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In the Matter of Mechanical and Digital Phonorecord Delivery Rate Adjustment Proceeding	Docket No. 2006-3 CRB DPRA

THE WRITTEN DIRECT STATEMENT, WITNESS STATEMENTS & EXHIBITS OF NATIONAL MUSIC PUBLISHERS' ASSOCIATION, INC., THE SONGWRITERS GUILD OF AMERICA, AND THE NASHVILLE SONGWRITERS ASSOCIATION INTERNATIONAL

VOLUME XVI

Filed on April 10, 2007

EXHIBIT CO 0920

ANNUAL REPORT 2004

RTL GROUP
RANDOM HOUSE
GRUNER + JAHR
BMG
ARVATO
DIRECT GROUP

BERTELSMANN

media worldwide

Bertelsmann Financial Highlights in € millions

	IFRS 2004	IFRS 2003	IFRS 2002	IFRS Pro forma 2001	IFRS 7/1/–12/31/ 2001
I Business Development					
Revenues	17,062	16,801	18,312	18,979	9,685
Operating EBIT	[illegible]	–	–	–	–
Operating EBITA	[illegible]	1,123	936	573	164
Net income before minority interest	1,217	208	968	1,378	931
Investments	930	761	5,263	2,639	1,057
Total assets	20,970	20,184	22,168	23,734	23,734
Personnel costs	[illegible]	4,151	4,554	4,812	2,343
II Equity					
Subscribed capital	1,000	606	606	606	606
Retained earnings	8,510	6,060	6,079	5,697	5,697
Minority interest	1,336	965	1,059	2,081	2,081
Equity	8,846	7,631	7,744	8,384	8,384
As percentage of total assets	42	38	35	35	35
Economic debt[1]	2,632	–	–	–	–
Leverage factor[2]	1.6	–	–	–	–
Net financial debt	[illegible]	820	2,741	859	859
Debt payback factor[3]	[illegible]	0.6	2.5	2.9	–
III Net Income					
Net income before minority interest	1,217	208	968	1,378	931
Net income after minority interest	1,032	154	928	1,235	949
Dividend Bertelsmann AG	[illegible]	220	240	–	300
IV Employees (in absolute numbers)					
Germany	27,350	27,064	31,712	31,870	31,870
Other countries	49,916	46,157	48,920	48,426	48,426
Total	76,266	73,221	80,632	80,296	80,296
Profit participation payments	[illegible]	76	77	77	39
Employee profit sharing	29	29	34	–	19

1) Net financial debt plus provisions for pensions and profit participation capital
2) Economic debt / Operating EBITDA (after modifications)
3) Net financial debt / Cash Flow

ANNUAL REPORT

January 1 through December 31, 2004

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Dear Friends of Bertelsmann,

The year 2004 was a good one for Bertelsmann. Despite tough market conditions, we significantly improved operating results and return on sales. Many of our most important businesses showed renewed growth and we were able to demonstrate anew our company's innovative strength.

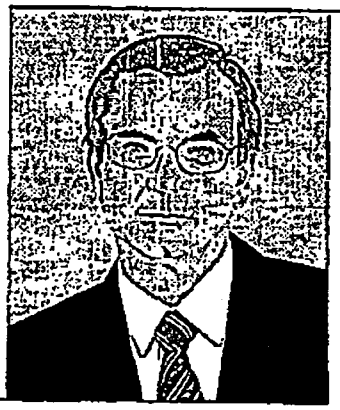
In 2004, Bertelsmann met or exceeded all its targets. In 2005, we continue resolutely on this successful path.

In the last Annual Report, I presented GAIN, our Growth and Innovation Initiative to promote quality, creativity and renewal. We have put this initiative at the center of our entrepreneurial actions to enable us to achieve organic growth in revenues and earnings in the years ahead.

This strategy has been an immediate success. Roughly 100 new business ideas with a medium-term revenue potential of around €1 billion are currently on the Bertelsmann GAIN agenda. Our divisions around the world developed new ideas, innovative products and services. The Executive Board has earmarked additional funds for investment in these endeavors.

All corporate divisions have made it their goal to grow and continue to improve results. Their strategies are widely diversified. For instance, in light of the increasing fragmentation of the TV markets, RTL Group plans to establish more clusters, or "families" of channels. At the same time, broadening its portfolio will reduce dependence on advertising sales. As a complement to its strong businesses in Germany and France, RTL Group is getting involved in new TV markets. One example is Croatia, where RTL Televizija has had an excellent start. In Germany, the first interactive dating channel was launched: "Traumpartner TV" invites viewers on a quest for their dream partner to participate in TV chats by sending SMS and MMS messages.

Arvato, our international media services group, will invest in additional countries and new lines of business. The success of Arvato Mobile is one example of our rapid response to impending market changes. The company identified the trend toward multimedia usage of mobile phones early on. Today, Arvato Mobile offers a variety of services related to the digital distribution of content, such as music, videos, games, images, and ringtones. Arvato is also focused on building a platform for downloading media products to mobile phones. Arvato's special skills – custom-tailored ser-



DR. GUNTER THIELEN
Bertelsmann AG Chairman & CEO

vices and customer focus – are in areas that present many interesting new avenues for growth.

The achievements of Gruner + Jahr verify that the creation and distribution of top-notch media content remains our vital core business. G+J launched more than 20 new titles last year. The performance at Prisma Presse in France was nothing short of sensational: its decision to publish bi-weekly TV guides for the first time in the country's history resulted in France's most successful magazine launch ever. "Télé 2 Semaines" has since become a fixture in the French market with 1.4 million copies sold per issue, while its sister publication "TV Grandes Chaînes" has circulation of over a million copies. In Germany, "Neon" magazine was named a "Newcomer of the Year," and in The Netherlands "Quest" magazine was hailed as "Launch of the Year."

Achieving growth often entails striking new paths. Throughout our long history, we have learned that taking non-traditional strategic and creative approaches in our businesses can result in major successes. The leadership of the Random House Group in the U.K. recently delivered an excellent example. Several of their imprints published Mark Haddon's novel "The Curious Incident of the Dog in the Night-time" in two different editions, one set for children and another one for adults. As a result, the author won the "British Book Award 2004" in two categories. To date, Random House has sold nearly two million copies of the book in the U.K. and almost four million copies worldwide. Another example is Random House's decision to become a major publisher for the international market of comic-style illustrated Japanese "Manga" novels, thereby opening a potential readership for them with a whole new, broader adult target audience in the Western world.

Direct Group, too, is putting new ideas into practice: one example is Yourmusic.com. The members of this Internet-based music club receive the CD of their choice each month, plus access to several thousand titles at the same low price. The Círculo de Lectores book club in Spain has further strengthened its role as a cultural institution through brand-building activities. These include recruiting honorary celebrity members, opening new cultural centers, and setting up its own foundation. France Loisirs is catering to new target groups as well. Recently opened media stores known as "Place Media" are a combination of club store, bookstore, multimedia store, and photo shop in an easy-to-shop atmosphere. Direct Group initiated its expansion in Eastern Europe with the acquisition of a profitable family media club in the Ukraine.

We strive to recruit and retain the most talented people in media. This includes editors, authors, musicians, and producers as well as executives, the latter whom Bertelsmann gives extensive entrepreneurial freedom. The principle of decentralization and delegation of responsibility is an essential element in Bertels-

"Achieving growth often entails striking new paths. Throughout our long history, we have learned that taking non-traditional strategic and creative approaches in our businesses can result in major successes."

mann's corporate culture. We firmly believe that cultivating an environment where entrepreneurs can flourish leads to vibrancy, innovation and growth.

Where outstanding creative and entrepreneurial minds are at work, there are innovative and inspired ideas in development – which is why we encourage all our employees to keep learning and continue their professional education. At the executive level, Bertelsmann University provides a valuable platform for sharing best practices. Bertelsmann's 76,000 plus employees have the opportunity to pursue personal development in their work as well. Qualification is one of the keys to long-term job security, so we offer a modern and comprehensive range of opportunities for education and skills enhancement.

The year 2004 was also one in which the group took important strategic steps to strengthen its structure and portfolio, with a focus on the challenges ahead.

In July, the European Commission approved the merger between Sony Music and BMG without conditions. The merger between the recorded music units was finalized on August 5, 2004. Thanks to many top positions on the international charts and a vast number of awards, we were able to bring BMG into the joint venture on excellent terms. With its 50-percent stake in Sony BMG Music Entertainment, Bertelsmann commands a leading position in the global music market. Sony BMG does business in a highly competitive music market threatened by counterfeits. The merger with Sony Music was the right step to meet this challenge: We believe that the joint venture has already made our music business much more competitive.

Beyond the joint venture with Sony, Bertelsmann Music Group will continue its highly successful music publishing business as a separate company. Composers and songwriters signed with BMG Music Publishing held top slots in the world's major music markets nearly every week last year.

The planned gravure joint venture between Gruner + Jahr, Arvato and Axel Springer AG has brought us a big step further after one of our most complex transactions in recent years. The joint venture will include the printing operations in Ahrensburg, Darmstadt, Dresden, Itzehoe and Nuremberg, as well as the printing plant currently under construction in Liverpool. Pending the EU Commission's approval, this will be a future-proof pan-European company.

Last year, Gruner + Jahr acquired a majority stake in Motor-Presse Stuttgart, a deal that is still subject to antitrust approval. With a revenue share of 60 percent outside Germany, Gruner + Jahr already is Europe's most international magazine publisher. This acquisition adds a number of countries in which Motor-Presse already does business but where G+J is not yet represented, e.g. Brazil, Mexico, Argentina, the Czech Republic, Portugal, and Switzerland.

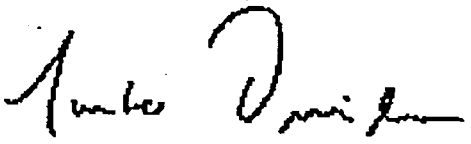
"We strive to recruit and retain the most talented people in media. This includes editors, authors, musicians and producers as well as executives."

We have set important goals for 2005 and will continue to systematically increase our return on sales, and safeguard jobs by generating stable earnings. We still have plenty of opportunities in Europe, which we will undertake for further growth. The U.S., as the world's biggest media market, remains an important one for Bertelsmann. We will also continue our internationalization strategy, especially in Eastern Europe and Asian markets.

Our experienced management continues to embrace the challenges we confront. We are in excellent shape for the future, with dedicated employees and cooperative workers councils all working together to successfully bring Bertelsmann into the next phase of our Growth and Innovation Initiative.

I thank you for your interest in Bertelsmann.

Yours,



Gunter Thielen

THE EXECUTIVE BOARD OF BERTELSMANN AG

DR. GUNTER THIELEN

Member of the Bertelsmann AG Executive Board since July 1, 1985, Chairman of the Bertelsmann AG Executive Board and Chief Executive Officer since August 5, 2002, Gütersloh. Born August 4, 1942 in Quierschied (Germany).

DR. SIEGFRIED LUTHER

Member of the Executive Board since July 1, 1990, Vice Chairman of the Executive Board since August 5, 2002, Chief Financial Officer and Head of the Bertelsmann AG Corporate Center, Gütersloh. Born August 5, 1944 in Hobeck (Germany).

DR. BERND KUNDRUN

Member of the Bertelsmann AG Executive Board and Chairman of the Gruner + Jahr AG Executive Board since November 1, 2000, Hamburg. Born November 8, 1957 in Wuppertal (Germany).

PETER OLSON J.D./MBA

Member of the Bertelsmann AG Executive Board since April 1, 2001, Chairman and Chief Executive Officer of Random House, New York. Born May 1, 1950 in Chicago (USA).

HARTMUT OSTROWSKI

Member of the Bertelsmann AG Executive Board and Chairman of the Bertelsmann Arvato AG Executive Board since September 1, 2002. Gütersloh. Born February 25, 1958 in Bielefeld (Germany).

ROLF SCHMIDT-HOLTZ

Member of the Bertelsmann AG Executive Board since July 1, 2000, Chairman and Chief Executive Officer of the Bertelsmann Music Group (BMG), Chief Creative Officer of Bertelsmann AG, Hamburg and New York. Born August 31, 1948 in Martinsreuth (Germany).

DR. EWALD WALGENBACH

Member of the Bertelsmann AG Executive Board since February 6, 2002, Chief Executive Officer of Direct Group Bertelsmann. Gütersloh. Born February 10, 1959 in Neustadt/Wied (Germany).

GERHARD ZEILER

Chief Executive Officer of RTL Group, permanent guest on the Bertelsmann AG Executive Board. Born July 20, 1955 in Vienna (Austria).

MANAGEMENT REPORT
CORPORATE GOVERNANCE
SUPERVISORY BOARD REPORT

MANAGEMENT REPORT / CORPORATE GOVERNANCE / SUPERVISORY BOARD REPORT

MANAGEMENT REPORT

In 2004, Bertelsmann strengthened its market position and increased profitability against market developments that were restrained overall. Operating EBIT rose to €1,429 million (previous year: €1,026 million). At €17.0 billion, 2004 revenues were up from the previous year's figure of €16.8 billion. Operating return on sales rose to 8.4 percent (previous year: 6.1 percent). Net income before minority interest amounted to €1,217 million, after €208 million in 2003. Bertelsmann delivered a gratifying overall business performance.

Business and Strategy

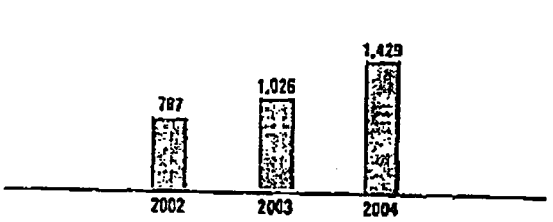
The global economy showed a marked recovery, which slowed down over the course of the year due to steep increases in the price of raw materials. The euro region showed only slight growth in 2004, mainly as a consequence of continued weak domestic demand in Germany. In contrast to this, there was clear growth in the U.S.

Bertelsmann's core markets are in Europe and the U.S., with a special focus on growth regions in Eastern Europe and Asia. The improved macroeconomic environment had a positive effect on the media markets relevant to Bertelsmann. The magazine and TV advertising business in Germany stayed on par with the previous year, while the book market showed a slight increase in 2004. In other euro region countries, the stabilization process proved more sustained. The U.S., too, saw a continuation of the positive trend in magazine advertising throughout 2004, while the book market here declined slightly. The music markets in the U.S. and U.K. showed positive sales growth for the first time in five years. However, the negative trend persisted in other important markets, especially Germany, France and Japan.

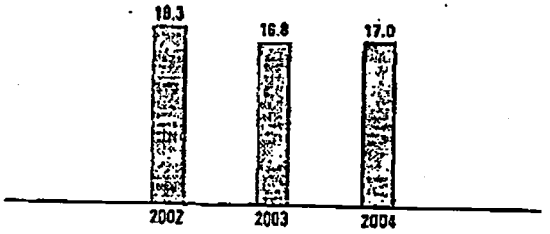
In fiscal year 2004, Bertelsmann concentrated on improving the profitability of its core businesses and on strengthening market positions in important segments. In early August, Sony Music and BMG merged their recorded music businesses into Sony BMG Music Entertainment. Contracts governing Gruner + Jahr's acquisition of a majority stake in Motor-Presse Stuttgart, as well as the gravure joint venture between Arvato, Gruner + Jahr and Axel Springer AG, are still pending antitrust approval.

Overview of Group Performance

Operating EBIT in € millions



Revenues in € millions



The company continued to put into practice its "Growth and Innovation" (GAIN) initiative launched in December 2003. The objective is to promote growth through new content, products and services across the group. From a vast pool of ideas, some 100 projects throughout the divisions were chosen for implementation, and have already delivered initial results. In 2005, the GAIN initiative will involve pursuing ongoing projects and generating further new ideas for sustained growth.

Revenues

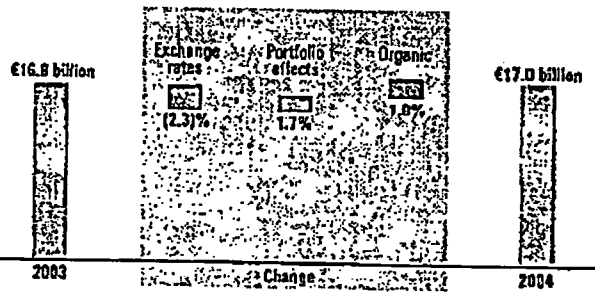
Consolidated revenues for the year under review amounted to €17.0 billion (previous year: €16.8 billion). This increase was fueled by organic growth of 1.9 percent as well as by portfolio effects, such as the first-time full consolidation of the French TV channel M6, which added €564 million to revenues. However, exchange rate movements, especially the weakening of the U.S. dollar against the euro, reduced revenues by 2.3 percent.

The regional breakdown of revenues was affected by portfolio and currency effects. Germany generated 29.7 percent (previous year: 30.7 percent) of total revenue. The other European countries contributed 42.2 percent (previous year: 38.6 percent), while the U.S. businesses accounted for 22.4 percent (previous year: 25.1 percent). All the remaining countries contributed 5.7 percent (previous year: 5.6 percent). The share of individual revenue streams in consolidated revenues changed only slightly.

Revenues by Division in € millions

	2004			2003		
	Germany	International	Total	Germany	International	Total
RTL Group	1,951	2,927	4,878	2,004	2,448	4,452
Random House	196	1,595	1,791	139	1,637	1,776
Gruner + Jahr	919	1,520	2,439	929	1,552	2,481
BMG	305	2,242	2,547	261	2,451	2,712
Arvato	1,557	2,199	3,756	1,630	2,009	3,639
Direct Group	354	1,821	2,175	383	1,903	2,286
Total revenues by division	5,282	12,304	17,586	5,346	12,000	17,346
Corporate / Consolidation	(223)	(347)	(570)	(180)	(365)	(545)
Consolidated revenues	5,059	11,957	17,016	5,166	11,635	16,801

Revenue Breakdown



Operating EBIT

In the year under review, Bertelsmann generated Operating EBIT of €1,429 million (previous year: €1,026 million). This corresponds to an 8.4 percent return on sales (previous year: 6.1 percent). In connection with changes to the IFRS, since January 1, 2004 Operating EBIT has been used instead of Operating EBITA to measure underlying business performance. The Operating EBIT now shown on the books corresponds to Operating EBITA as reported before, minus amortization of rights similar to goodwill with a definite useful life (see Notes, page 91). The previous year's figures were adjusted for better comparability.

RTL Group, BMG and Arvato were the main contributors to the increase in operating results in 2004. Random House and Direct Group both improved their results, due in part to a strong holiday season. Start-up losses for new magazines led to a slight decline in Operating EBIT at Gruner + Jahr. Meanwhile, operating results were boosted by optimizing business processes throughout the group. The first-time full consolidation of M6 increased Operating EBIT by €92 million. Excluding this effect, Operating EBIT increased by 30.3 percent year on year. Group Operating EBITDA amounted to €2,112 million (previous year: €1,866 million).

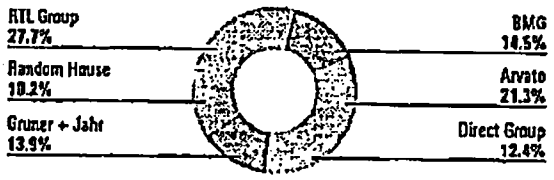
Net Income

Based on Operating EBIT and including special items of €318 million, earnings before interest and taxes totaled €1,747 million (previous year: €1,365 million). Based on the changed IFRS guidelines, regular amortization of goodwill and rights similar to goodwill with indefinite useful life no longer applies since January 1, 2004. In the previous year, these amounted to €632 million. These assets are now subjected to an annual impairment test instead and amortized if necessary. The year under review saw impairments of €34 million (previous year: €208 million). Taking into account the financial result and taxes, net income before minority interest came to €1,217 million in 2004 (previous year: €208 million). If regular amortization of goodwill were excluded, net income in 2003 would have been €840 million. After deducting for minority interest, which mostly consist of co-partner shares in RTL Group and Gruner + Jahr, and – as of 2004 – in M6, net income after minority interest came to €1,032 million (previous year: €154 million).

Special Items

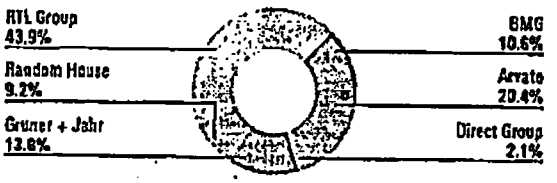
Special items for 2004 totaled €318 million. Income was mainly generated by a gain from merging BMG's recorded music division into the joint venture Sony BMG (€180 million), the sale of the Bertelsmann Building in New York (€174 million), the release of provisions in view of an out-of-court settlement of a lawsuit involving the former joint venture AOL Europe (€74 million), capital gains from the dissolution of a venture capital fund in which Bertelsmann had a stake (€47 million), and the value write-up in connection with the Shopping.com IPO (€22 million). Major items that had a negative impact on results included restructuring measures at BMG (minus €115 million) and Direct Group (minus €23 million), as well as an impairment of goodwill at Gruner + Jahr (minus €26 million).

Revenue Share by Division in percent*



*Based on total from divisions not including Corporate / Consolidation

Share of Total Operating EBIT by Division in percent*



Investments

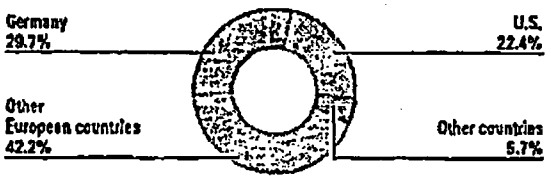
Investments in property, plant and equipment, financial assets, and intangible assets amounted to €930 million (previous year: €761 million). The €498 million (previous year: €413 million) invested in property, plant and equipment mostly went to Arvato, which in 2004, apart from regular investment activities, were invested in new gravure projects in the U.K. and Italy. Investments in intangible assets totaling €157 million (previous year: €166 million) were made mostly by RTL Group and BMG. Net investments in financial assets amounted to €275 million (previous year: €182 million) and comprised payments relating to the music joint venture, the acquisition of a stake in the Portuguese media company Grupo Media Capital, and other smaller acquisitions.

Results Breakdown in € millions

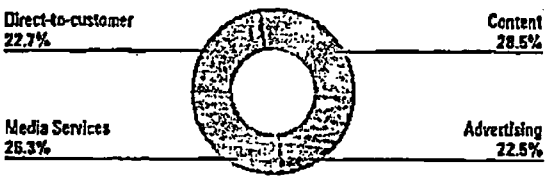
	2004	2003
Operating EBIT by division		
RTL Group	688	503
Random House	140	115
Gruner + Jahr	210	233
BMG	162	54
Arvato	310	261
Direct Group	32	4
Total Operating EBIT by division	1,522	1,170
Corporate / Consolidation	(93)	(144)
Group Operating EBIT	1,429	1,026
Special items	318	339
Earnings before interest and taxes	1,747	1,365
Regular amortization of goodwill*		(632)
Financial result	(267)	(322)
Income taxes	(263)	(203)
Net income before minority interest	1,217	208
Minority interest	(185)	(54)
Net income after minority interest	1,032	154

*The previous year's figures were adjusted to reflect amortization of rights similar to goodwill with a definite useful life. This relates particularly to Random House and BMG.

Consolidated Revenues by Region in percent



Revenues by Category in percent*



*Based on total from divisions not including Corporate / Consolidation

Consolidated Cash Flow Statement

Due to the increase in operating profit, net cash from operating activities rose to €1,654 million in 2004 (previous year: €1,362 million). Net cash from investing activities resulted in an outflow of €497 million in 2004 (previous year: inflow of €876 million). Proceeds from disposals of €366 million (previous year: €1.6 billion) were partly offset by payments for purchases of entities and financial assets totaling €208 million (previous year: €182 million). Investments in property, plant and equipment and in intangible assets amounted to €655 million, compared to €579 million in 2003.

There were net cash outflows of €670 million from financing activities in 2004 (previous year: €1,478 million), reflecting the continuing redemption of debt during the year. Debt repayment amounted to €375 million (previous year: €925 million). €315 million was distributed to shareholders of Bertelsmann AG and co-owners of consolidated companies.

As a result, group cash and cash equivalents increased to €2.1 billion at December 31, 2004 (previous year: €1.6 billion).

Balance Sheet

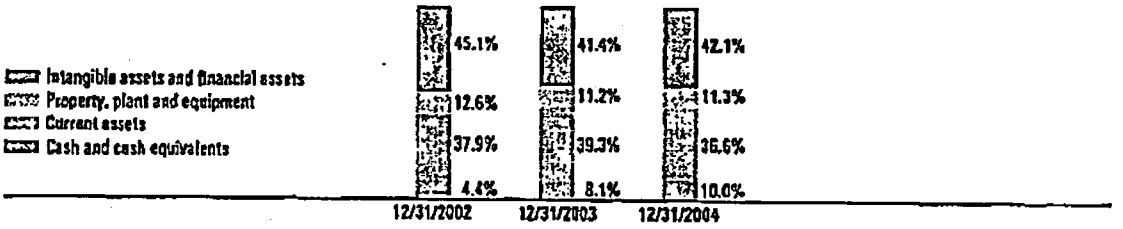
Total assets increased by €806 million to €21.0 billion in 2004. This increase is due primarily to the full consolidation of M6 and the formation of the Sony BMG joint venture. Equity amounted to €8,846 million. The equity ratio increased by 4.3 percentage points year on year, to 42.2 percent. This increase is due to increased net income on the one hand and the M6 minority interest on the other.

The share of gross financial debt in total assets was down to 10.2 percent from 12.2 percent the previous year. Cash and cash equivalents rose from 8.1 percent to 10.0 percent in the year under review. At balance sheet date, provisions for pensions and similar obligations totaled €1.9 billion (previous year: €1.7 billion). The sum total of net financial debt, pension provisions, and profit participation capital dropped from €3.2 billion to €2.6 billion. Apart from an increase in cash flow generated by the divisions, this decline may be attributed to one-time items such as the sale of the Bertelsmann Building in New York and the reduction of holdings in the sports rights trader Sportfive.

Cash Flow Statement (Summary) in € millions

	2004	2003
Cash flow from operating activities	1,654	1,362
Cash flow from investing activities	(497)	876
Cash flow from financing activities	(670)	(1,478)
Change in cash and cash equivalents	487	760
Exchange rate movements and other changes in cash and cash equivalents	(37)	(95)
Cash and cash equivalents at the beginning of the year	1,642	977
Cash and cash equivalents at the end of the year	2,092	1,642

Asset and Liability Structure
Assets



Financial Targets

Bertelsmann's financial targets traditionally take their cue from the group's capital structure and financial debt. The targets strive to ensure a balance between financial security, return on equity, and growth. Bertelsmann revised its corporate finance guidelines in fiscal year 2004 and now uses an expanded definition of economic debt. The new guideline underscores the company's steadfastly conservative financing policy.

The debt payback factor (net financial debt to cash flow) was replaced by a new target ratio, the "leverage factor." Basically, the leverage factor is the ratio of economic debt to Operating EBITDA. This switch means that the company now recognizes and treats not only net financial debt but also debt substitutes – which at Bertelsmann include pension provisions and profit participation capital – as economic debt. The reason for the switch is that debt substitutes have a similar effect on a company's financial strength as pure financial debt. In calculating the leverage factor, some modifications are made to the balance sheet figures, to better reflect the group's actual financial strength. The leverage factor should not exceed 2.3. In the year under review, the factor was 1.6 (equivalent previous year's value: 1.9). Compared to the earlier target of keeping the debt payback factor at 1.5 or below, the new target marginally reduces the group's maximum debt capacity.

The coverage ratio is now calculated as the ratio between Operating EBITDA and financial result, and should be greater than 4. In the year under review, the coverage ratio was 7.0 (equivalent previous year's value: 5.5), and thus remains well above target.

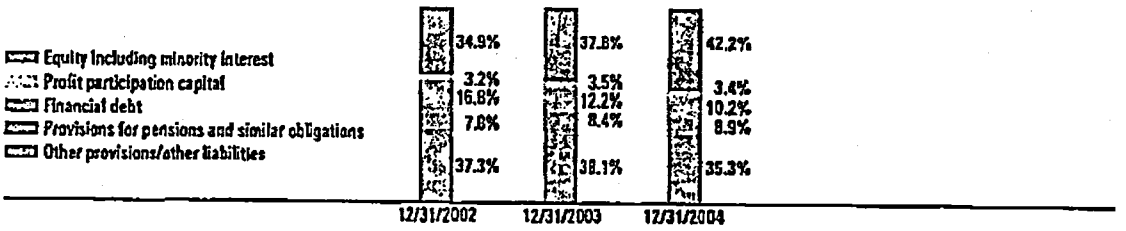
At 42.2 percent, the equity ratio exceeded both the 25 percent target and the previous year's ratio of 37.9 percent. In addition, Bertelsmann is careful to ensure that equity exceeds the goodwill shown on the balance sheet, including rights similar to goodwill with indefinite useful life. At €2,093 million, this coverage was achieved in 2004 (equivalent previous year's value: €797 million).

Financial Targets

	Target	2004	2003
Leverage factor Net financial debt plus pension provisions and profit participation capital / Operating EBITDA*	< 2.3	1.6	1.9
Coverage ratio Operating EBITDA/Financial result*	> 4.0	7.0	5.5
Equity ratio Equity to total assets (in percent)	> 25.0	42.2	37.9

* After modifications

Liabilities



Financing

To take advantage of the favorable financing environment, a syndicated €1.2 billion loan facility was signed with a consortium of banks in the fourth quarter of 2004. The facility has a maturity of five years and may be extended for another two years maximum with the approval of the consortium. This credit line prematurely replaces a syndicated €1.5 billion credit line agreed to in 2002. Bertelsmann's relatively high share of medium- and long-term financial debt and credit facilities underscores its long-term approach to financing. In 2004, the company paid back a $200 million bond according to schedule and prematurely redeemed a $100 million promissory note (both Bertelsmann U.S. Finance). Bertelsmann has a BBB+ rating from Standard & Poor's, and a Baa1 from Moody's, both with a stable outlook.

Profit Participation Capital

The par value of profit participation capital remained unchanged at €516 million. Including the premium, the total volume of profit participation capital at December 31, 2004 was €706 million. It is divided into mostly Profit Participation Certificates 2001 (PPC 2001, ISIN DE0005229942) and a small percentage of Profit Participation Certificates 1992 (PPC 1992, ISIN DE0005229900). The terms and conditions governing PPCs 2001 stipulate that the target dividend of 15 percent of par value be paid for every full fiscal year, provided there is sufficient consolidated net income and Bertelsmann AG net income. These conditions were met for the fiscal year ended December 31, 2004. Thus a 15 percent payout will again be made on the par value of PPCs 2001. The distribution on PPCs 1992 depends on the group's return on total assets. As the return on total assets for fiscal 2004 was 7.42 percent, the payout on PPCs 1992 is 8.42 percent of par value (previous year: 6.92 percent). In May 2005, distributions totaling some €76 million will be paid out on both types of certificates. The terms and conditions governing Bertelsmann PPCs require that Bertelsmann AG's auditors verify whether the profit distribution was correctly calculated. A confirmatory report from the auditors has been received for both types of profit participation certificates.

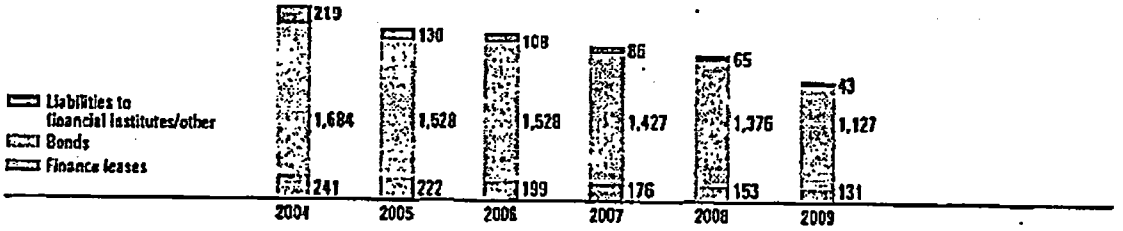
Status of Bertelsmann AG

Bertelsmann AG is a management holding company with no operating businesses of its own. Its tasks include supervisory functions for the Bertelsmann group, the management of its participations, financing, and the service functions performed by some departments at the Corporate Center. The AG's major sources of income are dividend payouts from subsidiaries and proceeds from services provided to subsidiaries. In 2004, Bertelsmann AG increased its subscribed capital from €606 million to €1,000 million by converting capital reserves. Shareholders' equity is reported at €9.5 billion. Bertelsmann AG's total assets at year-end 2004 amounted to €12.0 billion.

Ownership Structure

Bertelsmann AG is a privately held stock corporation. Its shareholders – by way of holding companies – are the Bertelsmann Stiftung foundation (57.6 percent), the Mohn family (17.3 percent), and Groupe Bruxelles Lambert (25.1 percent). The voting rights of Bertelsmann Stiftung and the Mohn family are exercised by Bertelsmann Verwaltungsgesellschaft (BVG). BVG controls 75.0 percent of voting rights at the Bertelsmann AG General Meeting, while Groupe Bruxelles Lambert controls 25.0 percent.

Maturity Structure of Financial Debt in € millions



Employees

At the end of fiscal 2004, the Bertelsmann group had 76,266 employees worldwide (previous year: 73,221 employees). The divisional breakdown is: Arvato 44.3 percent, Direct Group 15.9 percent, Gruner + Jahr 15.3 percent, RTL Group 10.6 percent, Random House 7.1 percent, BMG 5.6 percent, and Corporate Center 1.2 percent. In addition to organic growth, the increase of 3,045 staff is due to the full consolidation of M6 and other acquisitions made during the year.

At the end of the year, the company had 890 apprentices in Germany (previous year: 783). This increase is partly due to the first-time inclusion of student journalists in these numbers in 2004.

Human Resources work at Bertelsmann is governed by the corporate culture of partnership established by Reinhard Mohn in the 1960s. To regularly assess the state of the corporate culture and provide impulses for its ongoing evolution, the "Corporate Culture" task group was set up in 2004. It comprises representatives of the Human Resources Department, the Corporate Works Council, the Executive Board and the Supervisory Board. Interim employee surveys were carried out in 2004 upon the initiative of individual divisions. In all, 17,350 employees in 17 countries had the opportunity to participate in surveys during the year. Thus employee surveys, which have been a key instrument in HR work at Bertelsmann since 1977 and are performed throughout the group every four years, are being used more intensively than ever before.

In 2004, the first tranche of the Bertelsmann Virtual Stock Option Plan (VSOP) issued in 1999/2000 was settled. The VSOP is an executive bonus program that depends on the performance of the group and individual business units over several years.

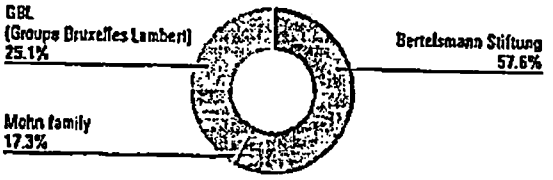
Bertelsmann sees the cultivation and promotion of employee health as an important task. A wide range of activities again served to enhance corporate health efforts during the year under review. In Germany, additional companies in the group formed a "People and Health" task group. In fall 2004, the Executive Board and Corporate Works Council agreed to gradually extend the health checkup for executives, which was introduced worldwide three years ago to great acclaim, to all employees in Germany over the age of 45 via company medical services. In some Bertelsmann companies outside Germany, such health checkups for all employees are already carried out in various forms.

Management development activities were stepped up further in 2004. Two years ago, Bertelsmann University began to internationalize its "Leadership Program," a management training course that has proven its worth in Germany over many years. At this point, the course has been successfully introduced in Spain, the U.S., and France. Bertelsmann University also extended its range by a country-specific management program. A total of three new programs were launched, with a focus on media technology, innovation management, and executive leadership.

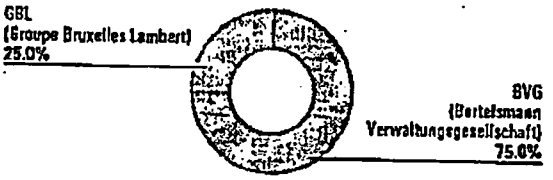
In 2002, Bertelsmann established an "Ethics & Compliance Program" in North America and created the position of Chief Ethics & Compliance Officer. The program is based on the "Code of Business Conduct." It provides clear guidelines for employees that reflect the company's values and come up to the legal and ethical demands of society. Other steps taken in 2004 include the establishment of an extensive multimedia training program, a 24/7 anonymous phone "Helpline," and an Ethics & Compliance website. The program helps to protect the company from legal and financial damage, as well as strengthen Bertelsmann's image, e.g. among employees, customers and public agencies.

Ownership Structure

Capital Shares



Voting Rights



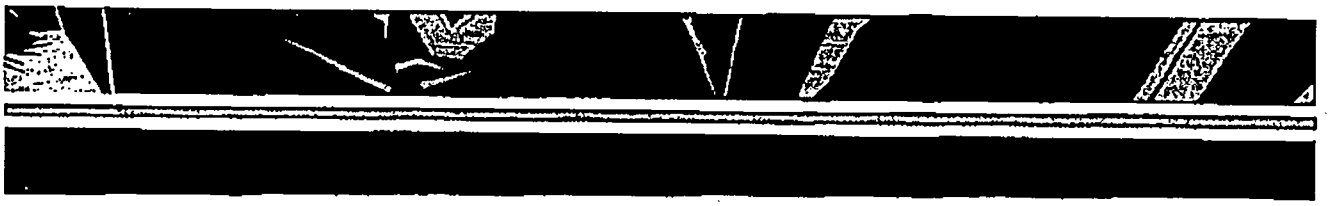
RTL GROUP

RTL Group is Europe's leading broadcast and TV production company, with holdings in 31 TV channels and 30 radio stations in ten countries, and worldwide content production. Its television arm includes the RTL Television family of channels in Germany, M6 in France, Five in the U.K., RTL channels in the Benelux countries, in Croatia and Hungary, and Antena 3 in Spain. Its best-known radio station is RTL in France. Fremantle Media is a subsidiary of RTL Group and is one of the largest international creators and producers of program brands in the world. It produces leading prime-time drama, serial drama, entertainment, factual, and comedy programming in over 40 countries. Bertelsmann owns more than 90 percent in the publicly listed RTL Group, making it the main shareholder.

INFORMATION AND EMOTION

Everything's easy on TV. Complicated facts are lucidly explained in the digital news studio.
Complex relationship problems are sensitively dealt with in daily soaps.

Excellent programming in its simplest form: RTL Group.

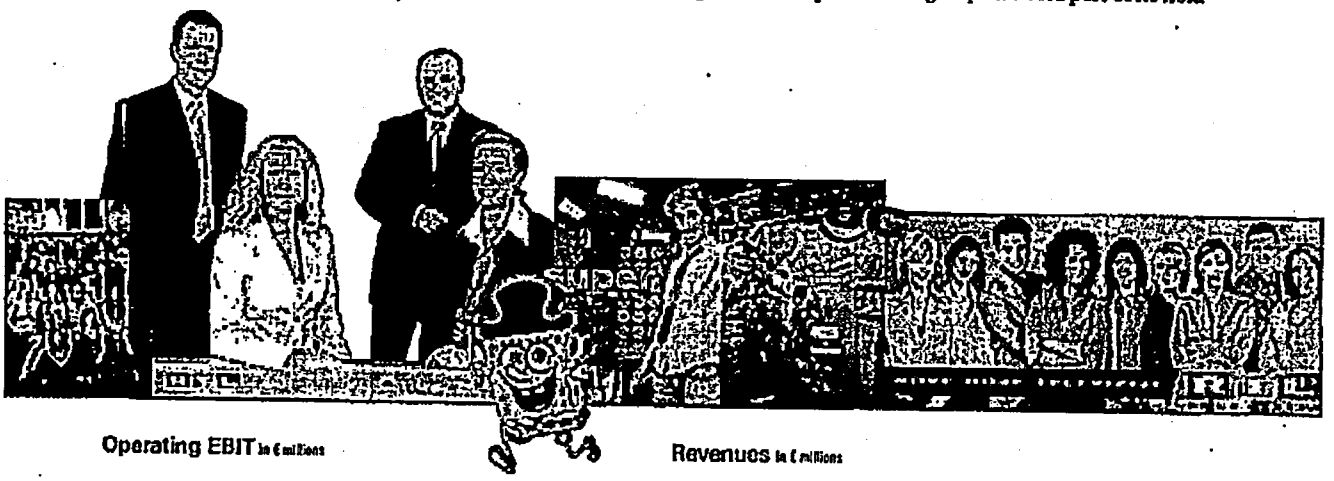


RTL GROUP HIGHLIGHTS 2004

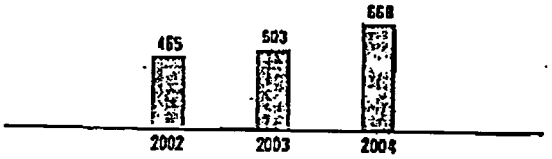
- All RTL Group channels defended their strong market positions
- Belgium saw the successful launch of Plug TV; RTL Televizija was founded in Croatia and went straight to the top of the market
- RTL Group bought an 11.6 percent stake in Portugal's Grupo Media Capital, one of the country's leading media companies
- In Germany, RTL launched its first digital special-interest channel: "Traumpartner TV," an interactive dating platform
- M6 was fully consolidated for the first time, after the French utilities company Suez largely completed its exit
- Fremantle Media significantly improved its profitability thanks to the successful international commercialization of the "Idols" format

RTL Group, Europe's leading television, radio, and TV production group, showed a favorable development in fiscal 2004. The company increased its revenues to €4.9 billion (previous year: €4.5 billion), due to the first-time full consolidation of the French channel M6. Revenues remained stable from an organic point of view. Operating EBIT rose considerably to €668 million (previous year: €503 million). This enhanced performance may be attributed to the M6 consolidation effect as well as to improved operating profitability. All RTL Group channels defended their strong market positions, even though the advertising economy was patchy in Europe and major sporting events such as the 2004 European Soccer Championship and the Summer Olympics in Athens created market distortions. All business units in the group ended the year with a positive result, excluding start-ups.

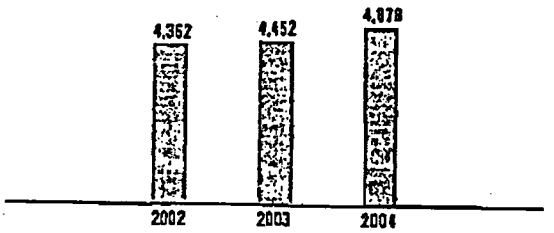
RTL Group's strategic business development centered on continuing its internationalization and creating larger "families" of channels to achieve greater market penetration. Belgium, for instance, saw the successful launch of Plug TV, the third channel devoted more intensely to the country's young adult demographic. RTL Televizija was founded in Croatia and went straight to the top of the market. In October, RTL Group bought an 11.6 percent stake in Portugal's Grupo Media Capital, one of the country's leading media companies. The group also sold part of its hold-



Operating EBIT in € millions



Revenues in € millions



ings in the sports rights trader Sportfive, retaining a 25-percent stake.

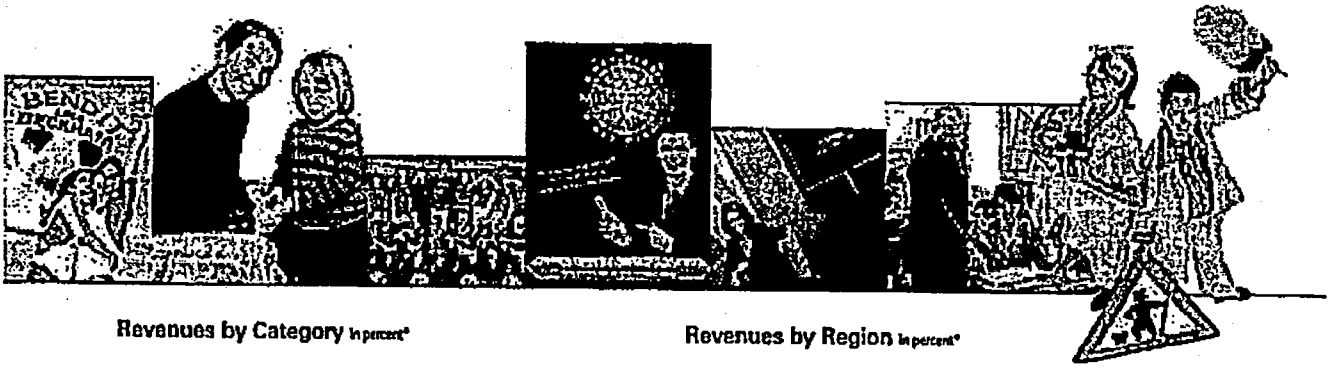
In Germany, RTL Television was able to defend its leading market position in the core demographic. Despite a difficult TV advertising market and a slight decline in revenue, performance remained on a par with last year's high level of earnings. The group of channels clustered around RTL Television thus remains the biggest mainstay of earnings in the Bertelsmann group. In early December, RTL launched its first digital special-interest channel in Germany: "Traumpartner TV," an interactive dating platform. Other members of the German RTL family were also successful, e.g. the channel Vox, which drew its highest-ever audience share in the 14- to 49-year-old target demographic in 2004. The German news channel N-TV concluded a year of restructuring with its move from Berlin to Cologne.

M6 in France delivered a successful business performance. RTL Group became the main shareholder of M6 in February, after the French utilities company Suez largely completed its exit. This shareholder shift resulted in the full consolidation of M6 by Bertelsmann starting February 1, 2004. Thanks to the full consolidation of the French group of channels, group revenues rose by €564 million, and Operating EBIT was up by €92 million. In May, M6 concluded its acquisition of Paris Premiere, a French satellite and cable channel.

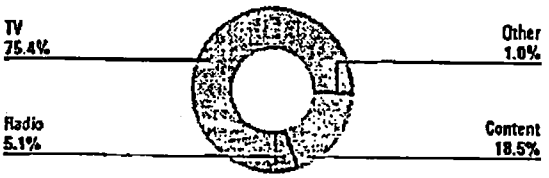
The TV channel "Five" in the U.K. extended its market share both among viewers and in the advertising market, and achieved significant enhancements to its operating business. The turnaround in the TV business in Spain and The Netherlands led to improved results. The Spanish channel Antena 3 in particular outperformed the market in terms of growth in viewer and advertising market share.

The production arm Fremantle Media significantly improved its profitability, increasing both its revenue and result. This was due among other things to a positive performance in the U.S. and Germany, and the international commercialization of the "Idols" format, which were broadcast in numerous other countries in 2004. In September, Fremantle Media and its production partner Vogue Planet set up a new joint venture in Japan. "The X Factor," a new international format from Fremantle Media, delivered a promising debut in the U.K. The lifestyle show "How Clean Is Your House," another U.K. success, is being produced in Germany, The Netherlands, Denmark, France, the U.S., and Russia as well. Local productions of the "Apprentice" format, to which Fremantle Media acquired the international rights and which was aired as "Big Boss" in Germany, have been agreed to in 16 countries.

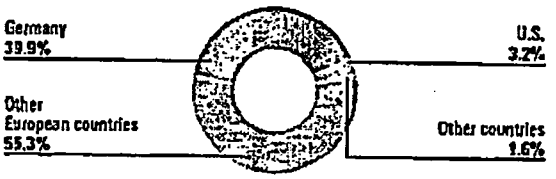
RTL Radio successfully defended its market-leading position in France and kept its operating result stable against rising revenues.



Revenues by Category in percent*



Revenues by Region in percent*



*Without intercompany revenues

RANDOM HOUSE

BERTELSMANN

Random House is the world's largest consumer book publisher and the only one that publishes adult and children's fiction and non-fiction hardcovers and paperbacks in English, German, Spanish, Japanese, and Korean. Its portfolio comprises more than 100 editorially independent imprints, including Knopf, Bantam, and Crown in the U.S., Ebury, Century, and Arrow in the U.K., and C. Bertelsmann, Siedler, Heyne, and Goldmann in Germany. Each year, some 9,000 new books enhance an active catalog of more than 50,000 titles. No other trade publisher tops the bestseller lists as often – with authors such as John Grisham, Dan Brown, and Danielle Steel – while also publishing as many Nobel Prize Literature laureates on its author roster. Random House is a wholly owned subsidiary of Bertelsmann.

GREAT READER

Bill Clinton completes recording the audio edition of his memoir, "My Life."

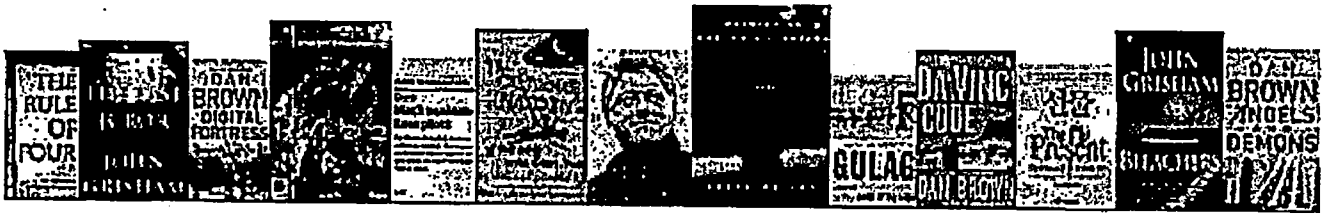
The hardcover edition sells 2.6 million copies in North America alone. The audiobook – read by the former U.S. President himself – wins the Grammy Award in 2005 for "Best Spoken Word Album."

In 2004, Random House further enhanced its leading market position and sold more books worldwide than any other trade book publisher. The company increased its stature as the one truly global book publisher with its growing presence in Asia. Despite a sluggish book industry economy internationally and a weakened U.S. dollar exchange rate compared to the euro, revenues expressed in euros remained stable at €1.6 billion (previous year: €1.8 billion). The negative currency effects also impacted reported operating results, particularly in North America, Random House's largest market. Nevertheless, operating results increased to €140 million (previous year: €115 million).

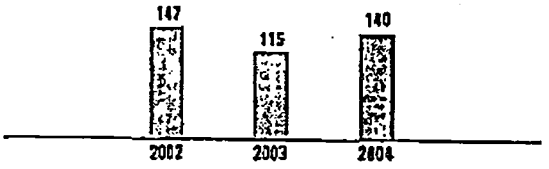
In North America, Random House again placed the most titles of any U.S. publisher on the "New York Times" national bestseller lists in 2004: 183, twenty of them at No.1. The year's publishing highlights included "My Life" by former President Bill Clinton, which set a first-week sales record for adult non-fiction hardcover, selling more than one million copies in North America; 2.6 million copies were in print at year-end. Dan Brown's "The Da Vinci Code" elevated its place in book publishing history as the biggest-selling adult hardcover novel of all time by selling another 4.2 million copies in 2004, bringing its total North American sales to 9.5 million so far. "The Rule of Four" by Ian Caldwell and Dustin Thomason became a one-million-copy-selling first novel. The strategy manual for the new Microsoft X-Box video game "Halo 2" sold 375,000 trade paperback copies on its first day in stores, and John Grisham had four No.1 bestselling fiction hardcovers and paperbacks with "The King of Torts," "The Last Juror," "Bleachers," and "Skipping Christmas."

Dan Brown also had multiple bestsellers in the year for the London-based Random House Group, which had an exceptionally strong year in the U.K., with substantial gains in market share. Random House's British imprints published nearly fifty percent of the titles on the year's Sunday Times of London lists. "The Curious Incident of the Dog in the Night-time" by Mark Haddon has sold more than 1.6 million paperback copies in the U.K. alone. Random House in Australia, New Zealand and South Africa also delivered a very positive performance; overall, Random House's revenues for the division increased significantly.

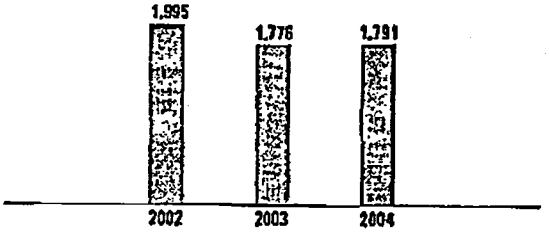
Verlagsgruppe Random House in Germany successfully completed the editorial and organizational integration of Heyne, which it acquired last year, enabling it to expand its market share in the German book market. Its 248 titles on the "Spiegel" and other major national bestseller lists were a company record, and led the German book industry. The year's most successful books here included "Das Methusalem-Komplott" by Frank Schirrmacher, "Die Mächte



Operating EBIT in € millions



Revenues in € millions



RANDOM HOUSE HIGHLIGHTS 2004

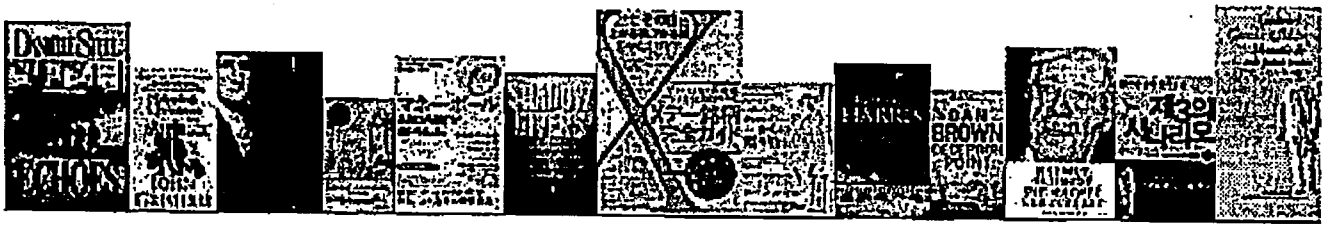
- Random House increased its stature as the one truly global book publisher with its growing presence in Asia
- Twenty titles made it to No.1 in the "New York Times" bestseller lists
- "My Life" by former President Bill Clinton set a first-week sales record in North America for adult non-fiction hardcover
- Dan Brown's thriller "The Da Vinci Code" elevated its place in book publishing history as the biggest-selling adult hardcover novel of all time
- Random House Group in the U.K. made substantial gains in market share
- Random House Mondadori enjoyed a turnaround to profitability in Spain and Latin America

der Zukunft" by former German chancellor Helmut Schmidt, and the historical novel "Pompeji" by Robert Harris.

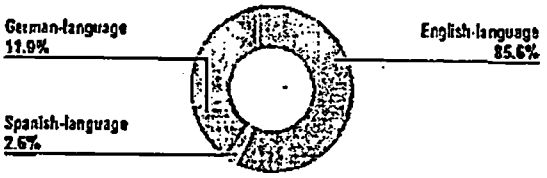
Random House Mondadori enjoyed a highly successful turnaround to profitability in Spain and Latin America in 2004, solidifying its position as the world's second-largest Spanish-language book publisher. Its publication of Nobel Prize in Literature laureate Gabriel García Márquez's first novel in a decade, "Memoria De Mis Putas Tristes," sold almost one million copies in its first month, setting new sales records.

Random House Kodansha, Random House's history-making joint venture with Japan's leading publisher, Kodansha, published 43 books in its first full year of operation and has expanded its publishing program to include original Japanese fiction and non-fiction. In Korea, Random House, in a joint venture partnership with media giant JoongAng M&B, formed Random House JoongAng in January, which became an immediate profitable market leader. Its successes include sales of roughly 700,000 copies of "The Present" by Spencer Johnson.

Random House authors won many prestigious literary awards worldwide last year, among them the Pulitzer Prizes in General Non-fiction for "Gulag: A History" by Anne Applebaum, and in Poetry for "Walking To Martha's Vineyard" by Franz Wright.

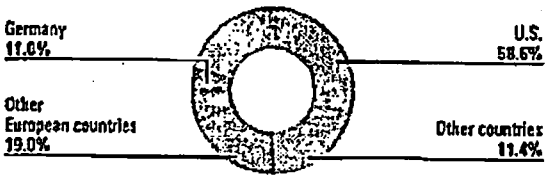


Revenues by Language Region in percent*



*Without intercompany revenues

Revenues by Region in percent*



The Gruner + Jahr printing and publishing company is Europe's biggest magazine publisher. It produces more than 125 magazines in ten countries on three continents, as well as the publications' complementary websites. G+J publications include Stern, Brigitte, Geo, Capital, Gala, Eltern for Family, P.M, Neon, Financial Times Deutschland, Essen & Trinken, National Geographic, as well as Télé 2 Semaines, Femme Actuelle, Fitness, and News – many of them in multiple editions and several countries. The company continually enhances its portfolio with innovative new launches and line extensions. Gruner + Jahr stands for quality journalism at its best: thoroughly researched, informative, inspiring, and entertaining. Bertelsmann AG owns 74.9 percent of the company; the Jahr publishing family in Hamburg owns 25.1 percent.

INNOVATION CAMPAIGN

Gruner + Jahr launches more than 20 new titles in 2004. "Gala" in Spain exceeds all expectations and has outstanding advertising sales. "Télé 2 Semaines" becomes one of the most successful launches ever in the French magazine market.

For Europe's biggest magazine publisher Gruner + Jahr, 2004 was a year of innovation campaigns and expansion to important markets. Gruner + Jahr embraced this growth strategy to counter the difficult situation in the domestic advertising and distribution markets. Revenues declined slightly to €2.4 billion (previous year: €2.5 billion). This decline was primarily the result of currency effects and changes to the portfolio, such as the sale of the newspaper operations in Eastern Europe and of "TVToday" magazine in Germany. Adjusted for these one-time items, Gruner + Jahr increased its revenues. The operating result declined to €210 million (previous year: €233 million), due primarily to publishing investments in new magazine titles, which reduced the bottom line by several tens of millions. A large proportion of this investment went to the French TV segment.

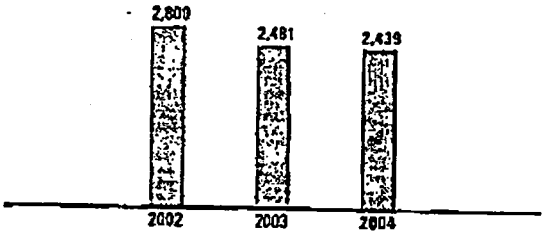
Gruner + Jahr launched more than 20 new titles worldwide in 2004 – more than ever before in the publisher's history. The growth strategy centered on tapping new markets and segments. In France, the two bi-weekly TV listings magazines "Télé 2 Semaines" and "TV Grandes Chaînes" got off to an excellent start, making them two of the most successful new launches in the French magazine market in recent years. Together with "Télé Loisirs," a weekly TV title already established in the French market, circulation for Prisma Presse's three TV guides totaled four million copies, which translates to market leadership in the TV listings sector. Other successful international launches in 2004 included the people magazine "Gala" in Spain, a

GRUNER + JAHR HIGHLIGHTS 2004

- Gruner + Jahr launched more than 20 new titles worldwide – more than ever before in a single year
- In France, the two bi-weekly TV listings magazines "Télé 2 Semaines" and "TV Grandes Chaînes" became two of the most successful new launches in the French magazine market in recent years
- A comprehensive structural reorganization was initiated in the U.S.
- A majority takeover of Motor-Presse Stuttgart was announced
- Gruner + Jahr, Arvato and the Axel Springer AG agreed to form a gravure joint venture; the project is pending antitrust approval

Operating EBIT in € millions

Revenues in € millions



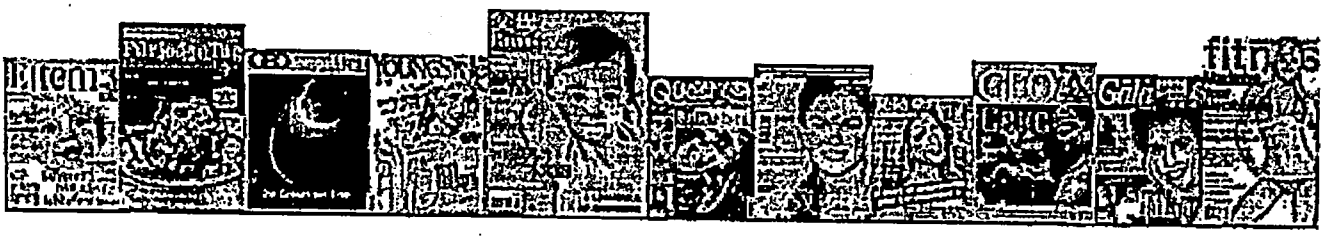
50:50 joint venture with the Spanish newspaper group Vocento that made its debut in September. "Gala" is also published in Germany, France, and Russia – and in Poland, where Gruner + Jahr has taken the lead in the advertising sales market for the first time since the Polish publishing arm was established in 1993. This was due in great part to young titles like "Gala" and "Glamour." In the Dutch market, G+J launched four magazines within a single year, including the high-circulation and multiple-award-winning popular-science title "Quest."

In the German magazine market, Gruner + Jahr set important points for future growth in 2004, focusing on segments in which it has already achieved leading market positions. Results improved thanks in part to strict cost discipline. The market was characterized by continuing intense predatory competition, but the established brands in Germany were able to transcend these difficult market conditions. G+J compensated for declines in newsstand sales by growing its subscriptions on the one hand and the positive performance of more recent titles like "Essen & Trinken für jeden Tag," "Neon," and "Brigitte Balance" on the other. One newcomer that deserves special mention is "Geo kompakt," which sold nearly 200,000 copies off the cuff. The advertising market showed a promising trend in the first half of the year, which unfortunately failed to continue in the second half. However, thanks to improved ad bookings and restructuring measures, titles in the German portfolio including the business publications "Capital" and "Impulse" picked up their results considerably. The German unit also invested in projects to safeguard future growth.

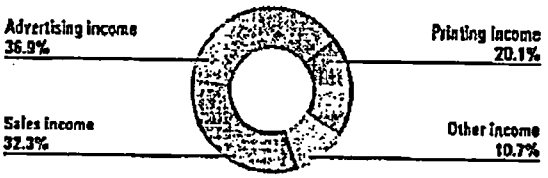
Business in the U.S. was difficult; revenues declined significantly. A comprehensive structural reorganization was initiated to improve profitability. While both the teen magazine "YM" and in particular the business publication "Fast Company" suffered a decline in advertising sales, the women's and family magazine "Family Circle" came under pressure in newsstand sales. In May, Russell Denson was named the new President & CEO of Gruner + Jahr USA. "YM" was sold to Condé Nast in October for lack of publishing and economic prospects.

In late November, Gruner + Jahr announced its majority takeover of Motor-Presse Stuttgart, with effect from January 1, 2005. This transaction, which is still pending antitrust approval, improves Gruner + Jahr's position in the German and international magazine markets. Motor-Presse Stuttgart publishes more than 90 successful magazines such as "Auto Motor und Sport" and "Men's Health" in a total of 14 countries, in market segments in which Gruner + Jahr was not present to date.

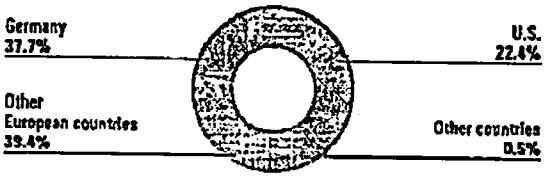
Results from Gruner + Jahr's printing operations were up for the year. In a step with far-reaching implications, Gruner + Jahr, Arvato and the Axel Springer AG agreed to merge their German gravure operations in a joint venture, including a project in Liverpool (see "Outlook" section, page 44).



Revenues by Category In percent



Revenues by Region In percent*



*Without intercompany revenues

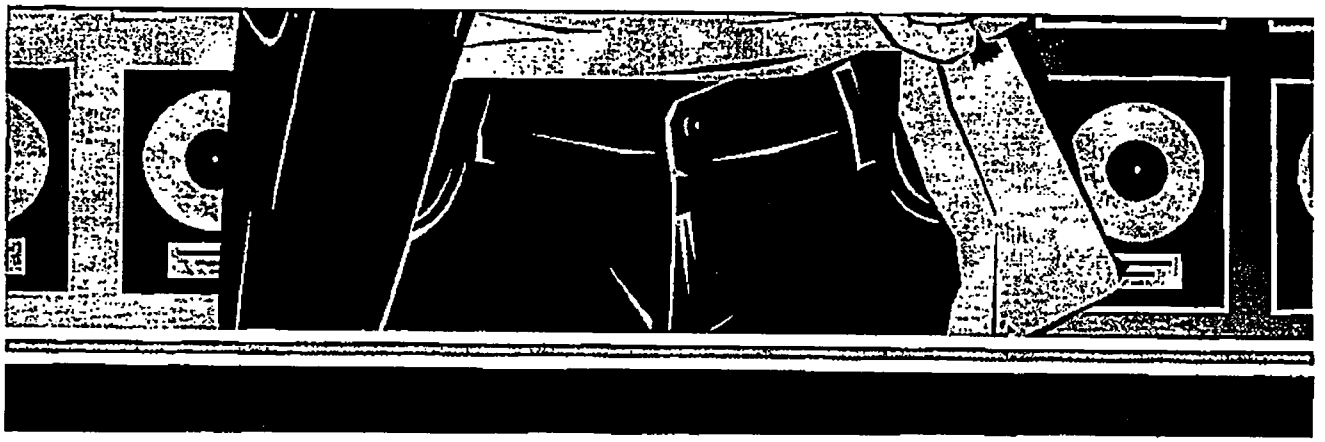
BMG

BERTELSMANN

The BMG division consists of the Sony BMG Music Entertainment joint venture and the BMG Music Publishing company. Sony BMG unites legendary labels like Arista, Columbia Records, Epic Records, Ricordi, Funhouse, Jive, J Records, and RCA Records under one roof. Its spectrum ranges from Hip-Hop to musical soundtracks, country to classical music, and gospel to rock. Sony BMG is home to a number of domestic and international stars, including Avril Lavigne, Beyoncé, Justin Timberlake, Britney Spears, Usher, Christina Aguilera, Dido, Anastacia, Alicia Keys, and Carlos Santana. The songwriters and composers signed with BMG Music Publishing also enjoy a superb reputation. The music publisher is one of the world's largest and most successful. Bertelsmann owns a 50-percent stake in Sony BMG; BMG Music Publishing is a wholly owned subsidiary of Bertelsmann AG.

WORLD CHAMPION 2004

Four consecutive No.1 hits – including the duet "My Boo" with BMG superstar Alicia Keys.
The world's best-selling album in 2004. In February 2005,
three Grammy Awards put the finishing touches on a year of incredible success for Usher.

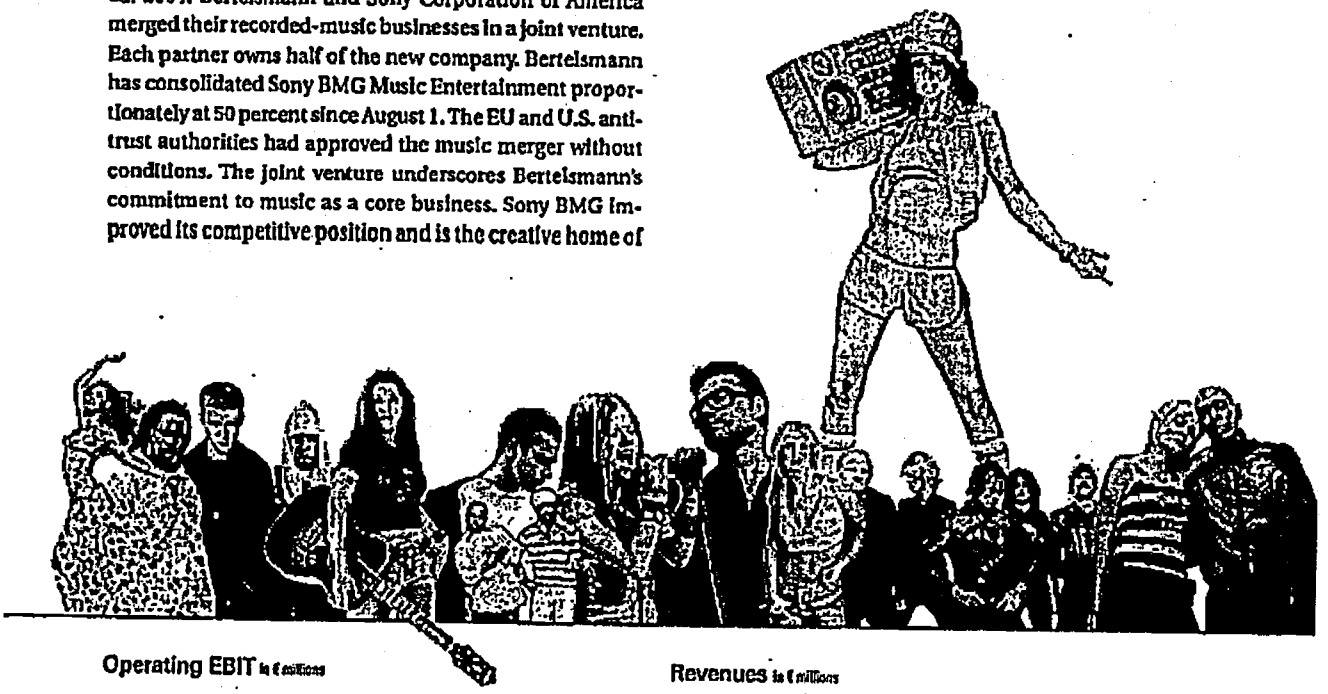


Bertelsmann Music Group (BMG) delivered a positive business performance in 2004, yet another difficult year for the global music industry. Despite pricing pressure, continued flat consumer demand, and the unlicensed distribution of music files on the Internet, BMG markedly improved its operating result to €162 million (previous year: €54 million) against slightly decreased revenues of €2.5 billion (previous year: €2.7 billion). Additional cost-cutting measures and a focus on the creative business contributed to this improvement. BMG's financials for fiscal 2004 include the results of BMG's recorded music business from January through July 2004 and half of the results from the Sony BMG joint venture from August through December 2004. They also include the results of BMG Music Publishing for the full fiscal year. Both of BMG's lines of business – recorded music and music publishing – delivered a positive business performance.

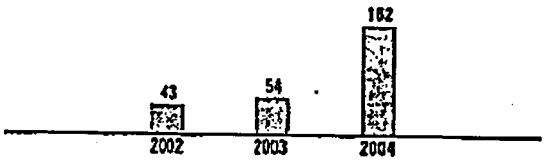
In strategic terms, the formation of the Sony BMG Music Entertainment joint venture was the key event in fiscal 2004. Bertelsmann and Sony Corporation of America merged their recorded-music businesses in a joint venture. Each partner owns half of the new company. Bertelsmann has consolidated Sony BMG Music Entertainment proportionately at 50 percent since August 1. The EU and U.S. antitrust authorities had approved the music merger without conditions. The joint venture underscores Bertelsmann's commitment to music as a core business. Sony BMG improved its competitive position and is the creative home of

BMG HIGHLIGHTS 2004

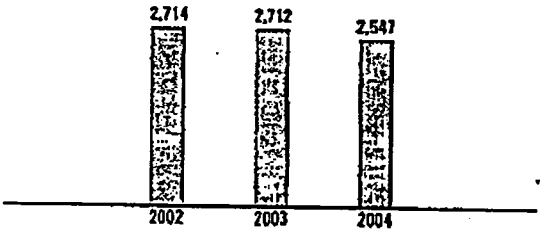
- The Sony BMG Music Entertainment joint venture, headquartered in New York, was formed, underscoring Bertelsmann's commitment to music as a core business
- Sony BMG acts dominated all the major awards ceremonies in 2004
- Sony BMG's integration proceeds apace and smoothly
- The world's bestselling album in 2004 was "Confessions" by Usher
- BMG Music Publishing's artist roster includes some of the world's most successful artists; the company had the best fiscal year in its history



Operating EBIT in € millions



Revenues in € millions



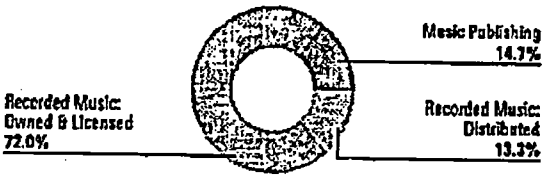
a large number of international superstars, major local acts and talented newcomers. BMG's music publishing business was not included in the joint venture. BMG Music Publishing is managed as a separate unit in the BMG division. It is the world's biggest independent music publisher and the third-biggest music publisher overall. Rolf Schmidt-Holtz will continue to represent the music business on the Bertelsmann AG Executive Board, in his function as Chairman & CEO of the BMG division. He also serves as Chairman of the Board of Directors of Sony BMG Music Entertainment. Andrew Lack is the CEO of Sony BMG; Nicholas Firth is the CEO of BMG Music Publishing.

Despite shrinking key markets, Sony BMG generated a distinctly positive operating result during the period from August 1 to December 31, 2004. This success may be attributed to high sales during the fourth quarter, which saw new releases by artists including Celine Dion, Britney Spears, Rod Stewart, Destiny's Child, and Good Charlotte. Sony BMG acts dominated all the major awards ceremonies in 2004. 121 Grammy 2005 nominations and 28 Grammys document the enormous artistic potential of the new music company, which plans to fuel the further dynamic development of its business with digital products and music videos. The integration of Sony BMG's global activities proceeds apace and smoothly. Once the process is completed in 2005, it will yield significant yearly savings and enable additional investments in the worldwide creative business. The restructuring costs associated with the integration should be seen alongside a gain from the merger at BMG (see "Special Items," section, page 12).

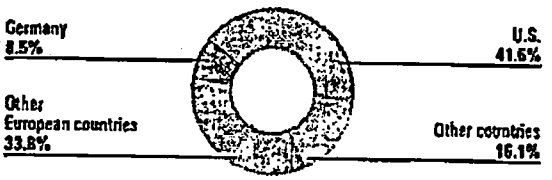
Prior to the merger, BMG's recorded-music business managed to accelerate the positive performance seen in the second half of 2003, and heftily improved its operating result from January to July 2004. The company added market shares in major markets worldwide, thanks to chart successes by artists including Usher, Avril Lavigne, Outkast, Dido, and Maroon 5. The world's best-selling album in 2004 was "Confessions" by Usher, which sold nearly 12 million units.

BMG Music Publishing earns revenues from royalties on the rights to over one million songs and musical works, and operates independently of Sony BMG. The company had the most successful fiscal year in its history, once again generating double-digit return on sales while keeping revenues stable year on year and improving the operating result. Creative triumphs all over the world contributed to this. Some of the most globally successful artists of the year 2004 are signed with BMG Music Publishing; they include Coldplay, Maroon 5, R. Kelly, Nelly, Robbie Williams, Keane, Linkin Park, Britney Spears, and Christina Aguilera. BMG Music Publishing renewed its contract with the independent music publisher Famous Music, and with BBC Worldwide. The company now also handles the commercialization of the worldwide music rights from TV programs by Fremantle Media, an RTL Group subsidiary.

Revenues by Category in percent



Revenues by Region in percent*

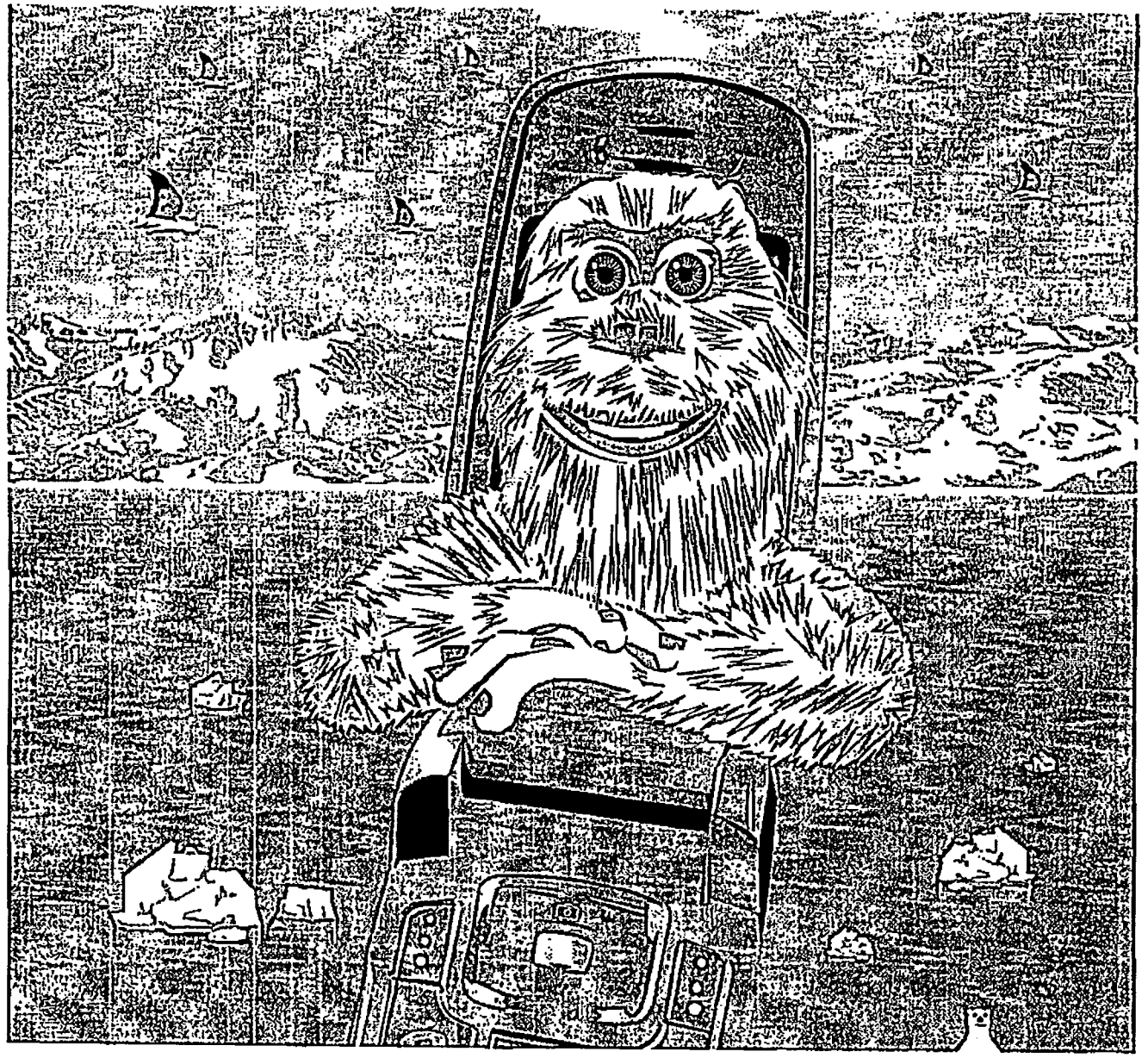


*Without intercompany revenues

arvato

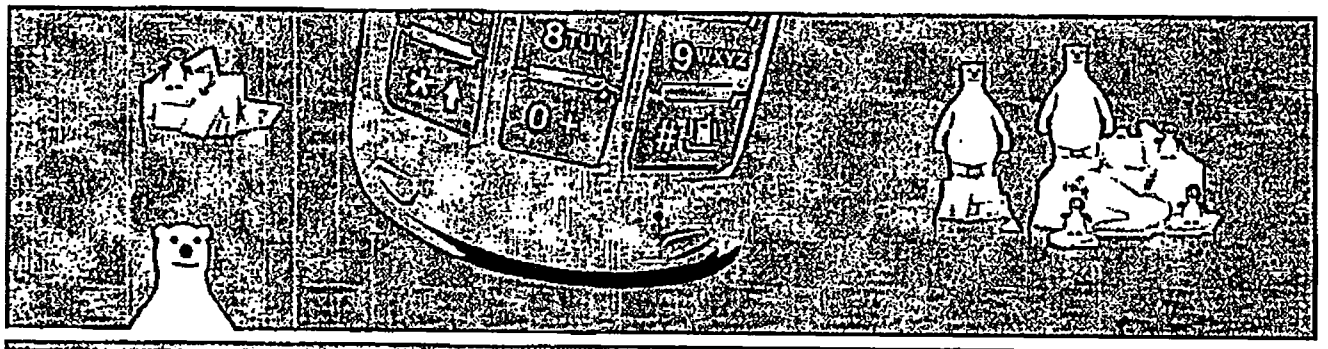
BERTELSMANN

Arvato AG, whose 250 subsidiaries make it one of the largest internationally networked media services providers, is Bertelsmann's media services division. Arvato AG includes the Arvato Print companies (Mohn Media, the Maul Belser media group, as well as several printing plants in Europe and America), the Arvato Direct Services (customer loyalty systems and call centers), Arvato Logistics Services (logistics and supply chain management), Arvato Storage Media (CD and DVD production), and Arvato Systems (international IT services) units. Empolis, a content and knowledge management solutions company, and the mobile entertainment provider Arvato Mobile, with its Handy.de and TJ.net brands, are also part of the division. Arvato AG is a wholly owned subsidiary of Bertelsmann AG.



ARVATO CHASES YETI ONTO MOBILES

Arvato Mobile brings popular games to mobile phones.
Downloads and exports to over 25 countries, "Yetisports"
is the most successful cell-phone game series in Arvato Mobile's range.

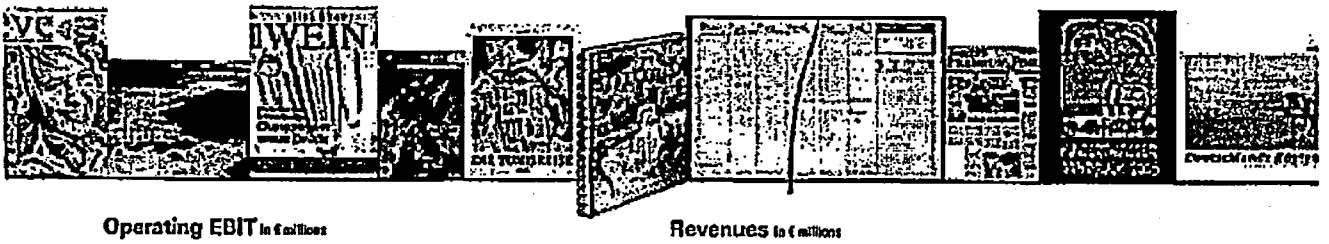


2004 went very well for the international media services provider Arvato. Despite difficult macroeconomic conditions, revenues rose to €3.8 billion (previous year: €3.6 billion). The operating result improved considerably to €310 million (previous year: €261 million). All business units of the division closed the year with a profit.

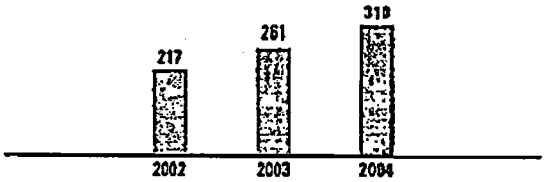
The service companies in the Arvato Services unit showed strong growth. This unit comprises Arvato Direct Services, a globally leading provider of the full range of services relating to customer relationship management, and Arvato Logistics Services, a global supply chain management specialist. Thanks primarily to its direct-to-customer, call-center and address management activities, Direct Services was able to improve its result year on year. In the Logistics Services department, the distribution and technology lines of business in particular showed a positive development.

Central elements in the division's growth strategy include forceful internationalization as well as enhancing and safeguarding its leading market positions. In spring, Arvato Services bought up the majority of shares in Phone Assistance, a Moroccan call center services provider, thereby improving its leading position in the French-speaking market. Service operations in other countries including India, Poland, Ireland, and Turkey were also built or expanded, most of them being multilingual call centers for international customers. By buying the Belgian direct-marketing company Vicindo, Arvato Services Benelux has secured the market leadership in the print, mail and fulfillment markets in Belgium. The AZ Direct subsidiary, which offers full-service customer recruitment and customer loyalty solutions, took over the Swiss DM-Plus group, bringing it a big step closer to market leadership in Austria and Switzerland. Meanwhile, in Germany, the takeover of the BFS Health Finance GmbH marked Arvato's entry into the health services market. Logistics services were extended with a focus on customers in the Telco, IT, and High-tech industries. The takeover of the Verlag Automobil Wirtschaft GmbH (VAW group) gave Arvato Services a full-service provider for technical documentation with operations in six countries, and another income driver in the automotive industry.

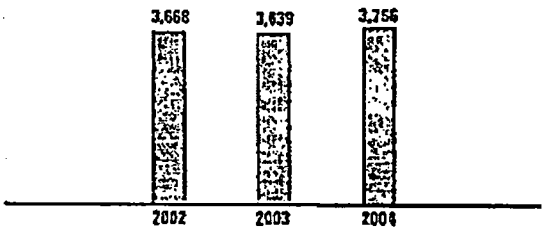
Arvato Print's business showed consistently good plant utilization. Results in Germany improved year on year, and remained stable at the international level. Arvato, Gruner + Jahr and the Axel Springer AG have agreed to merge their German gravure operations, as well as a new gravure project in Liverpool, in a joint venture (see "Outlook" section, page 44). An investment volume of €170 million has been earmarked for building the state-of-the-art gravure plant in



Operating EBIT in € millions



Revenues in € millions



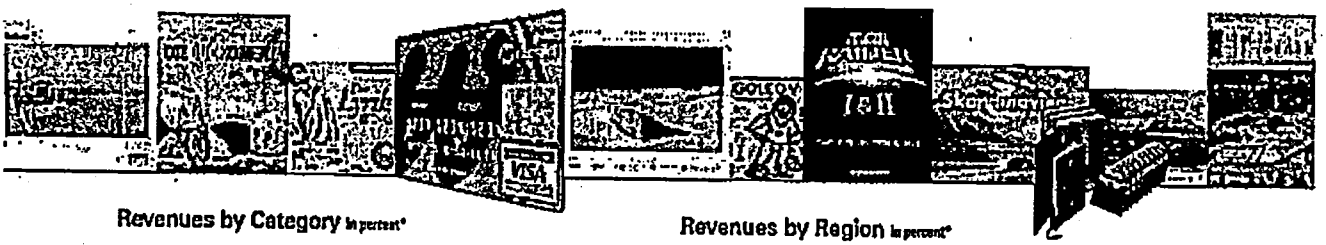
Liverpool. The construction of the "New Eurogravure" plant in Treviglio, Italy – a €110 million investment project – proceeds on plan. As part of a major €55 million project at the Maul Belser media group, the world's first gravure printer with a web width of 4.32 meters was installed and put into operation; the launch of a second such printer is planned for 2005/06. The division also successfully concluded the restructuring of its offset printing business in Spain.

In the Arvato Storage Media unit, Sonopress, a manufacturer of optical storage media, did well in its various markets, significantly increasing its volume of CDs and DVDs and enlarging its market share. Results were impacted by massive increases in the price of polycarbonate, which resulted in deteriorating margins. An investment program served to enhance the productive capacity of all of Sonopress' CD and DVD factories.

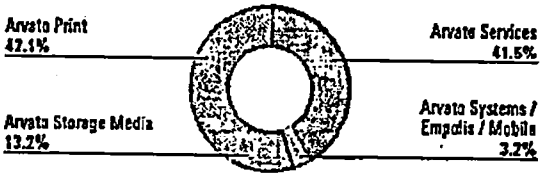
Arvato Systems – the IT unit – grew its external customer base. Arvato also made progress in the international extension of its mobile services unit, Arvato Mobile. The range includes everything from messaging services, mobile direct marketing, and mobile voting services down to Platform Hosting. At this point, Arvato Mobile does business as a full-service provider in 13 countries. Based on positive developments, especially in B2B, Arvato Mobile greatly improved its revenues and result.

ARVATO HIGHLIGHTS 2004

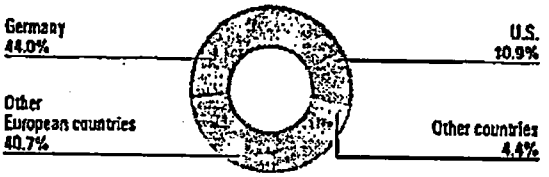
- All business units closed the year with a profit; Arvato Services showed strong growth
- The takeover of the majority of shares in Phone Assistance, a Moroccan call center services provider, enhanced Arvato's leading position in the French-speaking market
- Gruner + Jahr, Arvato and the Axel Springer AG agreed to form a gravure joint venture; the project is pending antitrust approval
- Sonopress enlarged its market share and increased its CD and DVD production capacity
- The international expansion of the mobile services offered by Arvato Mobile proceeds apace; the unit now does business as a full-service provider in 13 countries



Revenues by Category in percent*



Revenues by Region in percent*

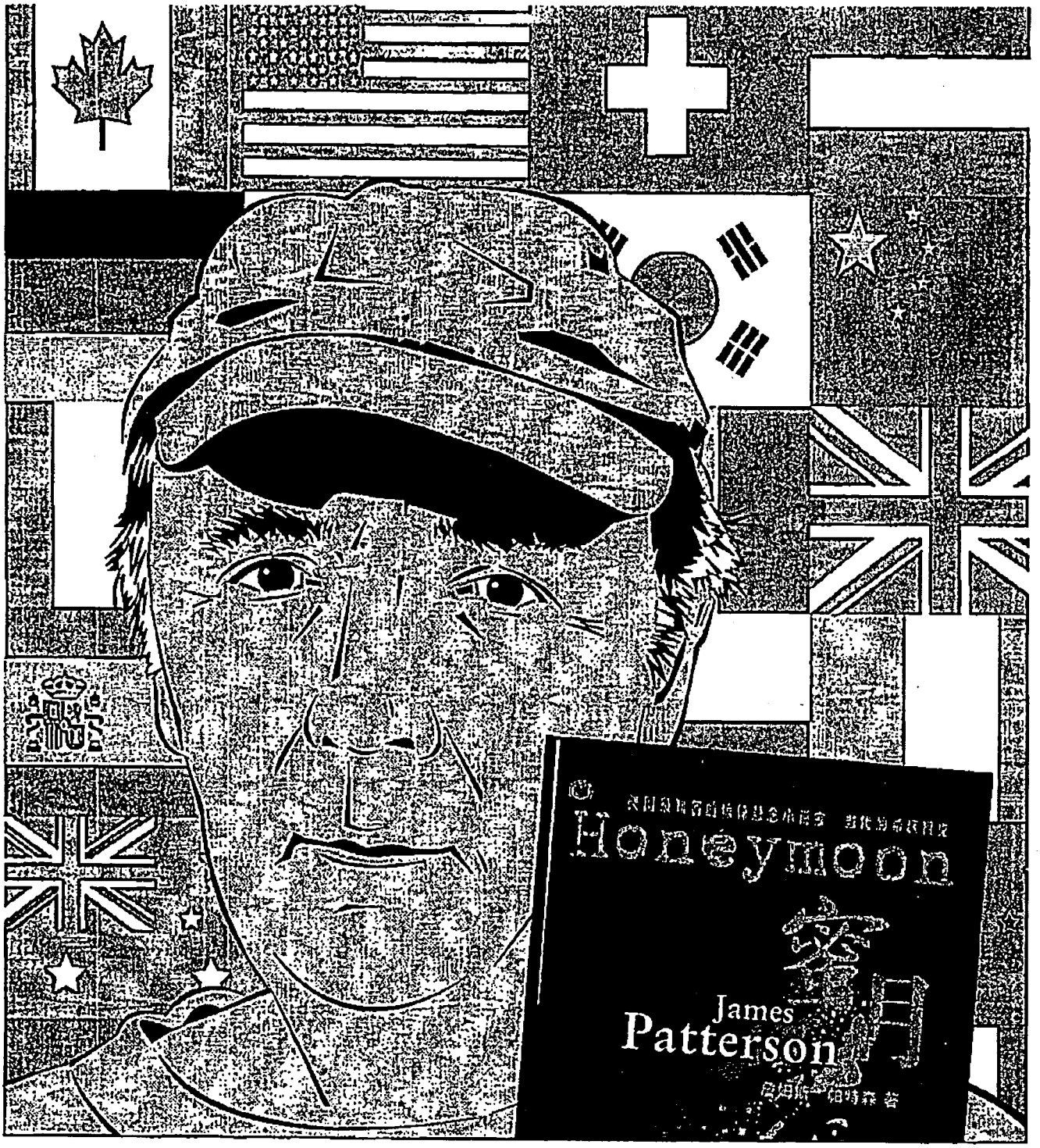


*Without intercompany revenues

DIRECTGROUP

BERTELSMANN

Direct Group Bertelsmann bundles Bertelsmann's worldwide direct-to-customer business with media products. More than 30 million club members drive Direct Group's business and ensure its position as one of the world's biggest media traders. At the heart of the business are its book and music clubs in 22 countries, including famous brands like France Loisirs (France), Book-of-the-Month-Club (U.S.), Der Club (Germany), Circulo de Lectores (Spain), and BMG Direct (U.S.). Members can access the clubs' broad range of products using catalogs, the Internet, or one of the 600-odd club centers around the world. Direct Group Bertelsmann is a wholly owned subsidiary of Bertelsmann AG.



GLOBAL MARKETING POWER

An innovation in the global book market: James Patterson's new thriller "Honeymoon" is published simultaneously in 16 countries, and exclusively through Direct Group's book clubs.

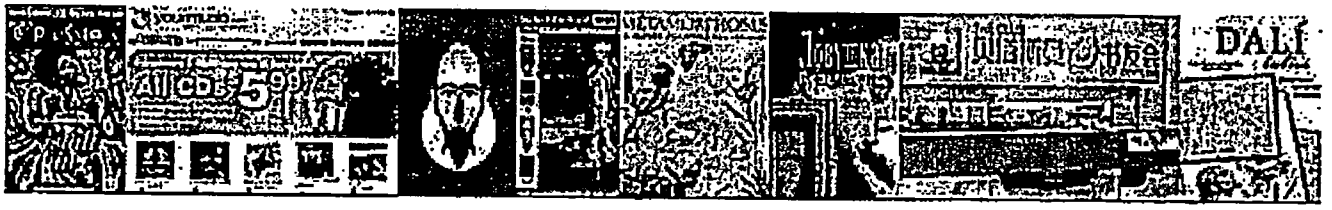
International bestsellers, made to order.

DIRECT GROUP HIGHLIGHTS 2004

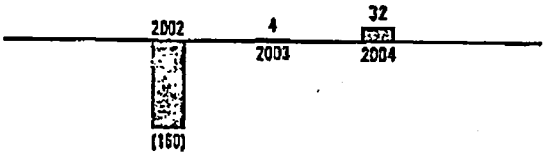
- Revenue decline slowed down considerably from the trend in previous years
- The French club announced the takeover of 50 percent in the French book club "Grand Livre du Mois" to strengthen core business; the transaction is pending antitrust approval
- An innovative approach: the online subscription service Yourmusic.com offers its customers the option of making personal selections from several thousand music titles for a fixed monthly fee
- The Family Leisure Club acquired in the Ukraine shows strong, profitable growth
- Growth in Asia: in Korea, club activities are now run by a joint venture with Korea's Daekyo company, which specializes in educational and entertainment products; in China, the extension of the store network proceeds apace
- The Shopping.com price comparison portal successfully went public in New York (Nasdaq)

Direct Group with its international club business activities generated improved results in 2004, though revenues continued to decline, to €2.2 billion (previous year: €2.3 billion). Operating EBIT rose to €32 million. The previous year, following a successful turnaround of the business, it was at €4 million. These positive developments may be attributed to higher results achieved by a number of clubs, as well as continued cost savings. Adjusted for currency effects, the revenue decline slowed down considerably from the trend in previous years. This moderate revenue decline is the result of consumer reluctance in important core markets and a slightly smaller membership base at the beginning of 2004. However, the main factor impacting revenue developments was the continuing deterioration of the U.S. dollar against the euro.

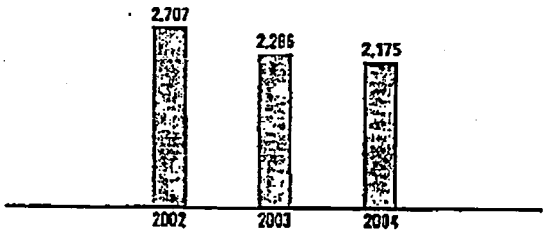
The club businesses in Southern and Western Europe continue on the road to success. The unit that includes France, Spain, Portugal, Italy, and Switzerland boosted its revenues slightly and further enhanced its status as Direct Group's biggest profit earner. The French club France Loisirs, one of Direct Group's biggest clubs, showed sustained growth. To strengthen its core business, the French club in December announced the takeover of 50 percent in the French book club "Grand Livre du Mois," which is still pending antitrust approval. The large U.S. book and music clubs Bookspan and BMG Direct, which account for about a third of Direct Group's total turnover, also showed positive



Operating EBIT in € millions



Revenues in € millions



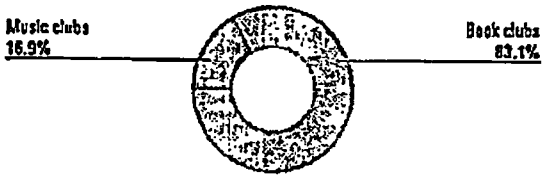
development and were able to improve their profitability significantly – unlike the clubs in Germany and the U.K., which suffered revenue declines. Yet, despite its revenue decline, the German club was able to further narrow its operating losses thanks to extensive cost-cutting measures. In December, a changeover in the management of the German-language operations was announced, which entails extensive restructuring measures in the German club business. Restructuring and a management changeover were instigated for BCA in the U.K. as well.

For Direct Group, 2004 was a year of innovations and of expansion to new growth markets. The French club France Loisirs is striking two new paths to expand on its traditional club business: one is a partnership with Audible.com, the leading U.S. vendor of online audiobooks, to offer downloads of the latest books as well as recordings of magazine articles and radio programs. This service, which is also available to non-club members, was launched in December, and positions France Loisirs as a trailblazer for digital applications in the French book market. The other path taken by France Loisirs involves the bricks-and-mortar business: the "Place Media" department stores represent a new, integrated marketing concept in partnership with local booksellers. Place Media combines the club's range with a broad selection of books, photo finishing services and multimedia products, making it an attractive destination for all media buyers. Innovative club models are also being tested at Bookspan (a book club) and BMG Direct (a music club) in the U.S., as well as at BCA in the U.K. For instance, the online subscription service Yourmusic.com offers its customers the option of making their own personal selection from several thousand music titles for a fixed monthly fee.

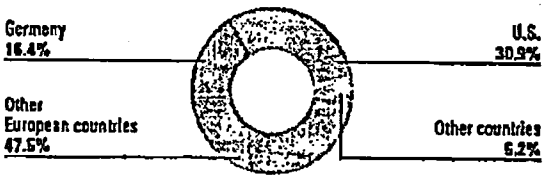
In addition to pursuing innovative business models, Direct Group set the points for future growth by practicing regional expansion. In September, the group announced its full takeover of the Family Leisure Club in the Ukraine with over 700,000 members and showing strong, profitable growth. Its mostly Russian-language publishing range also provides a possible stepping stone for expanding the business to neighboring Russia. Beyond Eastern Europe, Asia is Direct Group's second growth region. In Korea, club activities will henceforth be run by a joint venture with Korea's Daekyo company, which specializes in educational and entertainment products. In China, the extension of the store network as part of the "21st Century" joint venture proceeds apace: about 40 new bookstores were opened in 2004. The Chinese club stores sell books to non-members as well, albeit at different prices than to members.

In October, the Shopping.com price comparison portal, in which Direct Group is the biggest single shareholder with a roughly 11-percent stake, successfully went public in New York (Nasdaq).

Revenues by Category In percent*



Revenues by Region In percent*



*Without intercompany revenues

Corporate

"Corporate" includes the cost of the Corporate Center and results from investments made at the corporate level. Corporate Center expenditure arises from corporate management and governance tasks. Corporate Investments include all holdings that are not assigned to a specific corporate division. Corporate Operating EBIT totaled minus €72 million in 2004 (previous year: minus €90 million). This improvement is due in part to continued cost savings.

Risk Report

Bertelsmann has an integrated risk management system. This system is established as a fixed part of the company's management structure, is subject to continual evolution, and is part of ongoing reporting. The risk management system strives to identify and control potential risks from operating businesses, participations and financial assets. A major element of the risk identification process is a risk inventory which lists risks year by year, and then aggregates them at corporate level. This year, the risk reporting process identified the following significant risks for the Bertelsmann group and for Bertelsmann AG. Measures are continuously taken to monitor, reduce and/or eliminate these risks, which are subject to constant observation.

Doing business on an international scale exposes Bertelsmann to a range of financial risks. In particular, these include the effects of fluctuations in exchange and interest rates. Several hedging instruments are used, mainly interest and currency swaps and forwards.

The revenues generated by the RTL Group TV channels are highly dependent on advertising sales and thus exposed to the risk of a deteriorating TV advertising market. Keeping and extending viewer shares are thus important goals. At the same time, RTL Group is further reducing its dependency on advertising sales by diversifying its revenue base. International sports and movie rights are generally bought in U.S. dollars. Thus, significant exchange rate movements can have direct implications for RTL Group's profitability. To limit the currency risk, the RTL Group treasury department hedges foreign-currency contracts to an appropriate extent.

Random House is very dependent on the economic climate in North America, the U.K. and Germany for its growth prospects in these markets. These conditions can be expected to intensify competition with rival publishers, for market shares as well as for prospective authors. Further concentration among important key customers could also lead to increased pressure on margins. Alternative media and recreational offerings will continue to compete for the core book consumer's sparse free time in the medium term. Random House will be counteracting these competitive risks with editorial programs in new publishing areas and with expansion in Asia.

At Gruner + Jahr, advertising and sales revenues – as well as the revenue performance of the printing operations – are directly dependent on macroeconomic developments and competition in the magazine sales and advertising market. A weak economy could lead to a decline in sold circulation, which could result not only in declining sales revenues, but could also necessitate intensified sales and marketing expenditure. An appropriate product and marketing strategy is in place to try and maintain the market position achieved, or even improve on it.

The unlicensed use of copyrights in the form of free downloads, file sharing, and counterfeits of recorded music holds considerable risk for Sony BMG's recorded music business, and to a lesser degree for BMG Music Publishing's rights trading business. This, in connection with a music market that has been shrinking for several years, holds the threat of further revenue declines. In August 2004, Sony Music and BMG merged their recorded music operations

into Sony BMG, and a worldwide integration process was initiated. The integration has proceeded on schedule, and will be concluded in fiscal 2005. Nevertheless, a process of this magnitude involves risks that are unpredictable or very difficult to predict, e.g. in the area of systems integration.

Existing excess capacity and intense price competition may present a profit risk for the Arvato division, especially its Arvato Print and Arvato Storage Media units. Arvato's response to geographic and industry-specific macroeconomic risks is to diversify its range of services and establish a global presence. The flat music market, with declining CD volumes, and the substitution of CD-ROMs by DVD-ROMs, also present a risk for Arvato as a producer of physical storage media.

In its core markets Europe and North America, Direct Group is exposed to increasingly intense competition and a direct dependence on consumers' buying behavior. A lasting improvement in member recruitment, activation and loyalty continues to be a major challenge for Direct Group. Given the situation in various countries – including in the U.K. and Germany – further consolidation and/or strategic realignment may become necessary.

As an international group, Bertelsmann is also subject to several legal risks. This applies particularly to legal disputes in the U.S., where there are legal institutions unknown in Germany, such as class actions, punitive damages and pre-trial discovery. The outcomes of currently asserted or future unasserted lawsuits cannot be foreseen with any degree of certainty.

Legal risks could arise from the following lawsuits: Various music publishers and record labels submitted claims against Bertelsmann in a U.S. court in 2003. The plaintiffs base their claims on the allegation that Bertelsmann, by granting loans to the music file-sharing platform Napster (which has since gone bankrupt) enabled the service to survive longer than it would have done otherwise, and thereby contributed to the breaches of copyright by Napster and its users. As the allegations made by the plaintiffs are completely without legal foundation, Bertelsmann has only made provisions for expected lawyer fees on the balance sheet.

After the End of the Fiscal Year

In early February, the British council of East Riding signed an agreement with Bertelsmann's Arvato division to the effect that Arvato will take over parts of the council's administrative duties. Under the terms of this public private partnership, Arvato will handle the collection of local taxes, the administration of the citizens office, and wage accounting for the municipality's civil servants. It will also be in charge of all information technology.

Further, Arvato and the Infoscore group in Baden-Baden agreed to merge their operations in the integrated management of data, information and receivables into a joint venture. The new joint venture will offer its clients customized services and products for customer relationship management from a single source. The merger has been submitted to the appropriate antitrust authorities for approval.

Outlook

Bertelsmann expects the market to recover slightly in 2005. In light of a continuing weak domestic demand, Bertelsmann believes further development in the German media markets may be muted. A slight growth in the advertising and book markets is anticipated in the euro region and the U.S. The decline in the global music market is likely to slow down. Overall Bertelsmann forecasts higher revenues and profits.

RTL Group expects increased revenues and earnings in 2005, resulting from growth in the relevant markets, and improved viewer and listener market shares. Random House foresees a slight increase in revenues and earnings. Gruner + Jahr anticipates increased advertising sales, which will lead to an improved operating result. Gruner + Jahr also plans to increase its stake in the Motor-Presse Stuttgart publishing group, to expand into market segments in which it is not yet present. This acquisition is still pending antitrust approval. In the print sector, Bertelsmann plans to counteract growing price and cost pressure with a gravure joint venture, which would safeguard this line of business for the long term. Arvato, Gruner + Jahr and Axel Springer AG have agreed to merge their German gravure operations, as well as a gravure project in Liverpool, in a joint venture. An agreement to this effect was signed and submitted to the EU Commission in Brussels for antitrust review. Arvato und Gruner + Jahr each have a 37.45-percent stake in the joint venture, while Axel Springer AG holds 25.1 percent.

The BMG division expects to compensate the continuing decline in the global recorded-music business by adding market shares, and to further increase profits through the cost-cutting measures initiated at Sony BMG. This development will be supported by the global exploitation of its sales and marketing strength, the worldwide commercialization of both catalogs (Sony Music and BMG), and the tapping of new profitable revenue streams, especially music videos and digital products.

Arvato forecasts rising revenues and results in an intensely competitive environment – through process optimization, improvement of plant utilization and enhanced productivity.

Direct Group anticipates a slight growth in revenues and profits, to be achieved through operational measures such as continually improving the clubs' appeal, optimizing new customer recruitment, and focusing on customer loyalty, as well as through geographic expansion.

CORPORATE GOVERNANCE AT BERTELSMANN

Bertelsmann continues to see excellent corporate governance as its mission and mandate. Corporate governance is embedded in the corporate constitution and is an element in Bertelsmann's unique corporate culture. The performance of the Executive and Supervisory Boards is therefore subject to ongoing evaluation, discussion and evolution.

Since coming into effect in February 2002, the recommendations and suggestions of the German Corporate Governance Codex have also provided a benchmark for corporate management and supervision. The internal rules and procedures of the Bertelsmann Executive Board, Supervisory Board, and Annual General Meeting, as well as the company's accounting and transparency principles, are measured by this standard. The German Corporate Governance Codex has seen no changes since May 2003, meaning there were no new stipulations in fiscal 2004. Instead, interest in 2004 centered on a variety of legislative initiatives to implement the German government's 10-Point Plan on "Corporate Integrity and Investor Protection," some of which are already in force. Beyond strengthening investor protection, the 10-Point Plan aims at the practical implementation of proposals made by the Government Commission on Corporate Governance.

