share capital represented at the shareholders meeting that is to approve a capital increase has to vote for the exclusion or restriction of preemptive rights in connection with that increase. In addition to being approved by the shareholders, any exclusion or restriction of preemptive rights requires a justification, which our management board has to set forth in a written report to our shareholders. The justification requires a showing that our interest in excluding or restricting preemptive rights has to outweigh the shareholders interest in exercising these rights. If our management board increases our share capital in accordance with our Articles of Association, it may, for example, exclude preemptive rights:

If the newly issued shares are issued against a contribution in kind;

If the newly issued shares represent 10% or less of our existing share capital at the time we register the authorized capital or issue the new shares, and the issue price of the new shares is not substantially less than the stock exchange price as defined under German law; or

To the extent necessary to avoid fractional amounts that may arise in the case of share issuances upon the exercise of preemptive rights.

Under German law, preemptive rights may be transferred separately from the underlying shares and may be traded on any of the German stock exchanges on which our shares are traded until a certain number of days prior to the last date on which the preemptive rights may be exercised.

*Derivative suits*

Under German corporate law, individual shareholders are generally not entitled to bring derivative actions on behalf of or in the interest of our company in case a member of our management or supervisory board violates his or her fiduciary duties. A majority of the votes represented at a shareholders meeting or a minority representing at least 10% of our company s share capital, however, may demand that an action be brought by the management or the supervisory board against a member who has allegedly violated his or her duties. In addition, the shareholders meeting may, with a simple majority of the votes cast, appoint special representatives to bring an action. In special cases, such as when a board member allegedly has acted with gross negligence, the court, at the request of shareholders representing 5% of our company s share capital or shares with a nominal value of € 500,000, can appoint special representatives even if the shareholders meeting has not demanded that an action be brought.

**Disclosure Requirements**

Under Section 21 of the German Securities Trading Act (*Wertpapierhandelsgesetz*), which took effect on January 1, 1995, holders of voting securities of German corporations admitted to official trading on a stock exchange within the European Union or the European Economic Area are obliged to notify promptly and in writing the company in which they hold these securities as well as the German Federal Financial Supervisory Authority (*Bundesanstalt für Finanzdienstleistungsaufsicht*) of the level of their holdings whenever such holdings reach, exceed or fall below certain thresholds. These thresholds are set at 5%, 10%, 25%, 50% and 75% of a company s outstanding shares with voting rights. If a shareholder fails to notify the company as required, he or she is disqualified from exercising the voting rights associated with the shares held by him or her for so long as the default continues.

In July 2002, the German Securities Trading Act was amended to require the reporting of certain directors dealings. Members of the management and supervisory boards of an issuer whose securities

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are admitted for trading on a German stock exchange, or of an entity controlling the issuer, must notify both the issuer and the German Federal Financial Services Authority of any acquisitions and sales of shares of the issuer or of rights with respect to such shares. Transactions are exempt from the notification obligations if the value of the shares acquired or sold over a 30-day period does not exceed € 25,000 or if the acquisition was made under an employment contract or as part of a director s remuneration. This obligation also applies to certain relatives of board members, such as spouses and children. In addition, the issuer must publish on its website all notifications it has received and keep them posted for at least a period of one month. At the date of this annual report, we had not received any such notification from one of our board members or related persons.

In addition, the German Takeover Act (*Wertpapiererwerbs- und Übernahmegesetz*), which came into effect on January 1, 2002, provides that a person who has acquired 30% or more of the voting rights of an issuer whose securities are admitted for trading on a German stock exchange is deemed to have gained control of the issuer and is required to publish this fact and to launch a public tender offer for the outstanding shares.

**Share Repurchases**

We may not repurchase our own shares unless so authorized by a resolution duly adopted by our shareholders at a general meeting or in other very limited circumstances set forth in the German Stock Corporation Act. Any shareholders resolution that authorizes us to repurchase shares may not be in effect for a period longer than 18 months. On May 6, 2003, our shareholders authorized our management board to repurchase up to 14,040,000 shares on or before October 31, 2004. Under this authorization, we may transfer repurchased shares to third parties in connection with our acquisition of or participation in business. Moreover, repurchased shares may be used to satisfy obligations under our various stock option plans or as part of the supervisory board members compensation. The German Stock Corporation Act limits share repurchases to 10% of our share capital. Any resale of repurchased shares must be effected on a stock exchange or in a manner that treats all shareholders equally, unless otherwise approved by the shareholders meeting that authorized the repurchase of the shares.

**Anti-takeover Defenses**

The German Takeover Act provides that, while a tender offer for the shares of a company is underway, the company s management board may not take any action that may have the effect of thwarting the success of the tender offer. Certain defenses, however, are permitted. In particular, the company s management board may: (i) search for a white knight (*i.e.*, a third party that is willing to make a tender offer for the shares); (ii) perform any acts that a diligent and conscientious manager would perform in the absence of a tender offer; (iii) perform any acts that have been approved by the company s supervisory board. In addition, the Act permits the shareholders meeting of the company, provided no tender offer is currently underway, to authorize the company s management board to take any actions that may have the effect of frustrating the success of a future tender offer, so long as the authorization is sufficiently specific and falls within the competence of the shareholders meeting. Any such authorization may remain in effect for a maximum of 18 months. At the date of this annual report, our shareholders have not authorized our management board to take any actions that could delay or prevent a tender offer for the shares of our company.

**Material Contracts**

On January 22, 1997, ALTANA Pharma AG ( ALTANA Pharma ), formerly known as Byk Gulden Lomberg Chemische Fabrik GmbH, a wholly owned subsidiary of ours, entered into a License Agreement with Wyeth, Inc., which was then called American Home Products, acting through its pharmaceutical division, which was then called Wyeth-Ayerst Laboratories ( WA ). For a copy of the full text of the agreement, see Exhibit 4.1 to this annual report.

Under the terms of the agreement, WA and ALTANA Pharma originally collaborated in obtaining regulatory approval for Pantoprazole from the FDA, the costs of which were borne by WA.