The Bertelsmann AG Executive Board has direct responsibility for the management of the company. The Supervisory Board supervises the Executive Board and advises it in strategic matters and important business transactions. The Executive Board and the Supervisory Board have a close and mutually trusting working relationship, thereby reconciling the demands of effective corporate governance with the necessity of rapid decision-making. Fundamental matters of corporate strategy and its implementation are discussed and coordinated in joint sessions.

One essential element in Supervisory Board work at Bertelsmann has long been the delegation of competences and tasks to Supervisory Board committees. Empowering the committees gives the Supervisory Board more time to focus on decisions reserved for the plenum and on strategically important decision-making processes. The committees' decisions are then presented to the plenum. The scope and extent to which competences and tasks are delegated to the committees are subject to ongoing scrutiny as part of the Supervisory Board's self-evaluation. In addition to the Personnel Committee, the Bertelsmann AG Supervisory Board has set up a Strategy and Investment Committee, an Audit and Finance Committee, and a Working Group of Employee Representatives on the Supervisory Board.

Bertelsmann AG has decided to adopt the recommendations and suggestions of the German Corporate Governance Codex despite being an unlisted corporation with a limited number of shareholders. The rules for organizing the Annual General Meeting, which are aimed at listed corporations, are an exception. Further, the company's Directors and Officers liability insurance (D&O) provides for no deductible for members of the Executive and Supervisory Boards. The shareholders of Bertelsmann AG have full knowledge of the individual compensation of each member of the Executive and Supervisory Boards.

The Executive Board

The Supervisory Board

"Bertelsmann continues to see excellent corporate governance as its mission and mandate. Corporate governance is embedded in the corporate constitution and is an element in Bertelsmann's unique corporate culture."

SUPERVISORY BOARD REPORT

During fiscal year 2004, the Supervisory Board fulfilled the duties incumbent upon it by law, the articles of association and by-laws. The Supervisory Board was involved in all decisions of key relevance to the company. The Supervisory Board received regular oral and written reports on the business developments, the state of the company, and plans for major investments. It discussed the company's strategic alignment and significant business transactions with the Executive Board, made recommendations, and monitored compliance with the outline conditions set for the management of the company. The Supervisory and Executive Boards held a whole-day meeting to review basic matters of corporate strategy.

During fiscal year 2004, the Supervisory Board convened for four regular meetings. The Strategy and Investment Committee met six times, including phone conferences. The Personnel Committee met four times, the Audit and Finance Committee five times. The Working Group of Employee Representatives on the Supervisory Board convened four times. Between meetings, the Supervisory Board was notified, in writing, about projects and plans that were of special relevance and urgency for the company and – if applicable – asked for its opinion and/or decision. Beyond the Supervisory Board meetings, the Chairman of the Supervisory Board maintained an ongoing dialog with the Executive Board in general and the Chairman & CEO in particular. The primary topics covered were the current business situation and major business transactions.

Bertelsmann AG's consolidated financial statements and group management report for the fiscal year from January 1 through December 31, 2004 were audited by KPMG Deutsche Treuhand-Gesellschaft Wirtschaftsprüfungsgesellschaft, Berlin, and received an unqualified auditor's opinion.

The Supervisory Board Audit and Finance Committee determined the main focuses of the annual audit, together with the group auditor. The committee discussed the findings of the audit in detail. The auditor attended the Supervisory Board Audit and Finance Committee financial review meeting and submitted its report. The Supervisory Board noted and accepted the findings of the audit. After its own, final scrutiny of the consolidated financial statements and the group management report, the Supervisory Board raises no objections. The Supervisory Board approves the consolidated financial statements as prepared by the Executive Board.

The year under review saw the following changes to the composition of the Supervisory Board: In May, the Bertelsmann AG Annual General Meeting elected Dr. Claus-Michael Dill, Chairman & CEO of Axa Konzern AG (Cologne), and Dr. Hans-Joachim Körber, Chairman & CEO of Metro AG (Düsseldorf), as new Supervisory Board members. Prof. Dr. Michael Hoffmann-Becking, a longtime member, left the Supervisory Board at the same time. The Supervisory Board thanks Mr. Hoffmann-Becking for many years of mutually trusting collaboration, also on behalf of the shareholders. After former Supervisory Board Chairman Gerd Schulte-Hillen had resigned from his mandate at December 31, 2003, the Bertelsmann Supervisory Board is complete again with the election of the two new members.

There were no changes to the Bertelsmann AG Executive Board during the past fiscal year. In January 2004, the Supervisory Board decided to extend the appointment of Chairman & CEO Dr. Gunter Thielen through August 31, 2007. This decision ensures continuity at the top of the company. During the year under review, the Supervisory Board also decided to reappoint Messrs. Dr. Bernd Kun-

PROF. DR. DIETER H. VOGEL
Chairman of the Supervisory Board of Bertelsmann AG

drun, Hartmut Ostrowski, Rolf Schmidt-Holtz, and Dr. Ewald Walgenbach.

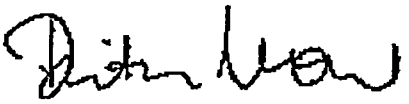
The market in fiscal year 2004 was restrained on the whole. Bertelsmann responded to the flat growth in the international media markets with its "Growth and Innovation" (GAIN) initiative. The Supervisory Board fully supports this initiative to generate organic growth and focus on improving the profitability of core businesses. A significant improvement in the operating result for fiscal year 2004 confirms the Supervisory Board in its belief that this direction, combined with Bertelsmann's proven decentralized management, is a winning path into the future.

The Supervisory Board constructively supported the Executive Board in its strategic measures to improve the competitiveness of important core businesses through M&A transactions. In this context, one key topic was the formation of the Sony BMG Music Entertainment joint venture in August 2004 following its approval by the EU and U.S. antitrust authorities, as well as the subsequent – and still ongoing – integration process. Beyond this, the planned merger of the German gravure operations of Arvato, Gruner + Jahr, and Axel Springer AG, including Arvato's plant currently under construction in Liverpool, were approved following extensive discussions. This step serves to gain long-term security for Bertelsmann's printing business. Likewise, the Bertelsmann AG Supervisory Board endorsed Gruner + Jahr's plans to acquire the majority of shares in Motor-Presse Stuttgart. This strategically important acquisition project enhances Gruner + Jahr's domestic and international magazine portfolio. Both transactions are still pending antitrust approval.

The Executive Board and Supervisory Board regularly discussed the company's financial situation. All of the financial targets jointly defined for Bertelsmann AG were met in fiscal year 2004.

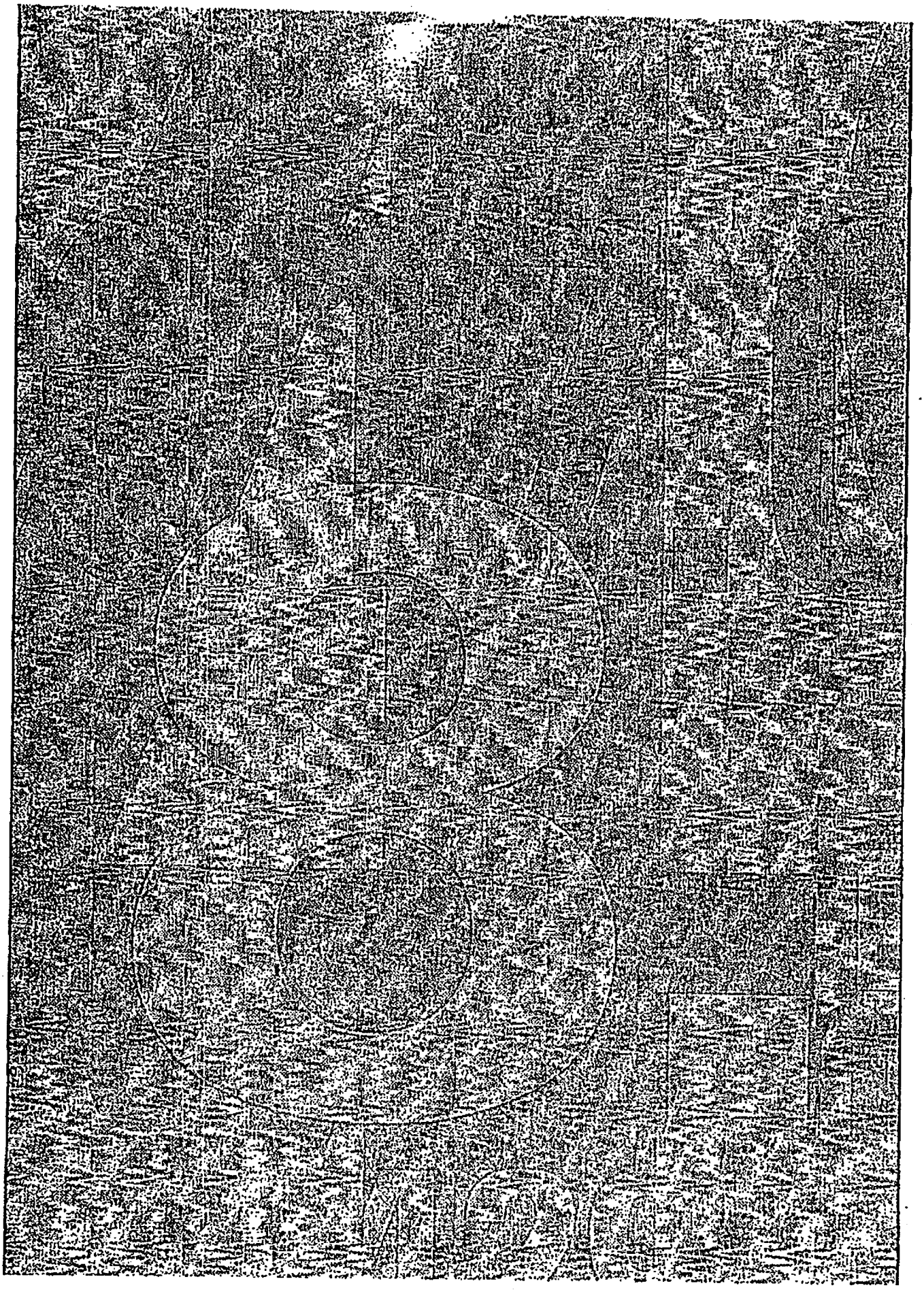
The Supervisory Board pays tribute to the Executive Board for its entrepreneurial success during the past fiscal year. It also thanks all executives and employees for their dedication and achievements.

Gütersloh, March 15, 2005



Prof. Dr. Dieter H. Vogel

"A significant improvement in the operating result for fiscal year 2004 confirms the Supervisory Board in its belief that the focus on organic growth, combined with Bertelsmann's proven decentralized management, is a winning path into the future."



CONSOLIDATED FINANCIAL STATEMENTS

CONSOLIDATED INCOME STATEMENT
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Consolidated Income Statement in € millions

	Notes	2004	2003 (adjusted)
Revenues	1	17,061	16,801
Other operating income	2	685	817
Change in inventories		80	26
Own costs capitalized		188	124
Cost of materials		(4,988)	(4,658)
Royalty and license fees		(1,391)	(1,650)
Personnel costs	3	(4,204)	(4,151)
Amortization of intangible assets and depreciation of property, plant and equipment excluding goodwill	4	(671)	(814)
Other operating expenses	5	(5,222)	(5,445)
Results from associated companies[1]	6	37	(11)
Income from other participations	6	(1)	(13)
Special items	7	318	339
EBIT (earnings before interest and taxes)		1,747	1,365
Regular amortization of goodwill			(632)
Net interest	8	(78)	(95)
Other financial expenses and income	8	(189)	(227)
Financial result		(267)	(322)
Income taxes	10	(263)	(203)
Net income before minority interest		1,217	208
Minority interest		(185)	(54)
Net income after minority interest		1,032	154

[1] excluding amortization of goodwill in 2003

Reconciliation to Operating EBIT

EBIT (Earnings before interest and taxes)		1,747	1,365
Special items:	7		
– Impairment of goodwill		34	208
– Gains/losses on disposals of participations		(305)	(620)
– Other special items		(46)	73
Operating EBIT	4	1,429	1,026
Operating EBITDA	4	2,112	1,866

Consolidated Balance Sheet in € millions

	Notes	12/31/2004	12/31/2003
Assets			
Non-current assets			
Goodwill	11	6,395	6,632
Other intangible assets	11	1,321	901
Property, plant and equipment	13	2,369	2,254
Investments in associates	14	432	398
Other financial assets	14	683	419
		11,205	10,604
Current assets			
Inventories	15	1,933	1,820
Trade accounts receivable	16	2,827	3,041
Other receivables and other assets	16	2,865	2,573
Cash and cash equivalents	17	2,092	1,642
		9,717	9,076
Deferred tax assets	18	286	275
Prepaid expenses		162	209
		20,970	20,164
Equity and liabilities			
Equity	19		
Subscribed capital		1,000	606
Capital reserve		2,331	2,725
Retained earnings		2,147	3,181
Net income after minority interest		1,032	154
Shareholders' equity		7,510	6,668
Minority interest		1,336	965
		8,846	7,631
Third-party liabilities			
Profit participation capital	19	706	706
Provisions			
Provisions for pensions and similar obligations	20	1,874	1,701
Other provisions[1]	21	619	1,174
		2,493	2,875
Liabilities			
Financial debt	22	2,144	2,452
Trade accounts payable[1]	22	3,685	3,826
Other liabilities[1]	22	2,587	2,218
		8,416	8,506
Deferred tax liabilities	18	208	114
Deferred income		301	332
		20,970	20,164

[1] Reclassification of short-term provisions in 2003

Consolidated Cash Flow Statement in € millions

	2004	2003
Net income before minority interest	(121)	209
Depreciation and write-ups of non-current assets	695	1,680
Change in long-term provisions	53	51
Other income/expenses not affecting cash flows	(424)	(566)
Result from disposals of non-current assets	(6)	(39)
Change in net working capital	(19)	28
Net cash from operating activities	**1,654**	**1,362**
Investments in:		
– intangible assets	(157)	(166)
– property, plant and equipment	(498)	(413)
– financial assets	(123)	(43)
– purchase price for acquired entities (net of acquired cash)	(85)	(139)
Proceeds from disposal of non-current assets	366	1,537
Net cash from investing activities	**(497)**	**(976)**
Change in bonds and promissory notes	(297)	867
Change in financial debt	(78)	(1,792)
Change in shareholders' equity	20	(216)
Dividend Bertelsmann AG and minority interest	(315)	(337)
Net cash from financing activities	**(670)**	**(1,478)**
Change in cash and cash equivalents	**487**	**(160)**
Exchange rate movements and other changes in cash and cash equivalents	(37)	(95)
Cash and cash equivalents at the beginning of the period	1,642	977
Cash and cash equivalents at the end of the period	**2,092**	**1,642**

Details of the cash flow statement are set out in note 27

Consolidated Statement of Changes in Shareholders' Equity in € millions

	Subscribed capital	Capital reserve	Retained earnings	Other comprehensive income: Currency translation differences	Other comprehensive income: Available-for-sale securities	Other comprehensive income: Derivative financial instruments	Net income after minority interest	Shareholders' equity	Minority interest	Total
Balance at 12/31/2002	606	2,725	2,457	14	4	(49)	928	6,685	1,059	7,744
Change in shareholders' equity due to										
Dividends		–		–		–	(240)	(240)	(97)	(337)
Other changes		–	(18)	–		–		(18)	(38)	(56)
Other comprehensive income										
Currency translation differences		–		54		–		54	(12)	42
Other changes		–		–	27	4		31	(1)	30
Change recognized in income										
Transfer to retained earnings		–	688	–		–	(688)			
Net income		–		–		–	154	154	54	208
Balance at 12/31/2003	606	2,725	3,127	68	31	(45)	154	6,666	965	7,631
Change in shareholders' equity due to										
Dividends		–		–		–	(220)	(220)	(95)	(315)
Other comprehensive income										
Currency translation differences		–		(42)		–		(42)	2	(40)
Other changes	394	(394)	21	–	51	2		74	279	353
Change recognized in income										
Transfer from retained earnings		–	(66)	–		–	66			
Net income		–		–		–	1,032	1,032	185	1,217
Balance at 12/31/2004	1,000	2,331	3,082	26	82	(43)	1,032	7,510	1,336	8,846

Details of the statement of changes in shareholders' equity are set out in note 11

Segment Reporting Primary Format in € millions

	RTL Group 2004	RTL Group 2003[1]	Random House 2004	Random House 2003	Gruner + Jahr 2004	Gruner + Jahr 2003	BMG 2004	BMG 2003
Consolidated revenues	4,862	4,393	1,777	1,755	2,425	2,471	2,632	2,680
Intercompany revenues	10	59	14	21	14	10	15	32
Divisional revenues	4,872	4,452	1,791	1,776	2,439	2,481	2,647	2,712
Operating EBIT	666	503	140	115	210	233	162	54
Special items	(24)	(102)	7	(2)	(11)	5	58	(89)
EBIT	642	401	147	113	199	238	220	(35)
ROS in %	13.7%	11.3%	7.8%	6.5%	8.6%	9.4%	6.1%	2.0%
Depreciation and amortization	212	609	49	104	76	192	70	207
Investments[2]	214	206	28	75	38	86	112	72
Segment assets	6,824	6,525	1,749	1,893	1,277	1,448	2,752	2,529
Segment liabilities	1,935	1,952	709	765	583	570	293	1,406
Results from associates[3]	28	16		(1)	4	2	7	(8)
Investments in associates	376	334	2	2	11	9	10	4
Employees (on closing date)	8,117	7,254	5,383	5,525	11,671	11,352	4,259	4,890
Employees (average)	7,717	7,269	5,408	5,487	11,632	11,849	4,510	5,090

1) 2003 adjusted for retrospective application of IFRS 2, see note on prior financial statements
2) Net of acquired cash
3) Excluding amortization of goodwill in 2003

Secondary Format in € millions

	Germany 2004	Germany 2003	Other European Countries 2004	Other European Countries 2003	USA 2004	USA 2003	Other countries 2004	Other countries 2003
Consolidated revenues	5,059	5,166	7,182	6,486	3,816	4,210	959	939
Segment assets	7,825	7,985	6,243	5,616	3,438	3,138	2,461	1,142
Investments	307	316	312	270	180	150	64	25

Details of the segment reporting are set out in note 5

	Arvato		Direct Group		Total Divisions		Corporate		Consolidation/other		Total Group	
	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
	3,249	3,070	2,150	2,264	17,003	16,633	13	10		158	17,016	16,801
	507	569	17	22	583	713		1	(583)	(714)		–
	3,756	3,639	2,175	2,286	17,586	17,346	13	11	(583)	(556)	17,016	16,801
	310	261	32		1,522	1,170	(72)	(90)	(21)	(54)	1,429	1,026
	(12)	(2)	2	124	28	(65)	290	405		(1)	318	339
	298	259	34	128	1,550	1,105	218	315	(21)	(55)	1,747	1,365
	8.0%	7.2%	1.5%	0.2%	8.8%	6.7%	–	–	–	–	8.1%	6.1%
	186	235	40	85	632	1,432	11	233		15	643	1,680
	369	224	57	39	818	702	45	45		14	863	761
	2,173	1,984	1,935	877	15,476	15,256	2,530	2,759	(262)	(134)	17,752	17,881
	133	1,248	520	522	8,371	6,463	413	844	(215)	(269)	8,569	7,038
	2	(1)	2	(7)	4	1	6	(12)		–	37	(11)
	42	–	6	–	406	363	3	49		–	437	398
	33,811	31,405	12,116	11,893	75,359	72,309	907	912		–	76,266	73,221
	32,857	31,245	11,879	11,993	74,703	72,923	947	913		1,282	75,050	75,118

	Group	
	2004	2003
	17,016	16,801
	17,752	17,881
	863	761

NOTES

General Principles

The consolidated financial statements of Bertelsmann AG for the year ended December 31, 2004 have been prepared in accordance with International Financial Reporting Standards (IFRS), including all currently applicable standards and interpretations issued by the International Accounting Standards Board (IASB). Except for the measurement of financial instruments, the consolidated financial statements have been prepared using the historical cost principle in compliance with IFRS.

The consolidated financial statements prepared in accordance with IFRS are consistent with the European Union's directive on group accounting and reporting (Directive 83/349/EEC). The main differences between IAS and HGB are set out in note 30. As the conditions for applying § 292a of the German Commercial Code (HGB) are met, consolidated financial statements have not been prepared in accordance with the regulations set out in HGB.

The consolidated financial statements have been prepared in euros; all amounts are stated in millions of euros (€ million). For the sake of clarity, certain captions in the income statement and in the balance sheet have been combined. These captions are disclosed in more detail and explained in the notes.

Effects of Applying New Accounting Standards

Bertelsmann has applied IFRS 3 (business combinations) and the amended versions of IAS 36 (impairments of assets) and IAS 38 (intangible assets) since January 1, 2004. As a result, regular amortization of goodwill, and rights similar to goodwill with indefinite useful lives, is no longer expensed in the income statement. On the other hand, these assets are subject to an annual impairment test and are subject to an impairment write-down, if applicable.

As a result of this change in accounting policy, amounts in the prior period income statement were adjusted in order to improve comparability. In this connection, all amortization of goodwill has been shown as a separate line item. Goodwill impairment write-downs are included under special items. Prior year segment results have been adjusted to reflect the retrospective application of IFRS 3. After reflecting the expanded definition of special items, Operating EBIT now represents the previously reported Operating EBITA, less amortization of rights similar to goodwill with limited useful lives. Short-term provisions of €1,706 million shown in the prior year's balance sheet have been reclassified to enhance international comparability and are now included under liabilities, reflecting their classification in the 2004 balance sheet.

Consolidation

Consolidation Methods

All material subsidiaries controlled either directly or indirectly by Bertelsmann AG as defined by IAS 27 have been consolidated. Material jointly-controlled companies as defined by IAS 31 have been proportionately consolidated. Material associated companies as defined by IAS 28 are reported using the equity method. This is deemed to be the case if between 20 percent and 50 percent of the company's voting stock is held. A list of material subsidiaries and participations is set out in note 33. All consolidated financial statements of the Bertelsmann group are prepared in accordance with uniform accounting policies.

Investments in subsidiaries are consolidated using the purchase method, by which, at the time of purchase, the acquisition cost of the investment is offset against the interest in the fair values of the net assets shareholders' equity acquired. If the acquisition cost exceeds the fair values of assets and liabilities acquired, this difference is recognized in the balance sheet as goodwill. Deferred taxes are recognized on temporary differences arising as a result of stating the proportion of assets and liabilities acquired at fair values at the time of acquisition to the extent such fair value adjustments are not also recognized for tax purposes. Differences arising as a result of stating assets and liabilities acquired at their fair values are carried forward, depreciated or released in the periods following the acquisition, depending on the nature of the assets and liabilities to which they relate. Negative goodwill is reflected as income in the period in which the acquisition is made. Minority interest also includes the fair values of their share of assets and liabilities. Investments in proportionately consolidated companies are measured using the same principles.

Investments in associated companies using the equity method are included at the proportionate share of the investment's shareholders' equity. The same method as for fully consolidated subsidiaries is used when accounting for differences between the purchase cost at the time of acquisition and the

share of net assets acquired. Associated company losses which exceed their carrying values are not recognized unless there is an obligation to make additional contributions.

All intercompany gains, losses, revenues, expenses, income, assets, liabilities, and provisions falling within the scope of the consolidation are eliminated. Deferred taxes are recognized on temporary differences arising on consolidation in accordance with IAS 12. Proportionate consolidations are carried out using the same principles. The group's share of unrealized profits or losses on intercompany transactions between group companies and associated companies is eliminated.

Scope of Consolidation

The scope of consolidation, including Bertelsmann AG, comprises 842 (previous year: 930) fully consolidated companies. All domestic and international affiliated companies are consolidated, with the exception of 237 companies (previous year: 137) which are not consolidated because they do not have significant business operations of their own and overall have no material impact on the group's net assets, financial position and results of operations.

The scope of consolidation changed during the year as follows:

Change in Scope of Consolidation

	Domestic	Foreign	Total
Consolidated at December 31, 2003	246	684	930
Additions	22	118	140
Disposals	(33)	(195)	(228)
Consolidated at December 31, 2004	235	607	842

Purchase price payments deducted by acquired cash and cash equivalents amounted to €85 million.

Sony Music and BMG merged their music businesses in August 2004 to form Sony BMG Music Entertainment, resulting in purchase costs of €558 million, which arose from the fair value of contributed assets and incidental costs.

Arvato acquired 55 percent of Phone Assistance S.A. in Marocco at the beginning of 2004, thus strengthening its strategic position in the call center business. The purchase price of €25 million led to goodwill of the same amount.

Following changes to the shareholder structure of M6, the French TV station, the participation in M6 was fully consolidated effective February 1, 2004; before that date, it had been proportionately consolidated. The consolidation involved stating the previous holding at fair values and, in accordance with IFRS 3, led to the recognition of additional intangible assets amounting to €261 million.

Acquisitions and disposals during the year had the following effect on Bertelsmann group's assets and liabilities as at the date of their initial consolidation or de-consolidation:

Effects of Acquisitions and Disposals in € millions

	Additions 2004	Disposals 2004	Net 2004	Additions 2003	Disposals 2003	Net 2003
Non-current assets	1,253	870	383	209	578	(369)
Current assets	867	864	3	65	361	(296)
Liabilities	1,266	1,245	21	58	484	(426)

239 (previous year: 119) joint ventures were proportionately consolidated in the consolidated financial statements.

The proportionate consolidation of joint ventures had the following effect on Bertelsmann group's assets, liabilities, income, and expenses:

Effects of Proportionate Consolidation in € millions

	12/31/2004	12/31/2003
Non-current assets	1,179	249
Current assets	[illegible]	1,057
Liabilities	1,829	702
Income	2,302	1,706
Expense	2,287	1,653

Changes compared with the previous year are mainly due to the proportionate consolidation of the joint venture, Sony BMG Music Entertainment, effective August 1, 2004 and the full consolidation of M6 since February 1, 2004.

125 (previous year: 94) associated companies were measured using the equity method. The increase mainly results from measuring Sportfive companies at equity, which were proportionately consolidated in 2003.

A list of the Bertelsmann group's shareholdings will be filed with the commercial register at the district court in Gütersloh (department B no. 3100). For 2004, those domestic subsidiaries listed in note 34 took advantage of the exemption from having their annual financial statements prepared, audited and published pursuant to § 264 para. 3 HGB and § 264 b no. 4 HGB.

Currency Translation

In Bertelsmann AG's consolidated financial statements, the financial statements of foreign subsidiaries are translated into euros using the reporting currency concept as described in IAS 21. Assets and liabilities are translated at the closing-date rate, while the income statement is translated at the average rate for the year. Currency translation differences are charged or credited directly to shareholders' equity. Such differences arise from translating items in the balance sheet at different rates compared with the previous year, and from using different rates to translate the income statement and balance sheet. When subsidiaries are de-consolidated, any related cumulative translation differences are reversed and recognized in income.

The following euro exchange rates were used to translate the currencies of those countries which are most significant to the Bertelsmann group:

Euro Exchange Rates for Major Foreign Currencies

Foreign currency unit per € 1		Average rate 2004	Average rate 2003	Closing rate 12/31/2004	Closing rate 12/31/2003
U.S. dollars	USD	1.2481	1.1312	1.3621	1.2630
Canadian dollars	CAD	1.6186	1.5898	1.6916	1.6234
British pounds	GBP	0.6892	0.6897	0.7051	0.7048
Japanese yen	JPY	134.12	131.06	139.65	135.04
Swiss francs	CHF	1.5418	1.5172	1.5443	1.5579

Accounting Policies

Revenue Recognition

Revenues are recognized when the service has been performed and risks have been transferred, except for revenues recognized using the percentage-of-completion method as set out in IAS 11. Other income is recognized when it is probable that the economic benefits will flow to Bertelsmann group and the amount can be measured reliably. Expenses are deferred based on underlying facts or the period of time to which they relate.

Interest income and expense are allocated to the period to which they relate. Dividends are recognized in the period in which the distribution is received.

Goodwill

Goodwill represents the excess of the purchase price of an acquired entity and the share of fair values of the assets and liabilities acquired. Goodwill is recognized as an asset and is subject to an annual impairment test. Any write-down is immediately charged to income as an impairment expense. Impairments of goodwill are not reversed.

Intangible Assets

Internally generated intangible assets are recognized at their development cost if the conditions for recognition as set out in IAS 38 have been met. Related borrowed capital costs are generally included as set out in IAS 23, but the amounts involved are insignificant to the group. Purchased intangible assets are stated at acquisition cost. Intangible assets are amortized on a straight-line basis over their useful lives. Capitalized software is amortized over a 3 to 4-year period, and licenses are amortized over the term of the respective license agreement. Supply rights and long-term subscribers are amortized over a maximum of 5 years, and music, film and publishing rights over a maximum period of 20 years.

Property, Plant and Equipment

Property, plant and equipment is measured at acquisition or manufacturing cost less depreciation. The cost of property, plant and equipment produced internally within the group includes direct costs and a portion of overheads directly attributable to their production. The cost of property, plant and equipment whose production takes place over a longer period of time includes third-party interest accrued up to the time of completion. The amounts involved are insignificant to the group. Maintenance expenses are recorded as expense in the period in which they were incurred, whereas costs incurred resulting in a prolongation of the asset's useful life, or in an improvement to its use, are recognized as an increase in the carrying value of the asset.

Items included in property, plant and equipment are depreciated straight-line over their estimated useful lives. Such depreciation is based on the following group-wide useful lives:

– Buildings	10 to 35 years
– Plant, technical equipment and machinery	3 to 10 years
– Other furniture and other equipment	3 to 12 years

Leasing

To the extent the Bertelsmann group assumes all significant opportunities and risks relating to a leased asset and is thus to be seen as the economic owner of the asset (finance lease), the leased asset is recognized in the balance sheet in the amount of the asset's fair value at the inception of the lease, or the present value of future lease payments, if lower. Payment obligations arising from finance leases are recognized as leasing liabilities in the same amount.

If it is sufficiently certain that ownership of the leased asset will pass to the lessee at the end of the lease term, the asset is depreciated over its useful life. Otherwise, it is depreciated over the term of the lease. There are no conditional lease payments or subleases.

The leased assets consist mainly of buildings. The finance leases are generally subject to non-cancelable minimum lease terms of approximately 20 years. Upon expiry of this term, the lessee is entitled to purchase the leased asset at its residual value. The installments paid by the lessee under the lease vary in accordance with changes in interest rates paid by the lessor.

In addition to finance leases, the Group has also entered into operating lease agreements. This means that economic ownership of the leased assets lies with the lessor and lease installments are recorded as expenses in the period in which they are due for payment. The total amount of lease installments due over the minimum uncancelable lease terms of these operating leases is disclosed in the notes as part of other financial commitments.

Impairments

As set out in IAS 36, write-downs are made to items included in property, plant and equipment if their recoverable amount is lower than their carrying value. The recoverable amount is the higher of the asset's net selling price and the present value of expected future cash flows from the asset. If cash flows cannot be attributed to the asset itself, the amount of any write-down is computed based on the cash flows of the next higher cash generating unit to which the asset can be allocated. Forecast cash flows are determined individually based on industry-specific growth rates of 0 to 3 percent and discounted using the group's pre-tax weighted average cost of capital (WACC) of 12.3 percent. If the reason for a write-down no longer exists, write-downs are reversed up to the amount that would have been determined if no impairment loss had been recognized in previous years. This does not apply to goodwill.

Participations and Securities

Significant participations are included using the equity method, and all other participations and other securities included in non-current assets and in current assets in the Bertelsmann group's consolidated financial statements are classified as available-for-sale or held-to-maturity.

Available-for-sale financial assets are stated at fair value on the balance sheet date in accordance with IAS 39, to the extent fair value can be determined. Any resulting unrealized gains and losses are recorded, net of deferred taxes, directly in shareholders' equity. However, any probable impairment losses which are other than temporary are recognized as an expense in the income statement. If the reasons for recording the write-down no longer exist, the write-down is reversed. Unrealized gains and losses on such financial assets are reclassified to income upon disposal of the asset concerned. If a fair value cannot be determined, the participations and securities are stated at amortized acquisition cost.

Financial assets with fixed payments and maturities, and which are held to maturity, are stated at amortized cost using the effective interest method.

Inventories

Inventories are stated at acquisition or manufacturing cost. Similar inventories are reported at average cost or using the FIFO (first-in, first-out) method. Inventories originating from intra-group suppliers are adjusted to eliminate intercompany profits and are measured at Group's manufacturing cost. If the acquisition or manufacturing cost exceeds their current fair value at the balance sheet date, inventories are written down to their net realizable value.

Customer-specific Contracts

A small volume of customer-specific contracts are reported in the IAS financial statements using the percentage-of-completion method, which requires revenues and profits from contracts to be recognized according to the percentage-of-completion of the respective project. The percentage-of-completion is calculated as the ratio of contract costs incurred up to the end of the year to total estimated project costs (cost-to-cost method). Irrespective of a project's percentage-of-completion, losses resulting from customer-specific contracts are immediately recognized in full in the period in which the loss is identified.

Receivables

Other receivables and other assets are stated at their nominal value or, where appropriate, at their fair value. Long-term receivables are discounted. Foreign currency receivables are translated at closing-date rates. Allowances are recognized for any discernible risks.

Cash and Cash Equivalents

Cash and cash equivalents include securities with an original maturity of less than three months, bank balances and cash on hand. Amounts in foreign currency are translated using rates ruling at the end of the year.

Deferred Taxes

As set out in IAS 12, deferred tax assets and liabilities are recognized for all temporary differences between carrying amounts reported for tax purposes and those reported in the IAS consolidated balance sheet (with the exception of goodwill not recognizable for tax purposes) and for tax loss carryforwards. Through the deduction of a valuation allowance, deferred tax assets are only reported to the extent to which they can be subsequently utilized. Such taxes are calculated using enacted tax rates that will apply in the future. The effects of changes in tax rates on deferred tax assets and liabilities are recognized in income in the period in which the relevant legislation has been enacted.

Other Comprehensive Income

Other comprehensive income includes foreign currency translation gains and losses, unrealized gains and losses from the fair value recognition of available-for-sale securities and derivatives acting as cash flow hedges, as set out in IAS 39.

Provisions

Provisions for pensions and similar obligations are calculated actuarially using the projected unit credit method as set out in IAS 19, which, in contrast to the entry-age-normal method, includes expected future salary increases. This method involves use of biometric calculation tables, current long-term market interest rates and current estimates of future increases in salaries and pensions. The interest element of pension expense is included in financial expense in the income statement.

With the exception of the other personnel-related provisions calculated as set out in IAS 19, all other provisions have been recognized in line with IAS 37 and to the extent there is a legal or constructive obligation to a third party. Provisions are measured at full cost in the amount of the probable obligation. Long-term provisions are discounted.

Liabilities

Liabilities are stated at nominal values. Long-term liabilities are discounted. Liabilities in foreign currency are translated into the reporting currency at rates ruling at the end of the year.

Derivative Financial Instruments

As set out in IAS 39, all derivative financial instruments are recognized at fair value on the balance sheet. Financial instruments are recognized on their transaction date. At the time a contract involving a derivative is entered into, it is determined whether it is intended to serve as a fair value hedge or as a cash flow hedge. However, some derivatives do not meet the requirements included in IAS 39 for recognition as a hedge, despite it being their economic purpose. Changes in fair values of derivatives are recorded as follows:

1. Fair value hedge: Fair value changes of these derivatives, which serve as hedges of assets or liabilities, are recorded in the income statement, thereby offsetting the change in fair value of the underlying balance sheet items also included in the income statement.

2. Cash flow hedge: Changes in fair values of these derivatives, which act as hedges of future cash flows, are recorded directly in other comprehensive income. These amounts are released to income in the same period as the underlying transaction affects the income statement.

3. Stand alone (no hedge relationship): Fair value changes of these derivatives, which do not meet the conditions for being recognized as hedges, are recognized in the income statement as held-for-trading financial instruments.

Notes to the Income Statement and Balance Sheet

(1) Revenues in € millions

	2004	2003
Revenues from selling goods and merchandise	19,693	9,819
Revenues from providing services	6,258	5,903
Revenues from use of assets	1,475	1,324
Gross revenues	17,426	17,046
Discounts and allowances	(410)	(245)
Revenues	17,016	16,801

(24) Other Operating Income in € millions

	2004	2003
Extra and supplementary income	166	210
Interest and foreign exchange gains	18	68
Prior year income and reimbursements	134	175
Reversal of provisions	99	123
Gains from disposals of non-current assets	24	39
Other	244	202
	685	817

(25) Personnel Costs in € millions

	2004	2003
Wages and salaries	3,502	3,462
State social security contributions	539	525
Profit sharing	29	29
Expense for pensions and similar obligations	126	120
Other employee benefits	8	15
	4,204	4,151

(26) Amortization of Intangible Assets and Depreciation of Property, Plant and Equipment Excluding Goodwill in € millions

	2004	2003
Amortization/depreciation of		
– intangible assets	268	378
– property, plant and equipment	403	436
	671	814

Amortization of intangible assets includes amortization of step ups arising on first consolidation.

19 Other Operating Expenses in € millions

	2004	2003
Administrative expenses	1,235	1,251
Consulting and audit fees	205	177
Interest and foreign exchange losses	19	78
Advertising costs	1,107	1,022
Selling expenses	765	882
Additions to other provisions	[illegible]	39
Allowances on current assets	372	385
Operating taxes	113	94
Losses on disposals of non-current assets	18	13
Other	388	1,504
	5,222	5,445

Administrative expenses include travel costs and communication expenses. Other operating expenses include rentals, repair and maintenance costs.

16 Results of Associated Companies and Participations in € millions

	2004	2003
Income from associated companies	53	43
Expenses from associated companies	(16)	(54)
Results of associated companies	37	(11)
Income from participations	11	16
Expenses from participations	[illegible]	(3)
Write-downs of investments	(15)	(31)
Write-ups of investments	[illegible]	5
Results of participations	(1)	(13)

Major contributions to income from associated companies came from RTL 2, with €19 million (previous year: €18 million). The losses recorded at equity related to miscellaneous companies.

Bertelsmann had no share in associated companies' contingent liabilities at December 31, 2004.

(7) Special Items in € millions

	2004	2003
Impairment of goodwill		
U.S. publisher, G+J	(126)	(54)
Sportfive, RTL Group		(48)
London Playout Center, RTL Group		(53)
Other	(6)	(53)
Gains/losses on disposals of participations		
Merger gain joint venture Sony BMG, BMG	180	–
Bertelsmann Venture Fund, Corporate Center	47	–
"TV Today", G+J	10	–
Sportfive, RTL Group	(14)	–
Legal dispute AOL Europe, Corporate Center	74	(234)
Bertelsmann Springer, Corporate Center		628
Barnesandnoble.com, Direct Group		145
Newspapers in Central and Eastern Europe, G+J		72
Other		9
Other special items		
Sale of the Bertelsmann Building New York, Corporate Center	174	–
IPO Shopping.com, Direct Group	22	–
Restructuring BMG	(119)	(73)
Restructuring Direct Group	(23)	–
Restructuring Arvato	(12)	–
	116	339

Special items are those matters which are not of an operating nature, as they are non-recurring. They include income and expense items which, due to their size and frequency of occurrence, have an effect on the assessment of the results of operations of the operating segment and of the group.

The merger gain of €180 million arose from transferring BMG Records to the joint venture, Sony BMG Music Entertainment, in which Bertelsmann holds 50 percent. The merger gain reflects, from a group perspective, the difference between fair values of assets received and assets given up.

Disposal gains of €47 million at Bertelsmann Venture Fund result mainly from the disposal of shares in Yahoo and Citrix. G+J showed a gain of €10 million on the disposal of "TV Today" in the first half of 2004, whereas RTL Group recorded a loss of €14 million on the sale of its participation in Sportfive. Sportfive is now measured at equity. A provision of €74 million could be released following settlement of a legal dispute with former AOL managers.

Other positive special items arose from the sale of the Bertelsmann Building in New York (€174 million) and the Shopping.com IPO (€22 million). These were partly offset by negative special items from restructuring at BMG, Direct Group and at Arvato.

(18) Net Interest in € millions

	2004	2003
Interest and similar income	175	189
Interest on finance lease	(16)	(13)
Interest and similar expenses	(237)	(271)
	(78)	(95)

(19) Other Financial Expenses and Income in € millions

	2004	2003
Defined Benefit Plans (Pensions and other)	(105)	(96)
Dividend entitlement on profit participation certificates	(76)	(76)
Other	(8)	(55)
	(189)	(227)

(20) Income Taxes in € millions

Income taxes, divided between domestic and foreign, current and deferred, are as follows:

	2004 Domestic	2004 Foreign	2004 Total	2003 Domestic	2003 Foreign	2003 Total
Net income before income taxes	297	1,183	1,480	(105)	516	411
Current income taxes	(43)	(243)	(286)	(30)	(197)	(227)
Deferred income taxes	4	19	23	(1)	25	24
Total income taxes	(39)	(224)	(263)	(31)	(172)	(203)
Net income after income taxes	258	959	1,217	(136)	344	208

Tax loss carryforwards of €353 million (previous year: €397 million) were utilized in 2004, reducing current tax expenses by €132 million (previous year: €116 million). Of the tax loss carryforwards utilized, €2 million related to domestic corporation tax, €1 million to domestic trade tax, and €350 million to foreign income tax.

Deferred tax assets and liabilities resulted from the following items and factors:

Deferred Taxes in € millions

	12/31/2004 Assets	12/31/2004 Liabilities	12/31/2003 Assets	12/31/2003 Liabilities
Intangible assets	304	205	309	57
Property, plant and equipment	13	117	30	120
Investments	8	88	12	15
Inventories	77	2	131	3
Accounts receivable	128	10	203	24
Prepayments and other assets	185	602	132	541
Provisions	182	29	159	33
Financial debt	37	6	68	1
Accounts payable	19	1	43	11
Prepayments and other liabilities	103	33	188	59
Loss carryforwards/tax credits	3,216	–	3,644	–
Valuation allowance	(3,127)	–	(3,894)	–
Total	1,145	1,087	1,025	864
Netting	(859)	(859)	(750)	(750)
Carrying amount	286	208	275	114

Deferred tax assets and liabilities are offset against each other if they relate to the same tax authority and can be offset.

Valuation allowances are deducted from deferred tax assets to the extent it is improbable they can be utilized in the foreseeable future.

Effective January 1, 2004, loss carry forwards in Germany can only be offset against the first €1 million of taxable profits, plus 60 percent of the excess over the first €1 million. Loss carryforwards in Germany can still be carried forward indefinitely.

The temporary differences, tax loss carryforwards, and tax credits against which a valuation allowance was made, can be carried forward for the following limited periods of time:

Maturity in € millions

	12/31/2004	12/31/2003
Tax loss carryforwards and temporary differences		
Can be carried forward for more than 5 years	9,565	11,589
Can be carried forward for up to 5 years	44	131
Tax credits		
Can be carried forward for more than 5 years	8	11

A reconciliation of expected net tax income/expense to actual tax income/expense is shown in the following table:

Reconciliation of Expected Net Tax in € millions

	2004	2003
Net earnings before income tax	1,480	411
Income tax rate applicable to Bertelsmann AG	38.40%	39.61%
Expected tax expense	(568)	(163)
The tax effects of the following items led to differences between the expected and actual tax expense:		
Adjustment for differing national tax rates	34	41
Changes in tax regulations or tax status	(6)	8
Amortization of goodwill not recognized for tax purposes	(2)	(232)
Tax-free disposal gains	67	230
Changes to tax-related factors in previous year	44	113
Changes in the valuation allowance	(303)	(113)
Permanent differences	(61)	(89)
Other	(14)	1
Total	305	(40)
Actual tax income/expense	(263)	(203)

The income tax rate applicable to Bertelsmann AG consists of corporation tax, solidarity surcharges and trade tax.

Effective Tax Rate

	2004 et seq.	2003
Corporation tax including solidarity surcharges	26.38%	27.95%
Trade tax	12.02%	11.65%
Effective income tax rate	38.40%	39.61%

As of December 31, 2004 there were still corporation tax credits available on distributions of €105 million.

18 Non-current Assets in €millions

	Goodwill	Other intangible assets	Property, plant and equipment	Investments in associates	Other financial assets	Total
Acquisition/production cost						
Balance at January 1, 2004	6,632	3,307	5,772	437	693	16,841
Currency differences	(75)	(134)	(102)	6	1	(304)
Acquisitions/disposals of entities	(139)	269	24	5	315	474
Additions	–	180	505	85	278	1,048
Disposals	–	(393)	(319)	(106)	(552)	(1,370)
Reclassifications and other changes	5	434	179	340	104	1,062
Balance at December 31, 2004	6,423	3,663	6,059	767	839	17,751
Depreciation/amortization						
Balance at January 1, 2004	–	2,408	3,510	39	274	6,231
Currency differences	–	(65)	(65)	(1)	(1)	(122)
Acquisitions/disposals of entities	–	(78)	20	–	(2)	(60)
Regular additions	–	254	395	–	–	649
Impairments	28	15	10	6	15	74
Disposals	–	(385)	(255)	–	(76)	(716)
Write-ups	–	(1)	(2)	–	(25)	(28)
Reclassifications and other changes	–	186	69	286	(29)	512
Balance at December 31, 2004	28	2,342	3,690	330	156	6,546
Book value at December 31, 2004	6,395	1,321	2,369	437	683	11,205
Book value at December 31, 2003	6,632	901	2,254	398	419	10,604

Applying IFRS 3, the cost and accumulated amortization of goodwill was netted starting January 1, 2004.

Reductions in goodwill are primarily due to the merger of BMG's and Sony's recorded-music business (€101 million) and the part-disposal of Sportfive (€120 million). Additions to goodwill are mainly made up of the acquisition of Phone Assistance S.A. in Marocco (€25 million) and a number of smaller acquisitions. The increase in intangible assets is substantially influenced by the first-time full consolidation of M6, as a result of which the former participation was restated at fair value, as well as by the first-time inclusion of the joint venture, Sony BMG Music Entertainment. The book value of intangible assets mainly includes music and publishing rights of €671 millions with an amortisation period between 9-18 years and trade marks of €120 million with indefinite useful life.

12 Other Intangible Assets in € millions

	Music, film and publishing rights	Other rights and licenses	Advance payments	Total
Acquisition/production cost				
Balance at January 1, 2004	2,433	853	21	3,307
Currency differences	(117)	(17)	–	(134)
Acquisitions/disposals of entities	273	–	(4)	269
Additions	77	79	24	180
Disposals	(359)	(33)	(1)	(393)
Reclassifications and other changes	167	287	(20)	434
Balance at December 31, 2004	2,474	1,169	20	3,663
Depreciation/amortization				
Balance at January 1, 2004	1,858	548	[illegible]	2,406
Currency differences	(46)	(9)	–	(55)
Acquisitions/disposals of entities	(70)	(8)	–	(78)
Regular additions	126	128	–	254
Impairments	8	7	–	15
Disposals	(358)	(27)	–	(385)
Write-ups	–	(1)	–	(1)
Re-classifications and other changes	133	53	–	186
Balance at December 31, 2004	1,651	691	[illegible]	2,342
Book value at December 31, 2004	823	478	20	1,321
Book value at December 31, 2003	575	305	21	901

13 Property, Plant and Equipment in € millions

	Land, rights equivalent to land and buildings	Plant, technical equipment and machinery	Other equipment, fixtures, furniture and office equipment	Advance payments and construction in progress	Total
Acquisition/production cost					
Balance at January 1, 2004	1,634	2,630	1,398	110	5,772
Currency differences	(19)	(59)	(23)	(1)	(102)
Acquisitions/disposals of entities	(7)	71	(40)	–	24
Additions	76	148	221	60	505
Disposals	(32)	(109)	(178)	–	(319)
Reclassifications and other changes	145	86	77	(129)	179
Balance at December 31, 2004	1,797	2,767	1,455	40	6,059
Depreciation					
Balance at January 1, 2004	622	1,919	977	–	3,518
Currency differences	(7)	(46)	(12)	–	(65)
Acquisitions/disposals of entities	(2)	60	(38)	–	20
Regular additions	63	195	137	–	395
Impairments	5	4	1	–	10
Disposals	(22)	(101)	(132)	–	(255)
Write-ups	–	(2)	–	–	(2)
Reclassifications and other changes	19	21	29	–	69
Balance at December 31, 2004	678	2,050	962	–	3,690
Book value at December 31, 2004	1,119	717	493	40	2,369
Book value at December 31, 2003	1,012	711	421	110	2,254

12 Investments in € millions

	Affiliated companies Shares in	Associates Shares in	Associates Loans to	Other participations	Other loans	Other securities	Total
Acquisition/production cost							
Balance at January 1, 2004	43	437	10	1316	277	47	1130
Currency differences	–	6	–	(1)	2	–	7
Acquisitions/disposals of entities	–	5	–	1	318	(4)	320
Additions	6	25	47	98	114	23	363
Disposals	–	(105)	(11)	(99)	(439)	(3)	(658)
Reclassifications and other changes	(2)	340	–	(22)	90	38	444
Balance at December 31, 2004	47	767	46	293	362	101	1606
Depreciation							
Balance at January 1, 2004	23	39	–	194	33	24	313
Currency differences	–	(1)	–	(2)	1	–	(2)
Acquisitions/disposals of entities	–	–	–	3	(5)	–	(2)
Regular additions	–	–	–	–	–	–	–
Impairments	3	6	–	4	1	7	21
Disposals	(4)	–	–	(64)	(8)	–	(76)
Write-ups	(2)	–	–	(22)	–	(1)	(25)
Reclassifications and other changes	(1)	286	–	(21)	3	(10)	257
Balance at December 31, 2004	19	330	–	92	25	20	486
Book value at December 31, 2004	28	437	46	191	337	81	1120
Book value at December 31, 2003	20	398	10	1122	244	23	1817

In contrast to the previous year, loans to affiliated companies and other participations have been combined under other loans. Other financial assets consist primarily of securities.

As set out in IAS 39, available-for-sale investments and securities are measured at fair value, or at acquisition cost if a market price cannot be determined:

Financial Assets: Available-for-Sale in € millions

	At acquisition cost 12/31/2004	At acquisition cost 12/31/2003	At fair value 12/31/2004	At fair value 12/31/2003	Total 12/31/2004	Total 12/31/2003
Investments	66	113	125	9	191	122
Securities	57	2	24	21	81	23
Total	123	115	149	30	272	145

15 Inventories In € millions

	12/31/2004	12/31/2003
Film rights	1,273	1,159
Raw materials and supplies	145	140
Work in process	101	109
Finished goods and merchandise	410	409
Advance payments	3	3
	1,933	1,820

16 Receivables and Other Assets In € millions

	Maturing in more than one year	12/31/2004	12/31/2003
Trade accounts receivable	14	2,721	2,825
Accounts receivable from royalties and licenses	–	106	216
Total trade accounts receivable	14	2,827	3,041
Accounts receivable from participations	–	43	72
Advance payments for royalties and licenses	242	909	1,152
Tax receivables	–	454	459
Securities	–	87	54
Derivative financial instruments	20	284	278
Net assets from pension plans	9	12	17
Other receivables	35	696	541
Other receivables and other assets	306	2,465	2,573

Available-for-sale securities are stated as follows:

Other Assets: Available-for-Sale In € millions

	At acquisition cost		At fair value		Total	
	12/31/2004	12/31/2003	12/31/2004	12/31/2003	12/31/2004	12/31/2003
	87	44		10	87	54

17 Cash and Cash Equivalents in € millions

	12/31/2004	12/31/2003
Cash	[illegible]	[illegible]
Other securities	[illegible]	1,641
	[illegible]	1
	[illegible]	[illegible]

Part of cash and cash equivalents are not freely available for use, particularly bank balances of €141 million (previous year: €160 million) relating to distribution business at Pinnacle.

18 Shareholders' Equity / Subscribed Capital

Number of shares	[illegible]
	[illegible]
Type A ordinary shares	[illegible]
Type A non-voting preference shares	[illegible]
Type B voting preference shares	[illegible]
Total shares	[illegible]

Bertelsmann AG's subscribed capital is made up of 111,829 no-par-value shares of various types. The ordinary shares are bearer shares and the preference shares are registered shares. The type B preference shares have preferred profit-sharing rights through December 31, 2010. The preferred profit-sharing rights of the type A preference shares are not limited in time. The type A preference shares have no voting rights. As resolved at the shareholders' annual general meeting on May 17, 2004, Bertelsmann AG's subscribed capital was increased to €1,000 million out of reserves without issuing new shares. The increase was carried out by converting part (€394 million) of the capital reserve.

Indirect holdings in the subscribed capital are as follows: 57.6 percent Bertelsmann Stiftung, 25.1 percent Groupe Bruxelles Lambert, 17.3 percent Mohn family. 75 percent of the voting rights are held by Bertelsmann Verwaltungsgesellschaft and 25 percent by Groupe Bruxelles Lambert.

Capital Reserve

The capital reserve includes mainly additional paid-in capital, or share premium, received on the issue of preference and ordinary shares in excess of their par values. In 2004, €394 million of the capital reserve was converted into subscribed capital.

Retained Earnings

Retained earnings include the past results of those companies included in the consolidated financial statements, to the extent they have not been distributed, as well as other comprehensive income. Following changes to the shareholder structure of M6, the French TV station, the participation in M6 was fully consolidated effective February 1, 2004; before that date, it had been proportionately consolidated. The consolidation involved stating the previous holding at fair values, with a resulting direct credit to shareholders' equity of €21 million.

Other Comprehensive Income in € millions

Movements in other comprehensive income were as follows:

	Available-for-sale securities			Cash flow hedges			Currency	Total
	Pre-tax amount	Taxes	Post-tax amount	Pre-tax amount	Taxes	Post-tax amount		
December 31, 2002	(4)		4	(61)	12	(49)	(1)	(3)
Change in fair value	28	–	28	(8)	14	6	54	88
Disposals affecting income	(1)	–	(1)	(2)	–	(2)	–	(3)
December 31, 2003	31		31	(71)	26	(45)	68	54
Change in fair value	59	–	59	6	(3)	3	(42)	20
Disposals affecting income	(8)	–	(8)	–	–	–	–	(8)
Change in scope of consolidation	–	–	–	(2)	1	(1)	–	(1)
December 31, 2004	82		82	(67)	24	(43)	26	65

Stock Option Plans at Subsidiaries

Various stock option plans are in operation at subsidiaries. At RTL Group in particular, stock option plans for senior management were introduced in 2000. The option price is derived from the market price at the time the options are granted. Within RTL Group there are also stock option plans at Metropole Television (M6).

RTL Group Stock Option Plan

RTL Group established a stock option plan for selected directors on July 25, 2000. In order to participate in the Stock Option Plan (SOP), the participant must be employed by RTL Group or one of its subsidiaries at the date the options are granted.

The number of options granted to a participant in the SOP is determined by the compensation committee. The compensation committee is made up of the company's Executive Board or a constituted committee thereof. Participants may renounce options granted to them. Participants do not have to make any payments for options granted under the SOP. The number of ordinary shares which may be placed under the SOP in any one year may not exceed one-half of one percent of the company's issued ordinary share capital.

As a general rule, the exercise price of options issued under the SOP is the average price of RTL shares over a period of 20 trading days before the day on which the options are granted. The exercise price may be another, higher or lower amount to be determined by the compensation committee.

One-third of the options granted may be exercised on each of the second, third and fourth anniversaries of the date the options were granted, or as otherwise determined by the compensation committee. The options granted must normally be exercised within ten years of the date the options were granted, or within a shorter period of time to be determined by the compensation committee. Options can be exercised earlier in the event of death.

Movements in stock options during the year:

Number of Options (RTL Group) in thousands

	2004	2003
Options outstanding at the beginning of the year	241	391
Options granted during the year	–	–
Options exercised/expired during the year	(24)	(150)
Options outstanding at the end of the year	217	241

The options outstanding at the end of the year have the following conditions:

Conditions for Stock Options (RTL Group)

	Exercise price in €	Number of options in thousands
2010	120.00	6
2010	85.24	209
2011	85.24	2
		217

RTL Group's closing share price on the Brussels stock exchange was €55 at December 31, 2004.

Metropole Television (M6)
Employee Stock Option Plan

M6 has introduced an employee stock option plan for selected members of management. The number of options granted to participants is determined by Metropole Television's Executive Board in conjunction with the shareholders' annual general meeting.

Options were granted in September 1998, December 1998, June 1999, January 2000, and June 2001. Options granted in September and December 1998 can only be exercised following a vesting period of three years from the date of grant and must be exercised within seven years of the grant date. Options granted in June 1999 and January 2000 can only be exercised following a vesting period of five years from the date of grant. Options granted in June 2001 can only be exercised following a vesting period of four years from the date of grant and must be exercised within seven years of the grant date.

The exercise price of the remaining options amounts to 95 percent of the average price of the shares in Metropole Television on the Paris stock exchange, calculated over the 20 days preceding the grant date.

Movements in stock options during the year:

Number of Options (M6) in thousands

	2004	2003
Options outstanding at the beginning of the year	3,179	3,301
Options granted during the year	940	91
Options exercised/expired during the year	(486)	(213)
Options outstanding at the end of the year	3,631	3,179

The options outstanding at the end of the year have the following conditions:

Conditions for Stock Options (M6)

	Exercise price in €	Number of options in thousands
Expiry date		
September 2005	14.00	425
December 2005	19.00	395
June 2007	57.00	259
January 2008	30.80	413
May 2009	28.60	594
June 2010	23.00	705
November 2011	25.00	840
		3,631

M6's closing share price on the Paris stock exchange was €20.90 at December 31, 2004.

Minority Interest

Minority interest in the equity of consolidated subsidiaries consists primarily of minority interest in the RTL Group, Gruner + Jahr and Maul Belser. The increase compared with 2003 is particularly due to the full consolidation of M6.

19 Profit Participation Capital in € millions

Bertelsmann AG's profit participation capital is made up as follows:

	12/31/2004	12/31/2003
Par value	516	516
Premium	190	190
	706	706

The profit participation capital is made up of 2001 profit participation certificates (listing code ISIN DE0005229942, or "PPC 2001") and 1992 profit participation certificates (listing code ISIN DE0005229900, or "PPC 1992"). PPC 2001 have a par value of €10, whereas the par value of PPC 1992 is €0.01. As of December 31, 2004 the par value of PPC 2001 was €499 million and the par value of PPC 1992 was €17 million. PPC 1992 and PPC 2001 have been admitted for trading on the stock exchange.

20 Provisions for Pensions and Similar Obligations in € millions

	12/31/2004	12/31/2003
Defined benefit plans	1,717	1,614
Obligations similar to pensions	157	87
	1,874	1,701

The Bertelsmann group operates various forms of pension plans for current and former employees and their surviving dependants, which are determined by the legal, tax, and economic situation of each country concerned. These company pension plans include both defined contribution and defined benefit schemes.

In the case of defined contribution plans, the company makes payments into an external fund or other welfare fund on a statutory, contractual or voluntary basis. Once the company has paid the contributions due, it is not obliged to provide any further benefits and hence no provision is recognized in the balance sheet. Defined contribution plan expenses for 2004 amounted to €21 million (previous year: €19 million).

All other pension plans are defined benefit schemes. Some are funded via an external investment (plan assets), others are unfunded. Provisions are set aside for these plans, most of which are final salary plans.

The provisions are actuarially calculated in accordance with IAS 19. The amount of provisions depends on employees' period of service with the company and their pensionable salary. Provisions are computed using the projected unit credit method, which, in contrast to the components-based method, assumes increasing salary costs over the period of service. The computation also involves using biometric calculations, prevailing long-term capital market interest rates and assumptions about future salary and pension increases. In Germany, the biometric calculations are based on mortality tables issued by Prof. Dr. Klaus Heubeck in 1998. The following actuarial assumptions have been used:

Actuarial Assumptions

	12/31/2004 Germany	12/31/2004 Foreign	12/31/2003 Germany	12/31/2003 Foreign
Discount rate	4.75%	2.0–6.25%	5.5%	2.0–6.25%
Expected return on plan assets	5.0%	2.5–8.25%	5.5%	3.0–8.25%
Rate of salary increase	2.5%	1.5–5.0%	2.5%	3.0–5.0%
Rate of pension increase	1.7%	1.0–3.0%	1.7%	1.7–3.0%
Fluctuation	Based on experience		Based on experience	

The corridor method is used to calculate provisions for defined benefit plans and related costs. This method does not take into account actuarial gains and losses resulting from the difference between actual amounts and the assumptions underlying the calculations unless they exceed ten percent of either the amount of the defined benefit obligation or plan assets, whichever is the greater. The amount in excess of this corridor is spread over the employees' average remaining period of service.

The expense for defined benefit plans in 2004 was €163 million (previous year: €167 million), comprising personnel costs of €58 million (previous year: €71 million) and other financial expense of €105 million (previous year: €96 million). The amortization of actuarial gains and losses was recorded in personnel expense in 2003, but is included in financial result for the first time in 2004. The expense is made up as follows:

Expenses for Defined Benefit Plans in € millions

	2004	2003
Current service cost	58	61
Interest cost	122	119
Expected return on plan assets	(28)	(23)
Amortization of actuarial gains/losses	(11)	10
Amortization of past service cost	1	2
Effect of curtailments or settlements	(1)	(2)
	163	167

Actual return on plan assets for the year amounted to €39 million (previous year: €40 million).

The net pension liability reported on the balance sheet is made up as follows:

Net Pension Obligation Recognized in € millions

	12/31/2004	12/31/2003
Defined benefit obligation of unfunded plans	1,914	1,662
Defined benefit obligation of funded plans	625	504
Total defined benefit obligation	2,539	2,166
Fair value of plan assets	(452)	(361)
Actuarial gains/losses not yet recognized	(382)	(208)
Net liability recognized in the balance sheet	1,705	1,597

The net liability is included in the following items on the balance sheet:

Net Pension Liability in € millions

	12/31/2004	12/31/2003
Provisions for pensions and similar obligations	1,717	1,614
Other assets	(12)	(17)
Net liability	1,705	1,597

Movements in the net liability during the year were as follows:

Movements in Net Pension Liability in € millions

	12/31/2004	12/31/2003
Net liability at the beginning of the year	1,597	1,639
Pension expense	163	187
Pension payments	(87)	(75)
Contributions to plan assets	(43)	(28)
Other effects	2	17
Changes of consolidation scope	60	(110)
Currency-related effects	(7)	(13)
Net liability at the end of the year	1,705	1,597

The net liability is divided by geographic region as follows:

Breakdown on Net Pension Liability by Region in € millions

	12/31/2004	12/31/2003
Germany	1,501	1,454
U.S.	87	65
Other Europe	111	69
Other countries	6	9
Net liability recognized in the balance sheet	1,705	1,597

The U.S. subsidiaries' liabilities for their employees' healthcare costs once they have retired constitute defined benefit obligations and account for €66 million (previous year: €68 million) of the provisions. They have been calculated according to the international standards described above. As in the previous year, healthcare cost increase trends were assumed to be between 5.5 percent and 9.5 percent, depending on the period of time concerned.

Obligations similar to pensions include provisions for employees' long-service awards, old age part-time schemes, amounts due but not yet paid for defined contribution plans, and severance payments at dismissal or retirement ("Abfertigungen"). These severance payments become due when an employee leaves the company and are based on legal obligations, mainly in Italy and Austria. Provisions for employees' long-service awards and for severance pay at retirement are calculated in the same manner as liabilities for defined benefit plans, but without using the corridor method.

Employees in Germany who are at least 55 years old and have an unlimited employment contract with the company qualify for its old age part-time scheme. The part-time employment period lasts for between two and five years.

21 Other Provisions in € millions

Short-term provisions were reclassified to liabilities, with a total of €1,706 million transferred to liabilities. Provisions can be divided into the following categories:

	12/31/2003	Change of consolidation scope	Other effects	Usage	Additions	Accrued interest	Releases	12/31/2004	Long-term
Provisions for taxes	245	5	(196)	(50)	20	–	(3)	21	–
Restructuring provisions	48	8	(5)	(56)	101	–	(7)	89	12
Other	881	(25)	(9)	(437)	284	–	(185)	509	124
	1,174	(12)	(210)	(543)	405	–	(195)	619	136

Other provisions are set up for probable contractually-related losses, indemnity risks and litigation costs. As an international group, Bertelsmann is also subject to several legal risks. This applies particularly to legal disputes in the U.S., where there are legal institutions unknown in Germany, such as class actions, punitive damages or pre-trial discovery. The outcomes of currently asserted or future unasserted lawsuits cannot be foreseen with any degree of certainty.

Legal risks could arise from the following lawsuits: Various music publishers and record labels submitted claims against Bertelsmann in a U.S. court in 2003. The plaintiffs base their claims on the allegation that Bertelsmann, by granting loans to the music file-sharing platform Napster, which has since gone bankrupt, enabled the service to survive longer than it would have done otherwise, and thereby contributed to the breaches of copyright by Napster and its users. As the allegations made by the plaintiffs are completely without legal foundation, Bertelsmann has only made provisions for expected lawyer fees on the balance sheet.

As set out in IAS 37, restructuring provisions include employee severance costs and other costs incurred in connection with the discontinuation of business activities. Total provisions of €89 million (previous year: €48 million) were set aside for various restructuring programs within the Bertelsmann group.

22 Financial Debt in € millions

Financial debt includes all of Bertelsmann group's interest-bearing liabilities to banks and capital markets at the balance sheet date. Carrying values are as follows:

	Remaining term in years			12/31/2004	12/31/2003
	< 1	1–5	> 5		
Bonds	156	199	1,127	1,482	1,635
Promissory notes	–	202	–	202	279
Syndicated loan facility	–	–	–	–	–
Liabilities to banks	87	29	2	118	242
Leasing liabilities	19	91	131	241	251
Other financial debt	2	58	41	101	55
	264	579	1,301	2,144	2,462

Through a number of contractual agreements, Bertelsmann group has access to variable and fixed-rate funds. Financial debt is normally unsecured and is of equal ranking. Long-term financial debt, including transaction costs, is amortized to nominal value at maturity. Liabilities in foreign currency are translated at rates ruling at the end of the year.

Due to the beneficial financial environment, in October 2004 the syndicated credit line of €1.5 billion agreed in 2002 was replaced before its contractually-agreed maturity (2007) by a new facility with an international bank consortium. The new credit line runs for 5 years and can be prolonged for a maximum further two years with the agreement of the banking consortium. During this period, the credit line can be drawn down in EUR, USD and GBP up to the equivalent of a revolving €1.2 billion, by Bertelsmann AG and its foreign finance companies (Bertelsmann U.S. Finance, Inc., Bertelsmann Capital Corporation N.V.). The amounts drawn down in EUR bear interest at EURIBOR (European Interbank Offered Rate). LIBOR (London Interbank Offered Rate) is used as the interest reference rate for the other currencies.

Additionally, the Bertelsmann group has bilateral loan agreements with international banks, involving Bertelsmann AG and Bertelsmann U.S. Finance, Inc. These credit lines can be utilized to draw down revolving floating rate loan facilities based on EURIBOR or LIBOR. The funding reserve from these credit lines, including the amounts not drawn down on the syndicated loan facility, totals some €1.8 billion and is freely available for use in the group's operating activities.

The reduction in credit lines compared with the previous year was initiated due to improved liquidity and the long-term financing completed in previous years. The remaining terms and utilization of these agreements at December 31, 2004 are set out in the following table:

Remaining Term in € millions

	Credit line 12/31/2004	Drawn down 12/31/2004	Available credit line 12/31/2004	Available credit line 12/31/2003
< 1 year	492		492	628
1 to 2 years				103
2 to 3 years				–
3 to 4 years				1,590
4 to 5 years	1,110		1,110	–
> 5 years				400
	1,602		1,602	2,721

There were publicly-listed bonds, private placements, and promissory notes with a nominal volume of €1,670 million outstanding at December 31, 2004. The decrease compared with the €1,937 million outstanding at the end of 2003 was primarily due to repayment on maturity of a bond for USD 200 million and the early redemption of a promissory note (USD 100 million). Differences between carrying values and nominal values in the following table arise from transaction costs as well as fair value effects arising on hedge relationships to derivative transactions. That part of transaction costs reducing the carrying value of bonds and promissory notes issued and consisting of issue discounts amounted to €6 million at December 31, 2004 (previous year: €7 million). Changes in transaction costs are reflected in interest result over the period of the paper concerned.

Bonds, Promissory Notes in € millions

	Due date	Effective interest rate in %	Book value 12/31/2004	Book value 12/31/2003
5.375% Bertelsmann U.S. Finance, Inc. (USD 200 million bond) 99/04	1/28/2004	5.60	[illegible]	159
4.500% Bertelsmann U.S. Finance, Inc. (DEM 300 million bond) 98/05	11/25/2005	4.62	156	157
Floating Rate Bertelsmann U.S. Finance, Inc. (EUR 50 million promissory note) 02/07	12/20/2007	–	50	50
4.70% Bertelsmann Capital Corp N.V. (EUR 50 million promissory note) 02/07	12/27/2007	4.91	49	50
4.40% Bertelsmann Capital Corp N.V. (EUR 50 million promissory note) 03/08	2/7/2008	4.55	51	50
Floating Rate Bertelsmann U.S. Finance, Inc. (USD 100 million promissory note) 99/09	2/11/2009	–	[illegible]	79
4.48% Bertelsmann Capital Corp N.V. (EUR 50 million promissory note) 99/09	5/7/2009	4.49	50	50
4.375% Bertelsmann U.S. Finance, Inc. (EUR 200 million bond) 99/09	5/12/2009	4.53	199	198
4.69% Bertelsmann U.S. Finance, Inc. (USD 100 million U.S. private placing) 03/10	4/17/2010	4.83	73	79
4.625% Bertelsmann U.S. Finance, Inc. (EUR 750 million bond) 03/10	6/3/2010	4.70	762	726
5.23% Bertelsmann U.S. Finance, Inc. (USD 200 million U.S. private placing) 03/13	4/17/2013	5.38	148	158
5.33% Bertelsmann U.S. Finance, Inc. (USD 200 million U.S. private placing) 03/15	4/17/2015	5.46	146	158
[illegible]	[illegible]	[illegible]	1,684	1,914

Documentation of the bonds is based on framework documentation in the form of a debt issuance program with a maximum issue volume of €3.0 billion, last updated in October 2004 and having an unchanged rating of BBB + (Standard & Poor's) and Baa1 (Moody's).

The USD private placements and the promissory notes were agreed with institutional investors based on separate documentation. Bertelsmann U.S. Finance Inc.'s EUR issues were hedged by USD currency swaps. Furthermore, original interest terms for some of these transactions were changed by entering into interest-rate swaps for some bond issues and loans. The hedge relationships between the underlying transaction and the corresponding derivative qualify as a hedge relationship as set out in IAS 39.

The table below sets out interest rates for bonds and promissory notes issued after reflecting existing interest-rate swaps:

Interest on Bonds and Promissory Notes in € millions

	Fair value at 12/31/2004			Fair value at 12/31/2003		
	Fixed interest	Floating rate	Total	Fixed interest	Floating rate	Total
Bonds	780	702	1,482	799	836	1,635
Promissory notes	100	102	202	179	100	279
Total	880	804	1,684	978	936	1,914

Finance lease obligations have the following maturities:

Minimum Lease Payments for Finance Leases in € millions

	12/31/2004			12/31/2003		
	Nominal value of lease payments	Discount amounts	Present value	Nominal value of lease payments	Discount amounts	Present value
Up to 1 year	27	8	19	34	4	30
1 to 5 years	132	41	91	125	25	100
Over 5 years	189	58	131	216	95	121
	348	107	241	375	124	251

24 Liabilities in € millions

	More than 1 year	12/31/2004	12/31/2003
Trade accounts payable	75	3,685	3,826
Liabilities to participations	–	325	85
Tax liabilities	23	696	330
Derivative financial instruments	–	106	165
Social security contributions	–	102	90
Personnel-related liabilities	17	351	548
Payment in advance	1	70	66
Other	419	1,137	936
Other liabilities	460	2,587	2,220

Other liabilities include obligations arising from long-term delivery commitments, credit balances in accounts receivable, and liabilities to non-group companies.

Off-balance-sheet Commitments

25 Contingent Liabilities in € millions

	12/31/2004	12/31/2003
Guarantees	145	268
Warranties	1	24
	146	292

It is considered unlikely that a usage of contingent liabilities listed will occur.

25 Other Financial Commitments in € millions

	12/31/2004	12/31/2003
Rental and leasing commitments	[illegible]	
Other commitments	1,611	1,561
	3,551	3,466
	5,162	5,027

Of the other commitments, €2,049 million (previous year: €2,110 million) relates to RTL Group's supply agreements for rights, (co-)productions, and programming, and €494 million (previous year: €485 million) relates to contracts for TV licenses, transmission rights, and other services. Other commitments of Random House amount to €349 million (previous year: €357 million) and represent the portion of commitments to authors for which no payments have yet been made and future payments depend on further events (such as delivery and acceptance of manuscripts).

There are the following payment obligations under all long-term rental commitments classified as operating leases:

Minimum Payments Under Operating Leases in € millions

	12/31/2004	12/31/2003
Nominal value		
– Up to 1 year	[illegible]	
– 1 to 5 years	229	221
– Over 5 years	947	780
	370	560
	1,611	1,561
Present value	1,347	1,262

These obligations essentially relate to long-term real estate tenancy agreements. These are partly offset by sub-leases with a nominal value of €105 million. The present values were computed taking country-specific interest rates into account. They show the net payout currently needed to cover the commitment.

Certain third parties have put options for the sale of share in entities to Bertelsmann group. As no fair values, as set out in IAS 39, can be determined for these options, they are not recognized in the consolidated balance sheet. The following table sets out the significant options and their underlying conditions:

Object of Option in € millions

	Percent of shares involved	Exercise period	Estimated purchase price
BW-TV Verwaltungs GmbH	20	Until 2022	504
Mondolibri, Italy	50	Exercisable at any time	65

BW-TV Verwaltungs GmbH, in which Bertelsmann has an 80 percent share, holds 37 percent of the shares in RTL Group. Under certain conditions, the minority shareholder of BW-TV has the right to tender its holding to Bertelsmann. The tender price for this is currently €504 million, which corresponds to a price of roughly €44 per RTL share.

28 Financial Instruments

Financial Risk Management

Because of its international activities, Bertelsmann group is exposed to a variety of financial risks, especially the effects of movements in foreign exchange and interest rates. The aim of the Bertelsmann group's risk management function is to mitigate these risks.

The Executive Board sets out overall risk management guidelines and stipulates the general procedures for hedging foreign exchange rate and interest rate risk and for the use of derivative financial instruments.

A treasury department located at corporate headquarters advises subsidiaries on operating risk and, where appropriate, hedges risks using derivatives. However, the subsidiaries are not obliged to use the services provided by this department for their operating risks. Certain subsidiaries, such as RTL Group and G+J, have their own treasury departments, but they must report their hedging activities to the treasury department located at corporate headquarters on a quarterly basis.

Exchange Rate Risk

Bertelsmann is exposed to exchange rate risk in various currencies. Its subsidiaries are advised, but not obliged, to hedge themselves against exchange rate risks in the local reporting currency by concluding forward agreements with banks of impeccable credit standing. Loans within the group which are subject to exchange rate risk are hedged by derivatives.

A number of subsidiaries operate outside the euro currency area. Management of the resulting translation risk is based on the relationship of financial debt to Operating EBITDA for significant currency areas. The objective is to achieve a reasonable relationship between financial debt and operating results for each major currency area in the long term, whereby Bertelsmann uses the upper limits for leverage defined for the group as a target.

Interest Rate Risk

Interest rate risk is managed in accordance with the group's planned net financial debt and expected interest-rate movements. There were no significant changes to the mix of floating-rate and fixed-rate debt in 2004.

Funds available are generally invested at floating rates for periods of less than one year.

Default Risk

The Bertelsmann group is exposed to default risks amounting to invested cash and cash equivalents, and the positive fair value of derivatives used. However, as financial transactions and instruments are only concluded with banks of impeccable credit standing, these risks are deemed to be low.

Accounting for Derivative Financial Instruments and Hedges

All derivatives are reported at their fair value. On the day a contract for a derivative is entered into, it is determined whether it is intended to be a fair value hedge or a cash flow hedge. However, some derivatives do not qualify as hedges despite the fact that they do economically represent a hedge.

Bertelsmann documents all relationships between hedging instruments and hedged positions as well as its risk management objectives and strategies in connection with the various hedges. This method includes linking all derivatives used for hedging purposes to the underlying assets, liabilities, firm commitments, and foreseeable transactions. Furthermore, the Bertelsmann group assesses and documents, both when derivatives are concluded and on an ongoing basis, to what extent the derivatives used are either fair value hedges or cash flow hedges.

Financial Derivatives

The vast majority of financial derivatives used by the Bertelsmann group are derivatives which are not traded on an organized exchange ("OTC instruments"). These mainly consist of forward agreements, currency swaps, currency options, and interest rate swaps, and are substantially concluded with banks of impeccable credit standing that have been approved by the Executive Board. Nominal volumes are the total of all underlying buying and selling amounts.

The great majority of the financial derivatives serve as hedges against foreign currency and interest rate risks arising from existing financial debt (44.5 percent). Foreign exchange fluctuation risks on internal funding within the group are normally hedged by foreign currency forward transactions. The volume of such transactions is €1,493 million (33.1 percent). Additionally, subsidiaries use financial derivatives to hedge against current and future foreign currency risks arising from operating receivables or payables (22.4 percent). No financial derivatives are used for speculative purposes.

Nominal Amounts of Financial Derivates in € millions

	Nominal amounts at 12/31/2004				Nominal amounts at 12/31/2003			
	< 1 year	1–5 years	> 5 years	Total	< 1 year	1–5 years	> 5 years	Total
Currency derivatives								
Forward contracts and currency swaps	2,359	587	655	3,601	1,929	423	843	3,195
Currency options	–	–	–		158	–	–	158
Interest rate derivatives								
Interest rate swaps	150	477	282	909	158	529	488	1,175
Other	–	7	–	7	–	–	–	
Total	2,509	1,071	937	4,517	2,245	1,952	1,331	4,528

Determination of Fair Value

The fair value of traded financial derivatives is determined on the basis of published market prices at the balance sheet date.

In order to determine the fair values of derivatives that are not publicly traded, Bertelsmann group uses various financial-related economic models based on market conditions and risks prevailing at the balance sheet date.

Fair Values of Financial Derivatos in € millions

	Nominal amounts		Present value	
	12/31/2004	12/31/2003	12/31/2004	12/31/2003
Currency derivatives				
Forward contracts and currency swaps	3,601	3,195	177	25
Currency options		158		–
Interest rate derivatives				
Interest rate swaps	909	1,175	121	98
Other		–	3	–
Total	4,517	4,528	178	123

Factoring

In individual cases, Bertelsmann group sells receivables to banks. These exceptions are limited to agreements in which Bertelsmann grants financing to its customers in separate contracts. The volume of receivables sold is limited contractually to €402 million and amounted to €373 million at December 31, 2004 (previous year: €340 million). The contractual conditions provide for transfer of the default and interest risk to the buyer of the receivables. Bertelsmann's risk is limited, and the resulting risks are included in provisions. The carrying value of these risks at December 31, 2004 amounts to €13 million (previous year: €7 million).

27 Cash Flow Statement

Bertelsmann's consolidated cash flow statement has been prepared in accordance with IAS 7. It is intended to assist the reader in assessing the group's ability to generate cash and cash equivalents. Cash flows are divided into those relating to operating, investing and financing activities. Cash flows from operating activities are shown using the indirect method, with net income after taxes adjusted for the effects of items not affecting cash flows. Income and expenses relating to cash flow from investing activities are also eliminated

The cash flow statement recognizes the effects of movements in exchange rates and changes in the companies included in the consolidated financial statements. Hence, the figures in the cash flow statement cannot simply be determined by comparing balance sheet items with the comparative figures for the previous year. Investing activities include purchases of non-current assets, payments for the acquisition of participations, and proceeds from disposals of non-current assets. Purchase price payments for acquired entities include, amongst others, payments in connection with the music joint venture and the acquisition of Phone Assistance S.A. Proceeds from disposals of non-current assets refer in particular to the partial sale of Sportfive, the sale of the Bertelsmann Building in New York, and Bertelsmann Venture Fund. Changes in shareholders' equity and financial debt affecting cash are included in financing activities.

Cash and cash equivalents comprise the total volume of liquid funds as set out in note 17. Interest payments of €330 million (previous year: €266 million), interest receipts of €139 million (previous year: €186 million), and income tax payments of €244 million (previous year: tax refunds €19 million) are included in cash flow from operating activities.

23 Segment Reporting

Segment reporting disclosures are made in accordance with IAS 14. The primary reporting format uses business segments of the Bertelsmann group. The secondary reporting format is broken down by the main geographical markets in which the Bertelsmann group operates.

Information on Segments

Segment reporting, comprising six operating segments, is based on the internal management and reporting structures applied within the Bertelsmann group. To the extent they reflect the financial management of the group, the segments are different from the group's legal structure.

Information on Segment Data

The definition of the various segment data is the same as that used for the group's management system. Segment data are reconciled to the relevant group figures in the "consolidation" column.

Intercompany revenues are recognized at normal market conditions, as applied to transactions with third parties.

A key performance indicator within the Bertelsmann group is Operating EBIT. Under normal business conditions, Operating EBIT represents normal operating earnings before interest and taxes. Hence, earnings before interest and taxes, or EBIT, are adjusted for special items which do not have operating characteristics, as they are non-recurring. These include income and expense items which, due to their size and frequency of occurrence, have an effect on the assessment of the results of operations of the operating segment and of the group. Elimination of these special items thus enables determination of a normalized result and hence simplifies forecasting and comparability. Special items include impairment of goodwill at (€6 million) and G+J (€26 million) as well as reversals of impairments at DirectGroup (€22 million).

Depreciation per segment includes depreciation of property, plant and equipment, amortization of intangible assets and write-downs of financial assets as set out in the statement of movements in non-current assets.

Capital expenditures consist of purchases of property, plant and equipment, intangible assets including goodwill, and investments.

Segment assets constitute the operating assets for each segment. They consist of property, plant and equipment, and intangible assets, including goodwill and investments. They also include current assets with the exception of cash and cash equivalents, tax receivables, and other non-operating assets.

Segment liabilities consist of operating liabilities and provisions. They therefore do not include provisions for pensions and similar obligations, tax liabilities, financial debt, or other non-operating liabilities and provisions.

Each segment shows the earnings of, and investments in, associated companies, provided these companies can be clearly allocated to the segment concerned. Results of associated companies are shown before depreciation of goodwill.

In addition, the number of employees at balance sheet date and the average number of employees for the year are shown for the primary reporting format.

For the secondary reporting format, revenues are shown by customer location, while segment assets and segment capital expenditures are included by company location.

Reconciliation from the Primary Reporting Format to the Consolidated Financial Statements in € millions

	2004	2003
Operating EBIT	1,429	1,026
Special items	318	339
EBIT (earnings before interest and taxes)	1,747	1,365
Regular amortization of goodwill		(632)
Financial result	(267)	(322)
Income taxes	(263)	(203)
Net income before minority interest	1,217	208

	12/31/2004	12/31/2003
Segment assets	17,762	17,681
Other current assets (not allocated)	840	356
Cash and cash equivalents	2,092	1,642
Deferred tax assets	286	275
Total assets	20,970	20,154
Segment liabilities	6,569	7,038
Shareholders' equity and minority interest	8,846	7,631
Profit participation capital	706	706
Provisions for pensions and similar obligations	1,674	1,701
Other provisions (not allocated)	110	255
Financial debt	2,144	2,462
Other liabilities (not allocated)	513	257
Deferred tax liabilities	208	114
Total liabilities	20,970	20,154

29 Reconciliation to Operating EBITDA

Starting with Operating EBIT, Operating EBITDA is determined by adding other depreciation and amortization, less any write-ups.

Reconciliation to Operating EBITDA in € millions

	2004	2003
Operating EBIT	1,429	1,026
Amortization of intangible assets	269	378
Depreciation of property, plant and equipment	405	436
Depreciation of other financial assets	6	31
Write-ups of property, plant and equipment	(28)	(5)
Write-downs/Write-ups in special items	22	–
Operating EBITDA	2,112	1,866

Impairment of goodwill amounting to €28 million, and €6 million for associated companies, has not been added back, as it is included in special items and has thus not reduced Operating EBIT.

30 Significant Differences from German Accounting Policies

Consolidation of Investments in Subsidiaries

IFRS 3 states that the acquisition of holdings in companies by share swap are to be accounted for at fair value using the purchase method. Under German accounting rules, by contrast, such acquisitions are reported at book value. In contrast to German accounting, IAS does not allow goodwill to be offset against shareholders' equity.

Goodwill

In accordance with IFRS 3, goodwill is no longer regularly amortized, but is subject to an annual impairment test. German accounting requires goodwill shown in the balance sheet to be amortized over its expected useful life.

Finance Leases

Long-term leases of assets which, viewed economically, represent a purchase using third-party financing, are recognized in the balance sheet as an asset and an equivalent liability as set out in IAS 17. Due to other definitions of economic ownership, all leasing contracts in the group are classified as rental contracts in accordance with German accounting practice and thus are not reflected in the balance sheet.

Participations and Securities

Participations and other securities included in non-current assets and in current assets in the Bertelsmann group financial statements are shown as available-for-sale or as held-to-maturity.

As set out in IAS 39, available-for-sale securities are measured at their fair value on the balance sheet date. The resulting unrealized gains and losses are recorded direct to shareholders equity, net of any applicable deferred taxes. If fair values cannot be determined, the participations or securities concerned are measured at amortized acquisition cost.

Financial investments with determinable payments and fixed maturity, which are intended to be held-to-maturity, are measured at amortized cost using the effective interest rate method.

The regulations set out in HGB require assets to be stated at amortized cost or their net realizable value, if lower.

Factoring

IAS 39 states that receivables sold may only be derecognized if a substantial part of the risk inherent in the receivables portfolio is transferred to the buyer.

Derivative Financial Instruments

As set out in IAS 39, all derivative financial instruments are recorded on the balance sheet at fair value, even if they act as a hedge of an underlying transaction. Changes to the fair value of these hedging instruments are recognized in the income statement for fair value hedges and are recorded directly in shareholders' equity for cash flow hedges.

German accounting principles only require financial derivatives to be recognized on the balance sheet to the extent that, after offset against the underlying, any balance represents a probable loss, and a provision is recognized accordingly. On the other hand, unrealized gains are not recognized.

Long-term Receivables, Provisions and Liabilities

Unless they yield market interest rates, long-term receivables, provisions and liabilities are discounted in accordance with IAS, whereas under HGB they are stated at nominal values.

Deferred Taxes

As set out in IAS 12, deferred tax assets and liabilities are recognized for all temporary differences between the carrying amounts reported for tax purposes and those reported in the IAS consolidated balance sheet, with the exception of goodwill which is not recognizable for tax purposes, and for tax loss carryforwards. Through the deduction of a valuation allowance, deferred tax assets are only reported to the extent to which they can be subsequently utilized. Such taxes are calculated using enacted future tax rates. The effects of changes in tax rates on deferred tax assets and liabilities are recognized in the period in which the relevant legislation has been enacted. German accounting does not permit the benefits of tax loss carryforwards to be shown as assets.

Profit Participation Capital

IAS does not permit Bertelsmann AG's profit participation capital to be reported as a component of shareholders' equity. Therefore, in contrast to HGB, distributions payable for the year relating to the profit participation capital is reported as a provision.

Provisions for Pensions

IAS 19 requires provisions for pensions and similar obligations to be measured using the projected unit credit method. This method uses biometric calculations, prevailing long-term capital market interest rates for discounting purposes, and the latest assumptions about future salary and pension increases. By contrast, recognition of provisions for pensions in accordance with HGB accounting rules is based on § 6a German Income Tax Act, which assumes a constant discount rate of six percent and does not recognize future increases in salaries and pensions.

31 Related Party Transactions

Bertelsmann Verwaltungsgesellschaft mbH, Gütersloh, a non-operating holding company, exercises control over the Bertelsmann group. Johannes Mohn GmbH, GBL Verwaltungs S.A.R.L. and Reinhard Mohn Verwaltungsgesellschaft mbH have informed Bertelsmann AG that they each own more than one-quarter of its share capital.

Transactions with related parties and associated companies mainly involve deliveries of goods and services. They are made under normal market conditions. From a group view-point, the related income and expense amounts are insignificant.

The remuneration paid to the Supervisory Board for the year ended December 31, 2004 totaled €1,398,000 plus value added tax. During 2004, the members of the Executive Board received remuneration totaling €31,195,718 of which €19,592,772 was paid by Bertelsmann AG. A loan of $5 million, currently bearing interest at 5.06 percent, has been granted to one member of the Executive Board in the previous year. This loan is repayable in full in 2010. There is no collateral on the loan. Former members of the Executive Board or their surviving dependants received amounts (pensions and termination benefits) totaling €2,808,828 from Bertelsmann AG. The provision established by Bertelsmann AG for pension obligations to former members of the Executive Board amounted to €37,279,024. The members of the Supervisory Board and the Executive Board are listed on pages 102–104.

32 Events After the Balance Sheet Date

Arvato and Infoscore Group, Baden-Baden, have agreed to merge their businesses into a joint venture. This merger has been reported to the relevant anti-trust authorities for their review. Furthermore, Arvato has agreed with the East Riding local authority to take over part of the local authority administration work.

33 Major Subsidiaries and Participations at December 31, 2004

RTL Group

Television			
GZSZ Vermarktungsgesellschaft GmbH, Cologne	Germany	82.71	v
IP Deutschland GmbH, Cologne	Germany	82.71	v
IP NEWMEDIA GmbH, Cologne	Germany	82.71	v
N-TV Nachrichtenfernsehen GmbH & Co. KG, Berlin	Germany	41.35	q
RTL 2 Fernsehen GmbH & Co. KG, Munich	Germany	29.70	e
RTL Disney Fernsehen GmbH & Co. KG, Cologne	Germany	41.31	q
RTL NEWMEDIA GmbH, Cologne	Germany	82.71	v
RTL Shop GmbH, Cologne	Germany	71.35	v
RTL Television GmbH, Cologne	Germany	82.71	v
S4M Solutions for Media GmbH, Cologne	Germany	82.71	v
VOX Film- und Fernseh GmbH & Co. KG, Cologne	Germany	82.46	v
Westdeutsche Universum-Film GmbH, Cologne	Germany	82.71	v
Antena 3 de Televisión S.A., Madrid	Spain	14.35	e
Audiomedia S.A., Luxembourg	Luxembourg	82.96	v
Bayard d'Antin S.A., Paris	France	82.71	v
Broadcasting Center Europe S.A., Luxembourg	Luxembourg	82.71	v
Channel 5 Broadcasting Limited, London	U.K.	53.52	q
CLT-UFA Holding S.A., Luxembourg	Luxembourg	82.96	v
CLT-UFA S.A., Luxembourg	Luxembourg	82.71	v
Holland FM Produktie B.V., Hilversum	Netherlands	82.71	v
Holland Media Group Business Nieuwe B.V., Hilversum	Netherlands	82.71	v
IP Belgium S.A., Brussels	Belgium	54.59	v
IP France S.A., Paris	France	82.71	v
IP Luxembourg S.A.R.L., Luxembourg	Luxembourg	82.71	v
M6 Editions S.A., Neuilly sur Seine	France	40.52	v
M6 Films S.A., Neuilly sur Seine	France	40.52	v
M-RTL Rt (RTL Klub), Budapest	Hungary	40.48	e
RTL 9 S.A., Luxembourg	Luxembourg	28.95	e
RTL4 Beheer B.V., Hilversum	Netherlands	82.71	v
RTL Croatia d.o.o., Zagreb	Croatia	27.29	v
Sky Five Text Limited, Middlesex	U.K.	26.80	q
Télévision Indépendante (TVI) S.A., Brussels	Belgium	54.59	v
Télévision Par Satellite S.N.C., Issy les Moulineaux	France	13.78	q
Yorin FM B.V., Hilversum	Netherlands	82.71	v
Content			
CLOU Entertainment TV Produktion GmbH, Cologne	Germany	46.29	v
CLT-UFA Multi Media GmbH, Hamburg	Germany	82.71	v
Grundy Light Entertainment GmbH, Hürth	Germany	82.96	v
Grundy UFA TV Produktions GmbH, Berlin	Germany	82.71	v
ISPR GmbH, Munich	Germany	20.67	e
Sportfive GmbH, Hamburg	Germany	20.67	e
Sportfive Tax GmbH, Hamburg	Germany	20.67	e
Teamwork Produktion für Kino und Fernsehen GmbH, Berlin	Germany	63.71	v
UFA Entertainment GmbH, Berlin	Germany	82.71	v
UFA Fernsehproduktion GmbH, Berlin	Germany	82.71	v
UFA Film- und Fernseh GmbH, Cologne	Germany	82.71	v
Football France Promotion S.A., Paris	France	20.67	e
Fremantle Media Australia Pty Limited, St. Leonard	Australia	82.96	v
Fremantle Productions Asia Limited, Hong Kong	China	82.96	v
FremantleMedia Limited, London	U.K.	82.96	v
FremantleMedia North America, Inc., Wilmington	U.S.	82.96	v
Grundy Productions Limited, London	U.K.	82.96	v
SportFive S.A., Paris	France	20.67	e
Talkback Productions Limited, London	U.K.	82.96	v
Radio			
Antenne Mecklenburg-Vorpommern GmbH & Co. KG, Plate	Germany	21.04	e
Antenne Sachsen Hörfunk- und Versorgungs GmbH, Dresden	Germany	40.43	e
BB Radio Landeswelle Brandenburg GmbH & Co. KG, Berlin	Germany	33.06	e
RTL Radio Deutschland GmbH, Berlin	Germany	82.71	v
AVE Gesellschaft für Hörfunkbeteiligungen, Berlin	Germany	82.28	v
Ediradio S.A., Paris	France	82.71	v
Contact S.A., Brussels	Belgium	40.85	e

Random House

Random House North America			
Content Link, Inc., Delaware	U.S.	100.00	v
Faders LLC, New York	U.S.	100.00	v
Golden Treasurers, Inc., Delaware	U.S.	100.00	v
G24 NA LLC, Wilmington	U.S.	100.00	v
McClelland & Stewart Limited, Toronto	Canada	25.00	e
Random House, Inc., New York	U.S.	100.00	v
Random House Direct, Inc., New Jersey	U.S.	100.00	v
Random House of Canada Limited, Toronto	Canada	100.00	v
Random House TPR, Inc., New York	U.S.	100.00	v
Random House Ventures LLC, New York	U.S.	100.00	v
Verlagsgruppe Random House			
Gütersloher Verlagshaus GmbH, Gütersloh	Germany	100.00	v
Verlag RM GmbH, Gütersloh	Germany	100.00	v
Verlagsgruppe Random House GmbH, Munich	Germany	100.00	v
Random House U.K., Australia, New Zealand, South Africa			
Random House (Proprietary) Limited, Parktown (Johannesburg)	South Africa	75.00	v
Random House Australia Pty. Limited, Melbourne	Australia	100.00	v
Random House New Zealand Limited, Glenfield	New Zealand	100.00	v
RHA Holdings Pty. Limited, Melbourne	Australia	100.00	v
The Random House Group Limited, London	U.K.	100.00	v
Random House Mondadori			
Editorial Sudamericana, S.A., Buenos Aires	Argentina	50.00	q
Editorial Lumen, S.A., Barcelona	Spain	50.00	q
Editorial Sudamericana Uruguaya, S.A., Montevideo	Uruguay	49.95	q
Grupo Editorial Random House Mondadori, S.L., Barcelona	Spain	50.00	q
Random House Mondadori S.A., Barcelona	Spain	50.00	q
Random House Mondadori S.A., Santiago de Chile	Chile	50.00	q
Random House Mondadori, S.A. de C.V., Mexico City	Mexico	50.00	q
Random House Mondadori, S.A., Bogotá	Colombia	50.00	q
Random House Mondadori, S.A., Caracas	Venezuela	50.00	q
Random House Asia			
Random House Kodansha Co., Limited, Tokyo	Japan	50.00	q
Random House JoongAng Inc., Seoul	Korea	50.00	q

As of December 31, 2004
Ownership of Group companies by percentage.

Consolidation method is defined as follows:

v = fully consolidated

q = proportionally consolidated

e = associated companies recognized at equity

Gruner + Jahr

Magazines Germany			
Berliner Presse Vertrieb GmbH, Berlin	Germany	74.90	v
DPV Deutscher Pressevertrieb GmbH, Hamburg	Germany	74.90	v
Ehlich & Sohn GmbH & Co. KG, Hamburg	Germany	74.90	v
G+J Corporate Media GmbH, Hamburg	Germany	74.90	v
G+J Electronic Media Sales GmbH, Hamburg	Germany	74.90	v
G+J Women Verlag GmbH, Hamburg	Germany	74.90	v
G+J Women New Media GmbH, Hamburg	Germany	74.90	v
G+J Zeitschriften-Verlagsgesellschaft mbH, Hamburg	Germany	74.90	v
G+J/RBA GmbH & Co. KG, Hamburg	Germany	37.45	e
Gruner + Jahr AG & Co KG, Hamburg	Germany	74.90	v
IPV Inland Pressevertrieb GmbH, Hamburg	Germany	74.90	v
Living at Home Multi Media GmbH, Hamburg	Germany	74.90	v
Neon Magazin GmbH, Hamburg	Germany	74.90	v
Norddeutsche Verlagsgesellschaft mbH, Hamburg	Germany	74.90	v
"Picture Press" Bild- und Textagentur GmbH, Hamburg	Germany	74.90	v
stern.de GmbH, Hamburg	Germany	74.90	v
W.E. Saarbach GmbH, Cologne	Germany	19.65	e
Magazines France & U.S.			
Gruner + Jahr Publishing, New York	U.S.	74.90	v
Lexo TV S.N.C., Paris	France	74.90	v
NG France S.N.C., Paris	France	74.90	v
Orion S.N.C., Paris	France	74.90	v
Prisma Presse S.N.C., Paris	France	74.90	v
VIVIA S.N.C., Paris	France	74.90	v
VSD S.N.C., Paris	France	74.90	v
Magazines International			
GALA Ediciones S.L., Madrid	Spain	37.45	q
G y J Espana Ediciones, S.L., S. en C., Madrid	Spain	74.90	v
G y J Publicaciones Internacionales, S.L. y Cia., S. en C., Madrid	Spain	37.45	v
G y J Revistas y Comunicaciones, S.L., Sociedad Unipersonal, Madrid	Spain	74.90	v
G+J – CLIP (Beijing) Publishing Consulting Co., Limited, Beijing	China	38.20	v
G+J/RBA Publishing C.V. National Geografic Nederland, Amsterdam	Netherlands	37.82	v
G+J RSA Sp. z o.o. & Co. Spolka komandytowa, Warsaw	Poland	74.53	v
G+J Uitgevers C.V., Diemen	Netherlands	74.90	v
Gruner + Jahr / Mondadori S.p.A., Milan	Italy	50.00	q
Gruner + Jahr Polska Sp. z o.o. & Co. Spolka Komandytowa, Wroclaw	Poland	74.90	v
Gruner + Jahr ZAO, Moscow	Russia	74.90	v
RBA Lexo Venture Polska Sp.z.o.o., Warsaw	Poland	74.90	v
Shanghai G+J Consulting and Service Co., Limited, Shanghai	China	74.90	v
Verlagsgruppe NEWS Ges.m.b.H., Vienna	Austria	41.98	v
Newspapers/Trade Press			
Berlin Online Stadtportal GmbH & Co. KG, Berlin	Germany	33.71	e
Börse Online Verlag GmbH & Co. KG, Munich	Germany	74.90	v
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden	Germany	44.94	v
Dresdner Magazin Verlag GmbH, Dresden	Germany	44.94	v
Financial Times Deutschland GmbH & Co. KG, Hamburg	Germany	37.45	q
Morgenpost Sachsen GmbH, Dresden	Germany	44.94	v
MVD Medien Vertrieb Dresden GmbH, Dresden	Germany	44.94	v
Saxo-Phon GmbH, Dresden	Germany	44.94	v
Printing			
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden (Printing plant)	Germany	44.94	v
Gruner + Jahr AG & Co KG, Hamburg (Printing plant Itzehoe)	Germany	74.90	v
GWL-Gruner Druck Weiterverarbeitung und Logistik GmbH, Itzehoe	Germany	74.90	v
Brown Printing Company, Waseca	U.S.	74.90	v
Corporate and Publishing Services			
Druck- und Verlagshaus Gruner + Jahr AG, Hamburg	Germany	74.90	v
Hamburger Journalistenschule Gruner + Jahr – DIE ZEIT GmbH, Hamburg	Germany	71.16	v
Manager Magazin Verlagsgesellschaft mbH, Hamburg	Germany	18.65	e
SPIEGEL-Verlag Rudolf Augstein GmbH & Co. KG, Hamburg	Germany	18.91	e

BMG

Sony BMG Music Entertainment

North America			
Arista Records, Delaware	U.S.	50.00	q
Columbia Records Corporation, New York	U.S.	50.00	q
Epic Records, New York	U.S.	50.00	q
J Records, New York	U.S.	50.00	q
LaFace Records, New York	U.S.	50.00	q
Legacy Recordings – Sony BMG Catalog, New York	U.S.	50.00	q
Provident Music Group, Wilmington	U.S.	50.00	q
RCA Label Group, Nashville	U.S.	50.00	q
RCA Music Group, New York	U.S.	50.00	q
Sony BMG Canada, Toronto	Canada	50.00	q
Sony BMG Masterworks, New York	U.S.	50.00	q
Sony Music Nashville	U.S.	50.00	q
Sony Wonder, New York	U.S.	50.00	q
Zomba Records, Wilmington	U.S.	50.00	q
Europe			
Sony BMG Germany, Munich	Germany	50.00	q
Sony BMG Belgium, Brussels	Belgium	50.00	q
Sony BMG France, Paris	France	50.00	q
Sony BMG Italy, Rome	Italy	50.00	q
Sony BMG Netherlands, Hilversum	Netherlands	50.00	q
Sony BMG Spain, Madrid	Spain	50.00	q
Sony BMG Sweden, Stockholm	Sweden	50.00	q
Sony BMG UK & Ireland, London	U.K.	50.00	q
Latin America			
Sony BMG Argentina, Buenos Aires	Argentina	50.00	q
Sony BMG Brazil, Rio de Janeiro	Brazil	50.00	q
Sony BMG Chile, Santiago	Chile	50.00	q
Sony BMG Mexico, Mexico City	Mexico	50.00	q
Asia/Pacific			
BMG Funhouse, Tokyo	Japan	50.00	q
Sony BMG Africa, Johannesburg	South Africa	50.00	q
Sony BMG Australia, Sydney	Australia	50.00	q
Sony BMG Hong Kong, Hong Kong	China	50.00	q
Sony BMG Korea, Seoul	Korea	50.00	q
Sony BMG New Zealand, Auckland	New Zealand	50.00	q
Sony BMG Singapore, Singapore	Singapore	50.00	q
Sony BMG Taiwan, Taipeh	Taiwan	50.00	q

BMG Music Publishing

North America			
BMG Songs, Inc., Sacramento	U.S.	100.00	v
Zomba Enterprises, Inc., New York	U.S.	100.00	v
Europe			
Arabella Musikverlag GmbH, Munich	Germany	100.00	v
BMG Music Publishing B.V., Hilversum	Netherlands	100.00	v
BMG Music Publishing France SARL, Paris	France	100.00	v
BMG Music Publishing Limited, London	U.K.	100.00	v
BMG Ricordi Music Publishing S.p.A., Milan	Italy	100.00	v
Cezame Argile Productions Editions S.A., Paris	France	100.00	v
Editions Durand S.A., Paris	France	100.00	v
Silvertone Records Limited, London	U.K.	100.00	v
Zomba Music Publishers Limited, London	U.K.	100.00	v
Latin America			
BMG Music Publishing, S.A. de C.V., Mexico City	Mexico	100.00	v
Asia/Pacific			
BMG Funhouse Music Publishing, Inc., Tokyo	Japan	100.00	v
Zomba Production Music (Australia), Pty Limited, North Sydney	Australia	100.00	v

Arvato

Printing			
Deutscher Supplement Verlag GmbH, Nuremberg	Germany	75.00	v
Fernwärme GmbH, Gütersloh	Germany	51.00	v
GGP Media GmbH, Pößneck	Germany	100.00	v
Maul + co – Chr. Belser GmbH, Nuremberg	Germany	75.00	v
Maul + co – Chr. Belser Klebebindung GmbH, Nuremberg	Germany	75.00	v
Maul + co – Chr. Belser Studios GmbH, Nuremberg	Germany	75.00	v
Maul-belser mb Tiefdruck GmbH & Co. KG, Nuremberg	Germany	75.00	v
MB Tiefdruck GmbH, Nuremberg	Germany	75.00	v
Medienfabrik Gütersloh GmbH, Gütersloh	Germany	90.00	v
Mobilitäts-Verlag GmbH, Berlin	Germany	100.00	v
MOHN Media Kalender & Promotion Service GmbH, Gütersloh	Germany	100.00	v
MOHN Media Mohndruck GmbH, Gütersloh	Germany	100.00	v
ProBind Professional Binding GmbH, Gütersloh	Germany	95.00	v
TV Information Services GmbH, Nuremberg	Germany	75.00	v
Wahl Media GmbH, Munich	Germany	100.00	v
WOSCHEK Verlags GmbH, Mainz	Germany	80.00	v
Berryville Graphics, Inc., Wilmington	U.S.	100.00	v
Cobrhi, S.L., Madrid	Spain	100.00	v
Coral Graphic Services, Inc., Hicksville	U.S.	95.10	v
Dynamic Graphic Finishing, Inc., Horsham	U.S.	95.10	v
Editoriale Johnson S.p.A., Seriate	Italy	98.82	v
Eurogravure S.p.A., Bergamo	Italy	89.18	v
Eurohueco, S.A., Castellbisbal (Barcelona)	Spain	75.00	v
Gravureworx Limited, Liverpool	U.K.	100.00	v
Istituto Italiano d'Arti Grafiche S.p.A., Bergamo	Italy	95.82	v
MOHN Media France S.A.R.L., Villepinte	France	100.00	v
Nuovo Istituto Italiano d'Arti Grafiche S.p.A., Bergamo	Italy	98.82	v
OAO Jaroslawski Poligraphicheski Kombinat, Jaroslawl	Russia	84.91	v
Offset Paperback MFRS., Inc., Dallas	U.S.	100.00	v
OOO Distributsionyy centr Bertelsmann, Jaroslawl	Russia	100.00	v
Printer Colombiana, S.A., Santa Fé de Bogotá	Colombia	50.89	v
Printer Industria Gráfica, S.A., Sant Vicenc dels Horts (Barcelona)	Spain	100.00	v
Printer Portuguesa-Indústria Gráfica, Limitada, Mem Martins (Algueirao)	Portugal	100.00	v
Rotedic, S.A., Madrid	Spain	100.00	v
Services			
ASIS GmbH, Frankfurt am Main	Germany	39.20	q
Adress Research GmbH, Gütersloh	Germany	39.20	q
Arvato Direct Services Cottbus GmbH, Cottbus	Germany	100.00	v
Arvato Direct Services Dortmund GmbH, Dortmund	Germany	100.00	v
Arvato Direct Services Elversberg GmbH, Heusweiler-Elversberg	Germany	100.00	v
Arvato Direct Services GmbH, Gütersloh	Germany	100.00	v
Arvato Direct Services Gütersloh GmbH, Gütersloh	Germany	100.00	v
Arvato Direct Services Münster GmbH, Münster	Germany	100.00	v
Arvato Direct Services Nürnberg GmbH, Nuremberg	Germany	100.00	v
Arvato Direct Services Stuttgart GmbH, Kornwestheim	Germany	100.00	v
Arvato Direct Services Wilhelmshaven GmbH, Schortens	Germany	100.00	v
Arvato Direct Services Wuppertal GmbH, Wuppertal	Germany	100.00	v
Arvato Distribution GmbH, Harsewinkel	Germany	100.00	v
Arvato Logistics Services GmbH, Gütersloh	Germany	100.00	v
Arvato Media GmbH, Gütersloh	Germany	100.00	v
Arvato Technology ELC GmbH, Düren	Germany	100.00	v
Arvato Technology GmbH, Gütersloh	Germany	100.00	v
AZ Direct GmbH, Gütersloh	Germany	100.00	v
Bertelsmann Direct GmbH & Co. KG, Gütersloh	Germany	50.00	q
BFS Finance GmbH, Verl	Germany	100.00	v
BFS Finance Münster GmbH, Münster	Germany	100.00	v
BFS Health Finance GmbH, Hagen	Germany	100.00	v
BFS Risk & Collection GmbH, Verl	Germany	100.00	v
BFS Risk Management GmbH, Verl	Germany	74.80	v
Cross Marketing Arvato Services GmbH, Munich	Germany	100.00	v
Deutsche Post Adress GmbH, Bonn	Germany	49.00	q
Inmedia One GmbH, Gütersloh	Germany	100.00	v
Lambourne Productions GmbH, Herne	Germany	100.00	v
Media Log Spedition GmbH, Gütersloh	Germany	100.00	v
PVS Mailmanagement GmbH, Nackenzum	Germany	100.00	v
Rough Trade Distribution GmbH, Herne	Germany	100.00	v
Thomas Abeking Verlag für technische Dokumentation GmbH, Grafrath	Germany	100.00	v
Verlag Automobil Wirtschaft GmbH, Grafrath	Germany	100.00	v
Verlagsdienst München GmbH, Gräfing	Germany	100.00	v
Webmites GmbH, Munich	Germany	87.53	v
ALLDIREKT Telemarketing GmbH, Salzburg	Austria	100.00	v
Arvato BPO Services India Private Limited, New Delhi	India	51.00	v
Arvato Communication Services France S.A.R.L., Noyelles sous Lens	France	100.00	v
Arvato Customer Services N.V., Kontich	Belgium	80.00	v
Arvato Data Services N.V., Kontich	Belgium	80.00	v
Arvato Logistics Services AG, Pratteln	Switzerland	100.00	v
Arvato Media Services France SAS, Noyelles sous Lens	France	100.00	v
Arvato Print and Mail Services N.V., Kontich	Belgium	80.00	v
Arvato Services (UK) Limited, Warley	U.K.	100.00	v
Arvato Services Asia Pacific Pte. Limited, Singapore	Singapore	100.00	v
Arvato Services Australia Pacific Pty. Limited, Castle Hill (Sydney)	Australia	100.00	v
Arvato Services Belgium N.V., Antwerp	Belgium	80.00	v
Arvato Services Canada, Inc., Toronto	Canada	100.00	v
Arvato Services France S.A.R.L., Noyelles sous Lens	France	100.00	v
Arvato Services Iberia, S.A., Barcelona	Spain	100.00	v
Arvato Services Netherlands B.V., Abcoude	Netherlands	80.00	v
Arvato Services, Inc., Valencia	U.S.	100.00	v
Arvato Telekomünikasyon Hizmetleri Anonim Sirketi, Istanbul	Turkey	100.00	v
AZ Direct AG, Lucern	Switzerland	100.00	v
BenefitNation, Inc., Fairfax Station	U.S.	100.00	v
Bertelsmann Marketing Service India Private Limited, New Delhi	India	51.00	v
Bertelsmann Media Sp. z o.o z siedzibe w Warszawie Oddział "Arvato Services Polska", Plewiska k/Poznania	Poland	100.00	v
Bertelsmann Österreich GmbH, Vienna	Austria	100.00	v
BFS Finance Limited, Dublin	Ireland	100.00	v
DM Michelotti AG, Rotkreuz	Switzerland	100.00	v
DM-Plus Direktmarketing AG, Rotkreuz	Switzerland	100.00	v
DM-Plus Direktmarketing GmbH, Vienna	Austria	100.00	v
Eurodirect – Société Européenne de Routage S.A., Geispolsheim	France	100.00	v
Eurodirect Marketing Lettershop SAS, Geispolsheim	France	100.00	v
Euromedia Group k.s., Prague	Czech Republic	100.00	v
Europost SAS, Seulcy sur Meurthe	France	100.00	v
Gauntlet Entertainment Limited, Orpington	U.K.	100.00	v
Maximail N.V., Brussels	Belgium	80.00	v
Phone Assistance, S.A., Casablanca	Morocco	54.90	v
Phone Serviplus, S.A., Casablanca	Morocco	55.00	v
Pinnacle Entertainment Limited, Orpington	U.K.	100.00	v
Pinnacle Software Limited, Orpington	U.K.	100.00	v
Total Distribución, S.A., Alcorcón (Madrid)	Spain	66.67	v
VAW CZ, s.r.o., Mladá Boleslav	Czech Republic	100.00	v
Verlag Automobil Wirtschaft (Pty.) Limited, Port Elizabeth	South Africa	100.00	v
Verlag Automobil Wirtschaft GmbH do Brasil Ltda., Sao Paulo	Brazil	100.00	v
Verlag Automobil Wirtschaft, S.L., Barcelona	Spain	100.00	v
Verlagsservice für Bildungssysteme und Kunstobjekte GmbH & Co. KG, Vienna	Austria	75.00	v
Verlagsservice Süd AG, Glattbrugg	Switzerland	100.00	v

Arvato Mobile GmbH, Hamburg	Germany	100.00	v
Arvato Systems GmbH, Gütersloh	Germany	100.00	v
Arvato Systems Technologies GmbH, Rostock	Germany	100.00	v
Empolis GmbH, Gütersloh	Germany	100.00	v
Arvato Systems (Shanghai) Co. Limited, Shanghai	China	100.00	v
Arvato Systems North America, Inc., Wilmington	U.S.	100.00	v
Arvato Systems UK & Ireland Limited, London	U.K.	100.00	v
Empolis NA, Inc., Burlington	U.S.	100.00	v
Empolis Polska Spolka z ograniczona odpowiedzialnoscia, Warsaw	Poland	95.05	v
Empolis UK Limited, Swindon	U.K.	100.00	v
TJ net S.p.A., Rome	Italy	100.00	v
Storage Media			
Arvato Storage Media GmbH, Gütersloh	Germany	100.00	v
Sonopress Produktionsgesellschaft für Ton- und Informationsträger mbH, Gütersloh	Germany	100.00	v
Topac Multimedia Print GmbH, Gütersloh	Germany	100.00	v
Arvato de Mexico, S.A. de C.V., Mexico City	Mexico	100.00	v
Arvato do Brasil Indústria e Servicos Gráficos, Logística e Distribuidora Ltda., Sao Paulo	Brazil	100.00	v
Sonopress – Rimo Argentina, S.A., Buenos Aires	Argentina	52.00	v
Sonopress (UK) Limited, Wednesbury (Birmingham)	U.K.	100.00	v
Sonopress France SAS, Paris	France	100.00	v
Sonopress Iber-Memory S.A., Coslada (Madrid)	Spain	51.00	v
Sonopress Ireland Limited, Dublin	Ireland	100.00	v
Sonopress Rafia S.r.l., Milan	Italy	100.00	v
Sonopress LLC, Wilmington	U.S.	100.00	v
Sonopress Pan Asia Limited, Hong Kong	China	100.00	v
Sonopress Pan Asia Tokyo Co., Limited, Tokyo	Japan	100.00	v
Sonopress Shanghai Multimedia Technology Co. Limited, Shanghai	China	100.00	v
Sonopress Singapore Pte. Limited, Singapore	Singapore	100.00	v
Sonopress South Africa (Proprietary) Limited, Bramhof (Johannesburg)	South Africa	100.00	v
Sonopress-Rimo Indústria e Comércio Fonográfica Ltda., Sao Paulo	Brazil	52.00	v

Direct Group

Clubs Central and Eastern Europe			
FCB FREIZEIT-CLUB Betreuungs-GmbH & Co., Hamburg	Germany	50.00	q
Nionex GmbH, Gütersloh	Germany	100.00	v
RM Buch und Medien Vertrieb GmbH, Gütersloh	Germany	100.00	v
RTL Club GmbH, Rheda-Wiedenbrück	Germany	100.00	v
Wissen Media Verlag GmbH, Gütersloh	Germany	100.00	v
Wissen.de GmbH Gesellschaft für Online-Information, Munich	Germany	100.00	v
Bertelsmann Media – Swiat Ksiazki, Warsaw	Poland	100.00	v
Bertelsmann Media Moskau AO, Moscow	Russia	100.00	v
Bertelsmann Medien (Schweiz) AG, Zug	Switzerland	100.00	v
Book Club "Family Leisure Club", Chaikow	Ukraine	100.00	v
Buchgemeinschaft Donauland Kremayr & Scheriau, Vienna	Austria	75.00	v
EUROMEDIA GROUP k.s., Prague	Czech Republic	100.00	v
IKAR a.s., Bratislava	Slovakia	100.00	v
Clubs/Direct Sales South-West Europe			
BOL Books On Line Italia S.p.A., Milan	Italy	50.00	e
Circulo de Lectores, S.A., Barcelona	Spain	100.00	v
Circulo de Leitores, S.A., Lisbon	Portugal	100.00	v
ECI voor Boeken en Platen B.V., Vianen	Netherlands	100.00	v
France Loisirs (Suisse) S.A., Crissier	Switzerland	100.00	v
France Loisirs Belgique S.A., Ath	Belgium	100.00	v
France Loisirs S.A.R.L., Paris	France	100.00	v
Lexicultural – Actividades Editoriais, Limitada, Bureça (Lisbon)	Portugal	100.00	v
Mondolibri S.p.A., Milan	Italy	50.00	q
Québec Loisirs Inc., Ville St. Laurent	Canada	100.00	v
Société Générale d'Edition et de Diffusion SGED, s.n.c. (L.L.), Paris	France	50.00	q
Clubs Asia			
Beijing 21st Century Book Chain Co. Limited, Beijing	China	40.00	q
Bertelsmann Asia Publishing, Hong Kong	China	100.00	v
Bertelsmann Korea Co., Limited, Seoul	Korea	100.00	v
DirectSourcing (HK) Limited, Hong Kong	China	100.00	v
Hangzhou Rongzhuxia Culture Information Consulting Co. Limited, Shanghai	China	53.50	v
Shanghai Bertelsmann Culture Industry Co. Limited, Shanghai	China	50.00	v
Shanghai Bertelsmann Information Technology Co. Limited, Shanghai	China	100.00	v
English-speaking Clubs			
BOL limited, London	U.K.	100.00	v
Book Club Associates, London	U.K.	100.00	v
Bookspan (Partnership), Delaware	U.S.	50.00	q
Doubleday Australia Pty. Limited, Lane Cove (Sydney)	Australia	100.00	v
Doubleday Canada Limited, Toronto	Canada	100.00	v
BMG Direct			
BMG Direct Marketing, Inc., Wilmington	U.S.	100.00	v
Others			
Bertelsmann Multimedia GmbH, Gütersloh	Germany	100.00	v
BOL.com AG, Gütersloh	Germany	100.00	v
Buch.de AG, Münster	Germany	28.70	e

v = fully consolidated

q = proportionally consolidated

e = associated companies recognized at equity

* = operating department

Exemption for Domestic Companies from Preparing, Audit and Publication of Financial Statements

The following subsidiaries took advantage of the exemption regulations set out in § 264 para. 3 HGB relating to additional requirements for limited liability companies to prepare annual financial statements and a management report, as well as the requirements for audit of, and publication by, limited liability companies for the year ended December 31, 2004:

ADLER Immobilienverwaltungs GmbH	Gütersloh
Arabella Musikverlag GmbH	Munich
Artur Wahl GmbH Reproduktionen Satzherstellung	Munich
Arvato AG	Gütersloh
Arvato Direct Services Dortmund GmbH	Dortmund
Arvato Direct Services elweiler GmbH	Heusweiler-Elweiler
Arvato Direct Services elweiler GmbH	Mannheim
Arvato Direct Services GmbH	Gütersloh
Arvato Direct Services Gütersloh GmbH	Gütersloh
Arvato Direct Services Gütersloh GmbH	Speinge
Arvato Direct Services Münster GmbH	Münster
Arvato Direct Services Neumünster GmbH	Neumünster
Arvato Direct Services Stuttgart GmbH	Kornwestheim
Arvato Direct Services Wilhelmshaven GmbH	Schortens
Arvato Direct Services Wuppertal GmbH	Wuppertal
Arvato Distribution GmbH	Harsewinkel
Arvato Logistics Services GmbH	Gütersloh
Arvato Media GmbH	Gütersloh
Arvato Middle East Sales GmbH	Gütersloh
Arvato Storage Media GmbH	Gütersloh
Arvato Systems GmbH	Gütersloh
Arvato Systems Technologies GmbH	Rostock
Arvato Technology ELC GmbH	Düren
Arvato Technology GmbH	Gütersloh
ASM Holding GmbH	Gütersloh
AZ Direct GmbH	Gütersloh
AZ Direct GmbH	Garching
Bavarian-Verlag Gesellschaft mit beschränkter Haftung	Munich
Bemobile GmbH	Hamburg
Bertelsmann Capital Holding GmbH	Hamburg
Bertelsmann Capital Ventures GmbH	Munich
Bertelsmann Immobilien GmbH	Gütersloh
Bertelsmann Interactive Studios GmbH	Gütersloh
Bertelsmann Korea Beteiligungs GmbH	Gütersloh
Bertelsmann Multimedia GmbH	Gütersloh
Bertelsmann Music Group GmbH	Gütersloh
Bertelsmann Music Group GmbH	Munich
Bertelsmann Online Beteiligungsgesellschaft mbH	Gütersloh
Bertelsmann Online International GmbH	Gütersloh
Bertelsmann Treuhand- und Anlagegesellschaft mit beschränkter Haftung	Gütersloh
BFS Finance GmbH	Verl
BFS Finance Münster GmbH	Münster
BFS Risk & Collection GmbH	Verl
BMG Deutschland GmbH	Gütersloh
BOL.com AG	Gütersloh
Crescendo Musikverlag GmbH	Munich
CS Central Service GmbH	Gerstheim
DirectGroup Bertelsmann GmbH	Gütersloh
Dreiklang-Dreimasken, Bühnen- und Musikverlag Gesellschaft mit beschränkter Haftung	Munich
EQ Transfer GmbH Gesellschaft für Qualifizierung	Gütersloh
Empolis GmbH	Gütersloh
GGP Media GmbH	Pößneck
Gütersloher Verlagshaus GmbH	Gütersloh
Hotel & Gastronomie Gütersloh GmbH	Gütersloh
Inmedia One GmbH	Gütersloh
Interworld Musik-Verlag Gesellschaft mit beschränkter Haftung	Munich
Media Log Spedition GmbH	Gütersloh
Medien Dr. phil. Egon Müller Service GmbH	Verl
Medienfabrik Gütersloh GmbH	Gütersloh
Mobilitäts-Verlag GmbH	Berlin
Mohn Media Bindery GmbH	Gütersloh
Mohn Media Eisnerdruck GmbH	Berlin
Mohn Media Energy GmbH	Gütersloh
MOHN Media Kalender & Promotion Service GmbH	Gütersloh
Mohn Media Print GmbH	Gütersloh
Mohn Media Sales GmbH	Gütersloh
MSI Multimedia Service International GmbH	Gütersloh
Musik Edition Discoton, Gesellschaft mit beschränkter Haftung	Munich
Profind Professional Binding GmbH	Gütersloh
PSC Print Service Center GmbH	Oppurg
PVS Mailmanagement GmbH	Neckarsulm
Reinhard Mohn GmbH	Gütersloh
RM Buch und Medien Vertrieb GmbH	Gütersloh
RM Buch und Medien Vertrieb GmbH	Rhede-Wiedenbrück
UFA – International Gesellschaft mit beschränkter Haftung	Munich
Ufaton-Verlagsgesellschaft mit beschränkter Haftung	Munich
Verlag RM GmbH	Gütersloh
Verlagsgruppe Random House GmbH	Gütersloh
Verlagsgruppe Random House GmbH	Berlin
Verlagsgruppe Random House GmbH	Munich
Wiener Bohème Verlag Gesellschaft mit beschränkter Haftung	Munich
Wissen Media Group GmbH	Munich
WOSCHEK Verlags GmbH	Mainz
Young Musikverlag GmbH	Munich

The exemption provisions set out in § 264 b HGB were again used for the following companies for the year ended December 31, 2004:

Andsohl GmbH & Co. KG	Gütersloh
Börse Online Verlag GmbH & Co. KG	Munich
Dresdner Druck- und Verlagshaus GmbH & Co. KG	Dresden
EB2B Market Place GmbH & Co. KG	Hamburg
Ehrlich & Sohn GmbH & Co. KG	Hamburg
Gruner + Jahr AG & Co KG	Hamburg
Verlagsdienst München Gesellschaft mit beschränkter Haftung & Co. KG	Gräfelfing

15 Recommendation on Appropriation of Retained Earnings

On May 19, 2004 and as provided by the statutes, €76 million will be distributed to the profit participation certificates out of Bertelsmann AG's retained earnings of €871 million.

The Executive Board recommends to the general meeting that the remaining retained earnings of €795 million be appropriated as follows:

	€ in millions
Remaining retained earnings	795
Dividends to shareholders	(324)
Carryforward to new fiscal year	471

Gütersloh, March 3, 2005

Bertelsmann AG
The Executive Board:

Dr. Thielen Dr. Luther Dr. Kundrun Olson

Ostrowski Schmidt-Holtz Dr. Walgenbach

SUPERVISORY BOARD

REINHARD MOHN
Honorary Chairman

PROF. DR. DIETER H. VOGEL
Chairman
(since 1/1/2004)
Managing partner of
LGB & Vogel GmbH
- Mapress GmbH (Chairman) (until 1/27/2004)
- Mobilcom AG (Chairman)
- Wacker Construction Equipment AG (Chairman)
- WCM Beteiligungs- und Grundbesitz AG (Chairman)
- Blücher Aps (until 1/27/2004)
- Gerling Beteiligungs-GmbH (since 1/1/2004)
- HSBC Trinkaus & Burkhardt KGaA

PROF. DR. JÜRGEN STRUBE
Vice Chairman
(since 1/1/2004)
Chairman of the Supervisory Board,
BASF AG
- Allianz Lebensversicherungs-AG
- BASF AG (Chairman)
- BMW AG
- Commerzbank AG
- Fuchs Petrolub AG (Chairman)
- Hapag-Lloyd AG
- Linde AG

DR. ROLF-E. BREUER
Chairman of the Supervisory Board,
Deutsche Bank AG
- Deutsche Bank AG (Chairman)
- Deutsche Börse AG (Chairman)
- Eon AG
- Compagnie de Saint-Gobain S.A.
- Kreditanstalt für Wiederaufbau
- Landwirtschaftliche Rentenbank

ANDRÉ DESMARAIS
President and Co-Chief Executive Officer, Power Corporation of Canada
- Bombardier Inc. (until 4/31/2004)
- CITIC Pacific Limited
- Great-West Lifeco Inc.
- Groupe Bruxelles Lambert S.A. (until 3/30/2004)
- IGM Financial Inc.
- Pargesa Holding S.A.
- Power Financial Corporation (Vice Chairman)
- The Great-West Life Assurance Company

DR. CLAUS-MICHAEL DILL
(since 5/17/2004)
Chairman of the Executive Board,
Axa Konzern AG
- Axa Krankenversicherung AG (Chairman)
- Axa Art Versicherung AG (Chairman)
- Deutsche Ärzteversicherung AG (Chairman)
- Roland Rechtsschutz-Versicherung-AG (Chairman)
- Kölnische Rückversicherung AG (Vice Chairman)
- Tüv Rheinland Holding AG (Chairman)
- Axa Financial Inc.
- Axa Technology Services
- Deutsche Bank AG
- Equitable Life Assurance Society of the United States
- Mony Life Insurance Company

PROF. DR. MICHAEL HOFFMANN-BECKING
(until 5/17/2004)
Lawyer
- Delton AG
- Rheinische Bahngesellschaft AG
- C.H. Boehringer Sohn
- de Haen-Carstanjen GmbH
- HSBC Trinkaus Burkhardt KGaA
- Felix Schoeller Holding GmbH & Co. KG (Chairman)

SIR PETER JOB
Former Chief Executive Officer, Reuters Group PLC
- Deutsche Bank AG
- Glaxo Smithkline PLC
- Instinet Group Inc.
- Schroders PLC
- Shell Transport and Trading PLC
- Tibco Software Inc.

JOHN R. JOYCE
Senior Vice President and Group Executive, IBM Global Services

DR. HANS-JOACHIM KÖRBER
(since 5/17/2004)
Chairman of the Executive Board, Metro AG
- Kaufhof Warenhaus AG (Chairman)
- Real Holding GmbH (until 2/19/2004 Chairman)
- Loyalty Partner GmbH
- Skandinaviska Enskilda Banken AB

OSWALD LEXER
Vice Chairman of the Bertelsmann Corporate Works Council

LIZ MOHN
Member of the Bertelsmann Stiftung Executive Board and Chairwoman of the Board of Bertelsmann Verwaltungsgesellschaft mbH (BVG)

WILLI PFANNKUCHE
Member of the Bertelsmann Corporate Works Council

ERICH RUPPIK
Chairman of the Bertelsmann Corporate Works Council

GILLES SAMYN
Managing Director of Frère-Bourgois, Managing Director and Vice Chairman of Compagnie Nationale à Portefeuille S.A.
- Groupe Bruxelles Lambert S.A.
- Groupe Taittinger S.A.
- Imerys S.A.
- Pargesa Holding S.A.
- Quick S.A.
- RTL Group S.A.
- Société du Louvre S.A.

RICHARD SARNOFF
Chairman of the Bertelsmann AG Management Representative Committee, Executive Vice President Random House
- Audible Inc.
- Classic Media Inc.
- Ebrary Inc.
- Princeton Review Inc.
- Xlibris Inc.

CHRISTIAN VAN THILLO
Chief Executive Officer, De Persgroep NV

COMMITTEES OF THE SUPERVISORY BOARD

Personnel Committee
Prof. Dr. Dieter H. Vogel (Chairman)
André Desmarais
Liz Mohn
Prof. Dr. Jürgen Strube

Audit and Finance Committee
Prof. Dr. Jürgen Strube (Chairman)
Dr. Rolf-E. Breuer
John R. Joyce
Erich Ruppik
Gilles Samyn

Strategy and Investment Committee
Prof. Dr. Dieter H. Vogel (Chairman)
Dr. Rolf-E. Breuer
André Desmarais
Sir Peter Job
Gilles Samyn
Richard Sarnoff

Working Group of Employee Representatives on the Supervisory Board
Liz Mohn (Chairwoman)
Oswald Lexer
Willi Pfannkuche
Erich Ruppik
Richard Sarnoff

- Supervisory Board mandates in accordance with § 100, para. 2 of the German Stock Corporation Act (AktG)
- Membership in comparable domestic and foreign supervisory bodies of commercial enterprises

EXECUTIVE BOARD

DR. GUNTER THIELEN
Chairman and Chief Executive Officer
- Arvato AG (Chairman)
- Druck- und Verlagshaus Gruner + Jahr AG (Chairman)
- Karstadt Quelle AG[1] (until 5/4/2004)
- Leipziger Messe GmbH[1]
- Bertelsmann Inc. (Chairman)
- RTL Group S.A.
- Sony BMG Music Management Co., LLC (since 8/5/2004)

DR. SIEGFRIED LUTHER
Vice Chairman and Chief Financial Officer
- Druck- und Verlagshaus Gruner + Jahr AG
- West LB AG[1] (until 6/29/2004)
- Bertelsmann Inc.
- RTL Group S.A. (since 12/9/2004 Chairman)
- Sony BMG Music Management Co., LLC (since 8/5/2004)

DR. BERND KUNDRUN
Chairman and Chief Executive Officer, Gruner + Jahr AG
- Gruner +Jahr Holding AG, Vienna
- Gruner + Jahr USA Group Inc.
- Stern Magazine Corporation

PETER OLSON, J.D./MBA
Chairman and Chief Executive Officer, Random House
- Bertelsmann Inc.
- Grupo Editorial Random House Mondadori S.L.
- Random House Direct Inc.
- Random House JoongAng Inc. (since 1/1/2004)
- Random House Kodansha Inc.
- Random House TPR Inc.
- Random House Ventures LLC

HARTMUT OSTROWSKI
Chairman Arvato AG
- Webmiles GmbH (Chairman)
- Arvato Services Canada Inc. (since 12/29/2004)
- Arvato Services Inc.
- Bertelsmann Holding Spain S.A. (Chairman)
- Berryville Graphics Inc.
- Coral Graphic Services of Kentucky Inc.
- Coral Graphic Services Inc.
- Coral Graphic Services of Virginia Inc.
- Dynamic Graphic Finishing Inc.
- Eurohueco S.A. (Chairman)
- Istituto Italiano d'Arti Grafiche S.p.A. (Chairman)
- Maul + co – Chr. Belser GmbH (Chairman)
- Phone Assistance S.A.
- Printer Industria Gráfica S.A. (Chairman)
- Offset Paperback MFRS Inc.
- Stampers Limited

ROLF SCHMIDT-HOLTZ
Chairman and Chief Executive Officer, Bertelsmann Music Group (BMG)
Chief Creative Officer Bertelsmann AG
- Druck- und Verlagshaus Gruner + Jahr AG
- Ariola Eurodisc Inc. (until 8/6/2004)
- Arista Records Inc. (until 7/30/2004)
- Bertelsmann Inc.
- Bertelsmann Music Group Inc. (until 8/6/2004)
- Bertelsmann Music Publishing NA Inc.
- Bertelsmann TJS Inc. (until 8/6/2004)
- BMG Australia Limited (until 8/6/2004)
- BMGJ LLC (until 8/6/2004)
- BMG Music (until 8/6/2004)
- BMG New Zealand Limited (until 8/6/2004)
- BMG Songs Inc. (until 6/30/2004)
- BMG Special Products Inc. (until 8/6/2004)
- Careers-BMG Music Publishing Inc. (until 7/29/2004)
- RTL Group S.A.
- Sony BMG Music Management Co., LLC (since 8/5/2004) (Chairman)
- Zomba Enterprises Inc.
- Zomba Recording Corporation (until 7/30/2004)
- Zomba Records Limited (until 8/6/2004)

DR. EWALD WALGENBACH
Chief Executive Officer, Direct Group Bertelsmann
- BOL.com AG (Chairman)
- Bertelsmann Korea Co. Limited
- Bookspan Partnership
- ECI voor boeken en platen B.V. (until 7/20/2004)
- FCB Freizeitclub GmbH & Co. KG
- RTL Group S.A.
- Shanghai Bertelsmann Culture Industry Co. Limited (until 6/17/2004)

- Supervisory Board mandates in accordance with § 100, para. 2 of the German Stock Corporation Act (AktG)
- Membership in comparable domestic and foreign supervisory bodies of commercial enterprises

[1] external mandates

AUDITOR'S REPORT

We have audited the consolidated financial statements, comprising the balance sheet, the income statement and the statements of changes in shareholders' equity and cash flows as well as the notes to the financial statements prepared by the Bertelsmann AG for the business year from January 1 to December 31, 2004. The preparation and the content of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) and in supplementary compliance with International Standards on Auditing (ISA). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements is examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the Group for the business year in accordance with International Financial Reporting Standards.

Our audit, which also extends to the group management report prepared by the Company's management for the business year from January 1 to December 31, 2004, has not led to any reservations. In our opinion on the whole the group management report provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the group management report for the business year from January 1 to December 31, 2004 satisfy the conditions required for the Company's exemption from its duty to prepare consolidated financial statements and the group management report in accordance with German law.

Bielefeld, March 4, 2005

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Reinke
Wirtschaftsprüfer

Kämpf
Wirtschaftsprüfer

SELECT TERMS AT A GLANCE

IFRS
International Financial Reporting Standards. Accounting standards intended to ensure internationally comparable accounting and reporting.

Impairment
Write-downs of assets to their recoverable amount.

Joint venture
Agreement to jointly operate, contribute capital to, supply know-how to, and divide profits from, an entity.

Operating EBIT
Earnings before interest, taxes and special items.

Operating EBITDA
Earnings before interest, taxes, depreciation, amortization and special items.

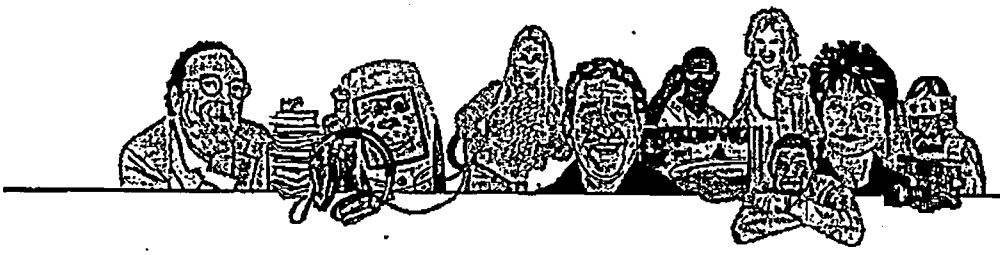
Rating
Expression of creditworthiness of a creditor or financial instrument by an agency specialized in analysis.

Syndicated credit line
Syndicated loan facility involving a consortium of banks.

Special items
Income and expense items which are distinguished by their nature and the size or frequency of occurrence, and disclosure of which is relevant for assessing the earnings power of the entity or its segments in the period affected. IFRS requires these items to be separately disclosed. They include, for example, restructuring measures, impairments and gains or losses on disposals of participations.

Merger gain
The positive difference between total carrying values of the net assets of the transferring entity and the total consideration paid by the acquiring entity.

VSOP
Virtual Stock Option Plan. Framework program for granting a long-term, performance-linked element to the remuneration of management.



The cover illustrations show from left to right: James Patterson; Yellsports by Arvato Mobile; Anastacia; Gabriel Garcia Márquez; Usher; Dido; Tim Mälzer; Isabel Allende

FINANCIAL CALENDAR

May 3, 2005
Announcement of figures for the first three months of 2005

May 19, 2005
Payout of dividends on Profit Participation Certificates for the 2004 fiscal year

September 7, 2005
Announcement of figures for the first half of 2005

November 16, 2005
Announcement of figures for the first nine months of 2005

IMPRINT

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Corporate Communications/
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Peter Stemmler, New York

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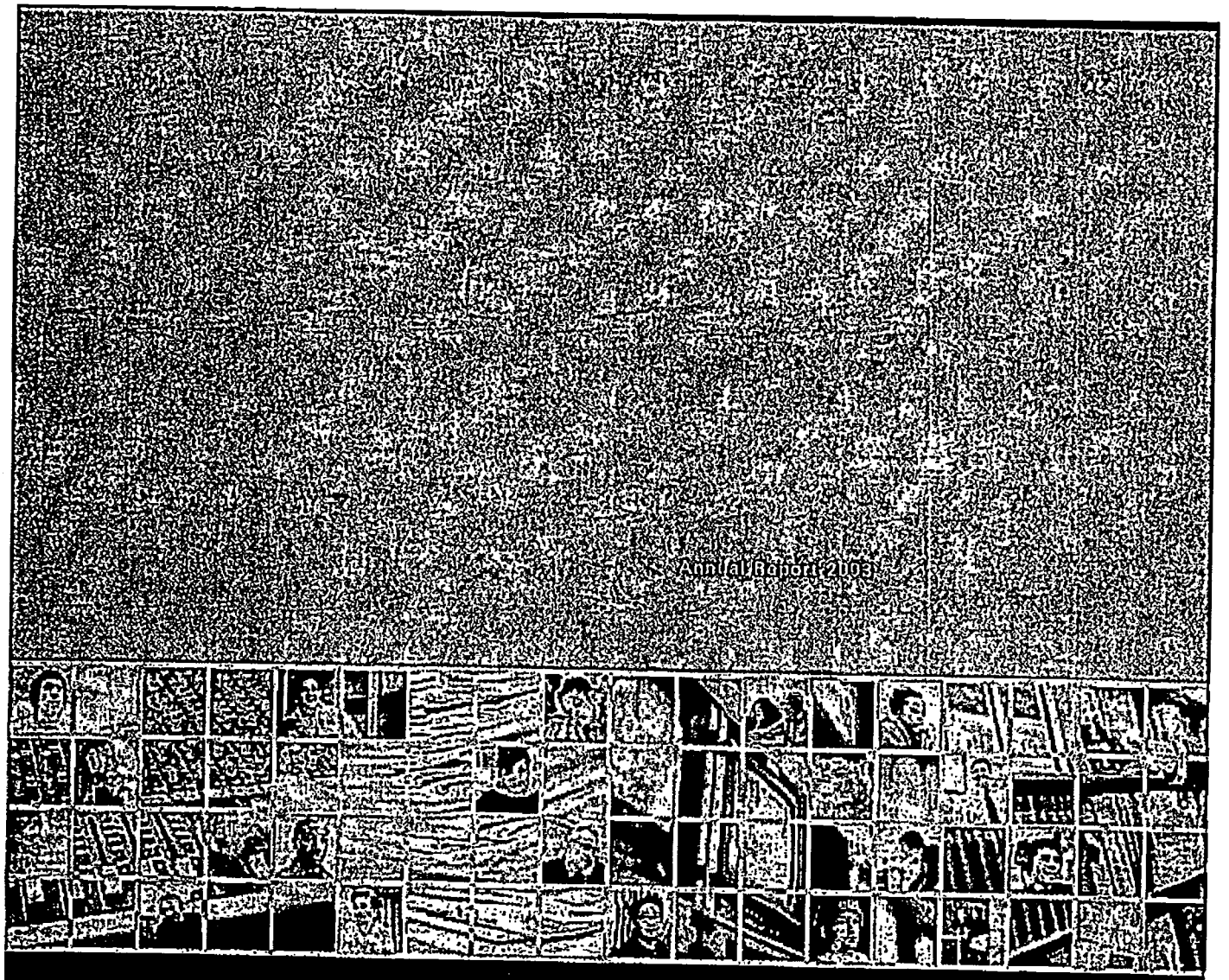
The Annual Report and current information on Bertelsmann is also posted at:
www.bertelsmann.de
www.bertelsmann.com

The Annual Report is also available in German.

EXHIBIT CO 0921



Annual Report 2003

BERTELSMANN

media worldwide

Bertelsmann Financial Highlights in € millions

	IFRS 2003	IFRS 2002	IFRS Pro forma 2001	IFRS 7/1/2001 -12/31/2001	IFRS 2000/ 2001
Business Development					
Revenues	18,901	18,312	18,979	9,665	18,749
Operating EBITA	1,123	938	573	164	826
Net income before minority interests	1,209	968	1,378	931	987
Cash Flow	1,373	1,115	294	127	160
Investments	761	5,263	2,639	1,057	2,744
Total assets	20,184	22,188	23,734	23,734	17,245
Personnel costs	4,151	4,554	4,812	2,343	4,319
Employees (in absolute numbers)					
Germany	27,064	31,712	31,870	31,870	30,732
Other countries	46,157	49,920	48,426	48,426	43,816
Total	73,221	80,632	80,296	80,296	74,548
Equity					
Subscribed capital [1]	606	606	606	606	463
Retained earnings	6,060	6,079	5,697	5,697	3,222
Minority interests	965	1,059	2,081	2,081	792
Equity	7,631	7,744	8,384	8,384	4,477
As percentage of total assets	38	35	35	35	28
Net financial debt	820	2,741	859	859	2,298
Debt payback factor [2]	0.6	2.5	2.9	n/m	n/m
Net Income					
Net income before minority interests	208	968	1,378	931	987
Minority interests	54	40	(143)	(18)	248
Dividend	220	240	n/a	300	50
Profit participation payments [3]	78	77	77	39	95
Employee profit sharing [3]	29	34	n/a	19	44

1) 57.6 percent Bertelsmann Foundation, 17.3 percent Mohn family, 25.1 percent Groupe Bruxelles Lambert (GBL) (as of 12/31/2003)
2) Net financial debt/Cash Flow
3) Offset in net income

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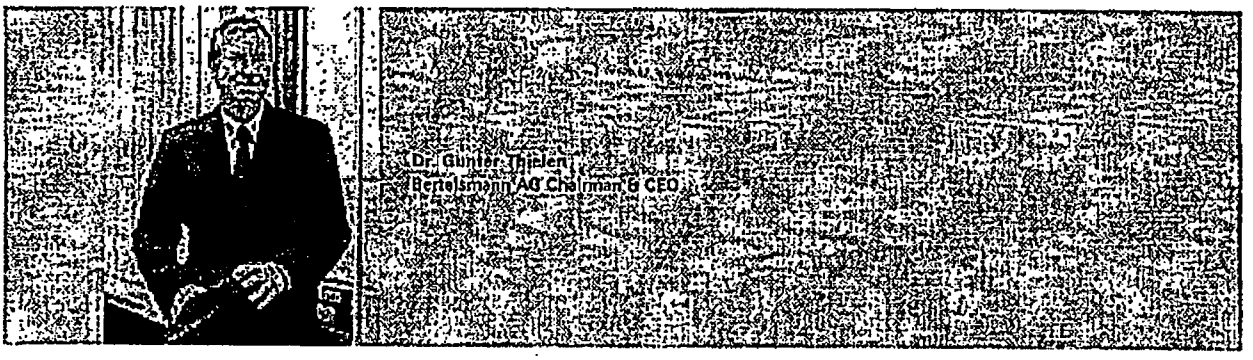
Dear Friends of Bertelsmann,

Berlin is a fascinating city. In November 2003, Bertelsmann opened its new representative premises in the heart of this vibrant metropolis: Since then, "Unter den Linden 1" has quickly become a very popular place for communications. Men and women from business and politics, from science, culture and the media meet here to share information, views and opinions.

Last December, Bertelsmann's top executives convened in this building for a congress that centered on growth and innovation and thereby established the future strategy of Europe's biggest media corporation.

cial structure, we have additional investment potential of at least € 2 billion available for new projects in the next three years, above and beyond the regular investment budget. These resources will be used to put business concepts into practice and extend market shares. We will open up new markets related to our core businesses, especially those that show high growth potential or promise above-average development in combination with core businesses.

Bertelsmann's businesses performed well in 2003 and generated significantly higher results and yields. Nevertheless, we intend to continue increasing the



Dr. Gunter Thielen
Bertelsmann AG Chairman & CEO

At the Management Congress, it became clear that focusing on our core businesses has created optimum conditions for new growth. Our management is suffused with energy and entrepreneurial spirit. We will continue to build on Bertelsmann's distinctive strengths – a corporate culture of partnership, decentralization and entrepreneurship – in the future as well. That is how we will foster the systematic development of our business and safeguard our employees' jobs.

We have put the current strategy under the acronymic heading "GAIN": Growth And Innovation – the company's stable situation now allows for new expansion. The objective is not size for its own sake, although we are sticking to our goal of taking the lead in all relevant markets. Growth is necessary to increase the company's value and maintain financial strength. We will proceed to generate organic growth in revenues and earnings with new products, attractive content and improved services. Thanks to our solid finan-

group's average return on sales and the company's value in the years ahead. The six corporate divisions will have to continue improving their operating business. Strategies have been drawn up to this end.

We can only achieve these goals if we and our 73,000 employees devote our efforts to the future of Bertelsmann. We have always believed that corporate culture goes hand in hand with corporate success. Our most recent large-scale, anonymous employee survey once again delivered proof for the thesis that there is a direct correlation between employee identification with their job and company on the one hand and that company's economic success on the other. Companies with an exceptional degree of employee identification also enjoy above-average economic success.

This identification with the company is rooted in our corporate culture of partnership. Essential elements in employee satisfaction are on-the-job freedom and self-fulfillment, along with opportunities for pro-

fessional development. Beyond this, the conduct of direct supervisors and the management's focus on employees are crucial in shaping the corporate culture and hence the employees' identification with their company. Bertelsmann's management concept is and will remain the prerequisite for its successful corporate development.

Bertelsmann will rely on growth and innovation in the years ahead. The Management Congress in Berlin showed that ideas and strategies are being developed in all six corporate divisions, promising attractive growth rates and return on sales.

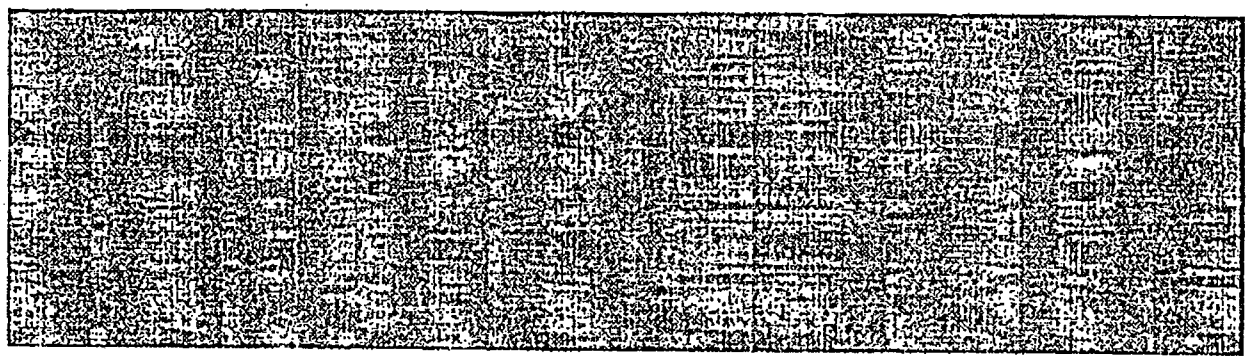
Bertelsmann businesses performed well and generated significantly higher results and yields. Nevertheless, we intend to continue increasing the group's average return on sales and the company's value. Strategies have been drawn up to this end.

In 2003, the Bertelsmann Music Group delivered outstanding creative triumphs and proved that it is on a good course. The months ahead call for peak entrepreneurial performance in a market that is experiencing considerable change through technological transformation. We now plan to merge BMG and Sony's recorded-music business into Sony BMG. If the antitrust authorities approve this transaction, it will be a big step towards safeguarding our music business. Following the integration process, Sony BMG's task will be to develop a future-proof business model for music. Our success will still be founded in our appeal for artists who can trust us to provide the best possible support for their talents.

Direct Group is back on track. The performance of its clubs was significantly improved thanks to a focus on core business, withdrawal from pure e-commerce, and enhanced decentralization. Most of the clubs, which have a total worldwide membership of 32 million, now operate at a profit. In the business year just past, the group managed an impressive turnaround. In particular, France Loisirs in France and Círculo de Lectores in Spain generated attractive earnings. The German and British clubs, as well as the start-ups in the emerging markets, are not yet profitable. We are looking into the potential for new clubs in Eastern Europe, especially in Russia and the Ukraine. In China, Direct Group is the first and only foreign media group with permission to set up a nationwide chain of stores in addition to its Club operations. This gives us a chance to increase the number of Club members in China from currently 1.5 million to five million in the next few years.

RTL Group intends to continue its growth, after having delivered the second-best performance in its history in 2003. Its TV and radio stations put the group at No. 1 or No. 2 in all of its markets except two. A major portion of its revenues and earnings is still generated in the two core markets Germany and France. Therefore, extending its operations in the UK, Spain and Eastern Europe is on the agenda for the next few years. The development of additional sources of revenues and earnings beyond broadcasting ad-financed TV programming offers a chance at lessening the group's dependence on the advertising market.

Innovations and customer focus have always been the driving force behind the media services provider Arvato, which has increased its revenues by a factor of 2.5 between 1990 and 2003. Key forces driving this dynamic growth include services for major inter-



national clients, expansion to new groups of products and customers, and the extension of Arvato's offerings to other countries e.g. in Eastern Europe, India and China. The goal for the future has been clearly stated: By 2010, Arvato plans to be the worldwide No. 1 in media services.

In a year that was difficult for the whole book-publishing industry, the revenue and earnings declines at Random House are attributable exclusively to currency effects. Adjusted for these effects, the group managed to improve both revenue and earnings. The more globally Random House does business, the greater the chances for its authors to gain international fame. The group currently publishes books in English, German, Spanish and Japanese. Tapping into new markets and opening up new countries is the top strategic priority. Japan, where we already operate the Random House Kodansha joint venture with our Japanese partner Kodansha, as well as Korea and India, all offer attractive growth opportunities in the years ahead. Random House will continue to concentrate on compelling, creative content while exploiting into new sales channels such as audiobooks to inspire young people – tomorrow's readers – as well.

Since the turn of the year 2000/2001, the magazine industry, especially in Germany, has experienced the most severe market decline in the past 50 years. Steady growth in the 1980s and the subsequent New Economy boom with new titles and an expanding advertising market were followed by a steep collapse, which confronted Gruner + Jahr with major challenges. However, its clear course of consolidation, cost cuts and portfolio streamlining has ensured that G+J looks back on a successful 2003 and faces 2004 with confidence. Crisis notwithstanding, the printing and publishing house launched a program offensive for new publications in spring of 2003, which is already bearing first fruit. By extending existing brands, trans-

Bertelsmann is on the right path with its innovations and growth. We will continue to concentrate on the markets in which we have experience and expertise. However, we are now also tackling new, rapidly growing markets with proven products.

ferring successful brands to new markets, and launching new titles such as "Woman" and "Neon" in Germany, "Tele 2 semaines" in France, and "Glamour" in Poland, G+J will demonstrate that innovative magazine concepts lead to interesting new business.

Bertelsmann is on the right path with its innovations and growth. We will continue to concentrate on the markets in which we have experience and expertise. However, we are now also tackling new, rapidly growing markets with proven products. In the process, creativity remains a guarantor for success. This race for the best ideas, along with the courage to take entrepreneurial risks, will lead to innovative new content, products and services.

At Bertelsmann, we have competent entrepreneurs who are not only given great freedom and scope of action, but actually take advantage of it. Our special appreciation goes out to our employees, who backed our tough decisions with understanding and professional consideration during the difficult years. This is the best possible provision for the future.

Our strategy is clear, and the financial scope opens up every possible opportunity. We are restarting the growth engine and embarking on another chapter in our company's success story. We are committed to safeguarding both the continuity of our company and its ability to change and evolve.

Sincerely yours

Gunter Thielen
Bertelsmann AG Chairman & CEO

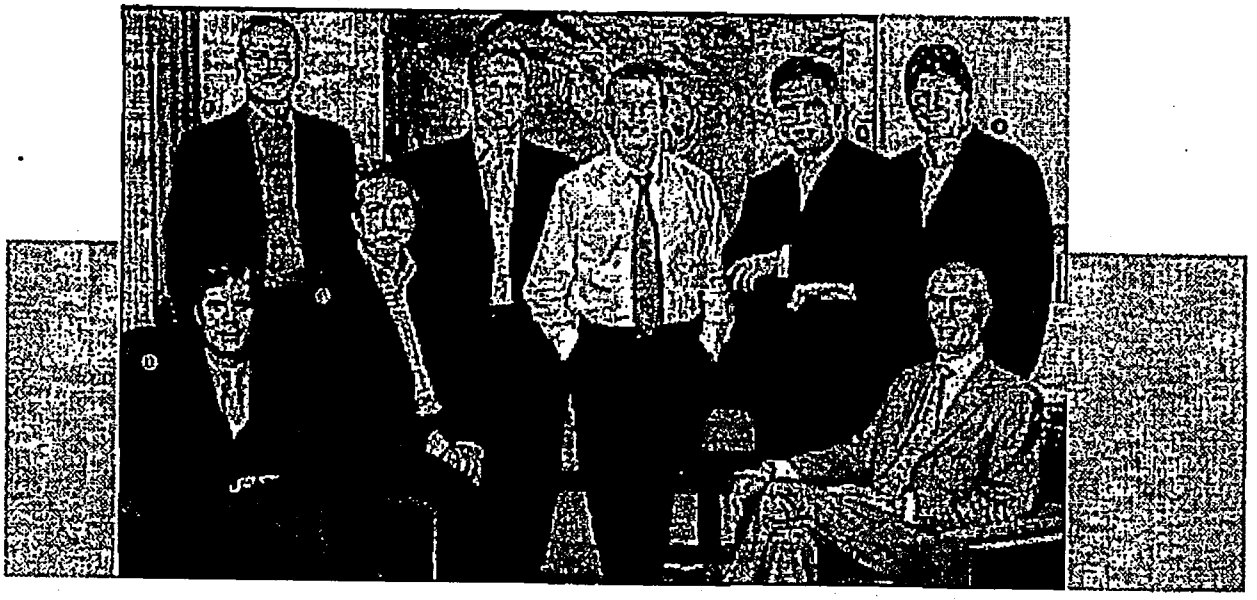
The Executive Board of Bertelsmann AG

Peter Olson J.D./MBA
Born on May 1, 1950
in Chicago (USA),
Member of the
Bertelsmann AG
Executive Board since
April 1, 2001,
Chairman and Chief
Executive Officer
of Random House Inc.,
New York

Dr. Bernd Kundrun
Born on
November 8, 1957
in Wuppertal (Germany),
Member of the
Bertelsmann AG Executive
Board and
Chairman of the
Gruner + Jahr AG
Executive Board
since November 1, 2000,
Hamburg

Rolf Schmidt-Holtz
Born on
August 31, 1948
in Martinsreuth (Germany),
Member of the
Bertelsmann AG Executive
Board
since July 1, 2000,
Chairman and Chief
Executive Officer of the
Bertelsmann Music
Group (BMG),
Chief Creative Officer
of Bertelsmann AG,
Hamburg and New York

Hartmut Ostrowski
Born on
February 25, 1958
in Bielefeld (Germany),
Deputy Member
of the Bertelsmann AG
Executive Board
since October 1, 2001,
Member of the
Bertelsmann AG
Executive Board
and Chairman of the
Bertelsmann Arvato AG
Executive Board
since September 1, 2002,
Gütersloh

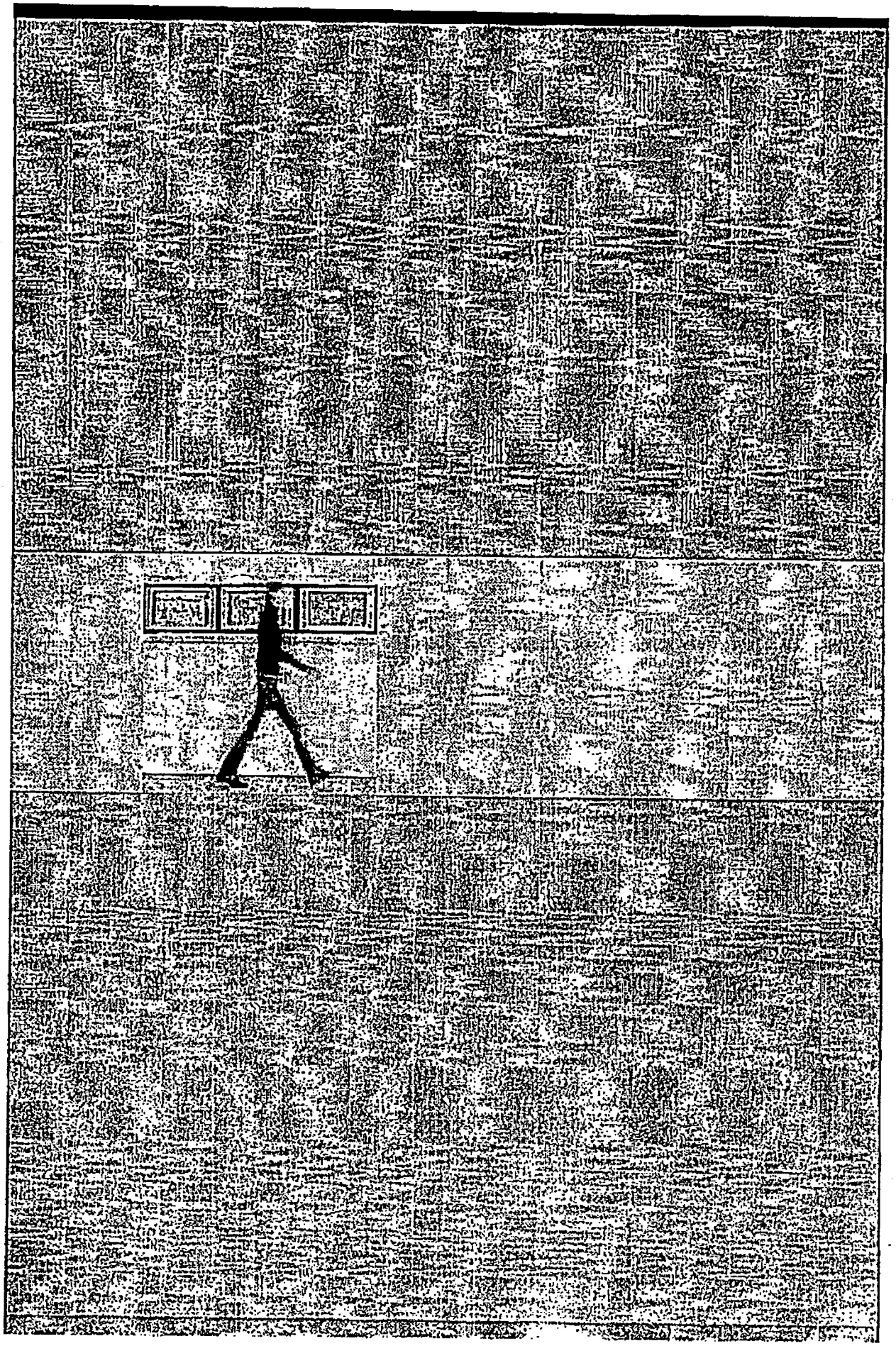


Dr. Gunter Thielen
Born on August 4, 1942
in Quierschied (Germany),
Member of the
Bertelsmann AG
Executive Board
since July 1, 1985,
Chairman of the
Bertelsmann AG
Executive Board
since August 5, 2002,
Gütersloh

Dr. Ewald Walgenbach
Born on
February 10, 1959
in Neustadt/Wied (Germany),
Member of the
Bertelsmann AG
Executive Board
since February 6, 2002,
Chief Executive Officer of
Direct Group Bertelsmann,
Gütersloh

Dr. Siegfried Luther
Born on August 5, 1944
in Hobeck (Germany),
Member of the Executive
Board since July 1, 1990,
Deputy Chairman of the
Executive Board
since August 5, 2002,
Chief Financial Officer and
Head of the Bertelsmann AG
Corporate Center,
Gütersloh

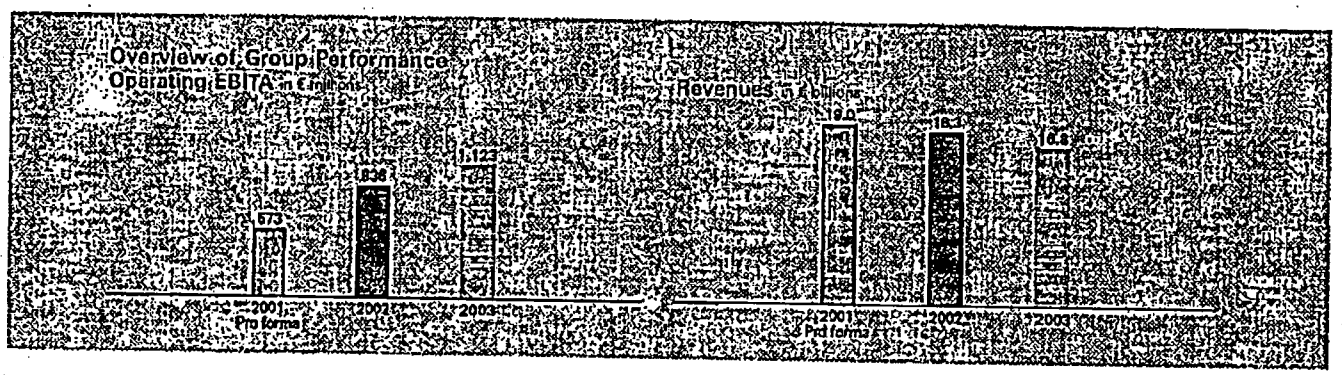
Gerhard Zeiler
Born on July 20, 1955
in Vienna (Austria),
Chief Executive Officer
of RTL Group,
Luxembourg and Cologne,
permanent guest
on the Bertelsmann AG
Executive Board



Management Report | Supervisory Board | Corporate Governance

Management Report

In 2003, Bertelsmann further strengthened its core businesses and achieved an operating result above previous year. At € 1,123 million, Operating EBITA was up by 20.0 percent over the previous year's level of € 936 million. Revenues declined to € 16.8 billion (previous year: € 18.3 billion), mainly due to currency effects. Operating Return on Sales (ROS) rose to 6.7 percent (previous year: 5.1 percent). Net income before minority interests amounted to € 208 million after € 968 million in 2002. The group again met all its key financial targets.



Business Development

In light of the current state of the economy, Bertelsmann made overall satisfactory progress in 2003.

The outset of a global economic recovery observed during the year differed strongly by geographic region. While the US economy recovered appreciably, especially in the second half of the year, the euro region was slow to follow suit. In Germany, the economy failed to rise above previous-year level, in particular due to a lack of domestic demand.

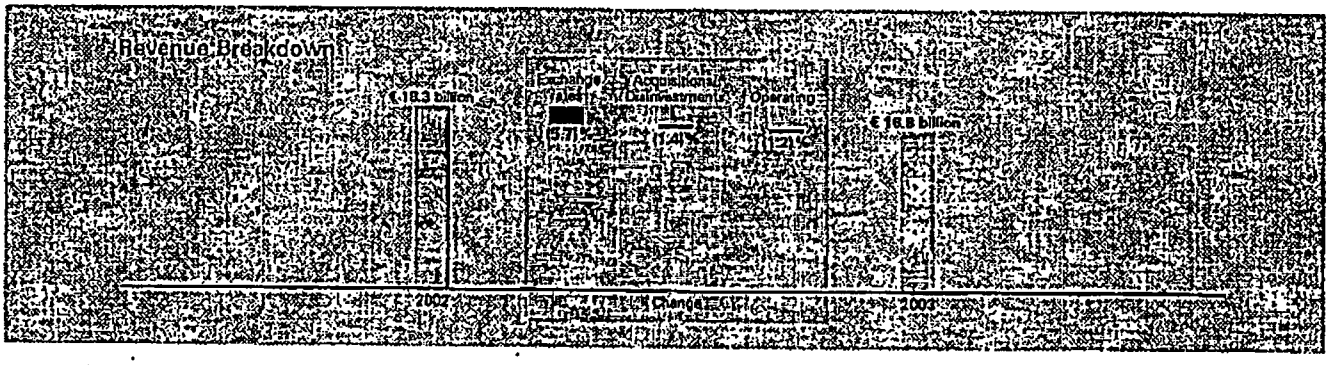
This varying performance was reflected in the media industry as well. In the US, advertising markets, in particular magazines, registered stronger growth than their European counterparts. In Germany, the TV advertising market was more responsive than that for magazines. And while the book market in Germany declined slightly, it essentially remained at previous-year levels in the US. The worldwide music business continued to labor under the negative impact of a number of special factors; Germany was especially hard hit.

In 2003, Bertelsmann came one step closer to its declared strategic goal of safeguarding its music business. Bertelsmann and Sony agreed to merge their recorded music operations in a joint venture. The transaction is pending antitrust approval.

Through the sale of the academic & professional publishing division, Bertelsmann Springer, the media content businesses are now focused on entertainment. Joint ventures by Random House in Japan and Korea and by Direct Group in China allowed further strategic steps to be taken in Asia. Bolt-on acquisitions such as the purchase of Heyne Verlag by Random House were successfully concluded. Gruner + Jahr continued its withdrawal from the regional newspaper business by selling its Eastern European newspaper titles. With the withdrawal from pure

Revenues by Division in € millions

	2003			2002		
	Germany	International	Total	Germany	International	Total
RTL Group	2,004	2,448	4,452	2,132	2,230	4,362
Random House	139	1,637	1,776	143	1,852	1,995
Gruner + Jahr	929	1,552	2,481	1,039	1,761	2,800
BMG	261	2,451	2,712	252	2,462	2,714
Arvato	1,630	2,009	3,639	1,629	2,039	3,668
Direct Group	383	1,903	2,286	395	2,312	2,707
Total revenues by division	5,346	12,000	17,346	5,590	12,656	18,246
Bertelsmann Springer	78	90	168	364	367	731
Corporate/Consolidation	(268)	(445)	(713)	(263)	(402)	(665)
Consolidated revenues	5,166	11,635	16,801	5,691	12,621	18,312



e-commerce businesses, Direct Group now concentrates its direct-to-customer operations on book and music clubs. Cross-divisional cooperation continued to develop in 2003.

Revenues

Especially due to the weakening of the US dollar against the euro, the group's revenues declined by 8.3 percent, from € 18.3 billion to € 16.8 billion. Changes to the portfolio (including the sale of Bertelsmann Springer) also played a role. Adjusted for currency and portfolio effects, group revenues remained largely unchanged year-on-year.

Due to the development of the US dollar, the share of US-based revenue as part of total consolidated revenues declined to 25.1 percent (previous year: 27.5 percent). Revenue contribution generated in Germany dropped slightly from 31.1 percent to 30.7 percent. The other European countries contributed 38.6 percent of the € 16.8 billion in consolidated revenues (previous year: 35.5 percent), and the remaining countries accounted for 5.6 percent (previous year: 5.9 percent).

The contribution of the various income streams to total group revenue remained largely stable.

Results Breakdown in € millions

	2003	2002
Operating EBITA by division		
RTL Group	503	465
Random House	147	169
Gruner + Jahr	234	228
BMG	110	125
Arvato	261	217
Direct Group	[illegible]	(150)
Total Operating EBITA by division	1,269	1,051
Bertelsmann Springer	0	71
Corporate/Consolidation	(136)	(186)
Group Operating EBITA	1,123	936
Amortization of goodwill and rights similar to goodwill*		
– Regular	(717)	(784)
– Impairments	(220)	(1,668)
Special items	547	2,807
Earnings before interest and taxes	733	1,291
Financial result	(322)	(266)
Taxes on income	(203)	(57)
Net income before minority interests	208	968
Minority interests	(54)	(40)
Net income after minority interests	154	928

* including amortization of goodwill from associated companies

Operating EBITA

Despite a challenging market environment, Operating EBITA amounted to € 1,123 million, exceeding the previous year's € 936 million by 20.0 percent. This translates to operating ROS of 6.7 percent, well above the 5.1 percent generated during the previous year. Major contributors to this rise in earnings were Direct Group, Arvato and RTL Group. RTL Group and Arvato each reported one of their best results ever. Random House was able to essentially maintain its profit contribution from core business. Gruner + Jahr slightly increased its earnings thanks to ongoing cost management. BMG is still faced with the structural problems in the music business. Operating performance was also improved by a group-wide optimization of business processes and cost structures. Group Operating EBITDA amounted to € 1,866 million.

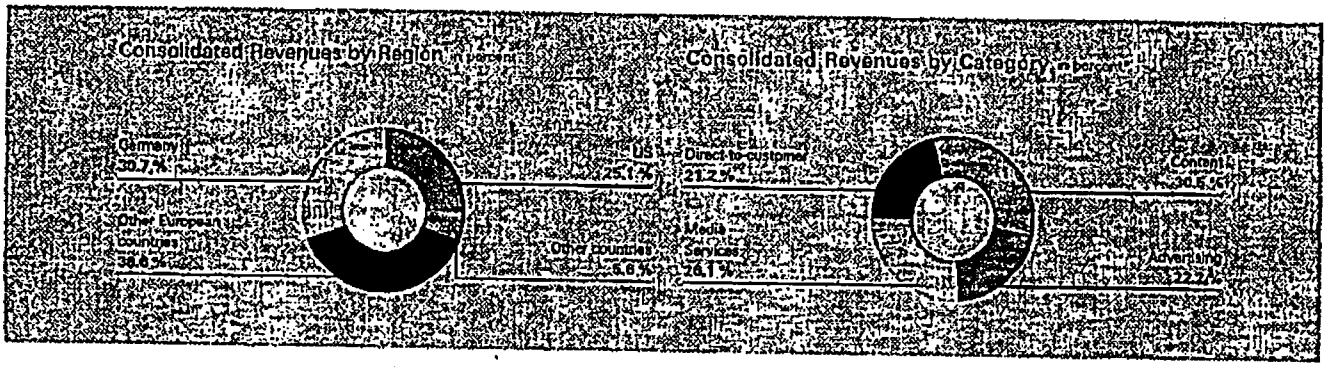
Net income

After amortization of goodwill and rights similar to goodwill of € 937 million (previous year: € 2.5 billion) and special items that in sum resulted in a positive contribution of € 547 million (previous year: € 2.8 billion), earnings before interest and taxes amounted to € 733 million (previous year: € 1.3 billion). After adjusting for financial results and taxes, net income before minority interests totaled € 208 million (previous year: € 968 million). In the previous year, net income was dominated by capital gains from the sale of shares in AOL Europe. After minority interests, mainly due to minority shareholders in RTL Group and Gruner + Jahr, net income amounted to € 154 million (previous year: € 928 million).

Revenue Share by Division in percent*

Share of Total Operating EBITA by Division in percent*

*Based on total from divisions not including Bertelsmann Springer and Corporate/Consolidation



Amortization of Goodwill and Rights Similar to Goodwill

Net income includes regular amortization of goodwill and rights similar to goodwill of € 717 million (previous year: € 784 million). Impairments amounted to € 220 million (previous year: € 1.7 billion). The previous year's comparative figure included € 1.3 billion impairments of goodwill at Zomba, the music company acquired in 2002.

Special Items

In addition to operational improvements, net income for the year was influenced significantly by special items resulting from capital gains amounting to € 620 million. These were generated mainly by the sale of the academic & professional publishing division, Bertelsmann Springer (€ 628 million), Direct Group's disposal of its shareholding in Barnesandnoble.com (€ 145 million) and Gruner + Jahr's sale of its Eastern European newspaper businesses to the Swiss publisher Ringier. Special items also include a € 234 million provision for a lawsuit against Bertelsmann AG, in which two former AOL Germany executives were granted damages in a court of first instance. In the previous year, capital gains were mainly derived from the sale of shares in AOL Europe. Other special items due to one-time charges and restructurings amounted to minus € 73 million (previous year: minus € 111 million) and were solely from integrating the music company Zomba, and restructuring at BMG.

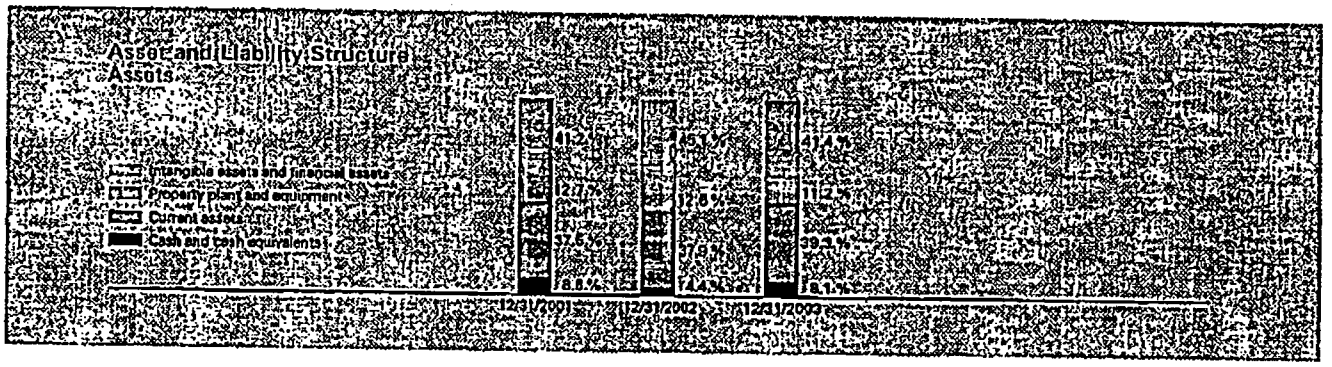
Investments

Investments totaled € 761 million (previous year: € 5.3 billion). The group practiced a restrained investment policy in 2003. In the previous year, € 3.8 billion were invested for the purchase of the music company Zomba and the takeover of a 22 percent share in RTL Group, which essentially affected the extraordinarily high investment level. Investments in tangible assets totaled € 413 million (previous year: € 543 million) and were largely for modernization and capacity extension purposes in the printing operations of the Arvato and Gruner + Jahr divisions. Investments in intangible assets of € 166 million (previous year: € 236 million) were made primarily by RTL Group and BMG, for the purchase of film and music rights. Net investments in financial assets totaled € 182 million (previous year: € 4.5 billion) and included the purchase of additional shares in the French TV channel M6 by RTL Group (€ 35 million) and the purchase of Heyne Verlag by Random House.

Consolidated Cash Flow Statement

In 2003, cash flow from operating activity increased to € 1.4 billion (previous year: € 1.2 billion). At € 1.4 billion cash flow according to DVFA/SG was 23.1 percent above previous year (€ 1.1 billion).

Net cash from investing activities resulted in a cash inflow of € 876 million for the year (previous year: € 2.7 billion outflow). The inflow was achieved through a combination of disposals of non-current assets and conservative investment practices. The year saw sales proceeds of € 1.6 billion (previous year: € 2.6 billion) against € 182 million in funds paid out for acquisitions and financial assets (previous year: € 4.5 billion). Payments for investments in tangible and intangible assets amounted to € 579 million, a year-on-year decrease (previous year: € 779 million).

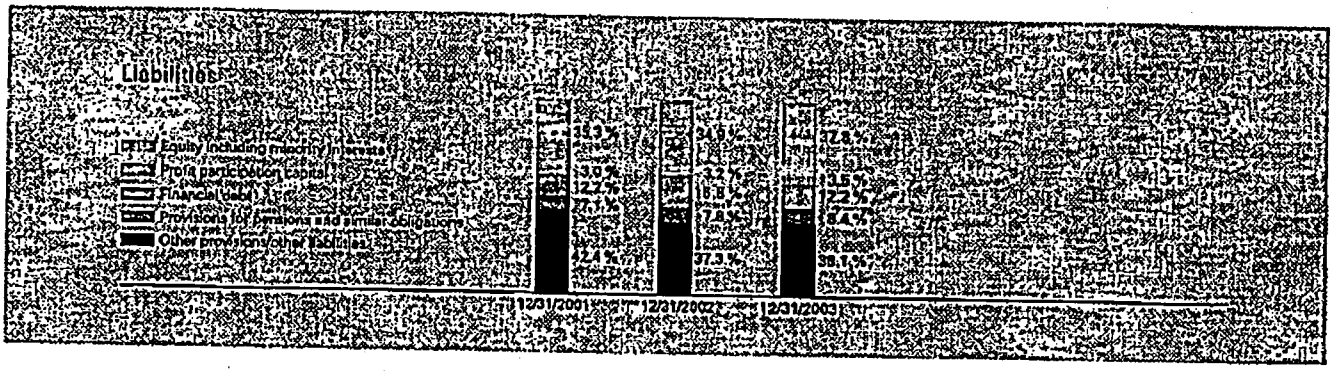


Net cash from financing activities resulted in an outflow of € 1.5 billion (previous year: € 498 million inflow). This reflects the resolute debt reduction practiced during 2003. € 925 million were used to pay down financial debt (previous year: € 1.1 billion inflow), while the buyback of the remaining Bertelsmann AG shares held by the ZEIT Foundation led to an outflow of € 208 million. € 337 million were paid out in dividends to Bertelsmann AG shareholders and co-owners of consolidated companies.

As a result of the above-described developments, the group's cash and cash equivalents at December 31, 2003 totaled € 1.6 billion (previous year: € 977 million).

Cash Flow Statement (Summary) in € millions

	2003	2002
Net cash from operating activities	[illegible]	
Net cash from investing activities	[illegible]	1,214
Net cash from financing activities	[illegible]	(2,711)
Change in cash and cash equivalents	[illegible]	498
Cash and cash equivalents	[illegible]	(990)
	[illegible]	577



Balance Sheet

At the end of 2003, total assets amounted to € 20.2 billion, 9.1 percent below previous year (€ 22.2 billion). This decline is largely due to the sale of Bertelsmann Springer and currency effects, in particular related to the US dollar. The equity ratio increased by 2.9 percentage points to 37.8 percent year-on-year. The gross financial debt now accounts for 12.2 percent of total assets, down from 16.8 percent the previous year.

Financial Targets

For many years Bertelsmann has pursued financial targets related to capital structure and financial debt. They are designed to ensure a balanced relationship between financial security, return on equity, and growth, and are geared towards the characteristics of a "Single A" credit rating category.

The group reduced its net financial debt from € 2.7 billion in 2002 to € 820 million in 2003. This represents a decrease of € 1.9 billion in comparison to the previous year, in which net financial debt rose steeply due to the acquisitions of Zomba and the Pearson's holding in RTL Group. Major contributing factors included the disposal of Bertelsmann Springer and the participation in Barnesandnoble.com. The sale of the Random House Tower in New York City was another positive factor that contributed to reducing the financial debt. A 15-year rental contract was signed with the building's new owners. In addition, the weakened US dollar had a positive effect on net financial debt.

Financial Targets

	Target	2003	2002
Debt payback factor Net financial debt/Cash flow according to DVFA/SG	< 1.5	0.6	2.5
Interest coverage ratio Operating EBITDA/Net interest	> 9.0	19.6	33.3
Equity ratio Equity to consolidated total assets (in percent)	> 25.0	37.8	34.9

By reducing its net financial debt, Bertelsmann has reattained a financial goal that was not met in the previous year: a maximum debt payback factor of 1.5. This factor describes the relationship of net financial debt to cash flow according to DVFA/SG, and amounted to 0.6 in 2003 (previous year: 2.5). The interest coverage ratio, which according to internal targets should exceed a factor of 9, amounted to 19.6 (previous year: 33.3). This ratio is calculated as Operating EBITDA to net interest. These self-imposed targets reflect the company's conservative financing policy. The existence of other financial commitments such as pension provisions and operating leases were also taken into account in formulating the financial targets. At balance sheet date, provisions for pensions and similar obligations amounted to € 1.7 billion (previous year: € 1.7 billion). The present value of operating lease obligations totaled € 1.3 billion (previous year: € 1.2 billion), most of which result from office lease contracts.

At 37.8 percent, the equity ratio clearly exceeded the 25-percent target and the previous year (34.9 percent). Bertelsmann also strives to ensure that total equity exceeds goodwill from acquisitions. This goal was achieved in 2003, when total equity exceeded goodwill and rights similar to goodwill by € 497 million (previous year: € 779 million shortfall).

Financing

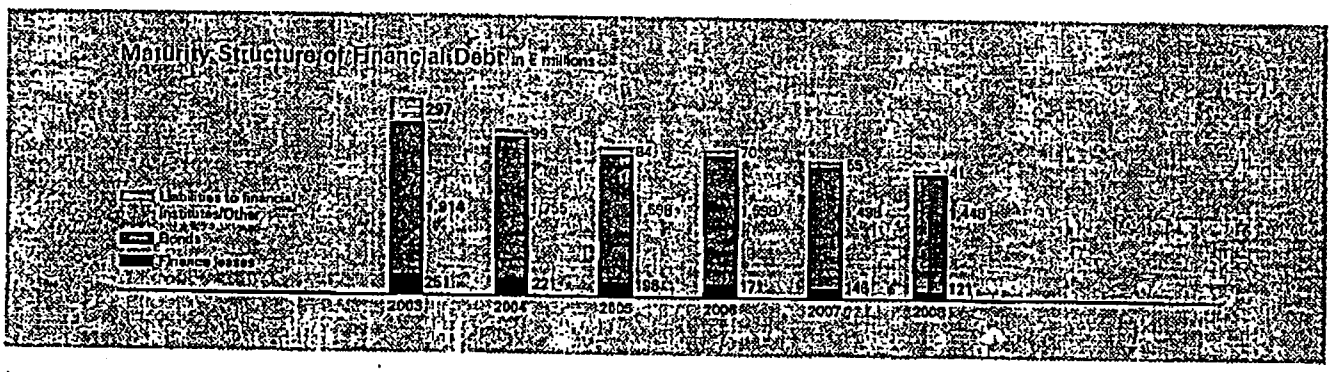
In April, Bertelsmann US Finance, Inc. raised $ 500 million with a Private Placement in the United States. The issuance, by then the biggest Private Placement by a German company in the US, is broken down into three different tranches with maturities between seven and twelve years.

In May, a € 650 million benchmark bond was placed in the capital market. The bond was issued by Bertelsmann US Finance, Inc. under the existing debt issuance program. Due to the strong demand from investors, the issuance was increased by € 100 million in June. At € 750 million, it is currently the biggest €-bond issued by a media company. The €-bond was rated BBB+ and Baa1 respectively by Standard & Poor's and Moody's, corresponding to the issuer credit rating of Bertelsmann AG.

Profit Participation Capital

The par value of profit participation capital remained unchanged at € 516 million at December 31, 2003. Including the premium, the total volume of profit participation capital at balance sheet date was € 706 million. It is divided between profit participation certificates 2001 (PPC 2001, ISIN DE0005229942) and, to a lesser extent, profit participation certificates 1992 (PPC 1992, ISIN DE0005229900).

The terms and conditions governing the PPCs 2001 stipulate that a dividend of 15 percent of par value be paid for each full fiscal year, provided there is sufficient consolidated net income and Bertelsmann AG net income. This condition was met for the fiscal year ended December 31, 2003. A 15 percent payout will thus again be made on the par value of the PPCs 2001.



The funds from the two issuances were used in particular to entirely replace the bridge loan signed in June 2002 and to pay down bank loans. They also enabled the premature buyback, in October, of a € 200 million bond issued in July 2002.

With its Private Placement in the US and issuance of the benchmark bond, Bertelsmann has extended the maturity terms of its financing instruments, while also systematically continuing its capital market alignment.

The distribution on PPCs 1992 depends on the group's return on total assets. As a return on total assets of 5.92 percent was achieved in 2003, the payout on PPCs 1992 is 6.92 percent of par value. In January 2001, in view of the change in the Bertelsmann financial management system used for controlling purposes, and the resulting possible fluctuation in payouts on PPCs 1992, Bertelsmann made an offer to all holders of this profit participation certificate to exchange their holdings for PPCs 2001.

Distributions totaling € 76 million will be paid out to holders of both forms of profit participation certificates in May 2004. The terms and conditions governing Bertelsmann's PPCs require that Bertelsmann AG's external auditors verify whether the profit distribution has been correctly calculated. A confirmatory report from the external auditors has been received for both types of profit participation certificates.

Sale of Bertelsmann Springer

In May 2003, Bertelsmann sold its academic & professional publishing division, Bertelsmann Springer, to the private equity investors Cinven and Candover. The transaction was effective to April 1, 2003. The purchase price amounted to € 1.05 billion, and all existing pension commitments were transferred with the sale. All in all, after deducting related expanses the gain from the disposal amounted to € 628 million. The effect of this sale, shown on the books as a Discontinuing Operation, on the group's assets, financial and earnings situation, is explained in detail in the Notes on the Consolidated Financial Statements.

Status of Bertelsmann AG

Bertelsmann AG is a management holding company with no operating businesses of its own. Its tasks include supervisory and service functions for the Bertelsmann group as well as the management of its participations and financing. Its major sources of income are dividend payouts from subsidiaries as well as proceeds from services provided to subsidiaries. At December 31, 2003, Bertelsmann AG's subscribed capital amounted to € 606 million, while equity totaled € 9.4 billion. Bertelsmann AG reports its figures according to the German Commercial Code HGB.

Corporate

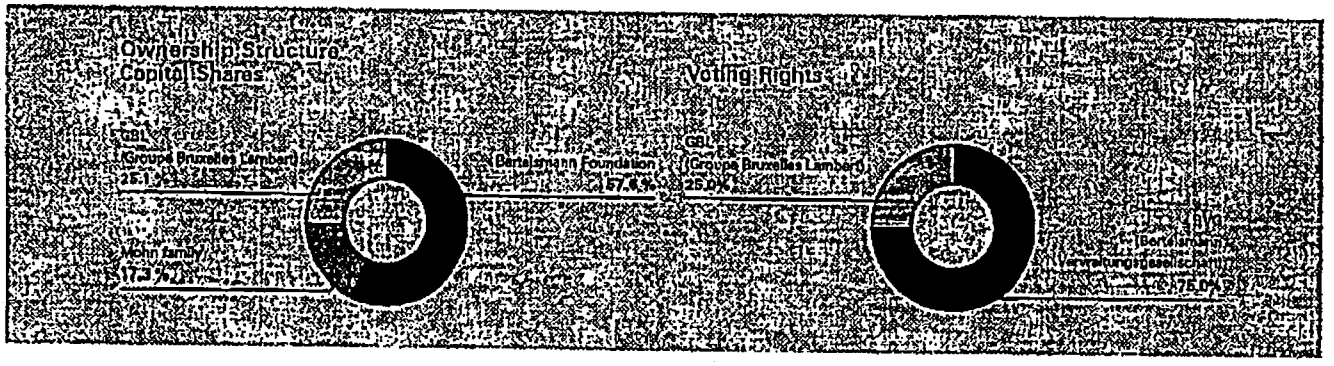
Corporate includes the costs of the Corporate Center and result from investments made at corporate level. Corporate Center expenditure arises from corporate management and governance tasks. Corporate Investments includes holdings formerly managed under Bertelsmann Capital as well as additional holdings that are not assigned to any corporate division. Corporate Operating EBITA totaled minus € 87 million in 2003 (previous year: minus € 180 million). This improvement is attributable primarily to reduced charges resulting from Corporate Investments as well as to the restructuring and continued streamlining of cost structures during the business year.

Ownership Structure

In November 2003, Bertelsmann AG bought back and redeemed the ZEIT Foundation's remaining shares in Bertelsmann AG for € 208 million. Bertelsmann had announced the agreement for a complete buyback of the shares held by the ZEIT Foundation in December 1999. The first tranche of the sale was concluded in August 2000, the second in October 2002. The buyback obligation was accounted for under "Other Liability." Indirectly owned capital shares are now distributed as follows: 57.6 percent Bertelsmann Foundation, 25.1 percent Groupe Bruxelles Lambert, 17.3 percent Mohn family. 75.0 percent of the voting rights are held by Bertelsmann Verwaltungsgesellschaft (BVG), the other 25.0 percent by Groupe Bruxelles Lambert (GBL).

corporate success. In companies where employees perceive their supervisors as "leading through partnership," employee identification with the company is stronger. Companies with higher employee identification are proven to have greater economic success. This confirmation of the "leadership through partnership" concept inspired the company to develop and offer its leadership program for young executives, already a success in Germany and the US, as well as for other countries. Bertelsmann University, the forum for Bertelsmann's international executives, will also assign the topic of "Leadership through Partnership" a greater priority in its programs from now on.

Profit sharing has played a central role in Bertelsmann's corporate concept since 1970. This principle of



Employees

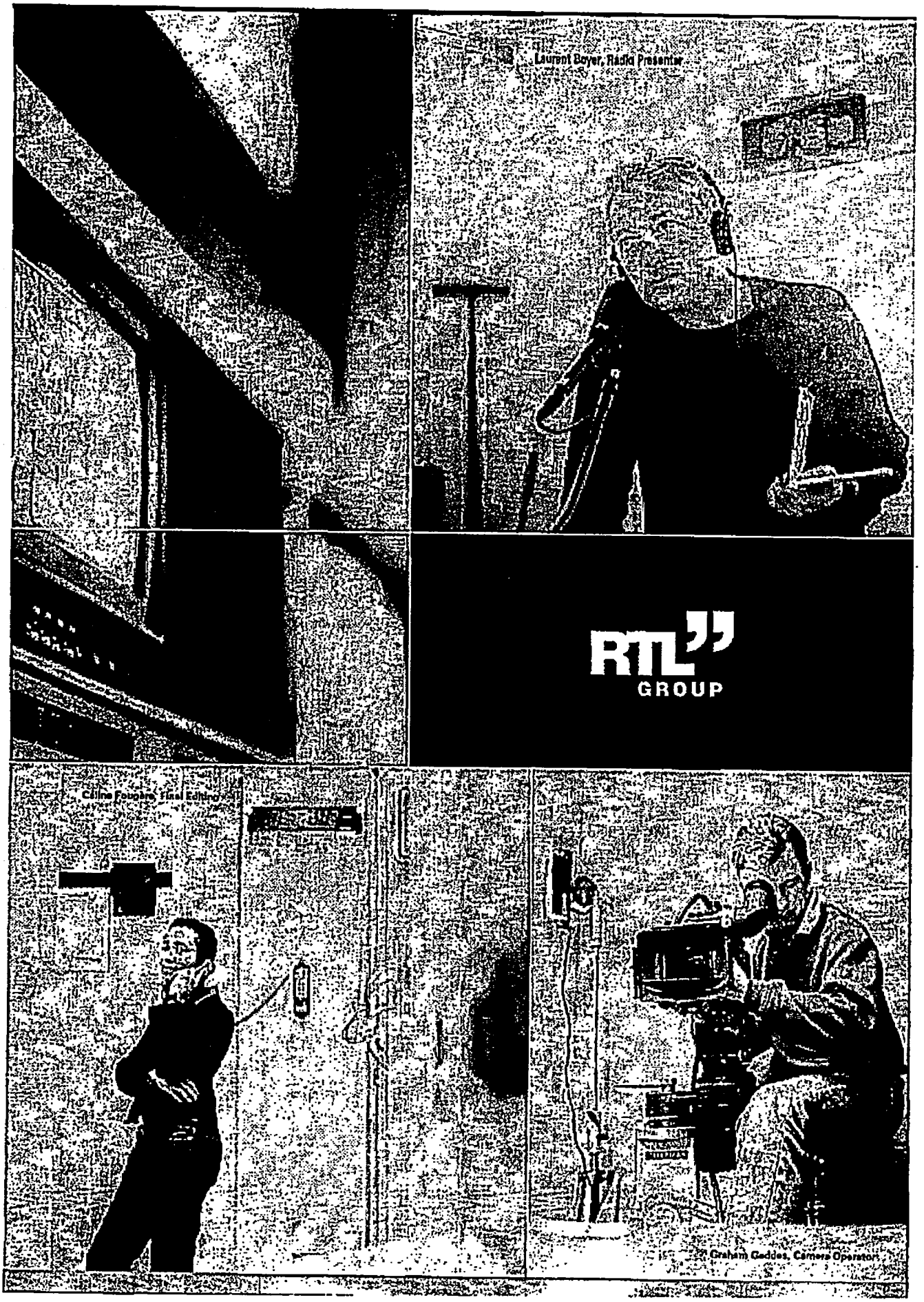
At the end of 2003, the group had 73,221 employees, of which 37.0 percent are employed in Germany. This decline by 7,411 employees vs. the previous year is largely attributable to the sale of Bertelsmann Springer, which had 5,125 employees worldwide at the time of sale. Other factors contributing to this development were restructuring measures, especially at BMG, as well as smaller divestments. At year-end, the company had 783 trainees in Germany (previous year: 918). Again, the decline is attributable to the sale of Bertelsmann Springer.

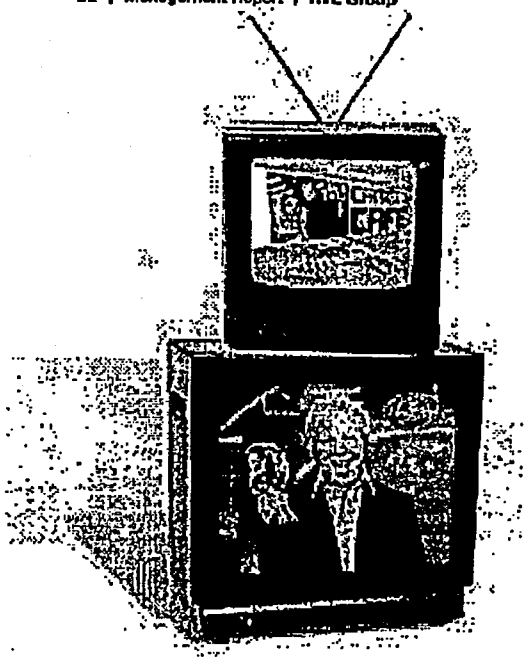
Since 1977, Bertelsmann has surveyed its employees in Germany about their satisfaction with the working conditions, their supervisors and the management of their company and the group. This survey is carried out every five years. A detailed analysis of the results from the first worldwide employee survey carried out in fall of 2002 substantiated the connection between corporate culture and

letting employees participate in the success of shared goals is hoped to promote their identification with the company and the group. In 2003, the employees profit sharing in Germany was put on a new footing, making it more dependent on the success of the individual companies. A corporate component has been added, which is contingent on Bertelsmann's worldwide performance. For the first time since 2000/2001, there will be a small profit-sharing payout again in 2003. Starting in 2003 the company no longer uses Bertelsmann Profit Participation Certificates as an instrument for profit sharing. Employees now have a choice between receiving their share of profits in cash or investing it in a pension fund as a provision for retirement. In total, 42,000 employees take part in profit-participation schemes.

RTL GROUP

Discover, Develop, Produce, Broadcast, Inform, Entertain


Laurent Boyer, Radio Presenter
RTL
GROUP
Céline Fouqueau, Final Editing
Graham Geddes, Camera Operator

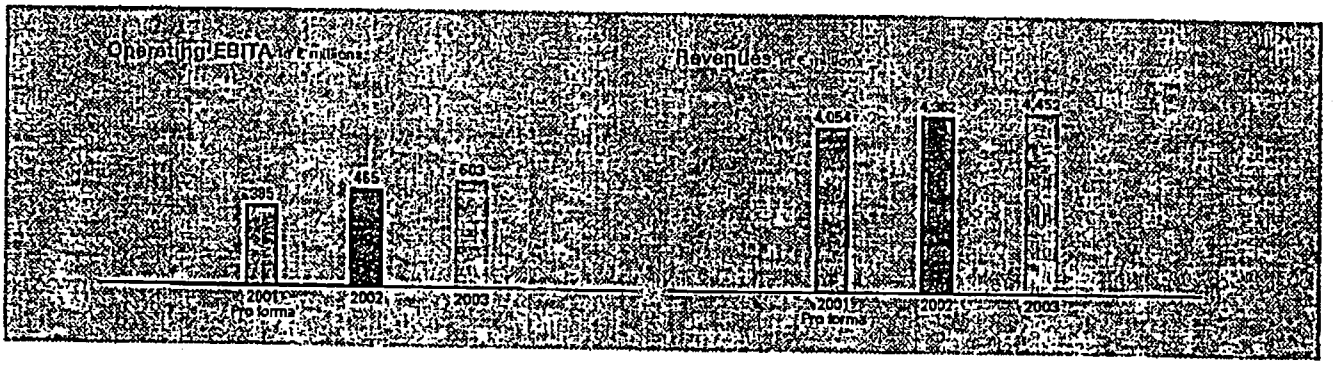


RTL Group, Europe's leading television, radio and TV production group, was able to improve its revenues and earnings in 2003 in a challenging market environment: Revenues amounted to € 4.5 billion vs. € 4.4 billion the previous year, while Operating EBITA rose to € 503 million from € 465 million the previous year.

RTL Group's companies relied on innovative programming, a more diversified revenue structure and strict cost control to counteract continuing weak advertising volume, most notably in Germany.

Rising viewer market shares and the profitability of all stations in the group bear testimony to the success of its approach.

In March, Gerhard Zeiler was appointed RTL Group's new Chief Executive Officer (CEO). Zeiler succeeds Didier Bellens, who left to join the telecommunications industry.

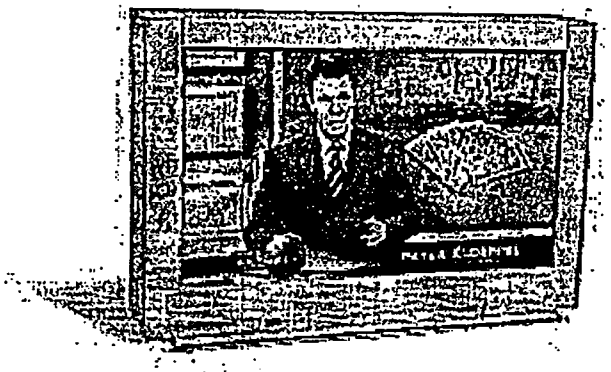


Highlights 2003

→ RTL Television contributed 62 of the 100 most-watched programs of the year in Germany.

→ For the first time, M6 generated more than half of its revenues with products and services not related to advertising.

→ RTL Group strengthened its influence in Spain's Antena 3 group of channels and was granted a TV broadcast license in Croatia.



2003 saw a number of small corporate transactions paving the way for continued growth outside the two important television markets of Germany and France. By mutual agreement with the new majority owner Grupo Planeta, RTL Group strengthened its influence in Spain's Antena 3 group of channels, after Telefónica initiated its withdrawal from the company. Following a phase of restructuring, Antena 3 expects to reach turnaround the following year. The group went public on the Madrid stock exchange in October 2003.

In September, RTL Group was awarded a license for a TV channel in Croatia. The new privately-run channel is scheduled to launch with a full program during the first half of 2004, and to follow the example of Hungary's RTL Klub, which within a few years took the lead in its chief target audience and now generates double-digit ROS. In the Netherlands, RTL Group prevailed in an auction for

the license for a new radio station and the option of further extending the reach of its existing radio license.

In its core operations, many RTL Group companies outperformed the competition. The German family of channels anchored by RTL Television again managed to add viewers and ad-market shares. In 2003, RTL Television scored the highest ratings since 1997 among 14 to 49-year-old audiences, the important target group for advertisers, once again securing its leadership of the market. RTL Television contributed 62 of the year's 100 most-watched programs. The channel garnered exceptionally high viewer ratings with its music talent show "Deutschland sucht den Superstar," whose finale was watched by up to 15 million viewers. RTL Television thus drew a roughly 50 percent market share of its chief target audience, its sister channel VOX and the TV holdings that are part of the family of channels (RTL II and Super RTL) also generated viewer and ad-sales shares above previous year.

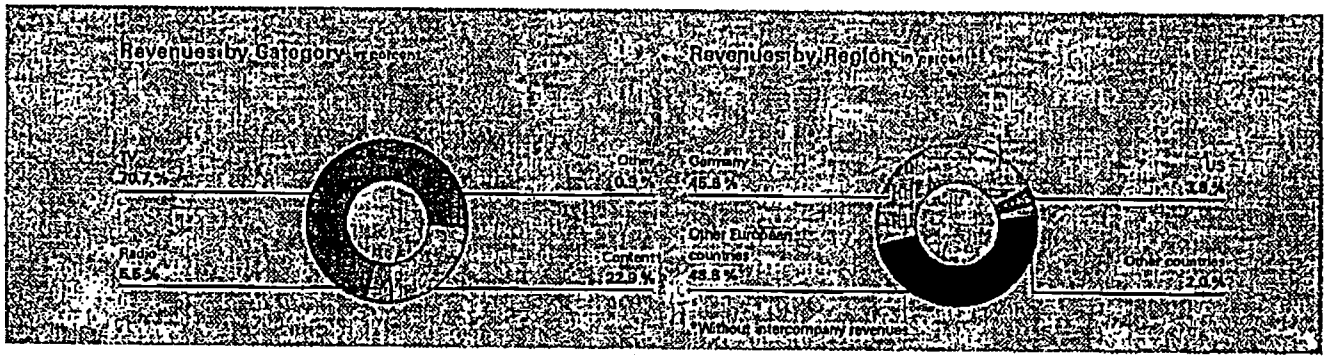
During the period under review RTL Television was able to significantly increase its non-advertising-related revenues. The company did so primarily by means of online services, merchandising, premium rate services, home-shopping offerings and the video and DVD distribution. RTL Television developed these lines of business in cooperation with the French channel M6. In a similar collaboration, RTL Radio in France and the TV channel RTL Klub in Hungary developed their merchandising businesses.

Due to these measures, the share of ad-related revenues in RTL Group's total revenue dropped to 61 percent (previous year: 62 percent).

Thanks to a broad revenue base, France's M6 was again able to set itself apart positively from developments in the industry. The company registered double-digit growth in both revenues and result, with products and services other than advertising generating more than half of its revenue for the first time. With its high viewer ratings, M6 cemented its No. 2 position in the French market. The British TV channel Five, which during the period under review achieved a first-time positive result, and the Holland Media Group (HMG) channels in the Netherlands also added viewer and ad-market shares. The channels in the Belgian RTL-Tvi group had an extraordinarily good year.

In TV production, Fremantle Media continued to profit from the worldwide rollout of the "Pop Idol" format. In 2003, the talent show was produced not only in Germany ("Deutschland sucht den Superstar") and France, but also in Canada, Denmark, Russia, Iceland and many other countries, scoring high ratings in all of them. Second seasons have already been planned or produced, e.g. in the US, the UK and Germany. In 2003, the company picked up the thread of "Idol" success with the dating show "Cupid" and new formats like "How Clean is Your House?" and "Finally Friday." Fremantle Media further strengthened its portfolio by acquiring the Australian production company Crackerjack.

In radio, the RTL Group channels in the core market of France stabilized listener market shares and improved their profits. In Germany, the focus was on integrating the radio holdings taken over in 2002 from the Georg von Holtzbrinck publishing group.



Milena Alberti, Corporate Development

Melanie Cheng, Associate Publicity Director RHCB;
Glenn Ellis, Vice President, Director of Field Sales Children's Division;
Kerry Milliron, Director, Brand Management;
Elmer Cancera, Sales Manager

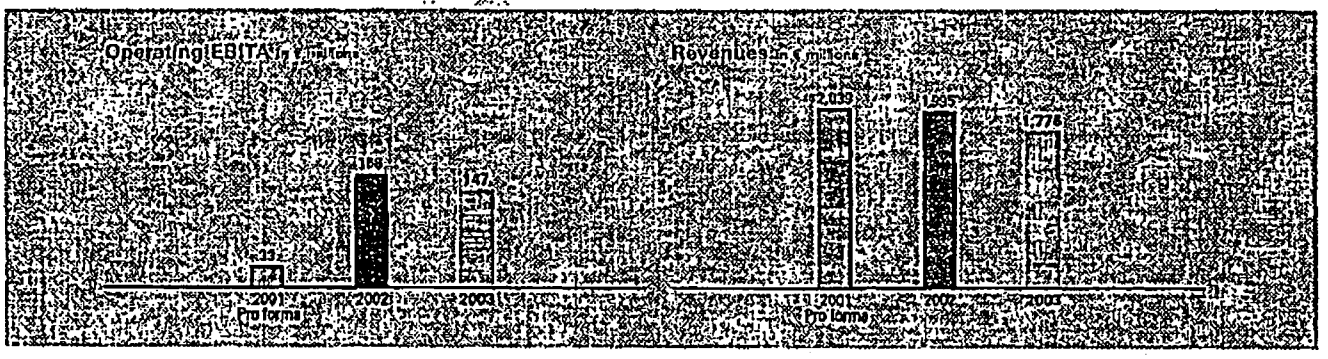
Random House:
Read, Write, Edit, Rhyme, Educate, Enthrall™

Ari Meyers, Actress, Reading B

Rob Waddington, Sales
RANDOM HOUSE
BERTELSMANN
Gail Rebuck, Chairman and CEO,
Random House Group UK
Ben Lee, Marketing Coordinator
Katharine Zige, Business Manager

Random House In 2003, an economically challenging year for the book industry, Random House enhanced its position as the global leader in trade book publishing. Revenues amounted to € 1.8 billion after € 2.0 billion the previous year, while Operating EBITA reached € 147 million after € 168 million the previous year. The decline in revenues and profits is attributable to foreign currency effects, which result mainly from the conversion of dollars to euro for the greatest part of Random House's business, which is done in the US. The euro results therefore do not reflect the underlying strength in the business. Adjusted for currency effects, Random House revenues and profits increased slightly year-on-year.

In North America, where book retail was slowed down by a weak first-half economy, Random House was



able to increase its book sales, achieving its best year-end holiday book sales ever. In the US, systematic cuts in administrative spending contributed to keeping profitability stable and counteracted the growing pressure on margins. For the sixth consecutive year, Random House placed more of its titles on the various New York Times bestseller lists than any of its publishing group competitors. Of these 176 titles, 28 reached No. 1. Random House authors John Grisham and Danielle Steel contributed 13 major bestsellers, seven of which were No. 1.

Random House's Doubleday imprint published the book that was not only the biggest-selling adult fiction title of the year but is on course to become one of the best-selling hardcover novels of all time: "The Da Vinci Code" by Dan Brown had 5.1 million copies in print at year's end, just nine months after publication. Random House Audio's Listening Library edition of "Harry Potter

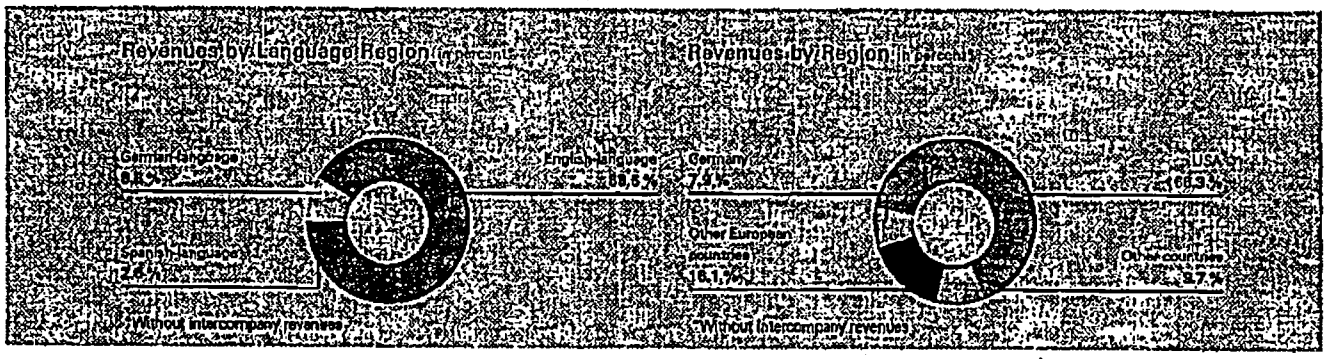
Highlights 2003

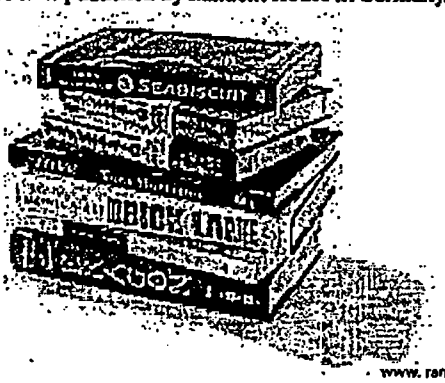
- In the US, Random House placed 176 titles on the "New York Times" bestseller lists. 28 of these titles made it to No.1.
- Doubleday published the thriller "The Da Vinci Code" by Dan Brown, which became the year's top-selling adult title in the fiction market.
- In Germany, Verlagsgruppe Random House extended its business by acquiring Heyne Verlag.
- The Random House Kodansha joint venture made Random House the first Western publishing company to enter the Japanese book market. A similar cooperation was signed in late 2003 with the Korean publishing company JoongAng Ilbo Publishers.

and the Order of the Phoenix" by J. K. Rowling, published in June, is on its way to becoming the format's biggest seller ever. Ballantine's paperback edition of "The Lord of the Rings" enjoyed another year of strong sales, as the release of the final film in the trilogy drew millions of moviegoers for the third consecutive year.

Random House of Canada had its best year ever in sales and profits and showed particular strength with its Canadian publishing program. In the United Kingdom, the Random House Group maintained market leadership and increased its share of the general retail market. A quarter of all Sunday Times weekly bestsellers were by Random House authors, of which 24 reached No. 1. New books by such established authors as Bill Bryson, Robert Harris, and Terry Pratchett sold especially well. Random House Australia, New Zealand, and South Africa all performed well in fragile markets.

In a flat German book market marked by further consolidation among publishers and booksellers, Verlagsgruppe Random House extended its operations significantly by acquiring Heyne Verlag. Thus, famous German authors like Wolfgang Hohlbein and Amelie Fried, as well as best-selling Anglo-American authors including John Grisham, Mary Higgins Clark, Stephen King and Nicholas Sparks, are now published by Random House in Germany.





The acquisition will influence Verlagsgruppe Random House's revenues and earnings beginning in 2004. The group divested Berlin Verlag in March. Verlagsgruppe Random House improved its results in 2003, especially in hardcover fiction. Including Heyne, the group had more titles on Germany's major hardcover and paperback bestseller lists than any other publishing group, including nine No. 1 titles.