The agreement also provided for the grant by ALTANA Pharma to WA of an exclusive license under its patents and know-how relating to Pantoprazole, which includes the right to carry out certain manufacturing tasks with respect to semi-finished Pantoprazole-based products supplied by ALTANA Pharma and to distribute the resulting drugs, either alone or in combination with other active ingredients, in the U.S. market as ethical therapeutics. In addition, it granted WA an option to license Pantoprazole for non-prescription purposes once the period of exclusivity has expired. In return, WA

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agreed to use commercially reasonable efforts to market the finished products and to pay ALTANA Pharma a fixed percentage of WA s net sales of these products, subject to a minimum price specified in the agreement. The agreement defines net sales as the amount billed by WA to third parties for sales of the products less customary cash discounts, trade discounts, sales and other excise taxes as well as allowances or credits to customers on account of settlements of complaints and returns. The parties further agreed that in September of each year, the consideration payable from WA to ALTANA Pharma in the following year would be adjusted in light of exchange rate movements between the Deutsche Mark or its successor currency, the euro, on the one hand, and the U.S. dollar, on the other hand. The amount of the consideration is subject to adjustments in certain other cases as well, for example, upon expiration of the substance patent for Pantoprazole in the United States. In addition, WA undertook not to compete with ALTANA Pharma during the term of the agreement. WA is free, however, to market generic omeprazole in the United States after the expiry of the U.S. substance patent for omeprazole.

The agreement initially runs for a term of 15 years from the first commercial sale by WA of Protonix® or the expiration of the substance patent covering Pantoprazole, whichever occurs later. Both parties may mutually agree to extend the initial term of the agreement for successive three-year periods. Each party has the right to terminate the agreement, among other things, upon insolvency or non-performance by the other party. In addition, WA has the right to terminate the agreement, among other things, if there is a final decision by the FDA preventing the use of Pantoprazole by humans, if third parties initiate a patent infringement suit against WA or ALTANA Pharma and, following the fifth anniversary of the date of approval of the first product based on Pantoprazole, upon one year s prior written notice. ALTANA Pharma in turn is entitled to terminate the agreement, among other things, if WA fails to achieve certain sales targets. If WA terminates the contract for a reason other than ALTANA Pharma becoming insolvent or committing a material breach of the agreement, it is required to transfer all of its rights pertaining to Pantoprazole and to products based on this substance, including any regulatory approvals that it has obtained, to ALTANA Pharma.

## Exchange Controls

At present, Germany does not restrict the transfer of capital between Germany and other countries or persons except Iraq, persons and entities associated with Osama bin Laden, the Al-Qaeda network and the Taliban as well as certain other countries and persons subject to embargoes. These restrictions were established in accordance with resolutions adopted by the United Nations and the European Union.

For statistical purposes, with some exceptions, every corporation or individual residing in Germany must report to the German Central Bank (*Deutsche Bundesbank)* any payment received from or made to a non-resident corporation or individual if the payment exceeds € 12,500 (or the equivalent in a foreign currency). Additionally, corporations and individuals residing in Germany must report to the German Central Bank any claims of a resident corporation or individual against, or liabilities payable to, a non-resident corporation or individual exceeding in the aggregate € 5 million (or the equivalent in a foreign currency) in any calendar month. Resident corporations and individuals are also required to report annually to the German Central Bank any stakes of 10% or more that they hold in corporations incorporated outside of Germany with total assets of more than € 3 million. Corporations residing in Germany with assets in excess of € 3 million must report annually to the German Central Bank any stake of 10% or more in the company held by an individual or a corporation located outside Germany.

Neither German law nor our Articles of Association restrict the right of non-resident or foreign shareholders to hold or vote their shares.

## Taxation

### German Taxation

The following discussion is a summary of the material German tax consequences for beneficial owners of our shares or ADSs (i) who are not German residents for German income tax purposes (*i.e.*, persons whose residence, habitual abode, statutory seat or place of effective management and control is not located in Germany) and (ii) whose shares do not form part of the business property of a permanent establishment or fixed base in Germany. Throughout this section we refer to these owners as Non-German Holders .

This summary is based on German tax laws and typical tax treaties to which Germany is a party as they are in effect on the date hereof and is subject to changes in German tax laws or such treaties.

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This summary also reflects changes applicable to us resulting from the German Tax Reduction Act (which we refer to as the German Tax Reform ) enacted into law in October 2000, the Flood Victim Solidarity Act, which was enacted in September 2002, as well as the 2003 Tax Preference Reduction Act Basket II enacted in December 2003. Most changes resulting from the German Tax Reform were applicable to us with respect to our fiscal year beginning January 1, 2001. The changes resulting from the Flood Victim Solidarity Act were applicable to us with respect to the fiscal year beginning January 1, 2003. The changes resulting from the 2003 Tax Preference Reduction Act- Basket II are generally applicable to us as of the fiscal year beginning January 1, 2004. The following discussion does not purport to be a comprehensive discussion of all German tax consequences that may be relevant for Non-German Holders. You should consult your tax advisor regarding the German federal, state and local tax consequences of the purchase, ownership and disposition of our shares or ADSs and the procedures to follow for the refund of German taxes withheld from dividends.

*Taxation of our Company in Germany*

Before the effective date for the German Tax Reform, German corporations, in general, were subject to corporate income tax at a rate of 40% on retained earnings and 30% on distributed earnings. In addition, a solidarity surcharge was levied at a rate of 5.5% on the net assessed corporate income tax charge. Corporate income tax and the solidarity surcharge, in the aggregate, amounted to 42.2% for retained earnings and 31.65% for distributed earnings.

As a result of the German Tax Reform, German corporations became subject to a corporate income tax rate of 25%. The solidarity surcharge of 5.5% on the net assessed corporate income tax has been retained, so that the corporate income tax and the solidarity surcharge, in the aggregate, amount to 26.375%. The corporate income tax rate was increased by the Flood Victim Solidarity Act from 25% to 26.5% for fiscal 2003 only.

In addition, German corporations are subject to profit-related trade tax on income, the exact amount of which depends on the municipality in which the corporation maintains its business establishment(s). Trade tax on income is a deductible item in computing the corporation s tax base for corporate income tax purposes.

*Taxation of Dividends*

Under the corporate income tax credit system in effect prior to changes enacted under the German Tax Reform, German taxpayers (*i.e.*, individual and corporate shareholders resident in Germany and shareholders whose shares or ADSs form part of the business property of a permanent establishment or fixed base in Germany) who received a dividend were entitled to a tax credit for the underlying German corporate income taxes paid by the distributing German corporation. This credit was not available to Non-German Holders.