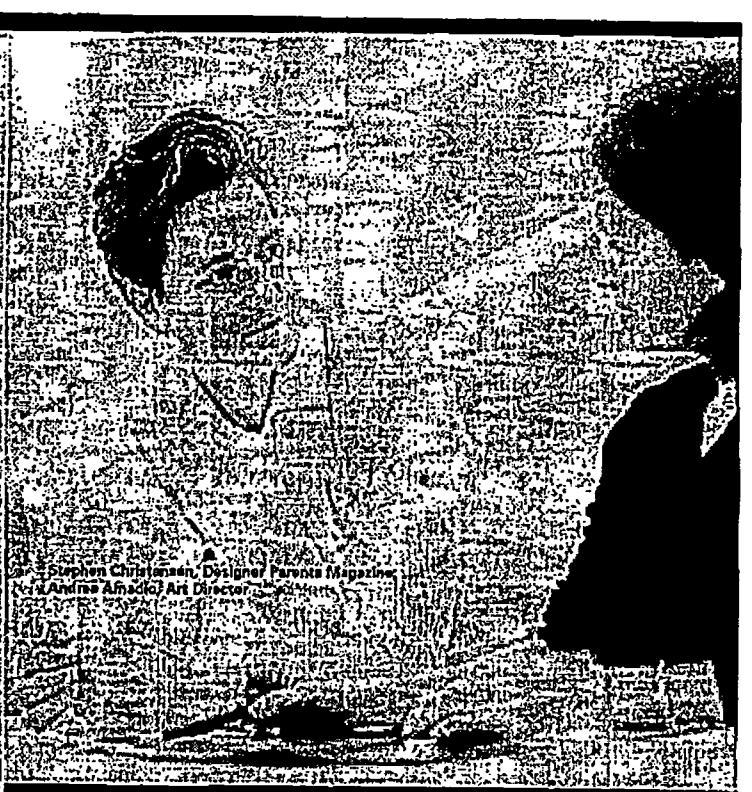
In Spain and Latin America, the joint venture Grupo Editorial Random House Mondadori strengthened its market-leading share of the paperback sector in Spain with a launch of a new imprint. Major organizational restructuring and a strong bestseller line-up enhanced the company's competitive position.

In January 2003, Random House became the first Western trade book publisher to enter the Asian book market by forming a joint venture with Kodansha, Japan's leading book publisher. Random House Kodansha published its first booklist in Japanese in November and will steadily grow its publishing program each year. A similar landmark collaboration was signed in December in Korea with JoongAng Ilbo Publishers. Random House JoongAng's publishing program will be comprised of 80 percent original Korean titles and 20 percent translations of international works.

Random House authors received many of the world's most prestigious literary awards in 2003. J. M. Coetzee, whom Random House has long published in the UK, Canada, Australasia, and Spain won the Nobel Prize for Literature. The Pulitzer Prize for Biography was awarded to Robert A. Caro for "Master of the Senate: The Years of Lyndon Johnson."

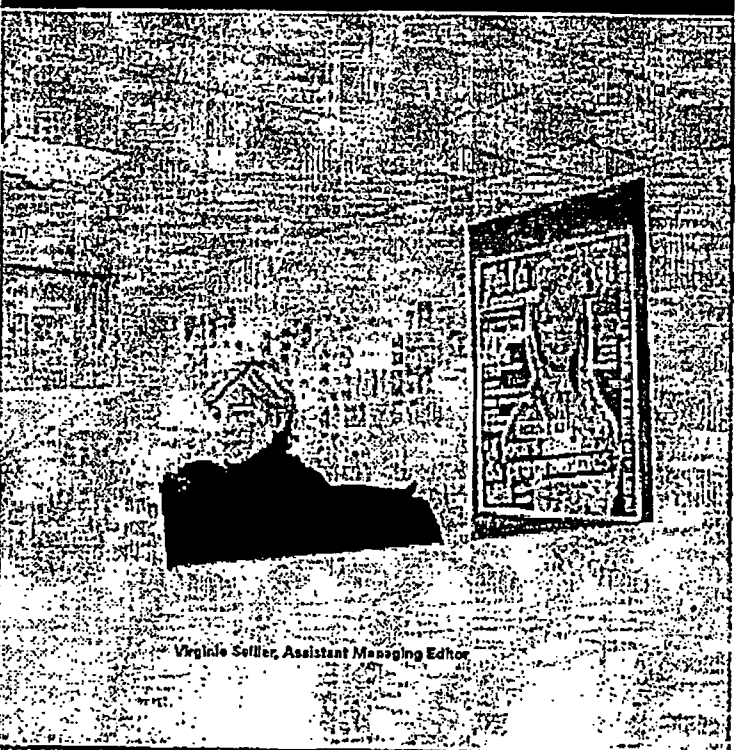
GRÜNER + JAHR
Research. Take Pictures. Comment. Design. Fascinate.

Martin Meister, Managing Editor Science and TV;
Tina Ahrens, Picture Editor

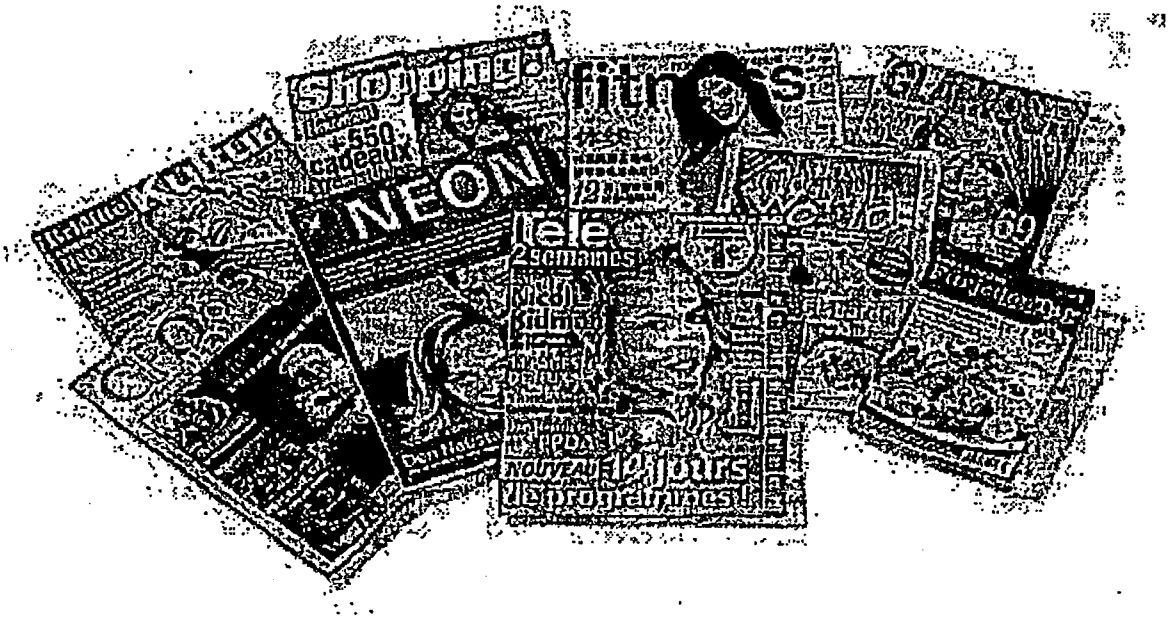


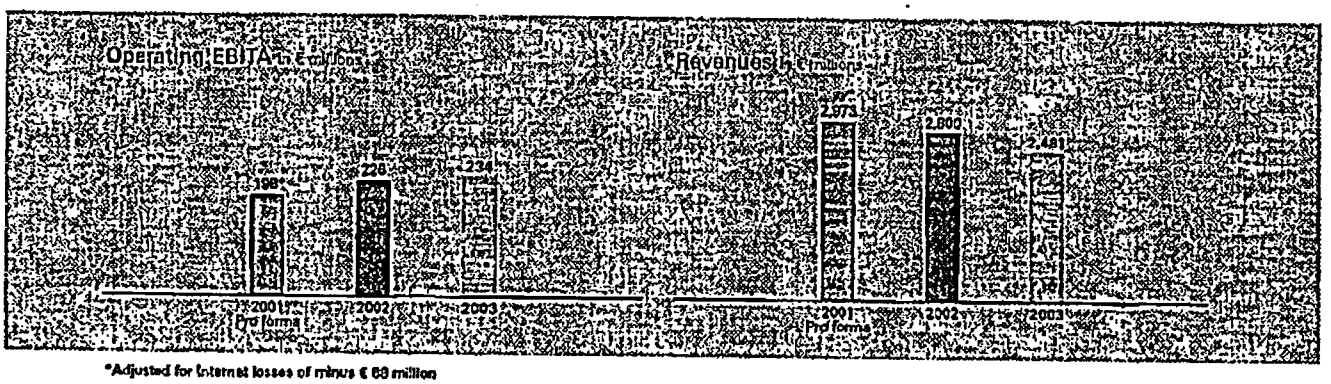
Stephen Christensen, Designer Parents Magazine;
Andrea Amadio, Art Director

G+J



Virginie Sellier, Assistant Managing Editor





*Adjusted for internet losses of minus € 68 million

Highlights 2003

- "Innovation Now!" campaign launched with the aim of strengthening established titles and creating new titles and line extensions.
- Successful examples: "Stern" magazine's line extensions "Neon" and "Gesund Leben," "Femme Actuelle Shopping" in France, and the children's magazine "GEOLenok" in Russia.
- The launch of France's first biweekly TV guide "Tele 2 semaines" marked the start of a promising new title for Prisma Presse. Following a successful test phase, the first issue in January 2004 sold over one million copies.
- The nationwide daily "Financial Times Deutschland" continued its growth against the market trend in ad sales and total circulation.

Innovations, along with unwavering cost discipline, were at the heart of business activities for the international magazine publisher Gruner + Jahr in 2003. Although revenues declined to € 2.5 billion (previous year: € 2.8 billion) due to diminished advertising income, portfolio streamlining and currency effects, and despite further steep investments, the company managed to improve its Operating EBITA to € 234 million (previous year: € 226 million).

Gruner + Jahr continued its policy of concentrating on the magazine business, begun in 2002 with the disposal of Berliner Verlag: At year-end 2003, the company sold its Central and Eastern European newspaper holdings to the Swiss publisher Ringier. 2003 revenues were impacted among other things by the discontinuation of the US women's magazine "Rosie" at year-end 2002.

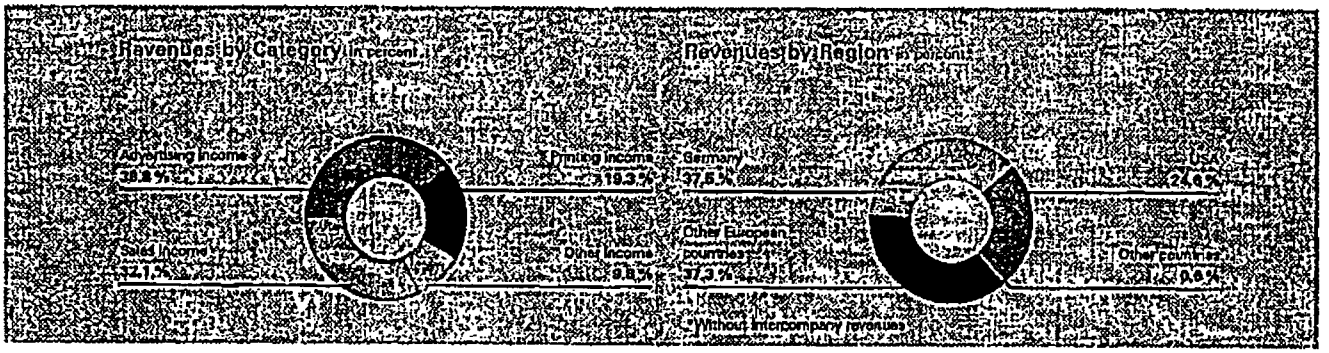
One important measure on the publishing front was the "Innovation Now!" initiative launched in spring of

2003. The program not only involved strengthening established titles, but also the launch of new titles and line extensions. Successful examples for this include "Femme Actuelle Shopping" and "Télé 2 semaines" in France and the new bilingual children's magazine "National Geographic World" in Germany. Gruner + Jahr also transferred established brands and magazine concepts to new markets, e.g. the children's magazine "GEOLenok" and the popular-science magazine "GEOfocus" to Russia.

Market response to new and relaunched titles in Germany was positive. "Neon," an innovative magazine for young men and women initially tested in two pilot issues in summer 2003, is now a fixture in the "stern" family.

In France, the G+J subsidiary Prisma Presse followed up its successful launch of "Femme Actuelle Shopping" – a quarterly line extension to the "Femme Actuelle" flagship – with several other special magazines that also sold well. With the launch of France's first biweekly TV guide "Télé 2 semaines," Gruner + Jahr managed to introduce another promising new title to the market. Following a successful test phase at the end of the year, the first issue in January 2004 sold over a million copies. "Télé 2 semaines" promises to become an important pillar in Gruner + Jahr's French and European magazine business. In Poland, "Glamour" magazine, published under license by G+J, was hailed as the "Debut of the Year 2003" by Poland's trade press. The magazine instantly became the No. 1 high-end women's magazine by number of copies sold.

In 2002, Gruner + Jahr had already successfully augmented its important women's segment with the biweekly title "Woman." In October 2003, its first line extension, the pocket-sized "Woman Shopping," was launched in Germany.



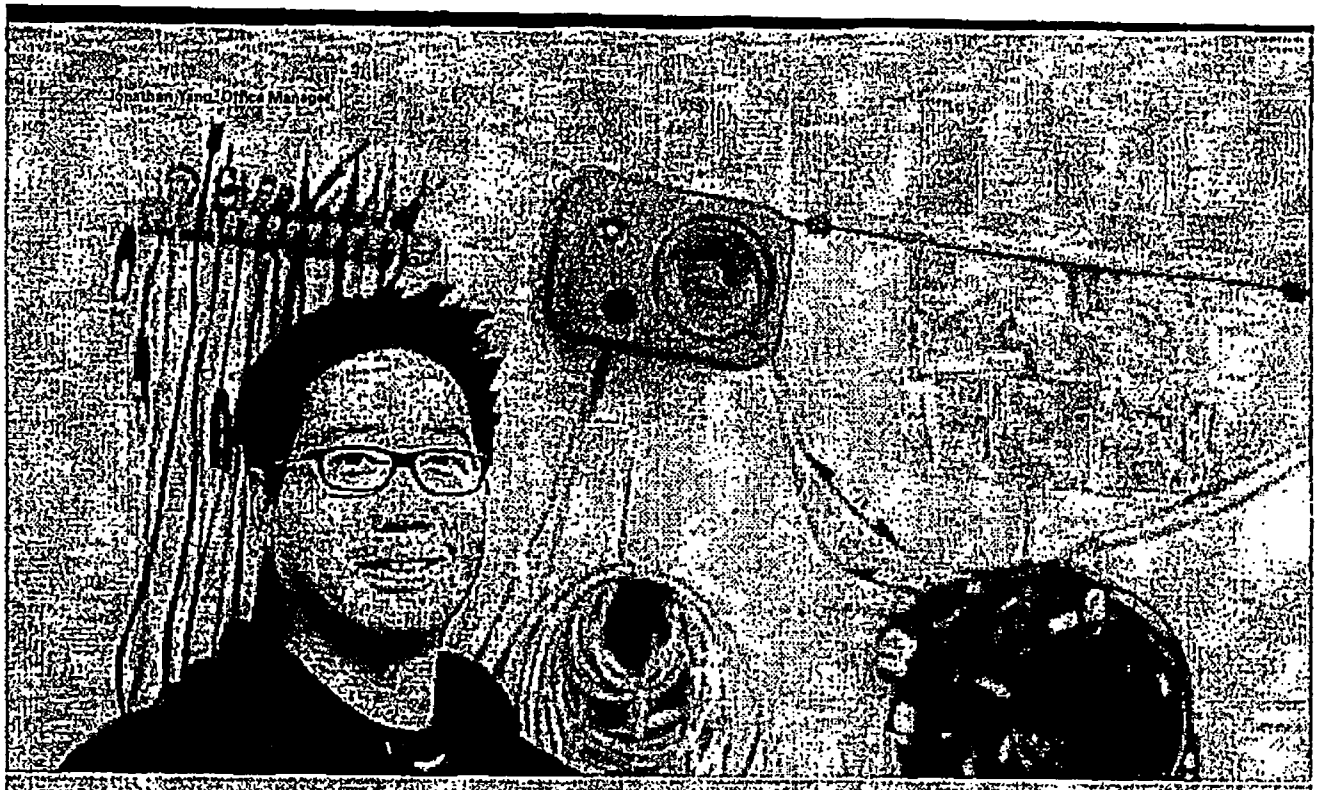
Gruner + Jahr's established, powerful brands in Germany were able to stand their ground in 2003, in a market characterized by tougher competition. The German weekly "stern" managed to increase its circulation, while the women's magazine "Brigitte" furthered its umbrella brand strategy ("Brigitte Young Miss," "Brigitte Cookie," "Brigitte Kultur"). This brand family expansion is modeled on the magazine "Geo," which has been systematically and successfully positioning sub-brands under the Geo umbrella for decades.

With a heightened market orientation and an editorial evolution of "Capital," "Impulse" and "Börse Online," Gruner + Jahr laid the groundwork in 2003 for growing its business press sector, in preparation for an economic recovery. The nationwide daily "Financial Times Deutschland" continued its growth against the market trend in ad sales and total circulation. In France, sturdy growth in sales and advertising was seen particularly in traditional people titles like "Voici" and "Gala."

In the US, where the advertising market was already experiencing a slight recovery by year-end 2003, the magazines "Family Circle," "Parents," "Fitness," "YM" and others outperformed the overall US magazine business tangibly, registering double-digit growth rates in ad sales. G+J USA's business publications "Fast Company" and "Inc." increased their market shares.

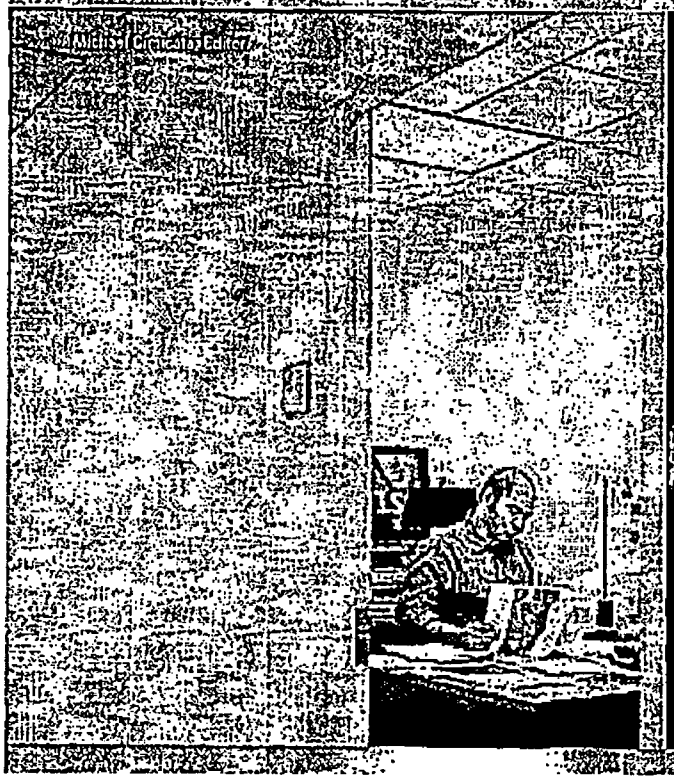
In Europe, G+J's printing operations were able to sustain their market shares, but registered diminished earnings in Germany in light of a persistent surplus capacity in the market. The US printing division grew during 2003; additional printing volume from the Time Inc. publishing group has been added for 2004 and beyond.

www.guj.de | neon-stern.de | tele2semaines.fr | brigitte.de | ftd.de | gluxx.com



Jonathan Jana, Office Manager

BMG
Compose, Sing, Dance, Inspire, Excite



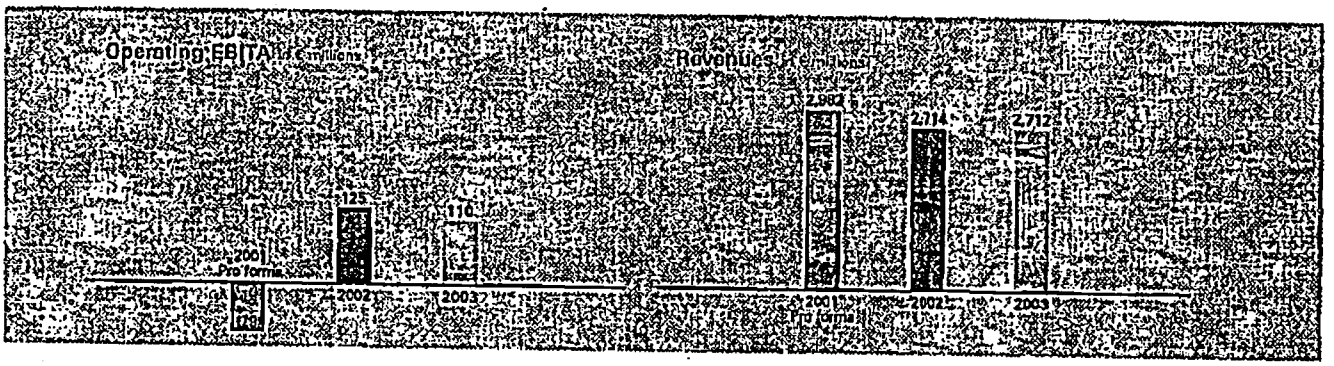
Matt Fowler, Assistant Mastering Engineer

BMG

BERTELSMANN

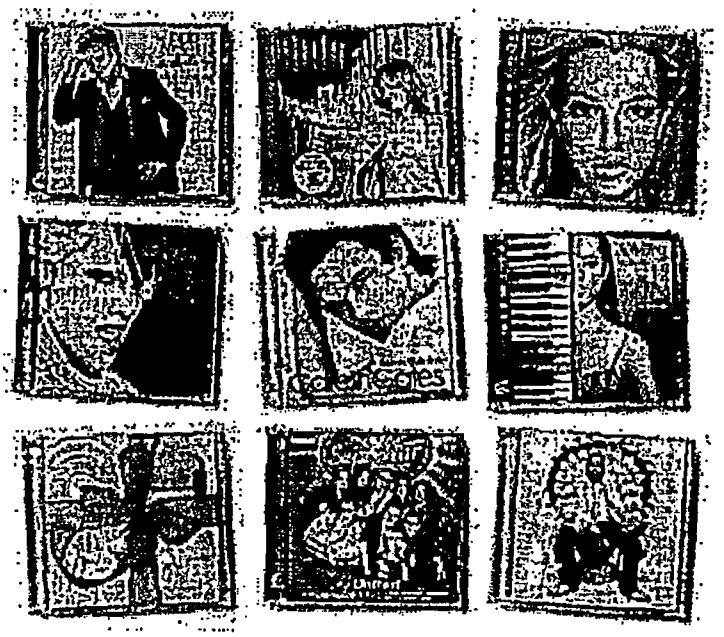
In 2003, the Bertelsmann Music Group (BMG) continued to do business in a strongly shrinking market. Yet revenues stayed level with the previous year at €2.7 billion. Revenues from Zomba, the music company acquired in 2002, were fully included for the first time this year. BMG's total revenue remained nearly on par with previous year even after adjusting for currency and portfolio effects. Operating EBITA amounted to €110 million, after €125 million in 2002.

At year-end, a far-reaching strategic decision was taken to ensure BMG's continued success in light of difficult times in the music industry: In December, Bertelsmann and Sony Corporation of America agreed to merge their music divisions. BMG and Sony Music Entertainment plan to contribute their respective recording divisions to the "Sony BMG" joint venture, which will be headquartered in



Highlights 2003

- Strategic decision: BMG and Sony Music Entertainment plan to contribute their respective recording divisions to the "Sony BMG" joint venture.
- Great creative triumphs in 2003: 17 top albums had sales of more than two million copies each, 22 Grammys.
- In the US, nine of the 30 top-selling albums in 2003 were by BMG artists.
- In Europe, Dido's latest album "Life for Rent" was at No.1 for eleven consecutive weeks.



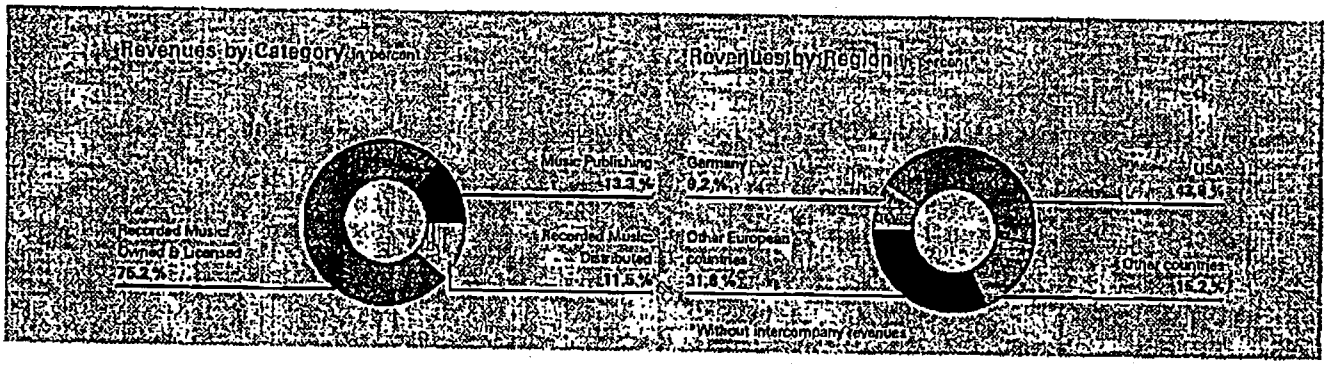
New York. The aim is to create a strong, healthy music major with an outstanding artist roster. The closing of this deal is subject to antitrust review.

The integration of Zomba was achieved more rapidly than expected during the period under review. Likewise, the assimilation of RCA and J Records into the RCA Music Group went off smoothly. Organizational streamlining at BMG resulted in high restructuring costs in 2003. By eliminating regional corporate groups around Europe, Asia and Latin regions, BMG enhanced its ability to bring music to global music markets quickly and more efficiently. The company bundled all marketing activities in a new Global Marketing Group.

BMG was able to increase its share of the global market from 11.1 to 11.6 percent in 2003, thanks to a string of artistic successes. In the world's biggest music market, the US, the group was able to further cement its position as the second-biggest music major, with a market share of 18.4 percent in Current Albums (vs. 17.3 percent the previous year). 17 top albums that sold in excess of two million copies each and a record 22 Grammy Awards testify to creative excellence across all musical genres and regional borders at RCA Music Group, Arista Records, Jive Records, RLG-Nashville, BMG UK and others. The year's top sellers were the work of BMG stars including Avril Lavigne, Pink, Britney Spears, Alicia Keys, R. Kelly, OutKast, Dido, Christina Aguilera, Justin Timberlake, Dave Matthews and Eros Ramazzotti.

In the US market, nine of the 30 top-selling albums in 2003 were by BMG acts. In Europe, Dido dominated the No. 1 position for eleven weeks running; the artist thus did her part to raise BMG's share in the European album charts by nearly two percentage points, to 12.2 percent. BMG also increased its market shares in Latin America and Asia.

In music publishing, BMG expanded its revenues by 33 percent during the period under review. This is attributable both to the integration of Zomba Publishing and to the large number of hits that BMG songwriters and composers were able to place in the worldwide charts in 2003. Among the famous artists who publish their lyrics and music through BMG Music Publishing in the US are Justin Timberlake, Robbie Williams and Christina Aguilera.



Meanwhile, BMG's economic environment in 2003 was still shaped by challenges including copying, file-sharing and counterfeits, and industry-side price dumping and competition from new entertainment products. To curb unauthorized copying, BMG stepped up its efforts to educate public authorities, business and consumers. During the period under review, the company intensified its cooperation with online music vendors that work on a licensing basis and are enjoying increasing consumer acceptance.

Felicia McDowell, Account Management

Arvato
Consult, Print, Press, Distribute, Network, Render Services

Bobby Thomas, Holger Simons, System Engineers

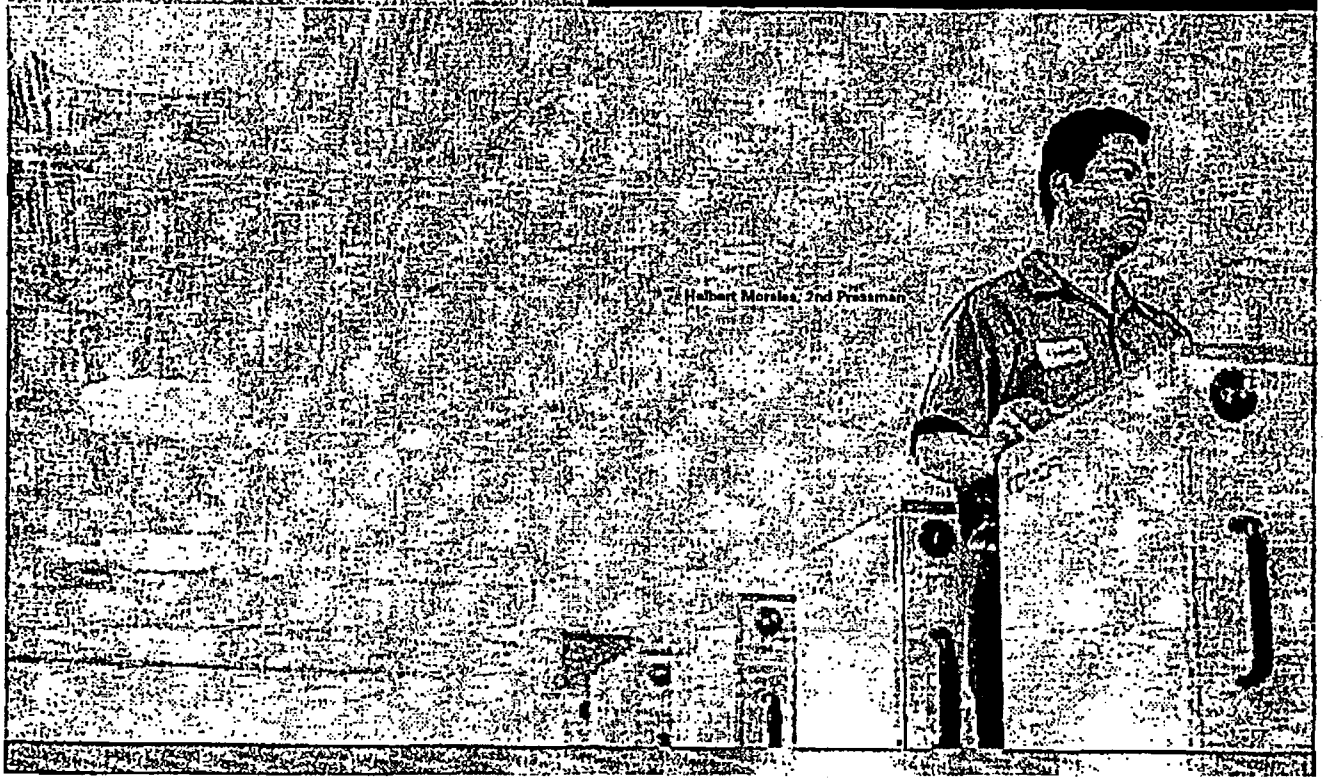
Vanessa Höhnen, Executive Assistant

Sikrit Das, Dispatch Worker

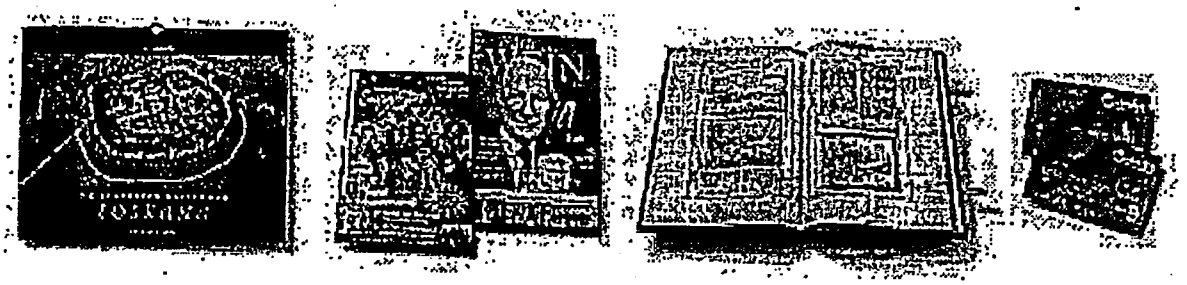
Walter Wenning, Glass Master Control

arvato

BERTELSMANN

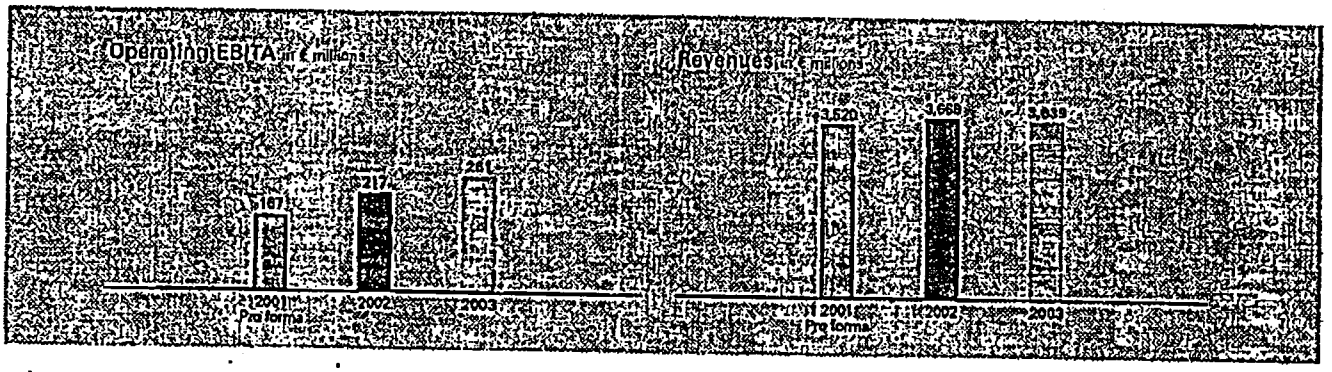


Halbert Morales, 2nd Pressman



In 2003, the media service provider Arvato generated revenues of € 3.6 billion, slightly down from the previous year (€ 3.7 billion), but was able to improve its Operating EBITA to a record € 261 million (previous year: € 217 million).

The Arvato Services unit again proved to be an important growth engine. The unit is comprised of Arvato Direct Services, one of the world's biggest service providers in Customer Relationship Management, and Arvato Logistics Services, a global provider of Supply Chain Management. In Services, Arvato continued its strategy of internationalization: For example, it built and expanded service plants in Toronto (Canada), Liverpool (UK), New Delhi (India) and Beijing (China), most of them multilingual call centers for international customers. Existing service contracts with key customers in the IT and wireless logistics sectors were extended and new ones were signed. In wireless logistics, repair services were added to the portfolio. Arvato Services also concentrated on building and extending its logistics services for the pharmaceuticals sector.

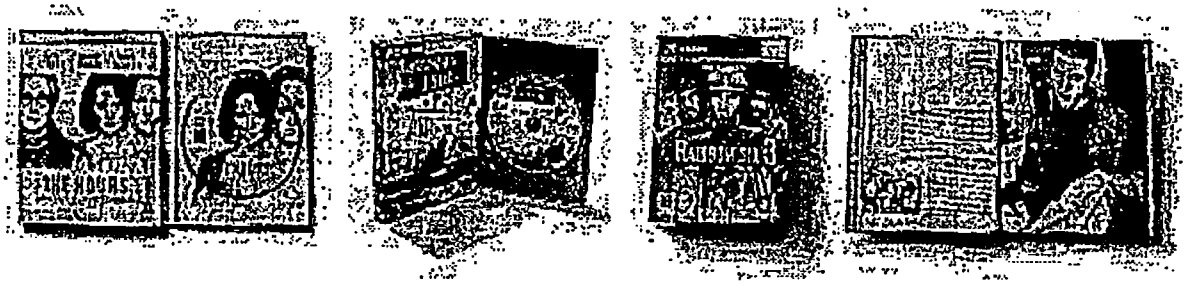


Highlights 2003

- Continued pursuit of internationalization strategy at Arvato Services: service plants were built and extended in Toronto (Canada), Liverpool (UK), New Delhi (India) and Beijing (China)
- The online bonus program company Webmiles, part of Arvato Direct Services, managed a turnaround in 2003.
- Holdings in the Eurodirect group in France including its Lettershop services were increased to 100 percent.
- At the end of 2003, construction on a state-of-the-art rotogravure plant was begun in Treviglio, Italy; the investment volume for the New Eurogravure project totals approx. € 100 million.

Arvato's Services unit intensified its efforts to offer customers a concept that covers the handling of entire process chains. These range from comprehensive customer loyalty programs (clubs, bonus programs etc.) to the creation, storage and distribution of advertising and information instruments for major financial services providers.

The Arvato Direct Services subsidiary Webmiles, an online bonus program company, achieved turnaround in

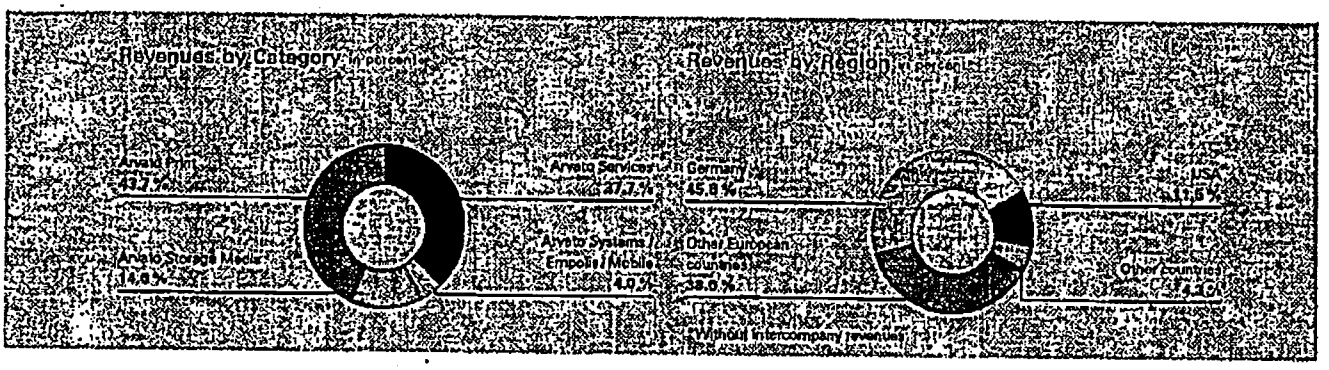


2003. Last year also saw the incorporation of Zomba Records' sales and distribution activities in Germany, Austria and Switzerland and in the UK Holdings in the Eurodirect Group in France with its Lettershop services, were stocked up to 100 percent.

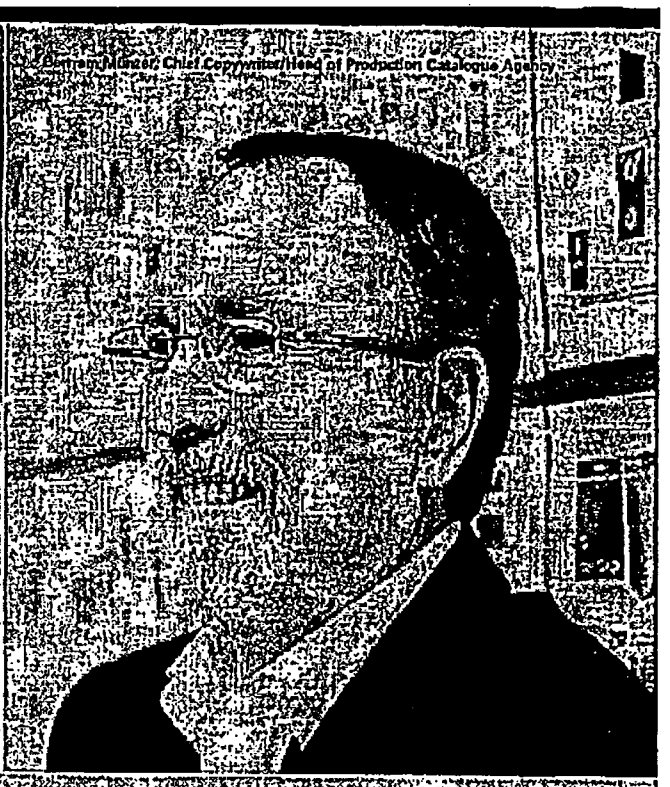
Arvato Print found itself facing massive fluctuations in capacity utilization, along with increasing pricing pressure. Nevertheless, the printing unit was able to bolster its leading position with investments in state-of-the-art technology. The reorganization of its book-printing operations in Germany was concluded with the integration of the Elsnerdruck paperback printing plant into the GGP Media book-printing unit. The Maul-Belser media group adopted a € 55 million investment package in 2003, with the primary aim of building two state-of-the-art gravure printing presses at the Nuremberg location in the years ahead. At the end of 2003, construction began on a high-tech gravure printing plant in Treviglio, Italy. The New Eurogravure project involves investments totaling approximately € 100 million. In Barcelona, the Spanish offset-printing business pressed ahead with its restructuring efforts. Arvato's US book-printing business was stable in 2003.

In the Arvato Storage Media unit, the storage media manufacturer Sonopress substantially increased its DVD volume while also expanding CD volume counter to the industry trend. The latter is attributable chiefly to the addition of US market shares in CD manufacturing. Sonopress was able to significantly increase revenues and earnings in the US, Brazil and Mexico. Arvato Storage Media's German business was dominated by consolidation in 2003. The cost situation was significantly improved thanks to optimized organizational structures and adjustments to workflow. In Asia, start-up was concluded and a first-time positive result achieved.

In the IT sector, Arvato Systems furthered its structural transformation from an in-house IT service provider for Bertelsmann to a separate Profit Center, by broadening its external customer base in core markets. Empolis, a leading provider of corporate content and knowledge management solutions, which is also part of Arvato's IT unit, systematically continued its transition from product to solutions provider. Arvato also made significant progress in the building and extension of Arvato Mobile, a full-service wireless provider with the brands Handy.de and TJ Net. The increase in both revenues and earnings were above average in 2003.



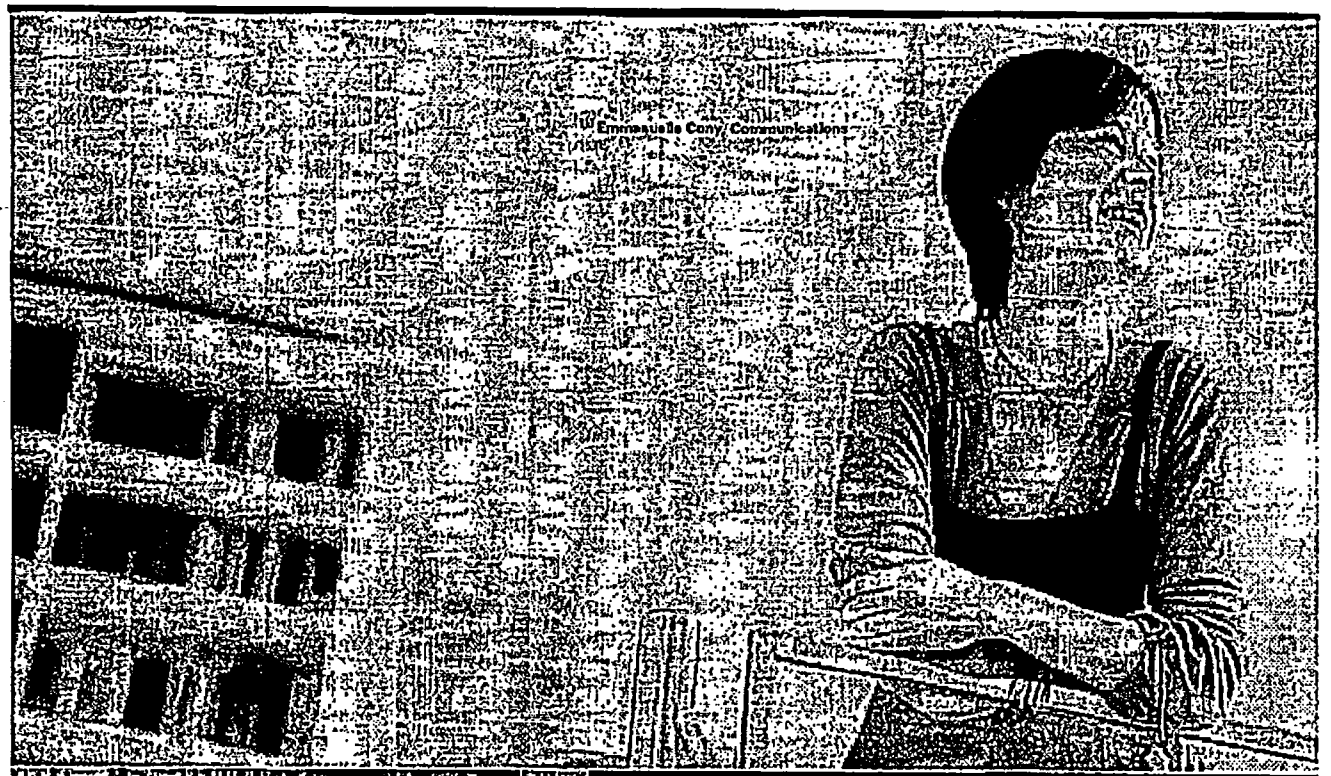
Melanie Werner, Program Assistant



Carsten Münzer, Chief Copywriter/Head of Production Catalogue Agency

Direct Group
Select, Publish, Prepare, Promote, Build Community

Karsten Dietrich, General Manager Editions France Loisirs



Emmanuelle Conyl Communications

DIRECTGROUP

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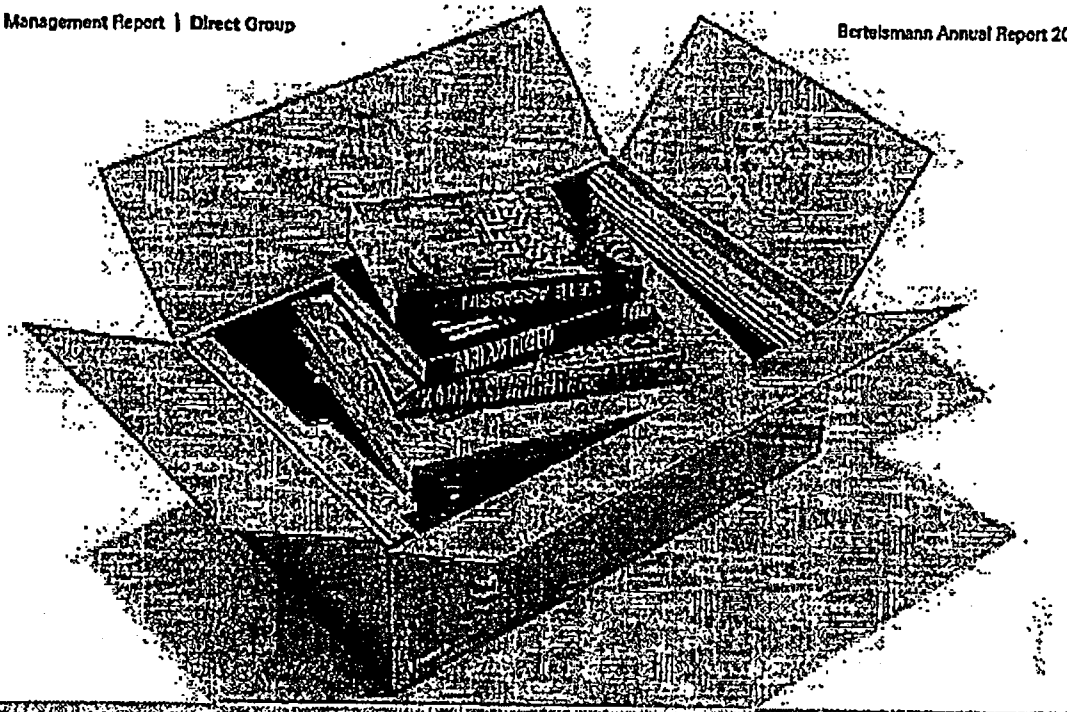
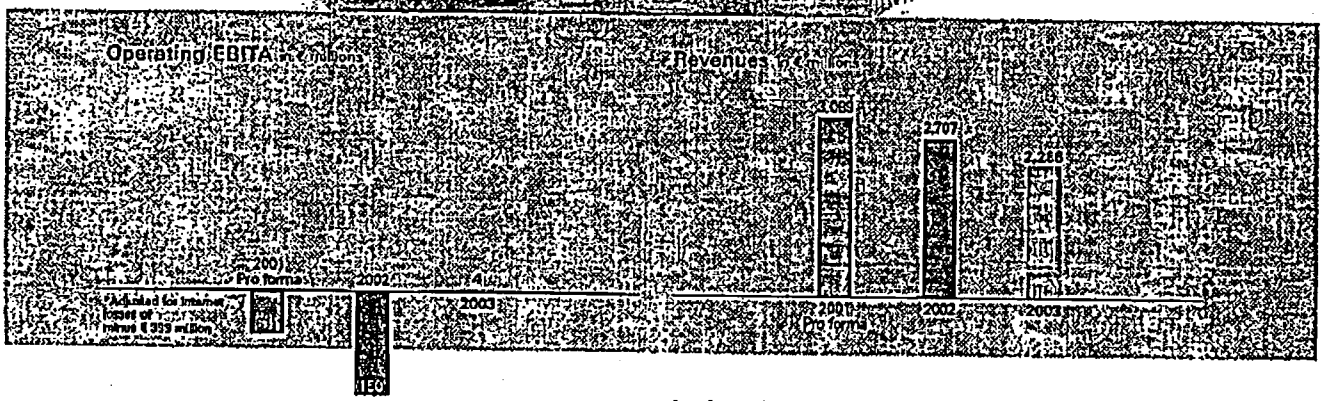
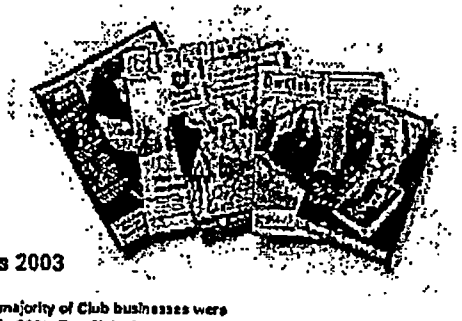
Michaela Werner, Book Production







Highlights 2003

- The great majority of Club businesses were profitable in 2003. The Clubs in Germany and Great Britain reduced their losses by about 70 percent.
- Investments into increasing the appeal of the Clubs: Measures included the overhaul of numerous Club stores, sweeping media campaigns, revised Internet homepages, more up-to-date books, and a greater number of exclusive titles for Club members.
- Growth strategy in China: The 21st Century Bookchain joint venture entered into with a Chinese partner opens up the possibility of building a nationwide bookstore business.

By focusing on Club businesses, Direct Group generated an earnings leap in 2003 despite a revenue decline to € 2.3 billion (previous year: € 2.7 billion): Operating EBITA, which in 2002 was minus € 150 million, improved to € 4 million despite a tough economic climate, bringing the group to break even.

The contracting revenues reflect a market impacted by economic decline and consumer reluctance, a weak dollar, and portfolio streamlining. In 2002, Direct Group had disposed of the online bookseller BOL in many countries. Meanwhile, the improved operating results are evidence of successful restructuring measures: a focus on core business, systematic withdrawal from pure e-commerce, and the increased delegation of responsibility to local management as part of strengthening the decentralized organization.

In 2003, Direct Group sold its holdings in the US online bookseller Barnesandnoble.com and disposed of

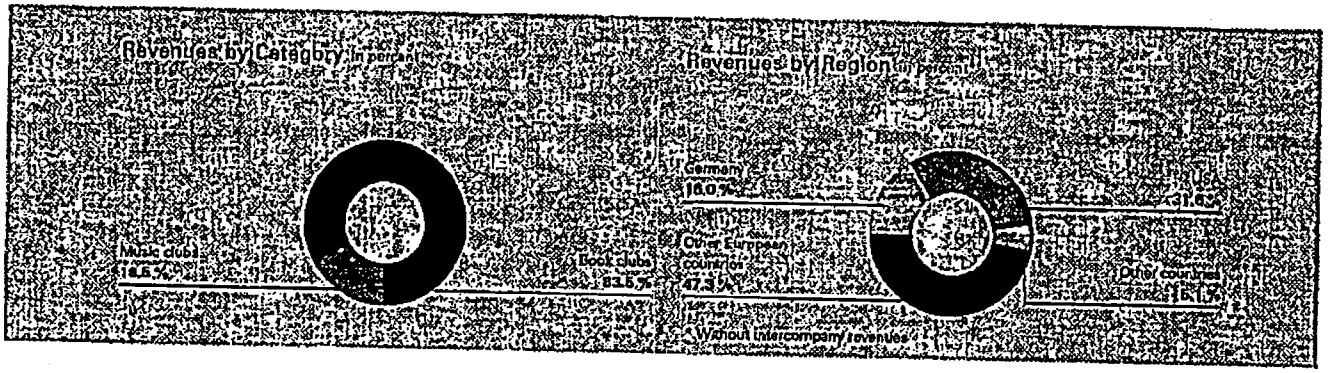
BOL in the Netherlands. This concludes the group's withdrawal from media e-commerce. The division also relied on active cost management, further reducing its administrative expenditure both at the head office and in the individual operations.

Parallel to its reorganization, Direct Group began enhancing the appeal of its Clubs by modernizing numerous Club stores and launching large-scale media campaigns, especially in France and Germany. Clubs all over the world revised and updated their catalogs and online presence. Club members are now offered a more up-to-date range of books and a broader spectrum of exclusive titles. The Clubs intensified their own publishing activities and collaboration with authors. For the first time, selected books were promoted worldwide as part of a joint marketing initiative. The Clubs' membership bases were selectively trimmed to enable a focus on loyal customers. At year-end, the worldwide book and music clubs of the group counted approx. 32 million members.

As a result of these measures, the Clubs showed significantly improved earnings for the year. The great majority of Club operations were profitable in 2003. The German and British Clubs reduced their losses by roughly 70 percent, but have not yet reached break even.

The French Club France Loisirs, Spain's Círculo de Lectores, ECI in the Netherlands, the US book club Bookspan and the US music club BMG Music Service generated comparatively high income. France Loisirs relied on a number of best-selling exclusive titles (Edition France Loisirs), while the Spanish book club Círculo de Lectores extended its business by adding exclusive book series. In the Netherlands, ECI continued the restructuring process begun in 2002, and established its own publishing company, "House of Books." Bookspan in the US had a restrained first half, due chiefly to consumer reluctance related to the Iraq War, but was able to compensate this with brisk business in the second half of the year. In a market that is still contracting, the music club BMG Music Service nearly doubled its earnings. This success is the result of a program that was well received by its customers, improved management of accounts receivable, manifold savings measures, and an intensified use of the Internet for recruiting customers.

The lung disease SARS and ensuing consumer insecurity impacted the business of the Club in China. Nevertheless it managed to increase membership numbers and improve its results. The 21st Century Bookchain joint venture set up with a Chinese partner in December 2003 is expected to bring further growth. Having gained the government's permission, the Club will now extend its chain of stores beyond the borders of Shanghai for the first time and significantly broaden its member base. Bertelsmann is the first international media company to be given the opportunity to build a nationwide book retail chain since the Chinese book market was opened in May 2003.



GAIN Initiative Launched

Towards the end of the year, Bertelsmann launched a "Growth and Innovation" (GAIN) initiative to promote organic growth. The basic idea of the initiative is to encourage entrepreneurs in Bertelsmann's companies and divisions to develop ideas for new content, products and services, and to support them in putting their business ideas into practice. GAIN will supplement a continued optimization of existing businesses, and systematic portfolio management.

In the two previous years, the group-wide "Bertelsmann Excellence Initiative" (BEX) had provided the foundation for new growth. Its goal was to improve the profitability of core businesses. Over the course of the initiative, which has since been concluded, the group's loss-making businesses were returned to the profit zone, shut down or sold. Additional BEX savings were achieved by streamlining central administrative offices and staff functions.

Risk Management and Risks of Future Development

Bertelsmann AG has an integrated risk management system. This system is established as a fixed part of the company's management structure. As in previous years, a voluntary audit was carried out in major areas by KPMG, the external auditors. A major part of the risk identification process is a complete risk inventory, to be carried out annually by the profit centers. The risks are then aggregated step-by-step for each business segment and for the whole group. This bottom-up process ensures that risks are recorded where they have an effect. A uniform framework is used for identifying risks, in order to make the risks identified comparable with each other and to be able to combine them sensibly as a further part of the process.

As a result of the risk reporting, the following significant risks for the Bertelsmann group and for Bertelsmann AG were identified. Measures are continuously taken to monitor, reduce or eliminate these risks, which are subject to constant observation.

The overall decline in the advertising industry over the past few years had a significant influence on RTL Group's potential revenue growth. Although it can be assumed that this trend will not continue, there is nevertheless a risk that advertising revenues could decrease further. This has to do with the overall weakness of the entire advertising market, as well as with the use of new forms of advertising, using new forms of media. The RTL Group purchases considerable amounts of movie rights from major US film studios on a US dollar basis. As any significant change in the exchange rate of the dollar versus the euro would directly affect the RTL Group profitability, currency fluctuation risks are hedged by RTL Group, using appropriate financial instruments. In France, RTL Radio France could lose key advertising customers due to the planned deregulation of TV advertising.

Random House is dependent on the economic climate in North America and in particular on consumer spending. Weakness in the smaller markets in Great Britain, Germany and the Spanish-speaking countries would also have a negative influence on income for this segment. Limited perspectives for growth in the book market in many regions and a process of concentration for many large customers lead to intensive competition with related procurement and sales risks.

At Gruner + Jahr, advertising and sales revenues, as well as the pattern of sales at printers, are directly dependent on growth of the sales and advertising markets for magazines. This is particularly true for the core markets of Germany, France and the US. It can be assumed that competition will grow in the expanding Russian and Chinese markets. An appropriate marketing strategy and improvements to individual products are intended to maintain or even improve this segment's market position.

BMG continues to operate in a challenging environment. The group generates a major part of its revenues from the sale of CDs and DVDs. In addition to other factors, the unlicensed use of copyrights owned by BMG in the form of burning CDs, among other activities, leads to a shrinking market for recorded music and hence to a decrease in revenues for BMG. As all other record companies, BMG is engaged in efforts to staunch such unlicensed copying activities. Although significant efforts have been made and some advances gained, the risk to BMG and the entire industry remains high. Changes in musical tastes and new trends in consumer behavior are a great challenge to BMG. Hence, new forms of artists' contracts are being examined, to bind the interests of artists and BMG closer to one another and secure new sources of revenue.

To ensure BMG's continued success in light of difficult times in the music industry, Bertelsmann and Sony Corporation of America agreed in December to merge their music divisions. BMG and Sony Music Entertainment plan to contribute their respective recording divisions to the "Sony BMG" joint venture, to be headquartered in New York. This merger and formation of a new company, Sony BMG, is subject to antitrust approval. BMG will continue to operate its business in the ordinary course until the regulatory process is completed.

The Arvato segment, in particular the Arvato Print and Arvato Storage Media business areas, operate in markets which are affected by intense competition and overcapacity. Due to its diversified range of services and global reach, Arvato is nevertheless confident that it can counter regional and industry-specific economic risks. As a producer of physical storage media, the weak music market with a decline in CD volumes represents a risk for Arvato Storage Media. It is uncertain whether the CD business will stabilize or whether its decline can be entirely compensated, and in time, by growth in the DVD business.

With its book and music clubs located in many countries throughout the world, Direct Group is also dependent on the overall state of the economy and consumer confidence, coupled with intense competition. Measures introduced in the Clubs' marketing and program policies are yielding positive results, although further improvements, primarily in capturing and keeping new customers, remain a major challenge for Direct Group. In certain countries, chiefly by the book clubs in Great Britain and Germany and the music club in the US, the new strategic direction and consolidation are not yet concluded.

As an international group, Bertelsmann is subject to several legal risks. This applies particularly to legal disputes in the US, where there are legal institutions unknown in Germany, such as class actions, punitive damages and pre-trial discovery. The outcomes of currently

asserted or future unasserted lawsuits cannot be foreseen with any degree of certainty, nor can they be entirely influenced. Legal risks could arise from the following: Various music publishers and record labels submitted claims against Bertelsmann at a New York court in 2003. The claimants mainly state that, by granting a loan, Bertelsmann enabled Napster, a former music file sharing service, to survive longer than it would have been able to without a loan. Hence, the argument goes, Bertelsmann allegedly contributed to the breaches of copyright by Napster's users, to which Napster itself allegedly also contributed.

Bertelsmann is convinced that these claims are without any foundation or merits and, accordingly, has filed a motion to dismiss the complaints with the court. No decision has yet been reached on Bertelsmann's motion to dismiss.

After the End of the Fiscal Year

In February 2004, a contract was signed for the sale of the Bertelsmann building on Times Square in New York City. Bertelsmann entered into a leasing contract for this building with a purchase option at a fixed price in 1992. The building has been sold to an investor. Bertelsmann will lease back part of the building for a period of ten years.

Outlook

The first weeks of 2004 indicate a worldwide economic recovery. Bertelsmann expects a slight upturn in the international media markets in 2004. While developments in Germany are subject to cautious optimism, the major international markets are expected to show stronger growth. Bertelsmann expects stable consolidated revenues for the year (before currency effects), and continuing improvement in the operating results.

In the years ahead, Bertelsmann will focus on intensifying innovation and accelerating expansion under the terms of the "Growth and Innovation" (GAIN) initiative. Core business optimization and medium-term creation and expansion of new business will yield a portfolio that lastingly safeguards the competitiveness and profitability of the group. The medium-term goal of a ten percent return on sales remains in place. Measures ranging from shared creation of media content to cooperative utilization of external customer relationships will serve to further tap into synergy potential and additional income streams.

The RTL Group expects moderate growth in key advertising markets in 2004. The elimination of restructuring costs and value adjustments to licenses will improve results. On the other hand, the group will face start-up expenses for building its business in Eastern Europe.

Random House expects an improved consumer climate in Europe and the US. In Germany, the division will pursue the integration of Heyne Verlag acquired in 2003.

Gruner + Jahr expects stable earnings in the international magazine business and further improved results in Germany in 2004. There are plans to continue impelling the development of new products, and increase efforts to expand on existing publications.

The planned merger between BMG's recorded music business and that of Sony Music Entertainment into a joint venture is subject to approval by the antitrust authorities. They are not expected to reach their decisions before the second half of 2004. BMG expects a further shrinkage of the global music market during the year. Regardless of the progress of the planned joint venture with Sony Music Entertainment, the division will reorganize its operations in North America to realize additional cost savings.

Arvato expects that earlier cost-cutting measures and productivity improvements will generate positive earnings contributions in 2004. Start-up costs for a new rotogravure plant in Italy and for restructuring measures in the Arvato Systems unit will impact results.

As a result of restructuring measures and portfolio streamlining in the past few years, Direct Group expects improved results in nearly all its Clubs in 2004, except its start-up operations in Asia. The division will invest in building a chain of stores in China and is reviewing the potential for new business in Eastern Europe.

Supervisory Board Report

During fiscal year 2003, the Supervisory Board fulfilled the duties incumbent upon it by law, the articles of association and by-laws. The Supervisory Board was involved in all decisions of key relevance to the company. The Supervisory Board received regular oral and written reports on the business developments, the state of the company and plans for major investments. It also reviewed the company's significant business transactions and strategic alignment with the Executive Board, and monitored the management of the company.

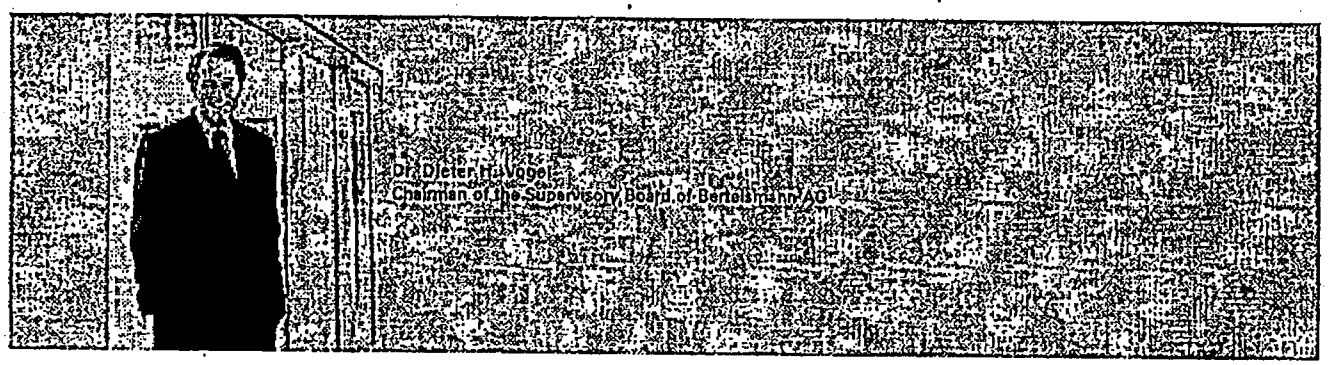
During fiscal year 2003, the Supervisory Board convened for four regular meetings. The Chairman of the Supervisory Board was also in contact with the Executive Board beyond the Supervisory Board meetings and regularly obtained information about current developments and important business transactions. Between meetings, the Supervisory Board was notified, in writing, about projects and plans that were of special relevance and urgency to the company, and – if applicable – asked for its opinion and/or decision.

The Bertelsmann AG consolidated financial statements and the group management report for the fiscal year from January 1 through December 31, 2003 were audited by the KPMG Deutsche Treuhand-Gesellschaft Wirtschaftsprüfungsgesellschaft, Berlin, and received an unqualified auditor's opinion.

The Supervisory Board Audit and Finance Committee determined the main focuses of the annual audit, together with the auditors. The committee discussed the findings of the audit in detail. The auditors attended the Supervisory Board Audit and Finance Committee financial review meeting and submitted their report. The Supervisory Board noted and accepted the findings of the audit. After its own, final scrutiny of the consolidated financial statements and the group management report, the Supervisory Board raises no objections. The Supervisory Board approves the consolidated financial statements as prepared by the Executive Board.

During the year under review, the following changes occurred in the composition of the Supervisory Board: In July, Bertelsmann AG's shareholders appointed Christian van Thillo, CEO of De Persgroep NV, as a new Supervisory Board member upon the Supervisory Board's proposal. Gerd Schulte-Hillen, who chaired the Supervisory Board since November 1, 2000, resigned from his Supervisory Board mandate on December 31, 2003 by mutual agreement with the shareholders. The Supervisory Board thanks Gerd Schulte-Hillen for his great dedication as its Chairman and for his many achievements for the company and its employees in his more than 34 years with the Bertelsmann group. Effective January 1, 2004, the Supervisory Board elected Dr. Dieter H. Vogel, the former Vice-Chairman of the Supervisory Board, as its new Chairman. Prof. Dr. Jürgen Strube is the new Vice-Chairman. A replacement for the Supervisory Board seat that was vacated upon Gerd Schulte-Hillen's departure will be decided upon at a later point in time.

The year just past also saw the following change in Bertelsmann AG's Executive Board: With the successful sale of Bertelsmann Springer, Dr. Arnold Bahlmann, most recently President and CEO of Bertelsmann Springer, left the Bertelsmann AG Executive Board and the company on June 30, 2003. The Supervisory Board thanks Mr. Bahlmann for his past work.



Dr. Dieter H. Vogel
Chairman of the Supervisory Board of Bertelsmann AG

The recovery of the international media markets expected for 2003 largely failed to materialize. Therefore, the Supervisory Board welcomes the fact that the Executive Board systematically and successfully continued on its consolidation course to improve operating profitability and pay down net financial debt. In this connection one topic that preoccupied the Supervisory Board was the sale of the Bertelsmann Springer trade publishing group, which also served to focus Bertelsmann's core media business on entertainment media. The sale of Bertelsmann's holdings in the American e-commerce vendor Barnesandnoble.com concluded the company's divestiture of media e-commerce and focused Bertelsmann AG's end-customer business on book and music clubs. The integration of the music company, Zomba, into BMG begun early in the year was repeatedly an object of discussion in the Supervisory Board. The continued prospects of the music business were at the heart of the strategy dialog between the Executive and Supervisory Boards in 2003. After reviewing the possible courses of action, Bertelsmann selected Sony as its strategic partner and decided to merge its recorded music business with that of Sony Music. Depending on the course of the antitrust approval procedure, the Supervisory Board will closely accompany the preparations for and implementation of the recorded-music merger, which is scheduled for the second half of 2004.

The Supervisory Board supports the "Growth and Innovation – GAIN" initiative initiated by the Executive Board at the end of the fiscal year, which strives to further improve the profitability of core business in the years ahead while generating organic growth in existing and new businesses.

The Supervisory Board supports the "Growth and Innovation – GAIN" initiative initiated by the Executive Board at the end of the fiscal year, which strives to further improve the profitability of core business in the years ahead while generating organic growth in existing and new businesses. The Supervisory Board expresses its gratitude and appreciation to the company's Executive Board, executives and employees for their entrepreneurial achievements and contributions to Bertelsmann's continued development in the year just past.

Gütersloh, March 26, 2004

Dr. Dieter H. Vogel

Corporate Governance at Bertelsmann

Bertelsmann regards exemplary corporate governance as an important element in its corporate culture, and as part of its overall objective of permanent and sustainably increasing the value of the company. Bertelsmann's corporate governance is embedded in its corporate constitution, whose permanent enhancement is one of the management's key concerns.

Management and Supervision: The Executive Board and Supervisory Board

The Bertelsmann AG Executive Board has direct responsibility for the management of the company. The members of the Executive Board manage the company jointly. The Executive Board is appointed by the Supervisory Board, which is committed solely to the company's interests and is independent in its decision-making. The Supervisory Board supervises the Executive Board and advises it in strategic matters and important business transactions.

The Executive Board and the Supervisory Board have a close and mutually trusting working relationship, thereby reconciling the demands of effective corporate governance with the necessity of rapid decision-making. Fundamental matters of corporate strategy and its implementation are discussed and coordinated in joint sessions.

The members of the Supervisory Board are elected by the Bertelsmann AG General Meeting. The Bertelsmann Verwaltungsgesellschaft mbH (BVG) holds 75 percent of the voting rights at the General Meeting; Groupe Bruxelles Lambert (GBL) holds the remaining 25 percent. The BVG shareholders' meeting decides on the exercise of BVG's voting rights at the General Meeting. BVG's shareholders consist of the Chairman of the Supervisory Board along with another member of the Bertelsmann AG Supervisory Board, the Chairman & CEO, a member of the senior management of a company in which Bertelsmann owns a stake, an employee representative, and three representatives of the Mohn family. BVG's mandate is to manage the shareholder interests of the nonprofit Bertelsmann Foundation and of the Mohn family, and to ensure continuity in the company's development. This includes safeguarding, implementing and enhancing the corporate culture developed by Reinhard Mohn.

Bertelsmann has always played a pioneering role in developing a modern and active supervisory board function. In the mid-1980s, certain tasks and functions associated with the Supervisory Board were delegated to Supervisory Board committees. This delegation of responsibility calls for professional competence of the committee members. Empowering the committees gives the Supervisory Board more time to focus on decisions reserved for the plenum and on strategically important decision-making processes. The committees' decisions are then presented to the plenum. Motions that exceed the committees' competence will be dealt with and decided by the plenum based on a recommendation by the related committee. The same applies for important personnel issues.

Bertelsmann has always played a pioneering role in developing a modern and active supervisory board function.

In addition to the Personnel Committee, the Bertelsmann AG Supervisory Board has a Strategy and Investment Committee, an Audit and Finance Committee and a Working Group of the Employee Representatives. The Supervisory Board has become more international in the recent past. At the same time, its composition is clearly aligned to industrial and capital market experience. Members are elected based on the criterion of complementary skills.

Continuous Enhancement of Corporate Governance

At Bertelsmann, the enhancement of corporate governance is regarded as a permanent process. The performance of the Executive and Supervisory Boards is therefore regularly evaluated by the Supervisory Board. Bertelsmann AG is one of the first major German stock corporations to have commissioned a Board Review, a third-party review of its supervisory board performance. A benchmark survey – part of the Board Review – was completed in 2003. It compared Bertelsmann with international companies reputed to have the best corporate governance. Bertelsmann achieved an excellent placement in this comparison. Recommendations for further evolving corporate governance at Bertelsmann in several areas were derived from the survey. One measure to be implemented will be to systematically promote the Supervisory Board members' proficiency for talks by strengthening their knowledge of Bertelsmann's markets and operations.

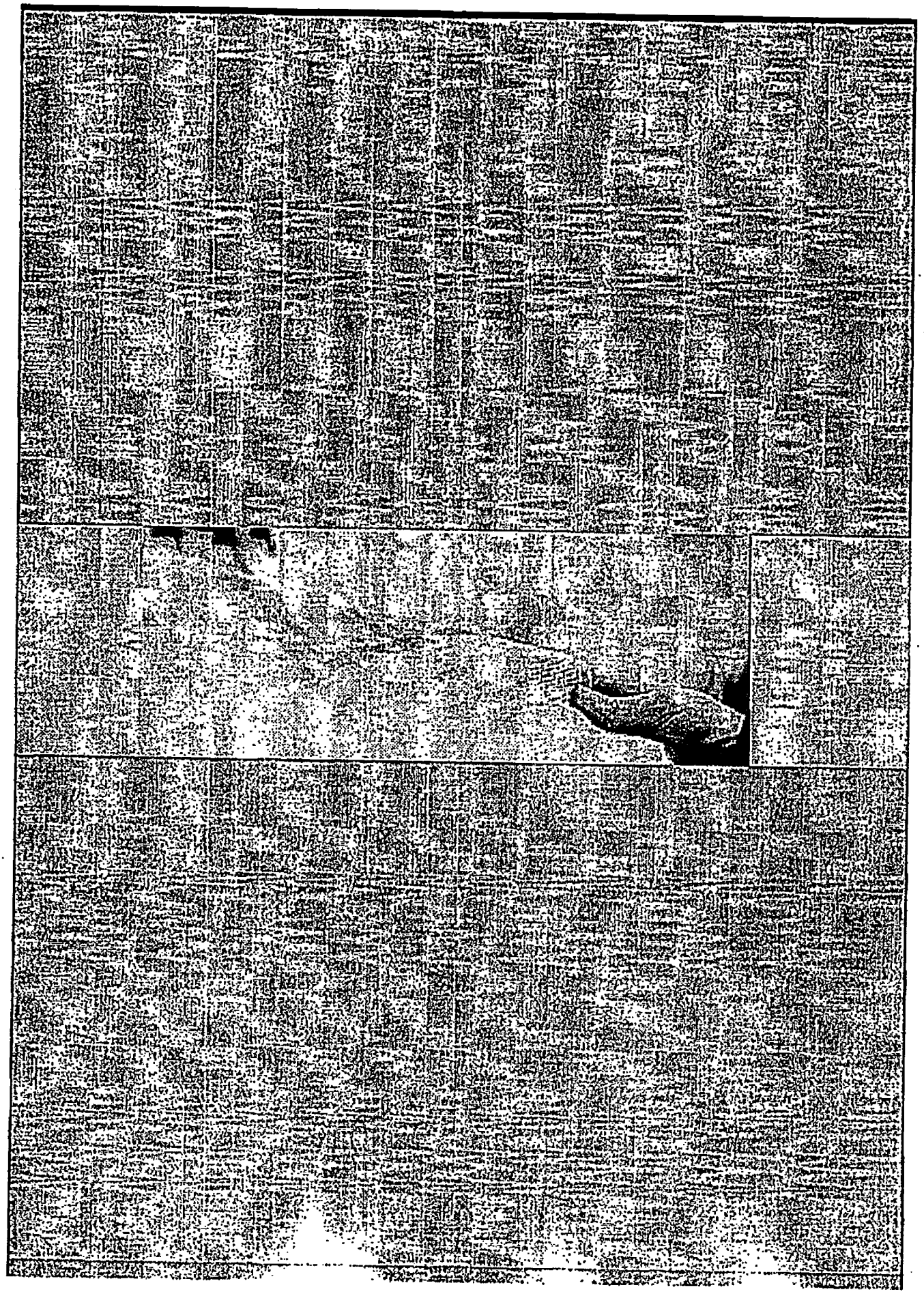
Bertelsmann AG is one of the first major German stock corporations to have commissioned a Board Review, a third-party review of its supervisory board performance.

To ensure that Corporate Governance standards remain high, the Executive and Supervisory Boards have initiated an interdisciplinary Corporate Governance committee. This committee systematically analyzes current developments and international "Best Practice" in the field of Corporate Governance and compares them with existing Corporate Governance structures and processes at Bertelsmann.

Since the German Corporate Governance Codex came into effect, its guidelines and recommendations have also provided a benchmark for corporate management and supervision at Bertelsmann. The internal rules and procedures of the Bertelsmann Executive Board, Supervisory Board and Annual General Meeting, as well as the company's accounting and transparency principles, are measured by this standard. Bertelsmann AG, despite being an unlisted corporation with a limited number of shareholders, has decided to largely adopt the recommendations and suggestions of the German Corporate Governance Codex, which addresses listed corporations. Bertelsmann therefore essentially complies with the standard for listed corporations set by the German Corporate Governance Codex.

The Executive Board

The Supervisory Board



Consolidated Income Statement | Consolidated Balance Sheet
Consolidated Cash Flow Statement | Consolidated Statement of Changes in Shareholders' Equity
Segment Reporting | Notes | Boards/Mandates | Auditor's Report

Consolidated Income Statement in € millions

	Notes	2003	2002
Revenues	1	16,801	18,312
Other operating income	2	181	768
Change in inventories		126	(59)
Own costs capitalized		124	22
Cost of materials	3	(4,658)	(5,247)
Royalty and license fees		(1,650)	(1,655)
Personnel costs	4	(4,151)	(4,554)
Amortization of intangible assets and depreciation of property, plant and equipment	5	(1,421)	(1,507)
Other operating expenses	6	(5,445)	(5,780)
Impairment of goodwill and rights similar to goodwill	7	(219)	(1,661)
Results from associated companies	8	(25)	(78)
Income from other participations	9	(19)	33
Special items	10	547	2,807
– *of which gain on sale of discontinuing operation*	10	628	–
Earnings before interest and taxes		733	1,291
Net interest	11	(95)	(50)
Other financial expenses and income	11	(27)	(216)
Financial result		(122)	(266)
Income taxes	12	(203)	(57)
Net income before minority interests		408	968
Minority interests		(54)	(40)
Net income after minority interests		354	928

Reconciliation to Operating EBITA

Earnings before interest and taxes		733	1,291
Special items	10	(547)	(2,807)
Amortization of goodwill and rights similar to goodwill		923	2,432
Amortization of goodwill from associated companies		14	20
Operating EBITA	13	1,123	936
Operating EBITDA	13	2,544	1,888

Consolidated Balance Sheet in € millions

	Notes	12/31/2003	12/31/2002
Assets			
Non-current assets			
Goodwill		8,832	7,787
Other intangible assets		901	1,231
Property, plant and equipment		2,254	2,802
Investments in associates		398	582
Other financial assets		419	404
		10,604	12,806
Current assets			
Inventories		1,820	1,961
Trade accounts receivable		3,041	3,251
Other receivables and other assets		2,573	2,780
Cash and cash equivalents		1,642	977
		9,076	8,959
Deferred tax assets		275	237
Prepaid expenses		209	176
		20,164	22,188
Equity and liabilities			
Equity			
Subscribed capital		606	606
Capital reserve		2,725	2,725
Retained earnings		3,181	2,428
Net income after minority interests		154	928
Shareholders' equity		6,666	6,685
Minority interests		965	1,059
		7,631	7,744
Third-party liabilities			
Profit participation capital		706	706
Provisions			
Provisions for pensions and similar obligations		1,701	1,737
Other provisions		2,880	2,944
		4,581	4,681
Liabilities			
Financial debt		2,452	3,718
Trade accounts payable		2,738	2,693
Other liabilities		1,600	2,031
		6,800	8,442
Deferred tax liabilities		114	83
Deferred income		332	532
		20,164	22,188

Consolidated Cash Flow Statement in € millions

	2003	2002
Net income before minority interests	[illegible]	964
Depreciation and write-ups of non-current assets	580	3,178
Change in long-term provisions	(5)	(83)
Other cash/non-cash items	(566)	(2,548)
Cash flow according to DVFA/SG	[illegible]	[illegible]
Result from disposals of non-current assets	[illegible]	(4)
Change in inventories	[illegible]	27
Change in receivables, other assets and prepaid expenses	58	336
Change in short-term provisions, other liabilities and deferred income	(31)	(260)
Net cash from operating activities	[illegible]	[illegible]
Investments in:		
– intangible assets	(66)	(236)
– property, plant and equipment	(113)	(543)
– financial assets	(49)	(72)
– purchase price for acquired entities (net of acquired cash)	(39)	(4,412)
Proceeds from disposals of non-current assets	637	2,552
Net cash from investing activities	(670)	(2,751)
Issue of bonds and promissory notes	887	145
Change in financial debt	(1,292)	905
Change in shareholders' equity	(5)	(199)
Dividend Bertelsmann AG and minority interests	(337)	(353)
Net cash from financing activities	(747)	498
Change in cash and cash equivalents	[illegible]	[illegible]
Exchange rate movements and other changes in cash and cash equivalents	(95)	(69)
Cash and cash equivalents at the beginning of the period	977	2,044
Cash and cash equivalents at the end of the period	[illegible]	977

Details of the cash flow statement are set out in note [illegible]

Consolidated Statement of Changes in Shareholders' Equity in € millions

	Subscribed capital	Capital reserve	Retained earnings	Other comprehensive income: Currency translation differences	Other comprehensive income: Available-for-sale securities	Other comprehensive income: Derivative financial instruments	Net income after minority interests	Shareholders' equity	Minority interests	Total
Balance at Dec. 31, 2001	606	2,725	1,808	(11)	50	(45)	945	6,303	2,081	8,384
Change in shareholders' equity due to										
– Dividends		–		–		–	(400)	(400)	(63)	(463)
– Increase in group share of RTL Group		–		–		–			(974)	(974)
– Other changes		–		–		–			(96)	(96)
Other comprehensive income										
– Currency translation differences		–		(97)		–		(97)	(15)	(112)
– Other changes		–		–	(55)	(94)		(149)	(15)	(164)
Change recognized in income										
– Transfer to retained earnings		–	649	–		–	(649)			
– Net income after minority interests		–		–		–	928	928	40	968
Balance at Dec. 31, 2002	606	2,725	2,457	(14)	(4)	(139)	928	6,685	1,059	7,744
Change in shareholders' equity due to										
– Dividends		–		–		–	(40)	(40)	(67)	(107)
– Other changes		–	(18)	–		–		(18)	(38)	(56)
Other comprehensive income										
– Currency translation differences		–		54		–		54	(12)	42
– Other changes		–		–	27	4		31	(1)	30
Change recognized in income										
– Transfer to retained earnings		–	680	–		–	(680)			
– Net income after minority interests		–		–		–	154	154	54	208
Balance at Dec. 31, 2003	606	2,725	3,127	40	(1)	(135)	154	6,668	995	7,663

Details of the statement of changes in shareholders' equity are set out in note 5

Segment Reporting Primary Format in € millions

	RTL Group 2003	RTL Group 2002	Random House 2003	Random House 2002	Gruner + Jahr 2003	Gruner + Jahr 2002	BMG 2003	BMG 2002	Arvato 2003	Arvato 2002
Consolidated revenues	4,393	4,355	1,755	1,987	2,471	2,788	2,880	2,689	3,070	3,021
Intercompany revenues	59	7	21	8	10	14	32	25	569	647
Divisional revenues	4,452	4,362	1,776	1,995	2,481	2,800	2,712	2,714	3,639	3,668
Operating EBITA	503	465	147	168	234	226	110	125	261	217
Special items	(1)	(93)	(2)	4	71	173	(73)	8		(3)
EBITA	502	372	145	172	305	399	37	133	261	214
Amortization of goodwill and rights similar to goodwill	(305)	(321)	(72)	(72)	(109)	(165)	(160)	(1,354)	(35)	(56)
Amortization of goodwill from associates	(12)	(8)		–		(5)	(2)	(1)		(6)
Earnings before interest and taxes	185	43	73	100	196	229	(125)	(1,222)	226	152
Operating EBIT	186	136	75	96	125	56	(92)	(1,230)	226	155
Depreciation, amortization and impairments	609	626	104	97	192	266	207	1,318	235	268
Investments	206	2,277	75	120	88	99	72	2,338	224	258
Segment assets	6,525	9,115	1,893	1,998	1,448	1,721	2,529	3,145	1,984	1,802
Segment liabilities	1,952	1,984	765	539	570	608	1,406	1,756	1,248	840
Result from associates*	4	26	(1)	–	2	(9)	(10)	(50)	(1)	1
Investments in associates	334	458	2	2	9	26	4	12		6
Employees (at closing date)	7,254	7,378	5,526	5,626	11,362	11,367	4,800	5,452	31,405	31,174
Employees (average)	7,269	7,199	5,487	5,723	11,049	12,056	5,090	5,131	31,245	30,710

*1/1/–3/31/2003
*Results after amortization of goodwill

Secondary Format in € millions

	Germany 2003	Germany 2002	Rest of Europe 2003	Rest of Europe 2002	USA 2003	USA 2002	Other countries 2003	Other countries 2002	Group 2003	Group 2002
Consolidated revenues	5,168	5,691	6,488	6,498	4,210	5,029	939	1,094	16,801	18,312
Segment assets	7,985	9,013	5,616	6,868	3,138	4,053	1,142	418	17,881	20,350
Investments	316	1,115	270	1,726	150	2,287	25	135	761	5,263

Details of the segment reporting are set out in note ⊙

Direct Group 2003	Direct Group 2002	Total Divisions 2003	Total Divisions 2002	Bertelsmann Springer 2003	Bertelsmann Springer 2002	Corporate 2003	Corporate 2002	Consolidation 2003	Consolidation 2002	Total Group 2003	Total Group 2002
2,284	2,695	16,533	17,533	(59)	730	(10)	49	(4)	–	16,801	18,312
(22)	12	713	713	1	1	(1)	1	(4)	(715)	–	–
2,286	2,707	17,246	18,246	158	731	(11)	50	(14)	(715)	16,801	18,312
2,[illegible]	2,[illegible]	2,[illegible]	1,[illegible]	[illegible]	(71)	(67)	(190)	[illegible]	(6)	[illegible]	2,926
(19)	(57)	143	32	[illegible]	–	405	2,775	[illegible]	–	547	2,807
152	(207)	1,402	1,083	(1)	(71)	318	2,595	[illegible]	(6)	1,670	3,743
(59)	(173)	(720)	(2,141)	(9)	(83)	(199)	(209)	[illegible]	1	(973)	(2,432)
	–	(5)	(20)	[illegible]	–	–	–	[illegible]	–	(14)	(20)
113	(380)	669	(1,078)	(10)	(12)	124	2,386	(49)	(5)	733	1,291
(35)	(32)	526	(110)	(9)	(12)	(281)	(389)	(49)	(5)	(46)	(1,516)
[illegible]	247	[illegible]	2,022	[illegible]	107	[illegible]	253	[illegible]	(1)	1,880	3,181
99	84	[illegible]	5,156	[illegible]	28	[illegible]	79	[illegible]	–	[illegible]	5,263
877	1,022	15,256	18,803	[illegible]	676	[illegible]	838	[illegible]	33	17,88[illegible]	20,350
522	573	[illegible]	6,496	[illegible]	265	[illegible]	645	[illegible]	(2)	[illegible]	7,408
(7)	(1)	[illegible]	(33)	[illegible]	1	(12)	(67)	[illegible]	–	(26)	(99)
[illegible]	11	[illegible]	515	[illegible]	2	[illegible]	85	[illegible]	–	398	602
11,893	12,309	72,309	74,308	[illegible]	5,282	[illegible]	1,044	[illegible]	–	73,221	80,832
11,893	12,442	72,923	73,261	1,282	5,364	[illegible]	1,317	[illegible]	–	75,118	79,942

Notes

General Principles

The consolidated financial statements of Bertelsmann AG for the year ended December 31, 2003 have been prepared in accordance with International Financial Reporting Standards (IFRS), including all currently applicable standards and interpretations issued by the International Accounting Standards Board (IASB). Except for the measurement of financial instruments, the consolidated financial statements have been prepared using the historical cost principle in compliance with IFRS.

The consolidated financial statements prepared in accordance with IFRS are consistent with the European Union's directive on group accounting and reporting (Directive 83/349/EEC). The main differences between IAS and HGB are set out in note 34. As the conditions for applying § 292a of the German Commercial Code (HGB) are met, consolidated financial statements have not been prepared in accordance with the regulations set out in HGB.

The consolidated financial statements have been prepared in euros; all amounts are stated in millions of euros (€ million). For the sake of clarity, certain captions in the income statement and in the balance sheet have been combined. These captions are disclosed in more detail and explained in the notes. The income statement is classified using the nature of expense method. Because of their importance, effects from changes to the portfolio, restructuring, and value adjustments are shown separately as special items. For the sake of comparability, previous-year figures are shown adjusted accordingly.

Consolidation

Consolidation Methods

All material subsidiaries controlled either directly or indirectly by Bertelsmann AG as defined by IAS 27 have been consolidated. Material jointly-controlled companies as defined by IAS 31 have been proportionately consolidated. Material associated companies as defined by IAS 28 are reported using the equity method. This is deemed to be the case if between 20 percent and 50 percent of the company's voting stock is held. A list of material subsidiaries and participations is set out in note 37. All consolidated financial statements of the Bertelsmann Group are prepared in accordance with uniform accounting policies.

Investments in subsidiaries are consolidated using the purchase method, by which, at the time of purchase, the acquisition cost of the investment is offset against the interest in the fair values of the net assets shareholders' equity acquired. Deferred taxes are recognized on temporary differences arising as a result of stating the proportion of assets and liabilities acquired at fair values at the time of acquisition, to the extent such fair value adjustments are not also recognized for tax purposes. Any remaining difference is recognized as goodwill and is amortized straight-line over its estimated useful life. Differences arising as a result of stating assets and liabilities acquired at their fair values are carried forward, depreciated or released in the periods following the acquisition, depending on the nature of the assets and liabilities to which they relate. To the extent it does not relate to expected future losses, any negative goodwill is presented as a deduction from assets in the balance sheet and recognized as income on a systematic basis in accordance with IAS 22. Investments in proportionately consolidated companies are consolidated according to the same principles.

Investments in associated companies using the equity method are included at the proportionate share of the shareholders' equity of the investment. The same method as for fully-consolidated subsidiaries is used when accounting for differences between the purchase cost at the time of acquisition and the share of net assets acquired. Associated company losses which exceed their carrying values are not recognized unless there is an obligation to make additional contributions.

All intercompany gains, losses, revenues, expenses, income, assets, liabilities, and provisions falling within the scope of the consolidation are eliminated. Deferred taxes are recognized on temporary differences arising on consolidation in accordance with IAS 12. Proportionate consolidations are carried out according to the same principles.

Scope of Consolidation

The scope of consolidation, including Bertelsmann AG, comprises 930 (previous year: 1,080) fully consolidated companies. All domestic and international affiliated companies are consolidated, with the exception of 137 companies (previous year: 157) which are not consolidated because they do not have significant business operations of their own and overall have no material impact on the group's net assets, financial position and results of operations.

The scope of consolidation changed during the year as follows:

Change in Scope of Consolidation

	Domestic	Foreign	Total
Consolidated at December 31, 2002	316	764	1,080
Additions	17	32	49
Disposals	87	112	199
Consolidated at December 31, 2003	246	684	930

Purchase price payments deducted by acquired cash and cash equivalents amounted to € 139 million.

At the beginning of 2003, Random House Deutschland signed an agreement to acquire Ullstein-Heyne-List (UHL), the publishing group. As the German antitrust authorities raised objections to the purchase of the entire publishing group, the Econ, Ullstein and List publishing units were sold on to Bonnier, the Swedish media group. The first-time consolidation of Heyne Verlag at December 31, 2003 yielded corporate goodwill of € 18 million.

Negotiations for the sale of Bertelsmann Springer, a separate segment, were successfully concluded in the first half of the year. At a purchase price of € 1,050 million free of debt, the gain on disposal was € 628 million.

Effective December 31, 2003, G+J sold its East European newspaper business. The gain on deconsolidation was € 72 million.

In September 2003, Direct Group sold its participation in Barnesandnoble.com, the US e-commerce company, in the process realizing capital gains of € 145 million. This associated company was stated at equity in the consolidated financial statements.

Acquisitions and disposals during the year had the following effect on Bertelsmann Group's assets and liabilities as at the date of their initial consolidation or deconsolidation:

Effects of Acquisitions and Disposals in € millions

	Additions 2003	Disposals 2003	Net 2003	Additions 2002	Disposals 2002	Net 2002
Non-current assets	209	578	(369)	591	173	418
Current assets	65	361	(296)	907	61	846
Liabilities	58	484	(426)	783	146	637

119 (previous year: 106) joint ventures were proportionately consolidated in the consolidated financial statements.

The proportionate consolidation of joint ventures had the following effect on Bertelsmann Group's assets, liabilities, income and expenses:

Effects of Proportionate Consolidation in € millions

	12/31/2003	12/31/2002
Non-current assets		
Current assets	249	265
	1,057	1,089
Liabilities		
	702	1,237
Income		
	1,708	1,781
Expense	1,653	1,782

Of the 167 (previous year: 183) associated companies, 94 (previous year: 93) are reported using the equity method; the remainder are reported at acquisition cost owing to their minor importance to the Bertelsmann consolidated financial statements.

A list of the Bertelsmann Group's shareholdings will be filed with the commercial register at the district court in Gütersloh (department B no. 3100). For 2003, those domestic subsidiaries listed in note 38 took advantage of the exemption from having their annual financial statements audited and published pursuant to § 264 para. 3 HGB and § 264 b no. 4 HGB.

Currency Translation

In Bertelsmann AG's consolidated financial statements, the financial statements of foreign subsidiaries are translated into euros using the reporting currency concept as described in IAS 21. Since all subsidiaries conduct their financial, commercial and organizational activities independently, their respective local currency is the functional currency. Assets and liabilities are translated at the closing-date rate, while the income statement is translated at the average rate for the year. Currency translation differences are charged or credited directly to shareholders' equity. Such differences arise from translating items in the balance sheet at different rates compared with the previous year, and from using different rates to translate the income statement and balance sheet. When subsidiaries are de-consolidated, any related cumulative translation differences are reversed and recognized in income.

The following euro exchange rates were used to translate the currencies of those countries which are most significant to the Bertelsmann Group:

Euro Exchange Rates for Major Foreign Currencies

Foreign currency unit per € 1		Average rate 2003	Average rate 2002	Closing rate 12/31/2003	Closing rate 12/31/2002
US dollars	USD	1.1312	0.9416	1.2630	1.0487
Canadian dollars	CAD	1.5898	1.4793	1.6234	1.6550
British pounds	GBP	0.6897	0.6277	0.7048	0.6505
Japanese yen	JPY	131.00	117.79	135.00	124.39
Swiss francs	CHF	1.5172	1.4673	1.5579	1.4524

Accounting Policies

Revenue Recognition

Revenues are recognized when the service has been performed and risks have been transferred, except for revenues recognized using the percentage-of-completion method as set out in IAS 11. Other income is recognized when it is probable that the economic benefits will flow to Bertelsmann Group and the amount can be measured reliably. Expenses are deferred based on underlying facts or the period of time to which they relate.

Interest income and expense are allocated to the period to which they relate. Dividends are recognized in the period in which the distribution is received.

Intangible Assets

Internally generated intangible assets are recognized at their development cost if the conditions for recognition as set out in IAS 38 have been met. Related borrowed capital costs are generally included as set out in IAS 23, but the amounts involved are insignificant to the group. Purchased intangible assets are stated at acquisition cost. Intangible assets are amortized on a straight-line basis over their useful lives. Capitalized software is amortized over a 3 to 4 year period, and licenses are amortized over the term of the respective license agreement. Trademarks are amortized over a maximum period of 15 years, supply rights and long-term subscribers over a maximum of 5 years, and music, film and publishing rights over a maximum period of 20 years. In accordance with IAS 22, goodwill arising on acquisition is recognized and amortized straight-line over probable useful lives of between 3 and 20 years. Goodwill arising on the acquisition of foreign subsidiaries is translated into the Group's reporting currency at foreign exchange rates ruling at the time of initial consolidation.

Property, Plant and Equipment

Property, plant and equipment is measured at acquisition or manufacturing cost less depreciation. The cost of property, plant and equipment produced internally within the group includes direct costs and a portion of overheads directly attributable to their production. The cost of property, plant and equipment whose production takes place over a longer period of time includes third-party interest accrued up to the time of completion. The amounts involved are insignificant to the group. Maintenance expenses are recorded as expense in the period in which they were incurred, whereas costs incurred resulting in a prolongation of the asset's useful life or in an improvement to its use, are recognized as an increase in the carrying value of the asset.

Items included in property, plant and equipment are depreciated straight-line over their estimated useful lives. Such depreciation is based on the following group-wide useful lives:

– Buildings	10 to 35 years
– Plant, technical equipment and machinery	3 to 10 years
– Office furniture and other equipment	3 to 12 years

Leasing

To the extent the Bertelsmann Group assumes all significant opportunities and risks relating to a leased asset and is thus to be seen as the economic owner of the asset (finance lease), the leased asset is recognized in the balance sheet in the amount of the asset's fair value at the inception of the lease or the present value of future lease payments, if lower. Payment obligations arising from finance leases are recognized as leasing liabilities in the same amount.

If it is sufficiently certain that ownership of the leased asset will pass to the lessee at the end of the lease term, the asset is depreciated over its useful life. Otherwise, it is depreciated over the term of the lease. There are no conditional lease payments or subleases.

The leased assets consist mainly of buildings. The finance leases are generally subject to non-cancelable minimum lease terms of approximately 20 years. Upon expiry of this term, the lessee is entitled to purchase the leased asset at its residual value. The installments paid by the lessee under the lease vary in accordance with changes in interest rates paid by the lessor.

In addition to finance leases, the Group has also entered into operating lease agreements. This means that economic ownership of the leased assets lies with the lessor and lease installments are recorded as expenses in the period in which they are due for payment. The total amount of lease installments due over the minimum uncancelable lease terms of these operating leases is disclosed in the notes as part of other financial commitments.

Impairments

As set out in IAS 36, write-downs are made to items included in property, plant and equipment if their recoverable amount is lower than their carrying value. The recoverable amount is the higher of the asset's net selling price and the present value of expected future cash flows from the asset. If cash flows cannot be attributed to the asset itself, the amount of any write-down is computed based on the cash flows of the next higher cash generating unit to which the asset can be allocated. Expected cash flows are generally discounted using an average pre-tax cost of capital (weighted-average cost of capital, WACC) for the group of 12.3 percent. If the reason for a write-down no longer exists, the write-down is reversed unless it was related to goodwill. Any reversal does not exceed the carrying amount that would have been determined if no impairment loss had been recognized in previous years.

Participations and Securities

Significant participations are included using the equity method, and all other participations and other securities included in non-current assets and in current assets in the Bertelsmann Group's consolidated financial statements are classified as available-for-sale or held-to-maturity.

Available-for-sale financial assets are stated at fair value on the balance sheet date in accordance with IAS 39, to the extent fair value can be determined. Any resulting unrealized gains and losses are recorded, net of deferred taxes, directly in shareholders' equity. However, any probable impairment losses which are other than temporary are recognized as an expense in the income statement. If the reasons for recording the write-down no longer exist, the write-down is reversed. Unrealized gains and losses on such financial assets are reclassified to income upon disposal of the asset concerned. If a fair value cannot be determined, the participations and securities are stated at amortized acquisition cost.

Financial assets with fixed payments and maturities and which are held-to-maturity are stated at amortized cost using the effective interest method.

Inventories

Inventories are stated at acquisition or manufacturing cost. Similar inventories are reported at average cost or using the FIFO (first-in, first-out) method. Inventories originating from intra-group suppliers are adjusted to eliminate intercompany profits and are measured at Group's manufacturing cost.

If the acquisition or manufacturing cost exceeds their current fair value at the balance sheet date, inventories are written down to their net realizable value.

Customer-specific Contracts

A small volume of customer-specific contracts are reported in the IAS financial statements using the percentage-of-completion method, which requires revenues and profits from contracts to be recognized according to the percentage-of-completion of the respective project. The percentage-of-completion is calculated as the ratio of contract costs incurred up to the end of the year to total estimated project costs (cost-to-cost method). Irrespective of a project's percentage-of-completion, losses resulting from customer-specific contracts are immediately recognized in full in the period in which the loss is identified.

Receivables

Other receivables and other assets are stated at their nominal value or, where appropriate, at their fair value. Long-term receivables are discounted. Foreign currency receivables are translated at closing-date rates. Allowances are recognized for any discernible risks.

Cash and Cash Equivalents

Cash and cash equivalents include securities with an original maturity of less than three months, bank balances and cash on hand. Amounts in foreign currency are translated using rates ruling at the end of the year.

Deferred Taxes

As set out in IAS 12, deferred tax assets and liabilities are recognized for all temporary differences between carrying amounts reported for tax purposes and those reported in the IAS consolidated balance sheet (with the exception of goodwill not recognizable for tax purposes) and for tax loss carryforwards. Through the deduction of a valuation allowance, deferred tax assets are only reported to the extent to which they can be subsequently utilized. Such taxes are calculated using enacted tax rates that will apply in the future. The effects of changes in tax rates on deferred tax assets and liabilities are recognized in income in the period in which the relevant legislation has been enacted.

Other Comprehensive Income

Other comprehensive income includes foreign currency translation gains and losses, unrealized gains and losses from the fair value recognition of available-for-sale securities and derivatives acting as cash flow hedges, as set out in IAS 39.

Provisions

Provisions for pensions and similar obligations are calculated actuarially using the projected unit credit method as set out in IAS 19, which, in contrast to the entry-age-normal method, includes expected future salary increases. This method involves use of biometric calculation tables, current long-term market interest rates and current estimates of future increases in salaries and pensions. The interest element of pension expense is included in financial expense in the income statement.

With the exception of the other personnel-related provisions calculated as set out in IAS 19, all other provisions have been recognized in line with IAS 37 and to the extent there is a legal or constructive obligation to a third party. Provisions are measured at full cost in the amount of the probable obligation. Long-term provisions are discounted.

Liabilities

Liabilities are stated at nominal values. Long-term liabilities are discounted. Liabilities in foreign currency are translated into the reporting currency at rates ruling at the end of the year.

Derivative Financial Instruments

As set out in IAS 39, all derivative financial instruments are recognized at fair value on the balance sheet. At the time a contract involving a derivative is entered into, it is determined whether it is intended to serve as a fair value hedge or as a cash flow hedge. However, some derivatives do not meet the requirements included in IAS 39 for recognition as a hedge, despite it being their economic purpose. Changes in fair values of derivatives are recorded as follows:

1. Fair value hedge: Fair value changes of these derivatives, which serve as hedges of assets or liabilities, are recorded in the income statement, thereby offsetting the change in fair value of the underlying balance sheet items also included in the income statement.

2. Cash flow hedge: Changes in fair values of these derivatives, which act as hedges of future cash flows, are recorded directly in other comprehensive income. These amounts are released to income in the same period as the underlying transaction affects the income statement.

3. Stand alone (no hedge relationship): Fair value changes of these derivatives, which do not meet the conditions for being recognized as hedges, are recognized in the income statement as held-for-trading financial instruments.

Notes to the Income Statement and Balance Sheet

(1) Revenues in € millions

	2003	2002
Revenues from selling goods and merchandise	9,995	11,372
Revenues from providing services	6,701	6,927
Revenues from use of assets	575	437
Gross revenues	17,271	18,736
Discounts and allowances	(170)	(424)
Revenues	16,901	18,312

(2) Other Operating Income in € millions

	2003	2002
Extra and supplementary income	210	200
Interest and foreign exchange gains	59	26
Prior year income and reimbursements	176	188
Reversal of provisions	122	123
Gains from disposals of non-current assets	39	4
Other	202	229
	812	768

50 Cost of Materials in € millions

	2003	2002
Raw materials and supplies	3,510	3,765
Purchased services	1,148	1,582
	4,658	5,347

51 Personnel Costs in € millions

	2003	2002
Wages and salaries	3,462	3,809
State social security contributions	626	582
Profit sharing	29	34
Expense for pensions and similar obligations	120	101
Other employee benefits	124	29
	4,161	4,555

52 Amortization of Intangible Assets and Depreciation of Property, Plant and Equipment in € millions

	2003	2002
Amortization/depreciation of		
– goodwill	618	701
– other intangible assets	368	318
– property, plant and equipment	436	488
	1,421	1,507

Amortization of other intangible assets includes amortization of step ups arising on initial consolidation as set out in IAS 22. For group management reporting purposes this is classified as amortization of rights similar to goodwill and is treated in the same manner as goodwill. Thus, this amortization does not reduce the EBITA. Amortization of rights similar to goodwill for the year was € 85 million (previous year: € 70 million), impairment write-downs are shown separately.

16 Other Operating Expenses in € millions

	2003	2002
Administrative expenses	1,250	1,328
Consulting and audit fees	177	211
Interest and foreign exchange losses	78	92
Advertising costs	1,022	1,138
Selling expenses	892	1,004
Additions to other provisions	139	59
Allowances on current assets	305	334
Operating taxes	94	88
Losses on disposals of non-current assets	13	58
Other	1,505	1,532
	5,445	6,780

Administrative expenses include travel costs, insurance premiums and communication expenses. Other operating expenses include rentals, repair and maintenance costs and donations.

17 Impairment of Goodwill and Rights Similar to Goodwill in € millions

	Amortization of goodwill	Amortization of rights similar to goodwill	Total 2003	Total 2002
Zomba, BMG				1,292
US publisher, G+J	64		64	85
London Playout Center, RTL Group	53		53	70
Sportfive, RTL Group	48		48	–
Bertelsmann Springer				51
CD Now, Direct Group				39
My Play, Direct Group				27
Handy.de, Corporate Center				20
BCA, Direct Group	17		17	–
National Geographic, G+J	16		16	–
Other	25	12	37	77
	207	12	219	1,661

18 Results of Associated Companies and Participations in € millions

	2003	2002
Income from associated companies	[illegible]	
Expenses from associated companies	[illegible]	49
Amortization of goodwill from associates	[illegible]	(107)
Results of associated companies	[illegible]	(20)
Income from participations	[illegible]	(78)
Expenses from participations	[illegible]	37
Write-downs of investments	[illegible]	(24)
Write-ups of investments	[illegible]	(56)
Results of participations	[illegible]	86

Most of the share of profits of affiliated companies came from RTL II, with € 18 million (previous year: € 27 million), and from MRTL Hungary, with € 6 million (previous year: € 7 million). The share of losses of associated companies included Antena 3, at € 14 million (previous year: € 3 million) Lycos Europe, at € 10 million (previous year: € 32 million), and Bertelsmann Ventures at € 5 million (previous year: € 31 million). Up to the date of sale of Barnesandnoble.com, the share of losses charged against Direct Group's results was € 7 million (previous year: € 28 million).

Bertelsmann had no share in associated companies' contingent liabilities at December 31, 2003 (previous year: € 10 million).

19 Special Items in € millions

	2003	2002
Disposals		
Bertelsmann Springer, Corporate Center	[illegible]	
Barnesandnoble.com, Direct Group	628	-
Eastern Europe newspapers, G+J	[illegible]	-
AOL Europe, Corporate Center	[illegible]	-
Daum, G+J/Direct Group	[illegible]	2,827
Berliner Zeitung, G+J	[illegible]	59
Bad Boy, BMG	[illegible]	138
Other	[illegible]	(56)
Restructurings, Value Allowances	(225)	(50)
Zomba, BMG	[illegible]	
Sportfive, HMG, RTL Group	(3)	68
Elsnerdruck, Arvato	[illegible]	(43)
CCIT, BOL, BeMusic, Direct Group	[illegible]	(14)
Lycos Europe, Musicnet, BC Ventures, Corporate Center	[illegible]	(84)
[illegible]	[illegible]	(36)

Starting this year gains and losses on disposals and exceptional one-time expenses are shown as special items in order to give more transparency to aperiodic influences.

"Other" includes a provision of € 234 million for damages to two former AOL Germany executives granted at first instance in a lawsuit against Bertelsmann. The litigation is connected to the former joint venture AOL Europe. Restructurings reported under special items in 2003 are attributable exclusively to the BMG division, and were caused mostly by the integration of Zomba.

The previous year's € 111 million in restructuring and value adjustments were reclassified from personnel costs (€ 20 million), write-offs of non-current assets (€ 13 million), other operating expenses (€ 57 million) and results of associated companies (€ 21 million).

9 Net Interest in € millions

	2003	2002
Interest and similar income	[illegible]	217
Interest on finance lease	[illegible]	(22)
Interest and similar expenses	(271)	(245)
	(95)	(50)

10 Other Financial Expenses and Income in € millions

	2003	2002
Interest on provisions for pensions and similar obligations	[illegible]	(122)
Dividend entitlement on profit participation certificates	[illegible]	(77)
Other	[illegible]	(17)
	(227)	(216)

13 Income Taxes in € millions

Income taxes, divided between domestic and foreign, current and deferred, are as follows:

	2003 Domestic	2003 Foreign	2003 Total	2002 Domestic	2002 Foreign	2002 Total
Net income before income taxes	(105)	516	411	1,077	(52)	1,025
Current income taxes	[illegible]	(107)	(227)	53	(243)	(190)
Deferred income taxes	[illegible]	25	21	31	102	133
Total income taxes	[illegible]	(172)	(206)	84	(141)	(57)
Net income after income taxes	(136)	344	208	[illegible]	(193)	968

Tax loss carryforwards of € 397 million (previous year: € 152 million) were utilized in 2003, reducing current tax expenses by € 116 million (previous year: € 45 million). Of the tax loss carryforwards utilized, € 17 million related to domestic corporation tax, € 20 million to domestic trade tax and € 360 million to foreign income tax.

Deferred tax assets and liabilities resulted from the following items and factors:

Deferred Taxes in € millions

	12/31/2003 Assets	12/31/2003 Liabilities	12/31/2002 Assets	12/31/2002 Liabilities
Intangible assets	309	67	109	62
Property, plant and equipment	30	120	22	141
Investments	12	15	25	3
Inventories	131	3	80	4
Accounts receivable	203	499	215	560
Prepayments and other assets	132	66	89	80
Provisions	159	33	138	47
Financial debt	68	1	88	6
Accounts payable	43	11	56	6
Prepayments and other liabilities	188	59	197	15
Loss carryforwards	3,644		3,722	–
Valuation allowance	(3,894)		(3,663)	–
Total	1,025	864	1,078	924
Netting	(750)	(750)	(841)	(841)
Carrying amount	275	114	237	83

Deferred tax assets and liabilities are offset against each other if they relate to the same tax authority and can be offset.

Valuation allowances are deducted from deferred tax assets to the extent it is improbable they can be utilized in the foreseeable future.

As a result of the law enacted in December 2003 to implement the German Federal Government's declaration relating to the parliamentary committee's recommendation on the Tax Benefit Reduction Law (the so-called Korb II law), only 95 percent of gains on disposals of shares in limited liability companies are tax-free, and the treatment of losses was also significantly changed. In future, tax loss carryforwards of corporates can be entirely deducted from the following year's taxable profit up to a maximum amount of € 1 million (the so-called base amount). Only up to 60 percent of any remaining taxable profit may then be offset against tax loss carryforwards from previous years. The minimum tax rule enters into force effective January 1, 2004 and also applies to trade tax loss carryforwards. Tax losses in Germany may still be carried forward for an indefinite period of time.

The temporary differences and tax loss carryforwards against which a valuation allowance was made can be carried forward for the following limited periods of time:

Maturity in € millions

	12/31/2003	12/31/2002
Can be carried forward for more than 5 years	11,618	11,049
Can be carried forward for up to 5 years	131	138

A reconciliation of expected net tax income/expense to actual tax income/expense is shown in the following table:

Reconciliation of Expected Net Tax in € millions

	2003	2002
Earnings before income tax	[illegible]	1,025
Income tax rate applicable to Bertelsmann AG	39.61%	38.29%
Expected tax expense	[illegible]	(392)
The tax effects of the following items led to differences between the expected and actual tax expense:		
Adjustment for differing national tax rates	[illegible]	4
Changes in tax regulations or tax status	[illegible]	(7)
Amortization of goodwill not recognized for tax purposes	[illegible]	(770)
Tax-free disposal gains	[illegible]	1,101
Changes to tax-related factors in previous year	[illegible]	67
Tax reduction because of dividends	[illegible]	50
Valuation allowance on deferred tax assets, current year	[illegible]	(93)
Permanent differences	[illegible]	(25)
Other	[illegible]	(2)
Total	[illegible]	335
Actual tax expense	[illegible]	(57)

The income tax rate applicable to Bertelsmann AG consists of corporation tax, solidarity surcharges and trade tax, which is a deductible expense for corporation tax purposes. The effective tax rate changed only for 2003 due to the one-time solidarity surcharge for flood victims:

Effective Tax Rate

	2003	2004 et seq.
Corporation tax including solidarity surcharges	27.96%	26.38%
Trade tax	11.65%	11.91%
Effective income tax rate	[illegible]	[illegible]

As of December 31, 2003 there were still corporation tax credits available on distributions of € 103 million.

18 Non-current Assets in € millions

	Goodwill	Other intangible assets	Property, plant and equipment	Investments in associates	Other financial assets	Total
Acquisition/production cost						
Balance at January 1, 2003	15,438	3,594	6,373	1,020	760	27,175
Currency differences	(617)	(256)	(316)	(15)	(29)	(1,233)
Acquisitions/disposals of entities	(159)	(288)	(201)	(1)	(25)	(674)
Additions	–	261	428	33	116	838
Disposals	(128)	(90)	(505)	(75)	(167)	(965)
Reclassifications	–	104	(7)	(135)	38	
Balance at December 31, 2003	14,534	3,325	5,772	827	693	25,151
Depreciation/amortization						
Balance at January 1, 2003	7,651	2,353	3,671	438	358	14,471
Currency differences	(314)	(158)	(169)	(9)	(10)	(660)
Acquisitions/disposals of entities	(242)	(113)	(100)	14	(19)	(460)
Regular additions	619	383	431	13	–	1,446
Impairments	207	15	5	1	31	259
Disposals	(21)	(53)	(220)	–	(107)	(401)
Write-ups	–	–	–	–	(5)	(5)
Reclassifications	2	(1)	–	(29)	28	
Balance at December 31, 2003	7,903	2,426	3,618	429	274	14,650
Book value at December 31, 2003	6,632	901	2,154	398	419	10,504
Book value at December 31, 2002	7,787	1,241	2,702	582	404	12,716

19 Goodwill

The major part of additions to goodwill relates to the acquisition of Heyne Verlag. Goodwill is amortized over 15 years. The largest disinvestment resulted from the sale of Bertelsmann Springer.

17 Other Intangible Assets in € millions

	Music, film and publishing rights	Other rights and licenses	Advance payments	Total
Acquisition/production cost				
Balance at January 1, 2003	2,424	1,133	127	[illegible]
Currency differences	(196)	(57)	(1)	(256)
Acquisitions/disposals of entities	2	(289)	–	[illegible]
Additions	127	110	14	[illegible]
Disposals	(34)	(55)	(1)	(90)
Reclassifications	112	10	(18)	[illegible]
Balance at December 31, 2003	2,435	851	121	[illegible]
Depreciation/amortization				
Balance at January 1, 2003	1,751	602	[illegible]	[illegible]
Currency differences	(133)	(25)	–	(158)
Acquisitions/disposals of entities	–	(113)	–	[illegible]
Regular additions	249	114	–	[illegible]
Impairments	12	3	–	15
Disposals	(20)	(33)	–	[illegible]
Write-ups	–	–	–	[illegible]
Reclassifications	(1)	–	–	[illegible]
Balance at December 31, 2003	1,858	548	[illegible]	2,406
Book value at December 31, 2003	577	303	[illegible]	[illegible]
Book value at December 31, 2002	673	531	27	[illegible]

(E) Property, Plant and Equipment in € millions

	Land, rights equivalent to land and buildings	Plant, technical equipment and machinery	Other equipment, fixtures, furniture and office equipment	Advance payments and construction in progress	Total
Acquisition/production cost					
Balance at January 1, 2003	2,014	2,767	1,538	158	6,371
Currency differences	(82)	(147)	(83)	(4)	(316)
Acquisitions/disposals of entities	(105)	(35)	(59)	(1)	(201)
Additions	48	103	135	142	428
Disposals	(253)	(93)	(149)	(10)	(505)
Reclassification	12	36	18	(73)	(7)
Balance at December 31, 2003	1,634	2,630	1,398	110	5,772
Depreciation					
Balance at January 1, 2003	626	1,918	1,028	–	3,572
Currency differences	(17)	(103)	(49)	–	(169)
Acquisitions/disposals of entities	(41)	(17)	(42)	–	(100)
Regular additions	54	206	181	–	441
Impairments	3	2	–	–	5
Disposals	(11)	(87)	(122)	–	(220)
Write-ups	–	–	–	–	–
Reclassifications	(1)	–	1	–	–
Balance at December 31, 2003	622	1,919	977	–	3,518
Book value at December 31, 2003	1,012	711	421	110	2,254
Book value at December 31, 2002	1,389	849	509	58	2,805

17 Investments in € millions

	Affiliated companies Shares in	Affiliated companies Loans to	Associates Shares in	Associates Loans to	Other participations Shares in	Other participations Loans to	Securities	Other loans	Total
Acquisition/production cost									
Balance at January 1, 2003	104	39	1,020	6	307	5	53	247	1,780
Currency differences	2	(3)	(15)	–	(8)	(1)	(1)	(20)	(46)
Acquisitions/disposals of entities	(27)	(1)	(1)	–	3	–	(1)	1	(26)
Additions	12	9	33	16	49	–	1	29	149
Disposals	(48)	(1)	(75)	(12)	(77)	–	(5)	(24)	(242)
Reclassifications	–	(2)	(135)	–	40	–	–	–	(97)
Balance at December 31, 2003	43	40	842	10	314	4	47	233	1,533
Write-downs									
Balance at January 1, 2003	68		438		232		24	44	806
Currency differences	(1)	–	(3)	–	(5)	–	–	(4)	(13)
Acquisitions/disposals of entities	(19)	–	14	–	–	–	–	–	(5)
Regular additions	–	–	13	–	–	–	–	–	13
Impairments	–	–	1	–	24	4	–	3	32
Disposals	(13)	–	–	–	(82)	–	–	(12)	(107)
Write-ups	–	–	–	–	(3)	–	–	(2)	(5)
Reclassifications	–	–	(29)	–	28	–	–	–	(1)
Balance at December 31, 2003	23		429		194		24	29	705
Book value at December 31, 2003	20	40	413	10	122	4	23	204	837
Book value at December 31, 2002	48	38	582	6	75	5	29	203	986

As set out in IAS 39, available-for-sale investments and securities are measured at fair value, or at acquisition cost if a market price cannot be determined:

Financial Assets: Available-for-Sale in € millions

	At acquisition cost 12/31/2003	At acquisition cost 12/31/2002	At fair value 12/31/2003	At fair value 12/31/2002	Total 12/31/2003	Total 12/31/2002
Investments	13	70	9	5	22	75
Securities	2	6	2	23	23	29
Total	15	76	130	28	145	104

18 Inventories in € millions

	12/31/2003	12/31/2002
Film rights	1,159	1,134
Raw materials and supplies	140	161
Work in process	109	149
Finished goods and merchandise	409	495
Advance payments	3	22
	1,820	1,961

19 Receivables and Other Assets in € millions

	Maturing in more than one year	12/31/2003	12/31/2002
Trade accounts receivable	18	2,825	3,039
Accounts receivable from royalties and licenses	–	216	212
Total trade accounts receivable	18	3,041	3,251
Accounts receivable from participations	–	72	49
Advance payments for royalties and licenses	211	1,152	1,172
Tax receivables	1	468	758
Securities	–	64	10
Derivative financial instruments	–	228	175
Net assets from pension plans	1	17	43
Other receivables	18	541	573
Other receivables and other assets	231	2,573	2,780

Available-for-sale securities are stated as follows:

Other Assets: Available-for-Sale in € millions

	At acquisition cost		At fair value		Total	
	12/31/2003	12/31/2002	12/31/2003	12/31/2002	12/31/2003	12/31/2002
	144	6	103	4	54	10

20 Cash and Cash Equivalents in € millions

	12/31/2003	12/31/2002
Cash	1,641	906
Other securities	201	71
	1,842	977

21 Shareholders' Equity

Number of shares	Ordinary shares	Preference	Total
Type A	83,760	149	83,909
Type B	–	27,920	27,920
Total	83,760	28,069	111,829

Subscribed Capital

Bertelsmann AG's subscribed capital remained unchanged at €606 million as of December 31, 2003 and is made up of 111,829 no-par-value shares of various types. The ordinary shares are bearer shares and the preference shares are registered shares. The type B preference shares have preferred profit-sharing rights through December 31, 2010. The preferred profit-sharing rights of the type A preference shares are not limited in time. The type A preference shares have no voting rights. As resolved by the Executive Board on December 4, 2003, 4,332 type B ordinary shares, previously acquired from the Zeit-Foundation, were withdrawn in 2003 without reducing the share capital.

Following this withdrawal, indirect holdings in the subscribed capital were as follows: 57.6 percent Bertelsmann-Foundation, 25.1 percent Groupe Bruxelles Lambert, 17.3 percent Mohn family. 75 percent of the voting rights are held by Bertelsmann Verwaltungsgesellschaft and 25 percent by Groupe Bruxelles Lambert.

Capital Reserve

The capital reserve includes mainly additional paid-in capital, or share premium, received on the issue of preference and ordinary shares in excess of their par values. A significant part of the capital reserve, €2,708 million, stems from the introduction of 29.88 percent of the RTL Group by GBL in the 2001 stub-period.

Retained Earnings

Retained earnings include the past results of those companies included in the consolidated financial statements, to the extent they have not been distributed, as well as other comprehensive income.

Other Comprehensive Income in € millions

	Available-for-sale securities			Cash flow hedges			Currency	Total
	Pre-tax amount	Taxes	Post-tax amount	Pre-tax amount	Taxes	Post-tax amount		
December 31, 2001	59		59	53	(8)	45	11	115
Change in minorities (RTL Group)	(3)	–	(3)	8	(3)	5	–	2
Changes in fair value	(5)	–	(5)	(122)	23	(99)	(97)	(201)
Impairments	32	–	32	–	–	–	–	32
Recognized in income	(79)	–	(79)	–	–	–	–	(79)
December 31, 2002	4		4	(61)	12	(49)	(86)	(131)
Changes in fair value	28	–	28	(9)	14	5	54	89
Impairments	(1)	–	(1)	(2)	–	(2)	–	(3)
December 31, 2003	31		31	(72)	26	(46)	(32)	(47)

Stock Option Plans at Subsidiaries

Various stock option plans are in operation at subsidiaries. At RTL Group in particular, stock option plans for senior management were introduced in 2000. The option price is derived from the market price at the time the options are granted. Within RTL Group there are also stock option plans at Metropole Television (M6) and Sportfive.

RTL Group Stock Option Plan

RTL Group established a stock option plan for selected directors on July 25, 2000. In order to participate in the Stock Option Plan ("SOP"), the participant must be employed by RTL Group or one of its subsidiaries at the date the options are granted.

The number of options granted to a participant in the SOP is determined by the compensation committee. The compensation committee is made up of the company's Executive Board or a constituted committee thereof. Participants may renounce options granted to them. Participants do not have to make any payments for options granted under the SOP. The number of ordinary shares which may be placed under the SOP in any one year may not exceed one-half of one per cent of the company's issued ordinary share capital.

As a general rule, the exercise price of options issued under the SOP is the average price of RTL shares over a period of 20 trading days before the day on which the options are granted. The exercise price may be another, higher or lower amount to be determined by the compensation committee.

One-third of the options granted may be exercised on each of the second, third and fourth anniversaries of the date the options were granted, or as otherwise determined by the compensation committee. The options granted must normally be exercised within ten years of the date the options were granted, or within a shorter period of time to be determined by the compensation committee. Options can be exercised earlier in the event of death.

Movements in stock options during the year:

Number of Options in thousands

	2003	2002
Options outstanding at the beginning of the year	439	450
Options granted during the year	[illegible]	–
Options exercised/expired during the year	(60)	(59)
Options outstanding at the end of the year	241	439

The options outstanding at the end of the year have the following conditions attached to them:

Conditions for Stock Options (RTL Group)

	Exercise price in €	Number of options in thousands
Expiry date		
2010	85.24	239
2011	85.24	2
		241

Metropole Television (M6)
Employee Stock Option Plan

M6 has introduced an employee stock option plan for selected members of management. The number of options granted to participants is determined by M6's Executive Board in conjunction with the shareholders' annual general meeting.

Options were granted in September 1998, December 1998, June 1999, January 2000 and June 2001. Options granted in September and December 1998 can only be exercised following a vesting period of three years from the date of grant and must be exercised within seven years of the grant date. Options granted in June 1999 and January 2000 can only be exercised following a vesting period of five years from the date of grant. Options granted in June 2001 can only be exercised following a vesting period of four years from the date of grant and must be exercised within seven years of the grant date.

The exercise price of the remaining options amounts to 95 percent of the average price of the shares in M6 on the Paris stock exchange, calculated over the 20 days preceding the grant date.

Movements in stock options during the year:

Number of Options in thousands

	2003	2002
Options outstanding at the beginning of the year	3,301	2,771
Options granted during the year	61	750
Options exercised/lapsed during the year	(183)	(220)
Options outstanding at the end of the year	3,179	3,301

The options outstanding at the end of the year have the following conditions attached to them:

Conditions for Stock Options (M6)

	Exercise price in €	Number of options in thousands
Expiry date		
September 2005	11.10	325
December 2005	13.64	375
June 2006	16.80	450
January 2007	44.93	20
June 2007	58.50	255
June 2008	30.80	416
June 2009	28.50	647
July 2010	22.50	671
November 2010	23.80	20
		3,179

Minority Interests

Minority interests in the consolidated subsidiaries' shareholders' equity essentially consist of minority interests in RTL Group, Gruner + Jahr and Maul-Belser.

22 Profit Participation Capital in € millions

Bertelsmann AG's profit participation capital is made up as follows:

	12/31/2003	12/31/2002
Par value	510	510
Premium	190	190
	700	700

The profit participation capital is made up of 2001 profit participation certificates (listing code ISIN DE0005229942, or "PPC 2001") and 1992 profit participation certificates (listing code ISIN DE0005229900, or "PPC 1992"). PPC 2001 have a par value of € 10, whereas the par value of PPC 1992 is € 0.01. As of December 31, 2003 the par value of PPC 2001 was € 490 million and the par value of PPC 1992 was € 26 million. PPC 1992 and PPC 2001 have been admitted for trading on the stock exchange.

23 Provisions for Pensions and Similar Obligations in € millions

	12/31/2003	12/31/2002
Defined benefit plans	1,614	1,582
Obligations similar to pensions	97	55
	1,711	1,637

The Bertelsmann Group operates various forms of pension plans for current and former employees and their surviving dependants, which are determined by the legal, tax and economic situation of each country concerned. These company pension plans include both defined contribution and defined benefit schemes.

In the case of defined contribution plans, the company makes payments into an external fund or other welfare fund on a statutory, contractual or voluntary basis. Once the company has paid the contributions due, it is not obliged to provide any further benefits and hence no provision is recognized in the balance sheet. Defined contribution plan expenses for 2003 amounted to € 19 million (previous year: € 13 millions).

All other pension plans are defined benefit schemes. Some are funded via an external investment (plan assets), others are unfunded. Provisions are set aside for these plans, most of which are final salary plans.

The provisions are actuarially calculated in accordance with IAS 19. The amount of provisions depends on employees' period of service with the company and their pensionable salary. Provisions are computed using the projected unit credit method, which, in contrast to the components-based method, assumes increasing salary costs over the period of service. The computation also involves using biometric calculations, prevailing long-term capital market interest rates and assumptions about future salary and pension increases. In Germany, the biometric calculations are based on mortality tables issued by Prof. Dr. Klaus Heubeck in 1998. The following actuarial assumptions have been used:

Actuarial Assumptions

	12/31/2003 Germany	12/31/2003 Foreign	12/31/2002 Germany	12/31/2002 Foreign
Discount rate	5.5%	2.0 – 8.25%	5.75%	4.0 – 7.0%
Expected return on plan assets	6.5%	3.0 – 8.25%	5.75%	3.0 – 8.25%
Rate of salary increase	2.5%	3.0 – 6.0%	2.5%	2.5 – 6.0%
Rate of pension increase	1.7%	1.5 – 3.0%	1.7%	1.7 – 2.5%
Fluctuation	Based on experience		Based on experience	

The corridor method is used to calculate provisions for defined benefit plans and related costs. This method does not take into account actuarial gains and losses resulting from the difference between actual amounts and the assumptions underlying the calculations unless they exceed ten percent of either the amount of the defined benefit obligation or plan assets, whichever is the greater. The amount in excess of this corridor is spread over the employees' average remaining period of service.

The expense for defined benefit plans in 2003 was € 167 million (previous year: € 165 million), comprising personnel costs of € 71 million (previous year: € 69 million) and other financial expense of € 96 million (previous year: € 121 million). The expected return on plan assets was included in other operating income in the previous year; this year, it is shown in the financial result for the first time, in the same manner as interest cost. These costs are broken down as follows:

Expenses for Defined Benefit Plans in € millions

	2003	2002
Current service cost	61	65
Interest cost	119	121
Expected return on plan assets	(2)	(26)
Amortization of actuarial gains/losses	10	4
Amortization of past service cost	2	1
Effect of curtailments or settlements	(2)	(1)
	167	165

Actual return on plan assets for the year amounted to € 40 million.

The net pension liability reported on the balance sheet is made up as follows:

Net Pension Obligation Recognized in € millions

	12/31/2003	12/31/2002
Defined benefit obligation of unfunded plans	1,662	1,687
Defined benefit obligation of funded plans	504	440
Total defined benefit obligation	2,166	2,127
Fair value of plan assets	(361)	(298)
Actuarial gains/losses not yet recognized	(208)	(192)
Past service cost not yet recognized		(1)
Amount not yet recognized as an asset because of the limit set out in IAS 19.58 (b)		3
Net liability recognized in the balance sheet	1,597	1,639

The net liability of € 1,597 million (previous year € 1,639 million) is made up of provisions of € 1,614 million (previous year € 1,682 million) and net assets of € 17 million (previous year € 43 million). The assets are included under other assets in the balance sheet.

Movements in the net liability during the year were as follows:

Movements in Net Pension Liability in € millions

	12/31/2003	12/31/2002
Net liability at the beginning of the year	1,639	1,614
Pension expense	157	165
Pension payments	175	(82)
Contributions to plan assets	28	(14)
Transferred obligations	173	(34)
Changes from acquisitions and disposals of entities	101	3
Currency-related effects	13	(13)
Net liability at the end of the year	1,597	1,639

The deconsolidation of the Bertelsmann Springer division reduced net liability by € 112 million.

Breakdown of Net Pension Liability by Region in € millions

	12/31/2003	12/31/2002
Germany	1,454	1,502
USA	65	67
Other Europe	69	57
Other countries	9	13
Net liability recognized in the balance sheet	1,597	1,639

The US subsidiaries' liabilities for their employees' healthcare costs once they have retired constitute defined benefit obligations and account for € 68 million (previous year € 74 million) of the provisions. They have been calculated according to the international standards described above. As in the previous year, healthcare cost increase trends were assumed to be between 5.5 percent and 9.5 percent, depending on the period of time concerned.

Obligations similar to pensions include provisions for employees' long-service awards, old age part-time schemes, amounts due but not yet paid for defined contribution plans, and severance payments at dismissal or retirement ("Abfertigungen"). These severance payments become due when an employee leaves the company and are based on legal obligations, mainly in Italy and Austria. These payments are classified as "similar obligations" for the first time in 2003, and contribute € 32 million (previous year: € 31 million) to the similar obligations. Provisions for employees' long-service awards and for severance pay at retirement are calculated in the same manner as liabilities for defined benefit plans, but without using the corridor method.

Employees in Germany who are at least 55 years old and have an unlimited employment contract with the company qualify for its old age part-time scheme. The part-time employment period lasts for between two and five years. Average normal working hours during this period are half of regular weekly working hours and are usually organized in such a way that they are performed in the first half of the part-time period, so that the employee is subsequently exempted from work in the second half (block model). Employees receive half of their previous gross compensation for the duration of the period. During the period the employee is still working, the employer

sets aside a provision to cover the liability amounting to the working hours for which the employee has not yet been compensated. Under IAS 19, this provision is stated at its present value. In addition, employees receive top-up payments in proportion to their underlying net income. These top-up payments constitute termination benefits as defined by IAS 19 and are recognized at their present value at the time the obligation arises.

4 Other Provisions in € millions

	12/31/2002	Consolidation scope	Other effects	Usage	Additions	Accrued interest	Releases	12/31/2003	Long-term
Provisions for taxes	348	1	(35)	(194)	144	–	(18)	245	68
Personnel-related provisions	550	(24)	(60)	(345)	365	4	(26)	464	65
Restructuring provisions	93	(3)	(25)	(53)	44	–	(8)	48	15
Provisions for fees and licenses	1,083	(2)	(131)	(806)	991	–	(6)	1,039	–
Other	870	(3)	(29)	(454)	775	3	(78)	1,084	123
	2,944	(31)	(281)	(1,842)	2,319	7	(136)	2,880	271

The short-term personnel-related provisions include employee profit participations, bonuses and outstanding vacation entitlements. The long-term personnel-related provisions mainly relate to severance payments of € 47 million (previous year: € 82 million) and obligations arising from the Virtual Stock Option Plan (VSOP).

VSOP is a program aimed at granting a long-term performance-related compensation component to executives. An "option" under the VSOP constitutes neither an ownership interest nor an option to acquire an ownership interest in the employer, Bertelsmann AG or other companies. It serves solely to calculate the compensation component.

As set out in IAS 37, restructuring provisions include employee severance costs and other costs incurred in connection with the discontinuation of business activities. Total provisions of € 48 million (previous year € 93 million) were set aside for various restructuring programs within the Bertelsmann Group.

Other provisions are set up for interest on profit participation certificates, bonuses and litigation costs. As an international group, Bertelsmann is subject to several legal risks. This applies particularly to legal disputes in the USA, where there are legal institutions unknown in Germany, such as class actions, punitive damages or pre-trial discovery. The outcomes of currently asserted or future unasserted lawsuits cannot be foreseen with any degree of certainty, nor can they be entirely influenced. There could be legal risks arising from a claim in which, in February 2003, two US music publishers filed a class action suit against Bertelsmann AG before the US district court in New York. They purport to also act on behalf of an unnamed class and unknown number of music publishers allegedly having similar claims. The claimants base their alleged claims on the contention that, by granting loans to Napster, Inc., which has gone into bankruptcy in the meantime, in October 2000 and January 2001, Bertelsmann AG enabled Napster to continue its business at a point in time at which Napster would not have been able to survive. As a result, the claimants argue Bertelsmann had facilitated Napster to continue to infringe the claimants' copyrights between October 2000 and the time it ceased operating at the beginning of July 2001. Bertelsmann, their argument goes, is to be held liable for such infringement, too. Damages claimed have been set at "at least $ 17 billion". In May 2003 UMG Recordings, Inc. ("Universal") filed a claim before the same court in New York, followed by EMI Christian Music Group Inc. ("EMI") in June 2003 and three other claimants. These claimants have not named a specific overall amount, but have filed for the maximum amount under US copyright law of $ 150,000 per allegedly infringed work of music.

Bertelsmann believes the claims to be without foundation, both regarding their merits and the amounts sought by plaintiffs and has filed a motion to dismiss the complaints with the court. No decision on the motion to dismiss has yet been rendered. As the contentions made by the claimants are entirely without legal foundation, Bertelsmann has only provided for the related legal costs in its 2003 financial statements.

Financial Debt in € millions

Financial debt includes all of Bertelsmann Group's interest-bearing liabilities to banks and capital markets at the balance sheet date. Carrying values are as follows:

	Remaining term in years			12/31/2003	12/31/2002
	< 1	1 – 5	> 5		
Bonds	159	157	1,319	1,635	752
Promissory notes	–	150	129	279	340
Syndicated loan facility	–	–	–	–	669
Bridge loan	–	–	–	–	763
Liabilities to banks	184	58	–	242	653
Leasing liabilities	30	100	121	251	292
Other financial debt	14	–	41	55	240
	387	465	1,610	2,462	3,718

Long-term financial debt, including transaction costs, is measured at present value and is amortized to nominal value at maturity. Transaction costs deducted from the carrying values of bonds and promissory notes issued amounted to € 7 million at December 31, 2003 (previous year: € 3 million). The costs are amortized over the remaining terms of the bonds and promissory notes and are included in interest expense. Liabilities in foreign currency are translated at rates ruling at the end of the year. In general, financial debt is not secured through mortgages and ranks equally for repayment in bankruptcy.

Bertelsmann Group has access to floating-rate funds via a number of contractual agreements. Average maturities of these agreements were considerably extended in 2003.

The bridge loan, US $ 800 million of which was drawn down at December 2002 (originally agreed line of € 2.5 billion), was completely repaid in 2003. The entire credit line was cancelled by Bertelsmann AG in April 2003 without taking up the six-month prolongation option.

The five-year syndicated loan facility outstanding at December 2002 was also repaid in July 2003. This credit line, agreed until November 2007, can also be used in future by Bertelsmann AG and its international finance companies (Bertelsmann U.S. Finance, Inc., Bertelsmann Capital Corporation N.V.) by amounts drawn down in EUR, USD and GBP up to a total equivalent of € 1.5 billion. The amounts drawn down in EUR bear interest at EURIBOR (Euro Interbank Offered Rate). LIBOR (London Interbank Offered Rate) is used as the interest reference rate for the other currencies.

Additionally, the Bertelsmann Group has bilateral loan agreements with international banks, involving Bertelsmann AG and Bertelsmann U.S. Finance, Inc. These credit lines can be utilized to draw down revolving floating rate loan facilities based on EURIBOR or LIBOR. The funding reserve from these credit lines, including the amounts not drawn down on the syndicated loan facility, totals some € 2.7 billion and is freely available for use in the group's operating activities.

The remaining terms and utilization of these agreements at December 31, 2003 are set out in the following table:

Remaining Term in € millions

	Credit line 12/31/2003	Drawn down 12/31/2003	Available credit line 12/31/2003	Available credit line 12/31/2002
< 1 year	628	–	628	1,057
1 to 2 years	103	–	103	172
2 to 3 years	–	–	–	–
3 to 4 years	1,590	–	1,590	45
4 to 5 years	–	–	–	872
> 5 years	400	–	400	335
	2,721	–	2,721	2,481

In June 2003, Bertelsmann U.S. Finance, Inc. issued a benchmark bond with a 4.625 percent coupon as part of the "Debt Issuance Program" launched in 2002. Due to the good take-up rate on the market, the original issue volume was increased by €100 million to €750 million a few days after the original issue.

The "Debt Issuance Program" was updated in September 2003. As for the bond described above, the framework documentation has still been given a rating of BBB+ (Standard & Poor's), or Baa1 (Moody's).

In October, a €200 million bond issued by Bertelsmann Capital Corporation N.V. was repurchased early, before its maturity.

Based on a separate documentation, Bertelsmann U.S. Finance, Inc. arranged a private placement of $ 500 million with American institutional investors. This was made up of three tranches, repayable at different dates of 7 years ($ 100 million), 10 years and 12 years ($ 200 million each).

Bonds, Promissory Notes in € millions

	Due date	Effective interest rate in %	Book value 12/31/2003	Book value 12/31/2002
Floating Rate Bertelsmann U.S. Finance, Inc. (USD 100 million promissory note) 99/03	12/15/2003	–	[illegible]	95
5.375% Bertelsmann U.S. Finance, Inc. (USD 200 million bond) 99/04	1/28/2004	5.60	159	198
5.07% Bertelsmann Capital Corp. N.V. (EUR 200 million bond) 02/05	7/25/2005	5.07	[illegible]	209
4.500% Bertelsmann U.S. Finance, Inc. (DEM 300 million bond) 99/05	11/25/2005	4.62	152	157
Floating Rate Bertelsmann U.S. Finance, Inc. (EUR 50 million promissory note) 02/07	12/20/2007	–	50	50
4.70% Bertelsmann Capital Corp. N.V. (EUR 50 million promissory note) 02/07	12/27/2007	4.91	50	50
4.40% Bertelsmann Capital Corp. N.V. (EUR 50 million promissory note) 03/08	2/1/2008	4.56	50	
Floating Rate Bertelsmann U.S. Finance, Inc. (USD 100 million promissory note) 99/09	2/11/2009	–	79	95
4.48% Bertelsmann Capital Corp. N.V. (EUR 50 million promissory note) 99/09	5/7/2009	4.49	50	50
4.375% Bertelsmann U.S. Finance, Inc. (EUR 200 million bond) 99/09	5/12/2009	4.53	199	198
4.89% Bertelsmann U.S. Finance, Inc. (USD 100 million US private placing) 03/10	4/17/2010	4.83	79	–
4.625% Bertelsmann U.S. Finance, Inc. (EUR 750 million bond) 03/10	6/3/2010	4.70	728	–
5.23% Bertelsmann U.S. Finance, Inc. (USD 200 million US private placing) 03/13	4/17/2013	5.38	159	–
5.33% Bertelsmann U.S. Finance, Inc. (USD 200 million US private placing) 03/15	4/17/2015	5.48	159	–
[illegible]			[illegible]	1,102

As of December 31, 2003, the Bertelsmann Group had issued bonds and promissory notes with a nominal volume of € 1,937 million. Bertelsmann AG has issued an irrevocable guarantee for all obligations in accordance with the contractual conditions.

Foreign currency fluctuation risks on euro issues made by Bertelsmann U.S. Finance Inc. are hedged by USD currency swaps. Furthermore, original interest terms for some of these transactions were changed by entering into interest-rate swaps for some bond issues and loans. The hedge relationships between the underlying transaction and the corresponding derivative qualify as a hedge relationship as set out in IAS 39.

The table below sets out interest rates for bonds and promissory notes issued after reflecting existing interest-rate swaps:

Interest on Bonds and Promissory Notes in € millions

	Fair value at 12/31/2003			Fair value at 12/31/2002		
	Fixed interest	Floating rate	Total	Fixed interest	Floating rate	Total
Bonds	799	836	1,635	407	355	762
Promissory notes	179	100	279	195	145	340
Total	978	936	1,914	602	500	1,102

Minimum Lease Payments for Finance Leases in € millions

	12/31/2003			12/31/2002		
	Nominal value of lease payments	Discount amounts	Present value	Nominal value of lease payments	Discount amounts	Present value
Up to 1 year	34	4	30	41	7	34
1 to 5 years	125	25	100	138	33	105
Over 5 years	218	96	121	276	121	155
	377	125	251	453	161	292

26 Liabilities in € millions

	more than 1 year	12/31/2003	12/31/2002
Trade accounts payable	88	2,718	2,603
Liabilities to participations	–	65	83
Repurchase obligation for Bertelsmann shares held by ZEIT Foundation	–	204	204
Tax liabilities	1	295	327
Derivative financial instruments	10	165	181
Social security contributions	1	90	95
Personnel-related liabilities	–	82	76
Payment in advance	–	66	74
Other	410	817	1,012
Other liabilities	422	1,600	1,731

Other liabilities include obligations arising from long-term delivery commitments, credit balances in accounts receivable and liabilities to non-group companies.

Off-balance-sheet Commitments

27 Contingent Liabilities in € millions

	12/31/2003	12/31/2002
Guarantees	[illegible]	
Warranties	[illegible]	383
Other obligations	[illegible]	29
	[illegible]	[illegible]

It is considered unlikely that a usage of contingent liabilities listed will occur.

28 Other Financial Commitments in € millions

	12/31/2003	12/31/2002
Rental and leasing commitments	[illegible]	
Other commitments	[illegible]	1,470
	[illegible]	3,922

Of the other commitments, € 2,081 million (previous year: € 2,378 million) relates to RTL Group's supply agreements for rights, (co-) productions and programming, and € 515 million (previous year: € 601 million) relates to contracts for TV licenses, transmission rights and other services. Other commitments of Random House amount to € 357 million (previous year: € 487 million) and represent the portion of commitments to authors for which no payments have yet been made and future payments depend on further events (such as delivery and acceptance of manuscripts).

There are the following payment obligations under all long-term rental commitments classified as operating leases:

Minimum Payments Under Operating Leases in € millions

	12/31/2003	12/31/2002
Nominal value		
Up to 1 year	[illegible]	247
1 to 5 years	[illegible]	773
over 5 years	[illegible]	450
	[illegible]	1,470
Present value	[illegible]	1,219

These obligations essentially relate to long-term real estate tenancy agreements. The present values were computed taking country-specific interest rates into account. They show the net payout currently needed to cover the commitment.

Certain third parties have put options for the sale of shares in entities to Bertelsmann Group. As no fair values, as set out in IAS 39, can be determined for these options, they are not recognized in the consolidated balance sheet. The following table sets out the significant options and their underlying conditions:

Object of Option in € millions

	Percent of shares involved	Exercise period	Estimated purchase price
BW-TV Verwaltungs GmbH	20	Until 2022	504
Mondolibri, Italy	50	Exercisable at any time	65
Sportfive	5	June 30, 2005 through November 30, 2005	50

BW-TV Verwaltungs GmbH, in which Bertelsmann has an 80 percent share, holds 37 percent of the shares in RTL Group. Under certain conditions, the minority shareholder of BW-TV has the right to tender its holding to Bertelsmann. The tender price for this is currently € 504 million, which corresponds to a price of roughly € 44 per RTL share.

28 Discontinuing Operation

In July 2002 it was announced that the Bertelsmann Springer segment was to be sold. Effective March 31 a joint venture between Cinven and Candover acquired this group of companies for € 1,050 million free of debt.

The following results of Bertelsmann Springer were included as a discontinuing operation in the Bertelsmann Group financial statements until the segment was deconsolidated:

Income Statement Bertelsmann Springer in € millions

	1/1/2003 – 3/31/2003	1/1/2002 – 12/31/2002
Revenues	158	731
Other operating income	10	34
Expenses	(178)	(777)
Earnings before interest and taxes	(10)	(12)
Financial result	(3)	(14)
Income taxes	(4)	18
Net income before minority interests	(17)	(8)
Minority interests		(8)
Net income after minority interests	(17)	(16)

Cash Flow Statement Bertelsmann Springer in € millions

	1/1/2003 – 3/31/2003	1/1/2002 – 12/31/2002
Net cash		
– from operating activities	(42)	23
– from investing activities	(12)	(22)
– from financing activities	(66)	(22)
Change in cash and cash equivalents	(117)	(21)

The assets and liabilities of the discontinuing operation at date of deconsolidation and during the previous year can be summarized as follows:

Net Assets Bertelsmann Springer in € millions

	3/31/2003	12/31/2002
Non-current assets	558	485
Current assets	312	442
Prepaid expenses	4	3
Provisions	(182)	(175)
Financial debt	(27)	(31)
Liabilities	(88)	(196)
Deferred income	(141)	(152)
Net assets	424	356
Purchase price	1,050	
Purchase price adjustments, related costs		
Net assets sold	(424)	
Gain on sale	626	

There are no taxes payable on the disposal gain.

30 Financial Instruments

Financial Risk Management

Because of its international activities, Bertelsmann Group is exposed to a variety of financial risks, especially the effects of movements in foreign exchange and interest rates. The aim of the Bertelsmann Group's risk management function is to mitigate these risks.

The Executive Board sets out overall risk management guidelines and stipulates the general procedures for hedging foreign exchange rate and interest rate risk and for the use of derivative financial instruments.

A treasury department located at corporate headquarters advises subsidiaries on financial risk and, where appropriate, hedges risks using derivatives. However, the subsidiaries are not obliged to use the services provided by this department. Although certain companies, such as RTL Group, have their own treasury departments, they must report their hedging activities to the treasury department located at corporate headquarters on a quarterly basis.

Exchange Rate Risk

Bertelsmann is exposed to exchange rate risk in various currencies. Its subsidiaries are advised, but not obliged, to hedge themselves against exchange rate risks in the local reporting currency by concluding forward agreements with banks of impeccable credit standing. The treasury department located at corporate headquarters bundles and manages those forward transactions concluded in Germany.

Bertelsmann operates internationally. The net assets of its subsidiaries outside Germany are exposed to exchange rate risk. This risk is managed in accordance with the currency hedging guidelines laid down by the Executive Board. Loans within the Bertelsmann Group that are exposed to exchange rate risk are hedged using derivatives.

Interest Rate Risk

Interest rate risk is managed in accordance with the group's planned net financial debt and expected interest-rate movements. In 2003, floating-rate financing was replaced by fixed-interest rate contracts. To maintain the desired interest mix between fix and floating in an overall view, some interest-rate swaps with fixed coupon terms (payer swaps) were cancelled.

Funds available are generally invested at floating rates for periods of less than one year.

Default Risk

The Bertelsmann Group is exposed to default risks amounting to invested cash and cash equivalents, and the positive fair value of derivatives used. However, as financial transactions and instruments are only concluded with banks of impeccable credit standing, these risks are deemed to be low.

Accounting for Derivative Financial Instruments and Hedges

All derivatives are reported at their fair value. On the day a contract for a derivative is entered into, it is determined whether it is intended to be a fair value hedge or a cash flow hedge. However, some derivatives do not qualify as hedges despite the fact that they do economically represent a hedge.

Bertelsmann documents all relationships between hedging instruments and hedged positions as well as its risk management objectives and strategies in connection with the various hedges. This method includes linking all derivatives used for hedging purposes to specific assets, liabilities, firm commitments and foreseeable transactions. Furthermore, the Bertelsmann Group assesses and documents, both when derivatives are concluded and on an ongoing basis, to what extent the derivatives used are either fair value hedges or cash flow hedges.

Financial Derivatives

The vast majority of financial derivatives used by the Bertelsmann Group are derivatives which are not traded on an organized exchange ("OTC instruments"). These mainly consist of forward agreements, currency swaps, currency options and interest rate swaps, and are only concluded with banks of impeccable credit standing that have been approved by the Executive Board. Nominal volumes are the total of all underlying buying and selling amounts.

The great majority of the financial derivatives serve as hedges against foreign currency and interest rate risks arising from existing financial debt (60.2 percent). Foreign exchange fluctuation risks on internal funding within the group are normally hedged by foreign currency forward transactions. The volume of such transactions is € 859 million (19.0 percent). Additionally, subsidiaries use financial derivatives to hedge against current and future foreign currency risks arising from operating receivables or payables. No financial derivatives are used for speculative purposes.

Nominal Amounts of Financial Derivates in € millions

	Nominal amounts at 12/31/2003				Nominal amounts at 12/31/2002			
	< 1 year	1–5 years	> 5 years	Total	< 1 year	1–5 years	> 5 years	Total
Currency derivatives								
Forward contracts and currency swaps	1,929	423	843	3,195	2,519	603	175	3,297
Currency options	158	–	–	158	–	–	–	
Interest rate derivatives								
Interest rate swaps	158	529	488	1,175	95	457	892	1,444
	2,245	952	1,331	4,528	2,614	1,060	1,067	4,741

Determination of Fair Value

The fair value of traded financial derivatives is determined on the basis of published market prices at the balance sheet date.

In order to determine the fair values of derivatives that are not publicly traded, Bertelsmann Group uses various financial-related economic models based on market conditions and risks prevailing at the balance sheet date.

Fair Values of Financial Derivates in € millions

	Nominal amounts		Present value	
	12/31/2003	12/31/2002	12/31/2003	12/31/2002
Currency derivatives				
Forward contracts and currency swaps	3,195	3,297	[illegible]	48
Currency options	158	–	[illegible]	–
Interest rate derivatives				
Interest rate swaps	1,175	1,444	[illegible]	(32)
	4,528	4,741	[illegible]	[illegible]

Factoring

In individual cases, Bertelsmann Group sells receivables to banks as an additional financing tool. These exceptions are limited to agreements in which Bertelsmann grants financing to its customers in separate contracts. The volume of receivables sold is limited contractually to € 365 million and amounted to € 340 million at December 31, 2003 (previous year: € 311 million). The contractual conditions provide for transfer of the credit and interest risk to the buyer of the receivables. Bertelsmann Group only bears a part of the credit risk from these receivables. The resulting risks are included in provisions. The carrying value of these risks at December 31, 2003 amounts to € 7 million (previous year: € 12 million).

31 Cash Flow Statement

The cash flow statement of the Bertelsmann Group is based on IAS 7 and is intended to enable the reader to assess the group's ability to generate cash and cash equivalents. Cash flows are divided into net cash provided or used by operating, investing and financing activities. The net cash provided or used by operating activities is shown using the indirect method, which adjusts net income for the year for items not generating or using cash. The amount of cash flow according to DVFA/SG is included voluntarily in the cash flow statement. Cash flow per DVFA/SG is defined by the German Association for Financial Analysis and Asset Management and the Schmalenbach Gesellschaft as cash flow based on net income for the year adjusted for significant items of income and expense not providing or using funds. Most of the other items (not) providing or using funds are the proceeds from sales of entities as described in note 9.

The cash flow statement recognizes the effects of movements in exchange rates and changes in the companies included in the consolidated financial statements. Hence, the figures in the cash flow statement cannot simply be determined by comparing balance sheet items with the comparative figures for the previous year. Investing activities include purchases of non-current assets, payments for the acquisition of participations, and proceeds from disposals of non-current assets. Purchase price payments for acquired entities include the purchase of Heyne Verlag, the purchase of additional shares in M6 and the acquisition of the music company Ronagold in the UK. Proceeds from disposals of non-current assets refer in particular to the sale of the Bertelsmann Springer division as shown in note 29, of Random House Tower in New York, and of the participation in the US e-commerce vendor Barnesandnoble.com. Financing activities include changes in shareholders' equity affecting cash and changes in financial debt.

Cash and cash equivalents comprise the total volume of liquid funds as set out in note 20. Interest payments of € 266 million (previous year: € 230 million), interest receipts of € 186 million (previous year: € 199 million) and income tax refunds of € 19 million (previous year: tax payments € 986 million) are included in cash flow from operating activities.

Segment Reporting

Segment reporting disclosures are made in accordance with IAS 14. The primary reporting format uses business segments of the Bertelsmann Group. The secondary reporting format is broken down by the main geographical markets in which the Bertelsmann Group operates.

Information on Segments

Segment reporting, comprising six operating segments, is based on the internal management and reporting structures applied within the Bertelsmann Group. To the extent they reflect the financial management of the group, the segments are different from the group's legal structure.

Information on Segment Data

The definition of the various segment data is the same as that used for the group's management system. Segment data are reconciled to the relevant group figures in the "consolidation" column.

Intercompany revenues are recognized at normal market conditions, as applied to transactions with third parties.

Various figures are shown for segment results. Operating EBITA is the earnings before financial result, taxes, amortization of goodwill and rights similar to goodwill, and special items. Special items refers to unscheduled expenditures and earnings that are special due to their nature, amount, and/or the frequency of their occurrence. Among these are effects from changes to the portfolio and restructuring. Adding back the special items results in EBITA. Segment results as set out in IAS 14 are Operating EBIT, earnings before financial results and taxes and excluding gains or losses on disposals.

The depreciation reported for each segment includes depreciation of property, plant and equipment, amortization of intangible assets, goodwill and rights similar to goodwill, and amortization and write-downs of investments.

Capital expenditures consist of purchases of property, plant and equipment, intangible assets including goodwill, and investments.

Segment assets constitute the operating assets for each segment. They consist of property, plant and equipment, intangible assets, including goodwill and investments. They also include current assets with the exception of cash and cash equivalents, tax receivables and other non-operating assets.

Segment liabilities consist of operating liabilities and operating provisions. They therefore do not include provisions for pensions and similar obligations, deferred tax liabilities, financial debt, or other non-operating liabilities and provisions.

Each segment shows the earnings of, and investments in, associated companies, provided these companies can be clearly allocated to the segment concerned. Results of associated companies are shown after depreciation of goodwill.

In addition, the number of employees at balance sheet date and the average number of employees for the year are shown for the primary reporting format.

For the secondary reporting format, revenues are shown by customer location, while segment assets and segment capital expenditures are included by company location.

Reconciliation from the Primary Reporting Format to the Consolidated Financial Statements in € millions

	2003	2002
Operating EBITA	1,123	936
Amortization of goodwill and rights similar to goodwill (including impairments)	(937)	(2,452)
Special items	647	2,807
Earnings before interest and taxes	833	1,291
Financial result	(322)	(266)
Income taxes	(203)	(57)
Net income before minority interests	308	968

	12/31/2003	12/31/2002
Segment assets	17,881	20,350
Other current assets (not allocated)	368	624
Cash and cash equivalents	1,642	977
Deferred tax assets	273	237
Total assets	20,164	22,188
Segment liabilities	7,039	7,408
Shareholders' equity and minority interests	7,831	7,744
Profit participation capital	708	708
Provisions for pensions and similar obligations	1,701	1,737
Other provisions (not allocated)	255	359
Financial debt	2,452	3,718
Other liabilities (not allocated)	257	435
Deferred tax liabilities	131	83
Total liabilities	20,164	22,188

Reconciliation to Operating EBITDA

The depreciation and amortization shown in the statement of movements in non-current assets is divided into amortization of goodwill and rights similar to goodwill, which is not included in operating EBITA, and other depreciation and amortization, as follows:

Amortization, Depreciation in € millions

	Amortization of goodwill and rights similar to goodwill			Other depreciation			Total amortization/ depreciation
	As scheduled	Impairment	Total	As scheduled	Impairment	Total	
Goodwill	619	207	826	–	–	–	826
Other intangible assets	85	12	97	278	3	281	378
Property, plant and equipment	–	–	–	431	5	436	436
Investments in associates	13	1	14	–	–	–	14
Other financial assets	–	–	–	–	31	31	31
	717	220	937	709	39	748	1,685

Starting with operating EBITA, operating EBITDA is determined by adding other depreciation and amortization, less any write-ups, including the adjustment of any depreciation, amortization and write-ups included in special items, as follows:

Reconciliation to Operating EBITDA in € millions

	2003	2002
Operating EBITA	1,123	938
Amortization of intangible assets	376	410
Amortization of rights similar to goodwill	(97)	(149)
Depreciation of property, plant and equipment	438	488
Depreciation of other financial assets	31	68
Write-ups of property, plant and equipment	(5)	(89)
Write-downs/write-ups in special items	[illegible]	4
Operating EBITDA	1,866	1,668

29 Significant Differences from German Accounting Policies

Consolidation of Investments in Subsidiaries

IAS 22 states that the acquisition of holdings in companies by an exchange of marketable shares must be accounted for at fair value. Under HGB, by contrast, such acquisitions are reported at book value. In contrast to HGB, IAS does not allow goodwill to be offset against shareholders' equity.

Under IAS, hidden reserves and liabilities identified at the time of the initial consolidation are subject to deferred taxes, unless such reserves and liabilities are recognized for tax purposes. In addition, deferred tax assets must be reported on loss carryforwards of the acquired company, provided their future utilization is probable.

Internally-generated Intangible Assets

Research costs are expensed in the period in which they are incurred, whereas development costs as set out in IAS 38 are to be recognized as internally-generated intangible assets to the extent future economic benefits will probably flow to the group and their cost can be measured reliably.

Finance Leases

Long-term leases of assets which, viewed economically, represent a purchase using third-party financing, are recognized in the balance sheet as an asset and an equivalent liability as set out in IAS 17. Due to other definitions of economic ownership, all leasing contracts in the group are classified as rental contracts in accordance with German accounting practice and thus are not reflected in the balance sheet.

Participations and Securities

Participations and other securities included in non-current assets and in current assets in the Bertelsmann Group financial statements are shown as available-for-sale or as held-to-maturity.

As set out in IAS 39, available-for-sale securities are measured at their fair value on the balance sheet date. The resulting unrealized gains and losses are recorded direct to shareholders equity, net of any applicable deferred taxes. If fair values cannot be determined, the participations or securities concerned are measured at amortized acquisition cost.

Financial investments with determinable payments and fixed maturity, which are intended to be held-to-maturity, are measured at amortized cost using the effective interest rate method.

The regulations set out in HGB require assets to be stated at amortized cost or their net realizable value, if lower.

Factoring

IAS 39 states that receivables sold may only be derecognized if a substantial part of the risk inherent in the receivables portfolio is transferred to the buyer.

Derivative Financial Instruments

As set out in IAS 39, all derivative financial instruments are recorded on the balance sheet at fair value, even if they act as a hedge of an underlying transaction. Changes to the fair value of these hedging instruments are recognized in the income statement for fair value hedges and are recorded directly in shareholders' equity for cash flow hedges.

German accounting principles only require financial derivatives to be recognized on the balance sheet to the extent that, after offset against the underlying, any balance represents a probable loss, and a provision is recognized accordingly. On the other hand, unrealized gains are not recognized.

Long-term Receivables, Provisions and Liabilities

Unless they yield market interest rates, long-term receivables, provisions and liabilities are discounted in accordance with IAS, whereas under HGB they are stated at nominal values.

Deferred Taxes

As set out in IAS 12, deferred tax assets and liabilities are recognized for all temporary differences between the carrying amounts reported for tax purposes and those reported in the IAS consolidated balance sheet, with the exception of goodwill which is not recognizable for tax purposes, and for tax loss carryforwards. Through the deduction of a valuation allowance, deferred tax assets are only reported to the extent to which they can be subsequently utilized. Such taxes are calculated using enacted future tax rates. The effects of changes in tax rates on deferred tax assets and liabilities are recognized in the period in which the relevant legislation has been enacted. German regulations set out in HGB permit companies to elect not to recognize the excess of any deferred tax assets over deferred tax liabilities.

Profit Participation Capital

IAS does not permit Bertelsmann AG's profit participation capital to be reported as a component of shareholders' equity. Therefore, in contrast to HGB, distributions payable for the year relating to the profit participation capital is reported as a provision.

Provisions for Pensions

IAS 19 requires provisions for pensions and similar obligations to be measured using the projected unit credit method. This method uses biometric calculations, prevailing long-term capital market interest rates for discounting purposes, and the latest assumptions about future salary and pension increases. By contrast, recognition of provisions for pensions in accordance with HGB accounting rules is based on § 6a German Income Tax Act, which assumes a constant discount rate of six percent and does not recognize future increases in salaries and pensions.

38 Related Party Transactions

Bertelsmann Verwaltungsgesellschaft mbH, Gütersloh, a non-operating holding company, exercises control over the Bertelsmann Group. Johannes Mohn GmbH, GBL Verwaltungs S.A.R.L. and Reinhard Mohn Verwaltungsgesellschaft mbH have informed Bertelsmann AG that they each own more than one-quarter of its share capital.

Transactions with related parties and associated companies mainly involve deliveries of goods and services. They are made under normal market conditions. From a group viewpoint, the related income and expense amounts are insignificant.

The remuneration paid to the Supervisory Board for the year ended December 31, 2003 totaled € 1,302,000 plus value added tax. During 2003, the members of the Executive Board received remuneration totaling € 30,134,572 of which € 18,205,301 was paid by Bertelsmann AG. A loan of $ 5 million, currently bearing interest at 5.06 percent, has been granted to one member of the Executive Board in the previous year. This loan is repayable in full in 2010. There is no collateral on the loan. Former members of the Executive Board or their surviving dependants received amounts (pensions and termination benefits) totaling € 2,692,641 from Bertelsmann AG. The provision established by Bertelsmann AG for pension obligations to former members of the Executive Board amounted to € 35,565,384. The members of the Supervisory Board and the Executive Board are listed on pages 104–106.

39 Events After the Balance Sheet Date

On December 12, 2003 a joint venture agreement was made between BMG and Sony Music Corporation to merge their recorded music businesses (excluding Sony Music Japan). The planned joint venture is subject to approval by the antitrust authorities. No decision is expected from the antitrust authorities before the second half of 2004.

Major Subsidiaries and Participations at December 31, 2003

RTL Group

Television			
GZSZ Vermarktungsgesellschaft GmbH, Cologne	Germany	82.71	v
IP Deutschland GmbH, Cologne	Germany	82.71	v
IP NEWMEDIA GmbH, Cologne	Germany	82.71	v
N-TV Nachrichtenfernsehen GmbH & Co. KG, Berlin	Germany	40.24	q
RTL 2 Fernsehen GmbH & Co. KG, Munich	Germany	29.70	e
RTL Disney Fernsehen GmbH & Co. KG, Cologne	Germany	41.31	q
RTL NEWMEDIA GmbH, Cologne	Germany	82.71	v
RTL Shop GmbH, Cologne	Germany	71.35	v
RTL Television GmbH, Cologne	Germany	82.71	v
S4M Solutions for Media GmbH, Cologne	Germany	82.71	v
VOX Film- und Fernseh GmbH & Co.KG, Cologne	Germany	82.46	v
Westdeutsche Universum-Film GmbH, Cologne	Germany	82.71	v
Antena 3 de Televisión S.A., Madrid	Spain	14.35	e
Audiomedia S.A., Luxembourg	Luxembourg	82.96	v
Bayard d'Antin S.A., Paris	France	82.71	v
Broadcasting Center Europe S.A., Luxembourg	Luxembourg	82.71	v
Channel 5 Broadcasting Limited, London	UK	63.52	q
CLT-UFA Holding S.A., Luxembourg	Luxembourg	82.96	v
CLT-UFA S.A., Luxembourg	Luxembourg	82.71	v
Holland FM Produktie B.V., Hilversum	Netherlands	82.71	v
Holland Media Group Business Nieuws B.V., Hilversum	Netherlands	82.71	v
IP Belgium S.A., Brussels	Belgium	54.59	v
IP France S.A., Paris	France	82.71	v
IP Luxembourg S.A.R.L., Luxembourg	Luxembourg	82.71	v
London Playout Center Limited, London	UK	82.96	v
M6 Editions S.A., Neuilly sur Seine	France	40.01	q
M6 Films S.A., Neuilly sur Seine	France	40.01	q
M-RTL Rt (RTL Klub), Budapest	Hungary	40.48	e
RTL 9 S.A., Luxembourg	Luxembourg	28.95	e
RTL4 Beheer B.V., Hilversum	Netherlands	82.71	v
RTL Croatia d.o.o., Zagreb	Croatia	27.29	v
Sky Five Text Limited, Middlesex	UK	28.00	q
Télévision Indépendante (TVI) S.A., Brussels	Belgium	54.59	v
Télévision Par Satellite S.N.C., Issy les Moulineaux	France	13.36	q
Yorin FM B.V., Hilversum	Netherlands	82.71	v
Content			
CLOU Entertainment TV Produktion GmbH, Cologne	Germany	46.20	v
CLT-UFA Multi Media GmbH, Hamburg	Germany	82.70	v
Fremantle (D) Fernsehproduktions GmbH, Hürth	Germany	82.90	v
Grundy UFA TV Produktions GmbH, Berlin	Germany	82.70	v
Sportfive GmbH, Hamburg	Germany	38.83	q
Sportfive Tbx GmbH, Hamburg	Germany	38.83	q
Teamwork Produktion für Kino und Fernsehen GmbH, Berlin	Germany	63.71	v
UFA Entertainment GmbH, Berlin	Germany	82.71	v
UFA Fernsehproduktion GmbH, Berlin	Germany	82.71	v
UFA Film- und Fernseh GmbH, Cologne	Germany	82.71	v
Football France Promotion S.A., Paris	France	38.83	q
Fremantle Media Australia Pty Ltd, St. Leonard	Australia	82.96	v
Fremantle Productions Asia Limited, Hong Kong	China	82.96	v
FremantleMedia Limited, London	UK	82.96	v
FremantleMedia North America, Inc., Wilmington	USA	82.96	v
Groupe JC Darmon S.A., Paris	France	38.83	q
Grundy Productions Limited, London	UK	82.96	v
SportFive S.A., Paris	France	38.83	q
Talkback Productions Limited, London	UK	82.96	v
UFA Sports France S.A., Paris	France	38.83	q
Radio			
Antenne Mecklenburg-Vorpommern GmbH & Co.KG, Plate	Germany	38.83	e
Antenne Sachsen Hörfunk- und Versorgungs GmbH, Dresden	Germany	38.83	e
RTL Radio Deutschland GmbH, Berlin	Germany	82.71	v
AVE Gesellschaft für Hörfunkbeteiligungen, Berlin	Germany	82.28	v
Ediradio S.A., Paris	France	82.71	v
Contact S.A., Brussels	Belgium	40.65	e

Random House

Random House North America			
Books on Tape, Inc., Santa Ana	USA	100.00	v
Content Link, Inc., Delaware	USA	100.00	v
Fodors LLC, New York	USA	100.00	v
Golden Treasurers, Inc., Delaware	USA	100.00	v
McClelland & Stewart Limited, Toronto	Canada	25.00	e
Random House, Inc., New York	USA	100.00	v
Random House Direct, Inc., New Jersey	USA	100.00	v
Random House of Canada Limited, Toronto	Canada	100.00	v
Random House Systems, Inc., New York	USA	100.00	v
Random House TPR, Inc., New York	USA	100.00	v
Random House Ventures LLC, New York	USA	100.00	v
Xlibris Corporation, Philadelphia	USA	49.00	e
Verlagsgruppe Random House			
Gütersloher Verlagshaus GmbH, Gütersloh	Germany	100.00	v
Verlag RM GmbH, Gütersloh	Germany	100.00	v
Verlagsgruppe Random House GmbH	Germany	100.00	v
Wilhelm Heyne Verlag GmbH, Munich	Germany	100.00	v
Random House Great Britain, Australia, New Zealand, South Africa			
Chetto, Virago, Bodley Head & Jonathan, Melbourne	Australia	100.00	v
Random Century Australia Pty. Limited, Melbourne	Australia	100.00	v
Random House (Proprietary) Limited, Parktown (Johannesburg)	South Africa	75.00	v
Random House Australia Pty. Limited, Melbourne	Australia	100.00	v
Random House New Zealand Limited, Glenfield	New Zealand	100.00	v
RHA Holdings Pty. Limited., Melbourne	Australia	100.00	v
The Random House Group Limited, London	UK	100.00	v
Random House Mondadori			
Editorial Sudamericana, S.A., Buenos Aires	Argentina	50.00	q
Editorial Lumen, S.A., Barcelona	Spain	50.00	q
Editorial Sudamericana Uruguaya, S.A., Montevideo	Uruguay	49.85	q
Grijalbo, S.A., Caracas	Venezuela	50.00	q
Grupo Editorial Random House Mondadori, S.L., Barcelona	Spain	50.00	q
Market Self S.A., Buenos Aires	Argentina	25.00	e
Nueva Galaxia Gutenberg, S.A., Barcelona	Spain	50.00	q
Random House Mondadori S.A., Barcelona	Spain	50.00	q
Random House Mondadori S.A., Santiago de Chile	Chile	50.00	q
Random House Mondadori, S.A. de C.V., Mexico City	Mexico	50.00	q
Random House Mondadori, S.A., Bogotá	Colombia	50.00	q
Random House Asia			
Random House Kodansha Co. Limited, Tokyo	Japan	50.00	q

As of December 31, 2003
Ownership of Group companies by percentage.

Consolidation method is defined as follows:

v = fully consolidated

q = proportionally consolidated

e = associated companies recognized at equity

Gruner + Jahr

Magazines Germany			
Berliner Presse Vertrieb GmbH, Berlin	Germany	74.90	v
Börse Online Verlag GmbH & Co., Munich	Germany	74.90	v
DPV Deutscher Pressevertrieb GmbH, Hamburg	Germany	74.90	v
SPV Medien Handel GmbH, Berlin	Germany	74.90	v
Ehrlich & Sohn GmbH & Co., Hamburg	Germany	74.90	v
G+J Corporate Media GmbH, Hamburg	Germany	74.90	v
G+J Electronic Media Sales GmbH, Hamburg	Germany	74.90	v
G+J Wirtschaftspresse Online GmbH, Munich	Germany	74.90	v
G+J Woman Verlag GmbH, Hamburg	Germany	74.90	v
G+J Women New Media GmbH, Hamburg	Germany	74.90	v
G+J Zeitschriften-Verlagsgesellschaft mbH, Hamburg	Germany	74.90	v
G+J/RBA GmbH & Co. KG, Hamburg	Germany	37.45	e
Gruner + Jahr AG & Co., Hamburg	Germany	74.90	v
IPV Inland Pressevertrieb GmbH, Hamburg	Germany	74.90	v
Living at Home Multi Media GmbH, Hamburg	Germany	74.90	v
M.C. Verlagsgesellschaft mbH, Munich	Germany	37.45	e
Neon Magazin GmbH, Hamburg	Germany	74.90	v
Norddeutsche Verlagsgesellschaft mbH, Hamburg	Germany	74.90	v
Picture Press Bild- und Textagentur GmbH, Hamburg	Germany	74.90	v
stern.de GmbH, Hamburg	Germany	74.90	v
W.E. Saarbach GmbH, Cologne	Germany	18.85	e
Gruner + Jahr Verlagsgesellschaft m.b.H., Vienna	Austria	74.90	v
Gruner + Jahr (Schweiz) AG, Zurich	Switzerland	74.90	v
Magazines International			
G y J Espana Ediciones, S.L., S. en C., Madrid	Spain	74.90	v
G y J Publicaciones Internacionales, S.L. y Cia., S. en C., Madrid	Spain	37.45	v
G y J Revistas y Comunicaciones, S.L., Sociedad Unipersonal, Madrid	Spain	74.90	v
G+J - CLIP (Beijing) Publishing Consulting Co., Limited, Beijing	China	38.20	v
G+J RBA Sp. z o.o. & Co. Spolka komanditowa, Warsaw	Poland	37.45	e
G+J/RBA Publishing C.V. National Geografic Nederland, Amsterdam	Netherlands	74.90	e
G+J/RBA S.N.C., Paris	France	37.45	e
G+J USA Publishing, New York	USA	74.90	v
Gruner + Jahr / Mondadori S.p.A., Milan	Italy	50.00	q
Gruner + Jahr Polska Sp. z o.o. & Co. Spolka Komandytowa, Breslau	Poland	74.90	v
Gruner + Jahr ZAO, Moscow	Russia	74.90	v
Prisma Presse S.N.C., Paris	France	74.90	v
Shanghai G+J Consulting and Service Co., Limited, Shanghai	China	74.90	v
VSD S.N.C., Paris	France	74.90	v
VIVIA S.N.C., Paris	France	74.90	v
Newspapers			
BerlinOnline Stadtportal GmbH & Co. KG, Berlin	Germany	33.71	e
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden	Germany	44.94	v
Dresdner Magazin Verlag GmbH, Dresden	Germany	44.94	v
Financial Times Deutschland GmbH & Co. KG, Hamburg	Germany	50.00	q
Saxo-Phon Telefonmarketing und Veranstaltungsservice GmbH, Dresden	Germany	44.94	v
Printing			
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden	Germany	44.94	v
Gruner + Jahr AG & Co., Hamburg (Printing Itzehoe)	Germany	74.90	v
Brown Printing Company, Wausau	USA	74.90	v
Central			
Druck- und Verlagshaus Gruner + Jahr AG, Hamburg	Germany	74.90	v
Hamburger Journalistenschule Gruner + Jahr - DIE ZEIT GmbH, Hamburg	Germany	71.16	v
manager magazin Verlagsgesellschaft mbH, Hamburg	Germany	18.85	e
SPIEGEL-Verlag Rudolf Augstein GmbH & Co. KG, Hamburg	Germany	18.54	e
Verlagsgruppe NEWS Ges.m.b.H., Vienna	Austria	41.95	v

BMG

BMG North America			
Arista Records, Inc., Wilmington	USA	100.00	v
BMG Canada Inc., Toronto	Canada	100.00	v
BMG Distribution, New York	USA	100.00	v
BMG Songs, Inc., Sacramento	USA	100.00	v
BMG Strategic Marketing Group, New York	USA	100.00	v
BMG US Latin, Miami	USA	100.00	v
Brentwood-Benson Music Publishing, Inc., Franklin	USA	100.00	v
J Records, LLC, Delaware	USA	100.00	v
LaFace Records, Inc., New York	USA	100.00	v
Provident Music Group, Tennessee	USA	100.00	v
RCA Label Group, Nashville	USA	100.00	v
RCA Music Group, New York	USA	100.00	v
RCA Victor Group, New York	USA	100.00	v
Volcano Entertainment, LLC, Delaware	USA	100.00	v
Zomba Records Jive, New York	USA	100.00	v
BMG Europe			
Arabella Musikverlag GmbH, Munich	Germany	100.00	v
Bertelsmann Music Group Belgium N.V., Brussels	Belgium	100.00	v
BMG Deutschland GmbH, Munich	Germany	100.00	v
BMG Ariola (Schweiz) AG, Zurich	Switzerland	100.00	v
BMG Ariola Austria Gesellschaft m.b.H., Vienna	Austria	100.00	v
BMG Czech Republic, Prague	Czech Republic	100.00	v
BMG Denmark A/S, Copenhagen	Denmark	100.00	v
BMG Finland Oy, Helsinki	Finland	100.00	v
BMG France S.A.S.U, Paris	France	100.00	v
BMG Music Publishing B.V., Hilversum	Netherlands	100.00	v
BMG Music Publishing France SARL, Paris	France	100.00	v
BMG Music Publishing Limited, London	UK	100.00	v
BMG Music Spain, S.A., Madrid	Spain	100.00	v
BMG Nederland B.V., Hilversum	Netherlands	100.00	v
BMG Norway AS, Oslo	Norway	100.00	v
BMG Poland Spolka, Warsaw	Poland	100.00	v
BMG Portugal - Actividades Audiovisuais, Lda., Lisbon	Portugal	100.00	v
BMG RICORDI S.p.A., Rome	Italy	100.00	v
BMG Sweden Aktiebolag, Stockholm	Sweden	100.00	v
BMG UK & Ireland Limited, London	UK	100.00	v
Cezame Argile Productions Editions S.A., Paris	France	100.00	v
Editio Musica Budapest Zenemukiado Kft., Budapest	Hungary	100.00	v
Editions Durand S.A., Paris	France	100.00	v
Rosagold Limited, London	UK	100.00	v
Silvertone Records Limited, London	UK	100.00	v
Zomba Music Publishers Limited, London	UK	100.00	v
Zomba Records Limited, London	UK	100.00	v
Zomba Record Holdings B.V., Laren	Netherlands	100.00	v
BMG Latin America			
Ariola, S.A. de C.V., Mexico City	Mexico	100.00	v
BMG Ariola Argentina, S.A., Buenos Aires	Argentina	100.00	v
BMG Brasil Ltda., Rio de Janeiro	Brazil	100.00	v
BMG Chile, S.A., Santiago de Chile	Chile	100.00	v
BMG Asia/Pacific			
BMG Australia Limited, North Sydney	Australia	100.00	v
BMG Entertainment (Thailand) Limited, Bangkok	Thailand	75.00	v
BMG FUNHOUSE, Inc., Tokyo	Japan	100.00	v
BMG Hong Kong Limited, Hong Kong	China	100.00	v
BMG Korea Co. Limited, Seoul	South Korea	100.00	v
BMG Music (Malaysia) SDN BHD, Kuala Lumpur	Malaysia	100.00	v
BMG Music Taiwan, Inc., Taipeh	Taiwan	100.00	v
BMG New Zealand Limited, Newton, Parnell, Auckland	New Zealand	100.00	v
BMG Records Africa (Proprietary) Limited, Sanainghill (Johannesburg)	South Africa	100.00	v
BMG Singapore Pte. Limited, Singapore	Singapore	100.00	v

Arvato

Printing & [illegible]			
Artur Wahl GmbH Reproduktionen Satzherstellung, Munich	Germany	100.00	v
Deutscher Supplement Verlag GmbH, Nuremberg	Germany	75.00	v
FernwärmeGmbH, Gütersloh	Germany	51.00	v
GEP Media GmbH, Pöcnack	Germany	100.00	v
maul + co - Chr. Belser GmbH, Nuremberg	Germany	75.00	v
maul + co - Chr. Belser Klebebindung GmbH, Nuremberg	Germany	75.00	v
maul + co - Chr. Belser Studios GmbH, Nuremberg	Germany	75.00	v
Medienfabrik Gütersloh GmbH, Gütersloh	Germany	50.00	v
Mobilitäts-Verlag GmbH, Berlin	Germany	100.00	v
MOHN Media Kalender & Promotion Service GmbH, Gütersloh	Germany	100.00	v
MOHN Media Mohndruck GmbH, Gütersloh	Germany	100.00	v
Präsenta Promotion International GmbH, Solingen	Germany	60.00	v
ProBind Professional Binding GmbH, Gütersloh	Germany	95.00	v
TV Information Services GmbH, Nuremberg	Germany	75.00	v
WOSCHEK Verlags GmbH, Mainz	Germany	90.00	v
Berryville Graphics, Inc., Wilmington	USA	100.00	v
Cobrhi, S.L., Madrid	Spain	100.00	v
Coral Graphic Services, Inc., Hicksville	USA	95.10	v
Dynamic Graphic Finishing, Inc., Horsham	USA	95.10	v
Editoriale Johnson S.p.A., Seriate	Italy	99.82	v
Eurogravure S.p.A., Bergamo	Italy	69.18	v
Eurohueco, S.A., Castellbisbal (Barcelona)	Spain	65.00	v
Istituto Italiano d'Arti Grafiche S.p.A., Bergamo	Italy	99.82	v
MOHN Media France S.A.R.L., Villepinte	France	100.00	v
Nuovo Istituto Italiano d'Arti Grafiche S.p.A., Bergamo	Italy	99.82	v
OAO Jaroslawskij Poligraphitscheskij Kombinat, Jaroslawl	Russia	50.90	v
Offset Paperback MFRS., Inc., Dallas	USA	100.00	v
OOO Distribuzionyzentr Bertelsmann, Jaroslawl	Russia	100.00	v
Printer Colombiana, S.A., Santa Fé de Bogotá	Colombia	50.89	v
Printer Industria Gráfica, S.A., Sant Vicenc dals Horts (Barcelona)	Spain	100.00	v
Printer Portuguesa-Indústria Gráfica, Limitada, Mem Martins (Algueirao)	Portugal	100.00	v
Publicitarna Söderberg & Co. Aktiebolag, Stockholm	Sweden	69.75	v
Rotedic, S.A., Madrid	Spain	100.00	v

Services			
Adress Research GmbH, Gütersloh	Germany	39.20	q
arvato direct services Dortmund GmbH, Dortmund	Germany	100.00	v
arvato direct services elweiler GmbH, Heusweiler-Elweiler	Germany	100.00	v
arvato direct services GmbH, Gütersloh	Germany	100.00	v
arvato direct services Gütersloh GmbH, Gütersloh	Germany	100.00	v
arvato direct services Münster GmbH, Münster	Germany	100.00	v
arvato direct services Neumünster GmbH, Neumünster	Germany	100.00	v
arvato direct services Stuttgart GmbH, Kornwestheim	Germany	100.00	v
arvato direct services Wilhelmshaven GmbH, Schortens	Germany	100.00	v
arvato direct services Wuppertal GmbH, Wuppertal	Germany	100.00	v
arvato distribution GmbH, Harsewinkel	Germany	100.00	v
arvato logistics services GmbH, Gütersloh	Germany	100.00	v
arvato media GmbH, Gütersloh	Germany	100.00	v
arvato technology ELC GmbH, Düren	Germany	100.00	v
arvato technology GmbH, Gütersloh	Germany	100.00	v
A2 Direct GmbH, Gütersloh	Germany	100.00	v
bedirect GmbH & Co. KG, Gütersloh	Germany	60.00	q
BFS finance GmbH, Verl	Germany	100.00	v
BFS finance Münster GmbH, Münster	Germany	100.00	v
BFS risk & collection GmbH, Verl	Germany	100.00	v
BFS risk management GmbH, Verl	Germany	74.80	v
Deutsche Post Adress GmbH, Bonn	Germany	49.00	q
InmediaONE GmbH, Gütersloh	Germany	100.00	v
Lambourne Productions GmbH, Herne	Germany	100.00	v
Media Log Spedition GmbH, Gütersloh	Germany	100.00	v
PVS Mailmanagement GmbH, Neckarsulm	Germany	100.00	v
Rough Trade Distribution GmbH, Herne	Germany	100.00	v
Verlagsdienst München GmbH, Gilching	Germany	100.00	v
webmiles GmbH, Munich	Germany	87.53	v
ALLDIREKT Telemarketing GmbH, Salzburg	Austria	100.00	v
arvato communication services France SARL, Noyelles sous Lens	France	100.00	v
arvato media services France SAS, Noyelles sous Lens	France	100.00	v
arvato services (UK) Limited, Warley	UK	100.00	v
arvato services Asia Pacific Pte. Limited, Singapore	Singapore	100.00	v
arvato services Australia Pacific Pty. Limited, Castle Hill (Sydney)	Australia	100.00	v
arvato services Belgium N.V., Antwerp	Belgium	60.00	v
arvato services Canada, Inc., Toronto	Canada	100.00	v
arvato services France S.A.R.L., Noyelles sous Lens	France	100.00	v
arvato services Iberia, S.A., Barcelona	Spain	100.00	v
arvato services, Inc., Valencia	USA	100.00	v
BD Medien-Service AG, Münchenstein	Switzerland	100.00	v
BenefitNation, Inc., Fairfax Station	USA	60.00	v
Bertelsmann Marketing Service India Private Limited, New Delhi	India	51.00	v
Bertelsmann Media Sp. z o.o z siedziba w Warszawie Oddział "Arvato Services Polska", Pierwiska k/Poznania	Poland	100.00	v
Bertelsmann Österreich GmbH, Vienna	Austria	100.00	v
BFS finance Limited, Dublin	Ireland	100.00	v
Eurodirect-Société Européenne de Routage S.A., Gelspolsheim	France	69.90	v
Eurodirect Marketing Lettershop SAS, Gelspolsheim	France	60.00	v
EUROMEDIA GROUP k.s., Prague	Czech Republic	100.00	v
Europost SAS, Sauley sur Meurthe	France	60.00	v
Forms Facility Group B.V., Abcoude	Netherlands	60.00	v
Gauntlet Entertainment Limited, Orpington	UK	75.00	v
Pinnacle Entertainment Limited, Orpington	UK	75.00	v
Pinnacle Software Limited, Orpington	UK	75.00	v
Routage et Diffusion SAS, Strasbourg	France	60.00	v
SPOS AG, Luzern	Switzerland	100.00	v
Total Distribución, S.A., Alcorcón (Madrid)	Spain	66.67	v
Verlagsservice für Bildungssysteme und Kunstobjekte GmbH & Co. KG, Vienna	Austria	75.00	v
Verlagsservice Süd AG, Glattbrugg	Switzerland	100.00	v

*= operating department

arvato systems GmbH, Gütersloh	Germany	100.00	v
arvato systems Technologies GmbH, Rostock	Germany	100.00	v
bertelsmann GmbH, Hamburg	Germany	100.00	v
empolis GmbH, Gütersloh	Germany	100.00	v
medicForma.com GmbH, Dortmund	Germany	31.58	e
arvato systems (Shanghai) Co. Limited, Shanghai	China	100.00	v
arvato systems Espana, S.L., Barcelona	Spain	100.00	v
arvato systems France S.A.R.L., Paris	France	100.00	v
arvato systems North America, Inc., Wilmington	USA	100.00	v
arvato systems UK & Ireland Limited, London	UK	100.00	v
empolis NA, Inc., Burlington	USA	100.00	v
empolis Polska Spolka z ograniczona odpowiedzialnoscia, Warsaw	Poland	95.05	v
empolis scandinavia AS, Oslo	Norway	100.00	v
empolis UK Limited, Swindon	UK	100.00	v
ij net S.p.A., Rome	Italy	100.00	v
Storage Media			
Arvato Storage Media GmbH, Gütersloh	Germany	100.00	v
FlexStorm GmbH, Gütersloh	Germany	100.00	v
Sonopress Produktionsgesellschaft für Ton- und Informationsträger mbH, Gütersloh	Germany	100.00	v
topac MultimediaPrint GmbH, Gütersloh	Germany	100.00	v
Sonopress - Rimo Argentina, S.A., Buenos Aires	Argentina	52.00	v
Sonopress (UK) Limited, Wednesbury (Birmingham)	UK	100.00	v
Sonopress France SAS, Paris	France	100.00	v
Sonopress Iber-Memory S.A., Coslada (Madrid)	Spain	51.00	v
Sonopress Ireland Limited, Dublin	Ireland	100.00	v
Sonopress Italia S.r.l., Milan	Italy	100.00	v
Sonopress LLC, Wilmington	USA	100.00	v
Sonopress Pan Asia Limited, Hong Kong	China	100.00	v
Sonopress Pan Asia Tokyo Co., Limited, Tokyo	Japan	100.00	v
Sonopress Shanghai Multimedia Technology Co. Limited, Shanghai	China	100.00	v
Sonopress Singapore Pte. Limited, Singapore	Singapore	100.00	v
Sonopress South Africa (Proprietary) Limited, Bromhof (Johannesburg)	South Africa	100.00	v
Sonopress-Rimo Indústria e Comércio Fonográfica Ltda., Sao Paulo	Brazil	52.00	v

Direct Group

Clubs Central and Eastern Europe			
FCB FREIZEIT-CLUB Betreuungs-GmbH & Co., Hamburg	Germany	50.00	q
Nionex GmbH, Gütersloh	Germany	100.00	v
RM Buch und Medien Vertrieb GmbH, Gütersloh	Germany	100.00	v
RTL Club GmbH, Rheda-Wiedenbrück	Germany	100.00	v
wissen Media Verlag GmbH, Gütersloh	Germany	100.00	v
wissen.de GmbH Gesellschaft für Online-Information, Munich	Germany	100.00	v
Bertelsmann Media Moskau AO, Moscow	Russia	100.00	v
Bertelsmann Media - Swiat Ksiazki, Warsaw	Poland	100.00	v
Bertelsmann Medien (Schweiz) AG, Zug	Switzerland	100.00	v
Buchgemeinschaft Donauland Kremayr & Scheriau, Vienna	Austria	75.00	v
EUROMÉDIA GROUP k.s., Prague	Czech Republic	100.00	v
IKAR s.s., Bratislava	Slovakia	100.00	v
Clubs/Direct Sales South West Europe			
BOL Books On Line Italia S.p.A., Milan	Italy	50.00	e
Circulo de Lectores, S.A., Barcelona	Spain	100.00	v
Circulo de Leitores, S.A., Lisbon	Portugal	100.00	v
ECI voor Boeken en Platen B.V., Vianen	Netherlands	82.80	v
France Loisirs (Suisse) S.A., Crissier	Switzerland	100.00	v
France Loisirs Belgique S.A., Ath	Belgium	100.00	v
FRANCE LOISIRS S.A.R.L., Paris	France	100.00	v
Lexicultural - Actividades Editoriais, Limitada, Buraca (Lisbon)	Portugal	100.00	v
Mondolibri S.p.A., Milan	Italy	50.00	q
Québec Loisirs, Inc., Ville St. Laurent	Canada	100.00	v
Société Générale d'Edition et de Diffusion SGED, s.n.c. (S.L.), Paris	France	50.00	q
Clubs Asia			
Bertelsmann Korea Co., Limited, Seoul	South Korea	100.00	v
Beijing 21st Century Book Chain Co., Limited, Beijing	China	40.00	q
Shanghai Bertelsmann Culture Industry Co. Limited, Shanghai	China	60.00	v
Shanghai Bertelsmann Information Technology Co. Limited, Shanghai	China	100.00	v
English-Speaking Clubs			
bol, limited, London	UK	100.00	v
Book Club Associates, London	UK	100.00	v
Booksper (Partnership), Delaware	USA	50.00	q
Doubleday Australia Pty. Limited, Lane Cove (Sydney)	Australia	100.00	v
Doubleday Canada Limited, Toronto	Canada	100.00	v
BeMusic/e-commerce			
BeMusic, Inc., Dauphin County	USA	100.00	v
buch.de AG, Münster	Germany	25.10	e
Others			
Bertelsmann DealTime Holding B.V., Amsterdam	Netherlands	89.33	v
Bertelsmann Multimedia GmbH, Gütersloh	Germany	100.00	v
bol.com AG, Gütersloh	Germany	100.00	v

* The company has availed of exemptions under Section 17 of the Irish Companies' (Amendment) Act 1986 from publicly filing its financial statements.

43 Exemption for Domestic Companies from Preparing, Audit and Publication of Financial Statements

The following subsidiaries took advantage of the exemption regulations set out in § 264 para. 3 HGB relating to additional requirements for limited liability companies to prepare annual financial statements and a management report, as well as the requirements for audit of, and publication by, limited liability companies for the year ended December 31, 2003:

ADLER Immobilienverwaltungs GmbH	Gütersloh
Arabella Musikverlag GmbH	Munich
Artur Wahl GmbH Reproduktionen Satzherstellung	Munich
arvato AG	Gütersloh
arvato direct services Dortmund GmbH	Dortmund
arvato direct services elweiler GmbH	Herxweiler-Elweiler
arvato direct services elweiler GmbH	Mannheim
arvato direct services GmbH	Gütersloh
arvato direct services Gütersloh GmbH	Gütersloh
arvato direct services Gütersloh GmbH	Springe
arvato direct services Münster GmbH	Münster
arvato direct services Neumünster GmbH	Neumünster
arvato direct services Stuttgart GmbH	Kornwestheim
arvato direct services Wilhelmshaven GmbH	Schortens
arvato direct services Wuppertal GmbH	Wuppertal
arvato distribution GmbH	Harsewinkel
arvato logistics services GmbH	Gütersloh
arvato media GmbH	Gütersloh
arvato middle east sales GmbH	Gütersloh
Arvato Storage Media GmbH	Gütersloh
arvato systems GmbH	Gütersloh
arvato systems Technologies GmbH	Rostock
arvato technology ELC GmbH	Düren
arvato technology GmbH	Gütersloh
ASM Holding GmbH	Gütersloh
AZ Direct GmbH	Gütersloh
AZ Direct GmbH	Garching
Bavaria-Verlag Gesellschaft mit beschränkter Haftung	Munich
bemobile GmbH	Hamburg
Bertelsmann Capital Holding GmbH	Hamburg
Bertelsmann Capital Ventures GmbH	Munich
Bertelsmann Immobilien GmbH	Gütersloh
Bertelsmann Interactive Studios GmbH	Gütersloh
Bertelsmann Korea Beteiligungs GmbH	Gütersloh
Bertelsmann Multimedia GmbH	Gütersloh
Bertelsmann Music Group GmbH	Gütersloh
Bertelsmann Music Group GmbH	Munich
Bertelsmann Online Beteiligungsgesellschaft mbH	Gütersloh
Bertelsmann Online International GmbH	Gütersloh
Bertelsmann Treuhand- und Anlagegesellschaft mit beschränkter Haftung	Gütersloh
BFS finance GmbH	Verl
BFS finance Münster GmbH	Münster
BFS risk & collection GmbH	Verl
BMG Berlin Musik GmbH	Berlin
BMG Deutschland GmbH	Gütersloh
BMG Music International Service GmbH	Munich
bol.com AG	Gütersloh
Crescendo Musikverlag GmbH	Munich
CS Central Service GmbH	Gütersloh
DirectGroup Bertelsmann GmbH	Gütersloh
Doelding-Drolmasken, Bühnen- und Musikverlag Gesellschaft mit beschränkter Haftung	Munich
ED Transfer GmbH Gesellschaft für Qualifizierung	Gütersloh
empolis GmbH	Gütersloh
GGP Media GmbH	Pößneck
Gun Records Musikproduktions GmbH	Bochum
Gütersloher Verlagshaus GmbH	Gütersloh
Hotel & Gastronomie Gütersloh GmbH	Gütersloh
ImmediaONE GmbH	Gütersloh
Interworld Musik-Verlag Gesellschaft mit beschränkter Haftung	Munich
Media Log Spedition GmbH	Gütersloh
Medien Dr. phil. Egon Müller Service GmbH	Verl
Medienfabrik Gütersloh GmbH	Gütersloh
Mobilitäts-Verlag GmbH	Berlin
Mohn Media Bindery GmbH	Gütersloh
Mohn Media Eisnerdruck GmbH	Berlin
Mohn Media Energy GmbH	Gütersloh
MOHN Media Kalender & Promotion Service GmbH	Gütersloh
Mohn Media Print GmbH	Gütersloh
Mohn Media Sales GmbH	Gütersloh
MSI Multimedia Service International GmbH	Gütersloh
Musik Edition Discoton, Gesellschaft mit beschränkter Haftung	Munich
ProBind Professional Binding GmbH	Gütersloh
PSC Print Service Center GmbH	Oppurg
PVS Mailmanagement GmbH	Neckarsulm
Reinhard Mohn GmbH	Gütersloh
RM Buch und Medien Vertrieb GmbH	Gütersloh
RM Buch und Medien Vertrieb GmbH	Rhada-Wiedenbrück
UFA - International Gesellschaft mit beschränkter Haftung	Munich
Ullstein-Verlagsgesellschaft mit beschränkter Haftung	Munich
Verlag RM GmbH	Gütersloh
Verlagsgruppe Random House GmbH	Gütersloh
Verlagsgruppe Random House GmbH	Berlin
Verlagsgruppe Random House GmbH	Munich
Wiener Bohème Verlag Gesellschaft mit beschränkter Haftung	Munich
wissen Media Group GmbH	Munich
WOSCHEK Verlags GmbH	Mainz
Young Musikverlag GmbH	Munich

The exemption provisions set out in § 264 b HGB were again used for the following companies for the year ended December 31, 2003:

ANDSOLD GmbH & Co. KG	Gütersloh
Börse Online Verlag GmbH & Co. KG	Munich
Dresdner Druck- und Verlagshaus GmbH & Co. KG	Dresden
eB2B market place GmbH & Co. KG	Hamburg
Ehrlich & Sohn GmbH & Co. KG	Hamburg
Gruner + Jahr AG & Co KG	Hamburg
Verlagsdienst München Gesellschaft mit beschränkter Haftung & Co. KG	Gräfelfing

39 Recommendation on Appropriation of Retained Earnings

On May 18, 2004 and as provided by the statutes, € 76 million will be distributed to the profit participation certificates out of Bertelsmann AG's retained earnings of € 2,008 million. The Executive Board recommends to the general meeting that the remaining retained earnings of € 1,932 million be appropriated as follows:

	€ in millions
	[illegible]
Dividends to shareholders	220
Carry forward to new fiscal year	1,712
	1,932

Gütersloh, March 12, 2004

Bertelsmann AG
The Executive Board:

Dr. Thielen Dr. Luther Dr. Kundrun Olson

Ostrowski Schmidt-Holtz Dr. Walgenbach

Supervisory Board

Reinhard Mohn
Honorary Chairman

Gerd Schulte-Hillen
Chairman

Vice-Chairman of the Bertelsmann Foundation Executive Board, and Shareholder Bertelsmann Verwaltungsgesellschaft mbH (BVG) (until 12/31/2003)
- Druck- und Verlagshaus Gruner + Jahr AG (Chairman) (until 10/30/2003)
- Hamburg-Mannheimer Versicherung-AG
- Hamburg-Mannheimer Sachversicherungs-AG
- National Geographic Society

Dr. Dieter H. Vogel
Vice-Chairman (until 12/31/2003)
Chairman (since 1/1/2004)

Managing partner of Bessemer, Vogel und Treichl GmbH
- ABB AG (Chairman) (until 3/27/2003)
- Gerling Industrie-Service AG (Vice-Chairman)
- Mapress GmbH (Chairman)
- Mobilcom AG (Chairman since 2/10/2003)
- WCM Beteiligungs- und Grundbesitz AG (Chairman) (since 10/9/2003)
- Blücher Aps
- HSBC Trinkaus & Burkhardt KGaA

Prof. Dr. Jürgen Strube
Vice-Chairman (since 1/1/2004)

Chairman of the Board of Executive Directors, BASF AG (until 5/5/2003)
Chairman of the Supervisory Board, BASF AG (since 6/5/2003)
- Allianz Lebensversicherungs-AG
- BASF AG (Chairman) (since 5/6/2003)
- BMW AG
- Commerzbank AG
- Fuchs Petrolub AG (Chairman) (since 6/5/2003)
- Hapag-Lloyd AG
- Hochtief AG (until 6/4/2003)
- Linde AG

Dr. Rolf-E. Breuer
Chairman of the Supervisory Board, Deutsche Bank AG
- Deutsche Bank AG (Chairman)
- Deutsche Börse AG (Chairman)
- Deutsche Lufthansa AG (until 6/18/2003)
- E.ON AG
- Siemens AG (Vice-Chairman) (until 1/23/2003)
- Compagnie de Saint-Gobain S.A.
- Kreditanstalt für Wiederaufbau
- Landwirtschaftliche Rentenbank

André Desmarais
President and Co Chief Executive Officer, Power Corporation of Canada
- Bombardier Inc.
- CITIC Pacific Limited
- Great-West Lifeco Inc.
- Groupe Bruxelles Lambert S.A.
- Investors Group Inc.
- Pargesa Holding S.A.
- Power Financial Corporation (Vice-Chairman)
- The Great-West Life Assurance Company

Prof. Dr. Michael Hoffmann-Becking
Lawyer
- Delton AG
- Hella KGaA Hueck Co. (Chairman) (since 11/13/2003)
- Rheinische Bahngesellschaft AG
- C.H. Boehringer Sohn
- de Haen-Carstanjen GmbH
- HSBC Trinkaus Burkhardt KGaA (since 4/2/2003)
- Felix Schoeller Holding GmbH & Co. KG (Chairman)

- Supervisory Board mandates in accordance with § 100, para. 2 of the German Stock Corporation Act (AktG)
- Membership in comparable domestic and foreign supervisory bodies of commercial enterprises.

Sir Peter Job
Former Chief Executive Officer,
Reuters Group PLC
- Deutsche Bank AG
- GlaxoSmithkline PLC
- Instinet Group Inc.
- Multex.com Inc. (until 2/18/2003)
- RVC
- Schroders PLC
- Shell Transport and Trading PLC
- Tibco Software Inc.

John R. Joyce
Chief Financial Officer IBM Corp.

Oswald Lexer
Vice-Chairman of the Bertelsmann
Corporate Works Council

Liz Mohn
Vice-Chairwoman of the Bertelsmann
Foundation Executive Board and
Chairwoman of the Board of Bertelsmann
Verwaltungsgesellschaft mbH (BVG)

Willi Pfannkuche
Member of the Bertelsmann Corporate
Works Council

Erich Ruppik
Chairman of the Bertelsmann Corporate
Works Council

Gilles Samyn
Managing Director and Vice-Chairman,
Compagnie Nationale à Portefeuille S.A.
- Fomento de Construcciones y Contratas (until 7/31/2003)
- Groupe Bruxelles Lambert S.A.
- Groupe Taittinger S.A. (since 1/1/2003)
- Imerys S.A.
- Petrofina S.A (until 5/31/2003)
- Pargesa Holding S.A.
- Quick S.A.
- RTL Group S.A.
- Société du Louvre S.A. (since 1/1/2003)

Richard Sarnoff
Chairman of the Bertelsmann AG
Management Representative Committee
Executive Vice President Random House
- Audible Inc.
- Classic Media Inc.
- ebrary Inc.
- Princeton Review Inc.
- Xlibris Inc.
- OAK Hill Securities Funds II, L.P.

Christian van Thillo
Chief Executive Officer De Persgroep NV,
Brussels (since 7/4/2003)

Committees of the Supervisory Board.

Personnel Committee
Dr. Dieter H. Vogel (Chairman)
André Desmarais
Liz Mohn
Prof. Dr. Jürgen Strube

Audit and Finance Committee
Prof. Dr. Jürgen Strube (Chairman)
Dr. Rolf-E. Breuer
Prof. Dr. Michael Hoffmann-Becking
John R. Joyce
Erich Ruppik
Gilles Samyn

Strategy and Investment Committee
Dr. Dieter H. Vogel (Chairman)
Dr. Rolf-E. Breuer
André Desmarais
Sir Peter Job
Gilles Samyn
Richard Sarnoff

Working Group of the Employee Representatives on the Supervisory Board
Liz Mohn (Chairwoman)
Oswald Lexer
Willi Pfannkuche
Erich Ruppik
Richard Sarnoff

Executive Board

- Supervisory Board mandates in accordance with § 100, para. 2 of the German Stock Corporation Act (AktG)
- Membership in comparable domestic and foreign supervisory bodies of commercial enterprises.
- * External mandates

Dr. Gunter Thielen
Chairman & Chief Executive Officer
- Arvato AG
- Druck- und Verlagshaus Gruner + Jahr AG (Chairman) (since 10/30/2003)
- KarstadtQuelle AG*
- Leipziger Messe GmbH*
- Bertelsmann Inc.
- Hannoversche Leben AG*
- RTL Group S.A.
- Saarländische Landesbank*

Dr. Siegfried Luther
Vice-Chairman
- Bertelsmann Buch AG (until 9/22/2003)
- Druck- und Verlagshaus Gruner + Jahr AG
- Springer Verlag GmbH & Co. KG (until 3/10/2003)
- WestLB AG*
- Bertelsmann Inc.
- Lycos Europe N.V. (until 5/23/2003)
- RTL Group S.A.

Dr. Arnold Bahlmann
(until 6/30/2003)
- Stürtz AG (Chairman) (until 6/30/2003)

Dr. Bernd Kundrun
- Gruner + Jahr Holding AG, Vienna
- Gruner + Jahr USA Group Inc.
- Stern Magazine Corporation

Peter Olson, J.D./MBA
- Barnesandnoble.com Inc. (until 9/2/2003)
- Bertelsmann Inc.
- Grupo Editorial Random House Mondadori S.L.
- Random House Inc.
- Random House Direct Inc.
- Random House Kodansha Inc. (since 5/19/2003)
- Random House TPR Inc.
- Random House Ventures LLC

Hartmut Ostrowski
- Webmiles GmbH (Chairman)
- arvato Services Inc.
- Bertelsmann Holding Spain S.A.
- Berryville Graphics Inc.
- Coral Graphic Services of Kentucky Inc.
- Coral Graphic Services Inc.
- Coral Graphic Services of Virginia Inc.
- Dynamic Graphic Finishing Inc.
- Eurohueco S.A.
- Nuovo Instituto Italiano d'Arti Grafiche S.p.A.
- maul + co – Chr. Belser GmbH
- Printer Industria Gráfica S.A.
- Offset Paperback MFRS Inc.
- Stampers Limited

Rolf Schmidt-Holtz
- Druck- und Verlagshaus Gruner + Jahr AG
- Ariola Eurodisc Inc
- Arista Records Inc.
- Bertelsmann Inc.
- Bertelsmann Music Group Inc.
- Bertelsmann TJS Inc.
- BMG Australia Limited
- BMG J LLC
- BMG Music
- BMG New Zealand Limited
- BMG Songs Inc.
- BMG Special Products Inc.
- Careers-BMG Music Publishing Inc.
- RTL Group S.A.
- Zomba Enterprises Inc.
- Zomba Recording Corporation
- Zomba Records Ltd.

Dr. Ewald Walgenbach
- Barnesandnoble.com Inc. (until 9/15/2003)
- Bertelsmann Corea Co. Ltd.
- bol.com AG (Chairman)
- Bookspan Partnership
- ECI voor boeken en platen B.V.
- FCB Freizeitclub GmbH & Co. KG
- RTL Group SA.
- Shanghai Bertelsmann Culture Industry Co. Limited

Auditor's Report

We have audited the consolidated financial statements, comprising the balance sheet, the income statement and the statements of changes in shareholders' equity and cash flows as well as the notes to the financial statements prepared by the Bertelsmann AG for the business year from January 1 to December 31, 2003. The preparation and the content of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) and in supplementary compliance with International Standards on Auditing (ISA). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements are examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the Group for the business year in accordance with International Financial Reporting Standards.

Our audit, which also extends to the group management report prepared by the Company's management for the business year from January 1 to December 31, 2003, has not led to any reservations. In our opinion on the whole the group management report provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the group management report for the business year from January 1 to December 31, 2003 satisfy the conditions required for the Company's exemption from its duty to prepare consolidated financial statements and the group management report in accordance with German law.

Bielefeld, March 15, 2004

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Reinke
German Public Auditor

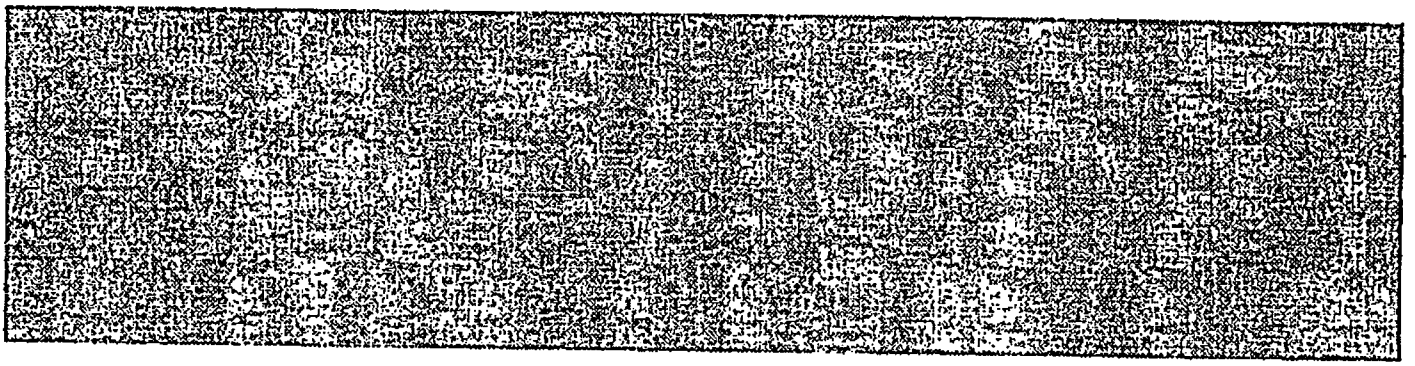
Kämpf
German Public Auditor

Overview of the Divisions

RTL Group is Europe's leading commercial broadcaster, with interests in 25 television channels and 23 radio stations in eight countries and content production throughout the world. Its television portfolio includes RTL Television in Germany, M6 in France, Five in the UK, and the RTL channels in the Netherlands, Belgium, Luxembourg and Hungary, as well as Antena 3 in Spain. RTL Group's flagship radio station is RTL in France, and it also owns or has interests in other stations in France, Germany, Belgium, the Netherlands and Luxembourg. RTL Group's content production arm, Fremantle Media, is one of the largest international producers outside the US. It currently produces over 260 programs in more than 39 countries including the US, providing a wide range of drama, entertainment and factual programming for viewers around the world.

Random House is the world's largest trade book publisher, publishing many of the most revered and most popular fiction and nonfiction authors in hardcover, trade and mass market paperback, audio, and electronic formats. Random House is the one truly global book publisher, the only one with an established network of leading publishers in the English-, German-, Spanish- and Japanese-language countries, four of the leading language groups, as well as Korea. Random House publishes the largest number of bestsellers annually in most of these countries and the greatest number of Nobel Prize winners, among them Toni Morrison, Thomas Mann, and William Faulkner.

The Gruner + Jahr printing and publishing company is Europe's biggest magazine publisher. Its more than 11,000 employees in 14 countries on three continents publish more than 120 magazines and newspapers, as well as the accompanying online sites. G+J magazines include "stern," "Brigitte," "GEO," "Capital," "Gala," "Eltern/Parents," "Financial Times Deutschland," "Essen & Trinken," "National Geographic" as well as "Inc.," "Fitness" and "Family Circle"; many of these titles are published in a number of editions in several countries. With international revenues accounting for more than 60 percent, G+J is the world's most international publishing company. Bertelsmann AG owns 74.9 percent of the company; the Jahr publishing family, Hamburg, owns 25.1 percent.



Select Terms at a Glance

Benchmark Bond
Large-volume bond with issue proceeds of € 500 million or more.

Cash Flow According to DVFA/SG
Sustainable cash flow before changes in working capital. It is defined by the German Association for Financial Analysis and Asset Management and the Schmalenbach Gesellschaft.

Debt Issuance Program
Contractual framework to issue debt instruments in a flexible manner. A Debt Issuance Program allows to make use of the capital markets for financing purposes.

Discontinuing Operation
Significant business units that are planned for divestment or have already been divested and which can be distinguished operationally as well as for financial reporting purposes. These are subject to special disclosure rules.

Rights Similar to Goodwill
As set out in IAS 22, intangible assets determined as a result of fair value accounting at the time of a business combination. These are treated in the same way as goodwill for the purpose of calculating key financial figures.

Net Financial Debt
Gross financial debt including liabilities from finance leases, minus cash and cash equivalents.

Operating EBITA
Earnings before interest, taxes, amortization of goodwill and rights similar to goodwill, and special items.

Operating EBITDA
Earnings before interest, taxes, amortization of goodwill and rights similar to goodwill, depreciation of property, plant and equipment, depreciation of financial assets, and special items.

Rating
Classification of the creditworthiness of a borrower through a credit analysis carried out by a specialist agency.

Special Items
Certain items of income and expense that are special due to their nature, amount or incidence and whose disclosure is relevant to explain the performance of the enterprise or its segments for the period. According to IFRS, these items are to be disclosed separately and may include restructuring measures and effects from portfolio adjustments.

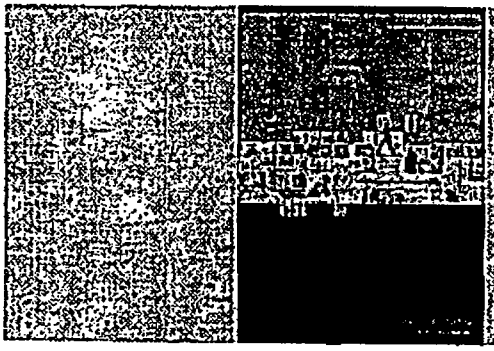
Syndicated Loan
Credit line granted by a group of banks.