One major change resulting from the German Tax Reform was the abolition of the corporate income tax credit system. Dividend distributions paid by us attributable to the fiscal year ending December 31, 2000 or prior years, however, were subject to the corporate income tax credit system. The new system applies to dividend distributions paid by us attributable to the fiscal year ending December 31, 2001 and subsequent years. Under current corporate tax law, a tax credit is no longer available to German taxpayers with respect to such dividends.

Following the German Tax Reform, German corporate tax law generally provided for an exemption comparable to a full dividend-received deduction for inter-corporate dividends received by a German resident corporate shareholder, irrespective of ownership percentage. Under the 2003 Tax Preference Reduction Act Basket II dividends received are effectively 95% tax exempt at the level of the resident corporate German shareholder from the fiscal year beginning January 1, 2004 onwards. German resident individuals must recognize 50% of the dividends received as taxable income.

*Imposition of Withholding Tax*

Dividend distributions made by a German corporation prior to the German Tax Reform effective date were subject to a 25% withholding tax. In addition, a solidarity surcharge at a rate of 5.5% on the withholding tax was levied such that the aggregate withholding from dividends was 26.375% of the declared dividend. For dividend distributions made by us attributable to fiscal years beginning on or after January 1, 2001, the withholding tax is reduced to 20% as a result of the German Tax Reform. The solidarity surcharge of 5.5% on the withholding tax has been retained, resulting in a total withholding from dividends of 21.1%.

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For many Non-German Holders, the withholding tax rate is reduced under applicable income tax treaties. Under most income tax treaties to which Germany is a party, the rate of dividend withholding tax is reduced to 15%. To reduce the withholding to the applicable treaty rate of 15%, a Non-German Holder may apply for a refund of withholding taxes paid. The refund amounts to 11.375% of the declared dividend for dividend distributions withheld at an aggregate 26.375% rate prior to the German Tax Reform effective date and 6.1% of the declared dividend for dividend distributions withheld thereafter at the new rate of 21.1%. The application for refund must be filed with the German Federal Tax Office (Bundesamt für Finanzen, Friedhofstrasse 1, D 53221 Bonn, Germany; http://www.bff-online.de/). The relevant forms can be obtained from the German Federal Tax Office or from German embassies and consulates.

*Special Tax Rules for U.S. Shareholders*

Under the U.S. German Income Tax Treaty (the Treaty ), the withholding tax rate is reduced to 15% of the gross amount of the dividends. As long as the corporate income tax credit system was applicable to dividends paid by us to individual German shareholders, eligible U.S. holders, as defined below under United States Taxation, were entitled to an additional reduction in German dividend withholding tax equal to 5% of the declared dividend. The corporate income tax credit system applied for the last time to German shareholders for dividends paid in respect of fiscal 2000. Therefore, dividend payments by us to an eligible U.S. holder made in 2001 attributable to the fiscal year ended December 31, 2000 or prior years were subject to the additional 5% withholding tax reduction, whereas dividends paid by us in 2002 and thereafter attributable to fiscal 2001 or subsequent years are subject to a 15% general withholding tax rate under the Treaty.

For dividend distributions made by us in 2002 and thereafter, attributable to fiscal 2001 or subsequent years, the dividends are, in the absence of the Treaty, subject to a 20% withholding tax plus a solidarity surcharge of 5.5% on the withholding tax, resulting in an aggregate withholding of 21.1% of the declared dividend. Eligible U.S. holders are entitled to receive a payment from the German tax authorities equal to 6.1% of the declared dividend. Accordingly, for a declared dividend of 100, an eligible U.S. holder initially will receive 78.9 (100 minus the 21.1% withholding tax). The eligible U.S. holder is then entitled to a refund from the German tax authorities of 6.1 and will, as a result, effectively receive a total of 85 (*i.e.*, 85% of the declared dividend). Thus, the eligible U.S. holder will be deemed to have received a dividend of 100, subject to German withholding tax of 15.

*Refund Procedure for U.S. Shareholders*

For shares and ADSs kept in custody with The Depository Trust Company in New York or one of its participating banks, the German tax authorities have introduced a collective procedure for the refund of German dividend withholding tax and the solidarity surcharge thereon on a trial basis. Under this procedure, The Depository Trust Company may submit claims for refunds payable to eligible U.S. holders under the Treaty collectively to the German tax authorities on behalf of these eligible U.S. holders. The German Federal Tax Office will pay the refund amounts on a preliminary basis to The Depository Trust Company, which will redistribute these amounts to the eligible U.S. holders according to the regulations governing the procedure. The German Federal Tax Office may review whether the refund was made in accordance with the law within four years after making the payment to The Depository Trust Company. Details of this collective procedure are available from The Depository Trust Company at +1 212 855 2700 or +1 44 20 7444 0000.

Individual claims for refunds may be made on a special German form which must be filed with the German Federal Tax Office at the address noted above. Copies of this form may be obtained from the German Federal Tax Office at the same address or from the Embassy of the Federal Republic of Germany, 4645 Reservoir Road, N.W., Washington, D.C. 20007 1998. Claims must be filed within a four-year period from the end of the calendar year in which the dividend was received.

As part of the individual refund claim, an eligible U.S. holder must submit to the German tax authorities the original bank voucher (or a certified copy thereof) issued by the paying agent documenting the tax withheld, and an official certification on IRS Form 6166 of its most recent United States federal income tax return. IRS Form 6166 may be obtained by filing a request with the Internal Revenue Service Center in Philadelphia, Pennsylvania, Foreign Certification Request, P.O. Box 16347, Philadelphia, PA 19114 0447. Requests for certification must include the eligible U.S. holder s name, Social Security or Employer Identification Number, tax return form number, and tax period for which the certification is requested. Requests for certifications can include a request to the Internal Revenue Service to send the certification directly to the German tax authorities. If no such

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request is made, the Internal Revenue Service will send a certification on IRS Form 6166 to the eligible U.S. holder, who then must submit this document with his refund claim.

*Capital Gains*

Under German tax law as currently in effect, capital gains derived by a Non-German Holder from the sale or other disposition of shares or ADSs are subject to tax in Germany only if such Non-German Holder has held, directly or indirectly, shares or ADSs representing 1% or more of the registered share capital of the company at any time during the five-year period immediately preceding the disposition. In computing the relevant size of a Non-German Holder s shareholding, shareholdings existing prior to the effective date of the German Tax Reform are also be taken into account. In general, pursuant to the German corporate tax law, corporate Non-German Holders were fully exempt from German tax on capital gains derived on or after January 1, 2002 from the sale or other disposition of shares or ADSs. Under the 2003 Tax Preference Reduction Act- Basket II capital gains are basically only 95% tax exempt at the level of the corporate Non-German Holder from the fiscal year beginning January 1, 2004 onwards.