VSOP
Acronym for Virtual Stock Option Plan: Program for granting management a long-term, earnings-related component of their remuneration.

Bertelsmann Music Group (BMG) does business in 41 countries with its 200 labels. The group's best-known labels include Ariola, Arista Records, J Records, Jive Records, RCA Records and the RCA Label Group – Nashville. BMG Music Publishing is the world's third-biggest music publisher. BMG works with numerous world-class stars including Santana, Ozzy, Pink, Avril Lavigne, Aretha Franklin, Christina Aguilera, Britney Spears, Justin Timberlake, Eros Ramazzotti and Alicia Keys.

Arvato AG with its roughly 55 subsidiaries is among the largest worldwide media service providers with internationally networked operations. The Arvato AG subsidiaries all around the world currently employ more than 31,000 staff. Companies belonging to Arvato AG include Arvato Print (including MOHN Media, the Maul Baiser media group as well as numerous printers in Europe and America), the divisions Arvato Direct Services (including customer loyalty systems and service center facilities), Arvato Logistics Services (logistics and supply chain management), Arvato Storage Media (including the production of CD-ROMs, DVDs and audio CDs), and Arvato Systems (international provider of qualified and customized IT services) as well as specialist publishers.

Direct Group Bertelsmann integrates Bertelsmann's global media direct-to-customer businesses. Roughly 32 million customer relationships secure Direct Group's position among the largest enterprises in media commerce. Cornerstone of this success are the book and music clubs in 21 countries incorporating strong brands like France Loisirs (France), Book-of-the-Month-Club (USA), Der Club (Germany), Círculo de Lectores (Spain) and BeMusic (USA). Members have access to the clubs' product range via catalogue, Internet or one of the more than 600 worldwide club shops.



Bertelsmann Corporate Responsibility Report 2003

With its Corporate Responsibility Report 2003, Bertelsmann AG is not only upholding at international level the tradition of a social report focusing on Germany; at the same time, it is also taking a further step towards greater transparency. This report reflects Bertelsmann's commitment and involvement on behalf of employees, society and the environment. It describes the basic principles of Bertelsmann's social responsibility that have developed over the decades, and at the same time it provides an insight into case studies and exemplary projects, which provide specific evidence of its contribution towards society.

Financial Calendar

May 5, 2004
Announcement of Q1 figures

May 18, 2004
Payout of dividends on Profit Participation Certificates for the 2003 fiscal year

September 8, 2004
Announcement of figures for the first half of 2004

November 9, 2004
Announcement of figures for the first nine months of 2004

Imprint

Editing and Coordination
Bertelsmann AG
Corporate Communications/
Media Relations

Design
ringzwei, Hamburg

Production
medienfabrik Gütersloh GmbH,
Gütersloh

Print
MOHN Media - Mohndruck GmbH,
Gütersloh

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The Annual Report and current information on Bertelsmann is also posted at:
www.bertelsmann.de
www.bertelsmann.com

EXHIBIT CO 0922

Annual Report

"My Hero is..."

BERTELSMANN

media worldwide

Bertelsmann Financial Highlights

		IAS 2002 € millions	IAS Pro forma 2001 € millions	IAS 12/31/2001 € millions	IAS 2001 € millions	HGB 2000 € millions
Group Development	Revenues	16,312	18,979	9,685	16,748	16,524
	Operating EBITA	936	573	164	826	1,195
	Net income before minority interests	968	1,378	931	987	672
	Cash Flow	1,115	294	127	160	1,317
	Investments	5,263	2,639	1,067	2,744	2,049
	Total assets	22,188	23,734	23,734	17,245	14,692
	Personnel costs	4,674	4,812	2,343	4,319	3,765
Employees	Germany	31,712	31,870	31,870	30,732	30,984
	Other countries	48,920	48,426	48,426	43,816	45,273
	Total	80,632	80,296	80,296	74,548	76,257
Equity	Subscribed capital 1)	606	606	606	463	463
	Retained earnings	6,079	5,697	5,697	3,222	1,212
	Minority interests	1,059	2,081	2,081	792	1,278
	Equity	7,744	8,384	8,384	4,477	3,638 2)
	– As percentage of total assets	35	35	35	26	25
	Net financial debt	2,741 3)	859 3)	859 3)	2,298 3)	2,148
	Net financial debt repayment factor (in years) 4)	2.5	2.9	n/m	n/m	1.6
Net Income	Net income before minority interests	968	1,378	931	987	672
	– Minority interests	40	(143)	(18)	246	243
	– Dividends paid	240	n/a	300	50	88
	– Allocation to retained earnings	688	n/a	649	691	265
	Profit participation payments	77 5)	77 5)	39 5)	95 5)	76
	Employee profit sharing 6)	34	n/a	19	44	65

1) of which at December 31, 2002, 57.6 percent belong to the Bertelsmann Foundation, 17.3 percent to the Mohn family, and 25.1 percent to Groupe Bruxelles Lambert (GBL); this reflects the purchase obligation of ZEIT shares
2) including profit sharing capital of € 637 million
3) including finance leasing obligations
4) net financial debt/cash flow
5) offset in net income according to IAS
6) offset in net income

Annual Report January 1 through December 31, 2002

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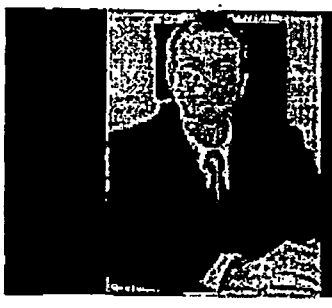


Gunter Thielen
Bertelsmann AG Chairman & CEO

Dear Friends of Bertelsmann,

Last August, immediately after taking up office, I paid inaugural visits to many of my colleagues throughout the group. The trip took me first to New York, then to Luxembourg, Barcelona, Milan, London and Paris, and finally to Munich, Hamburg and Cologne. My experience was similar wherever I went: The companies' executives and employees let me know that the Executive Board can count on their creativity and enthusiasm, on their willingness to cooperate and their commitment. That is what has always been behind Bertelsmann's success: decentralization, delegation of responsibility, partnership, diversity and cooperation. The Executive Board entrusts the enterprise to its entrepreneurs.

This is as true in our biggest market America as it is in Europe or Asia. In the year just ended, this attitude again ensured that Bertelsmann companies were able to respond swiftly and resolutely to the challenges of the market.

Bertelsmann made a good showing in 2002: earnings were up despite falling revenues. We improved our cost structure and strengthened our profitability. My appreciation goes out to all the employees whose dedicated efforts made this success possible.

As a private company, Bertelsmann has grown to its current proportions on its own steam. Our equity ratio continues at a high level. At 34.9 percent, it is well above our target of 25 percent. Thanks to our conservative financial benchmarks and integrated risk management, we command an excellent competitive position. The integration of RTL Group, the acquisition of the music company Zomba, and the takeover of the Holtzbrinck group's radio and television activities brought investments to € 5.3 billion for 2002. As a result of these capital expenditures, net financial debt at December 31, 2002 was at € 2.7 billion. To quickly pay down our financial debt, we are selling the BertelsmannSpringer specialist publishing group.

2002 was a year of difficult business conditions. Consumer reluctance and the crisis in advertising took their toll on Bertelsmann's companies. So it is all the more encouraging that our divisions were largely able to compensate the revenue declines, and achieved overall earnings that were much higher than during the previous year. Innovation, portfolio measures, cost management, and increased efficiency all played a key role. Above and beyond this, RTL Group garnered a great deal of attention and good results with internationally successful formats such as "Pop Idol." Gruner + Jahr decreased its involvement in the regional newspaper business and successfully launched a major new title in Germany's tough magazine market: "Woman." Random House reduced its expenditure on administration and operative processes without restricting its publishers' options. At the same time, it extended its market positioning: in Japan, through a joint venture with the

Bertelsmann has gathered its strength for continued organic growth – through creative product innovation and reasonable acquisitions. We plan and act with a view to the long term.

Kodansha Ltd. publishing company – Japan's first such venture with a Western book publishing group – and in Germany, through the takeover of Axel Springer Verlag's historic Ullstein Heyne List publishing group.

Bertelsmann Music Group (BMG), whose more than 200 labels in 41 countries make it one of the major global players in the industry, achieved turnaround last year. This positive news is all the more pleasing given the fact that the music industry as a whole continues to suffer from music piracy and dramatic revenue declines in recorded music.

The arvato group once again proved its stability despite the difficult situation of quite a few of its customers. Business is excellent at arvato direct services, one of Europe's biggest providers of customer loyalty systems.

DirectGroup's businesses, too, were impacted by the prolonged consumer slump, especially the club businesses. Meanwhile, DirectGroup has done an excellent job handling its purposeful portfolio streamlining in the e-commerce sector. The Internet continues to be an important distribution channel for us. In fact, it is showing very positive development as an integral part of our core businesses: many new members in the clubs are recruited on the World Wide Web, and the share of club revenues generated on the Internet is growing steadily.

Bertelsmann has gathered its strength for continued organic growth – through creative product innovation and reasonable acquisitions. We plan and act with a view to the long term. The days of great leaps, blockbuster deals and billion-euro acquisitions are over for now. Our focus is firmly on investments that can be swiftly integrated in our existing core businesses. Many recent examples show that the time needed for integration and hence the money that is swallowed up by the merged companies is underestimated in mega-deals. Bertelsmann's history shows that there is a different way. We operate on the principle of doing things simply – and simply doing them.

Bertelsmann launched its Excellence Initiative (BEX) very early on, in spring 2001. BEX stands for a steady and sustainable improvement of our products and services and hence for increased earnings and returns. It takes our strong companies and makes them even stronger, faster and more efficient. The goal is to improve how we do what we do best. This procedure is more conducive to success than the attempt to concentrate one's energy solely on eliminating weak points.

Excellence at Bertelsmann does not just mean optimizing costs and processes. It also means partnership and collaboration. Two examples from the last year show our group's powerful potential for synergy. On the 25th anniversary of Elvis Presley's death, the BMG

sold millions of copies worldwide of its "ELVIS 30 #1 Hits" album. arvato produced the CDs, and an Elvis calendar. Random House published books on Elvis; RTL Group and Gruner + Jahr came out with special Elvis editions. Our Clubs marketed Elvis specials all over the world. The fruit of this carefully planned collaboration was roughly € 100 million in additional revenue.

Another example of excellent collaboration between our companies was the worldwide dissemination of the above-mentioned TV format, "Pop Idol." RTL Group, BMG and arvato all participated in the quest for Germany's "Superstar." In the U.S., Random House and Gruner + Jahr contributed the tie-in publications. Today, more than 50 countries want to adopt the talent-show format conceived by RTL's production subsidiary, FremantleMedia.

Bertelsmann has also completed a significant step in its historiography. From 1999 to 2002, an Independent Historical Commission headed by the internationally renowned Holocaust expert Prof. Saul Friedlaender meticulously researched Bertelsmann's role in the Third Reich. The report that resulted from this research and documentation was published in book form by C. Bertelsmann in fall 2002 and is accepted by the Executive Board, without qualification, as the official corporate history. We regret that earlier depictions of our corporate history contained considerable gaps and errors, and that we did not treat our historical legacy with great enough care in the past. The archives accumulated during the research will be made available to the public as the heart of a historical archive in Gütersloh.

Finally, I would like to mention two more examples of how we are internationalizing our corporate culture: In fall 2002, we modified our traditional profit-participation scheme to make it more international and fit for the future. The success of their individual companies will play a much greater role for each employee from now on. Depending on their company's performance, employees may receive a bonus of up to one-and-a-half months' salary. At the same time, the idea of solidarity should not be given short shrift; employees should be able to identify with their company and with greater Bertelsmann. Therefore, we are now testing a corporate component in Germany. Depending on the group's worldwide results, employees can earn a maximum of half a month's salary on top of their regular annual pay. This new model will go into effect during the current year, 2003. If the new corporate profit participation model is a success in Germany, we plan its step by step introduction at the international level.

For 25 years now, it has been part of our corporate culture of partnership to ask employees in Germany for their opinion on key matters pertaining to their work and to the company. Last fall, the employee survey went international for the first time, and was

BEX takes our strong companies and makes them even stronger, faster and more efficient. The goal is to improve how we do what we do best. This procedure is more conducive to success than the attempt to concentrate one's energy solely on eliminating weak points.

systematically carried out in 407 companies in 46 countries. At the same time, we achieved a participation rate of 78.7 percent, a new record in the history of our employee surveys. This underscores our employees' commitment to their company. The results differ from division to division and from country to country, but some interesting insights apply for Bertelsmann as a whole. For instance, 74 percent of all employees indicated that they are satisfied or very satisfied with their work. Given the choice, 69 percent would choose their company all over again. The vast majority of employees feel that their companies provide them with a good work environment. More than two thirds believe that Bertelsmann's management is capable of safeguarding success and continuity in the future. The Executive Board is grateful for this vote of confidence. At the same time, the survey clearly showed where there is room for improvement. Areas of criticism will be dealt with in detail and transformed into specific measures, by means of open discussions at all levels, in which all employees are invited to contribute their ideas.

While continuing the evolution of our corporate culture, Bertelsmann is accelerating its rapprochement to the capital market. This stands in connection with our preparations for a possible IPO of the shares held by our shareholder Groupe Bruxelles Lambert (GBL). Our shareholders, Supervisory Board and management are agreed that we want to improve Bertelsmann's earnings and make the company fit for the stock market. The management will continue to keep its eye firmly on customer focus and high-quality products. Bertelsmann will continue to deliver first-class work, first-rate figures and transparent communication.

Sincerely yours

Gunter Thielen
Bertelsmann AG Chairman & CEO

[redacted]

Dr. Gunter Thielen
Born on August 4, 1942 in Quierschied, Germany. Member of the Bertelsmann AG Executive Board since July 1, 1985. Chairman of the Bertelsmann AG Executive Board & Chief Executive Officer since August 5, 2002. Gütersloh

Dr. Siegfried Luther
Born on August 5, 1944 in Hobeck, Germany. Member of the Bertelsmann AG Executive Board since July 1, 1990. Deputy Chairman of the Bertelsmann AG Executive Board since August 5, 2002, and Chief Financial Officer. Gütersloh

Peter Olson J.D./MBA
Born on May 1, 1950 in Chicago, Illinois (USA). Member of the Bertelsmann AG Executive Board since April 1, 2001. Chairman & Chief Executive Officer of Random House Inc. New York

Hartmut Ostrowski
Born on February 25, 1958 in Bielefeld, Germany. Deputy member of the Bertelsmann AG Executive Board since October 1, 2001. Member of the Bertelsmann AG Executive Board and Chairman & Chief Executive Officer of Bertelsmann arvato AG since September 1, 2002. Gütersloh

Dr. Arnold Bahlmann
Born on November 28, 1952 in Cologne, Germany. Member of the Bertelsmann AG Executive Board since January 1, 2001. President & Chief Executive Officer of BertelsmannSpringer, Berlin

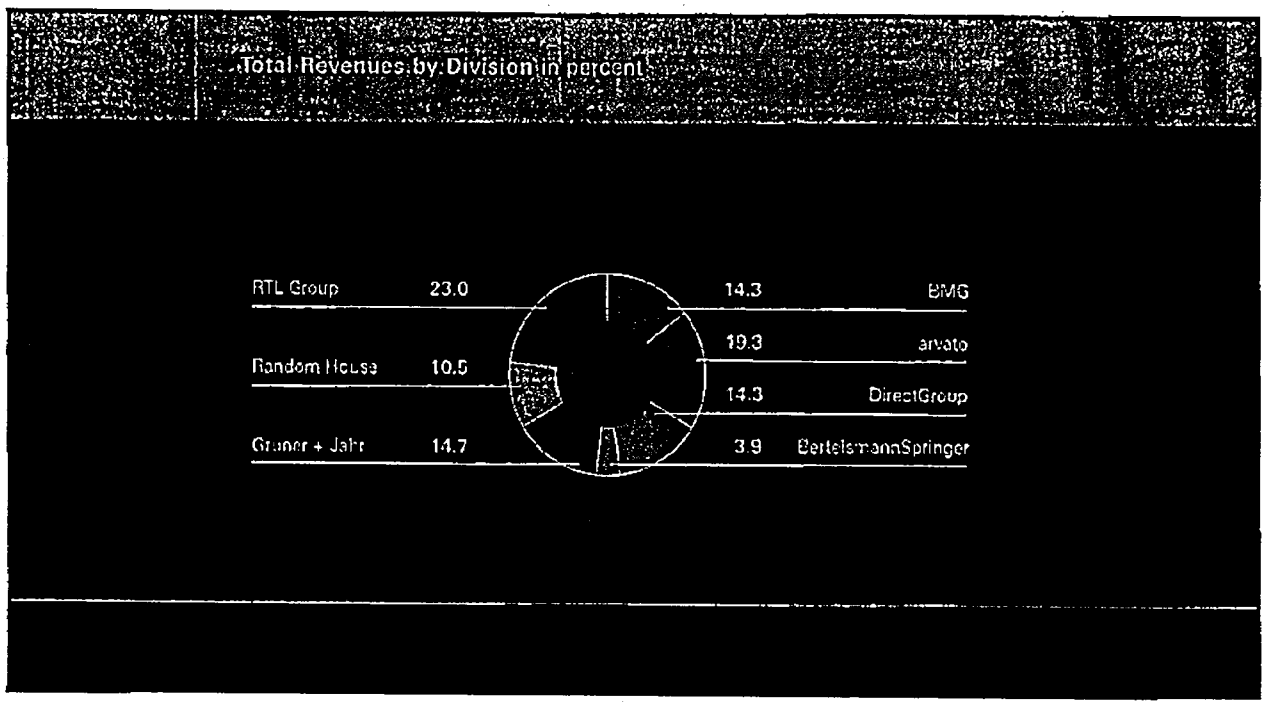
Dr. Bernd Kundrun
Born on November 8, 1957 in Wuppertal, Germany. Member of the Bertelsmann AG Executive Board and Chairman & Chief Executive Officer of Gruner + Jahr AG since November 1, 2000, Hamburg

Rolf Schmidt-Holtz
Born on August 31, 1948 in Martinsreuth, Germany. Member of the Bertelsmann AG Executive Board since July 1, 2000. Chairman & Chief Executive Officer of Bertelsmann Music Group (BMG) and Chief Creative Officer of Bertelsmann AG, Hamburg and New York

Dr. Ewald Walgenbach
Born on February 10, 1959 in Neustadt/Wied, Germany. Member of the Bertelsmann AG Executive Board since February 6, 2002. Chief Executive Officer of DirectGroup Bertelsmann, Gütersloh

My Hero Is...

On the following pages young people from New York, Tokyo, Berlin and Paris present the names of famous authors, musicians, scientists, journalists and radio anchors their heroes in the world of media. Bertelsmann sees itself as a home for creative talent. Our media serve to provide information, education and entertainment around the globe.



Management Report

Bertelsmann managed to improve its operating performance in 2002 despite a difficult business environment. At € 18.3 billion, revenues for 2002 were slightly below the pro forma € 19.0 billion achieved in 2001 [1]. This was largely due to the weak dollar. The group managed to increase its Operating EBITA [2] to € 936 million (previous year: € 573 million). Net income before minority interests amounted to € 968 million (previous year: € 1.4 billion).
The number of employees was 80,632 at December 31, 2002 (December 31, 2001: 80,296).

[1] The pro forma figures assume a scope of consolidation as at December 31, 2001, i.e. with RTL Group and France Loisirs shown fully consolidated for the calendar year 2001. The management report's commentary on the Bertelsmann group's economic development is based on these unaudited pro forma figures. For legal purposes, fiscal year 2002 should be compared to the stub period 2001; this is done on pp. 60 ff.
[2] Operating EBITA represents the earnings before financial result, taxes and amortizations of goodwill and similar rights, as well as before capital gains/losses and special items, in particular restructuring costs. Internet losses have been included in the Operating EBITA as from 2002.

Revenues by Division in € millions

Division	2002 Germany € millions	2002 International € millions	2002 Total € millions	Pro forma 2001 Total € millions
RTL Group	2,132	2,230	4,362	4,054
Random House	143	1,852	1,996	2,039
Gruner + Jahr	1,039	1,761	2,800	2,973
BMG	252	2,482	2,734	2,982
arvato	1,629	2,039	3,668	3,520
DirectGroup	395	2,312	2,707	3,089
Total for all divisions except BertelsmannSpringer	5,590	12,656	18,246	18,657
BertelsmannSpringer	364	367	731	748
Total for all divisions	5,954	13,023	18,977	19,405
Other	46	4	50	192
Intercompany revenues	(309)	(406)	(715)	(618)
Consolidated revenues	5,691	12,621	18,312	18,979

Having changed its accounting standards from the German Commercial Code (HGB) to International Financial Reporting Standards (IFRS, formerly IAS) and reported an abbreviated fiscal year (from July through December 2001), Bertelsmann herewith submits its first financial statement during which the fiscal year is identical to the calendar year. To facilitate comparability, pro forma figures were calculated for the calender year 2001.

Revenues

Slightly down, mostly due to the weak dollar

Consolidated revenues declined by 3.5 percent to € 18.3 billion, primarily due to the weak dollar. In addition to this currency effect, the continuing weak economy, the negative trend in the advertising industry, and a decline in sales, particularly at DirectGroup, all contributed to this development. The ad-financed businesses, most of which are part of RTL Group and Gruner + Jahr, contributed less than 25 percent to total sales in 2002.

Operating EBITA

Increased to € 936 million from € 573 million

Bertelsmann was able to improve its Operating EBITA despite the decline in revenues. Much of this was due to the Bertelsmann Excellence Initiative (BEX) to improve operating results. Operating EBITA reached € 936 million vs. € 573 million in 2001. This translates to a 5.1 percent return on sales. 2002 Operating EBITA includes Internet losses of € 138 million, while Operating EBITA for the previous year was calculated without taking into consideration Internet losses totaling € 808 million. This approach reflects the stance of continuing Internet activities as part of the core businesses or phasing them out in the future. The group Operating EBITA is the sum of the Operating EBITA in all divisions including the Corporate items. Beyond expenditures for the Corporate Center, the Corporate items also include the income effects of investments at the corporate level (Corporate Investments).

Analysis of the Net Income in € millions

	2002	Pro forma 2001
Operating EBITA by division		
RTL Group	465	385
Random House	168	33
Gruner + Jahr	226	198
BMG	125	(79)
arvato	217	167
DirectGroup	(150)	(61)
Total Operating EBITA by division	1,051	643
BertelsmannSpringer	71	59
Corporate/consolidation	(186)	(129)
Operating EBITA	936	573
Internet losses	[illegible]	(808)
Special items	(111)	(927)
Amortization of goodwill* and similar rights		
– Regular	(784)	(856)
– Impairments	(1,668)	(518)
Capital gains/losses	2,918	5,533
Profit before financial result and taxes	1,291	2,997
Financial result	(266)	(433)
Taxes on income	(57)	(1,186)
Net income before minority interests	968	1,378
Minority interests	(40)	(143)
Net income after minority interests	928	1,235

* Including amortization of goodwill from associated companies.

"Bertelsmann has improved its profitability in challenging market environments."

Siegfried Luther, Chief Financial Officer

Net Income

Below previous year due to lower capital gains

Capital gains totaled €2.9 billion (previous year: €5.5 billion), €2.8 billion of which are proceeds from the sale of the holding in the AOL Europe online service. The step-by-step sale agreed to with AOL Time Warner in 2000 was concluded in 2002. It brought Bertelsmann total proceeds of $ 6.75 billion. Special items were reduced to just minus € 111 million (previous year: minus € 1.7 billion including Internet losses of € 808 million). After amortization of goodwill and similar rights of € 2.5 billion (previous year: € 1.4 billion), earnings before financial results and taxes amounted to € 1.3 billion (previous year: € 3.0 billion). The larger part of the amortization of goodwill was due to an impairment of goodwill resulting from the acquisition of the music company Zomba. After subtracting the financial result and taxes, net income before minority interests totaled € 958 million (previous year: € 1.4 billion).

Investments

High investment volume due to Zomba acquisition

Investments amounted to € 5.3 billion (previous year: € 2.6 billion). The acquisition of the Zomba music company accounted for € 2.3 billion, while the purchase of another 22 percent in RTL Group accounted for € 1.5 billion.

New Chairman & CEO

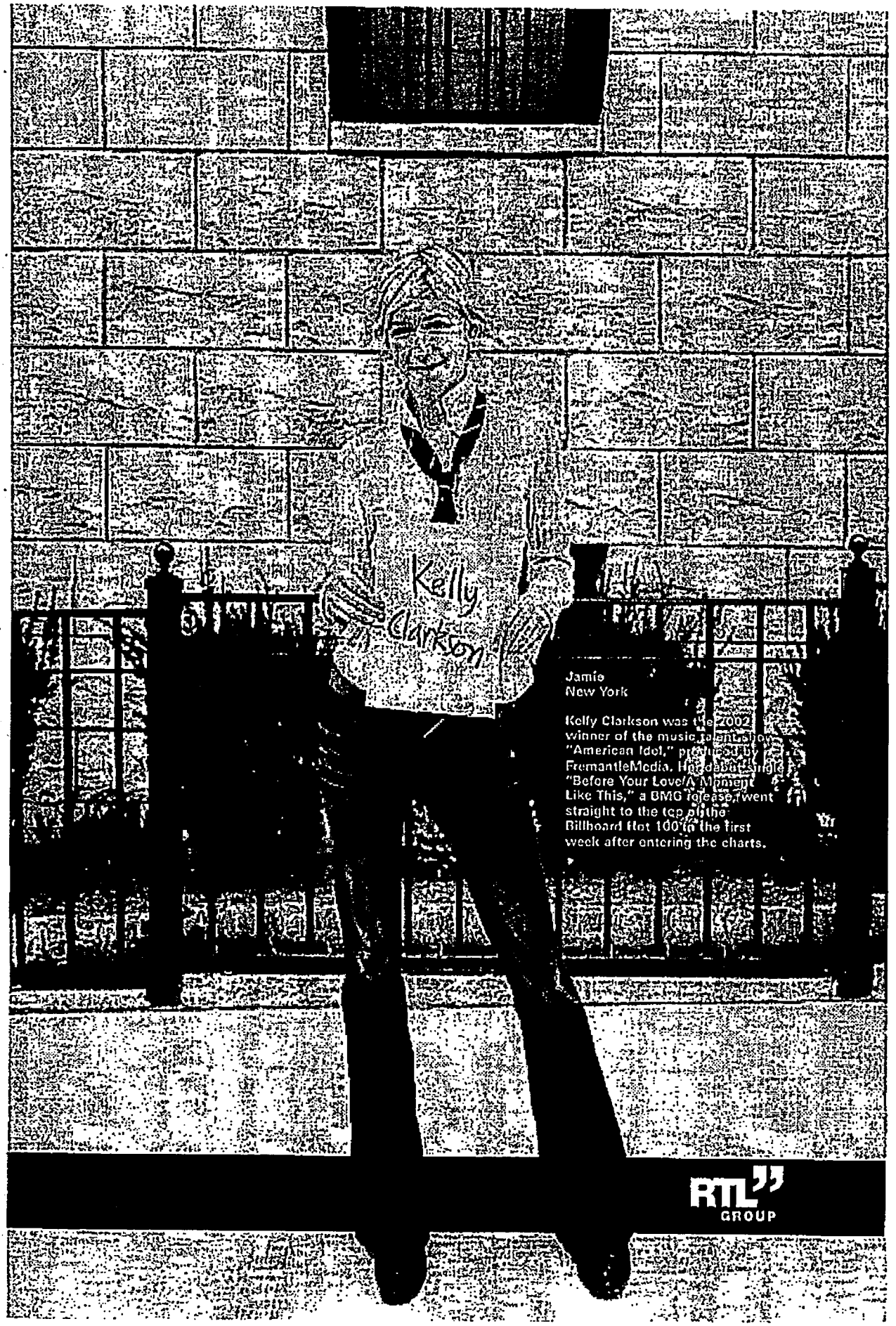
Gunter Thielen took over on August 5, 2002

On August 5, 2002, Gunter Thielen took over from Thomas Middelhoff as Chairman & CEO. The Executive Board declared a clear focus on the profitability of its core businesses – television, radio and TV production, book and magazine publishers, music, print and media services, and the Clubs – and proceeded to set the necessary priorities in the operations. At the same time, the Executive Board reinforced the principle of decentralized management.

Jean
Paris

"Arthur – Un mythe. Un rol. Une radio." The "Planetarthur" show mesmerizes Fun Radio listeners every Monday through Friday. Arthur is fast becoming the king of French radio.

"My Hero is..."



Jamie
New York

Kelly Clarkson was the 2002 winner of the music talent show "American Idol," produced by FremantleMedia. Her debut single "Before Your Love/A Moment Like This," a BMG release, went straight to the top of the Billboard Hot 100 in the first week after entering the charts.

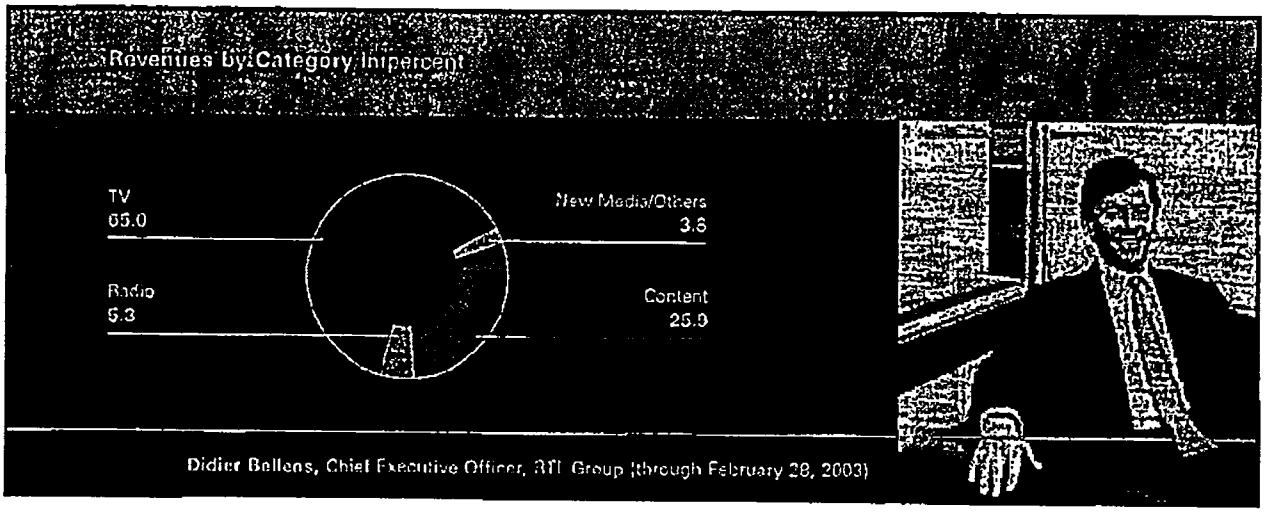
RTL GROUP

RTL Group

Earnings improved significantly despite slump in advertising

RTL Group, Europe's No.1 in television, radio and TV production, had revenues of € 4.4 billion in 2002 (previous year: € 4.1 billion). Despite the crisis in advertising, the company achieved Operating EBITA of € 465 million, a significant increase over the previous year's Operating EBITA of € 385 million.

Advertising revenues around the world were considerably down for the second consecutive year, especially in Germany, RTL Group's most important market. RTL Group was able to compensate for this with internationally successful formats, a broad portfolio (both in terms of types of business and geography), cost management and a diversified revenue structure. The group forcefully pursued additional income streams such as merchandising, home shopping and SMS messaging, which contributed considerably to reducing its dependence on the advertising market and to further stabilizing its business development. The French channel M6 and RTL Television in Germany in particular have been very successful in pursuing these additional sources of



income, and stood out positively from the development of the overall market in 2002. In important markets such as Germany, France and Great Britain, RTL Group's TV channels were able to maintain or extend their audience shares despite the Olympic games and Soccer World Cup, which were mostly broadcast by other providers. For example, the young British channel "five" (formerly Channel 5) registered significant increases in revenue and ratings due to careful investments in its programming and a contemporary market image. RTL Klub in Hungary which, like "five," celebrated its 5th birthday in 2002, also showed growth. In Germany, the RTL family of channels led by the market leader RTL Television managed to add ad-market shares and maintain their audience shares, and RTL Television itself celebrated its 10th year as market leader in the 14–49 demographic. Shows that guaranteed high ratings this year included the quiz show format "Who Wants To Be A Millionaire" and coverage of ski-jumping and Formula One events. VOX looks back on the most successful year in its history. Meanwhile, RTL Group stations in the Netherlands implemented restructuring programs designed to return them to the profit zone.

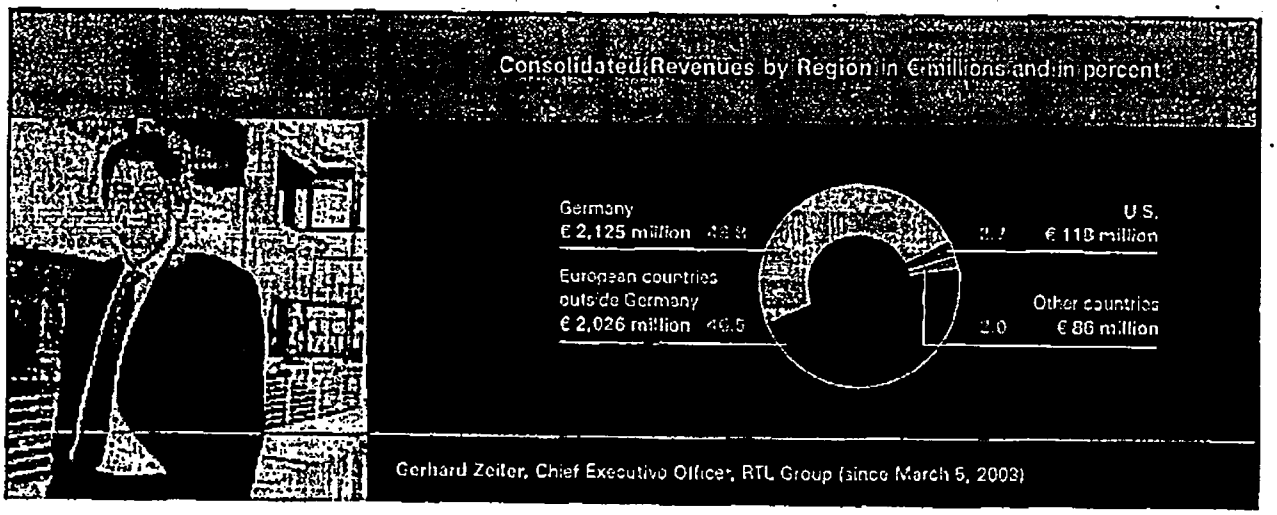
The difficult advertising economy was felt in RTL Group's radio business as well. In most cases, the stations were able to maintain their respective total listener shares.

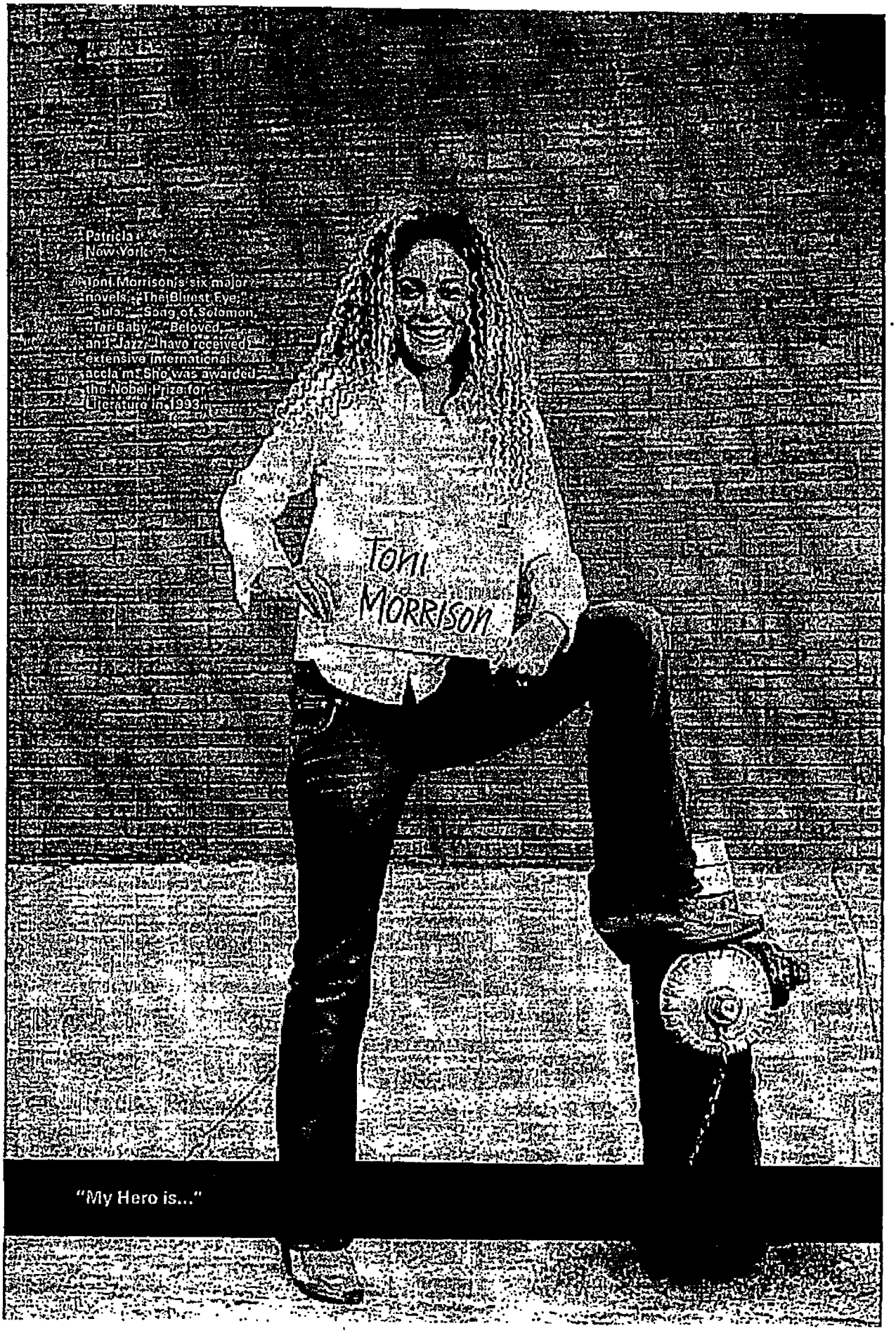
The sports rights business operated throughout Europe by RTL Group's market-leading joint venture Sportfive was hit, as were other sports businesses, by dwindling rights prices.

It was a good year for the FremantleMedia production company. RTL Group subsidiary developed an unprecedented number of program formats and distributed them all over the world. FremantleMedia landed an international coup with the TV format "Pop Idol," which involves would-be pop idols first presenting themselves to a professional jury, then allowing the audience to vote. Following a record-breaking debut in Great Britain in 2001, the TV show's U.S. incarnation, "American Idol," proceeded to set new ratings records in the U.S. over the course of 2002. The winner of "American Idol" not only won a recording contract with BMG, but also a position at the top of the charts. In November, RTL Television launched the format in Germany as "Deutschland sucht den Superstar," again with tremendous success. More than 50 countries have already signed up to create their own version of the talent show or have indicated their interest in doing so.

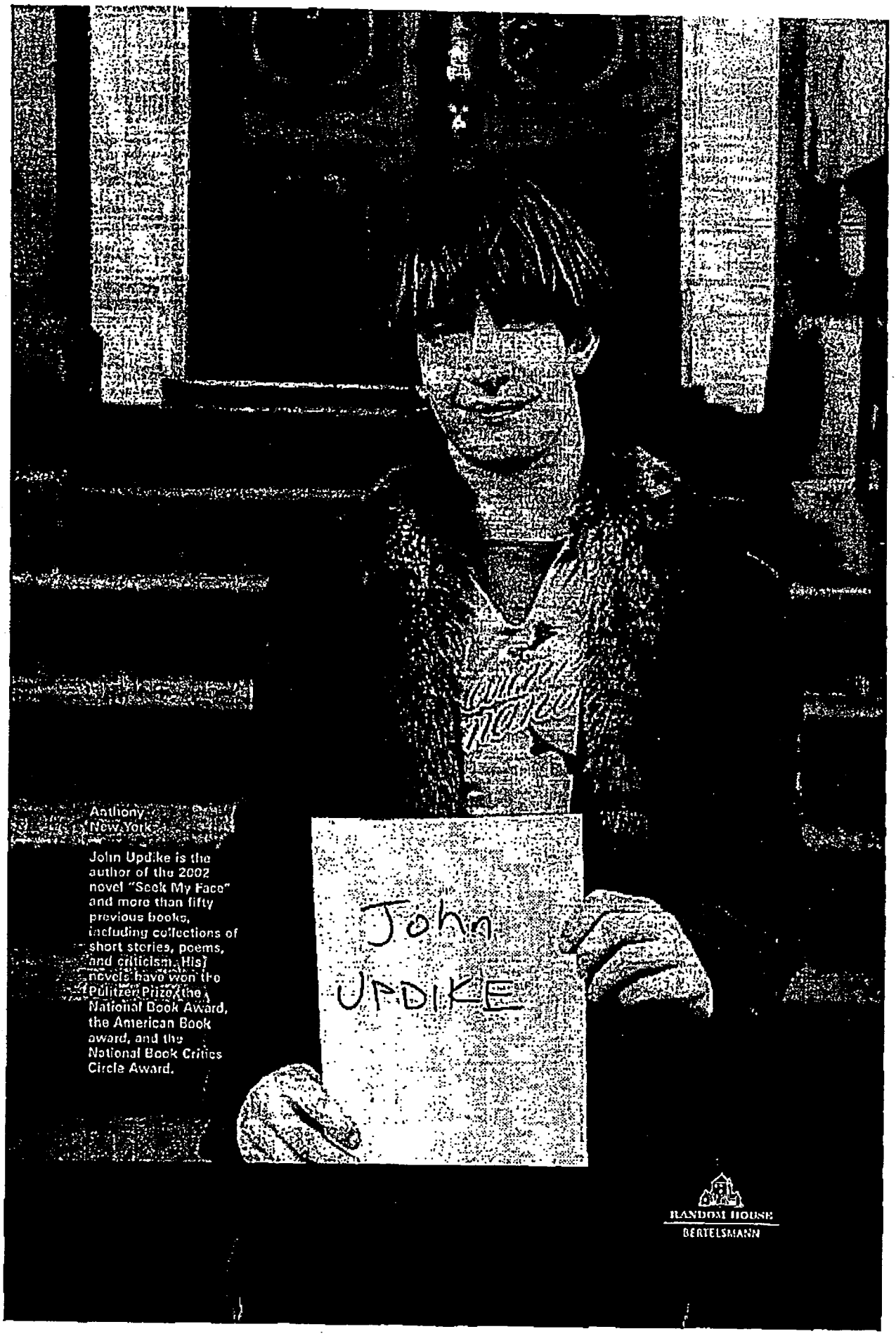
2002 was a year of important acquisitions for RTL Group. First, the majority shareholder Bertelsmann increased its RTL Group holdings to more than 90 percent in 2002. Secondly, the broadcasting group grew through acquisitions of its own: In August, RTL Group bought the television and radio activities owned by the Georg von Holtzbrinck publishing group. In the process, RTL Group acquired a 47.3 percent stake in the German business and news channel n-tv, as well as in twelve radio stations. Three of these radio acquisitions are still in the regulatory approval process.

rtlgroup.com | m6.fr | RTL.de | channel5.co.uk | fremantlemedia.com




Patricia
New York
Toni Morrison's six major
novels, The Bluest Eye,
Sula, Song of Solomon,
Tar Baby, Beloved
and Jazz, have received
extensive international
acclaim. She was awarded
the Nobel Prize for
Literature in 1993.
Toni
MORRISON

"My Hero is..."



Anthony
New York

John Updike is the author of the 2002 novel "Seek My Face" and more than fifty previous books, including collections of short stories, poems, and criticism. His novels have won the Pulitzer Prize, the National Book Award, the American Book award, and the National Book Critics Circle Award.

RANDOM HOUSE
BERTELSMANN

Random House

Success through publishing diversity

Random House, the world's leading trade book publisher, outperformed a persistently weak international book economy to achieve ambitious earnings goals, thanks to excellent publishing performance and rigorous cost management: Revenues, at €2.0 billion, remained at previous-year levels, due primarily to the weak dollar. Operating EBITA reached €168 million for 2002 (previous year: €33 million).

During 2002, Random House made significant reductions in corporate overhead and operating expenses without compromising the editorial accomplishments of its more than 100 publishing imprints worldwide. Book sales were up again after two years of slow growth as recovery in the English-speaking regions offset the recession in the German-speaking book market.

In the U.S. and Germany, Random House placed more than 250 titles on the leading national bestseller lists in 2002. Random House led the publishing industry with the most "New York Times" bestsellers – 182 – for the fourth consecutive year in the U.S. Its eighteen No. 1 bestsellers in 2002 is an all-time Random House record. Random House U.S. published 3,500 new titles in 2002. Of these, more than one hundred were first novels and debut short-story collections, underscoring its ongoing commitment to identify and nurture new talent.

In the United Kingdom, the Random House Group solidified its market leadership: a full quarter of all "Sunday Times" bestsellers were by Random House authors; twelve titles reached the No. 1 slot. In 2002, the Random House Group acquired The Harvill Press, publisher of a number of prestigious and bestselling authors, and the highly regarded children's publisher David Fickling, integrated in 2001, launched its first list of books. Random House of Canada and Random House Australia also had a highly successful business and publishing year.

Verlagsgruppe Random House successfully completed its corporate restructuring in 2002 and strengthened its German-speaking publishing programs to further expand its leadership in the German market. As part of its strategic focus on its core publishing activities, the self-help publishers Falken and Mosaik were discontinued and smaller publishing houses, such as Frederking & Thaler (four-color books) and Kremayr & Scheriau (Austria), were spun off. The publishing houses and imprints that comprise Verlagsgruppe Random House had 69 bestsellers in 2002; three titles went to No.1 on the "Spiegel" bestseller list.

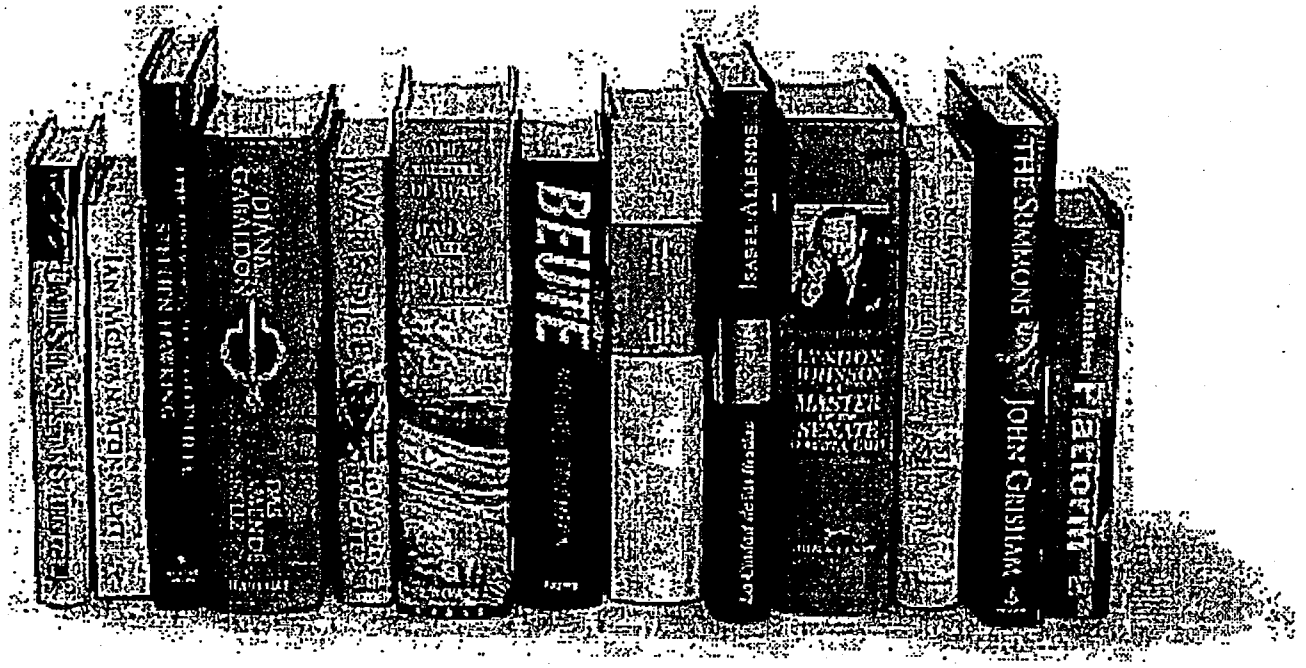
The Random House Mondadori joint venture for Spanish-speaking countries, founded in 2001, celebrated many successful publications in 2002, including the two biggest Spanish bestsellers of the decade: Gabriel Garcia Marquez' autobiography "Vivir para contarla" and Isabel Allende's young adult's book "La ciudad de las bestias." Random House Mondadori, now well established in its international market, benefits from a unified infrastructure in the seven countries in which it operates.

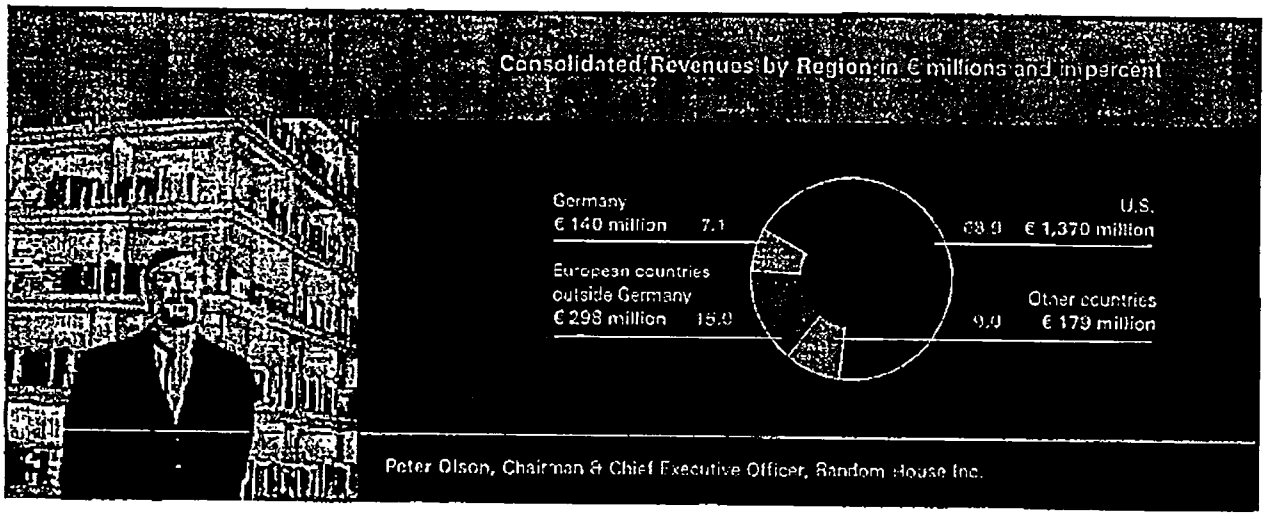
Random House Highlights 2002

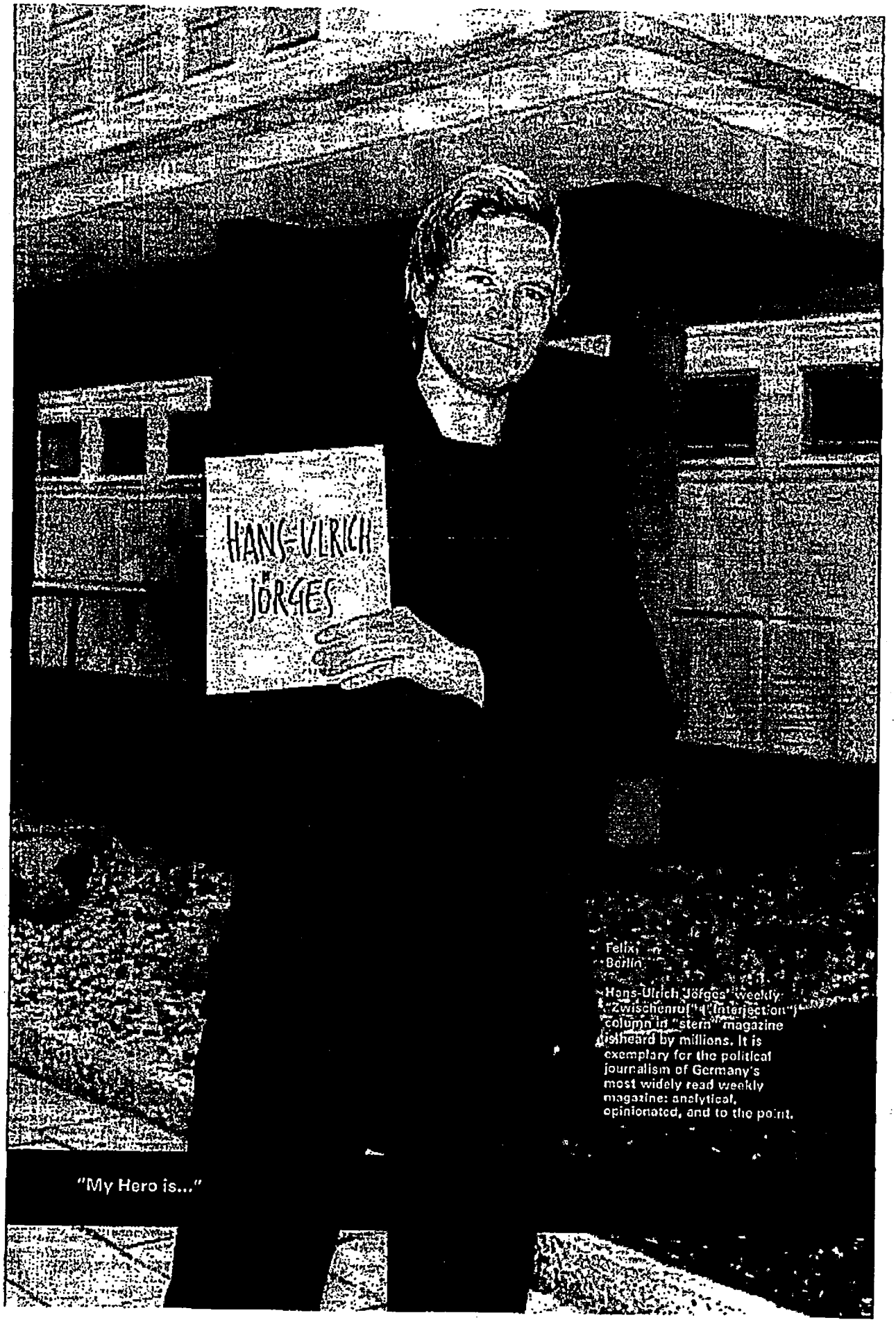
- In the U.S. and Germany, Random House placed more than 250 titles on major national bestseller lists in 2002.
  18 Random House titles made it to the No 1 slot on the "New York Times" bestseller list – a new Random House record
- In Great Britain, roughly a quarter of all "Sunday Times" bestsellers were by Random House authors.
- In the U.S., Random House brought out more than 3,500 new releases – including more than 100 first novels and debut short story collections.
- Random House Mondadori published the two top selling Spanish-language books of the past decade: Gabriel Garcia Marquez' autobiography "Vivir para contarla" and Isabel Allende's youth novel "La ciudad de las bestias".

Random House authors worldwide were honored with numerous important literary awards during 2002: Richard Russo's "Empire Falls" (Knopf) won the Pulitzer Prize for Fiction. The prestigious National Book Award for General Nonfiction was awarded to Knopf author Robert A. Caro for "Master of the Senate: The Years of Lyndon Johnson," while "Three Junes" by Julia Glass (Pantheon) won in the Fiction category. Elfriede Jelinek received Germany's Heinrich Heine Award for her social criticism. "The Life of Pi" by Random House of Canada author Yann Martel won the "Booker Prize," the most important literary award in Great Britain.

randomhouse.com | randomhouse.de | randomhouse.co.uk | randomhousemondadori.es







Felix
Berlin

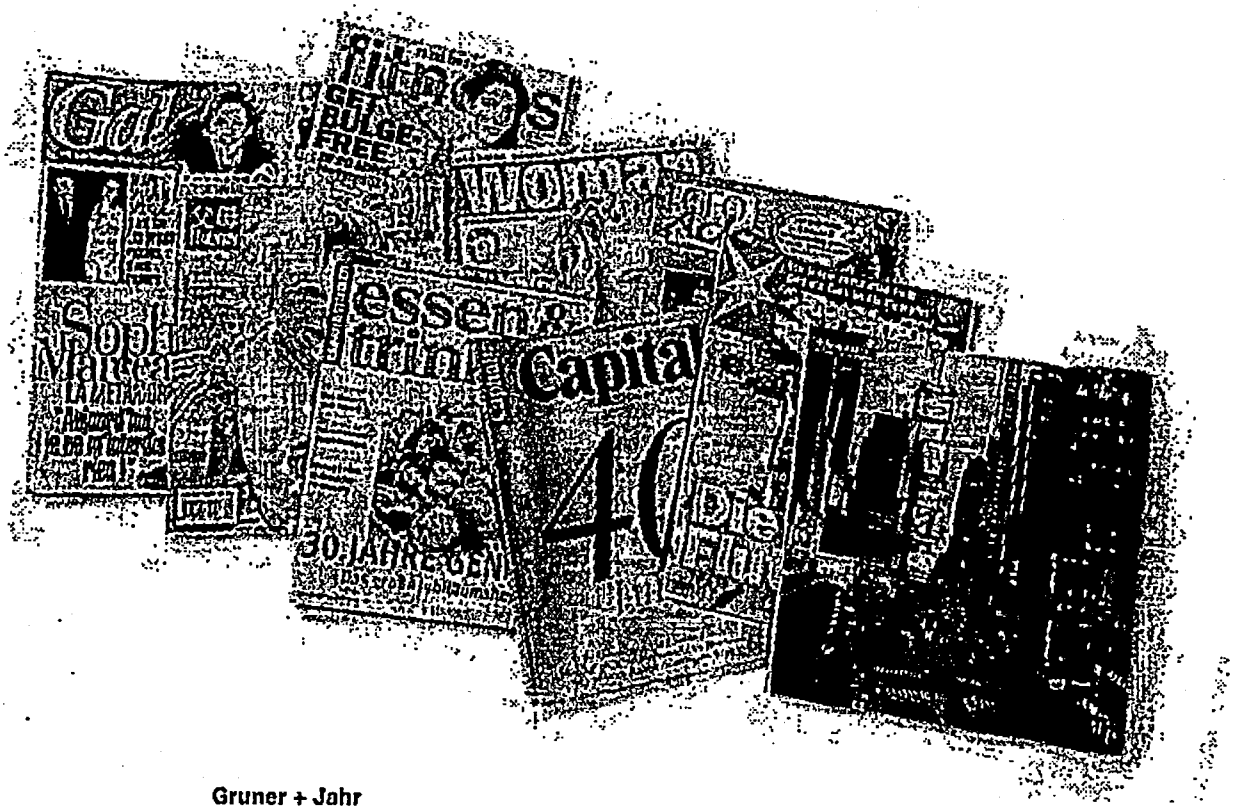
Hans-Ulrich Jörges' weekly "Zwischenruf" ("Interjection") column in "stern" magazine is heard by millions. It is exemplary for the political journalism of Germany's most widely read weekly magazine: analytical, opinionated, and to the point.

"My Hero is..."

Maria
New York

In "Fitness," G+J USA's wellness and fitness magazine, editor-in-chief Emily Listfield caters to her readers' interest in everything having to do with "mind, body, [illegible]." The payoff is increased circulation on the one hand and delighted advertisers on the other: In 2002, "Fitness" increased its ad volume by 65 percent in a contracting market.

G+J



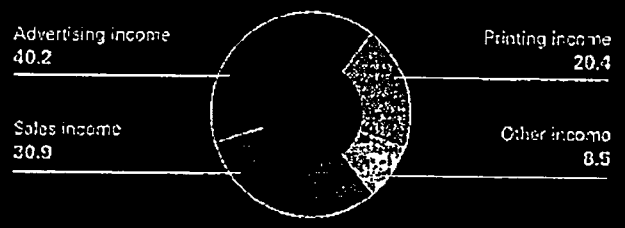
Gruner + Jahr

Strategic focus, investments in publishing

Gruner + Jahr, Europe's biggest magazine publisher, generated revenues of € 2.8 billion in 2002 (previous year: € 3.0 billion). Most of this decline in revenues is the result of the disposal of Berliner Verlag, which was only shown on the books through June 30, 2002. The decline in the advertising industry, especially in Germany, put an additional strain on revenues. Operating EBITA amounted to € 226 million (previous year: € 198 million). 2002 Operating EBITA includes Internet losses, while pro forma Operating EBITA 2001 was adjusted by € 88 million. Taking the Internet losses for 2001 into account, Operating EBITA has doubled year-on-year, increasing by € 116 million.

Gruner + Jahr was able to master the crisis in advertising with a number of countermeasures taken early on. Measures ranged from innovations such as the launch of new magazine titles to extensive cost and efficiency measures. The "Cost and Processes" (CAP) program begun in 2001 resulted in savings of roughly € 70 million over the course of the year 2002.

Total Revenues by Category, in percent



Gruner + Jahr Highlights 2002

- Successful launch of the women's magazine "Woman" in Germany: With circulation steady at well over 300,000 copies, the magazine has significantly exceeded expectations.
- G+J USA showed ad sales growth of over 13 percent – 2.5 times the growth in the overall U.S. market (5.2 percent).

Due to the high share of revenues generated outside Germany, i.e. more than 60 percent, Gruner + Jahr was largely able to cushion the negative effects of the recessive German advertising market. While Gruner + Jahr's home country Germany showed no sign of improving, important international markets such as the U.S. and France showed indications of a turnaround or had stable advertising markets.

In October, Gruner + Jahr took a publisher's approach to transcending the crisis by launching a new bi-weekly women's magazine in Germany. With circulation constant at well over 300,000 copies, "Woman" has significantly exceeded all expectations. The move underscored Gruner + Jahr's role as market leader and growth engine for the industry.

"stern" was the only big magazine in the German market to register a growth in advertising volume in 2002. The magazine also extended its reach and had nearly eight million readers at year-end.

In Germany, Gruner + Jahr initiated its withdrawal from the regional newspaper business as the result of a strategy process. In June, the Berlin-based newspaper activities (flagship "Berliner Zeitung") were sold to the Georg von Holtzbrinck publishing group, which also bears the antitrust risk. Talks regarding the sale of the regional newspaper group in Dresden were discontinued due to the strained market situation. As a nationwide paper, the "Financial Times Deutschland" is not affected by the realignment. During 2002, the "Financial Times Deutschland" bucked the crisis in the newspaper sector, increasing its circulation and advertising volume.

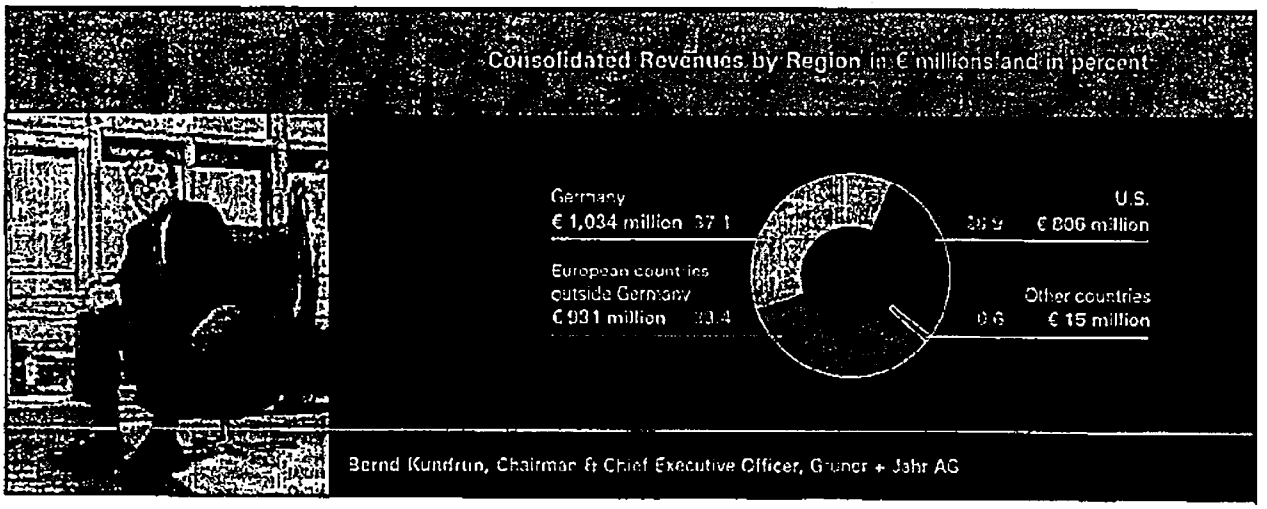
Titles lacking economic and journalistic prospects were shut down, e.g. "Online Today" and the business magazine "BIZZ." In the U.S., the women's magazine "Rosie" was discontinued at year-end.

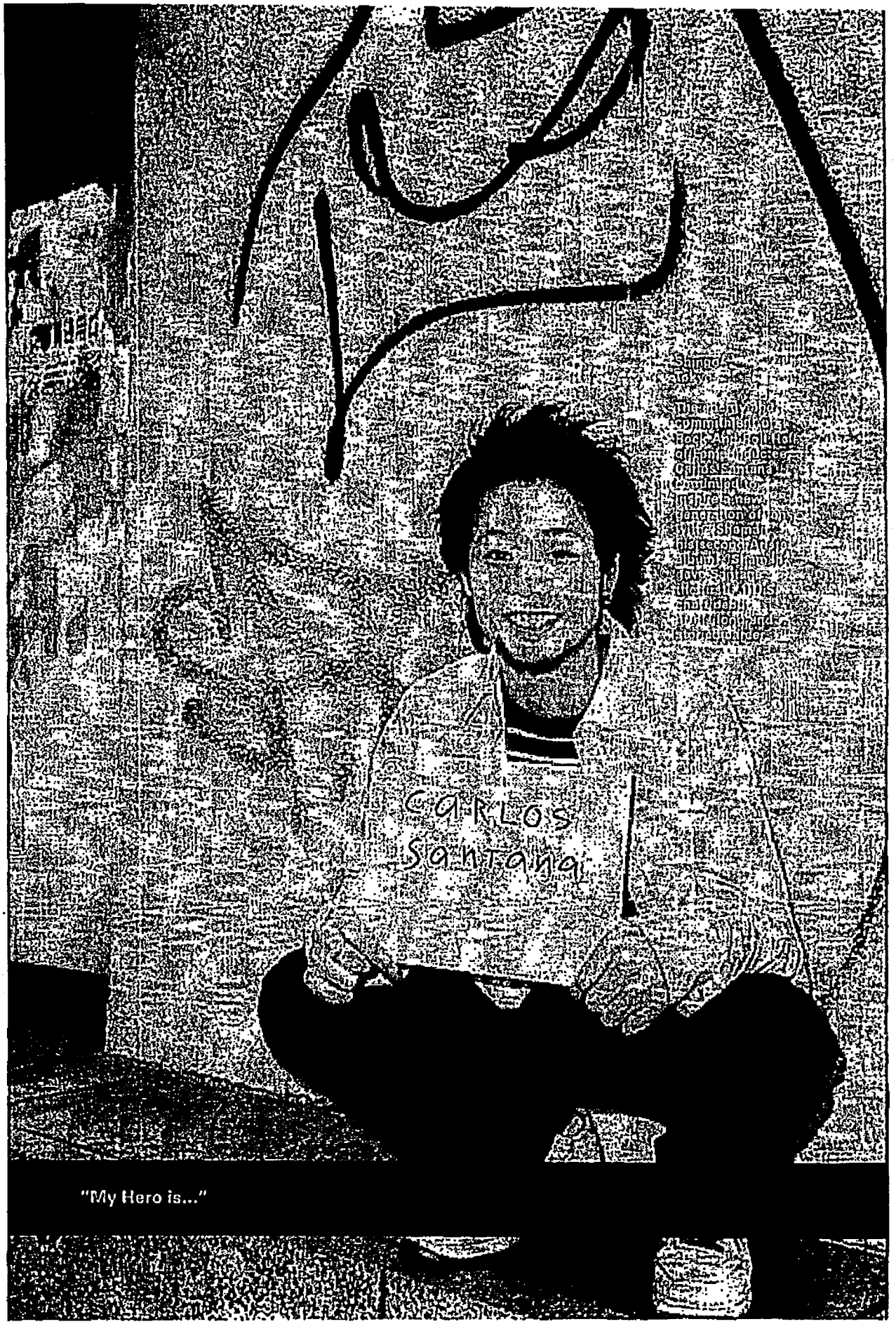
The Gruner + Jahr subsidiary Prisma Presse was the No. 2 among French magazine publishers. Its TV magazine "Télé Loisirs" was able to establish its circulation above the two-million-copy mark. "Gala" and "Voici" showed growth in the ad sales market and were able to increase and maintain their circulation respectively. The youth magazine "GEO Ado" further extended the international "GEO" family.

G+J USA increased its ad sales by over 13 percent – 2.5 times the growth in the overall U.S. market (5.2 percent) – outperforming the Top 3 U.S. magazine publishers by far. Thus, the teen magazine "YM" was able to increase its ad volume by 48 percent year-on-year, while "Child" added more than 20 percent vs. previous year, and "Fitness" increased its ad volume by over 65 percent.

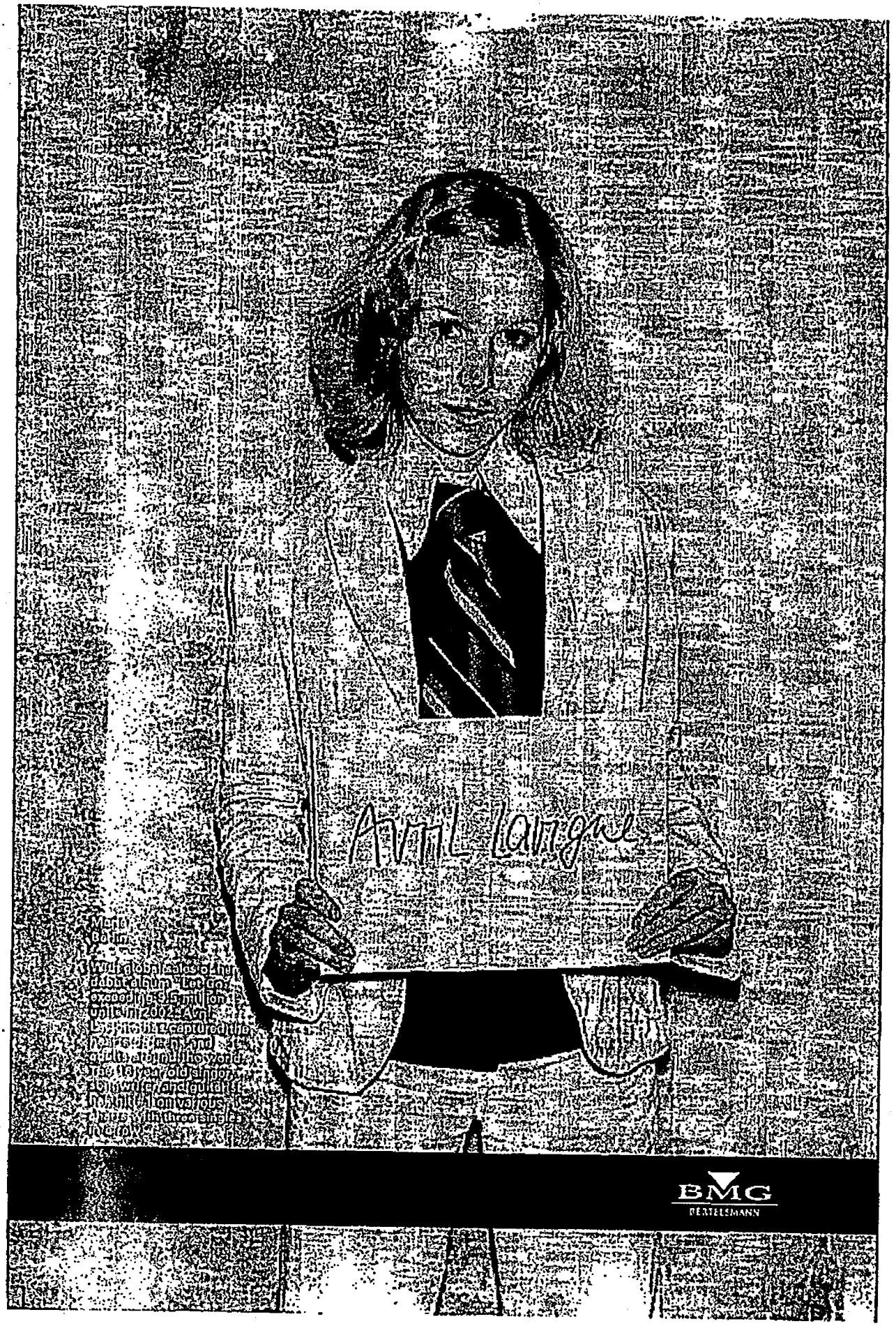
Positive development was also seen in the emerging markets Eastern Europe, Russia and China, where Gruner + Jahr launched new titles. The results of Gruner + Jahr's printing operations remained stable.

gnj.com | gjusa.com | prisma-presse.com | stern.de | ftd.de | brigitte.de | parents.com | gala.fr





"My Hero is..."


Avril Lavigne
BMG
BERTELSMANN

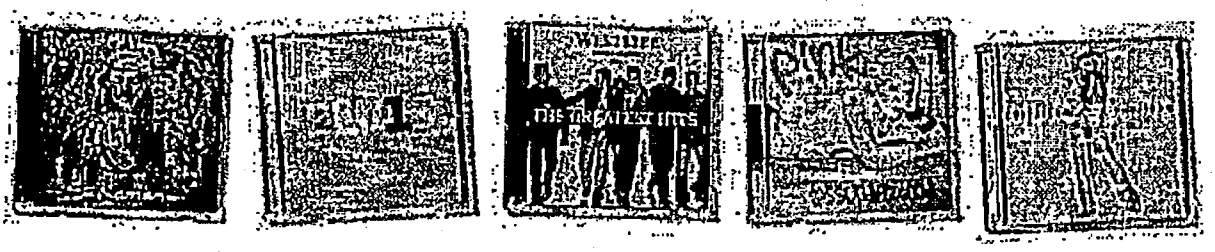
BMG

Strategic realignment bears fruit

Following extensive restructuring and strategic realignment, the Bertelsmann Music Group (BMG) delivered a year of strong chart performances, increasing market shares and expansion through acquisition. Against the backdrop of globally depressed music sales, increasing product piracy and the weak dollar, revenues were reduced to € 2.7 billion (previous year: € 3.0 billion). However, 2002 Operating EBITA reached € 125 million (previous year: loss of € 79 million). BMG thus successfully managed its return to profitability in 2002.

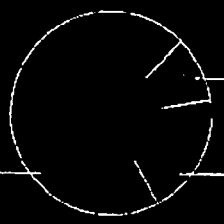
Over the course of the year, BMG was able to increase its share of the global music market to approx. ten percent from approx. eight percent, while also increasing its share in the world's most important music market, the U.S., to more than 17 percent, making BMG the No.2 music major in the U.S. This was achieved with a series of successful releases by stars including Carlos Santana, Christina Aguilera and Rod Stewart, new CDs commemorating the 25th anniversary of Elvis Presley's death, and the introduction of young, innovative artists such as Avril Lavigne and Pink. The latter two alone had global sales of 9.5 and 7 million albums respectively.

In November, BMG acquired the world's biggest independent music company, Zomba, for



$ 2.7 billion. Zomba includes top acts such as Britney Spears, *NSYNC and the Backstreet Boys. The purchase was initiated in June; when Zomba's owner exercised a put option for BMG's takeover of the shares originally signed in 1991. Given the projected development of the music market, a review of Zomba's valuation became necessary and resulted in an impairment of € 1.3 billion. The investment in Zomba is decreased by € 470 million in cash and cash equivalents taken over as part of the purchase. By taking over Zomba, BMG not only enhanced its artist roster, but also became the No. 3 music publisher, and came to occupy a globally leading position in the emerging market of gospel and Christian music. The acquisition will not affect BMG's revenues and earnings until 2003.

Revenues by Category in percent



* incl. BMG's revenues from Zomba in North America and from joint venture compilations.

BMG Highlights 2002

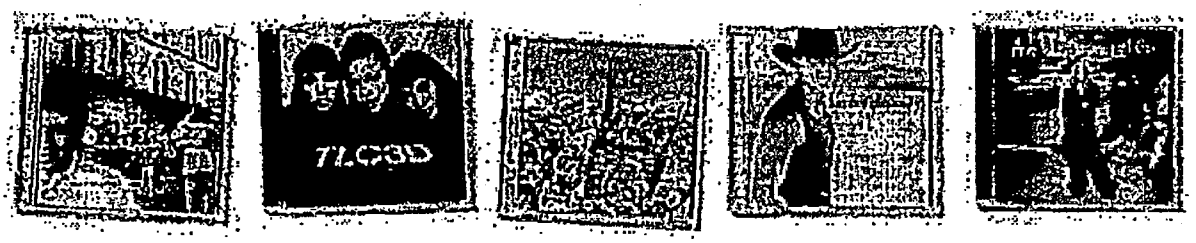
- BMG's share in the worldwide music market rose from approx. 8 to approx. 10 percent in 2002. In the U.S., BMG became the No.2 music major, with a market share of more than 17 percent.
- A total of 22 BMG albums sold more than a million copies each in 2002. The compilation "ELVIS 30 # 1 Hits" went to No.1 on the album charts in 26 countries.

Also in November, BMG bought up the remaining 50 percent in the J Records joint venture, bringing music executive Clive Davis back into the company. Davis was entrusted with managing the RCA Music Group, newly created during the integration of J Records.

Beyond the music publishing business BMG/Zomba Publishing Group, the Bertelsmann Music Group is now comprised of the RCA Music Group, Jive/Zomba Records, RLG-Nashville and Arista Records – four noted label groups that together run more than 200 individual labels in 41 countries.

BMG artists left plenty of tracks on the charts in 2002: In October, BMG artists Santana, Foo Fighters, Rod Stewart and Elvis Presley had four of the five top-selling albums in the U.S. and three of the top five albums in Europe. A commemorative compilation of thirty No.1 hits by Elvis Presley, the "King of Rock 'n' Roll," shot to the top of the charts in 26 countries and sold 8.5 million albums worldwide.

A total of 22 BMG albums sold more than a million copies each in 2002 – a significant improvement over 2001, when the company had 15 million-seller albums. Other big sellers were Alicia Keys, who dominated the "Grammy Awards" in February 2002 by winning five of the coveted

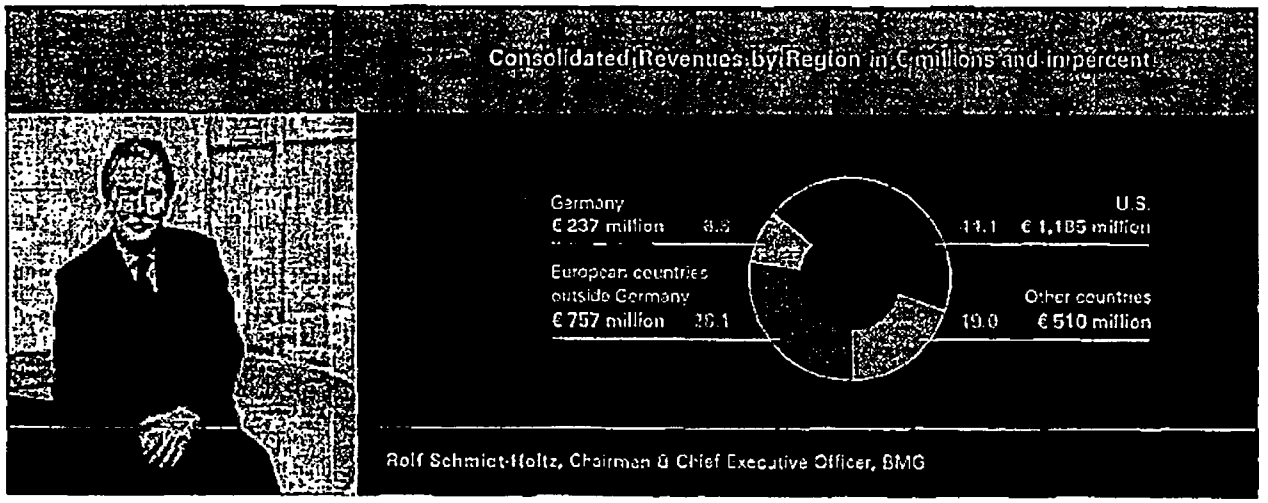


prizes, alongside the Dave Matthews Band and award-winning Country star Alan Jackson.

BMG took a pioneering role in the music industry in the fall 2002, when it introduced an updated royalty accounting system for artists. The company also introduced an improved "Parental Advisory Program" labeling system in the U.S., which gives CD buyers additional information about whether album lyrics are harmful to minors.

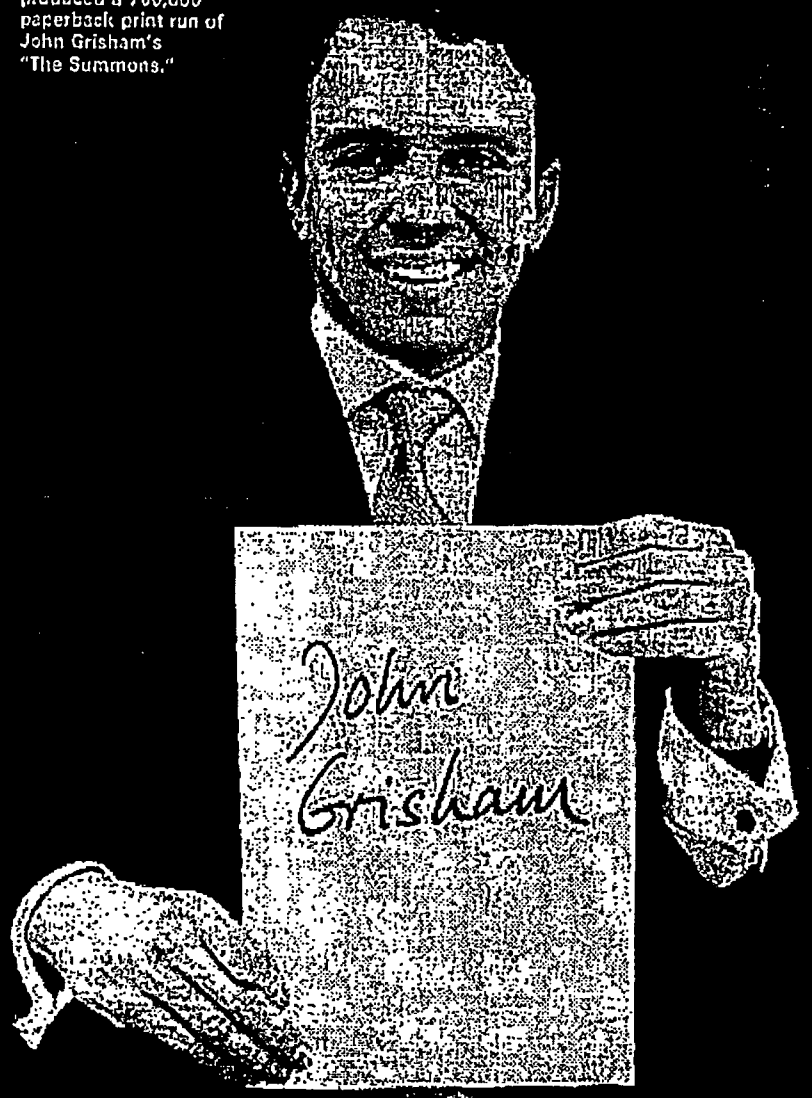
BMG stepped up the licensing of its titles for online distribution, to services including MusicNet, OD2, Listen.com's Rhapsody, Streamwaves, MusicMatch, FullAudio and Pressplay.

bmg.com | arista.com | zomba.de | jrecords.com | rcarecords.com | bmgmusicsearch.com

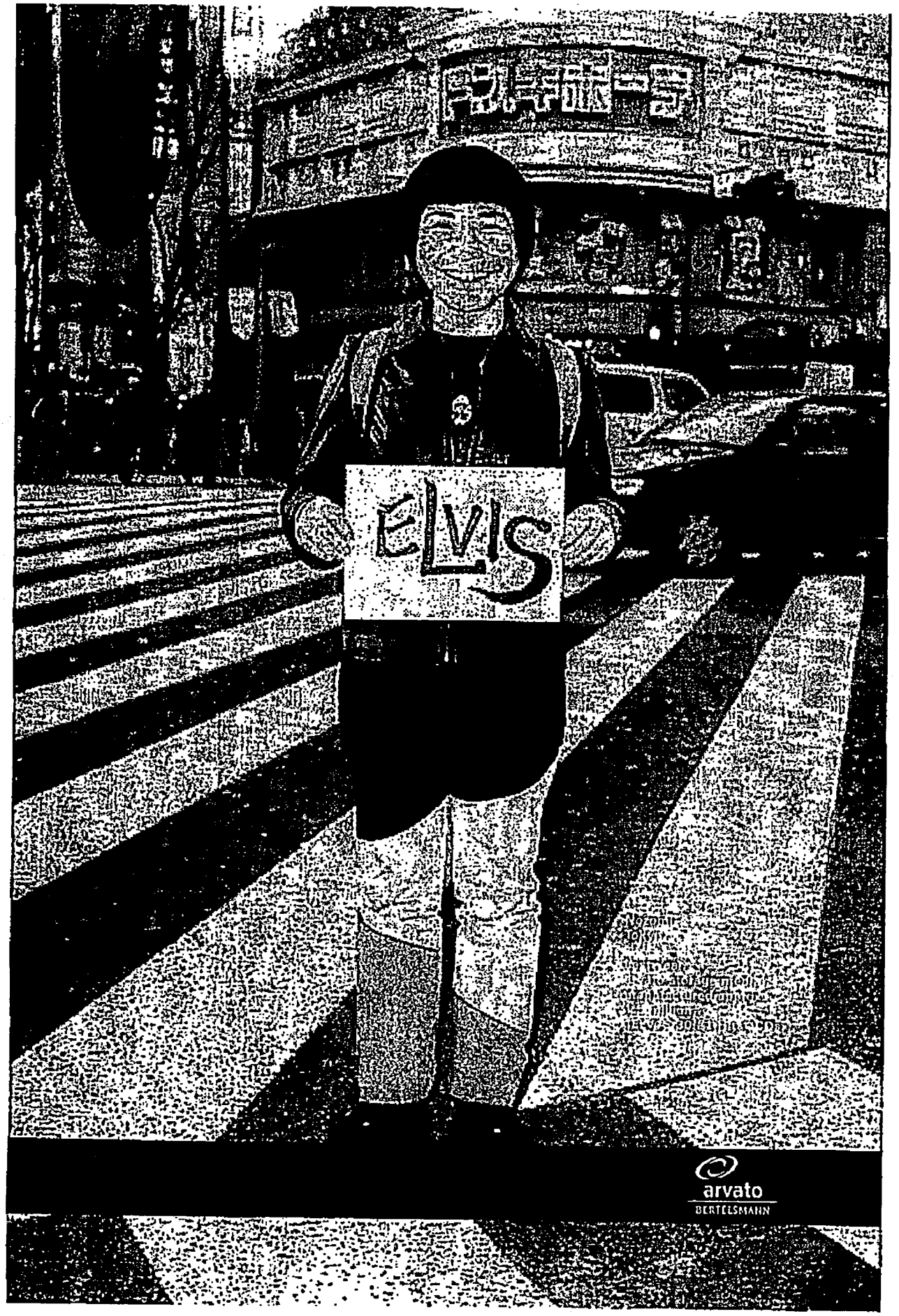


Iddo
New York

In 2002, ervato print produced a 700,000 paperback print run of John Grisham's "The Summons."



"My Hero is..."


ELVIS
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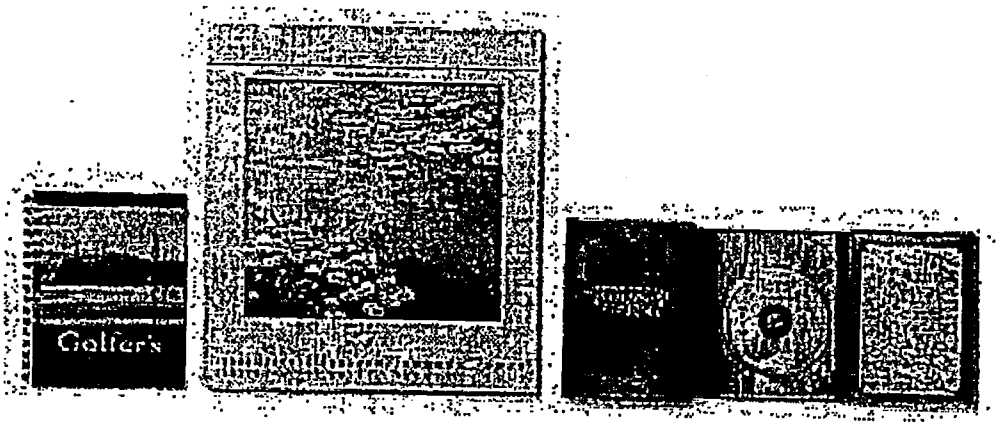
BERTELSMANN



arvato

Dynamic growth in the services sector

In 2002, the media services provider arvato achieved revenues of € 3.7 billion (previous year: € 3.5 billion) and Operating EBITA of € 217 million, well above previous year (€ 167 million).

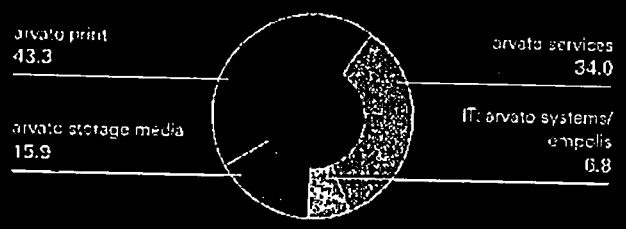
In 2002, all of arvato's divisions grappled with negative macroeconomic effects, insolvent customers and pricing pressure. However, overall growth in revenues and income once again proved the corporate division's dynamic force. In particular, the Services segment was able to increase its growth rate again following a weaker previous year.

In September 2002, Hartmut Ostrowski succeeded Gunter Thielen as chief executive of arvato. Mr. Thielen took over as Chairman & CEO of Bertelsmann AG. As the new arvato management took up its work, a new organizational structure was introduced. The Bertelsmann Services Group was broken down into the arvato direct services and arvato logistics services divisions; the printing division now does business as arvato print; Bertelsmann mediaSystems became arvato systems; and the former Storage Media division has been renamed arvato storage media.

arvato logistics services offers the entire spectrum of Supply Chain Management services to major corporations, ranging from order procurement, warehousing and order entry, to distribution and associated financial services. The distribution division showed particularly strong growth during the year. Vereinigte Verlagsauslieferung (VVA), part of arvato logistics services, extended its market leadership in supply services by acquiring Verlegerdienst München and taking over Libri-Distribution.

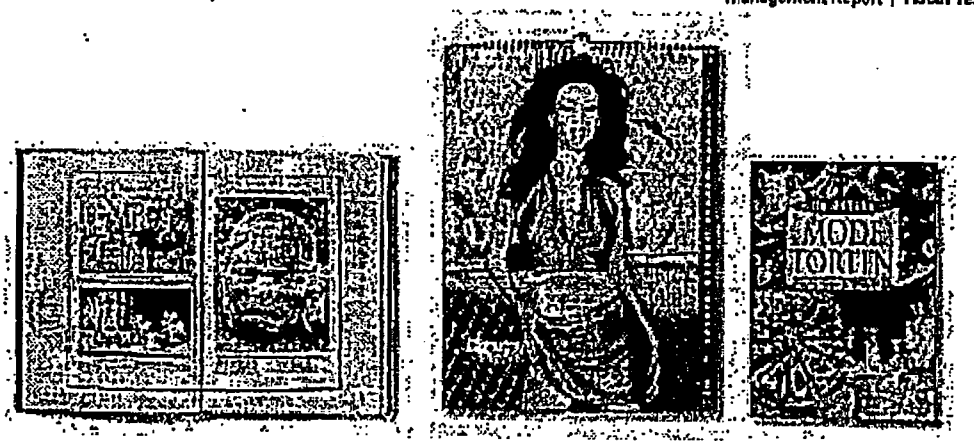
The arvato direct services division, which services some 35 million consumers in more than 20 languages with its customer retention programs and service centers, was able to further stabilize its position as one of Europe's biggest services providers for Customer Relationship Management. Important portfolio decisions in 2002 included buying a share in Eurodirect Marketing's Letter-

Revenues by Category in percent



arvato Highlights 2002

- arvato direct services operates customer programs and service centers servicing approx. 35 million consumers in more than 20 languages.
- More than € 75 million spent on expansion and modernization – in mid-2002, MOHN Media concluded its biggest capital expenditure program ever.



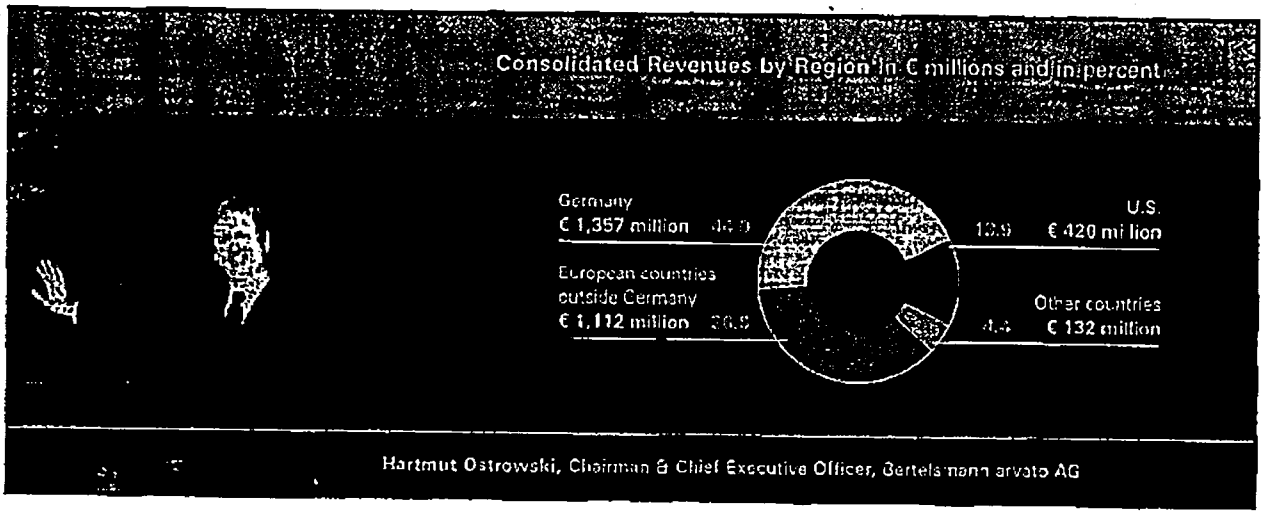
shops, the takeover of PVS Mailmanagement in Neckarsulm, and the sale of the "Trust" hotel reservation system. The Service Center business experienced especially strong growth in Germany and France.

arvato print's printing facilities were largely working at capacity in 2002, but the price level continued to drop all over the world as the year progressed. Printers in the United States developed above plan, which is attributable mainly to the long-term increase in printing volume and the successful integration of Coral Graphic Services, a company taken over in 2001. Towards the middle of the year, the printing services provider MOHN Media completed its biggest capital expenditure program ever: more than € 75 million were invested in enlargement and modernization; the positive effects already made themselves felt in the second half of the year. The maul-belser media combine implemented an extensive cost-cutting program in 2002, successfully reorganized the Deutscher Supplement Verlag and inaugurated a big photo-studio complex in Pforzheim at mid-year. The Spanish and Portuguese printers were combined under a shared management and umbrella brand, arvato print iberica.

In the arvato storage media division, Sonopress achieved turnaround in the U.S. Its Asian businesses were not operating at capacity in 2002, and businesses in South America were impacted by the local economic crisis. The overall decrease in CD production volumes was compensated by increased production in the DVD sector.

Although arvato systems suffered declines in revenue due to cost pressure and the dwindling investment budgets of its increasingly external customers, it was able to meet income targets thanks to stringent cost management.

arvato.com | arvato-logistics-services.com | mohnmedia.com | sonopress.com | arvato-systems.com



Hartmut Ostrowski, Chairman & Chief Executive Officer, Bertelsmann arvato AG

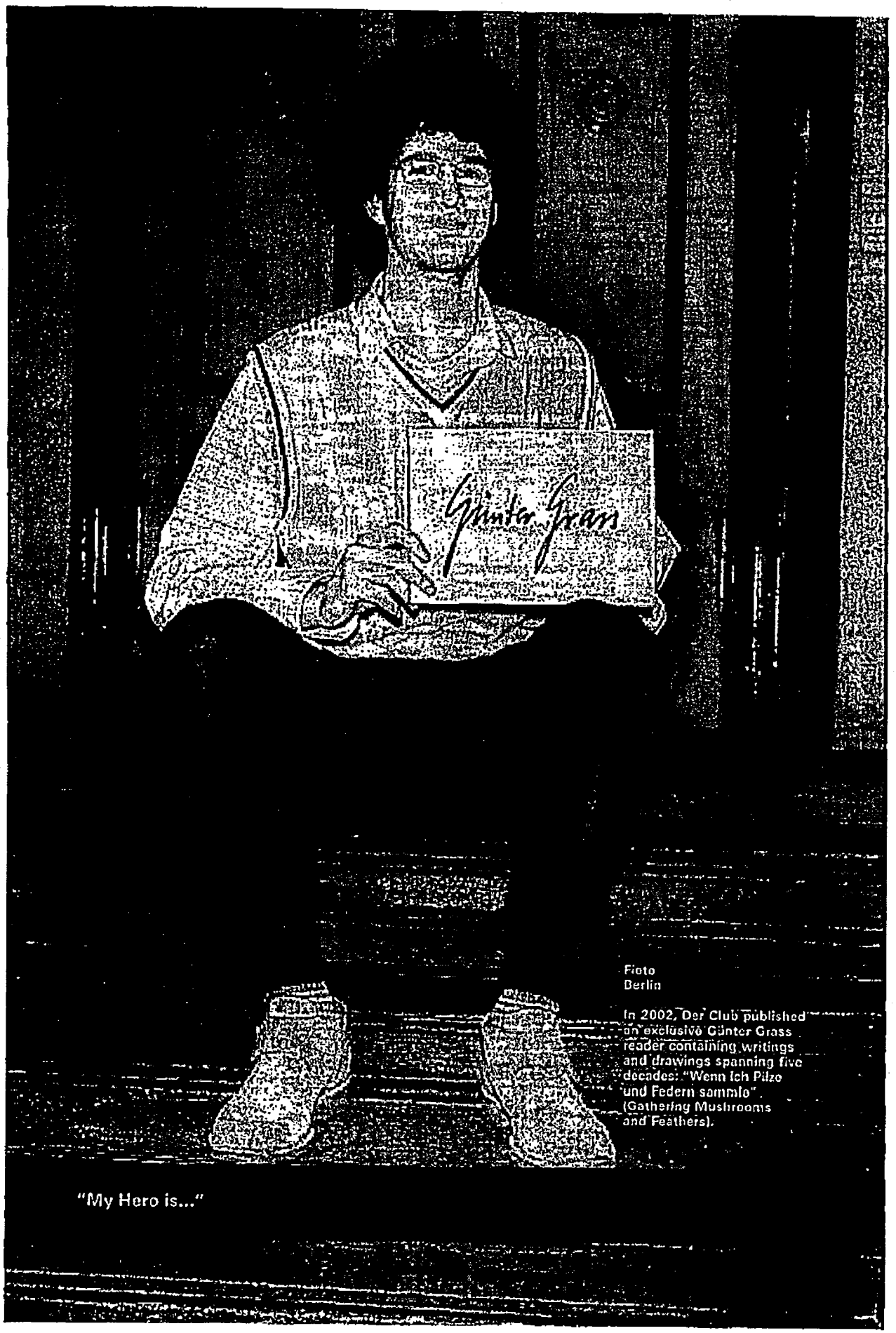
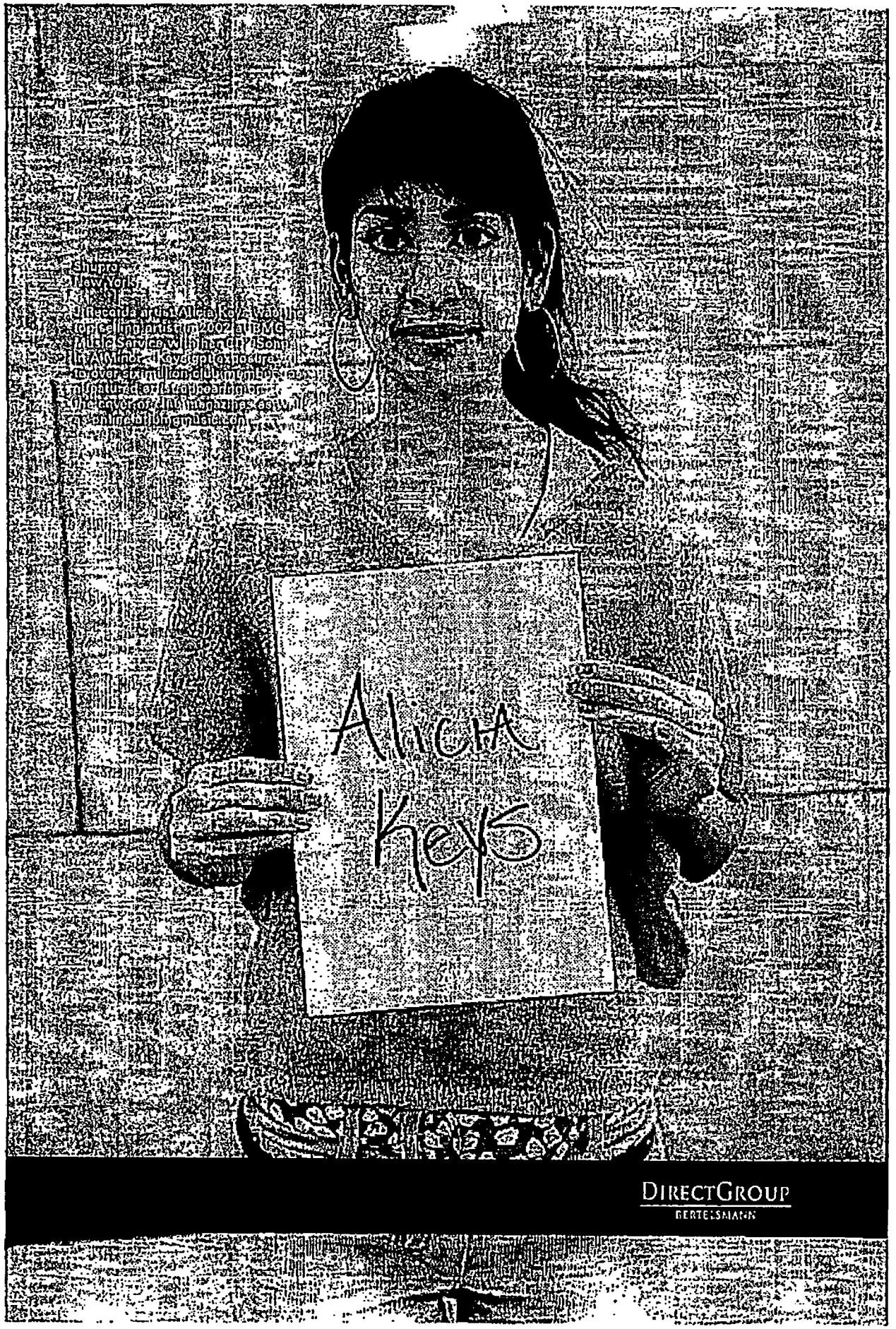


Foto
Berlin

In 2002, Der Club published an exclusive Günter Grass reader containing writings and drawings spanning five decades: "Wenn ich Pilze und Federn sammle" (Gathering Mushrooms and Feathers).

"My Hero is..."


Alicia
Keys
DIRECTGROUP
BERTELSMANN

DirectGoup

Continued restructuring and portfolio streamlining

DirectGroup, which comprises book clubs, music clubs and e-commerce activities in 20 countries, generated revenues of € 2.7 billion (previous year: € 3.1 billion) with its direct-to-customer businesses in 2002. The decline in revenue is attributable to a cyclical decline in consumer spending on the one hand and a deliberate reduction of the membership base on the other. Operating EBITA amounted to minus € 150 million, well below the previous year's negative Operating EBITA of minus € 61 million. Operating EBITA 2002 includes Internet losses, while the pro forma Operating EBITA 2001 was adjusted for Internet losses of € 399 million. Taking the Internet losses for 2001 into account, the Operating EBITA has improved € 310 million.

This year-on-year comparison shows that DirectGroup was able to effectively reduce its Internet losses during the year. Key factors in this were a strategic realignment with a focus on Club businesses, the portfolio cleanup, and restructuring. In August 2002, Ewald Walgenbach, formerly Bertelsmann's Chief Operating Officer, succeeded Klaus Eierhoff as DirectGroup CEO. The restructuring measures undertaken as part of this management changeover included, first and foremost, a withdrawal from pure e-commerce with media products in Europe. DirectGroup sold its online vendor BOL in Germany, Sweden, Austria and Switzerland, and announced the proposed sale of BOL in the Netherlands. In Great Britain, BOL was converted into the BCA book club's first pure online club. BOL's sites in Italy and China remained in place due to their strong interweaving with the local Clubs.

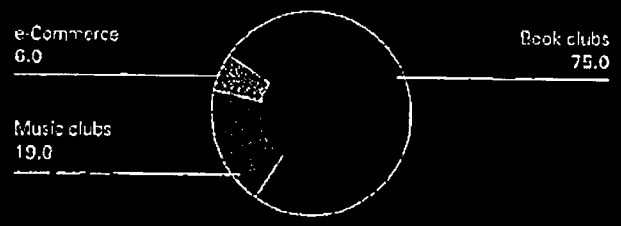
CDNOW signed a cooperation agreement with Amazon near the end of the year. In South Korea, DirectGroup and Gruner + Jahr both sold their holdings in the listed Internet portal DAUM. A takeover of Napster's assets as part of that company's bankruptcy proceedings failed to materialize due to objections by the bankruptcy court.

The break with pure media-e-commerce notwithstanding, the importance of the Internet to the Clubs' business continued to grow. The share of revenues generated on the Internet ranged between 4 percent and 20 percent for the various Clubs. At the same time, a growing number of new members was recruited on the worldwide web.

Most of the Club businesses were able to improve their earnings year-on-year; the French Club France Loisirs and Circulo de Lectores in Spain in particular increased their revenues and income. DirectGroup's two biggest Clubs, the U.S. book club Bookspan and the U.S. music club BMG Music Service, managed a return to profitability. Meanwhile, Germany and Great Britain suffered considerable revenue declines and ended the year with high losses. The German Club was given a new management at the end of the year.

DirectGroup increased its reliance on selective growth and targeted program campaigns in 2002. In December, the Chinese book club joined partners in Peking in opening two shops outside

Revenues by Category in percent



DirectGroup Highlights 2002

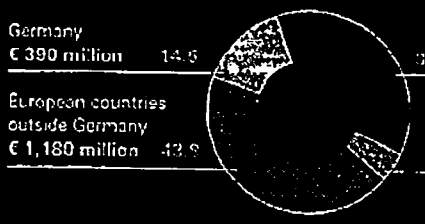
- DirectGroup's two biggest Clubs, the U.S. book club Bookspan and the U.S. music club BMG Music Service, managed their operative return to profitability.
- Four of France's five top-selling books in 2002 were France Loisirs titles offered exclusively to members.

Shanghai. The newly launched Mosaico Club very successfully targets the Spanish-speaking population in the U.S. Four of the five top-selling books in France in 2002 were France Loisirs titles offered exclusively to members. In Germany, Der Club was the main sponsor behind a new one-hour TV literature program entitled "Welcome to the Club." The exclusive Club premiere of "Dio Farm" ("A Painted House") by John Grisham sold some 500,000 copies in the German Club.

A decentralized restructuring of the Clubs' IT system has also been initiated. Although a shared IT system for the Clubs had just been introduced, it failed to meet expectations and amplified IT expenditure in the Clubs disproportionately. Der Club in Germany, ECI in the Netherlands and BCA in UK were particularly hard hit by this. Starting in 2003, Wissen Media Group, including its Internet company Wissen.de and the publisher Wissen Media Verlag, will be transferred from arvato to the German Clubs. This greatly strengthens the "advice" segment as well as the "own publishing" activities in the Club business.

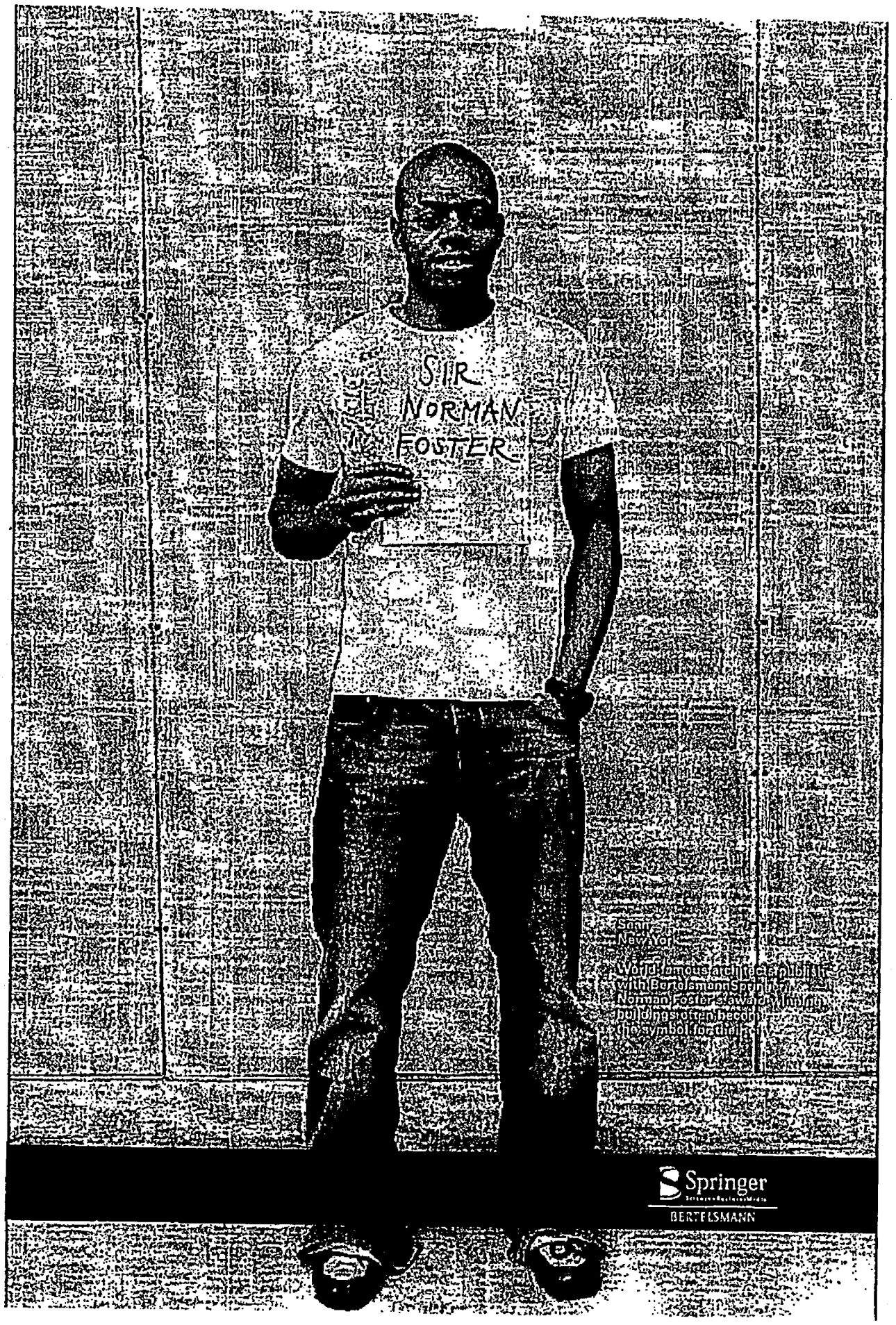
directgroup-bertelsmann.de | bookspan.com | bmgmusic.com | franceloisirs.com | circulo.es | derclub.de

Consolidated Revenues by Regions in € millions and in percent



Ewald Walgenbach, Chief Executive Officer, DirectGroup Bertelsmann

"My Hero is..."



Springer
BERTELSMANN

BertelsmannSpringer

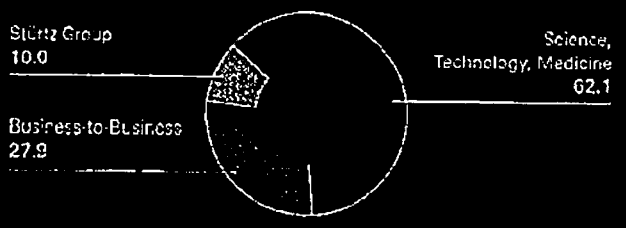
Profitability continues high

The specialist-publishing division BertelsmannSpringer, an internationally renowned provider of science and trade information, achieved revenues of €731 million in 2002 (previous year: €748 million). This decline is attributable to a significant deterioration in business-to-business advertising, which constitutes a considerable portion of BertelsmannSpringer's revenue. Operating EBITA amounted to €71 million (previous year: €59 million). In August, Arnold Bahlmann took over the management of BertelsmannSpringer.

The division, which publishes approx. 25,000 book titles and 700 magazines, is to be divested during the first half of 2003 and is therefore shown separately as a "Discontinuing Operation" in the group financial statements.

BertelsmannSpringer's mainstays of income are books, magazine and online products from the fields of medicine, natural sciences and technology. As part of the process of internationalizing the company's business, the Science division pressed ahead with its global program development. Commercial and logistical functions were centralized to cut costs. Birkhäuser Verlag, a publisher in the Science division, enhanced its architecture and design program by taking over the renowned magazine "form" and two book series in the sector. The Science division was able to increase its online revenues thanks to new distribution models. In 2002, 130 networking agreements were signed

Revenues by Category in percent



BertelsmannSpringer Highlights 2002

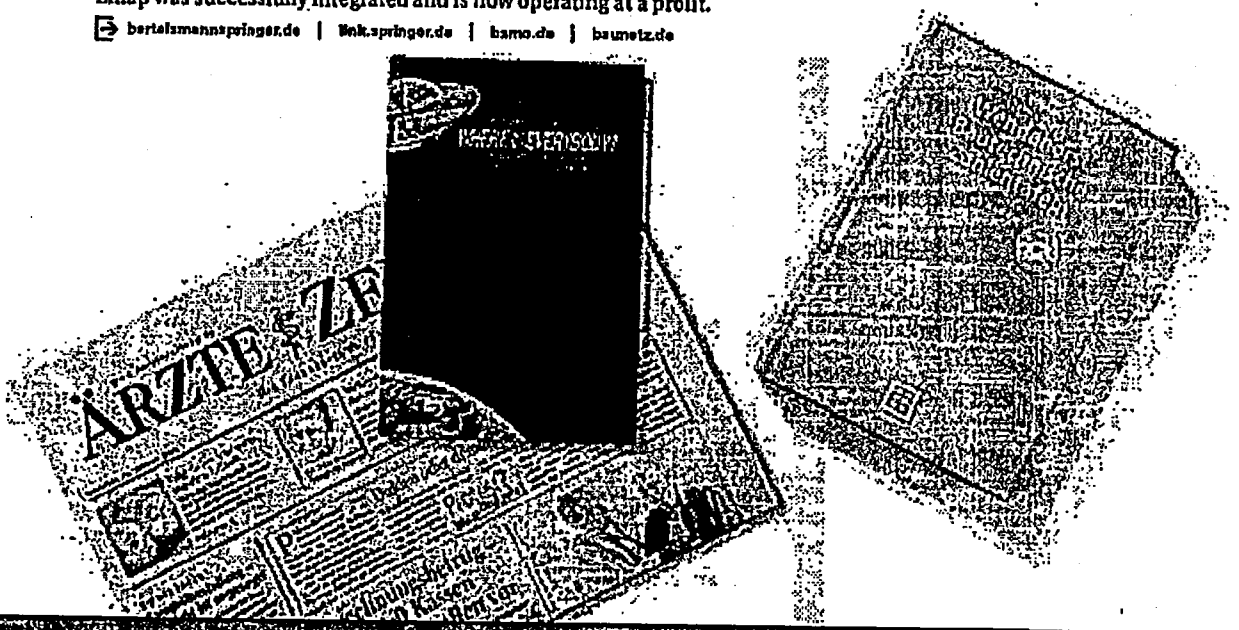
- With 70 publishing companies, 700 trade magazines and more than 4,000 new book releases, BertelsmannSpringer is one of the world's leading providers of science and specialist literature.
- BertelsmannSpringer Medizin Online reported its first profits in 2002.

with libraries and research institutes all over the world. The business and technology trade segment submitted good results despite negative cyclical effects on GWV Fachverlage, Gabler's book and advertising business, and on the subscription business of the stock-market newsletters "Platow Brief" and "Fuchsbriefe." Likewise, the medicine and health publishing segment was able to transcend the difficult market environment. BertelsmannSpringer Medizin Online booked its first profits in the year under review.

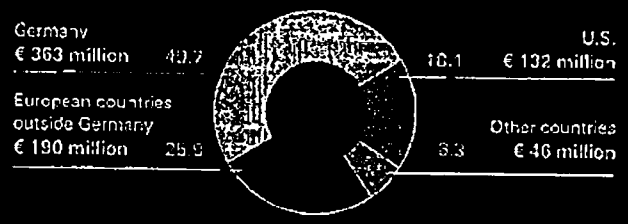
In the Business-to-Business (B2B) publishing sector, the traffic segment in particular managed to increase its revenues and earnings. In general, the trade magazine publishers suffered from the downturn in advertising business. However, this was partially mitigated by strict cost management and the creation of new mainstays of sales such as Corporate Publishing and online offerings. The company strengthened its market position in Austria by taking over Kompetenz Verlag.

In the construction segment, B2B publishing was still subject to difficult overall conditions due to the continuing recession in the construction industry, but was able to add market shares and show positive earnings. A construction trade publisher taken over from the British media company Emap was successfully integrated and is now operating at a profit.

bertelsmannspringer.de | link.springer.de | bamo.de | baunetz.de

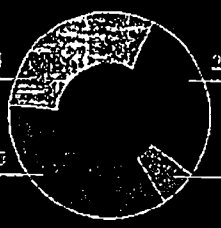


Consolidated Revenues by Region in € millions and in percent



Arnold Bahlmann, President & Chief Executive Officer, BertelsmannSpringer

Consolidated Revenues by Region, in € millions and in percent



Corporate

Corporate Center, Corporate Investments

Corporate includes expenditure on the Corporate Center and on investments in venture capital activities and Internet holdings that affect the balance sheet at the group level. The Corporate Operating EBITA for 2002 amounted to minus € 160 million (previous year: minus € 135 million). 2002 includes the effects of venture capital activities and Internet holdings totaling minus € 68 million, while the pro forma Operating EBITA of the previous year was adjusted for these items.

Revenues by Region

31.1 percent in Germany, 27.5 percent in the U.S.

In 2002, 31.1 percent of the € 18.3 billion in total revenues were generated in Germany, 35.5 percent in the other European countries, 27.5 percent in the U.S. and 5.9 percent in other countries. This reflects a slightly reduced revenue contribution from the U.S. region. Exchange rate developments are the main reason behind this decline. Revenues achieved outside Germany amounted to € 12.6 billion (previous year: € 13.2 billion).

Special Items and Internet Losses

Significant reduction

In the previous year, the group had to cope with special items of minus € 927 million; in 2002, these totaled minus € 111 million and were caused by restructuring and write-offs. The expenses included under special items were all unscheduled and are the result of one-off business occurrences and special projects. The major special items pertain to DirectGroup, RTL Group and Corporate Investments. At DirectGroup, special items totaled minus € 84 million (previous year: minus € 371 million) and are the result of write-offs on the Club's IT system, restructuring at BeMusic, and the disposal of the online vendor BOL in Germany, Sweden, Austria and Switzerland. Special items at RTL Group amounted to minus € 43 million (previous year: minus € 45 million), and write-downs on various former Bertelsmann Capital holdings now listed under Corporate Investments (the BeCapital unit has since been dissolved) resulted in charges of € 36 million (previous year: € 187 million). This is partly offset by income at BMG from provisions created last year to adjust the value of the Zomba holdings, which have now been released.

Unlike in 2001, the Internet losses are included in the 2002 Operating EBITA and amount to € 138 million in all (previous year: € 808 million).

Bertelsmann has strengthened its operating business while also significantly reducing Internet losses and special items.

Amortization of Goodwill and Similar Rights

Shaped by Impairment of Zomba

In all, amortization of goodwill and similar rights amounted to € 2.5 billion (previous year: € 1.4 billion). Key factors included the impairment of Zomba goodwill (€ 1.3 billion) as well as other impairments amounting to € 376 million.

Capital Gains/Losses

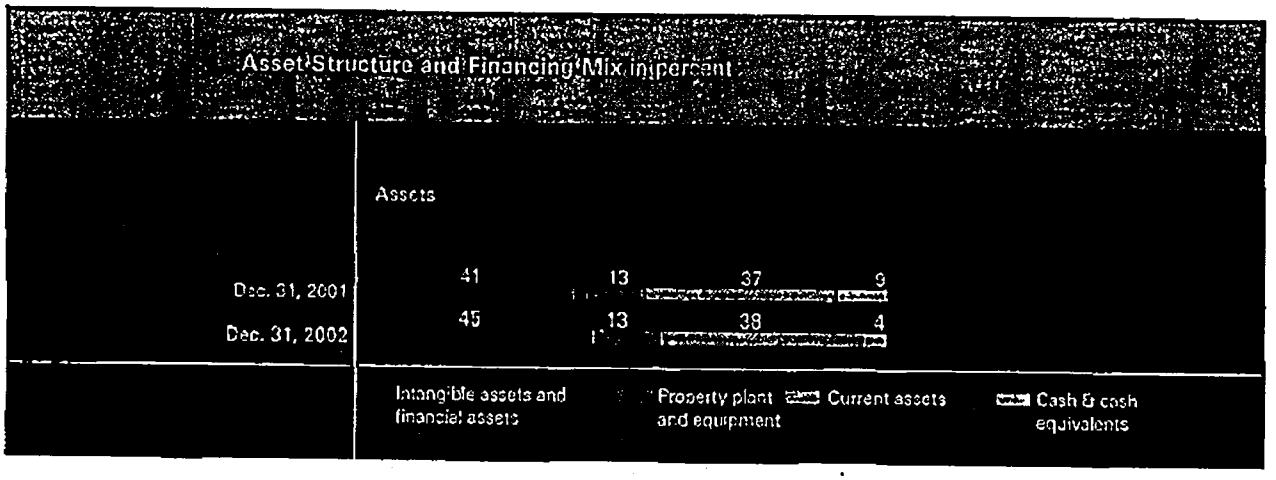
Sale of AOL Europe holding concluded

Capital gains, offset by minor losses, totaled € 2.9 billion (previous year: € 5.5 billion). Of this, € 2.8 billion derived from the now fully concluded sale of holdings in the online service AOL Europe to its U.S. parent company AOL Time Warner Inc. In 2002, Bertelsmann received the last installment from the transaction, which has brought Bertelsmann a total of $ 6.75 billion since 2001. Other gains included proceeds from Gruner + Jahr's sale of the Berlin-based newspaper operations (€ 138 million) and the sale of Gruner + Jahr's and DirectGroup's holdings in the South Korean Internet portal, DAUM (€ 59 million). This was set off by capital losses, e.g. at BMG from the sale of the Bad Boys label (minus € 56 million), and the losses from reducing the Pixelpark AG holdings from 60.3 percent to 20.0 percent, listed under Corporate Investments.

Investments

Extraordinarily high, mainly due to Zomba acquisition

At € 5.3 billion (previous year: € 2.6 billion), investments were extraordinarily high in 2002, mainly due to the Zomba acquisition. In November 2002, BMG acquired Zomba for € 2.7 billion. The purchase price was based on a put option signed in 1991. When acquiring Zomba, Bertelsmann also acquired cash and cash equivalents of € 470 million, which reduced the investment volume for Zomba to € 2.3 billion. In the television business, Bertelsmann bought a 22 percent stake in RTL Group from the British media group Pearson for € 1.5 billion in January 2002. The group's total RTL Group holdings rose to over 90 percent. In addition, RTL Group bought up the Holtzbrinck group's radio and television activities. Thus net investments in financial assets totaled € 4.5 billion. Capital expenditures on tangible assets amounted to € 543 million (previous year: € 922 million), e.g. the modernization and extension of printing facilities at arvato print and Gruner + Jahr, as well as the construction of Random House's new headquarters in New York. Capital expenditure in film and publishing rights amounted to € 236 million (previous year: € 390 million).



Total Assets

Equity ratio remains high

At December 31, 2002, total assets amounted to € 22.2 billion, i.e. slightly below previous year (€ 23.7 billion). This was due primarily to a decrease in current assets and a reduction in cash and cash equivalents. Net of cash and cash equivalents, current assets amounted to 38 percent of total assets, slightly above previous year. On the liabilities side, equity was at € 7.7 billion (December 31, 2001: € 8.4 billion). While shareholders' equity increased by € 382 million to € 6.7 billion, the share of minority interests decreased when holdings in RTL Group were increased by € 1.0 billion. At 34.9 percent, the equity ratio was slightly below the previous year's ratio of 35.3 percent, but well above the 25 percent target. Financial debt including finance leasing liabilities rose to 16.7 percent due to capital expenditures. This represents an increase of 4.5 percentage points over the previous year.

Financing and Key Financial Figures

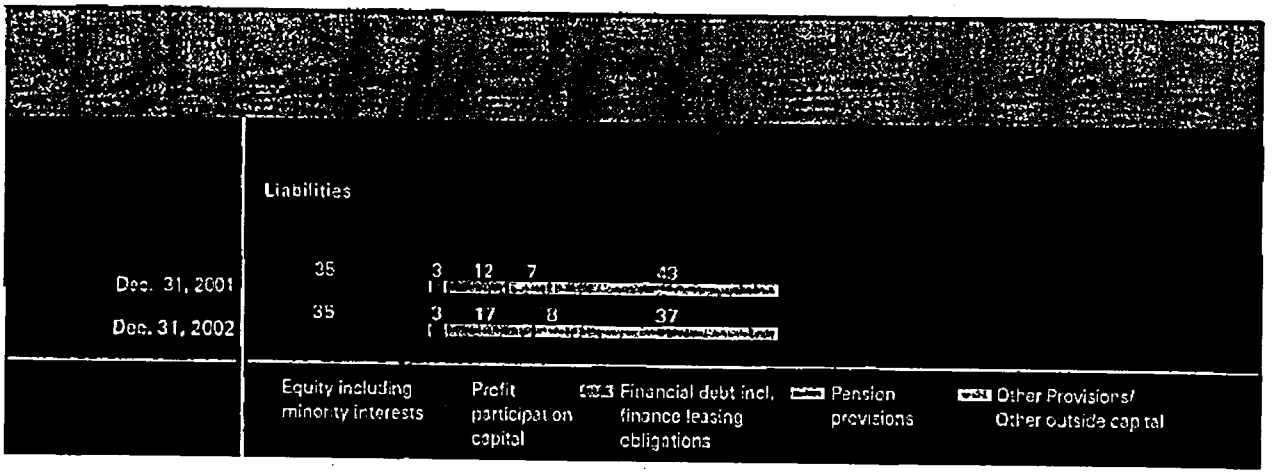
Maturity profile improved

Bertelsmann's first rating was published in June 2002. The Standard & Poor's rating agency gave Bertelsmann a BBB+, while Moody's gave Bertelsmann a comparable Baa1 rating. By attaining these ratings, Bertelsmann continues its focus on the capital market and creates the conditions for a stronger diversification of its sources of financing.

During the year, the group's net financial debt – i.e. the financial debt including finance leasing obligations offset against cash and cash equivalents – rose from € 859 million to € 2.7 billion. The increase is a result of the high volume of investmens, which exceeded the gains from sales.

For many years Bertelsmann has managed its operations according to self-imposed financial targets. These targets pertain primarily to the capital structure and financial debt. At 34.9 percent, the equity ratio was well above the target of 25 percent. The company also reviews the equity-to-goodwill ratio in acquired companies (including rights similar to goodwill). At € 7.7 billion (previous year: € 8.4 billion), equity was nearly € 800 million below goodwill and similar rights.

At a factor of 2.5, the financial debt repayment factor, i.e. the ratio of net financial debt to cash flow as defined by DVFA/SG (German Association of Financial Analysts; Schmalenbach Gesellschaft) did not meet the group's conservative internal target of max. 1.5. At 33.3, the interest coverage ratio, which according to internal targets should exceed a factor of 9, was well above the self-imposed goal. The interest coverage rate is defined as the ratio of EBITDA to net interest income. Bertelsmann's goal is to quickly return to its self-imposed target debt redemption factor. Individual measures to this effect refer to the pay-down of financial debt e.g. through the instigated sale of the BertelsmannSpringer publishing group on the one hand, and through improvements in profitability on the other.



To secure financing for the purchase of Zomba, a bridge loan in the amount of € 2.5 billion was agreed to with a group of six banks in June 2002. Shortly after the bridge loan was negotiated, the company planned to issue a medium-term euro benchmark bond with a volume of some € 1 billion. Despite high investor interest, the issue was postponed as current developments at other companies in the TMT sector (Technology/Media/Telecommunications) had greatly increased the volatility of the capital markets.

In preparing for the scheduled euro benchmark bond issue, the company had authorized a new debt issuance program with a maximum volume of € 3 billion. This umbrella program gives Bertelsmann AG and its financing vehicles Bertelsmann U.S. Finance, Inc. and Bertelsmann Capital Corporation N.V. the option of flexibly issuing loans under a shared documentation.

The debt issuance program was first used in July, when the financing vehicle Bertelsmann Capital Corporation N.V. placed a three-year, € 200 million loan as a private placement.

In November, Bertelsmann obtained a five-year syndicated credit line of € 1.5 billion. The offer was very positively received in the market and was oversubscribed to € 1.8 billion. This facility partially replaced the bridge loan signed in June. A total of 19 banks with varying business and geographical focuses participated in the syndicated line. Bertelsmann's debut on the European market for syndicated loans also served to define its future group of key banks. The long maturity term of the credit line helps to further improve the maturity structure of Bertelsmann's financing instruments.

BEX Extended

An entrepreneurial approach

The BEX initiative begun in spring 2001 was systematically extended in 2002. The aim of BEX is to continually and sustainably enhance the quality of Bertelsmann's products and services, to improve cooperation and processes within the group, and to raise earnings and returns in all areas of the group, including the Corporate Center. The target is to achieve an average operative return on sales of 10 percent (2002: 5.1 percent) throughout the group within three years.

The management changeover was accompanied by a trimming-down of Corporate Center staff and administrative functions. For example, the Bertelsmann Capital unit, which chiefly concerned itself with mergers & acquisitions, strategy and venture capital, was dissolved. Its tasks were taken over by the Chairman & CEO and his deputy. The Executive Board position of Chief Operating Officer was also eliminated, along with the Office of the Chairman. Units serving the Chairman & CEO, except Corporate Communications, which reports directly to the Chairman & CEO, were bundled in the Executive Board Council.

The bundle of measures to commemorate Elvis alone generated additional revenue of € 100 millions in 2002.

Group-wide Cooperation

Added income from Elvis Presley and Pop Idol

Synergy potentials within the group were vigorously exploited. One big success was the cooperation of nearly all corporate divisions for the occasion of the 25th anniversary of Elvis Presley's death on August 16, 2002. BMG released a compilation of 30 No.1 hits ("ELVIS # 1 Hits"), which sold millions of copies worldwide, and a 4-CD box ("Today, Tomorrow & Forever") with 100 previously unpublished versions of Elvis songs. arvato manufactured the CDs and also produced an Elvis calendar. Random House published Elvis books, while RTL Group's TV and radio stations aired special programs and DirectGroup came up with Elvis specials for its Club customers all over the world. Many Gruner + Jahr magazines published reports and special publications about the artist. The bundled measures generated additional revenues of approx. € 100 million in 2002.

Likewise, several corporate divisions are part of the worldwide success of the "Pop Idol" TV format (see page 17). The talent show is produced by the RTL Group subsidiary FremantleMedia; the winners of the show are each guaranteed a recording contract with BMG. In Germany, the "Pop Idol" variant "Deutschland sucht den Superstar" was broadcast by RTL Television, while an arvato subsidiary produced a tie-in Superstar magazine. In the U.S., Random House and Gruner + Jahr were involved in publications tying in to "American Idol."

Employees

Slight increase, mostly from Zomba

At the end of the year, the number of employees totaled 80,632, or 336 employees more than twelve months earlier (80,296). The Zomba music company brought in an additional 1,889 employees. The media services provider arvato also added jobs. The payroll increase at BMG and arvato was offset by job cuts at Gruner + Jahr, Random House, DirectGroup and central services units. At the end of the fiscal year, Bertelsmann employed 918 trainees (year-end 2001: 943).

Status of Bertelsmann AG

Equity amounted to € 7.2 billion

Bertelsmann AG is a management holding company without any operating businesses of its own. Its major sources of revenue are dividend payouts and services provided to its subsidiaries. Total equity amounted to € 7.2 billion, which corresponds to 89.9 percent of non-current assets.

Profit Participation Capital

Target payout of 15 percent achieved

The par value of profit participation capital was approx. € 516 million at the balance sheet date. Including the premium, the total volume of profit participation capital at December 31, 2002 remained unchanged at approx. € 706 million.

Profit participation capital is divided into Profit Participation Certificates from 2001 (SIN 522 994; "PPC 2001") and Profit Participation Certificates from 1992 (SIN 522 990; "PPC 1992"). Over 90 percent of the par value of profit participation capital is accounted for by the PPC 2001, which are authorized for trading on the Düsseldorf and Frankfurt stock exchanges and are among the most frequently traded profit participation certificates in the market.

The terms and conditions governing the PPC 2001 stipulate that a dividend of 15 percent of par value be paid for each full fiscal year provided there is sufficient consolidated net income and Bertelsmann AG net income. This condition was met for 2002. A 15 percent payout is also forthcoming for the PPC 1992. Thus, a total dividend of €77 million will be paid out on both types of Profit Participation Certificates in May 2003.

This marks the conclusion of the shift in the payout schedule. For the six-month stub period from July to December 2001, a pro-rated payout of 7.5 percent, i.e. exactly half of the annual target payout, was made in May 2002. The last payout for a twelve-month fiscal year occurred in October 2001, for fiscal year 2000/01. In future, dividends will be paid out in spring, for the calendar year just ended.

Under the terms and conditions governing the Profit Participation Certificates, Bertelsmann AG's auditors must review whether the dividend payout was correctly determined. The auditors have issued an unqualified opinion on this matter.

In 2002, the stock-market performance of PPC 2001 was determined largely by the overall development of the capital market. Until mid-year, the Profit Participation Certificate was able to buck the overall downward trend in the stock markets; its trading range remained stable between 220 and 210 percent. In the second half of the year, the Profit Participation Certificate succumbed to the overall nervousness governing the securities exchanges. Much like the Profit Participation Certificates issued by other big German companies, Bertelsmann's PPC 2001 registered a significant price decline, while its market price fluctuated widely.

Risk Management

A substantial element in the corporate philosophy

Bertelsmann has an integrated risk management system, which is complemented by an annual risk inventory and compulsory ad-hoc reporting at all companies involved. As in past years, the risk management system was subjected to intense scrutiny in selected segments, both by auditors from KPMG and by Bertelsmann's Corporate Audit and Consulting division.

The basic concept behind Bertelsmann's existing system has remained the same over the past few years and has become an essential element in the company's corporate philosophy.

As part of routine risk reporting, the divisions identified the following material risks, among others. Measures have been taken to control, reduce or prevent these risks.

During 2002, the steep decline in the advertising market had a considerable impact on RTL Group's operations. Due to poor macroeconomic conditions, no significant recovery is expected for this revenue stream – a key source of income for RTL Group – in fiscal year 2003. This risk is being countermanded with cost-cutting measures, as well as with the tapping of new revenue streams through secondary businesses.

Another risk RTL Group faces is the postponement or cancellation of programs by customers who find themselves forced to take cost-cutting measures due to the overall weak consumer climate.

In addition, the far-reaching changes and consolidation in the competitive environment, and the associated repercussions for RTL Group's main business, can result in an added impact on its profits. Continuing technological progress and the volatility of exchange rates represent added risk potentials, which, however, may be controlled through proactive measures.

Likewise, Random House as a global provider suffers from the recessive trend in the global economy. Regional markets such as Germany, as well as Argentina and Venezuela, failed to deliver satisfactory development in the year now ended. At the moment, no significant recovery of these markets is in sight. In this connection, Random House sees a weakening of the North American economy as a key risk, as this would mean the loss of additional compensation potential.

Random House was able to maintain its economic position in North America in 2002. Management is continuously monitoring the attendant sales-/procurement-related partial risks, including any risks from disruption of business, and controlling them with targeted countermeasures.

Much like the TV sector, Gruner + Jahr is and will continue to be exposed to the risk of a much more fiercely competitive advertising market. Combined with increasing consumer reluctance, this not only holds the risk of diminishing circulation, revenues and earnings, but also has implications for other production steps such as the printing operations.

In 2002, the Bertelsmann Music Group continued its cost reduction program "Fast & Flexible." Risks such as those from online music file-sharing platforms, the illegal reproduction of music and musical tastes that change at an ever-accelerating pace ("fashion" industry) can work against such efforts. The measures taken, particularly those against music piracy in all its manifestations, have borne first fruit, but must be continued resolutely and sustained for the long term. Strategic alternatives and new business models are being evaluated on an ongoing basis and are intended to strengthen BMG's competitive position.

The arvato group is especially hard hit by the poor cyclical trend, which impacted its core lines of business in particular: arvato print and arvato storage media. For fiscal year 2003, too, the aim is to ensure that its businesses operate at capacity in a difficult market environment – however, this is frequently only possible by coming down with prices. Meanwhile, the pricing pressure is not merely a result of the weak overall economy, but is also exacerbated by surplus capacity on the supply side. In the storage media industry, the worldwide decline in CD volume presents a risk that cannot be completely recompensed even with compensation options in the DVD sector.

DirectGroup significantly reduced its risk position during fiscal year 2002, by streamlining its e-commerce portfolio and adjusting its CCIT operating software to changed market conditions. In some countries, there are risks from intensified competition as well as the persistent consumer slump. This could continue to impact the strategic realignment and/or consolidation process – above all in Great Britain and Germany, as well as the U.S. music club – in fiscal year 2003, resulting in inadequate profitability.

BertelsmannSpringer faces the challenge of counteracting its dependence on a market that is stagnant overall and contracting in parts. To do so, it is tapping new market segments and creating new types of products and marketing. This difficult market environment prevents a speedy recovery of the advertising markets, which are crucial for BertelsmannSpringer. Budget cuts and budget shifts result in stagnant buying power on the part of BertelsmannSpringer's institutional customers. The risk associated with new types of products and marketing and the attendant capital expenditure are being controlled by means of a long-term business strategy. The aim of this strategy is to guide the gradual evolution of existing means of distribution, in order to organically grow BertelsmannSpringer's core business while safeguarding profitability.

After the End of the Fiscal Year

Random House, BMG, RTL Group

In January 2003, Random House became the first Western book publishing group to enter into a joint venture with the leading Japanese publisher Kodansha. As a result, Random House now publishes books in four of the leading languages of the worldwide book market – English, German, Spanish and Japanese. Random House Kodansha will publish both non-fiction and fiction titles, by international authors as well as Japanese writers.

In spring, BMG gave itself a new structure intended to bring management and artists closer together. Its former corporate organization by region was replaced with operating units, in particular the Label Group and Territory Management units.

In February 2003, Random House agreed to take over the Ullstein Heyne List publishing group from Axel Springer Verlag AG. The integration of Ullstein Heyne List into the Random House publishing group (Verlagsgruppe Random House) in Germany will be backdated to the beginning of the year. Ullstein Heyne List had revenues of € 178 million in 2001. Verlagsgruppe Random House reported turnover of € 243 million for the same year. Antitrust authorization for the takeover was still pending at time of print.

Also in February 2003, Bertelsmann learned from the press that several music publishers are apparently taking Bertelsmann AG to court in New York over loans granted to Napster by Bertelsmann. Bertelsmann believes that the complaint is without merit.

In early March, Gerhard Zeiler was appointed the new CEO of RTL Group. He will also remain in place as managing director of RTL Television, Cologne. Zeiler succeeds Didier Bellens, who left RTL Group in late February to join the Belgian telecommunications corporation, Belgacom.

Outlook

Stable revenues, rising earnings

As Bertelsmann sees it, the international media markets will remain stagnant in fiscal year 2003. Bertelsmann expects stable consolidated revenues (before currency effects) and a growth in operating income. The turnaround in profitability achieved in 2002 will be substantiated in 2003 with further strengthening and cost optimization in the core areas of television and radio, books, music, magazines, media services and direct-to-customer businesses.

Bertelsmann is preparing a variety of financing measures to further improve the maturity profile of its financing, and to switch financing to various capital market instruments.

The company does not expect a lasting upturn in the advertising industry in the near future, even if regional markets show clear signs of improvement. Accordingly, the RTL Group and Gruner+Jahr corporate divisions, with their heavy dependence on the advertising market, will stay focused on increasing their market shares, controlling costs, diversifying revenues, and increasing synergies and product innovations.

Random House is preparing for a continuingly difficult book market, especially in the German-speaking countries and in Latin America. BMG, given the backdrop of declining music sales and the still-unsolved piracy problem, is dedicating itself primarily to extending its market position, the promotion of promising artists and the integration of Zomba.

arvato expects continued pricing pressure in the print sector, but is counting on overall growth in revenues and income. In Germany, plans include the reorganization of the book-printing activities. In Italy, a sophisticated rotogravure project is planned. DirectGroup Bertelsmann hopes to achieve turnaround by year-end 2003. The intention is to achieve this with a combination of increased operating efficiency and quality in the company, portfolio management, and stabilized membership figures in the Clubs.

Consolidated Income Statement

	1/1/2002 – 12/31/2002	1/1/2001 – 12/31/2001 Pro forma
	€ million	€ million
Revenues	19,312	18,979
– of which from discontinuing operations	731	739
Other operating income	766	1,191
Change in inventories	(69)	28
Own costs capitalized	22	33
Costs of materials	(5,347)	(6,362)
Royalty and licence fees	(1,855)	(1,868)
Personnel costs	(4,574)	(4,812)
Amortization of intangible assets and depreciation of property, plant and equipment	(1,520)	(1,835)
Other operating expenses	(5,837)	(6,807)
Impairments of goodwill and similar rights	(1,661)	(232)
Capital gains/losses	129	5,533
Income from operating activities	1,357	3,848
Results of associated companies	(99)	(327)
Income from other participations	33	(524)
Profit before financial result and taxes	1,291	2,997
– of which from discounting operations	(12)	35
Net interests	(50)	(271)
Other financial expenses and income	(216)	(162)
Financial result	(266)	(433)
Income taxes	(57)	(1,186)
Net income after minority interests	968	1,378
Minority interests	(40)	(143)
Net income after minority interests	928	1,235

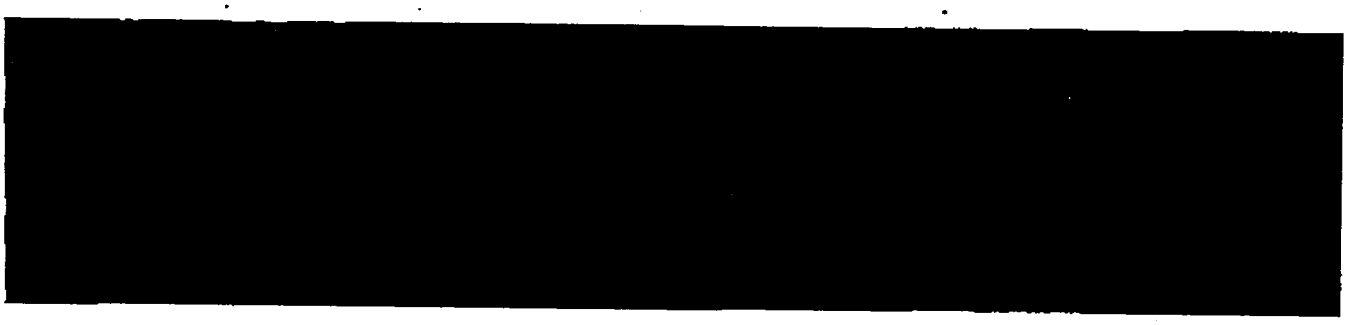
The charts shown here are not part of the audited Management Report.
They are provided solely as supplementary information

Segment Reporting 2002

	RTL Group € millions	Random House € millions	G+J € millions	BMG € millions	arvato € millions	Direct Group € millions	Total Segments € millions	Corporate € millions	Consolidation € millions	Bertelsmann Springer € millions	Total Group € millions
Revenues	4,362	1,995	2,800	2,714	3,668	2,707	18,246	50	(715)	731	18,312
Operating EBITA	465	168	226	125	217	(150)	1,051	(180)	(6)	71	936
Internet losses		–		–		–		–		–	
Operating EBITA incl. Internet losses	465	168	226	125	217	(150)	1,051	(180)	(6)	71	936
Special items	(43)	–		66	(14)	(84)	(75)	(36)		–	(111)
Capital gains/ losses	(50)	4	173	(58)	11	27	107	2,811		–	2,918
Total result	372	172	399	133	214	(207)	1,083	2,595	(6)	71	3,743

Segment Reporting Pro Forma 2001

	RTL Group € millions	Random House € millions	G+J € millions	BMG € millions	arvato € millions	Direct Group € millions	Total Segments € millions	Corporate € millions	Consolidation € millions	Bertelsmann Springer € millions	Total Group € millions
Revenues	4,054	2,039	2,973	2,982	3,520	3,089	18,657	192	(618)	748	18,979
Operating EBITA	385	33	198	(79)	167	(61)	643	(135)	6	59	573
Internet losses	(110)	(16)	(88)	(9)	(40)	(399)	(662)	(130)		(16)	(808)
Operating EBITA incl. Internet losses	275	17	110	(88)	127	(460)	(19)	(265)	6	43	(235)
Special items	(45)	(25)		(267)	(32)	(371)	(740)	(187)		–	(927)
Capital gains/ losses	240	–		–		–	240	5,293	–	–	5,533
Total result	470	(8)	110	(355)	95	(831)	(519)	4,841	6	43	4,371



Supervisory Board Report

During fiscal year 2002, the Supervisory Board fulfilled the duties incumbent upon it by law, the articles of corporation, and rules of internal procedure. The Supervisory Board was involved in all decisions of key relevance to the company. The Supervisory Board received regular oral and written reports on the business developments, the state of the company, and plans for major investments. It also reviewed the company's significant business transactions and strategic alignment with the Executive Board, and monitored the management of the company.

During fiscal year 2002, the Supervisory Board convened for four regular sessions and two special sessions. The Supervisory Board chairman was also in contact with the Executive Board beyond the Supervisory Board sessions and regularly obtained information about current developments and important business transactions. Between sessions, the Supervisory Board was notified about projects and plans that were of special relevance and urgency to the company, and – if applicable – asked for its opinion and/or decision.

The Bertelsmann AG consolidated financial statement and the group management report for the fiscal year from January 1 through December 31, 2002 were audited by KPMG Deutsche Treuhand-Gesellschaft Wirtschaftsprüfungsgesellschaft, Berlin, and received an unqualified auditor's opinion.

The Supervisory Board Audit and Finance Committee determined the main focuses of the annual audit, together with the auditors. The committee discussed the findings of the audit in detail. The auditors attended the Supervisory Board Audit and Finance Committee's financial review meeting and submitted their report. The Supervisory Board noted and accepted the findings of the audit. After its own, final scrutiny of consolidated financial statement and the group management report, the Supervisory Board raises no objections. The Supervisory Board approves the consolidated financial statement as prepared by the Executive Board.

Another review conducted in 2002 involved the risk management system set up by the Executive Board to provide early detection of developments that threaten the continued existence of Bertelsmann AG. The auditor concluded that the Executive Board has taken all measures demanded under Paragraph 91 Sect. 2 AktG in the divisions under review and that the early risk detection system is basically suited for detecting developments that threaten the continued existence of Bertelsmann AG.

During the year under review, the Bertelsmann AG Supervisory Board underwent further internationalization, and its composition was adjusted to more strongly reflect media and capital market experience. Upon the suggestion of the Supervisory Board, the Bertelsmann AG Annual General Meeting on June 10, 2002 unanimously elected three new members to the governing body. Since July 1, 2002 the following members are new to the Supervisory Board: IBM's Chief Financial Officer John R. Joyce (US), Sir Peter Job (UK), long-time head of the Reuters group, and Richard Sarnoff (US), Executive Vice President of the Random House book publishing group and new chairman of the Bertelsmann Management Representative Committee. They replaced the departing Supervisory Board members Dr. Hugo Bütler, managing director and editor-in-chief of the Neue Zürcher Zeitung, Bernd Wrede, former chairman of the Hapag-Lloyd AG executive board, Dr. Heinrich Weiss, SMS AG CEO, and Dr. Uwe Swientek, former chairman of the Bertelsmann Management Representative Committee, all of whom relinquished their seats on the board in June 2002. The Supervisory Board thanks the four departing members for their long years of commitment to the company's welfare. A new member will be appointed in Fiscal Year 2003 to fill the vacant 15th seat on the Bertelsmann AG Supervisory Board.

Gerd Schulte-Hillen
Chairman of the Supervisory Board of Bertelsmann AG

The fiscal year just past also saw significant personnel changes in Bertelsmann's senior management. In early August 2002, the former Chairman & CEO Dr. Thomas Middelhoff left the company. The reason behind the separation was a difference in opinions about the company's future strategy and the collaboration between the Supervisory and Executive Boards. The Bertelsmann AG Supervisory Board thanks Thomas Middelhoff for his achievements and his dedication.

Effective August 5, 2002, the Supervisory Board appointed Dr. Gunter Thielen as the new Chairman & CEO and Dr. Siegfried Luther as his deputy. Gunter Thielen has been a member of the Bertelsmann AG Executive Board since 1985 and was in charge of arvato AG prior to his appointment as CEO. Upon the suggestion of the new Chairman & CEO, the Supervisory Board transferred the management of DirectGroup Bertelsmann to Dr. Ewald Walgenbach in early August 2002, effective immediately. Earlier, in February, Ewald Walgenbach was appointed to the Bertelsmann AG Executive Board as Chief Operating Officer (COO). The CEO of DirectGroup division at the time, Dr. Klaus Eierhoff, ceded his seat on the Executive Board with immediate effect and left the company by mutual agreement on December 31, 2002. The Supervisory Board expresses its appreciation to Klaus Eierhoff for his past efforts.

Business developments in the year 2002 were shaped by the continuing weak economy and the regressive development in the advertising industry. Against this backdrop, the Supervisory Board supports the decisions, made after the management changeover, to largely withdraw from stand-alone e-commerce businesses and focus on Bertelsmann's core businesses including their Internet operations. The Supervisory Board closely supervised the Executive Board's Bertelsmann Excellence Initiative (BEX) to lastingly strengthen profitability. The corporate divisions managed to considerably improve their earnings year-on-year, thanks to measures taken to cut losses and improve operating results. Group earnings for fiscal year 2002 were significantly shaped by the last capital gains from the sale of the remaining AOL Europe holdings. These gains were offset by considerable financial investment e.g. in increasing the holding in RTL Group and Bertelsmann Music Group's (BMG) complete takeover of the Zomba music company. Additional Bertelsmann shares were bought back from the ZEIT Foundation. The takeover of Zomba carried out in November 2002 was triggered in June when a put option dating back to 1991 was exercised. It resulted in added financial requirements and an increase in net financial debt for the group. The Executive and Supervisory Boards both seek to reduce the financial debt rapidly.

Against the backdrop of an economy that continues to be difficult, Bertelsmann took resolute entrepreneurial steps during fiscal year 2002 to lay the key foundations for continued profitable growth. The Supervisory Board acknowledges the achievements of the company's Executive Board, executives and employees with gratitude and appreciation.

Gütersloh, March 19, 2003

Gerd Schulte-Hillen

Corporate Governance at Bertelsmann

The quest for excellent, effective Corporate Governance is firmly embodied in our corporate culture and part of our entrepreneurial identity at Bertelsmann.

Over the past few years, we reviewed the structures and processes defined in the rules of procedure of the Supervisory Board: We adjusted the working methods and jurisdiction of the committees and spelled out the reporting requirements. We gave special priority to a more open and factual discussion both with the Executive Board and within the Supervisory Board itself. Presentation times were shortened for all items on the agenda, to increase the time available for discussion. We also introduced a regular strategy dialog with the Executive Board. At Bertelsmann, we are not only content to merely fulfill the relevant structural and semantic demands of contemporary, active corporate governance as outlined in the Transparency and Disclosure Law and in the German Corporate Governance Codex – we also strive to cultivate a culture of discussion to promote frank exchange among professionals and steadily improve the quality of our Supervisory Board work.

Focuses of Corporate Governance activities in 2002 included the renewal of the Supervisory Board and a thorough review of Supervisory Board work at Bertelsmann ("Board Review").

The professional and personal competence of our Supervisory Board members is a key prerequisite for excellent corporate governance. To ensure that the strategic challenges of the future are reflected in the makeup of the Board, we hired specialized HR consultants and initiated a meticulous selection process. This helped us to find new members whose personality, leadership experience and professional skills match our strategy. In the process, we made especially sure that the new members understand and support our corporate culture.

We have shortened the terms of office of Supervisory Board members to three years. Members may be reelected up to two times, to ensure the necessary continuity even in the face of regular renewal. These shortened terms of office do not apply for employee representatives on the Supervisory Board and representatives of Bertelsmann shareholder Group Bruxelles Lambert (GBL).

Focuses of Corporate Governance activities in 2002 included the renewal of the Supervisory Board and a thorough review of Supervisory Board work at Bertelsmann ("Board Review").

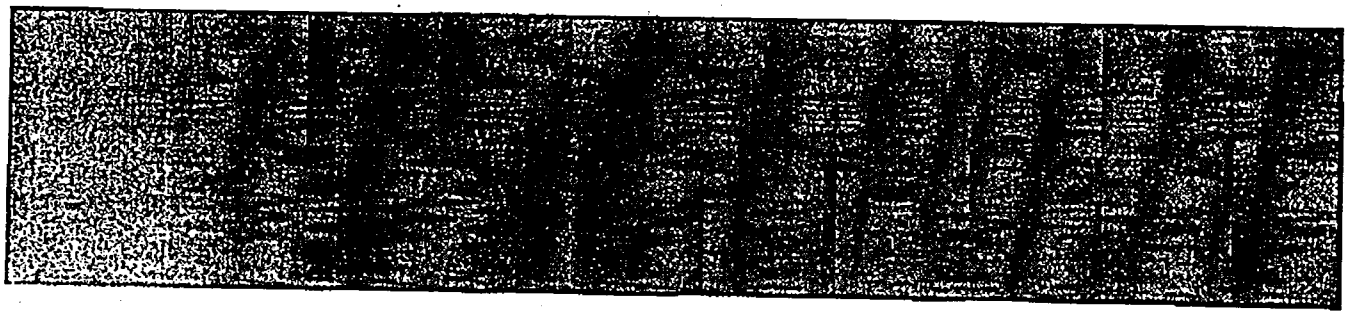
The quest for excellent, effective Corporate Governance is firmly embodied in our corporate culture and part of our entrepreneurial identity at Bertelsmann.

We believe the performance of supervisory bodies needs to be reviewed on a regular basis. Bertelsmann has repeatedly used systematic self-assessment as an effective tool to increase the efficiency and effectiveness of its Supervisory Board's work. During the business year just past, we became one of the first big stock corporations in Germany to carry out a comprehensive review of our Supervisory Board's work, assisted by an HR consultancy with experience in this field. The consultants held carefully prepared and confidential interviews with all Supervisory Board and Executive Board members in an atmosphere of complete openness. Critique and recommendations were summarized in a report that was discussed in the Supervisory Board and contained suggestions for the further improvement of our work.

In summary, the work done in the plenary assembly and in the committees was rated as exemplary. A number of suggestions have already been put into practice: For instance, once a year, in addition to the regular Supervisory Board sessions, there will be a separate strategy retreat with the Executive Board. Based on the evaluation results for the first time we also introduced a Supervisory Board retreat concerning the common objectives of the Supervisory Board and possibilities for improving its work. At its first session 2003 there was already an increased emphasis on focal points in the plenary assembly, to further improve the scope and quality of debate in this area. Furthermore, in the future each plenary session will end with a short Executive Session for the Supervisory Board members, to sum up and review the major topics and discussion items.

The Supervisory Board and Executive Board hope that the current fiscal year 2003 will bring added impulses for the continued evolution of Corporate Governance at Bertelsmann. To this end, we have initiated a benchmark study of eight companies that are considered leaders in the area of Corporate Governance in their countries.

The Supervisory Board



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Consolidated Income Statement

	Notes	1/1/2002–12/31/2002 in € millions	7/1/2001–12/31/2001 in € millions
Revenues	11	18,812	9,695
– of which from discontinuing operations	29	731	369
Other operating income	12	769	826
Change in inventories		(69)	(15)
Own costs capitalized		22	18
Cost of materials	13	(6,347)	(3,267)
Royalty and license fees		(1,855)	(1,015)
Personnel costs	14	(4,574)	(2,343)
Amortization of intangible assets and depreciation of property, plant and equipment	15	(1,520)	(893)
Other operating expenses	16	(5,837)	(3,598)
Impairments of goodwill and similar rights	17	(1,661)	(55)
Capital gains/losses	18	2,918	2,225
Income from operating activities		1,357	1,568
Results of associated companies	19	(99)	(257)
Income from other participations	20	33	(179)
Profit before financial result and taxes		1,291	1,132
– of which from discontinuing operations	29	(12)	–
Net interest	10	(50)	(108)
Other financial expenses and income	21	(216)	(100)
Financial result		(266)	(208)
Income taxes	22	(57)	7
Net income before minority interests		968	931
Minority interests		(40)	18
Net income after minority interests		928	949
Reconciliation to Operating EBITA			
Profit before financial result and taxes		1,291	1,132
Capital gains/losses	18	(2,918)	(2,225)
Special items	42	111	432
Internet losses	43	not stated	254
Amortization of goodwill and similar rights		2,432	451
Amortization of goodwill from associated companies		20	120
Operating EBITA		936	164
Operating EBITDA	43	1,666	642

Consolidated Balance Sheet

	Notes	12/31/2002 in € millions	12/31/2001 in € millions
Assets			
Non-current assets	14		
Goodwill	15	7,787	7,289
Other intangible assets	16	1,231	1,158
Property, plant and equipment	16	2,802	3,017
Investments in associates	17	582	578
Other financial assets	12	404	737
		12,806	12,780
Current assets			
Inventories	18	1,961	1,941
Trade accounts receivable	19	3,251	3,631
Other receivables and other assets	19	2,780	2,959
Cash and cash equivalents	20	977	2,044
		8,969	10,575
Deferred tax assets	12	237	190
Prepaid expenses		176	189
		22,188	23,734
Equity and Liabilities			
Equity	21		
Subscribed capital		606	606
Capital reserve		2,725	2,725
Retained earnings		2,428	2,023
Net income after minority interests		928	949
Shareholders' equity		6,685	6,303
Minority interests		1,059	2,081
		7,744	8,384
Third-party liabilities			
Profit participation certificates	22	706	706
Provisions			
Provisions for pensions and similar obligations	23	1,737	1,682
Other provisions	24	2,944	3,854
		4,681	5,536
Liabilities			
Financial debt	25	3,718	2,903
Trade accounts payable	26	2,693	2,713
Other liabilities	26	2,031	2,862
		8,442	8,478
Deferred tax liabilities	12	83	150
Deferred income		532	480
		22,188	23,734

Consolidated Cash Flow Statement

	1/1/2002 – 12/31/2002	1/1/2001 – 12/31/2001
	€ million	€ million
Net income before minority interests	968	931
Depreciation/amortization/write-ups of non-current assets	3,178	1,142
Change in long-term provisions	(83)	41
Other cash/non-cash items	(2,948)	(1,987)
Cash flow according to DVFA/SG	1,115	127
Result from disposal of non-current assets	(4)	(13)
Change in inventories	(127)	50
Change in receivables, other assets and prepaid expenses	336	(14)
Change in short-term provisions, other liabilities and deferred income	(260)	76
Net cash from operating activities	1,214	226
Investments in:		
– intangible assets	(236)	(221)
– property, plant and equipment	(543)	(392)
– financial assets	(72)	(155)
– purchase price for acquired entities (net of acquired cash)	(3,412)	(299)
Proceeds from disposals of non-current assets	2,552	2,390
Net cash from investing activities	(2,711)	1,323
Issue of bonds and promissory notes	146	–
Change in financial debt	505	(320)
Change in shareholders' equity	(199)	233
Dividends for Bertelsmann AG and minority interests	(359)	(75)
Net cash from financing activities	490	(162)
Change in cash and cash equivalents	(999)	1,387
Exchange rate movements and other changes in cash and cash equivalents	(68)	258
Cash and cash equivalents at the beginning of the period	2,044	399
Cash and cash equivalents	977	2,044

Consolidated Statement of Changes in Shareholders' Equity

	Subscribed capital	Capital reserve	Retained earnings	Other comprehensive income			Net income after minority interests	Shareholders' equity
				Currency translation differences	Available-for-sale securities	Derivative financial instruments		
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Balance at June 30, 2001	463	17	1,526	121	804	13	741	3,685
Change in shareholders' equity due to								
– Dividends		–		–		–	(50)	(50)
– Capital increases	143	2,708		–		–		2,851
– Obligation to purchase ZEIT shares		–	(409)	–		–		(409)
Other comprehensive income								
– Currency translation differences		–		(10)		–		(10)
– Other changes		–		–	(745)	32		(713)
Change recognized in income								
– Transfer to retained earnings		–	691	–		–	(691)	
– Net income after minority interests		–		–		–	949	949
Balance at Dec. 31, 2001	606	2,725	1,808	111	59	45	949	6,303
Change in shareholders' equity due to								
– Dividends		–		–		–	(300)	(300)
Other comprehensive income								
– Currency translation differences		–		(97)		–		(97)
– Other changes		–		–	(55)	(94)		(149)
Change recognized in income								
– Transfer to retained earnings		–	649	–		–	(649)	
– Net income after minority interests		–		–		–	928	928
Balance at Dec. 31, 2002	606	2,725	2,457	14	4	(49)	928	6,685

Notes

General Principles

The consolidated financial statements of Bertelsmann AG have been prepared in accordance with International Financial Reporting Standards (IFRS), including all currently applicable standards and interpretations issued by the International Accounting Standards Board (IASB). Except for the measurement of financial instruments, the consolidated financial statements have been prepared on an historical basis.

The consolidated financial statements prepared in accordance with IFRS are consistent with the European Union's directives on group accounting and reporting (Directive 83/349/EEC). The main differences between IFRS and HGB are set out in note 34. As the conditions for applying § 292a of the German Commercial Code (HGB) are met, no consolidated financial statements have been prepared in accordance with the regulations set out in HGB.

The financial year is the same as the calendar year, from January 1 through December 31, 2002. As required, the consolidated financial statements and notes show comparative figures for the preceding period. As the preceding period, from July 1 through December 31, 2001, was only a stub period covering six months, the figures are not directly comparable. For this reason pro-forma, unaudited financial data for the previous twelve months is set out on pages 50–51, which are the basis for disclosures in the management report.

The consolidated financial statements have been prepared in euro; all amounts are stated in millions of euro (€ million). In order to increase clarity, certain positions in the income statement and in the balance sheet have been reclassified. These positions are disclosed in more detail and explained in the notes. The income statement is classified using the nature of expense method.

Due to their significance, goodwill write-downs and capital gains/losses of subsidiaries and investments are shown separately. In order to ensure comparability, the prior period figures have been adjusted accordingly.

Consolidation

Consolidation Methods

All material subsidiaries controlled either directly or indirectly by Bertelsmann AG as defined by IAS 27 have been consolidated. Material jointly controlled companies as defined by IAS 31 have been proportionately consolidated. Material associated companies as defined by IAS 28 are reported using the equity method. This is deemed to be the case if between 20 percent and 50 percent of the company's voting stock is held. A list of material subsidiaries and participations is set out in note 36 (pages 109–112). The consolidated financial statements of Bertelsmann AG, as parent company, and the financial statements of its consolidated subsidiaries are prepared in accordance with uniform accounting policies.

Investments in subsidiaries are consolidated using the purchase method, by which, at the time of purchase, the acquisition cost of the investment is offset against the interest in the fair values of the net assets shareholders' equity acquired. Deferred taxes are recognized on temporary differences arising as a result of stating the proportion of assets and liabilities acquired at fair values at the time of acquisition, to the extent such fair value adjustments are not also recognized for tax purposes. Any remaining difference is recognized as goodwill and is amortized straight-line over its estimated useful life. Differences arising as a result of stating assets and liabilities acquired at their fair values are carried forward, depreciated or released in the periods following the acquisition, depending on the nature of the assets and liabilities to which they relate. To the extent it does not relate to expected future losses, any negative goodwill is presented as a deduction from assets in the balance sheet and recognized as income on a systematic basis in accordance with IAS 22. Investments in proportionately consolidated companies are consolidated according to the same principles.

Investments in associated companies using the equity method are included at the proportionate share of the shareholders' equity of the investment. The same method as for fully-consolidated subsidiaries is used when accounting for differences between the purchase cost at the time of acquisition and the share of net assets acquired. Associated company losses which exceed their carrying values are not recognized unless there is an obligation to make additional contributions.

All intercompany gains, losses, revenues, expenses, income, assets, liabilities, and provisions falling within the scope of the consolidation are eliminated. Deferred taxes are recognized on temporary differences arising on consolidation in accordance with IAS 12. Proportionate consolidations are carried out according to the same principles.

Scope of Consolidation

The scope of consolidation, including Bertelsmann AG, comprises 1,080 (previous year: 1,034) fully consolidated companies. All domestic and international affiliated companies are consolidated, with the exception of 157 (previous year: 165) companies which are not consolidated because they do not have significant business operations of their own and overall have no material impact on the Group's net worth, financial position and results of the company.

The scope of consolidation changed during the year as follows:

Change in Scope of Consolidation

	Domestic	Foreign	Totals
Consolidated at December 31, 2001	311	723	1,034
Additions	62	123	185
Disposals	57	82	139
Consolidated at December 31, 2002	316	764	1,080

Total investments leading to consolidation amounted to € 2,909 million during the year, the largest amount being for the purchase of shares in Zomba.

On November 26, 2002 Bertelsmann Music Group acquired the remaining shares in Zomba Publishing (75 percent) and Zomba Records (80 percent) from Summer Shore N.V. The purchase price of € 2,737 million was based on an agreement made in the year 1991 and led to goodwill of € 2,023 million.

The RTL Group acquired participations in 12 radio stations from the Holtzbrinck Group for € 75 million. This resulted in goodwill of € 46 million on initial consolidation at December 31, 2002.

Effective July 1, 2002, Gruner + Jahr sold its Berlin newspaper activities centered around "Berliner Zeitung," the regional newspaper, to the Holtzbrinck Group. The gain on sale was € 138 million.

arvato disposed off its hotel reservation service, included in TRUST GmbH, to Cendant Corporation also effective July 1, 2002, and the gain on disposal amounted to € 11 million.

In the first half of 2002 Bertelsmann Music Group disposed off Arista Good Girls Inc., which owns the "Bad Boys" label, for a loss of € 56 million.

A further loss of € 30 million arose from deconsolidation of Pixelpark effective July 1, 2002. Bertelsmann reduced its investment in Pixelpark from 60.3 percent to 20 percent.

Acquisitions and disposals during the year had the following effect on Bertelsmann Group's assets and liabilities as at the date of their initial consolidation or de-consolidation:

Effects of Acquisitions and Disposals

	Additions 7/1/2002 – 12/31/2002 € millions	Disposals 7/1/2002 – 12/31/2002 € millions	Net 7/1/2002 – 12/31/2002 € millions	Additions 7/1/2001 – 12/31/2001 € millions	Disposals 7/1/2001 – 12/31/2001 € millions	Net 7/1/2001 – 12/31/2001 € millions
Non-current assets	591	173	418	4,523	3	4,526
Current assets	907	61	846	1,754	34	1,788
Liabilities	783	146	637	2,407	48	2,455

106 joint ventures (previous year: 91) were proportionately consolidated in the consolidated financial statements.

The proportionate consolidation of joint ventures had the following effect on the Bertelsmann Group's assets, liabilities, income and expenses:

Effects of Proportionate Consolidation on the Balance Sheet

	12/31/2002 € millions	12/31/2001 € millions
Non-current assets	265	727
Current assets	1,089	988
Liabilities	1,237	1,322

Effects of Proportionate Consolidation on the Statement of Income

	12/31/2002 € millions	12/31/2001 € millions
Income	1,781	650
Expenses	1,762	700

Of the 183 (previous year: 183) associated companies, 93 (previous year: 75) are reported using the equity method; the remaining are reported at acquisition cost owing to their minor importance to the Bertelsmann consolidated financial statements.

A list of the Bertelsmann Group's shareholdings will be filed with the commercial register at the district court in Gütersloh (department B no. 3100). For 2002, those domestic subsidiaries listed in note 37 took advantage of the exemption from having their annual financial statements audited and published pursuant to § 264 para. 3 HGB and § 264b no. 4 HGB.

Currency Translation

In Bertelsmann AG's consolidated financial statements, the financial statements of foreign subsidiaries are translated into euros using the reporting currency concept as described in IAS 21. Since all subsidiaries conduct their financial, commercial and organizational activities independently, their respective local currency is the functional currency. Assets and liabilities are translated at the closing-date rate, while the income statement is translated at the average rate for the year. Currency translation differences are charged or credited directly to shareholders' equity. Such differences arise from translating items in the balance sheet at different rates compared with the previous year, and from using different rates to translate the income statement and balance sheet. When subsidiaries are deconsolidated, any related cumulative translation differences are reversed and recognized in income.

The following euro exchange rates were used to translate the currencies of those countries which are most significant to the Bertelsmann Group:

Euro Exchange Rates for Major Foreign Currencies

Foreign currency unit per €1		Average rate		Closing date rate	
		12/31/2002	12/31/2001	12/31/2002	12/31/2001
US dollars	USD	0.9416	0.8889	1.0487	0.8813
Canadian dollars	CAD	1.4783	1.3889	1.6660	1.4077
British pounds	GBP	0.6277	0.6173	0.6505	0.6085
Japanese yen	JPY	117.79	109.65	124.39	115.33
Swiss francs	CHF	1.4573	1.4924	1.4524	1.4829

Accounting Policies

Revenue Recognition

Revenues and other operating income are recognized when the service has been performed and the risks have been transferred, except for revenues recognized using the percentage-of-completion method as set out in IAS 11. Revenues are stated net of discounts and allowances. Expenses are deferred based on underlying facts or the period of time to which they relate.

Interest income and expense are allocated to the period to which they relate. Dividends are recognized in the period in which the distribution is received.

Intangible Assets

Internally generated intangible assets are recognized at their development cost if the conditions for recognition as set out in IAS 38 have been met. Related borrowing costs are generally included as set out in IAS 23, but the amounts involved are insignificant to the Group. Purchased intangible assets are stated at acquisition cost. Intangible assets are amortized on a straight-line basis over their useful lives. Capitalized software is amortized over a 3 to 4 year period, and licenses are amortized over the term of the respective license agreement. Trademarks are amortized over a maximum period of 15 years, supply rights and long-term subscribers over a maximum of 5 years, and music rights over a maximum period of 15 years. In accordance with IAS 22, goodwill arising on acquisition is recognized and amortized straight-line over probable useful lives of between 3 and 20 years. Goodwill arising on the acquisition of foreign subsidiaries is translated into the Group's reporting currency at foreign exchange rates ruling at the time of initial consolidation.

Property, Plant and Equipment

Property, plant and equipment is measured at acquisition or manufacturing cost less depreciation. The cost of property, plant and equipment produced internally within the Group includes direct costs and a portion of overheads directly attributable to their production. The cost of property, plant and equipment whose production takes place over a longer period of time includes third-party interest accrued up to the time of completion. The amounts involved are insignificant to the Group. Maintenance expenses are recorded as expense in the period in which they are incurred, whereas costs incurred resulting in a prolongation of the asset's useful life or in an improvement to its use, is recognized as an increase in the carrying value of the asset.

Items included in property, plant and equipment are depreciated on a straight-line basis over their estimated useful lives. Such depreciation is based on the following Group-wide useful lives:

–Buildings	10 to 35 years
–Plant, technical equipment and machinery	3 to 10 years
–Office furniture and other equipment	3 to 12 years

Leasing

To the extent the Bertelsmann Group assumes all significant opportunities and risks relating to a leased asset and is thus to be seen as the economic owner of the asset (finance lease), the leased asset is recognized in the balance sheet in the amount of the asset's fair value at the inception of the lease or the present value of future lease payments, if lower. Payment obligations arising from the finance lease are recognized in the same amount as leasing liabilities.

If it is sufficiently certain that ownership of the leased asset will pass to the lessee at the end of the lease term, the asset is depreciated over its useful life. Otherwise, it is depreciated over the term of the lease. There are no conditional lease payments.

The leased assets consist mainly of buildings. The finance leases are generally subject to a non-cancelable minimum lease term of approximately 20 years. Upon expiry of this term, the lessee is entitled to purchase the leased asset at its residual value. The installments paid by the lessee under the lease vary in accordance with changes in interest rates paid by the lessor. The leases do not contain any prolongation options.

In addition to finance leases, the Group has also entered into operating lease agreements. This means that economic ownership of the leased assets lies with the lessor and lease installments are recorded as expenses in the period in which they are due for payment. The total amount of lease installments due over the minimum non-cancelable lease terms of these operating leases is disclosed in the notes as part of other financial commitments.

Write-downs

As set out in IAS 36, write-downs are made to items included in property, plant and equipment if their recoverable amount is lower than their carrying value. The recoverable amount is the higher of the asset's net selling price and the present value of expected future cash flows from the asset. If cash flows cannot be attributed to the asset itself, the amount of any write-down is computed based on the cash flows of the next higher cash generating unit to which the asset can be allocated. Expected cash flows are discounted using an average pre-tax cost of capital (weighted-average cost of capital, WACC) for the group of 12.3 percent. If the reason for making a write-down no longer exists, the write-down is reversed unless it related to goodwill. Any reversal does not exceed the carrying amount that would have been determined if no impairment loss had been recognized in previous years.

Participations and Securities

Significant participations are included using the equity method, and all other participations and other securities included in non-current assets and in current assets in the Bertelsmann Group's consolidated financial statements are classified as available-for-sale or held-to-maturity.

Available-for-sale financial assets are stated at fair value on the balance sheet date in accordance with IAS 39, to the extent fair value can be determined. Any resulting unrealized gains and losses are recorded, net of deferred taxes, directly in shareholders' equity. However, any probable impairment losses which are other than temporary are recognized as an expense in the income statement. If the reasons for charging the write-down no longer exist, the write-down is reversed. Unrealized gains and losses on such financial assets are reclassified to income upon disposal of the asset concerned. If a fair value cannot be determined, the participations and securities are stated at amortized acquisition cost.

Financial assets held to maturity, are stated at amortized cost using the effective interest method.

Inventories

Inventories are stated at acquisition or manufacturing cost. Similar inventories are reported at average cost or using the FIFO (first-in, first-out) method. Inventories originating from intra-Group suppliers are adjusted to eliminate intercompany profits and are measured at Group manufacturing cost.

If the acquisition or manufacturing cost exceeds their current fair value at the balance sheet date, inventories are written down to their net realizable value.

Customer-specific Contracts

A small volume of customer-specific contracts are reported in the IAS financial statements using the percentage-of-completion method, which requires revenues and profits from contracts to be recognized according to the percentage of completion of the respective project. The percentage of completion is calculated as the ratio of contract costs incurred up to the end of the year to total estimated project costs (cost-to-cost method). Irrespective of a project's percentage of completion, losses resulting from customer-specific contracts are immediately recognized in full in the period in which the loss is identified.

Receivables

Other receivables and other assets are stated at their nominal value or, where appropriate, at their fair value. Long-term receivables are discounted. Foreign currency receivables are translated at closing-date rates. Allowances are recognized for any discernible risks.

Cash and Cash Equivalents

Cash and cash equivalents include securities with an original maturity of less than three months, bank balances and cash on hand. Amounts in foreign currency are translated using rates ruling at the end of the year.

Deferred Taxes

As set out in IAS 12, deferred tax assets and liabilities are recognized for all temporary differences between carrying amounts reported for tax purposes and those reported in the IFRS consolidated balance sheet (with the exception of goodwill not recognizable for tax purposes) and for tax loss carryforwards. Through the deduction of a valuation allowance, deferred tax assets are only reported to the extent to which they can be subsequently utilized. Such taxes are calculated using enacted tax rates that will apply in the future. The effect of changes in tax rates on deferred tax assets and liabilities is recognized in the period in which the relevant legislation has been enacted.

Other Comprehensive Income

Other comprehensive income includes – without affecting the income statement – foreign currency translation gains and losses, unrealized gains and losses from the fair value recognition of available-for-sale securities and derivatives acting as cash flow hedges, as set out in IAS 39.

Provisions

Provisions for pensions and similar obligations are calculated actuarially using the projected unit credit method as set out in IAS 19, which, in contrast to the entry-age-normal method, includes expected future salary increases. This method involves use of biometric calculation tables, current long-term market interest rates and current estimates of future increases in salaries and pensions. The interest element of pension expense is included in financial expense in the income statement.

With the exception of the other personnel-related provisions calculated as set out in IAS 19, all other provisions have been recognized in line with IAS 37 and to the extent there is a legal or constructive obligation to a third party.

Liabilities

Liabilities are stated at nominal values. Long-term liabilities are discounted. Liabilities in foreign currency are translated into the reporting currency at rates ruling at the end of the year.

Derivative Financial Instruments

As set out in IAS 39, all derivative financial instruments are recognized at fair value on the balance sheet. At the time a contract involving a derivative is entered into, it is determined whether it is intended to serve as a fair value hedge or as a cash flow hedge. However, some derivatives do not meet the requirements included in IAS 39 for recognition as a hedge, despite it being their economic purpose. Changes in fair values of derivatives are recorded as follows:

1. Fair value hedge: Fair value changes of these derivatives, which serve as hedges of assets or liabilities, are recorded in the income statement, thereby offsetting the change in fair value of the underlying balance sheet items also included in the income statement.

2. Cash flow hedge: Changes in fair values of these derivatives, which act as hedges of future cash flows, are recorded directly in other comprehensive income. These amounts are released to income in the same period as the underlying transaction effects the income statement.

3. Stand alone (no hedge relationship): Fair value changes of these derivatives, which do not meet the conditions for being recognized as hedges, are recognized in the income statement as held-for-trading financial instruments.

Notes to the Income Statement and Balance Sheet

1 Revenues

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Revenues from selling goods and merchandise	11,372	6,332
Revenues from providing services	6,927	3,316
Revenues from use of assets	437	226
Gross revenues	18,736	9,874
Discounts and allowances	(424)	(189)
Revenues	18,312	9,685

2 Other Operating Income

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Extra and supplementary income	200	106
Operating foreign exchange gains	26	135
Prior year income and reimbursements	86	197
Release of provisions	123	132
Gains from disposal of non-current assets	41	13
Sundry income	229	243
	705	826

3 Cost of Materials

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Raw materials and supplies	3,765	2,144
Purchased services	1,582	1,123
	5,347	3,267

④ Personnel Costs

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Wages and salaries	3,828	1,962
Social security contributions	682	289
Profit sharing	34	19
Pensions and similar expenses	101	51
Other employee benefits	29	23
	4,574	2,343

⑤ Amortization of Intangible Assets and Depreciation of Property, Plant and Equipment

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Amortization/depreciation of		
– goodwill	701	363
– other intangible assets	331	257
– property, plant and equipment	488	273
	1,520	893

Amortization of other intangible assets includes amortization of step ups arising on initial consolidation as set out in IAS 22. For Group management reporting purposes this is classified as amortization of rights similar to goodwill and is treated in the same manner as goodwill. Thus, this amortization does not reduce the Operating EBITA. Amortization for the year was € 70 million (previous year: € 33 million), impairments are shown separately.

6 Other Operating Expenses

	1/1/2002 – 12/31/2002 € millions	7/1/2001 – 12/31/2001 € millions
Rental and leasing expense	431	232
Administrative expenses	2,040	828
Consulting and audit fees	211	265
Operating foreign exchange losses	321	110
Advertising costs	1,136	712
Selling expenses	1,004	532
Additions to other provisions	68	46
Allowances on current assets	334	312
Operating taxes	88	44
Losses on disposal of non-current assets	68	14
Sundry expenses	444	505
	5,837	3,598

Administrative expenses include travel costs, insurance premiums and communication expenses. Sundry expenses include repair and maintenance costs and donations.

7 Impairments of Goodwill and Similar Rights

	Amortization of goodwill and rights similar to goodwill 1/1/2002 – 12/31/2002 € millions	1/1/2002 – 12/31/2002 € millions	Total 1/1/2002 – 12/31/2002 € millions	Total 7/1/2001 – 12/31/2001 € millions
Zomba, BMG	1,225	67	1,292	–
"Fast Company", G+J	85		85	–
London Playout Center, RTL Group	70		70	–
Various, BertelsmannSpringer	49	2	51	–
CDNOW, DirectGroup	39		39	–
myplay, DirectGroup	20	7	27	–
Handy.de, Corporate Center	20		20	–
"McCall's", ("Rosie"), G+J				20
Pixelpark, Corporate Center				30
Other	74	3	77	5
	1,582	79	1,661	55

The impairment of € 1,292 million for Zomba was required as the purchase price, which was calculated based on an agreement made in 1991, no longer reflected current market conditions. The recoverable amount was calculated based on estimated cash flows.

8 Capital Gains/Losses

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
AOL Europe, Corporate Center	2,827	1,412
AOL Time Warner, Corporate Center	[illegible]	669
UFA Sports/Sportfive, RTL Group	[illegible]	144
DAUM, G+J/DirectGroup	(59)	–
"Berliner Zeitung", G+J	(138)	–
Bad Boy, BMG	(56)	–
Other	(50)	–
	2,918	2,225

"Other" includes gains and losses resulting from a number of smaller transactions, together with transaction costs incurred to date relating to the intended disposal of BertelsmannSpringer in the first half of 2003.

The disposal gain on the sale of AOL Europe and AOL Time Warner shares in 2001 was included in investment income in last year's financial statements, whereas the gain on disposal of Sportfive was included in other operating income.

9 Results of Associated Companies and Participations

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Income from associated companies	49	24
Expenses from associated companies	(128)	(161)
Amortization of goodwill from associated companies	(20)	(120)
Results of associated companies	(99)	(257)
Income from participations	37	15
Expenses from participations	(24)	–
Depreciation of investments	(66)	–
Write-ups of participations	86	(194)
Results of participations	33	(179)

Most of the share of profits of affiliated companies came from RTL II, with € 27 million (previous year: € 5 million), and from RTL Klub Hungary, with € 7 million (previous year: € 3 million). The share of losses of associated companies included Lycos Europe, at € 32 million (previous year: € 12 million), barnesandnoble.com, at € 28 million (previous year: € 68 million), and Bertelsmann Ventures at € 5 million (previous year: € 31 million). The share of losses of J Records up to the date of its acquisition amounted to € 43 million (previous year: € 7 million). The Group's share of associated companies' contingent liabilities amounted to € 10 million at December 31, 2002.

10 Net Interest

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Interest and similar income	217	73
Interest on finance leases	(22)	(13)
Interest and similar expenses	(245)	(168)
	(50)	(108)

Finance lease liabilities are included in financial debt, so that the related interest expense is included here. The previous year's amounts have been reclassified.

11 Other Financial Expenses and Income

	1/1/2002 – 12/31/2002 € millions	1/1/2001 – 12/31/2001 € millions
Interest on provisions for pensions and similar obligations	(122)	(61)
Dividend entitlement on profit participation certificates	(77)	(39)
Other	(17)	–
	(216)	(100)

12 Income Taxes

Income taxes, divided between domestic and foreign, current and deferred, are as follows:

Income Taxes

	Domestic 2002 € millions	Foreign 2002 € millions	Total 2002 € millions	Domestic 2001 € millions	Foreign 2001 € millions	Total 2001 € millions
Net income before income taxes	1,077	(52)	1,025	1,739	(815)	924
Current income taxes	53	(243)	(190)	10	6	16
Deferred income taxes	31	102	133	(33)	24	(9)
Total income taxes	84	(141)	(57)	(23)	30	7
Net income after income taxes	181	(193)	968	1,716	(785)	931

Tax loss carryforwards of € 152 million (previous year: € 170 million) were utilized in 2002, reducing current tax expenses by € 45 million (previous year: € 61 million). Of the tax loss carryforwards utilized, € 30 million related to domestic corporation tax, € 24 million to domestic trade tax and € 98 million to foreign income tax.

Deferred tax assets and liabilities resulted from the following items and factors:

Deferred Taxes	Assets 12/31/2002 in € millions	Liabilities 12/31/2002 in € millions	Assets 12/31/2001 in € millions	Liabilities 12/31/2001 in € millions
Intangible assets	109	92	49	84
Property, plant and equipment	22	141	7	178
Investments	25	93	39	58
Inventories	160	41	140	3
Accounts receivable	216	60	223	58
Prepayments and other assets	109	90	122	98
Provisions	138	47	144	119
Financial debt	88	6	180	–
Accounts payable	56	16	145	19
Prepayments and other liabilities	97	16	203	38
Loss carryforwards	3,722		3,693	–
Valuation allowance	(3,663)		(4,242)	–
Total	1,078	1,924	703	663
Netting	(841)	(841)	(513)	(513)
Carrying amount	237	1,083	190	150

Deferred tax assets and liabilities are offset against each other if they relate to the same tax authority and can be offset.

Valuation allowances are deducted from deferred tax assets to the extent it is improbable they can be utilized in the foreseeable future.

The amounts for the previous year have been adjusted for RTL Group tax loss carryforwards for which a valuation allowance was made in full. This adjustment had no effect on the amounts recognized in the financial statements in the current and previous years.

The temporary differences and tax loss carryforwards against which a valuation allowance was made can be carried forward for the following limited periods of time:

Maturity	12/31/2002 in € millions	12/31/2001 in € millions
Can be carried forward for more than 5 years	11,049	10,984
Can be carried forward for up to 5 years	186	207

Reconciliation of Expected Net Tax Income/Expense

	12/31/2002	12/31/2001
	€ million	€ million
Earnings before income taxes	1,025	924
Income tax rate applicable to Bertelsmann AG	38.29%	38.28%
Expected tax expense	(392)	(354)
Differences from the expected tax expense:		
Different national tax rates	41	30
Changes in tax regulations or tax status	(7)	–
Amortization of goodwill not recognized for tax purposes	(770)	(150)
Tax-free disposal gains	101	–
Changes tax-related factors in previous year	61	111
Tax reduction because of dividends	150	–
Valuation allowance on deferred tax assets	(83)	(471)
Permanent differences on consolidation	(66)	75
Tax adjustment for AOL Europe in 1999/2000 and 2000/2001		782
Other	11	(16)
Total	(335)	361
Actual tax expense	(57)	7

The income tax rate applicable to Bertelsmann AG consists of corporation tax, solidarity surcharge and trade tax, which is a deductible expense for corporation tax purposes. The effective tax rate only changes in 2003, due to the limited period of time to which the change in tax law applies:

Effective Tax Rate

	2002	2003	2004 ff.
Corporation tax including solidarity surcharge	26.38%	27.96%	26.38%
Trade tax	11.91%	11.65%	11.91%
Effective income tax rate	38.29%	39.61%	38.29%

As of December 31, 2003 there were still corporation tax credits available on distributions of € 117 million.

13 Non-current Assets

	Goodwill	Other intangible assets	Property, plant and equipment	Investments in associates	Other financial assets	Total
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Acquisition/ production cost						
Balance at January 1, 2002	13,972	3,191	6,544	1,012	1,280	25,999
Currency differences	(481)	(199)	(381)	(23)	(26)	(1,110)
Acquisitions/disposals of entities	2,945	132	3	127	(31)	3,176
Additions	–	569	543	117	174	1,403
Disposals	(1,015)	(105)	(331)	(208)	(634)	(2,293)
Reclassifications	17	(4)	(5)	(5)	(3)	–
Balance at December 31, 2002	15,438	3,584	6,373	1,020	760	27,175
Depreciation/amortization						
Balance at January 1, 2002	6,683	2,033	3,527	433	543	13,219
Currency differences	(272)	(128)	(193)	(14)	(8)	(615)
Acquisitions/disposals of entities	(56)	76	(2)	1	(11)	8
Expenses for the year	701	314	482	13	–	1,510
Impairments	1,582	96	6	7	66	1,757
Disposals	(1,003)	(22)	(245)	(5)	(146)	(1,421)
Write-ups	–	–	(3)	–	(86)	(89)
Reclassifications	16	(16)	(1)	3	(2)	–
Balance at December 31, 2002	7,651	2,353	3,571	438	356	14,369
Book Value at Dec. 31, 2002	7,787	1,231	2,802	582	404	12,806
Book value at Dec. 31, 2001	7,289	1,158	3,017	579	737	12,780

14 Goodwill

The main part of additions to goodwill relates to the acquisition of Zomba at € 2,023 million, and the purchase of additional RTL shares (€593 million). In total Bertelsmann acquired the 22 percent interest in RTL Group held by the British Pearson Group and other shares in the Group for € 1,555 million. Bertelsmann's holding thus rose from 67 percent to more than 90 percent. Goodwill on this purchase is being amortized over fifteen years.

(15) Other Intangible Assets

	Music and movie rights	Other rights and licences	Advance payments	Total
	€ millions	€ millions	€ millions	€ millions
Acquisition/ production cost				
Balance at January 1, 2002	1,991	1,136	64	3,191
Currency differences	(134)	(83)	(2)	(199)
Acquisitions/disposals of entities	151	(17)	(2)	132
Additions	428	105	36	569
Disposals	(37)	(49)	(19)	(105)
Reclassifications	25	21	(50)	(4)
Balance at December 31, 2002	2,424	1,113	27	3,564
Depreciation/amortization				
Balance at January 1, 2002	1,491	541	1	2,033
Currency differences	(105)	(23)	–	(128)
Acquisitions/disposals of entities	87	(11)	–	76
Expenses for the year	199	115	–	314
Impairments	67	29	–	96
Disposals	12	(33)	(1)	(22)
Write-ups	–	–	–	–
Reclassifications	–	(16)	–	(16)
Balance value at Dec. 31, 2002	1,751	602	1	2,353
Book value at Dec. 31, 2002	673	531	26	1,231
Book value at Dec. 31, 2001	500	595	63	1,158

16 Property, Plant and Equipment

	Land, rights equivalent to land and buildings	Plant, technical equipment and machinery	Other equipment, fixtures and fittings, and office equipment	Advance payments and construction in progress	Total
	€ million	€ millions	€ millions	€ millions	€ millions
Acquisition/ production cost					
Balance at January 1, 2002	1,782	2,847	1,494	421	6,544
Currency differences	(95)	(166)	(96)	(24)	(381)
Acquisitions/disposals of entities	(26)	(48)	77	–	3
Additions	74	165	166	138	543
Disposals	(4)	(93)	(194)	(40)	(331)
Reclassifications	283	62	89	(439)	(6)
Balance at Dec. 31, 2002	2,014	2,767	1,536	56	6,373
Depreciation					
Balance at January 1, 2002	583	1,924	1,019	1	3,527
Currency differences	(19)	(116)	(58)	–	(193)
Acquisitions/disposals of entities	(2)	(34)	34	–	(2)
Expenses for the year	69	227	187	–	482
Impairments	1	2	3	–	6
Disposals	(1)	(88)	(156)	–	(245)
Write-ups	(3)	–	–	–	(3)
Reclassifications	(2)	3	(1)	(1)	(1)
Balance value at Dec. 31, 2002	626	1,918	1,028	0	3,572
Book value at Dec. 31, 2002	1,389	849	508	56	2,802
Book value at Dec. 31, 2001	1,199	923	475	420	3,017

(17) Financial Assets

	Affiliated companies		Associated companies		Other participations		Securities	Other loans	Total
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Acquisition/ production cost									
Balance at January 1, 2002	143	409	1,012	15	389	1	85	239	2,292
Currency differences	–	(1)	(23)	(1)	(10)	–	(2)	(12)	(49)
Acquisitions/disposals of entities	(7)	–	127	2	–	–	–	(26)	96
Additions	7	7	117	1	86	5	28	40	291
Disposals	(39)	(1)	(208)	(11)	(185)	–	(95)	(303)	(842)
Reclassifications	–	(376)	(5)	–	27	–	37	309	(8)
Balance at Dec. 31, 2002	104	38	1,020	6	307	6	53	247	1,780
Write-downs									
Balance at January 1, 2002	80	–	433	–	278	–	–	175	976
Currency differences	–	–	(14)	–	(4)	–	–	(4)	(22)
Acquisitions/disposals of entities	1	–	1	–	–	–	–	(12)	(10)
Expenses for the year	–	–	13	–	–	–	–	–	13
Impairments	4	–	7	–	60	–	–	2	73
Disposals	(14)	(18)	(5)	–	(9)	–	–	(105)	(151)
Write-ups	(16)	–	–	–	(66)	–	–	(4)	(86)
Reclassifications	(9)	18	3	–	(27)	–	24	(8)	1
Balance at Dec. 31, 2002	56	0	438	0	232	0	24	44	794
Book value at Dec. 31, 2002	48	38	582	6	75	6	29	203	986
Book value at Dec. 31, 2001	53	409	579	15	111	0	85	64	1,316

On August 13, 2002, RTL Group acquired 47.3 percent of n-tv, the news station, from the Georg von Holtzbrinck publishing group. This company is included using the equity method. With a purchase price of €95 million, goodwill amounted to €97 million.

As set out in IAS 39, available-for-sale investments and securities are measured at fair value or at acquisition cost if a market price cannot be determined:

Financial Assets: Available-for-Sale

	Historical cost		Fair value		Total	
	12/31/2002	12/31/2001	12/31/2002	12/31/2001	12/31/2002	12/31/2001
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Investments	[illegible]	93	205	18	205	111
Securities	61	19	23	66	29	85
Total	61	112	228	84	234	196

18 Inventories

	12/31/2002 € millions	12/31/2001 € millions
Movie rights	1,134	1,061
Raw materials and supplies	181	180
Work in process	149	160
Finished goods and merchandise	495	517
Advance payments	22	23
	1,981	1,941

19 Receivables and Other Assets

	Maturing after more than one year € millions	12/31/2002 € millions	12/31/2001 € millions
Trade accounts receivable	84	3,039	3,399
Accounts receivable from royalties and licenses	2	212	232
Total trade accounts receivable	86	3,251	3,631
Accounts receivable from participations	–	49	119
Advance payments for royalties and licenses	231	172	1,191
Tax receivables	–	758	538
Securities	–	109	373
Derivative financial instruments	40	175	99
Assets from pension plans	20	43	21
Other receivables	16	673	618
Other receivables and other assets	307	2,780	2,959

Available-for-sale securities are stated as follows:

Other Assets: Available-for-Sale

	Historical cost		Fair Value		Total	
	12/31/2002 € millions	12/31/2001 € millions	12/31/2002 € millions	12/31/2001 € millions	12/31/2002 € millions	12/31/2001 € millions
	373	10	–	10		373

The change in available-for-sale securities is due to the sale of AOL Europe shares. No market price could be calculated for these shares and hence they were stated at historical cost until they were sold. All other securities were valued at acquisition cost.

20 Cash and Cash Equivalents

	12/31/2002 € million	12/31/2001 € million
Cash	906	1,928
Other securities	71	116
	977	2,044

21 Equity

Subscribed Capital

	Ordinary shares	Preference	Total
Type A	83,760	149	83,909
Type B	4,332	27,920	32,252
Total	88,092	28,069	116,161

Bertelsmann AG's subscribed capital remained at € 606 million as of December 31, 2002 and is made up of 116,161 no-par value shares of various types. The ordinary shares are bearer shares, whereas the preference shares are registered shares. The type B ordinary shares have guaranteed rights to a dividend until December 31, 2004, whereas the type B preference shares have preferred profit rights through December 31, 2010. The preference profit-sharing rights of the type A preference shares are not limited in time. The type A preference shares have no voting rights. 2,388 of the type B ordinary shares were cancelled during 2002 without reducing the share capital.

Capital Reserve

The capital reserve includes additional paid-in capital, or share premium, received on the issue of preference and ordinary shares in excess of their par values. A significant part of the capital reserve stems from the injection of 29.88 percent of the RTL Group by Group Bruxelles Lambert (GBL) in the previous period.

Retained Earnings

The retained earnings also include the past results of those companies included in the consolidated financial statements, to the extent they have not been distributed as well as the other comprehensive income. The obligation by Bertelsmann AG to repurchase and cancel 3,360 (previous year: 6,720) Bertelsmann ordinary shares currently held by the ZEIT-Stiftung has been deducted from retained earnings. This obligation is included in other liabilities and amounts to € 204 million (previous year: € 409 million).

Other Comprehensive Income

Movements in Other Comprehensive Income

	Pre-tax amount	Taxes	Available-for-sale securities Post-tax amount	Pre-tax amount	Taxes	Cash flow hedges Post-tax amount	Pre-tax amount	Taxes	Currency Post-tax amount	Total
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
June 30, 2001	811	(7)	804	23	(10)	13	121		121	938
Changes in value	(60)	7	(73)	30	2	32	(10)		(10)	(51)
Disposals recognized in income	(672)	–	(672)	–	–	–	–		–	(672)
December 31, 2001	59		59	53	(8)	45	111		111	215
Change in minorities (RTL Group)	(3)	–	(3)	8	(3)	5				2
Changes in value	(5)	–	(5)	(122)	23	(99)	(97)		(97)	(201)
Impairments	32	–	32	–	–	–				32
Recognized in income	(79)	–	(79)	–	–	–				(79)
December 31, 2002	4		4	(61)	12	(49)	14		14	(31)

Of the disposals amounting to a loss of € 79 million and recognized in the income statement from other comprehensive income, was mainly due to the disposal of the participation in DAUM. The impairment of € 32 million related to the participation in Via Digital.

Treasury Shares

Bertelsmann AG holds 972 type B ordinary shares with a book value of € 59 million as treasury shares.

Minority Interests

Minority interests in the consolidated subsidiaries' shareholders' equity essentially consist of minority interests in the RTL Group, Gruner + Jahr and maul-beiser.

Stock Option Plans at Subsidiaries

Various stock option plans are in operation at subsidiaries. At RTL Group in particular, stock option plans for senior management were introduced in 2000. The option price is derived from the market price at the time the options are granted. Within RTL Group there are also stock option plans at Metropole Television (M6) and Sportfive.

RTL Group Stock Option Plan

RTL Group established a stock option plan for certain directors and employees on July 25, 2000.

Eligibility

All participants in the stock option plan (SOP) must be employed by the RTL Group or one of its subsidiaries at the date the options are granted.

Grant

The number of options granted to a participant in the SOP is determined by the compensation committee. The compensation committee is made up of the company's board of directors or a duly constituted committee thereof. Participants may renounce options granted to them. Participants do not have to make any payments for options granted under the SOP.

Scheme Limits

The number of ordinary shares which may be placed under option under the SOP in any one year may not exceed one-half of one percent of the company's issued ordinary share capital.

Exercise Price

The exercise price of options granted under the SOP to be paid by the participants is the average closing middle market price of the company's shares on the London stock exchange, determined over the period of twenty trading days before the options are granted. The exercise price may be another, higher or lower amount to be determined by the compensation committee.

Exercise

One-third of the options granted may be exercised on each of the second, third and fourth anniversaries of the date the options were granted, or as otherwise determined by the compensation committee. The options granted must normally be exercised within ten years of the date the options were granted, or within a shorter period of time to be determined by the compensation committee. Options can be exercised earlier in the event of death.

Movements on stock options:

Number of Options in Thousands (RTL Group)

	2002	2001
Options outstanding at the beginning of the year	450	492
Options granted during the year		14
Options exercised during the year		–
Options expired during the year	(59)	(56)
Options outstanding at the end of the year	391	450

The options outstanding at the end of the year (in thousands) have the following conditions attached to them:

Conditions for Stock Options (RTL Group)

Expiry date	Exercise price in EUR	Number of options
Before 2010	120.00	12
2010	120.00	62
2010	85.24	317
		391

Metropole Television (M6) Employee Stock Option Plan

M6 introduced an employee stock option plan for directors and certain employees.

The number of options granted to participants is determined by Metropole Television's executive board in conjunction with the general meeting of shareholders.

Options were granted in September 1998, December 1998, June 1999, January 2000 and June 2001. Options granted in September and December 1998 can only be exercised following a vesting period of three years from the date of grant and must be exercised within seven years of the grant date. Options granted in June 1999 and January 2000 can only be exercised following a vesting period of five years from the date of grant. Options granted in June 2001 can only be exercised following a vesting period of four years from the date of grant and must be exercised within seven years of the grant date.

The exercise price of the remaining options amounts to 95 percent of the average price of the shares in Metropole Television on the Paris stock exchange, calculated over the twenty days preceding the grant date.

Movements on stock options during the year:

Number of Options in Thousands (M6)	2002	2001
Options outstanding at the beginning of the year	2,777	2,434
Options granted during the year	750	552
Options exercised during the year	(220)	(215)
Options expired during the year	(300)	–
Options outstanding at the end of the year	3,001	2,771

The options outstanding at the end of the year (in thousands) have the following conditions attached to them:

Conditions for Stock Options (M6)	Exercise price in EUR	Number of options
Expiry date		
September 2, 2005	14.10	415
December 4, 2005	13.64	480
June 4, 2006	18.80	525
January 19, 2007	44.63	50
May 26, 2007	58.58	294
June 6, 2008	30.80	498
June 1, 2009	28.60	739
		3,001

22 Profit Participation Certificates of Bertelsmann AG

	12/31/2002 in millions €	12/31/2001 in millions €
Par value	516	516
Premium	190	190
	706	706

The profit participation capital is made up of 2001 profit participation certificates (listing code SIN 522 994, or "PPC 2001") and 1992 profit participation certificates (listing code SIN 522 990, or "PPC 1992"). PPC 2001 have a par value of € 10, whereas the par value of PPC 1992 is € 0.01. As of December 31, 2002 the par value of PPC 2001 was € 488 million and the par value of PPC 1992 was € 28 million. PPC 1992 and PPC 2001 have been admitted for trading on the stock exchange.

23 Provisions for Pensions and Similar Obligations

	12/31/2002 € millions	12/31/2001 € millions
Pensions	1,682	1,636
Similar obligations	156	46
	1,838	1,682

The Bertelsmann Group operates various forms of pension plans for current and former employees and their surviving dependants, which are determined by the legal, tax and economic situation of each country concerned. These company pension plans include both defined contribution and defined benefit schemes.

In the case of defined contribution plans, the company makes payments into an external fund or other welfare fund on a statutory, contractual or voluntary basis. Once the company has paid the contributions due, it is not obliged to provide any further benefits and hence no provision is recognized in the balance sheet. Contribution plan expenses for 2002 amounted to € 13 million.

All other pension plans are defined benefit schemes. Some are funded via an external fund (plan assets), others are unfunded. Provisions are set aside for these plans, most of which are fixed-salary plans.

The provisions are actuarially calculated in accordance with IAS 19. The amount of provisions depends on employees' period of service with the company and their pensionable salary. Provisions are computed using the projected unit credit method, which, in contrast to the entry-age-normal method, assumes increasing salary costs over the period of service. The calculation also uses biometric calculations, prevailing long-term capital market interest rates and assumptions about future salary and pension increases. In Germany, the biometric calculations are based on mortality tables issued by Prof. Dr. Klaus Heubeck in 1998. The following actuarial assumptions have been used:

Actuarial Assumptions

	12/31/2002 Germany	12/31/2002 Abroad	12/31/2001 Germany	12/31/2001 Abroad
Discount rate	5.75%	4.0–7.0%	6.0%	4.0–7.0%
Expected return on plan assets	6.75%	3.0–8.25%	6.0%	4.0–9.0%
Rate of salary increase	2.5%	2.6–6.0%	2.5%	2.6–6.0%
Rate of pension increase	1.7%	1.7–2.5%	1.7%	1.7–2.5%
Fluctuation	Based on experience	Based on experience	Based on experience	Based on experience

The corridor method is used to calculate provisions for defined benefit plans and related costs. This method does not take into account actuarial gains and losses resulting from the difference between actual amounts and the assumptions underlying the calculations unless they exceed ten percent of either the amount of the defined benefit obligation or plan assets, whichever is the greater. The amount in excess of this corridor is spread over the employees' average remaining period of service.

The expense for defined benefit plans in 2002 was € 165 million (previous year: € 67 million), comprising personnel costs of € 69 million (previous year: € 19 million) and interest expense of € 121 million (previous year: € 61 million). The expected return on plan assets of € 25 million (previous year: € 13 million) was included in other income. These costs are broken down as follows:

Expenses for Defined Benefit Plans

	12/31/2002 € million	12/31/2001 € million
Current service cost	165	16
Interest cost	121	61
Expected return on plan assets	(25)	(13)
Expected return on reimbursement rights	3	3
Amortized actuarial gains/losses	4	(1)
Amortized past service cost	1	2
Effect of curtailments or settlements	(1)	(1)
	165	67

The net pension liability reported on the balance sheet is made up as follows:

Net Pension Obligation Recognized

	12/31/2002 € million	12/31/2001 € million
Defined benefit obligation of unfunded plans	1,687	1,629
Defined benefit obligation of funded plans	440	385
Total defined benefit obligation	2,127	2,014
Fair value of plan assets	(298)	(336)
Actuarial gains/losses not yet recognized	(192)	(64)
Past service cost not yet recognized	(1)	–
Amount not yet recognized as an asset because of the limit set out in IAS 19.58 (b)	3	–
Net pension liability	1,639	1,614

The net pension liability of € 1,639 million (previous year: € 1,614 million) is made up of provisions of € 1,682 million (previous year: € 1,636 million) and assets of € 43 million (previous year: € 22 million). The assets are included under other assets in the balance sheet.

Movements in Net Pension Liability

	12/31/2002 € millions	12/31/2001 € millions
Net pension liability at the beginning of the year	1,614	1,538
Pension expense	165	67
Correction of expected return on reimbursement rights	[illegible]	(3)
Pension payments	(82)	(37)
Contributions to plan assets	(14)	(8)
Transferred obligations	(34)	16
Change from acquisitions and disposals of entities	(3)	47
Currency-related effects	(13)	(4)
Net pension liability at end of year	1,639	1,614

Breakdown of Net Pension Liability by Region

	12/31/2002 € millions	12/31/2001 € millions
Germany	1,502	1,463
USA	67	106
Other Europe	57	32
Other countries	13	13
Net pension liability	1,639	1,614

The U.S. subsidiaries' liabilities for their employees' healthcare costs once they have retired constitute defined benefit obligations and account for € 74 million (previous year: € 90 million) of the provisions. They have been calculated according to the international standards described above. Healthcare cost increase trends have been assumed to be between 5.5 percent and 9.5 percent (previous year: straight-line trend of 6 percent), depending on the period of time assumed.

Similar obligations include provisions for employees' anniversaries, old age part-time schemes and amounts due but not yet paid for defined contribution plans. Provisions for employees' long-service awards are calculated in the same manner as liabilities for defined-benefit plans, but without using the corridor method.

Employees in Germany who are at least 55 years old and have an unlimited employment contract with the company qualify for its old age part-time scheme. The part-time employment period lasts for between two and five years. Average normal working hours during this period are half the regular weekly working hours and are usually organized in such a way that they are performed in the first half of the part-time retirement period, so that the employee is subsequently exempted from work in the second half (block model). Employees receive half of their previous gross compensation for the duration of the part-time retirement period. During the period the employee is still working, the employer sets aside a provision to cover the liability amounting to the working hours for which the employee has not yet been compensated. Under IAS 19, this provision is stated at its present value. In addition, employees receive top-up payments in proportion to their underlying net income. These top-up payments constitute termination benefits as defined by IAS 19 and are recognized at their present value at the time the obligation arises.

29 Other Provisions

	12/31/2001 € millions	Consolidation scope € millions	Other effects € millions	Usage € millions	Additions € millions	Accrued interest € millions	Release € millions	12/31/2002 € millions	Thereof long-term € millions
Provisions for taxes	1,175	11	(78)	(802)	184	–	(142)	348	117
Personnel-related provisions	524	4	(45)	(305)	392	1	(21)	550	111
Restructuring provisions	149	(11)	(21)	(92)	73	–	(5)	93	3
Provisions for fees and licenses	1,106	158	(154)	(936)	919	–	(10)	1,083	6
Other provisions	900	(13)	(38)	(517)	613	3	(78)	870	172
	3,854	149	(336)	(2,652)	2,181	4	(256)	2,944	409

The decrease in tax provisions is primarily due to tax payments of € 632 million on the taxable gains on disposal of AOL Europe and mediaWays.

The short-term personnel-related provisions include employee profit participations, bonuses and outstanding vacation entitlements. The long-term personnel-related provisions mainly relate to severance pay of € 82 million (previous year: € 43 million) and obligations arising from the Virtual Stock Option Plan (VSOP).

The virtual stock option plan (VSOP) is a program aimed at granting a long-term performance-related compensation component to executives.

In addition to the number of "options" granted, compensation is based on value added, measured in terms of Operating EBITA and capital invested, by the business managed by the executive and on value added for the entire Bertelsmann Group. If value has been added at the end of the period, the executive concerned receives a payment.

Expected benefits arising from the VSOP are expensed evenly over a period of five financial years. Because of the long-term nature of the provisions, they are discounted using country-specific interest rates. Provisions for two tranches totaling € 23 million (previous year: € 22 million) are reported at December 31, 2002. These tranches expire effective December 31, 2003 and December 31, 2004.

An "option" under the VSOP constitutes neither an ownership interest nor an option to acquire an ownership interest in the employer, Bertelsmann AG or other companies. It serves solely to calculate the compensation component.

As set out in IAS 37, restructuring provisions include employee severance costs and other costs incurred in connection with the discontinuation of business activities. Total provisions of € 93 million (previous year: € 149 million) were set aside for various restructuring programs within the Bertelsmann Group. A major element is the reorganization at the DirectGroup, at € 40 million, and this relates primarily to outplacement and exit costs at BeMusic. The other provisions include among other things interest on profit participation certificates, legal costs and rebates.

25 Financial Debt

Financial debt includes all of the Bertelsmann Group's interest-bearing liabilities at the balance sheet date. In contrast to the previous year, liabilities from finance lease contracts have been included in financial debt. Comparative figures have been restated to make them comparable. Carrying values are as follows:

Financial Debt

	Remaining term in years				
	< 1	1 to 5	> 5	12/31/2002	12/31/2001
	€ millions	€ millions	€ millions	€ millions	€ millions
Bonds	–	564	198	762	746
Promissory notes	95	100	145	340	277
Syndicated loan facility	–	668	–	668	–
Bridge loan	763	–	–	763	–
Liabilities to banks	577	57	19	653	810
Finance leases	34	103	155	292	437
Other financial debt	3	97	140	240	633
Total	1,472	1,589	657	3,718	2,903

Long-term financial debt, including transaction costs, is measured at present value and is amortized to nominal value at maturity. The related financial expense recorded in the income statement is equivalent to the effective interest rate. Foreign currency liabilities are translated into reporting currency at rates ruling at the end of the year. Financial debt is unsecured and is of equal ranking.

Bertelsmann Group has access to floating-rate funds via a number of contractual agreements. The overall volume of financing reserves was increased during the year, with a corresponding prolongation of maturity structure, as follows:

A term loan of € 2.5 billion was agreed within the framework of a bridge loan to finance the Zomba acquisition. The agreement has a term of 364 days and the Bertelsmann Group has a six-month prolongation option. Due to early cancellation by Bertelsmann AG, the overall credit line has been reduced to € 800 million, of which $ 800 million had been drawn at December 31, 2002.