U.S. holders that qualify for benefits under the Treaty are exempt from taxation in Germany on capital gains derived from the sale or disposition of shares or ADSs.

*Inheritance and Gift Tax*

Under German law, German gift or inheritance tax will be imposed only on transfers of shares or ADSs by a Non-German Holder at death or by way of gift, if

- the decedent or donor, or the heir, donee or other transferee has his residence in Germany at the time of the transfer;
- the decedent or donor, or the heir, donee or other transferee is a citizen of Germany, is not a resident in Germany, but has not been continuously outside of Germany for a period of more than five years; or
- the shares or ADSs subject to such transfer form part of a portfolio that represents 10% or more of the registered share capital of the company and has been held, directly or indirectly, by the decedent or donor, respectively, actually or constructively together with related parties.

The right of the German government to impose inheritance or gift tax on a Non-German Holder may be further limited by an applicable inheritance and estate tax treaty (such as the U.S.-German Inheritances and Gifts Tax Treaty of December 3, 1980).

*Other Taxes*

No German transfer, stamp or similar taxes apply to the purchase, sale or other disposition of shares or ADSs by a Non-German Holder. Currently, net worth tax is not levied in Germany.

**U.S. Taxation**

This section describes the material United States federal income tax consequences of owning and disposing of shares or ADSs to U.S. holders, as defined below. It applies to you only if you hold your shares or ADSs as capital assets for tax purposes. This section does not address all material tax consequences of owning and disposing of shares or ADSs. It does not address special classes of holders, some of whom may be subject to other rules, including:

- tax-exempt entities,
- certain insurance companies,
- broker-dealers,
- traders in securities that elect to mark to market,
- investors liable for alternative minimum tax,

investors that actually or constructively own 10% or more of our voting stock,

investors that hold shares or ADSs as part of a straddle or a hedging or conversion transaction, or

investors whose functional currency is not the U.S. dollar.

This section is based on the Internal Revenue Code of 1986, as amended, its legislative history, existing and proposed regulations, and published rulings and court decisions, as currently in effect, as well as on the Treaty. These laws are subject to change, possibly on a retroactive basis. In addition,

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this section is based in part upon the representations of The Bank of New York, Inc., the depositary for the American Depositary Receipt (or ADR) program, and the assumption that each obligation in the deposit agreement and any related agreement will be performed in accordance with its terms. Based on this assumption, for United States federal income tax purposes, if you hold ADRs evidencing ADSs, you will be treated as the owner of the shares represented by those ADRs. Exchanges of shares for ADRs, and ADRs for shares, generally will not be subject to United States federal income tax.

You are a U.S. holder if you are a beneficial owner of shares or ADSs and you are for United States federal income tax purposes:

a citizen or resident of the United States,

a domestic corporation,

an estate whose income is subject to United States federal income tax regardless of its source, or

a trust if a United States court can exercise primary supervision over the trust s administration and one or more United States persons are authorized to control all substantial decisions of the trust.

*You should consult your own tax advisor regarding the United States federal, state, local and other tax consequences of owning and disposing of shares and ADSs in your particular circumstances. In particular, you should confirm that you are eligible for the benefits under the Treaty with respect to income and gain from the shares or ADSs.*

*Taxation of Dividends*

Under the United States federal income tax laws and subject to the passive foreign investment company rules discussed below, if you are a U.S. holder, the gross amount of any dividend we pay out of our current or accumulated earnings and profits (as determined for United States federal income tax purposes) is subject to United States federal income taxation. If you are a non-corporate U.S. holder, dividends paid to you in taxable years beginning after December 31, 2002 and before January 1, 2009 that constitute qualified dividend income will be taxable to you at a maximum tax rate of 15%, provided that you hold the shares or ADSs for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date and meet other holding period requirements. The Internal Revenue Service recently announced that it will permit taxpayers to apply a proposed legislative change to this holding period requirement as if such change were already effective. This legislative technical correction would change the minimum required holding period, retroactive to January 1, 2003, to more than 60 days during the 120-day period beginning 60 days before the ex-dividend date. Dividends we pay with respect to the shares or ADSs generally will be qualified dividend income.

You must include any German tax withheld from the dividend payment and any additional dividend associated with the Treaty refund in this gross amount even though you do not in fact receive it. You must include the dividend in income when you, in the case of shares, or the depositary, in the case of ADSs, receive the dividend, actually or constructively. The dividend will not be eligible for the dividends-received deduction generally allowed to United States corporations in respect of dividends received from other United States corporations. The amount of the dividend distribution that you must include in your income as a U.S. holder will be the U.S. dollar value of the euro payments made, determined at the spot euro/U.S. dollar rate on the date the dividend distribution is includible in your income, regardless of whether the payment is in fact converted into U.S. dollars. Generally, any gain or loss resulting from currency exchange fluctuations during the period from the date you include the dividend payment in income to the date you convert the payment into U.S. dollars will be treated as ordinary income or loss. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes. Distributions in excess of current and accumulated earnings and profits, as determined for United States federal income tax purposes, will be treated as a non-taxable return of capital to the extent of your basis in the shares or ADSs and thereafter as capital gain.

Subject to certain limitations, the German tax withheld in accordance with the Treaty and paid over to Germany will be creditable against your United States federal income tax liability. Special rules apply in determining the foreign tax credit limitation with respect to dividends that are subject to the maximum 15% tax rate. To the extent a refund of the tax withheld is available to you under German law or under the Treaty, the amount of tax withheld that is refundable will not be eligible

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for credit against your United States federal income tax liability. See German Taxation Dividend Refund Procedure for U.S. Holders , above, for the procedures for obtaining a tax refund. Dividends will be income from sources outside the United States, but generally will be passive income or financial services income , which is treated separately from other types of income for purposes of computing the foreign tax credit allowable to you.