Furthermore, a € 1.5 billion syndicated loan facility with a term of 5 years was agreed in November, 2002. The credit line can be utilized by Bertelsmann AG and the foreign financing vehicles (Bertelsmann U.S. Finance, Inc., Bertelsmann Capital Corporation N.V.) by draw-downs in EUR, USD and GBP. The amounts drawn down in EUR bear interest at EURIBOR (Euro Interbank Offered Rate). LIBOR (London Interbank Offered Rate) is used as the interest reference rate for the other currencies. $ 700 million had been drawn down as of December 31, 2002.

Additionally, the Bertelsmann Group has bilateral credit facilities with international banks, mainly involving Bertelsmann AG and Bertelsmann U.S. Finance, Inc.. These credit lines can be utilized to draw down revolving floating rate loan facilities based on EURIBOR or LIBOR. The unutilized funding potential from these facilities amounts to some € 1,650 million and is freely available for use in operations. The remaining terms and utilization of these agreements at December 31, 2002 are set out in the following table:

Remaining Term

	Credit line 12/31/2002	Drawn down 12/31/2002	Available credit line 12/31/2002
< 1 year	1,242	185	1,057
1 to 2 years	172	–	172
2 to 3 years	48	48	–
3 to 4 years	45	–	45
4 to 5 years	60	20	40
> 5 years	438	103	335
Total	2,005	356	1,649

The amount drawn down at December 31, 2002 totals € 356 million and is divided by currency into US dollars (233 million) and euros (123 million). These balances are included in the balance sheet as part of liabilities to banks (€ 653 million).

A € 3.0 billion debt issuance program was signed by Bertelsmann AG and the Group's financing companies in June, 2002. The program has been given a rating of BBB+ (Standard & Poor's) and Baa1 (Moody's) and replaces the umbrella documentation from 1996 (€ 750 million), which will no longer be used for issuing bonds.

The first bond under the new documentation was issued by Bertelsmann Capital Corporation N.V. in July, 2002, as a 5.07 percent coupon bond for € 200 million in the form of a private placement. The bond's term is three years. The issue price was agreed at 99.98 percent.

Promissory notes were issued during 2002 based on separate documentation. The total volume of these transactions is € 100 million and they have a term of five years.

Bertelsmann AG has issued an unconditional guarantee for all outstanding issues made by the financing vehicles with respect to the obligations arising under the terms of the bonds.

Bonds, Promissory Notes

	Due date	Effective interest rate in %	Book value 12/31/2002 € million	Book value 12/31/2001 € million
4.600% Bertelsmann U.S. Finance, Inc. (DEM 200 million bond) 97/02	2/19/2002	4.87	[illegible]	102
5.125% RTL Group S. A. (LUF 2.5 billion) 97/02	12/27/2002	4.90	[illegible]	62
Floating rate Bertelsmann U.S. Finance, Inc. (USD 100 million promissory note) 98/03	12/15/2003	–	95	114
5.375% Bertelsmann U.S. Finance, Inc. (USD 200 million bond) 99/04	1/28/2004	5.60	198	233
5.07% Bertelsmann Capital Corp. N.V. (EUR 200 million bond) 02/05	7/25/2005	5.07	209	–
4.500% Bertelsmann U.S. Finance, Inc. (DEM 300 million bond) 98/05	11/25/2005	4.62	154	151
Floating rate Bertelsmann U.S. Finance, Inc. (EUR 50 million promissory note) 02/07	12/20/2007	–	50	–
4.70% Bertelsmann Capital Corp N.V. (EUR 50 million promissory note) 02/07	12/27/2007	4.91	50	–
Floating rate Bertelsmann U.S. Finance, Inc. (USD 100 million promissory note) 99/09	2/11/2009	–	95	113
4.48% Bertelsmann Capital Corp N.V. (EUR 50 million promissory note) 99/09	5/7/2009	4.49	50	50
4.375% Bertelsmann U.S. Finance, Inc. (EUR 200 million bond) 99/09	5/12/2009	4.63	198	198
			1,102	1,023

As of December 31, 2002, the Bertelsmann Group had only issued fixed-interest bonds with a nominal volume of € 744 million. Promissory notes with a nominal volume of € 240 million were issued via Bertelsmann U.S. Finance, Inc. The notes bear interest at variable rates. In addition, Bertelsmann Capital Corporation N.V. has outstanding promissory notes with a nominal volume of € 100 million, of which 50 percent are fixed interest loans and the other 50 percent bear interest at floating rates.

The bonds issued by Bertelsmann U.S. Finance, Inc. have been converted into US dollar liabilities by means of currency swaps. These have been determined as hedge relationships as set out in IAS 39. The effect of changes in the fair value of the bonds and the corresponding derivatives are recognized in the income statement (fair value hedge) or in shareholders' equity (cash flow hedge).

The following table sets out the effective interest on the bonds and promissory notes issued after taking account of the interest swap agreements entered into:

Interest on Bonds and Promissory Notes

	Book value as 12/31/2002			Book value as 12/31/2001		
	Fixed interest	Floating interest rate	Total	Fixed interest	Floating interest rate	Total
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Bonds	407	355	762	164	582	746
Promissory notes	195	145	340	50	227	277
Total	602	500	1,102	214	809	1,023

Amounts for liabilities from finance leases are as follows:

Minimum Lease Payments Finance Lease

	12/31/2002			12/31/2001		
	Nominal value of lease payments	Discount amounts	Present value of lease payments	Nominal value of lease payments	Discount amounts	Present value of lease payments
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Up to 1 year	41	7	34	53	17	36
1 to 5 years	136	33	103	249	124	125
Over 5 years	276	121	155	329	53	276
	453	161	292	631	194	437

The decrease in leasing liabilities is due to a finance lease agreement not being classified as a finance lease as set out in IAS 17 based on SIC 27. FremantleMedia, the film production company, sold its internally-produced films to a leasing company and, at the same time, leased them back as finance leases through 2016. The cash received by FremantleMedia was deposited with a bank as funds available to meet the lease installments. As this cash deposit of € 130 million cash is not freely available, it has to be offset against the leasing liabilities in the balance sheet in accordance with SIC 27.

26 Liabilities

		More than 1 year	12/31/2002	12/31/2001
		€ millions	€ millions	€ millions
Trade accounts payable		73	2,695	2,713
Liabilities to participations	1		93	92
Repurchase obligation for ZEIT-Stiftung shares	204		204	409
Tax liabilities	–		327	266
Derivative financial instruments	35		161	130
Social security contributions	–		95	83
Personnel-related liabilities	–		76	64
Payment in advance	–		74	53
Other liabilities	514		1,012	1,765
Miscellaneous liabilities	754		2,031	2,862

Other liabilities include obligations arising from long-term production contracts, credit balances in accounts receivable and liabilities to non-group companies.

Off-Balance Commitments

27 Contingent Liabilities

	12/31/2002 € millions	12/31/2001 € millions
Guarantees	383	596
Warranties	29	44
Other obligations	4	8
	416	648

It is considered unlikely that the contingent liabilities listed will crystallize. The guarantees include guaranties for €26 million bank credit lines for participations.

28 Other Financial Commitments

	12/31/2002 € millions	12/31/2001 € millions
Rental and leasing commitments	1,332	1,371
Other commitments	3,922	3,698
	5,254	5,069

In addition to the rental and leasing commitments set out above, there is a long-term lease for real estate located in New York expiring in 2098. Total lease installments payable over the term of this lease amount to $ 485 million, but the present value of the total commitment over the entire period of the lease, using a discount rate of 5.5, is only € 51 million.

Of the other commitments, €2,378 million (previous year: €2,591 million) relates to RTL Group's supply agreements for rights, (co-) productions and programming, and € 603 million (previous year: € 443 million) relates to contracts for TV licenses, transmission rights and other services. Other commitments for Random House amount to € 487 million (previous year: € 567 million) and represent the portion of commitments to authors for which no payments have yet been made and future payments depends on further events (such as delivery and acceptance of manuscripts).

There are the following payment obligations under all long-term rental commitments classified as operating leases:

Minimum Payments Under Operating Leases

	12/31/2002 Nominal value in € millions	12/31/2001 Nominal value in € millions
Up to 1 year	219	228
1 to 5 years	691	741
Over 5 years	422	402
	1,332	1,371

These obligations essentially relate to long-term real estate rental agreements.

Certain third parties have put options for the sale of shares in entities to Bertelsmann Group. As no fair values, as set out in IAS 39, can be determined for these options, they are not recognized in the consolidated balance sheet. The following table sets out the significant options and their underlying conditions:

Object of Option

	Percent acquired	Exercise period	Estimated purchase price in € millions
BW-TV Verwaltungs GmbH	20	Until end of 2022	504
Mondolibri, Italy	50	Exercisable at any time	65
Sportfive	5	June 30, 2005 through November 30, 2005	50

BW-TV Verwaltungs GmbH, in which Bertelsmann has an 80 percent share, holds 37 percent of the shares in RTL Group. Under certain preconditions the minority shareholder of BW-TV has the right to sell its holding to Bertelsmann. The cost of this put option is currently € 504 million, equivalent to a price per RTL Group share of € 44.

29 Discontinuing Operation

In July 2002 it was announced that the BertelsmannSpringer segment was to be sold. In view of the advanced stage of negotiations, it is expected that the sale will be completed in the first half of 2003. As a result, the expenses and income relating to this discontinuing operation have been shown separately, as set out in IAS 35.

Consolidated Income Statement BertelsmannSpringer

	1/1/2002 12/31/2002 € millions	7/1/2001 12/31/2001 € millions
Revenues	(731)	(369)
Other operating income	34	12
Change in inventories	8	1
Own costs capitalized	3	1
Cost of materials	(206)	(99)
Royalty and license fees	(27)	(17)
Personnel costs	(258)	(137)
Amortization of intangible assets, and depreciation of property, plant and equipment	(67)	(35)
Other operating expenses	(188)	(100)
Impairments of goodwill and similar rights	(40)	–
Income from operating activities	(12)	(5)
Results of associated companies	1	1
Income from other participations	(1)	4
Profit before financial result and taxes	(12)	–
Net interest	(7)	(2)
Other financial expenses and income	(7)	(3)
Financial result	(14)	(5)
Income taxes	18	1
Net income before minority interests	(8)	(4)
Minority interests	(8)	(5)
Net income after minority interests	(16)	(9)

The assets and liabilities of the discontinuing operation at the end of the periods can be summarized as follows:

Assets	12/31/2002 € millions	12/31/2001 € millions
Non-current assets	465	551
Current assets	442	480
Prepaid expenses	3	5
	910	1,036

Liabilities	12/31/2002 € millions	12/31/2001 € millions
Provisions	175	192
Financial debt	31	37
Liabilities	196	364
Deferred income	152	82
	554	675

The statement of cash flows for BertelsmannSpringer is as follows:

Cash Flow Statement BertelsmannSpringer	1/1/2002 – 12/31/2002 € millions	7/1/2001 – 12/31/2001 € million
Net income	(9)	(4)
Depreciation/amortization/write-ups of non-current assets	107	35
Change in long-term provisions	19	5
Other cash/non-cash items	11	–
Cash flow according to DVFA/SG	108	36
Result from disposal of non-current assets	1	(1)
Change in inventories	7	(4)
Change in receivables, other assets and prepaid expenses	34	(41)
Change in short-term provisions	(27)	14
Change in other liabilities and deferred income	(99)	46
Net cash from operating activities	23	50
Investments in:		
– intangible assets	(9)	(15)
– property, plant and equipment	(12)	(13)
– financial assets	(7)	–
Proceeds from disposals of non-current assets	6	2
Net cash used in investing activities	(22)	(26)
Change in financial debt	(25)	2
Change in shareholders' equity	3	(2)
Dividend payments	–	–
Net cash from financing activities	(22)	0
Change in cash and cash equivalents	(21)	24
Exchange rate movements and other changes in cash and cash equivalents	9	–
Cash and Cash equivalents at the beginning of the period	60	36
Cash and Cash equivalents	48	60

39 Financial Instruments

Financial Risk Management

Because of its international activities, the Bertelsmann Group is exposed to a variety of financial risks, especially the effects of movements in foreign exchange rates and interest rates. The aim of the Bertelsmann Group's risk management function is to reduce these risks.

The executive board sets out overall risk management guidelines and stipulates the general procedures for hedging foreign exchange rate and interest rate risk and for the use of derivative financial instruments.

A treasury department located at corporate headquarters advises subsidiaries on financial risk and, where appropriate, hedges risks using derivatives. However, the subsidiaries are not obliged to use the services provided by this department. Although certain companies, in particular the RTL Group, have their own treasury departments, they must report their hedging activities to the treasury department located at corporate headquarters on a quarterly basis.

Exchange Rate Risk

The Bertelsmann Group is exposed to exchange rate risk in various currencies. Its subsidiaries are advised, but not obliged, to hedge themselves against exchange rate risks in the local reporting currency by concluding forward agreements with banks of impeccable credit standing. The treasury department located at corporate headquarters bundles and manages those forward transactions concluded in Germany.

The Bertelsmann Group operates internationally. The net assets of its subsidiaries outside Germany are exposed to exchange rate risk. This risk is managed in accordance with the currency hedging guidelines laid down by the executive board. Loans within the Bertelsmann Group that are exposed to exchange rate risk are hedged using derivatives.

Interest Rate Risk

Interest rate risk is managed in accordance with the Group's planned net financial debt and the expected interest rate. Most of the financial debt bears interest at floating rates. The historically comparatively low level of interest rates were used in 2002 to swap part of the financial debt to fixed interest. This change is made as at the start of the next variable interest period and includes interest rate swap agreements, the commencement date for which was agreed for the first quarter of 2003. Financial debt includes loans with maturities of up to seven years.

Funds are generally invested on a floating-rate basis for periods of less than one year.

Counter Party Risk

The Bertelsmann Group is exposed to default risks amounting to the positive fair value of derivatives used. However, as financial instruments are only concluded with banks of impeccable credit standing, these risks are deemed to be minimal.

Accounting for Derivative Financial Instruments and Hedges

All derivatives are reported at their fair value. When a contract is entered into for a derivative, it is stipulated whether it is intended to be a fair value hedge or a cash flow hedge. However, some derivatives do not qualify as hedges despite the fact that they do economically represent a hedge.

The Bertelsmann Group documents all relationships between hedging instruments and hedged positions as well as its risk management objectives and strategies in connection with the various hedges. This method includes linking all derivatives used for hedging purposes to specific assets, liabilities, firm commitments and foreseeable transactions. Furthermore, the Bertelsmann Group assesses and documents, both when derivatives are concluded and on an ongoing basis, to what extent the derivatives used are either fair value hedges or cash flow hedges.

Financial Derivatives

The vast majority of financial derivatives used by the Bertelsmann Group are derivatives which are not traded on an organized exchange (so-called OTC instruments). These mainly consist of forward agreements, currency swaps and interest rate swaps. They are only concluded with banks of impeccable credit standing that have been approved by the executive board. Nominal volumes are the total of all underlying buying and selling amounts.

The great majority of the financial derivatives serve as hedges of foreign currency and interest rate risks arising from existing financial debt (47.4 percent). Foreign exchange fluctuation risks on internal funding within the group is normally hedged by foreign currency forward transactions. The volume of such transactions is € 1,398 million (29.1 percent). Additionally, subsidiaries use financial derivatives to hedge against current and future foreign currency risks arising from operating receivables or payables. Transactions entered into amount to 23.5 percent of the total volume are mature between 2003 and 2008. No financial derivatives are used for speculative purposes.

Nominal Amounts of Financial Derivates

	Nominal amounts at 12/31/2002				Nominal amounts at 12/31/2001			
	< 1 year	1–5 years	> 5 years	Total	< 1 year	1–5 years	> 5 years	Total
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
Currency derivatives								
Forward contracts and currency swaps	2,519	603	175	3,297	4,726	375	204	5,305
Interest rate derivatives								
Interest rate swaps	95	457	892	1,444	271	472	197	940
Interest rate options	–	–	–	–	47	–	–	47
Total	2,614	1,060	1,067	4,741	5,044	847	401	6,292

Determination of Fair Value

The fair values of traded financial derivatives are determined on the basis of published market prices at the balance sheet date.

In order to determine the fair values of derivatives that are not publicly traded, the Bertelsmann Group uses various financial-related mathematical models that are based on market conditions and risks prevailing at the balance sheet date.

Fair Values of Financial Derivates

	Nominal Amounts		Fair Value	
	12/31/2002	12/31/2001	12/31/2002	12/31/2001
	€ millions	€ millions	€ millions	€ millions
Currency derivatives				
Forward contracts and currency swaps	3,297	5,305	(41)	(27)
Interest rate derivatives				
Interest rate swaps	1,444	940	(32)	(2)
Interest rate options		47		–
Total	4,741	6,292	(14)	(29)

Factoring

In exceptional situations Bertelsmann Group sells receivables to banks as a source of financing. These exceptions are limited to agreements in which Bertelsmann grants long-term financing to its customers. The volume of receivables sold is limited contractually to € 365 million and amounted to € 311 million at December 31, 2002. The contractual conditions provide for transfer of the credit and interest risk to the buyer of the receivables. Bertelsmann Group only bears a part of the credit risk from these receivables. The resulting liabilities are included in provisions. The carrying value of these liabilities at December 31, 2002 amounts to € 12 million (previous year: € 20 million). As required by IAS 39, all receivables sold were de-recognized at December 31, 2002.

31 Cash Flow Statement

The cash flow statement of the Bertelsmann Group is based on IAS 7 and is intended to enable the reader to assess the Group's ability to generate cash and cash equivalents. Cash flows are divided into net cash provided or used by operating, investing and financing activities. The net cash provided or used by operating activities is shown using the indirect method, which adjusts net income for the year for items not generating or using cash. The amount of cash flow according to DVFA/SG is included voluntarily in the cash flow statement. Cash flow per DVFA/SG is defined by the Deutsche Vereinigung für Finanzanalyse/Schmalenbach-Gesellschaft as cash flow from operating activities based on net earnings for the year adjusted for significant items of income and expense not providing or using funds.

The cash flow statement recognizes the effects of movements in exchange rates and changes in the scope of consolidation. Hence, the figures in the cash flow statement flows cannot be determined by comparing balance sheet items with the comparative figures for the previous year. Investing activities include purchases of non-current assets, payments for the acquisition of participations, and proceeds from disposals of non-current assets. Financing activities include changes in shareholders' equity affecting cash and changes in financial debt.

Cash and cash equivalents comprise the total volume of liquid funds as set out in note 20. Interest payments of € 230 million (previous year: € 260 million), interest receipts of € 199 million (previous year: € 67 million) and income tax payments of € 354 million (previous year: € 359 million) are included in the net cash provided/used by operating activities. Another € 632 million (previous year: € – million) were offset against gains from disposals.

32 Segment Reporting

Segment reporting disclosures are made in accordance with IAS 14. The primary reporting format used is business segments of the Bertelsmann Group. The secondary reporting format is broken down by geographical segment and by the main markets in which the Bertelsmann Group operates.

Information on Segments

Segment reporting, comprising six operating segments, is based on the internal management and reporting structures applied within the Bertelsmann Group. Due to the financial management of the Group, the segments are different from the Group's legal structure. There have been the following changes affecting primary segments compared with the previous period.

BertelsmannSpringer was shown as a separate segment in the previous period. Due to the intended disposal of BertelsmannSpringer, it is no longer shown as a separate segment, but rather as a discontinuing operation in the reconciliation of the segment data to the balances shown in the Bertelsmann Group financial statements. The BeCapital executive board responsibility has been dissolved as part of the reorganization in the executive board of Bertelsmann AG. Those entities allocated to this executive board responsibility have been partly re-allocated to other operating segments and partly allocated to the "corporate" segment, together with Bertelsmann AG.

Information on Segment Data

The definition of the various segment data is the same as that used for the Group's management system. Segment data are reconciled to the relevant Group figures in the "consolidation" column.

Intercompany revenues are generally recognized at normal market conditions, as applied to transactions with third parties.

Various figures are shown for segment results. Operating EBITA is the earnings before financial result, taxes, amortization of goodwill and similar rights, gains and losses on disposals, and special items. Adding back the special items results in earnings before financial results, taxes, amortization of goodwill and similar rights, and gains and losses on disposals. A further amount shown is total earnings, which consists of earnings before financial results, taxes, amortization of goodwill and similar rights, but including gains and losses on disposals. Earnings before financial results and taxes are calculated as total earnings less amortization of goodwill, similar rights and associated company goodwill. Segment results as set out in IAS 14 are earnings before financial results and taxes and excluding gains or losses on disposals.

The previous year's amounts have been adjusted to reflect the changes in definition of the results shown. As gains and losses on disposals have been allocated to segments, € 144 million gains relating to Sportfive are no longer shown in the consolidation column, but have been included in the RTL Group segment.

The depreciation, amortization and write-downs reported for each segment includes depreciation of property, plant and equipment, amortization of intangible assets, goodwill and similar rights, and amortization and write-downs of investments. Write-downs are disclosed separately.

Segment assets constitute the operating assets for each segment. They consist of property, plant and equipment, intangible assets, including goodwill and investments. They also include current assets with the exception of cash and cash equivalents, tax receivables and other non-operating assets.

Segment liabilities consist of operating liabilities and operating provisions. They therefore do not include provisions for pensions and similar obligations, deferred tax liabilities, financial debt, or other non-operating liabilities and provisions.

Each segment shows the earnings of, and investments in, associated companies, provided these companies can be clearly allocated to the segment concerned. Capital expenditures consist of purchases of property, plant and equipment, intangible assets including goodwill, and investments. For the secondary reporting format, revenues are shown by customer location, while segment assets and segment capital expenditures are included by company location. In addition, the number of employees both at the balance sheet date and as an average for the period is disclosed for the primary reporting format.

Segment Reporting 1/1/2002 – 12/31/2002 Primary Format

	RTL Group	Random House	Gruner + Jahr	BMG
	€ million	€ million	€ million	€ million
Consolidated revenues	4,355	1,987	2,786	2,689
Intercompany revenues	7	8	14	25
Revenues	4,362	1,995	2,800	2,714
Operating EBITA	465	168	226	125
Internet losses		–		–
Special items	(43)	–		66
Profit before financial result, taxes and amortization of goodwill and similar rights and capital gains/losses	422	168	226	191
Capital gains/losses	(50)	4	(173)	(58)
Total result	372	172	399	133
Amortization of goodwill and similar rights	(321)	(72)	(165)	(1,354)
Amortization of goodwill from associated companies	(8)	–	(5)	(1)
Profit before financial result and taxes				
Financial result				
Taxes				
Net income before minority interests				
Profit before financial result, taxes and capital gains/losses	103	196	56	(1,164)
Depreciation, amortization and impairments	(625)	(97)	(266)	(1,318)
– thereof impairments	(70)	(7)	(107)	(1,300)
Investments	1,277	120	99	2,338
Segment assets	9,115	1,898	1,721	3,145
Segment liabilities	1,984	639	606	1,756
Result from associates	26	–	(9)	(50)
Investments in associates	458	2	26	12
Employees (at closing date)	7,378	5,626	1,367	6,452
Employees (average)	7,199	5,723	12,056	5,131

[illegible]	Nard [illegible] € millions	RTL Group € millions	Total Segments € millions	Corporate € millions	Consolidations € millions	Bertelsmann Springer € millions	Total Group € millions
	3,021	2,695	17,553	49		730	18,312
	647	12	713	1	(715)	1	
	3,668	2,707	18,266	50	(715)	731	18,312
	217	(150)	1,051	(180)	(6)	71	936
		–		–		–	
	14	(84)	(75)	(36)		–	(111)
	203	(234)	976	(216)	(6)	71	825
	11	27	107	2,811		–	2,918
	214	(207)	1,083	2,595	(6)	71	3,743
	(56)	(173)	(2,141)	(209)		(83)	(2,432)
	(6)	–	(20)	–		–	(20)
							(1,291)
							(266)
							(57)
							968
	(4)	(407)	(1,185)	(425)	(5)	(12)	(1,627)
	(268)	(247)	(2,822)	(251)		(107)	(3,179)
	(32)	(80)	(1,696)	(32)		(40)	(1,668)
	258	64	5,156	79		28	5,263
	1,802	1,022	18,803	838	33	676	20,350
	940	573	6,498	646	12	265	7,406
	(1)	(1)	(33)	(67)		1	(99)
	16	11	515	67		2	584
	31,174	12,309	74,306	1,044		5,282	80,632
	30,710	12,442	73,261	1,317		5,364	79,942

Secondary Format 1/1/2002 – 12/31/2002

[illegible]	Germany € millions	Other European Countries € millions	USA € millions	Other Countries € millions	Group € millions
Consolidated revenues	6,691	6,498	5,029	1,094	18,312
Segment assets	9,013	6,868	4,053	416	20,350
Investments	1,115	1,728	2,287	135	6,263

Segment Reporting 7/1/2001 – 12/31/2001 Primary Format

	RTL Group in € millions	Random House in € millions	Gruner + Jahr in € millions	BMG in € millions
Consolidated revenues	2,044	1,080	1,467	1,620
Intercompany revenues	10	5	9	13
Revenues	2,054	1,085	1,476	1,633
Operating EBITA	107	(15)	88	(43)
Internet losses	(59)	(4)	(40)	–
Special items	(23)	(25)	[illegible]	(66)
Profit before financial result, taxes and amortization of goodwill and similar rights and capital gains/losses	25	(44)	58	(109)
Capital gains/losses	144	–	–	–
Total result	169	(44)	58	(109)
Amortization of goodwill and similar rights	(129)	(24)	(121)	(27)
Amortization of goodwill from associated companies	(1)	(1)	(2)	(1)
Profit before financial result and taxes				
Financial result				
Taxes				
Net income before minority interests				
Profit before financial result, taxes and capital gains/losses	(218)	(69)	(65)	(137)
Depreciation, amortization and impairments	(368)	(46)	(179)	(116)
– thereof impairments	(135)	(7)	(35)	(77)
Investments	316	126	84	62
Segment assets	9,048	2,075	2,181	2,346
Segment liabilities	1,981	694	611	1,834
Result from associates	(109)	(1)	[illegible]	(41)
Investments in associates	333	23	67	35
Employees (at closing date)	6,625	6,121	13,033	5,010
Employees (average)	6,625	6,171	13,37[illegible]	5,175

	[illegible]	[illegible]	Total Segments	Corporate	Consolidations	Bertelsmann Springer	Total Group
	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions	€ millions
	578	1,492	79,281	35	[illegible]	369	9,685
	311	2	350	1	(352)	1	[illegible]
	889	494	9,63[illegible]	36	(352)	370	9,686
	174	(40)	221	(90)	5	28	164
	(14)	(127)	(244)	(4)	[illegible]	(6)	(254)
	(32)	(297)	(443)	11	[illegible]	–	(432)
	68	(464)	(466)	(83)	5	22	(522)
		–	144	2,081	[illegible]	–	2,225
	68	(464)	(322)	1,998	[illegible]	22	1,703
	(2)	(48)	(351)	(92)	(4)	(22)	(45)
	(1)	(1)	(120)	–	[illegible]	–	(120)
	[illegible]		[illegible]				1,132
							(208)
			[illegible]				17
	[illegible]		[illegible]				931
			75				
	65	(513)	(937)	(175)	319	1	(1,093)
	(120)	(90)	(919)	(203)	15	(35)	(1,142)
	(6)	(9)	(269)	(119)		(2)	(390)
	18	242	930	119		18	1,067
	913	1,500	19,043	1,593	(25)	663	21,274
	894	778	6,753	1,569	(285)	290	8,387
							[illegible]
	5	(69)	(215)	(43)		1	(257)
	12	39	509	69		1	578
	28,892	13,535	73,216	1,724		5,356	80,296
	28,037	13,240	73,019	1,793		5,351	80,783

Secondary Format 7/1/2001 – 12/31/2001

	Germany	Other European Countries	USA	Other Countries	Group
	€ millions	€ millions	€ millions	€ millions	€ millions
Consolidated revenues	3,027	3,097	3,031	530	9,685
Segment assets	8,370	7,527	4,721	656	21,274
Investments	331	380	329	27	1,067

Primary Reporting Format – Reconciliation to Consolidated Financial Statements

	12/31/2002 € millions	12/31/2001 € millions
Segment assets	20,350	21,274
Other current assets (not allocated)	624	226
Cash and cash equivalents	977	2,044
Deferred tax assets	237	190
Total assets	22,188	23,734
Segment liabilities	7,406	8,367
Equity inclusive minority interests	7,744	8,384
Profit participation capital	706	706
Provisions for pensions and similar obligations	1,737	1,682
Other provisions (not allocated)	359	1,307
Financial debt	1,718	2,903
Other liabilities (not allocated)	435	235
Deferred tax liabilities	83	150
Total liabilities	22,188	23,734

23 Reconciliation to Operating EBITDA

The depreciation and amortization shown in the statement of movements in non-current assets is divided into amortization of goodwill and similar rights, which is not included in Operating EBITA, and other depreciation and amortization, as follows:

Amortization, Depreciation

	Amortization of goodwill and similar rights			Depreciation			Total amortization, depreciation
	as scheduled € millions	impairment € millions	total € millions	as scheduled € millions	impairment € millions	total € millions	€ millions
Goodwill	701	1,582	2,283	–	–	–	2,283
Other intangible assets	70	79	149	244	17	261	410
Property, plant and equipment	–	–	–	482	6	488	488
Investments in associates	13	7	20	–	–	–	20
Other financial assets	–	–	–	–	66	66	66
	784	1,668	2,452	726	89	815	3,267

Starting with Operating EBITA, Operating EBITDA is determined by adding other depreciation and amortization, less any write-ups, including the adjustment of any depreciation, amortization and write-ups included in the special items or internet losses, as follows:

Reconciliation to Operating EBITDA

	1/1/2002–12/31/2002 in € million	1/1/2001–12/31/2001 in € million
Operating EBITA	936	164
Amortization of intangible assets	410	257
Amortization of rights similar to goodwill	(135)	(33)
Depreciation of property, plant and equipment	488	273
Depreciation of investments in associated companies	120	136
Amortization of goodwill from associated companies	(20)	(120)
Depreciation of other financial assets	551	194
Write-ups of non-current assets	(89)	–
Write-ups/amortization/depreciation included in special items	4	(187)
Amortization/depreciation included in internet losses	1	(42)
Operating EBITDA	1,666	1,642

29 Significant Differences from German Accounting Principles

Consolidation of Investments in Subsidiaries

IAS 22 states that the acquisition of holdings in companies by an exchange of marketable shares must be accounted for at fair value. Under HGB, by contrast, such acquisitions are reported at book value. In contrast to HGB, IAS does not allow goodwill to be offset against shareholders' equity. Under IAS, hidden reserves and liabilities identified at the time of the initial consolidation are subject to deferred taxes, unless such reserves and liabilities are recognized for tax purposes. In addition, deferred tax assets must be reported on loss carryforwards of the acquired company, provided their future utilization is probable.

Internally-Generated Intangible Assets

Research costs are expensed in the period in which they are incurred, whereas development costs as set out in IAS 38 are to be recognized as internally-generated intangible assets to the extent future economic benefits will probably flow to the Group and their cost can be measured reliably.

Finance Leases

Long-term leases of assets which, viewed economically, represent a purchase using third-party financing, are recognized in the balance sheet as an asset and an equivalent liability as set out in IAS 17. Due to other definitions of economic ownership, all leasing contracts in the Group are classified as rental contracts in accordance with German accounting practice.

Participations and Securities

Participations and other securities included in non-current assets and in current assets in the Bertelsmann Group financial statements are shown as available-for-sale or as held-to-maturity. As set out in IAS 39, available-for-sale securities are measured at their fair value on the balance sheet date. The resulting unrealized gains and losses are recorded direct to shareholders' equity, net of any applicable deferred taxes. If fair values cannot be determined, the participations or securities concerned are measured at amortized acquisition cost. Financial investments with fixed payments and fixed maturity, which are intended to be held to maturity, are measured at amortized cost using the effective interest rate method. The regulations set out in HGB require assets to be stated at amortized cost or their net realizable value, if lower.

Factoring

IAS 39 states that receivables sold may only be de-recognized if a substantial part of the risk inherent in the receivables portfolio is transferred to the buyer.

Derivative Financial Instruments

As set out in IAS 39, all derivative financial instruments are recorded on the balance sheet at fair value, even if they act as a hedge of an underlying transaction. Changes to the fair value of these hedging instruments are recognized in the income statement for fair value hedges and are recorded directly in shareholders' equity for cash flow hedges. German accounting principles only require financial derivatives to be recognized on the balance sheet to the extent that, after offset against the underlying, any balance represents a probable loss, and a provision is recognized accordingly. On the other hand, unrealized gains are not recognized.

Long-term Receivables, Provisions and Liabilities

Unless they yield market interest rates, long-term receivables, provisions and liabilities are discounted in accordance with IAS, whereas under HGB they are stated at nominal values.

Deferred Taxes

As set out in IAS 12, deferred tax assets and liabilities are recognized for all temporary differences between the carrying amounts reported for tax purposes and those reported in the IAS consolidated balance sheet, with the exception of goodwill which is not recognizable for tax purposes, and for tax loss carryforwards. Through the deduction of a valuation allowance, deferred tax assets are only reported to the extent to which they can be subsequently utilized. Such taxes are calculated using enacted future tax rates. The effects of changes in tax rates on deferred tax assets and liabilities are recognized in the period in which the relevant legislation has been enacted.

Profit Participation Capital

IAS does not permit Bertelsmann AG's profit participation capital to be reported as a component of shareholders' equity. Therefore, in contrast to HGB, distributions payable for the year relating to the profit participation capital is reported as a provision.

Provisions for Pensions

IAS 19 requires provisions for pensions and similar obligations to be measured using the projected unit credit method. This method uses biometric calculations, prevailing long-term capital market interest rates for discounting purposes, and the latest assumptions about future salary and pension increases. By contrast, recognition of provisions for pensions in accordance with HGB accounting rules is based on § 6a German Income Tax Act, which assumes a constant discount rate of 6 percent and does not recognize future increases in salaries and pensions.

35 Related-Party Transactions

Bertelsmann Verwaltungsgesellschaft mbH, Gütersloh, a non-operating holding company, exercises control over the Bertelsmann Group. Johannes Mohn GmbH and Reinhard Mohn Verwaltungsgesellschaft mbH have informed Bertelsmann AG that they each own more than one-quarter of its share capital. Transactions with related parties and associated companies mainly related to deliveries of goods and services. They are made under normal market conditions. From a group viewpoint, the related income and expense amounts are insignificant.

The remuneration paid to the supervisory board for the year ended December 31, 2002 totaled € 1,370,000 plus value added tax. During 2002, the members of the executive board received remuneration totaling € 26,816,920, of which € 15,009,103 was paid by Bertelsmann AG. A loan of $ 5 million, currently bearing interest at 5.06%, has been granted to one member of the executive board. This loan is repayable in full in 2010. There is no collateral on the loan. Former members of the executive board or their surviving dependants received pensions totaling € 14,832,665 from Bertelsmann AG. The provision established by Bertelsmann AG for pension obligations to former members of the executive board amounted to € 32,661,788. The members of the supervisory board and the executive board are listed on pages 114–116.

28 Material Subsidiaries and Participations at December 31, 2002

RTL Group

Television			
GZSZ Vermarktungsgesellschaft GmbH, Cologne	Germany	82.69	v
IP Deutschland GmbH, Cologne	Germany	82.69	v
IP NEWMEDIA GmbH, Cologne	Germany	82.69	v
N-TV Nachrichtenfernsehen GmbH & Co. KG, Berlin	Germany	39.13	e
RTL 2 Fernsehen GmbH & Co. KG, Munich	Germany	29.69	e
RTL Club GmbH, Rheda-Wiedenbrück	Germany	31.27	v
RTL Disney Fernsehen GmbH & Co. KG, Cologne	Germany	41.30	q
RTL NEWMEDIA GmbH, Cologne	Germany	82.69	v
RTL Shop GmbH, Cologne	Germany	71.33	v
RTL Television GmbH, Cologne	Germany	82.69	v
UFA Sports Television GmbH, Hamburg	Germany	38.48	q
VOX Film- und Fernseh GmbH & Co.KG, Cologne	Germany	82.44	v
Westdeutsche Universum-Film GmbH, Cologne	Germany	82.69	v
Antena 3 de Televisión S.A., Madrid	Spain	14.27	e
Audiomedia S.A., Luxembourg	Luxembourg	82.94	v
Bayard d'Antin S.A., Paris	France	82.69	v
Broadcasting Center Europe S.A., Luxembourg	Luxembourg	82.69	v
Channel 5 Broadcasting Limited, London	UK	53.50	q
CLT-UFA Holding S.A., Luxembourg	Luxembourg	82.94	v
CLT-UFA S.A., Luxembourg	Luxembourg	82.69	v
Holland FM Produkties B.V., Hilversum	Netherlands	82.69	v
Holland Media Groep Business Nieuwe B.V., Hilversum	Netherlands	82.69	v
IP Belgium S.A., Brussels	Belgium	54.57	v
IP France S.A., Paris	France	82.69	v
IP Luxembourg S.A.R.L., Luxembourg	Luxembourg	82.69	v
London Playout Center Limited, London	UK	82.94	v
M6 Editions S.A., Neuilly sur Seine	France	39.65	q
M6 Films S.A., Neuilly sur Seine	France	39.65	q
M-RTL Rt (RTL Klub), Budapest	Hungary	40.47	e
RTL 9 S.A., Luxembourg	Luxembourg	28.95	e
RTL4 Beheer B.V., Hilversum	Netherlands	82.69	v
Sky Five Test Limited, Middlesex	UK	28.79	q
Télévision Indépendante (TVI) S.A., Brussels	Belgium	54.57	v
Télévision Par Satellite S.N.C., Issy les Moulineaux	France	9.37	q
Yorin FM B.V., Hilversum	Netherlands	82.69	v
Content			
CLOU Entertainment TV Produktion GmbH, Cologne	Germany	40.28	v
CLT-UFA Multi Media GmbH, Hamburg	Germany	82.69	v
Fremantle (D) Fernsehproduktions GmbH, Hürth	Germany	82.94	v
Grundy UFA TV Produktions GmbH, Berlin	Germany	82.69	v
Sportfive GmbH, Hamburg	Germany	38.48	q
Sportfive Tlox GmbH, Hamburg	Germany	38.48	q
Teamworx Produktion für Kino und Fernsehen GmbH, Berlin	Germany	63.70	v
UFA Entertainment GmbH, Berlin	Germany	82.69	v
UFA Fernsehproduktion GmbH, Berlin	Germany	82.69	v
UFA Film- und Fernseh GmbH, Cologne	Germany	82.69	v
Football France Promotion S.A., Paris	France	38.48	q
Fremantle Media Australia Pty. Limited, St. Leonard, NSW	Australia	82.94	v
Fremantle Productions Asia Limited, Hong Kong	Hong Kong	82.94	v
FremantleMedia Limited, London	UK	82.94	v
FremantleMedia North America, Inc., Wilmington	USA	82.94	v
Groupe JC Decaux S.A., Paris	France	38.48	q
Grundy Productions Limited, London	UK	82.94	v
SportFive S.A., Paris	France	38.48	q
Talkback Productions Limited, London	UK	82.94	v
UFA Sports France S.A., Paris	France	38.48	q
Radio			
RTL Radio Deutschland GmbH, Berlin	Germany	82.69	v
AVE Gesellschaft für Hörfunkbeteiligungen, Berlin	Germany	82.29	v
Ediradio S.A., Paris	France	82.69	v
Contact S.A., Brussels	Belgium	40.64	e

Random House

Random House North America			
Books on Tape, Inc., Santa Ana	USA	100.00	v
Content Link, Inc., Delaware	USA	100.00	v
Crayon Box LLC, New York	USA	50.00	e
Fodors LLC, New York	USA	100.00	v
Golden Books Publishing (Canada) Inc., Cambridge	Canada	100.00	v
McClelland & Stewart Limited, Toronto	Canada	25.00	e
Presidio Press, Inc., California	USA	100.00	v
Random House Direct, Inc., New Jersey	USA	100.00	v
Random House of Canada Limited, Toronto	Canada	100.00	v
Random House TPR, Inc., New York	USA	100.00	v
Random House Ventures LLC, New York	USA	100.00	v
Random House, Inc., New York	USA	100.00	v
Xlibris Corporation, Philadelphia	USA	41.50	e
Verlagsgruppe Random House Germany			
Berlin Verlag Beteiligungsgesellschaft mbH, Berlin	Germany	100.00	v
BERLIN VERLAG GmbH & Co. KG, Berlin	Germany	100.00	v
Gütersloher Verlagshaus GmbH, Gütersloh	Germany	100.00	v
Limes Verlag GmbH, Munich	Germany	100.00	v
Luchterhand Literaturverlag GmbH, Munich	Germany	100.00	v
MBV Media Berlin Verlag GmbH, Berlin	Germany	100.00	v
Routing GmbH, Gütersloh	Germany	98.00	v
Verlag RM GmbH, Gütersloh	Germany	100.00	v
Verlag Volk und Welt GmbH, Berlin	Germany	100.00	v
Verlagsgruppe Random House GmbH, Munich	Germany	100.00	v
Random House Great Britain, Australia, New Zealand, South Africa			
Chatto, Virago, Bodley Head & Jonathan, Melbourne	Australia	100.00	v
Cape Australia Pty. Limited, Melbourne	Australia	100.00	v
Random Century Australia Pty. Limited, Melbourne	Australia	100.00	v
Random House (Proprietary) Limited, Parktown (Johannesburg)	South Africa	75.00	v
Random House Australia Pty. Limited, Melbourne	Australia	100.00	v
Random House New Zealand Limited, Glenfield	New Zealand	100.00	v
RHA Holdings Pty. Limited, Melbourne	Australia	100.00	v
The Random House Group Limited, London	UK	100.00	v
Random House Mondadori (Spanish-speaking countries)			
Editorial Sudamericana, S.A., Buenos Aires	Argentina	49.38	q
Diana, S.A. de C.V., Mexico City	Mexico	50.00	q
Distribuidora Exclusiva Grijalbo, S.A., Bogotá	Colombia	50.00	q
Editorial Grijalbo Colombia LTDA, Bogotá	Colombia	49.50	q
Editorial Grijalbo, S.A. de C.V., Mexico City	Mexico	50.00	q
Editorial Lumen, S.A., Barcelona	Spain	50.00	q
Editorial Sudamericana Uruguaya, S.A., Montevideo	Uruguay	49.38	q
Grijalbo, S.A., Caracas	Venezuela	50.00	q
Grupo Editorial Random House Mondadori, S.L., Barcelona	Spain	50.00	q
Market Self S.A., Buenos Aires	Argentina	24.78	e
Nueva Galaxia Gutenberg, S.A., Barcelona	Spain	45.00	q
Plaza y Janés Mexico, S.A. de C.V., Mexico City	Mexico	50.00	q
Random House Mondadori S.A., Barcelona	Spain	50.00	q
Random House Mondadori S.A., Santiago de Chile	Chile	50.00	q

As of December 31, 2002

Ownership of Group companies by percentage.

* = operating department

Consolidation method is defined as follows:

v = fully consolidated

q = proportionally consolidated

e = associated companies recognized at equity

Gruner + Jahr

Magazines Germany			
Berliner Presse Vertrieb GmbH, Berlin	Germany	74.90	v
Börse Online Verlag GmbH & Co., Munich	Germany	74.90	v
DPV Deutscher Pressevertrieb GmbH, Hamburg	Germany	74.90	v
Ehlich & Sohn GmbH & Co., Hamburg	Germany	74.90	v
G+J Corporate Media GmbH, Hamburg	Germany	74.90	v
G+J Electronic Media Sales GmbH, Hamburg	Germany	74.90	v
G+J Wirtschaftspresse Online GmbH, Munich	Germany	74.90	v
G+J Women Verlag GmbH, Hamburg	Germany	74.90	v
G+J Women New Media GmbH, Hamburg	Germany	74.90	v
G+J Zeitschriften-Verlagsgesellschaft mbH, Hamburg	Germany	74.90	v
G+J/RBA GmbH & Co. KG, Hamburg	Germany	37.45	e
Gruner + Jahr AG & Co., Hamburg	Germany	74.90	v
DPV Inland Pressevertrieb GmbH, Hamburg	Germany	74.90	v
Living at Home Multi Media GmbH, Hamburg	Germany	74.90	v
M.C. Verlagsgesellschaft mbH, Munich	Germany	37.45	e
Norddeutsche Verlagsgesellschaft mbH, Hamburg	Germany	74.90	v
"Picture Press" Bild- und Textagentur GmbH, Hamburg	Germany	74.90	v
stern.de GmbH, Hamburg	Germany	74.90	v
travelchannel GmbH, Hamburg	Germany	37.45	e
W.E. Saarbach GmbH, Cologne	Germany	18.65	e
Gruner + Jahr Verlagsgesellschaft m.b.H., Vienna	Austria	74.90	v
Gruner + Jahr (Schweiz) AG, Zurich	Switzerland	74.90	v
Magazines International			
G y J Espana Ediciones, S.L., S. en C., Madrid	Spain	74.90	v
G y J Publicaciones Internacionales, S.L. y Cia., S. en C., Madrid	Spain	37.45	v
G y J Revistas y Comunicaciones, S.L., Sociedad Unipersonal, Madrid	Spain	74.90	v
G+J - CLIP (Beijing) Publishing Consulting Co., Limited, Beijing	China	38.20	v
G+J RBA Sp. z o.o. & Co. Spolka komandytowa, Warsaw	Poland	37.45	e
G+J/RBA Publishing C.V. National Geografic Nederland, Amsterdam	Netherlands	74.90	e
G+J/RBA S.N.C., Paris	France	37.45	e
G+J USA Publishing, New York	USA	74.90	v
Gruner + Jahr / Mondadori S.p.A., Milan	Italy	50.00	q
Gruner + Jahr Polska Sp. z o.o. & Co. Spolka Komandytowa, Breslau	Poland	74.90	v
Gruner + Jahr ZAO, Moscow	Russia	74.90	v
Prisma Presse S.N.C., Paris	France	74.90	v
Shanghai G+J Consulting and Service Co., Limited, Shanghai	China	74.90	v
VSD S.N.C., Paris	France	74.90	v
Newspapers			
BerlinOnline Stadtportal GmbH & Co. KG, Berlin*	Germany	33.71	e
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden	Germany	44.94	v
Dresdner Magazin Verlag GmbH, Dresden	Germany	44.94	v
Financial Times Deutschland GmbH & Co. KG, Hamburg	Germany	50.00	q
Sano-Phon Telefonmarketing und Veranstaltungsservice GmbH, Dresden	Germany	44.94	v
S.C. Express s.r.l., Bucharest	Romania	68.02	v
S.C. Infopress Romania s.r.l., Bucharest	Romania	46.51	v
Bilc Press, d.o.o., Belgrade	Jugoslavia	38.70	e
Vydavatelstvo casopisov a kniha spol. s r.o., Bratislava	Slovakia	38.20	v
Printing			
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden (Printing)	Germany	44.94	v
Gruner + Jahr AG & Co., Hamburg (Printing School)	Germany	74.90	v
Brown Printing Company, Waseca	USA	74.90	v
Central Units			
Druck- und Verlagshaus Gruner + Jahr AG, Hamburg	Germany	74.90	v
Hamburger Journalistenschule Gruner + Jahr – DIE ZEIT GmbH, Hamburg	Germany	71.18	v
manager magazin Verlagsgesellschaft mbH, Hamburg	Germany	18.65	e
SPIEGEL-Verlag Rudolf Augstein GmbH & Co. KG, Hamburg	Germany	18.64	e
Verlagsgruppe NEWS Ges.m.b.H., Vienna	Austria	41.98	v

* Sale scheduled for December 31, 2002

BMG

BMG North America			
Arista Records, Inc., Wilmington	USA	100.00	v
BMG Canada Inc., Toronto	Canada	100.00	v
BMG Distribution, New York	USA	100.00	v
BMG Songs, Inc., Sacramento	USA	100.00	v
BMG US Latin, Miami	USA	100.00	v
Brentwood Music Essential, Franklin	USA	100.00	v
Brentwood Music Inc, Franklin	USA	100.00	v
Brentwood-Benson Music Publishing Inc, Franklin	USA	100.00	v
J Records, LLC, Delaware	USA	100.00	v
LaFace Records, Inc., New York	USA	100.00	v
RCA Label Group, Nashville	USA	100.00	v
RCA Record Label, New York	USA	100.00	v
RCA Victor Group, New York	USA	100.00	v
Reunion Records Inc, Nashville	USA	100.00	v
Volcano Entertainment, LLC	USA	100.00	v
Zomba Recording Corporation, New York	USA	100.00	v
Zomba Records Jive, New York	USA	100.00	v
BMG Europe			
Arabella Musikverlag GmbH, Munich	Germany	100.00	v
BMG Ariola München GmbH, Munich	Germany	100.00	v
Bertelsmann Music Group Belgium N.V., Brussels	Belgium	100.00	v
BMG Ariola (Schweiz) AG, Zurich	Switzerland	100.00	v
BMG Ariola Austria Gesellschaft m.b.H., Vienna	Austria	100.00	v
BMG Czech Republic, Prague	Czech Republic	100.00	v
BMG Denmark A/S, Copenhagen	Denmark	100.00	v
BMG Finland Oy, Helsinki	Finland	100.00	v
BMG France S.A.S.U, Paris	France	100.00	v
BMG Music Publishing B.V., Hilversum	Netherlands	100.00	v
BMG Music Publishing France SARL, Paris	France	100.00	v
BMG Music Publishing Limited, London	UK	100.00	v
BMG Music Spain, S.A., Madrid	Spain	100.00	v
BMG Nederland B.V., Hilversum	Netherlands	100.00	v
BMG Norway AS, Oslo	Norway	100.00	v
BMG Poland Spolka z ograniczona odpowiedzialnoscia, Warsaw	Poland	100.00	v
BMG Portugal - Actividades Audiovisuais, Lda., Lisbon	Portugal	100.00	v
BMG RICORDI S.p.A., Rome	Italy	100.00	v
BMG Sweden Aktiebolag, Stockholm	Sweden	100.00	v
BMG UK & Ireland Limited, London	UK	100.00	v
Cezame Argile Productions Editions S.A., Paris	France	100.00	v
Editio Musica Budapest Zeneműkiadó Kft., Budapest	Hungary	100.00	v
Editions Durand S.A., Paris	France	100.00	v
Pinnacle Software Limited, Orpington	UK	100.00	v
Windsong Holdings Limited, Orpington	UK	75.00	v
Zomba Music Publishers Limited, London	UK	100.00	v
Zomba Records Limited, London	UK	100.00	v
BMG Latin America			
Ariola, S.A. de C.V., Mexico City	Mexico	100.00	v
BMG Ariola Argentina, S.A., Buenos Aires	Argentina	100.00	v
BMG Brasil Ltda., Rio de Janeiro	Brazil	100.00	v
BMG Asia / Pacific			
BMG Australia Limited, North Sydney	Australia	100.00	v
BMG Entertainment (Thailand) Limited, Bangkok	Thailand	75.00	v
BMG FUNHOUSE, Inc., Tokyo	Japan	100.00	v
BMG Hong Kong Limited, Hong Kong	China	100.00	v
BMG Korea Co. Limited, Seoul	South Korea	100.00	v
BMG Music (Malaysia) SDN BHD, Kuala Lumpur	Malaysia	100.00	v
BMG Music Taiwan, Inc., Taipeh	Taiwan	100.00	v
BMG New Zealand Limited, Newton, Parnell, Auckland	New Zealand	100.00	v
BMG Records Africa (Proprietary) Limited, Sunninghill (Johannesbug)	South Africa	100.00	v
BMG Singapore Pte. Limited, Singapore	Singapore	100.00	v

arvato

arvato print			
Artur Wahl GmbH Reproduktionen Satzherstellung, Munich	Germany	100.00	v
Deutscher Supplement Verlag GmbH, Nuremberg	Germany	75.00	v
Farbwerke GmbH, Gütersloh	Germany	51.00	v
GGP Media GmbH, Pößneck	Germany	100.00	v
maul + co – Chr. Belser GmbH, Nuremberg	Germany	75.00	v
maul + co – Chr. Belser Klebebindung GmbH, Nuremberg	Germany	75.00	v
maul + co – Chr. Belser Studios GmbH, Nuremberg	Germany	75.00	v
Medienfabrik Gütersloh GmbH, Gütersloh	Germany	50.00	v
Mohnlitz-Verlag GmbH, Berlin	Germany	100.00	v
MOHN Media Elanzedruck GmbH, Berlin	Germany	100.00	v
MOHN Media Kalender & Promotion Service GmbH, Gütersloh	Germany	100.00	v
MOHN Media Mohndruck GmbH, Gütersloh	Germany	100.00	v
Präsenta Promotion International GmbH, Solingen	Germany	60.00	v
ProBind Professional Binding GmbH, Gütersloh	Germany	95.00	v
TV Information Services GmbH, Nuremberg	Germany	75.00	v
WOSCHEK Verlags GmbH, Mainz	Germany	80.00	v
ASTROSAT, spol. s r.o., Prague	Czech Republic	98.75	e
Berryville Graphics, Inc., Wilmington	USA	100.00	v
Cobrhi, S.L., Madrid	Spain	100.00	v
Coral Graphic Services, Inc., Hicksville	USA	96.10	v
Dynamic Graphic Finishing, Inc., Horsham	USA	93.10	v
Editoriale Johnson S.p.A., Seriate	Italy	98.82	v
Eurogravure S.p.A., Bergamo	Italy	69.18	v
Eurohueco, S.A., Castellbisbal (Barcelona)	Spain	65.00	v
Nuovo Istituto Italiano d'Arti Grafiche S.p.A., Bergamo	Italy	99.82	v
OAO Jaroslawskij Poligraphitscheskij Kombinat, Jaroslavl	Russia	50.90	v
Offset Paperback MFRS., Inc., Dallas	USA	100.00	v
OOO Distribuziony zentr Bertelsmann, Jaroslavl	Russia	100.00	v
Printer Colombiana, S.A., Santa Fé de Bogotá	Colombia	50.89	v
Printer Industria Gráfica, S.A., Sant Vicenç dels Horts (Barcelona)	Spain	100.00	v
Printer Portuguesa-Indústria Gráfica, Limitada, Mem Martins (Algueirão)	Portugal	100.00	v
Publicitarna Söderberg & Co. Aktiebolag, Stockholm	Sweden	69.75	v
Rotedic, S.A., Madrid	Spain	100.00	v
arvato direct services / arvato logistics services			
arvato direct services Dortmund GmbH, Dortmund	Germany	100.00	v
arvato direct services Elweiler GmbH, Heusweiler-Elweiler	Germany	100.00	v
arvato direct services GmbH, Gütersloh	Germany	100.00	v
arvato direct services Gütersloh GmbH, Gütersloh	Germany	100.00	v
arvato direct services Münster GmbH, Münster	Germany	100.00	v
arvato direct services Stuttgart GmbH, Kornwestheim	Germany	100.00	v
arvato direct services Wilhelmshaven GmbH, Schortens	Germany	100.00	v
arvato direct services Wuppertal GmbH, Wuppertal	Germany	100.00	v
arvato distribution GmbH, Harsewinkel	Germany	100.00	v
arvato logistics services GmbH, Gütersloh	Germany	100.00	v
arvato media GmbH, Gütersloh	Germany	100.00	v
arvato technology ELC GmbH, Düren	Germany	100.00	v
arvato technology GmbH, Gütersloh	Germany	100.00	v
AZ Direct GmbH, Gütersloh	Germany	100.00	v
bedirect GmbH & Co. KG, Gütersloh	Germany	50.00	e
BFS finance Münster GmbH, Münster	Germany	100.00	v
BFS finance, Verl	Germany	100.00	v
BFS risk & collection GmbH, Verl	Germany	100.00	v
BFS risk management GmbH, Verl	Germany	74.80	v
Deutsche Post Adress GmbH, Bonn	Germany	49.00	e
InmediaONE) GmbH, Gütersloh	Germany	100.00	v
Media Log Spedition GmbH, Gütersloh	Germany	100.00	v
NIONEX GmbH, Gütersloh	Germany	100.00	v
PVS Mailmanagement GmbH, Neckarsulm	Germany	100.00	v
Verlagsdienst München GmbH, Gilching	Germany	100.00	v
webmiles GmbH, Munich	Germany	87.53	v
wissen Media Verlag GmbH, Gütersloh	Germany	100.00	v
wissen.de GmbH Gesellschaft für Online-Information, Munich	Germany	100.00	v
ALLDIREKT Telemarketing GmbH, Salzburg	Austria	100.00	v
arvato communication services France SARL, Noyelles sous Lens	France	100.00	v
arvato services (UK) Limited, Watley	UK	100.00	v
arvato services Asia Pacific Pte. Limited, Singapore	Singapore	100.00	v
arvato services Australia Pacific Pty. Limited, Castle Hill (Sydney)	Australia	100.00	v
arvato services France S.A.R.L., Noyelles sous Lens	France	100.00	v
arvato services Iberia, S.A., Barcelona	Spain	100.00	v
arvato services, Inc., Valencia	USA	100.00	v
BD Medien-Service AG, Münchenstein	Switzerland	100.00	v
BenefitNation, Inc., Fairfax Station	USA	60.00	v
Bertelsmann Media Sp. z o.o z siedziba w Warszawie Oddział arvato services Polska, Plewiska k/Poznania	Poland*	100.00	v
Bertelsmann Österreich GmbH, Vienna	Austria	100.00	v
BFS finance Limited, Dublin	Ireland	100.00	v
DISTODO, Distribuicao e Logistica, LDA., Vila Nova de Rainha	Spain	33.33	e
Eurodirect Marketing Lettershop SAS, Geispolsheim	France	60.00	v
EUROMEDIA GROUP k.s., Prague	Czech Republic*	100.00	v
Forms Facility Group B.V., Abcoude	Netherlands	60.00	v
SPDS AG, Luzern	Switzerland	100.00	v
Total Distribución, S.A., Alcorcón (Madrid)	Spain	66.67	v
Verlagsservice für Bildungssysteme und Kunstobjekte GmbH & Co. KG, Vienna	Austria	75.00	v
Verlagsservice SSD AG, Glattbrugg	Switzerland	100.00	v
arvato systems			
arvato systems GmbH, Gütersloh	Germany	100.00	v
arvato systems Technologies GmbH, Rostock	Germany	100.00	v
empolis GmbH, Gütersloh	Germany	100.00	v
SSB Software Service und Beratung GmbH, Munich	Germany	54.71	e
arvato Middle East Sales FZE, Dubai	V.A.E.	100.00	v
arvato systems (Shanghai) Co. Limited, Shanghai	China	100.00	v
arvato systems France S.A.R.L., Paris	France	100.00	v
arvato systems Global 24 North America LLC, Wilmington	USA	100.00	v
arvato systems Hungary Tanácsadó és Szolgáltató Kft., Budapest	Hungary	51.00	e
arvato systems North America, Inc., Wilmington	USA	100.00	v
arvato systems UK & Ireland Limited, London	UK	100.00	v
empolis NA, Inc., Burlington	USA	100.00	v
empolis Polska Spolka z ograniczona odpowiedzialnoscia, Warsaw	Poland	95.05	v
empolis scandinavia AS, Oslo	Norway	100.00	v
empolis UK Limited, Swindon	UK	100.00	v
arvato storage media			
arvato storage media GmbH, Gütersloh	Germany	100.00	v
Digital World Services GmbH, Hamburg	Germany	100.00	v
FlexStorm GmbH, Gütersloh	Germany	100.00	v
Sonopress Data Replication Gesellschaft für Informationsträgervervielfältigung mbH, Gütersloh	Germany	100.00	v
Sonopress Produktionsgesellschaft für Ton- und Informationsträger mbH, Gütersloh	Germany	100.00	v
topse MultimediaPrint GmbH, Gütersloh	Germany	100.00	v
Digital World Services LLC, Delaware	USA	100.00	v
Sonopress - Rimo Argentina, S.A., Buenos Aires	Argentina	52.00	v
Sonopress (UK) Limited, Wednesbury (Birmingham)	UK	100.00	v
Sonopress France SAS, Paris	France	100.00	v
Sonopress Real-Memory S.A., Coslada (Madrid)	Spain	61.00	v
Sonopress Ireland Limited, Dublin	Ireland*	100.00	v
Sonopress LLC, Wilmington	USA	100.00	v
Sonopress Pan Asia Limited, Hong Kong	China	100.00	v
Sonopress Pan Asia Tokyo Co., Limited, Tokyo	Japan	100.00	v
Sonopress Shanghai Multimedia Technology Co. Limited, Shanghai	China	100.00	v
Sonopress Singapore Pte. Limited, Singapore	Singapore	100.00	v
Sonopress South Africa (Proprietary) Limited, Bromhof (Johannesburg)	South Africa	100.00	v
Sonopress-Rimo Indústria e Comércio Fonográfica Ltda., Sao Paulo	Brazil	52.00	v

*) The company has availed of exemptions under Section 17 of the Irish Companies' (Amendment) Act 1986 from publicly filing its financial statements.

DirectGroup Bertelsmann

Clubs Central and Eastern Europe			
Bertelsmann Multimedia GmbH, Gütersloh	Germany	100.00	v
FCB FREIZEIT-CLUB Betreuungs-GmbH & Co., Hamburg	Germany	50.00	q
RM Buch und Medien Vertrieb GmbH, Gütersloh	Germany	100.00	v
Bertelsmann Media Moskau AO, Moscow	Russia	100.00	v
Bertelsmann Media - Swiat Ksiazki, Warsaw	Poland	100.00	v
Bertelsmann Medien (Schweiz) AG, Zug	Switzerland	100.00	v
Buchgemeinschaft Donauland Kremayr & Scharlau, Vienna	Austria	75.00	v
EUROMEDIA GROUP k.s., Prague	Czech Republic	100.00	v
IKAR s.r., Bratislava	Slovakia	100.00	v
Clubs / Direct Sales South West Europe			
Bertelsmann OnLine B.V., Vianen	Netherlands	100.00	v
BOL Books On Line Italia S.p.A., Milan	Italy	50.00	e
Círculo de Lectores, S.A., Barcelona	Spain	100.00	v
Círculo de Leitores, S.A., Lisbon	Portugal	100.00	v
ECI voor Boeken en Platen B.V., Vianen	Netherlands	99.80	v
France Loisirs (Suisse) S.A., Crissier	Switzerland	100.00	v
France Loisirs Belgique S.A., Ath	Belgium	100.00	v
FRANCE LOISIRS S.A.R.L., Paris	France	100.00	v
Lexicultural - Actividades Editoriais, Limitada, Branco (Lisbon)	Portugal	100.00	v
Mondolibri S.p.A., Milan	Italy	50.00	q
Québec Loisirs Inc., Ville St. Laurent	Canada	100.00	v
Société Générale d'Edition et de Diffusion SGED, s.n.c. (l.l.), Paris	France	50.00	q
Clubs Asia			
Bertelsmann Korea Co., Limited, Seoul	Korea	100.00	v
Shanghai Bertelsmann Culture Industry Co. Limited, Shanghai	China	80.00	v
Shanghai Bertelsmann Information Technology Co. Limited, Shanghai	China	100.00	v
English Speaking Clubs			
bol, Limited, London	UK	100.00	v
Book Club Associates, London	UK	100.00	v
Bookspan (Partnership), Delaware	USA	50.00	q
Doubleday Australia Pty. Limited, Lane Cove (Sydney)	Australien	100.00	v
Doubleday Canada Limited, Toronto	Canada	100.00	v
BeMusic / eCommerce			
buch.de AG, Münster	Germany	25.10	e
barnesandnoble.com llc, New York	USA	38.00	e
BeMusic, Inc., Dauphin County	USA	100.00	v
Other			
bol.com AG, Gütersloh	Germany	100.00	v
Bertelsmann DealTime Holding B.V., Amsterdam	Netherlands	89.33	v

BertelsmannSpringer

Science, Technology, Medicine			
BertelsmannSpringer Medizin OnLine GmbH, Berlin	Germany	76.50	v
B.G. Teubner GmbH, Wiesbaden	Germany	100.00	v
Dr. Dietrich Steinkopff Verlag GmbH & Co. KG, Darmstadt	Germany	87.08	v
FUCHSBRIEFE Dr. Hans Fuchs GmbH, Berlin	Germany	100.00	v
GWV Fachverlage GmbH, Wiesbaden	Germany	100.00	v
InfoChem Gesellschaft für chemische Information mbH, Göbenzell	Germany	69.67	v
MED.KOMM. Gesellschaft für medizinische Kommunikation mbH, Munich	Germany	93.54	v
Springer GmbH & Co. Auslieferungs-Gesellschaft, Heidelberg	Germany	87.08	v
Springer-Verlag GmbH & Co. KG, Berlin	Germany	87.08	v
Urban & Vogel Medien und Medizin Verlagsgesellschaft mbH & Co.KG, Munich	Germany	93.54	v
Verlag Aktuelle Information GmbH, Frankfurt	Germany	100.00	v
Westdeutscher Verlag GmbH, Wiesbaden	Germany	100.00	v
GROUPE IMPACT MEDECIN S.A., Paris	France	100.00	v
Minerva wissenschaftliche Buchhandlung GmbH, Vienna	Austria	67.87	v
ÄRZTEWOCHE Zeitungsverlagsgesellschaft m.b.H., Vienna	Austria	100.00	v
Birkhäuser Boston, Inc., Cambridge	USA	88.42	v
Birkhäuser Verlag AG, Basel	Switzerland	87.08	v
Eastern Book Service, Inc., Tokyo	Japan	87.08	v
Ferdinand Springer GmbH, Vienna	Austria	87.08	v
Key Curriculum Press, Inc., Emeryville	USA	68.27	v
MMV 2 Medien & Medizin Verlag AG, Basel	Switzerland	93.74	v
Princeton Architectural Press, Inc., New York	USA	44.08	v
Springer-Verlag (London) Limited, Farncombe, Godalming	UK	87.08	v
Springer-Verlag France S.A.R.L., Paris	France	87.08	v
Springer-Verlag Hong Kong Limited, Hong Kong	China	87.08	v
Springer-Verlag Italia S.r.l., Milan	Italy	87.08	v
Springer-Verlag KG, Vienna	Austria	67.87	v
Springer-Verlag New York, Inc., New York	USA	88.42	v
Springer-Verlag Tokyo, Inc., Tokyo	Japan	87.08	v
Business-to-Business (B2B)			
Auto Business Verlag GmbH & Co. KG, Ottobrunn	Germany	100.00	v
BauNetz Online-Dienst GmbH & Co. KG, Berlin	Germany	100.00	v
BertelsmannSpringer Bauverlag GmbH, Gütersloh	Germany	100.00	v
HEINZE GmbH, Celle	Germany	100.00	v
Verlag Heinrich Vogel GmbH Fachverlag, Munich	Germany	100.00	v
Wendel-Verlag GmbH, Kassel	Germany	100.00	v
ABI Building Data Limited, Neston	UK	100.00	v
BAU-DATA GmbH, Vigaun	Austria	100.00	v
Bertelsmann Information Professionnelle S.A.S., Paris	France	100.00	v
BertelsmannSpringer Business-to-Business (Benelux) N.V., Kortrijk	Belgium	100.00	v
BertelsmannSpringer Business-to-Business (Schweiz) AG, Schlieren	Switzerland	100.00	v
BertelsmannSpringer CZ s r.o., Prague	Czech Republic	100.00	v
BertelsmannSpringer Magyarország Kiadó Kft., Budapest	Hungary	100.00	v
CeboSystems N.V., Zeventem	Belgium	100.00	v
Codes Rousseau S.A.S., Les Sables d'Olonne	France	100.00	v
Editorial Trafico Vial, S.A., Móstoles (Madrid)	Spain	100.00	v
Fachmedien Verlag GmbH, Klosterneuburg	Austria	96.00	v
Grupo Imago Spółka z o.o., Warsaw	Poland	100.00	v
Media-Daten AG, Zurich	Switzerland	100.00	v
MediaOffice N.V., Lasne	Belgium	100.00	v
Plus Point Marketing B.V.B.A., Kortrijk	Belgium	100.00	v
Schlück Söhne AG Druckerei und Verlag, Rüschlikon	Switzerland	100.00	v
Stürtz Group			
design & production GmbH Verlagsservice, Heidelberg	Germany	92.73	v
Safadruck GmbH, Berlin	Germany	87.08	v
Stürtz Verlag GmbH, Würzburg	Germany	87.08	v
Universitätsdruckerei H. Stürtz AG, Würzburg	Germany	87.08	v
Scientific Publishing Services (P) Limited, Bangalore	India	78.38	v

(27) Exemption of Domestic Companies from preparation, Audit and Publication of Financial Statements

The exemption provisions set out in § 264 para. 3 HGB regarding the supplementary requirements for limited liability companies to prepare financial statements and a management report and on audit and publication by limited liability companies were implemented by the following subsidiaries for the year ended December 31, 2002:

Arabella Musikverlag GmbH	Munich
Arbor TV-Filmproduktion GmbH	Tutzing
arvato AG	Gütersloh
arvato direct services Dortmund GmbH	Dortmund
arvato direct services GmbH	Gütersloh
arvato direct services Gütersloh GmbH	Gütersloh
arvato direct services Gütersloh GmbH	Springe
arvato direct services Münster GmbH	Münster
arvato direct services Neumünster GmbH	Neumünster
arvato direct services Stuttgart GmbH	Ludwigsburg
arvato direct services Wilhelmshaven GmbH	Wilhelmshaven
arvato direct services Wuppertal GmbH	Wuppertal
arvato distribution GmbH	Gütersloh
arvato logistics services GmbH	Gütersloh
arvato media GmbH	Gütersloh
arvato storage media GmbH	Gütersloh
arvato systems GmbH	Gütersloh
arvato systems Technologies GmbH	Rostock
arvato technology ELC GmbH	Düren
AZ Direct GmbH	Gütersloh
AZ Direct GmbH	Bad Homburg
AZ Direct GmbH	Munich
B.G. Teubner Gesellschaft mit beschränkter Haftung	Wiesbaden
Bavariaton-Verlag Gesellschaft mit beschränkter Haftung	Munich
Bertelsmann arvato middle east sales GmbH	Gütersloh
Bertelsmann Buch Aktiengesellschaft	Gütersloh
Bertelsmann Capital Holding GmbH	Hamburg
Bertelsmann Immobilien GmbH	Gütersloh
Bertelsmann Interactive Studios GmbH	Gütersloh
Bertelsmann Korea Beteiligungs GmbH	Gütersloh
Bertelsmann Multimedia GmbH	Gütersloh
Bertelsmann Music Group GmbH	Gütersloh
Bertelsmann Music Group GmbH	Munich
Bertelsmann Online Beteiligungsgesellschaft mbH	Gütersloh
Bertelsmann Online International GmbH	Gütersloh
Bertelsmann Valley GmbH.	Gütersloh
BertelsmannSpringer Science+Business Media GmbH	Gütersloh
BertelsmannSpringer Science+Business Media GmbH	Berlin
BFS finance GmbH	Gütersloh
BFS risk & collection GmbH	Gütersloh
BIP Industrieplanungs-GmbH	Gütersloh
BMG Berlin Musik GmbH	Berlin
BMG Deutschland GmbH	Gütersloh
BMG Music International Service GmbH	Munich
bol.com AG	Gütersloh
CLT-UFA Multimedia GmbH	Cologne
Creation GmbH	Cologne
Crescendo Musikverlag GmbH	Munich
Cutup GmbH	Cologne
Darper 128 GmbH	Cologne
Die Berliner Produktion GmbH	Berlin
Dreiklang-Dreimasken, Bühnen- und Musikverlag Gesellschaft mit beschränkter Haftung	Munich
empolis GmbH	Gütersloh
Fremantle Licensing Germany GmbH	Berlin
FUCHSBRIEFE Dr. Hans Fuchs GmbH	Berlin
GGP Media GmbH	Gera
Grundy Light Entertainment GmbH	Cologne
Grundy UFA TV Produktions GmbH	Berlin
Gum Records Musikproduktions GmbH	Bochum
Gütersloher Verlagshaus GmbH	Gütersloh
Gyula Trebitsch Fernsehproduktion GmbH	Ludwigsburg
HEINZE Gesellschaft mit beschränkter Haftung	Celle
Hotel & Gastronomie Gütersloh GmbH	Gütersloh
InmediaONE! GmbH	Gütersloh
Interworld Musik-Verlag Gesellschaft mit beschränkter Haftung	Munich
Luchterhand Literaturverlag GmbH	Munich
MBV Media Berlin Verlag GmbH	Berlin
Media Log Spedition GmbH	Gütersloh
Medien Dr. phil. Egon Müller Service GmbH	Gütersloh
Mohn Media Bindery GmbH	Gütersloh
Mohn Media Eisendruck GmbH	Berlin
Mohn Media Energy GmbH	Gütersloh
Mohn Media Print GmbH	Gütersloh
Mohn Media Sales GmbH	Gütersloh
Musik Edition Discoton, Gesellschaft mit beschränkter Haftung	Munich
OSB Olympische Sportbibliothek Gesellschaft mbH	Munich
Phoebus Geschäftsführungs GmbH	Berlin
PRO FUTURA GmbH	Gütersloh
ProBind Professional Binding GmbH	Gütersloh
PSC Print Service Center GmbH	Gera
Reinhard Mohn GmbH	Gütersloh
RM Buch und Medien Vertrieb GmbH	Gütersloh
RM Buch und Medien Vertrieb GmbH Rheda-Wiedenbrück	Rheda-Wiedenbrück.
RTL Group Verwaltungs und Holding GmbH	Cologne
RTL Hessen GmbH	Cologne
RTL Nord GmbH	Cologne
RTL Radio Berlin GmbH	Berlin
RTL Radio Deutschland GmbH	Berlin
Sonopress Data Replication Gesellschaft für Informationsträgerverviel-fältigung mbH	Gütersloh
UFA - International Gesellschaft mit beschränkter Haftung	Munich
UFA Entertainment GmbH	Berlin
UFA Fernsehproduktion GmbH	Berlin
UFA Film & Fernseh GmbH	Hamburg
UFA Film & Medienproduktion GmbH	Leipzig
UFA Film & TV Produktion GmbH	Berlin
UFA Film Finance GmbH	Berlin
UFA Film München GmbH	Munich
UFA Filmproduktion GmbH	Berlin
UFA International Film & TV Produktions GmbH	Berlin
UFA non fiction Productions GmbH	Berlin
UFA Sport Television GmbH	Hamburg
Ufaton-Verlagsgesellschaft mit beschränkter Haftung	Munich
Universum Film Beteiligungs GmbH	Munich
Verlag Aktuelle Information Gesellschaft mit beschränkter Haftung	Frankfurt
Verlag Heinrich Vogel GmbH Fachverlag	Munich
Verlag RM GmbH	Gütersloh
Verlagsgruppe Random House GmbH	Gütersloh
Verlagsgruppe Random House GmbH München	Munich
Westdeutsche Universum-Film GmbH	Cologne
Wiener Bohème Verlag Gesellschaft mit beschränkter Haftung	Munich
Wilhelm Goldmann Verlag GmbH	Munich
wissen Media Group GmbH	Munich

The exemption provisions set out in § 264b HGB were again implemented by the following companies for the year ended December 31, 2002:

ANDSOLD GmbH & Co. KG	Gütersloh
Börse Online Verlag GmbH & Co.	Munich
Deutsche Synchron Filmgesellschaft mbH & Co. Produktions KG	Berlin
Dresdner Druck- und Verlagshaus GmbH & Co. KG	Dresden
eB2B market place GmbH & Co. KG	Hamburg
Ehrlich & Sohn GmbH & Co.	Hamburg
Gruner+Jahr AG & Co.	Hamburg
Pantheon Film GmbH & Co. Produktions KG	Berlin
Phoebus Film GmbH & Co. Produktions KG	Berlin
Phoebus Film Karlheinz Brunnemann GmbH & Co. Produktions KG	Berlin
Universum Film GmbH & Co. KG	Munich
Verlagsdienst München Gesellschaft mit beschränkter Haftung & Co. KG	Munich

Supervisory Board

Reinhard Mohn
Honorary Chairman

Gerd Schulte-Hillen
Chairman
Vice-Chairman of the Bertelsmann Foundation Executive Board and Shareholder Bertelsmann Verwaltungsgesellschaft mbH (BVG)
- Druck- und Verlagshaus Gruner + Jahr AG (Chairman)
- Hamburg-Mannheimer Versicherung AG
- Hamburg-Mannheimer Sachversicherungs-AG

Dr. Dieter H. Vogel
Vice-Chairman
Managing Partner of Bessemer Vogel und Treichl GmbH
- ABB AG (Chairman)
- Gerling Industrie-Service AG (Vice-Chairman)
- Mapress GmbH (Chairman)
- Mobilcom AG
- Blücher Apa
- Ernst & Young Deutsche Allgemeine Treuhand AG
- HSBC Trinkaus & Burkhardt KGaA

Dr. Rolf E. Breuer
Chairman of the Supervisory Board Deutsche Bank AG
- DB Industrial Holdings AG (Chairman) (until 6/21/2002)
- Deutsche Bank AG (Chairman) (since 5/22/2002)
- Deutsche Börse AG (Chairman)
- Deutsche Lufthansa AG
- E.ON AG
- Münchener Rückversicherungs-Gesellschaft AG (until 12/6/2002)
- Siemens AG (Vice-Chairman)
- Compagnie de Saint-Gobain S.A.
- Kreditanstalt für Wiederaufbau (since 5/10/2002)
- Landwirtschaftliche Rentenbank

Dr. Hugo Bütler
(until 6/30/2002)
Editor-in-Chief and Managing Director of Neue Zürcher Zeitung
- Robert Bosch Internationale Beteiligungen AG
- LZ Medien Holding (since 6/18/2002)

André Desmarais
President and Chief Executive Officer Power Corporation of Canada
- Bombardier Inc.
- CITIC Pacific Limited
- Great-West Life & Annuity Insurance Company
- Great-West Lifeco Inc.
- Groupe Bruxelles Lambert S.A.
- Investors Group Inc.
- Pargesa Holding S.A.
- Power Financial Corporation
- Power Financial Europe B.V.
- Parjointco N.V.
- The Great-West Life Assurance Company

Prof. Dr. Michael Hoffmann-Becking
Lawyer
- Delton AG
- Rheinische Bahngesellschaft AG
- C.H. Boehringer Sohn
- de Haen-Carstanjen GmbH
- Felix Schoeller Holding GmbH & Co. KG

Sir Peter Job
(since 7/1/2002)
Former Chairman of the Executive Board Reuters Group PLC
- Deutsche Bank AG
- GlaxoSmithKline PLC
- Instinet Group, Inc.
- Multex.com, Inc.
- RVCI
- Schroders PLC
- Shell Transport and Trading PLC
- Teco Software, Inc.

John R. Joyce
(since 7/1/2002)
Chief Financial Officer IBM

Oswald Leixer
Vice-Chairman of the Bertelsmann Corporate Works Council

- Supervisory Board mandates in accordance with § 100, para. 2 of the German Stock Corporation Act (AktG)
- Membership in comparable domestic and foreign supervisory bodies of commercial enterprises

As of December 31, 2002

Liz Mohn
Member of the Bertelsmann Foundation Executive Board and Chairwoman of the Board of Bertelsmann Verwaltungsgesellschaft mbH (BVG)

Willi Pfannkuche
Member of the Bertelsmann Corporate Works Council

Erich Ruppik
Chairman of the Bertelsmann Corporate Works Council

Gilles Samyn
Managing Director and Vice-Chairman Compagnie Nationale à Portefeuille S.A.
- Fomento de Construcciones y Contratas
- Groupe Bruxelles Lambert S.A.
- Imerys S.A.
- Petrofina S.A.
- Pargesa Holding S.A.
- Quick S.A.
- RTL Group S.A.

Richard Sarnoff
(since 7/1/2002)
Chairman of the Bertelsmann AG Management Representative Committee (since 6/1/2002)
Executive Vice President Random House
- Audible Inc.
- Classic Media Inc.
- Library Inc.
- Princeton Review
- Random House Mondadori Group (until 6/30/2002)
- Xlibris Inc.

Prof. Dr. Jürgen Strube
Chairman of the Board of Executive Directors BASF AG
- Allianz Lebensversicherungs-AG
- BMW AG
- Commerzbank AG
- Hapag-Lloyd AG
- Hochtief AG
- Linde AG

Dr. Uwe Swientek
(until 6/30/2002)
Chairman of the Bertelsmann AG Management Representative Committee (until 3/30/2002)
Chief Executive Officer arvato storage media (until 4/30/2002)
- CEYONIQ AG (Chairman)
- Sonopress Bermemory S.A. (until 4/30/2002)
- Sonopress Rima Industria e Comercio Fonografica Ltda. (until 4/30/2002)
- Sonopress Pan Asia Limited (until 4/30/2002)
- Sonopress Pan Asia Tokyo Limited (until 4/30/2002)

Dr. Ing. E.h. Heinrich Weiss
(until 6/30/2002)
Chairman of the Management Board SMS AG
- Commerzbank AG
- Deutsche Bahn AG
- Ferrostaal AG
- Hochtief AG
- J.M. Voith AG
- SMS Demag AG (Chairman)
- Thyssen-Bornemisza Group
- Concast Holding AG
- Concast AG

Bernd Wrede
(until 6/30/2002)
Former Chairman of the Executive Board Hapag-Lloyd AG
- Bankgesellschaft Berlin AG (since 3/28/2002)
- Deutsche Hyp Deutsche Hypothekenbank Frankfurt-Hamburg AG
- ERGO Versicherungsgruppe AG
- Goldschmidt AG
- Landesbank Berlin (since 3/28/2002)
- Kühne & Nagel International AG

Committees of the Supervisory Board

Personnel Committee
Gerd Schulte-Hillen (Chairman)
André Desmarais
Liz Mohn
Prof. Dr. Jürgen Strube

Audit and Finance Committee
Dr. Dieter H. Vogel (Chairman)
Dr. Rolf E. Breuer
Prof. Dr. Michael Hoffmann-Becking
John R. Joyce
Erich Ruppik
Gilles Samyn

Strategy and Investment Committee
Gerd Schulte-Hillen (Chairman)
Dr. Rolf E. Breuer
André Desmarais
Sir Peter Job
Gilles Samyn
Richard Sarnoff
Dr. Dieter H. Vogel

Working Group of the Employee Representatives on the Supervisory Board
Gerd Schulte-Hillen (Chairman)
Oswald Lexen
Liz Mohn
Willi Pfannkuche
Erich Ruppik
Richard Sarnoff

Executive Board

Dr. Gunter Thielen
Chairman & Chief Executive Officer
(since 8/5/2002)

- arvato AG (since 12/8/2002)
- Karstadt Quelle AG (1)
- Leipziger Messe GmbH
- Berryville Graphics, Inc. (until 9/1/2002)
- Bertelsmann Holding Spain, S.A. (until 5/8/2002)
- Bertelsmann Inc. (since 8/5/2002)
- Cobra S.A. (until 5/8/2002)
- Coral Graphic Services, Inc. (until 9/1/2002)
- Coral Graphic Services of Virginia, Inc. (until 9/1/2002)
- Dynamic Graphic Finishing, Inc. (until 9/1/2002)
- Eurohueco S.A. (until 7/15/2002)
- Hannover'sche Leben (1)
- Istituto Italiano d'Arti Grafiche S.p.A. (until 9/1/2002)
- maul + co – Chr. Belser GmbH (until 11/19/2002)
- Nuevo Sistema Actuaciones y Servicios S.L. (until 5/8/2002)
- Offset Paperback MFRS, Inc. (until 9/1/2002)
- Printer Colombiana S.A. (until 11/5/2002)
- Printer Industria Gráfica, S.A. (until 5/8/2002)
- RTL Group S.A. (since 9/3/2002)
- Hotedis, S.A. (until 5/8/2002)
- Saarländische Landesbank (1)
- Stampers Limited (until 9/1/2002)

Dr. Siegfried Luther
Deputy Chairman
(since 8/5/2002)

- Bertelsmann Buch AG
- Druck- und Verlagshaus Gruner + Jahr AG
- Springer Verlag GmbH & Co. KG
- WestLB AG (since 8/1/2002) (1)
- Bertelsmann Inc.
- Lycos Europe N.V.
- RTL Group S.A.

Dr. Arnold Bahlmann
President & Chief Executive Officer
BertelsmannSpringer

- Stürtz AG (Chairman) (since 12/18/2002)

Dr. Klaus Eierhoff
(until 8/8/2002)

- bol.com AG (Chairman) (until 10/31/2002)
- barnesandnoble.com (until 8/9/2002)
- BOOKSPAN (until 8/9/2002)
- DealTime.com, Inc. (until 8/9/2002)
- Odnauland – Gesellschaftsführungsgesellschaft mbH (until 8/8/2002)
- ECI voor boeken en platen B.V. (until 8/9/2002)
- Shanghai Bertelsmann Culture Industry Co. Limited (until 8/9/2002)

Dr. Bernd Kundrun
Chairman & Chief Executive Officer
Gruner + Jahr AG

- Gruner + Jahr Holding AG
- Gruner + Jahr USA Group, Inc.
- News Networld Internetservice AG (until 12/18/2002)
- Stern Magazine Corporation

Dr. Thomas Middelhoff
(until 8/5/2002)

- Bertelsmann Buch AG (Chairman) (until 8/5/2002)
- Bertelsmann Inc. (until 7/27/2002)
- Bertelsmann Ventures LP (until 8/5/2002)
- RTL Group S.A. (until 8/5/2002)

Peter Olson, J.D./MBA
Chairman & Chief Executive Officer
Random House, Inc.

- barnesandnoble.com (since 8/9/2002)
- Bertelsmann Inc.
- Random House, Inc.
- Random House Direct, Inc.
- Random House TRF, Inc.

Hartmut Ostrowski
Chairman & Chief Executive Officer
Bertelsmann arvato AG

- Webmiles GmbH (Chairman)
- arvato Services, Inc.
- Bertelsmann Holding Spain, S.A. (since 5/8/2002)
- Berryville Graphics, Inc. (since 9/1/2002)
- Coral Graphic Services of Kentucky, Inc. (since 9/1/2002)
- Coral Graphic Services, Inc. (since 9/1/2002)
- Coral Graphic Services of Virginia, Inc. (since 9/1/2002)
- Dynamic Graphic Finishing, Inc. (since 9/1/2002)
- Eurohueco, S.A. (since 7/15/2002)
- Nuovo Istituto Italiano d'Arti Grafiche S.p.A. (since 9/1/2002)
- maul + co – Chr. Belser GmbH (since 11/19/2002)
- Printer Industria Gráfica, S.A. (since 5/8/2002)
- Offset Paperback MFRS, Inc. (since 9/1/2002)
- Stampers Limited (since 9/1/2002)

Rolf Schmidt-Holtz
Chairman & Chief Executive Officer
Bertelsmann Music Group (BMG)
Chief Creative Officer Bertelsmann AG

- Druck- und Verlagshaus Gruner + Jahr AG
- Arola Eurodisc, Inc.
- Arista Records, Inc.
- Bertelsmann, Inc. (since 8/15/2002)
- Bertelsmann Music Group, Inc.
- Bertelsmann DJS, Inc.
- BMG Australia Limited
- BMG U, LLC
- BMG Music
- BMG New Zealand Limited
- BMG Songs, Inc.
- BMG Special Products, Inc.
- Careers-BMG Music Publishing, Inc.
- RTL Group S.A.
- Zomba Enterprises, Inc.
- Zomba Music Publishers Limited (until 8/28/2002)
- Zomba Record Holdings B.V. (until 7/17/2002)
- Zomba Recording Corporation
- Zomba Records Limited

Dr. Ewald Walgenbach
(since 2/8/2002)
Chief Executive Officer
Direct Group Bertelsmann

- bol.com AG (Chairman) (since 11/1/2002)
- barnesandnoble.com (since 11/1/2002)
- Bertelsmann Corea Co. Limited (since 8/28/2002)
- CLT-UFA S.A. (until 2/8/2002)
- CLT-UFA Los Angeles Inc. (until 2/22/2002)
- CLT-UFA UK Television Limited (until 2/22/2002)
- Delux Productions S.A. (until 2/22/2002)
- ECI voor boeken en platen B.V. (since 11/13/2002)
- Ediradio S.A. (until 2/22/2002)
- FCB Freizeitclub
- International Film Productions S.A. (until 2/8/2002)
- IP Deutschland GmbH (until 2/22/2002)
- IP Medien GmbH (until 2/22/2002)
- Métropole Television S.A. (until 2/22/2002)
- RTL De Holland Media Groep S.A. (until 2/8/2002)
- RTL Group S.A.
- RTL New Media GmbH (until 2/22/2002)
- RTL Plus S.A. (until 2/8/2002)
- RTL Television GmbH (until 2/22/2002)
- Shanghai Bertelsmann Culture Industry
- SPORTFIVE S.A. (until 2/22/2002)
- Studio Luxembourg S.A. (until 2/22/2002)

■ Supervisory Board mandates in accordance with §100, para. 2 of the German Stock Corporation Act (AktG)
■ Membership in comparable domestic and foreign supervisory bodies of commercial enterprises
(1) External mandates

As of December 31, 2002

39 Events After the Balance Sheet Date

In February 2003 Random House agreed with Axel Springer Verlag AG to acquire the Ullstein Heyne List publishing group. It will be integrated into the Random House publishing group in Germany as from the beginning of 2003. Approval by the merger authorities was still outstanding at time of print.

41 Recommendation on Appropriation of Retained Earnings

On May 20, 2003 and as provided by the statutes, € 77 million, being 15 percent of € 516 million, will be distributed to holders of the profit participation certificates out of Bertelsmann AG's retained earnings of € 914 million. The Executive Board recommends to the annual general meeting that the remaining retained earnings of € 837 million after the distribution to holders of the profit participation certificates be appropriated as follows:

Appropriation of Retained Earnings	
	€ Million
Dividends to shareholders	240
Carry forward to new fiscal year	597
	837

Gütersloh, March 7, 2003

Bertelsmann Aktiengesellschaft
The Executive Board:

Dr. Thielen Dr. Luther Dr. Bahlmann Dr. Kundrun

Olson Ostrowski Schmidt-Holtz Dr. Walgenbach

Auditor's Report

We have audited the consolidated financial statements, comprising the balance sheet, the income statement and the statements of changes in shareholders' equity and cash flows as well as the notes to the financial statements prepared by the Bertelsmann AG for the business year from January 1 to December 31, 2002. The preparation and the content of the consolidated financial statements in accordance with International Financial Reporting Standards (IFRS) are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and German generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW) and in supplementary compliance with International Standards on Auditing (ISA). Those standards require that we plan and perform the audit such that it can be assessed with reasonable assurance whether the consolidated financial statements are free of material misstatements. Knowledge of the business activities and the economic and legal environment of the Group and evaluations of possible misstatements are taken into account in the determination of audit procedures. The evidence supporting the amounts and disclosures in the consolidated financial statements are examined on a test basis within the framework of the audit. The audit includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position, results of operations and cash flows of the Group for the business year in accordance with International Financial Reporting Standards.

Our audit, which also extends to the group management report prepared by the Company's management for the business year from January 1 to December 31, 2002, has not led to any reservations. In our opinion on the whole the group management report provides a suitable understanding of the Group's position and suitably presents the risks of future development. In addition, we confirm that the consolidated financial statements and the group management report for the business year from January 1 to December 31, 2002 satisfy the conditions required for the Company's exemption from its duty to prepare consolidated financial statements and the group management report in accordance with German law.

Bielefeld, March 10, 2003

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Reinke
German Public Auditor

Kämpf
German Public Auditor

Select Terms at a Glance

BEX
Short for Bertelsmann Excellence Initiative, aimed at achieving a continuous improvement in cooperation and processes within the Group, together with a steady increase in profitability and return on investment.

Benchmark Bond
Large volume bond with issue proceeds of € 500 million or more.

Bridge Loan
Credit lines granted to provide interim short- and medium-term funds.

Cash Flow per DVFA/SG
Net cash flow from operating activities as defined by the German Association of Financial Analysts and the Schmalenbach-Gesellschaft.

Debt Issuance Program
Program enabling flexible placements of promissory notes on the market.

Discontinuing Operation
Significant component of operations which can be distinguished operationally and for financial reporting purposes.

Rights Similar to Goodwill
Intangible assets determined as a result of fair value accounting at the time of a business combination, as set out in IAS 22. These are treated in the same way as goodwill for Group controlling purposes.

Total Earnings
Earnings before financial result, taxes and amortization of goodwill and similar rights, including capital gains/losses.

Operating EBITA
Earnings before financial result, taxes, amortization of goodwill and similar rights, capital gains/losses and special items, in particular restructuring expenses. Internet losses have been included in Operating EBITA as from 2002.

Operating EBITDA
Earnings before financial result, taxes, amortization of goodwill and similar rights, depreciation of property, plant and equipment, depreciation of financial assets, capital gains/losses and special items, in particular restructuring expenses. Internet losses have been included in Operating EBITDA as from 2002.

Rating
Estimate of the creditworthiness of a creditor, made as a result of a credit analysis carried out by a specialist agency.

Syndicated Credit Line
Credit line granted by a group of banks. Also called syndicated loan facility.

VSOP
Short for virtual stock option plan: Program for granting management a long-term, earnings-related component of their remuneration.

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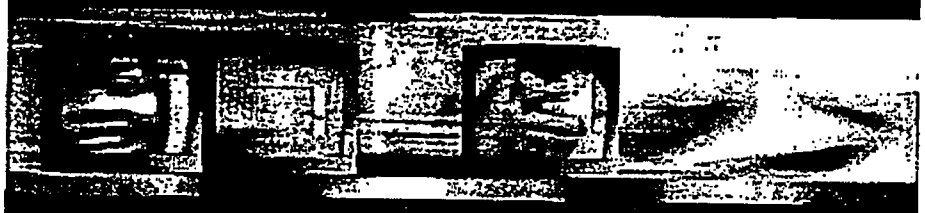

Annual Report
2000/01

BERTELSMANN
media worldwide

Bertelsmann Financial Highlights

		2000/01 € in millions	1999/00 € in millions	1998/99 € in millions	1997/98 € in millions	1996/97 € in millions
Group Development	Revenues	20,045	16,524	13,289	11,338	11,460
	Cash flow	653	1,317	924	662	990
	Investments	3,268	2,049	2,338	726	1,378
	Results from ordinary business activities	2,292	1,160	897	640	726
	Net income after tax	970	672	465	573	523
	Total assets	17,551	14,092	10,070	7,041	6,931
	Personnel costs	4,765	3,755	3,201	2,752	2,605
Employees (as of June 30, 2001)	Germany	32,143	30,984	26,637	24,076	23,371
	Other countries	50,019	45,273	39,802	33,343	33,339
	Total	82,162	76,257	66,439	58,419	56,710
Stockholders' Equity	Capital stock					
	Bertelsmann Foundation 71.2%	330	330	330	330	330
	Mohn Family 21.4%	99	99	99	99	99
	Zilli Foundation 7.4%	34	51	51	51	51
		463	463	480	480	480
	Retained earnings	1,455	1,212	1,109	614	651
	Profit participation certificates	739	687	687	667	641
	Minority interests	1,076	1,276	458	272	371
	Stockholders' equity	3,601	3,638	2,734	2,033	2,143
	As percent of total assets	20	25	27	33	31
Net Income	Net income	970	672	465	573	523
	To shareholders					
	Dividends paid	150	86	68	61	60
	Change in retained earnings	541	265	189	305	277
		691	351	257	366	337
	To minority interests	150	243	132	133	114
	Profit participation dividends (19.51%)	69	76	76	74	72
	Employee profit sharing (offset in net income)	49	55	52	58	60

Thomas Middelhoff
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DirectGroup
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Annual Report
July 1, 2000 to June 30, 2001

Dear Friends of Bertelsmann,

In a few minutes we will be landing in New York following a flight I make every couple of weeks. Nothing out of the ordinary in the air itself, and yet everything is different in the time. As I write this, it is just a week since September 11, but it is still impossible to find words to express the impact of the tragedy of the attacks on the World Trade Center and the Pentagon. Every member of the Bertelsmann family throughout the world has been concerned about the well-being of our 9,000 employees in Manhattan. Are they safe and sound?

The news of the attacks reached me as I gave a report to our staff in Gütersloh on Bertelsmann's current status. My secretary came up on stage and handed me a note. I read aloud the words on the slip of paper and the room filled with horror and shock. In the past hours we realized the extent of the catastrophe and set up task forces in Gütersloh and New York to do what we could to help. We passed an Executive Board resolution to make a donation to the people left behind by the firefighters, police and rescue workers who died in the line of duty. Hundreds of staff members sent e-mails to say how they could help. Reinhard Mohn made a spontaneous donation of DM 10,000 - funds originally earmarked for a company party. Offers of aid reached Gütersloh from throughout the Bertelsmann world.

The wave of solidarity that rolled through our entire organization was simply indescribable. People reached out to one another across country and company borders. Reflecting now, I see this as an expression of a strong corporate culture of which we are all extremely proud. The e-mails I received included one a minute more often than any other: I am proud to work for this company.

On this trip, my plane lands in Wilkes-Barre, a dozen miles north of New York City, because JFK is still closed. On the way to our corporate offices in Times Square, I recall an e-mail I received from Marvlene Lindsey of Somerset in Weaverville, Sha'ar Ha'amakim. The attack is an attack on us all. It is a sentiment echoed by everyone I spoke to at our New York headquarters. Even today the shock of September 11 remains beyond belief and I sense that people are more determined than ever not to let hate and violence prevail. We are more aware than ever of the responsibilities of Bertelsmann as a media company active in 54 countries, and our divisions have taken the lead in organizing a campaign with a clear theme: For Freedom and Humanity – Against Hatred and Terror.

Despite our grief, we still must focus on our jobs and continue to run our businesses. Otherwise, we would concede victory to the terrorists. We fully concur with New York's Mayor Rudolph Giuliani, who spoke for so many when he vowed not to let this terrible event defeat our spirit.

Dear Fellow Shareholders,

I am writing now on a trip to our most important cities – Hamburg and Munich via Gütersloh, with further stops planned in London, Barcelona, Paris, and back to New York – where I will deliver reports on the state of our company. It's our first opportunity to make these reports on an international scale, and people are highly interested in what we have to say! In the course of this tour I will get the chance to speak in person to more than 12,000 of our 82,000 employees. It is important to me to bring everyone the same message and to hear what people working for Bertelsmann worldwide think of our progress we are making. The global networking of our divisions and companies and a broad exchange of information have never been more critical for our success. Only in this way can we take full advantage of our strengths and meet changing customer demands.

The list of updates is long. One deals with the Bertelsmann Excellence Initiative designed to improve our yearly processes and fix ambitious financial targets. Later here information on the rebirth and comprehensive restructuring of BMG, the club business turnaround and our corporate performance. All of this is primarily due to the hard work of the employees with whom I am speaking. Bertelsmann has developed significantly and posted record results despite these turbulent times and adverse economic conditions. Revenue was up 21 percent to € 20 billion and earnings (before interest, taxes and amortization) surged 79 percent to € 3.17 billion.

Over the past three years, we have nearly doubled revenue and more than tripled our profit. I relate one impressive fact that serves characteristic of the phenomenal transition we have gone through: half of our corporate value comes from businesses that didn't even exist before 1995. Our employees are surprised by this and applaud this remarkable fact. The incredible dynamism of the media industry is thrilling and exciting again and again.

Half of our Corporate Value is Made up of Businesses that Didn't Exist Before 1995

At the same time, we continued to focus on our traditional strengths. Bertelsmann has become a global player in the printed book. Whether content is printed or downloaded, we generate sizable revenue in 1995, it contributes over 50 percent today – and the trend is upward. In the last few years, Bertelsmann has invested some € 9 billion in content businesses. From print, music, film and TV to Videos and DVDs, Bertelsmann has gathered the entire range of content formats under a single roof. This has taken us a major step closer to achieving our goal of becoming an integrated media powerhouse. On the one hand, we generate compelling content and provide an environment in which talent can blossom, while on the other we materially strong bonds of trust with our customers, club members and subscribers.

Including the majority of RTL Group enabled us to strengthen our position in the driving force in the broadcasting industry, the key market of the future. Our television operations form the strategic and commercial spearhead of our organization. The RTL acquisition was an historic benchmark for Bertelsmann. Both Reinhard Mohn and I share the belief that it will have a lasting importance for our company. Once again, I was impressed by how open Reinhard has been to thinking in entirely new directions and his willingness to put the status quo to the test. He secured the additional stake in RTL through a stock swap with Groupe Bruxelles Lambert (GBL). In exchange, GBL obtained a 25.1 percent interest in Bertelsmann AG, 0.1 percent of which was in the form of non-voting stock. GBL has the option of making a public offering of these Bertelsmann shares in three to four years. An IPO subjects us to additional external controls, which we believe is a positive. Going public will motivate us to work even more efficiently and focus on our targets with even more accuracy. It is against this backdrop that we are making preparations for public trading of our stock by changing our economic measurement controls, switching from the present fiscal year to a calendar year, and establishing an investor relations department. These changes have made us a great deal more transparent even now.

Speaking of stock exchanges: We have all been aware of the difficult phase of the New Economy on stock markets worldwide and have heard pronouncements of the 'End of the Internet Dream.' I don't agree. I am convinced that for the media industry the dreams have already come true. The Internet is crucial to the future of media enterprises today. Regardless of the standing the New Economy enjoys on the world's stock markets, the Internet has become part of day-to-day activity of all our divisions. With our e-commerce operations and Web offerings – along with our partners – we reach 41 million unique visitors per month (as of June 2001). Together with AOL Time Warner, we are far ahead of all our competitors.

The Internet is
Indispensable for Today's
Media Company

With Our "PC/WEB OFFER FOR ALL"
Program We have
Delivered 50,000 Computers

Our first large-scale Human Resources image campaign addresses the advantages of our corporate culture, and this message is apparently well received by potential employees. According to recent surveys, Bertelsmann is regarded as a most attractive employer by high potentials and young professionals. One illustration of this came in a letter we received from a promising applicant to our corporate strategy unit. She wrote: "Bertelsmann's culture is truly unique. Anyone who has his or her own ideas simply has to be excited by a company that gives you entrepreneurial leeway in such an innovative environment."

This annual report confirms that fiscal 2000/01 was a successful year for us overall. I want to express my thanks to all the employees who contributed to this accomplishment through their commitment and hard work.

New additions to the Executive Board are: Arnold Bahlmann, who assumed direction of the newly created Bertelsmann Capital division; and Peter Olson, who was put in charge of our entire portfolio of book publishers as of April. Rolf Schmidt-Holtz inherits the ambitious legacy Rudi Gassner left behind as Chairman and CEO of BMG on his sudden and unexpected passing last December. The death of Rudi Gassner is a huge loss for us – it takes from our midst a wonderful human being and an excellent entrepreneur.

Joel Klein has been at the helm of Bertelsmann Inc. in the United States since February. Thanks to our highly competent international team, we are optimally equipped to meet the challenges that lie ahead of us.

Sincerely yours,

Thomas Middelhoff

Thomas Middelhoff

Dr. Thomas Middelhoff

Dr. Arnold Bahlmann

Dr. Rolf Schmidt-Holtz

Dr. Peter Olson

Dr. Rudi Gassner

Peter Olson, CO-CEO

Gerd Schulte-Hillen

Dr. Michael Dornemann

Frank Wössner

High Speed, High Trust – Bertelsmann in Transition

Status Report

Consolidated Bertelsmann revenues in fiscal year 2000/01 increased by 21 percent to € 20.0 billion (previous year: € 16.5 billion). The proportion of revenues generated in Germany, the remaining European countries and the United States was approximately equal. Earnings before interest, taxes and amortization (EBITA) rose 28 percent to € 2.17 billion, while net income increased 44 percent to € 870 million. At the end of the fiscal year, the Group employed 82,183 people, an increase of 8,905 from the previous fiscal year.

The first-time full-year consolidation of the RTL Group resulted in a revenue increase of € 3.4 billion, while acquisitions also contributed € 1.4 billion and currency exchange effects accounted for € 0.7 billion in revenue growth. Lower revenues at BMG offset organic growth at other divisions including the RTL Group, the Arvato Services Group and Random House.

Total assets increased to € 17.6 billion, a 20 percent increase over the previous year. At € 3.27 billion, investments reached an all-time high (previous year: € 2.05 billion).

Revenues by Division € in millions						
RTL Group	5,279	2,414	2,135	1,028	1,821	1,316
Random House	2,024	574	177	(1)	1,287	177
Gruner + Jahr	2,027	94	1,183	(46)	1,843	138
BMG	3,464	(422)	428	(14)	2,224	(149)
Bertelsmann Springer	149	61	346	6	364	57
Arvato	2,382	177	1,675	124	1,411	113
DirectGroup	2,343	191	484	116	2,281	178
Total revenues	20,352	3,113	6,198	1,728	11,931	2,210
Other	406	151	128	28	280	177
Intercompany sales	(712)	(9)	(334)	(59)	(318)	(47)
Consolidated revenues	20,036	3,312	6,139	1,697	12,893	2,425

Revenues by Region: Revenues generated by Bertelsmann companies outside Germany rose by 21 percent to € 13.8 billion. As in the previous year, they represented 63.4 percent of Bertelsmann's aggregate revenues, which also rose by 21 percent. There was particularly strong growth of 33 percent in the other European countries, which was primarily attributable to the merger with Pearson TV in Great Britain and the first-time full-year consolidation of the RTL Group.

Continued improvement in international sales

Profit: As a result of high capital gains, earnings before interest, taxes and amortization amounted to € 1.17 billion. This represented an increase of € 1.40 billion or 78 percent above the previous year's profit of € 1.77 billion. At € 1.21 billion, the divisional results (EBITA) – ongoing operating results before Internet businesses and positive/negative one-time items – nearly reached the previous year's level of € 1.25 billion. Net income improved by € 298 million or 41 percent to € 970 million (previous year: € 672 million). At € 1.32 billion (previous year: € 428 million), income tax increased, both in absolute terms and in terms of the tax rate. This rate increased to 57.7 percent (previous year: 34.9 percent). This is due to the fact that capital gains are fully taxable and that tax loss carry forwards, especially in the United States, were built up. Given the record level of investment, net interest surged to minus € 313 million (previous year: minus € 71 million), while amortization of goodwill and similar assets rose to € 562 million (previous year: € 139 million).

Bertelsmann with record profits

Results by Division: RTL Group achieved record divisional earnings of € 537 million (previous year: € 357 million; fully consolidated as of January 1, 2000). This was attributable chiefly to the economic success of RTL Television in Germany and France's M6 channel and to the increase in market share achieved by the division's core stations in Germany and France.

Results as profitability leader