*Taxation of Capital Gains*

Subject to the passive foreign investment company rules discussed below, if you are a U.S. holder and sell or otherwise dispose of your shares or ADSs, you will recognize capital gain or loss for United States federal income tax purposes equal to the difference between the U.S. dollar value of the amount that you realize and your tax basis, determined in U.S. dollars, in your shares or ADSs. Capital gain of a non-corporate U.S. holder that is recognized on or after May 6, 2003 and before January 1, 2009 is generally taxed at a maximum rate of 15% where the holder has a holding period greater than one year. The gain or loss generally will be income or loss from sources within the United States for foreign tax credit limitation purposes.

*Passive Foreign Investment Company Rules*

We believe that our shares and ADSs should not be treated as stock of a passive foreign investment company, or PFIC, for Un ited States federal income tax purposes, but this conclusion is a factual determination that is made annually and thus may be subject to change. If we were to be treated as a PFIC, unless a U.S. holder elects to be taxed annually on a mark-to-market basis with respect to the shares or ADSs, gain realized on the sale or other disposition of your shares or ADSs would in general not be treated as capital gain. Instead, if you are a U.S. holder, you would be treated as if you had realized such gain and certain excess distributions ratably over your holding period for the shares or ADSs and would be taxed at the highest tax rate in effect for each such year to which the gain was allocated, together with an interest charge in respect of the tax attributable to each such year. In addition, dividends that you receive from us will not be eligible for the special tax rates applicable to qualified dividend income if we are a PFIC either in the taxable year of distribution or the preceding taxable year, but instead will be taxable at rates applicable to ordinary income.

If you own shares or ADSs during any year that we are a PFIC, you must file Internal Revenue Service Form 8621.

**Documents on Display**

We are subject to the informational requirements of the Securities Exchange Act of 1934, as amended. In accordance with these requirements, we file reports and other information with the Securities and Exchange Commission. These materials, including this annual report and the exhibits thereto, may be inspected and copied at the Commission s Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the materials may be obtained from the Public Reference Room of the Commission at 450 Fifth Street, N.W., Washington, D.C. 20549 at prescribed rates. The public may obtain information on the operation of the Commission s Public Reference Room by calling the Commission in the United States at 1-800-SEC-0330. Our Securities and Exchange Commission filings made after November 4, 2002 are also available over the Internet at the Securities and Exchange Commission s website at http://www.sec.gov. In addition, material filed by us may be inspected at the offices of the New York Stock Exchange at 20 Broad Street, New York, New York 10005.

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## ITEM 11: QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to market risks resulting from changes in foreign currency exchange rates, interest rates and equity prices that may adversely affect our results of operations and financial condition. We seek to minimize these risks within the framework of our regular operating and financial activities and, to the extent we consider it appropriate, by using derivative instruments. We do not, however, use financial instruments for trading or other speculative purposes.

Generally, each of our subsidiaries is responsible for managing its own risks. Within each subsidiary, the responsibility is centralized within a committee that determines that subsidiary s general hedging strategy. Long-term hedging transactions, however, are agreed with our group headquarters. In 2003, we introduced a uniform hedging strategy for our main currency exposures. Decisions taken by a subsidiary s hedging committee are implemented by the respective subsidiary s corporate treasury department. Corporate treasury is responsible for assessing, consolidating and managing the risk exposure through transactions with banks and other international financial institutions. The management board of each of our subsidiaries regularly receives updates on decisions taken by the respective subsidiary s committee as well as on the actions taken by corporate treasury to implement these decisions. In most of our subsidiaries, brief liquidity reports are prepared on a daily basis, and risk reports are made available monthly. Consolidated risk reports for our pharmaceuticals and chemicals divisions are compiled monthly.

Guidelines for risk assessment procedures and controls for the use of derivative financial instruments are established on a group-wide basis. These guidelines provide for a clear segregation of duties with regard to execution on the one hand and administration, accounting and controlling on the other.

### Transaction Risk and Currency Risk Management

As a result of the global nature of our business, our operations, our reported financial results and our cash flows are exposed to risks associated with fluctuations in the exchange rates between the euro, the U.S. dollar and other major currencies. We are exposed to transaction risk whenever we achieve revenues that are denominated in a currency other than the currency in which we incur the costs associated with these revenues. This risk exposure affects both our pharmaceuticals and chemicals divisions. Each of our divisions revenues are typically denominated in the currencies of the countries in which these divisions sell their products, whereas their manufacturing costs are partially denominated in euro. Cash inflows and outflows of transactions are netted if they are denominated in the same currency. Therefore, only the unmatched amounts are subject to transaction risk. Our exposure to transaction and currency risk is essentially confined to our overseas business, as transaction risk with respect to currencies of participating EU member states was eliminated following the introduction of the euro on January 1, 1999.

The principal derivative financial instruments that we use in order to hedge foreign currency denominated assets, liabilities, firm commitments and forecasted transactions are forward foreign exchange contracts. In 2003, we complemented our hedging strategy using currency options. We determine the maturity dates of these forward contracts in light of our anticipated cash flows.

As of December 31, 2001, 2002 and 2003, we were party to forward foreign exchange contracts with nominal values of € 75.4 million, € 68.5 million and € 444.6 million, respectively. The nominal value of our currency options at December 31, 2003 was € 148.6 million.

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We enter into derivative financial instruments denominated in the currencies of the markets with respect to which we are subject to transaction risk. The following table sets forth information relating to our forward foreign exchange contracts for 2001, 2002 and 2003. For the reasons stated above, only the risks arising from the exchange rates of the major currencies are listed.

| 2001 | Effective hedge rate(1) | Change(2) | Market average(3) | Change(2) | Year end spot rate(3) | Change(2) |
|---|---|---|---|---|---|---|
| | | ( % ) | | ( % ) | | (%) |
| U.S. dollar | 0.897 | 3.1 | 0.896 | 3.0 | 0.881 | 5.3 |
| British pound | 0.638 | 1.9 | 0.622 | 2.0 | 0.609 | 2.5 |
| Japanese yen | 107.6 | 8.7 | 108.7 | 9.7 | 115.3 | 7.9 |

| 2002 | Effective hedge rate(1) | Change(2) | Market average(3) | Change(2) | Year end spot rate(3) | Change(2) |
|---|---|---|---|---|---|---|
| | | ( % ) | | ( % ) | | (%) |
| U.S. dollar | 0.930 | 3.7 | 0.941 | 5.1 | 1.049 | 19.0 |
| British pound | 0.621 | (2.7) | 0.628 | 1.0 | 0.651 | 6.8 |
| Japanese yen | 114.6 | 6.5 | 118.0 | 8.6 | 124.4 | 7.9 |

| 2003 | Effective hedge rate(1) | Change(2) | Market average(3) | Change(2) | Year end spot rate(3) | Change(2) |
|---|---|---|---|---|---|---|
| | | (%) | | ( % ) | | (%) |
| U.S. dollar | 1.099 | 21.6 | 1.128 | 19.9 | 1.263 | 20.4 |
| British pound | 0.675 | 9.7 | 0.692 | 10.0 | 0.705 | 8.3 |
| Japanese yen | 128.8 | 12.7 | 130.8 | 10.8 | 135.0 | 8.6 |

(1) The effective rates set forth in the table represent the average of all hedging transactions that matured during the periods indicated.
(2) The percentage changes indicate the differences between the figures set forth in the respective column of each table and the figures stated in the corresponding columns of the previous year s table
(3) The rates for the foreign currencies shown are consistent with the rates used for the preparation of ALTANA AG financial statements as described in this report (see Item 3: Key Information ).

Effective January 1, 2001, we adopted IAS 39 (rev. 2000), which requires the recognition of all financial assets and liabilities, as well as all derivative instruments, as assets or liabilities in the balance sheet and, generally, requires that all financial instruments be measured at fair value, regardless of our intent. Changes in the fair value of derivative instruments are recognized in income or shareholders equity (as a revaluation reserve), depending on whether the relevant derivative is designated as a fair value or cash flow hedge. For derivatives designated as fair value hedges, changes in fair value of the hedged item and the derivative are recognized currently in the income statement. For derivatives designated as a cash flow hedge, changes in the fair value of the effective portion of the hedging instrument are recognized in equity (the revaluation reserve) until the hedged item is recognized in the income statement. The ineffective portion of the fair value changes and fair value changes of derivatives that do not qualify for hedge accounting are recognized in the income statement immediately. In 2003, we expanded the scope of our hedging strategy by starting to hedge forecasted foreign currency transactions. As a result, the degree to which we recognize unrealized gains and losses in a special revaluation reserve increased compared with prior periods.

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The following table provides an overview of our foreign currency forward contracts at December 31, 2001, 2002 and 2003:

**Foreign Currency Risk**

| Derivative financial instruments(1) | December 31, 2001 | 2002 | 2003 |
|---|---|---|---|
| **Sales of currencies against euro** | | | |
| **U.S. dollar** | | | |
| Notional amount (2) | 64.763 | 62.186 | 571.63 |
| Average contract rate (currency/euro) (3) | 0.89 | 0.99 | 1.178 |
| Fair value (2) | (0.752) | 3.534 | 37.40 |
| **Japanese yen** | | | |
| Notional amount (2) | 2.462 | 1.901 | 12.96 |
| Average contract rate (currency/euro) (3) | 109.00 | 121.00 | 129.59 |
| Fair value (2) | 0.127 | (0.048) | 0.345 |
| **British pound** | | | |
| Notional amount (2) | 0.986 | 4.366 | 8.596 |
| Average contract rate (currency/euro) (3) | 0.60 | 0.62 | 0.70 |
| Fair value (2) | (0.017) | 0.214 | 0.005 |

(1) Comprises foreign currency forward contracts and foreign currency options.
(2) Euro equivalent in millions of euro.
(3) The effective rates shown represent the average of all hedging transactions for each specific currency entered into in the year shown.

**Exchange Rate Sensitivity**

Because we enter into derivative foreign exchange transactions for our contracted foreign exchange exposure, fluctuations in the exchange rates of the euro relative to other major currencies should not, in the short term, materially affect our cash flows. However, if we are unable to reflect the effect of exchange rate movements in the pricing of our products, our cash flows could be materially affected in the long term. An appreciation of the euro relative to other currencies would have an adverse effect on our reported revenues and results, whereas a devaluation of the euro should have a positive effect.

**Effects of Currency Translation**

Since our financial reporting currency is the euro, we translate the income statements of those of our subsidiaries that are located outside the euro zone before including them in our consolidated financial statements. Thus, period-to-period changes in average exchange rates can significantly affect the translation into euro of both revenue and operating income denominated in foreign currencies. Unlike the effect of exchange rate fluctuations on transaction exposure, the effect of exchange rate translation exposure does not affect our local currency cash flows.

While we have assets and operations outside of Germany, which are denominated in local currencies, the foreign currency risk arising from foreign investments is partially offset by related liabilities denominated in the same local currency.

**Interest Rate Exposure and Equity Price Risk**

We hold a variety of interest rate-sensitive financial instruments, mainly as financial investments, some of which we use to manage the liquidity and daily cash needs of our business. Responsibility for assessing, consolidating and managing our financial investments is centralized within a committee at the holding company level. We manage the interest rate risk arising from these financial instruments through risk management and controlling functions in cooperation with banks and other financial institutions. The reporting process that we use for this purpose functions

independently of our corporate treasury department.

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The tables below provide information concerning our principal financial instruments that are sensitive to changes in interest rates and equity price risk. They do not include information on short-term liabilities. Furthermore, unlike the presentation in our consolidated financial statements, where the individual assets of our wholly-owned funds have been consolidated, the presentation below shows these funds on an unconsolidated basis since the fund management is outsourced. The table below presents notional amounts and the principal cash flows by expected maturity dates in 2001, 2002 and 2003, respectively. Since the euro is our reporting currency, the numbers are presented in euro equivalents.

**As of December 31, 2001**

| Interest Rate and Equity Price Risk | 2002 | 2003 | 2004 | 2005 | 2006 | There-after | Total | Fair Value(1) |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Fixed interest securities (2) | 5.113 | 22.956 | 5.613 | 0.350 | 0.801 | 11.337 | 46.170 | 45.929 |
| Fixed interest rate (%)(3) | 4.10 | 4.11 | 4.17 | 4.90 | 4.50 | 6.42 | 4.70 | |
| Floating rate notes (2) | 10.226 | | | | | 10.000 | 20.226 | 20.256 |
| Equity (2) | | | | | | | 17.707 | 17.707 |
| Special funds (2) | | | | | | | 219.855 | 221.274 |
| **Liabilities** | | | | | | | | |
| Fixed interest loans (2) | 22.737 | 14.645 | | | | 23.207 | 60.589 | 60.589 |
| Fixed interest rate (%)(3) | 0.68 | 5.28 | | | | 4.94 | 3.42 | |
| Employees profit-sharing certificates (2) | | | | | | | 8.672 | 8.672 |

(1) Financial instruments where a fair value is not available from market data or where we are not able to calculate a fair value on our own due to unpredictable parameters are shown with their nominal values.
(2) Euro equivalent in millions of euro.
(3) The interest rates shown represent the average of the interest received or paid in the year shown.

**As of December 31, 2002**

| Interest Rate and Equity Price Risk | 2003 | 2004 | 2005 | 2006 | 2007 | There-after | Total | Fair Value(1) |
|---|---|---|---|---|---|---|---|---|
| **Assets** | | | | | | | | |
| Fixed interest securities (2) | 13.05 | 5.41 | 0.30 | 10.60 | 0.60 | 4.50 | 34.46 | 34.49 |
| Fixed interest rate (%)(3) | 3.54 | 3.40 | 3.40 | 3.37 | 1.47 | 1.0 | 3.09 | |
| Floating rate notes (2) | 31.56 | | | | | 25.27 | 56.83 | 55.52 |
| Equity (2) | | | | | | | 36.68 | 32.46 |
| Special funds (2) | | | | | | | 205.97 | 205.99 |
| **Liabilities** | | | | | | | | |
| Fixed interest loans (2) | 4.969 | 2.430 | 2.217 | 2.346 | 2.162 | 8.210 | 22.334 | 22.334 |
| Fixed interest rate (%)(3) | 4.63 | 4.93 | 4.93 | 4.97 | 5.07 | 5.11 | 4.95 | |
| Floating interest loans (2) | 52.54 | | | | | | 52.54 | 52.54 |
| Employees profit-sharing certificates (2) | | | | | | | 8.553 | 8.553 |

(1) Financial instruments where a fair value is not available from market data or where we are not able to calculate a fair value on our own due to unpredictable parameters are shown with their nominal values.
(2) Euro equivalent in millions of euro.

(3) The interest rates shown represent the average of the interest received or paid in the year shown.

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| Interest Rate and Equity Price Risk | As of December 31, 2003 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2004 | 2005 | 2006 | 2007 | 2008 | There-after | Total | Fair Value(1) |
| **Assets** | | | | | | | | |
| Fixed interest securities (2) | 10.04 | 10.86 | 10.86 | 2.00 | 2.55 | 12.00 | 48.31 | 48.59 |
| Fixed interest rate (%)(3) | 3.12 | 3.01 | 2.94 | 2.85 | 3.11 | 3.60 | 3.16 | |
| Floating rate notes (2) | 7.40 | 0.90 | 1.20 | 1.45 | 1.95 | 47.44 | 60.34 | |
| Equity (2) | | | | | | | 43.92 | 43.92 |
| Special funds (2) | | | | | | | 210.14 | 210.14 |
| **Liabilities** | | | | | | | | |
| Fixed interest loans (2) | (2.36) | 1.15 | 1.45 | 1.46 | 1.95 | 20.62 | 24.27 | 24.27 |
| Fixed interest rate (%)(3) | 2.93 | 2.95 | 2.97 | 3.98 | 3.98 | 3.98 | 3.98 | |
| Floating interest loans (2) | 25.59 | | | | | | 25.59 | 25.59 |
| Employees profit-sharing certificates (2) | | | | | | | 8.252 | 8.252 |

(1) Financial instruments where a fair value is not available from market data or where we are not able to calculate a fair value on our own due to unpredictable parameters are shown with their nominal values.
(2) Euro equivalent in millions of euro.
(3) The interest rates shown represent the average of the interest received or paid in the year shown.

For 2001, 2002 and 2003 the fair value of all liabilities to banks and other financial institutions arising from normal business, excluding the employees profit-sharing certificates, aggregated to € 118.0 million, € 108.0 million and € 88.2 million, respectively. The sum of all liabilities in 2001, 2002 and 2003 was € 126.7 million, € 116.5 million and € 96.5 million, respectively.

The fair value risk to our portfolio of interest and equity-sensitive financial instruments in 2001, 2002 and 2003 was on average € 304.6 million, € 328.5 million and € 362.3 million, respectively. The fair value of interest rate-sensitive financial instruments increased from € 90.0 million in 2002 to € 108.2 million in 2003. The fair value risk to our portfolio of equity securities as of December 31, 2001, 2002 and 2003 remained nearly constant at € 238.5 million, € 238.5 million and € 254.1 million, respectively.

For our primary financial instruments, the weighted average interest rates in 2001, 2002 and 2003 were 4.16%, 3.96% and 2.66%, respectively.

**Commodity Price Risk**

We do not use derivatives in order to hedge ourselves against movements in the value of commodities. Therefore, rising commodity prices would have an adverse effect on our reported revenues and results, while falling prices should have a positive effect.

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**ITEM 12: DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

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## PART II

## ITEM 13: DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES

None.

## ITEM 14: MATERIAL MODIFICATIONS TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS

None.

## ITEM 15: CONTROLS AND PROCEDURES

Our management, with the participation and under the supervision of our chief executive officer (CEO) and chief financial officer (CFO), performed an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of December 31, 2003. Our disclosure controls and procedures are designed to ensure that all material financial and non-financial information required to be disclosed in documents filed or submitted by us with the Securities and Exchange Commission is recorded, processed, summarized and reported in a timely manner. In evaluating our disclosure controls and procedures, our management recognized that any controls and procedures, no matter how well designed and operated, can provide only reasonable, rather than absolute, assurance of achieving the desired objectives. Based on the foregoing, our CEO and CFO concluded that our disclosure controls and procedures are effective. In 2003, we rolled out a new group-wide financial reporting IT system. Other than that, there have been no changes in our internal control over financial reporting or in other factors that have materially affected or are reasonably likely to affect our internal control over financial reporting.

## ITEM 16A: AUDIT COMMITTEE FINANCIAL EXPERT

On May 6, 2003, our supervisory board determined that Dr. Klaus-Jürgen Schmieder qualifies as an audit committee financial expert within the meaning of Section 407 of the Sarbanes-Oxley Act of 2002.

## ITEM 16B: CODE OF ETHICS

On November 18, 2003, our audit committee adopted a code of ethics within the meaning of Section 406 of the Sarbanes -Oxley Act of 2002 that applies to the members of our management board, our principal accounting officer and to the chief financial officer of each of our two divisions. See Exhibit 11.1 to this annual report for a copy of this code of ethics.

## ITEM 16C: PRINCIPAL ACCOUNTANT FEES AND SERVICES

The following table provides an overview of the fees billed by KPMG, our principal accountant in respect of 2002, and PwC, our principal accountant in respect of 2003, for professional services performed in respect of 2002 and 2003, respectively.

**Principal Accountant Fees and Services(1)**

| | Year ended December 31, | |
|---|---|---|
| | 2002 | 2003 |
| | (€ in thousands) | |
| Audit fees | 4,463 | 3,009 |
| Audit-related fees | 138 | 696 |
| Tax fees | 233 | 152 |
| All Other fees | 203 | 3 |
| **Total** | **5,038** | **3,860** |

(1) Columns may not add due to rounding.

The above table sets forth the aggregate fees billed by KPMG in respect of 2002 and PwC in respect of 2003 for services performed in connection with the preparation of our company s consolidated and unconsolidated financial statements for each of these years ( Audit Fees ); audit and related services usually undertaken in connection with the preparation of audited financial statements

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( Audit-Related Fees ); services related to ongoing tax compliance, planning and advice ( Tax Fees ); as well as certain other audit and tax unrelated services ( All Other Fees ).

Our shareholders meeting is responsible for electing and dismissing our auditor. In doing so, it relies on proposals submitted to it by our supervisory board and our audit committee. Our audit committee, in turn, is responsible for engaging the auditor, setting the terms of the engagement and administering the engagement on a day-to-day basis. Our audit committee has adopted policies and procedures for the approval of audit and non-audit services to be performed by our principal accountant. According to these policies and procedures, a number of audit, audit-related, tax and other services have been pre-approved by our audit committee, subject to certain limits. Specifically, the pre-approval policies and procedures provide that in any given year there shall be a reasonable relationship between fees charged for audit and audit-related services on the one hand and tax and other services on the other hand. The audit committee is required to monitor this relationship on an ongoing basis and to take it into account in approving specific services. In addition, the pre-approval policies and procedures provide that the audit committee is responsible for agreeing the fees charged by the auditor for the audit of our financial statements. All other fees may be agreed by our management, subject to certain monetary limits set forth in the pre-approval policies and procedures. If the fees charged for a specific service are expected to exceed these limits, the auditor is required to notify our chief financial officer as soon as possible, who will in turn notify the chairman of the audit committee and seek to obtain specific approval of the service in question. Each year, all services provided on the basis of our pre-approval policies and procedures, together with information on the fees charged for these services, must be communicated to the audit committee at the meeting at which it discusses our audited financial statements for that year. Services not covered by these policies and procedures require separate approval by the audit committee on a case-by-case basis. If such a service is required to be provided on short notice and the audit committee is unable to convene in a timely manner, the chairman of the audit committee may approve the service. Our pre-approval policies and procedures also provide that the audit committee shall take measures to monitor the work of our auditor and to ensure that it remains independent with respect to our company. In doing so, it is required to, among other things, review the auditor s relationship with our company and discuss the internal processes and methods the auditor has put in place to ensure that it remains independent.

**ITEM 16D: EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Not yet applicable.

**ITEM 16E: PURCHASES OF EQUITY SECURITIES BY THE ISSUER AND AFFILIATED PURCHASERS**

Not yet applicable.

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**PART III**

**ITEM 17: FINANCIAL STATEMENTS**

Not applicable.

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**ITEM 18: FINANCIAL STATEMENTS**

See our consolidated financial statements beginning at page F-1.

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**ITEM 19: EXHIBITS**

| Exhibit | Description |
|---|---|
| 1.1 | English translation of Articles of Association of ALTANA Aktiengesellschaft, as in effect on July 9, 2003 (incorporated by reference to Exhibit 99.1 of the Registrant s Report on Form 6-K dated September 24, 2003) |
| 4.1 | License Agreement between Byk Gulden Lomberg Chemische Fabrik GmbH and Wyeth Corporation, dated January 22, 1997 and amendments thereto (incorporated by reference to Exhibit 4.1 of the Registrant s Registration Statement on Form 20-F (File No. 1-31325)) |
| 8.1 | List of Significant Subsidiaries (see Item 4: Information on the Company Significant Subsidiaries ) |
| 11.1 | Code of Ethics for the Members of ALTANA Aktiengesellschaft s Management Board, its Principal Accounting Officer and Other Officers |
| 12.1 | Certifications pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 13.1 | Certifications pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 14.1 | Consent by KPMG Deutsche Treuhand-Gesellschaft AG Wirtschaftsprüfungsgesellschaft |
| 14.2 | Consent by PwC Deutsche Revision Aktiengesellschaft Wirtschaftsprüfungsgesellschaft |

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this registration statement on its behalf.

Date: April 21, 2004 ALTANA Aktiengesellschaft

By: /S/ NIKOLAUS SCHWEICKART
Dr. Nikolaus Schweickart
Chairman of the Management Board and
Chief Executive Officer

/S/ HERMANN KÜLLMER
Dr. Hermann Küllmer
Member of the Management Board and
Chief Financial Officer

**ALTANA AG**

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**ALTANA AG**

**Independent auditors report**

To the Management Board of
ALTANA Aktiengesellschaft:

We have audited the accompanying consolidated balance sheets of Altana AG (the Company ), Bad Homburg vor der Höhe, as of December 31, 2003, and the related consolidated statements of income, stockholders equity and cash flows. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company at December 31, 2003, and the results of its operations and its cash flows for the year then ended in conformity with International Financial Reporting Standards of the IASB (IFRS).

Accounting principles generally accepted under IFRS vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Note 33 to the consolidated financial statements.

Frankfurt, Germany
March 2, 2004

PwC Deutsche Revision
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

| | |
|---|---|
| Eberhard Dreissig | ppa. Martin Beyersdorff |
| Wirtschaftsprüfer | Wirtschaftsprüfer |
| [German Public Auditor] | [German Public Auditor] |

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**ALTANA AG**

**Independent auditors report**

To the Management Board of
ALTANA Aktiengesellschaft:

We have audited the accompanying consolidated balance sheet of ALTANA Aktiengesellschaft and subsidiaries as of December 31, 2002, and the related consolidated income statements, statements of changes in shareholders equity, and statements of cash flows for the years ended December 31, 2002 and 2001. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatemen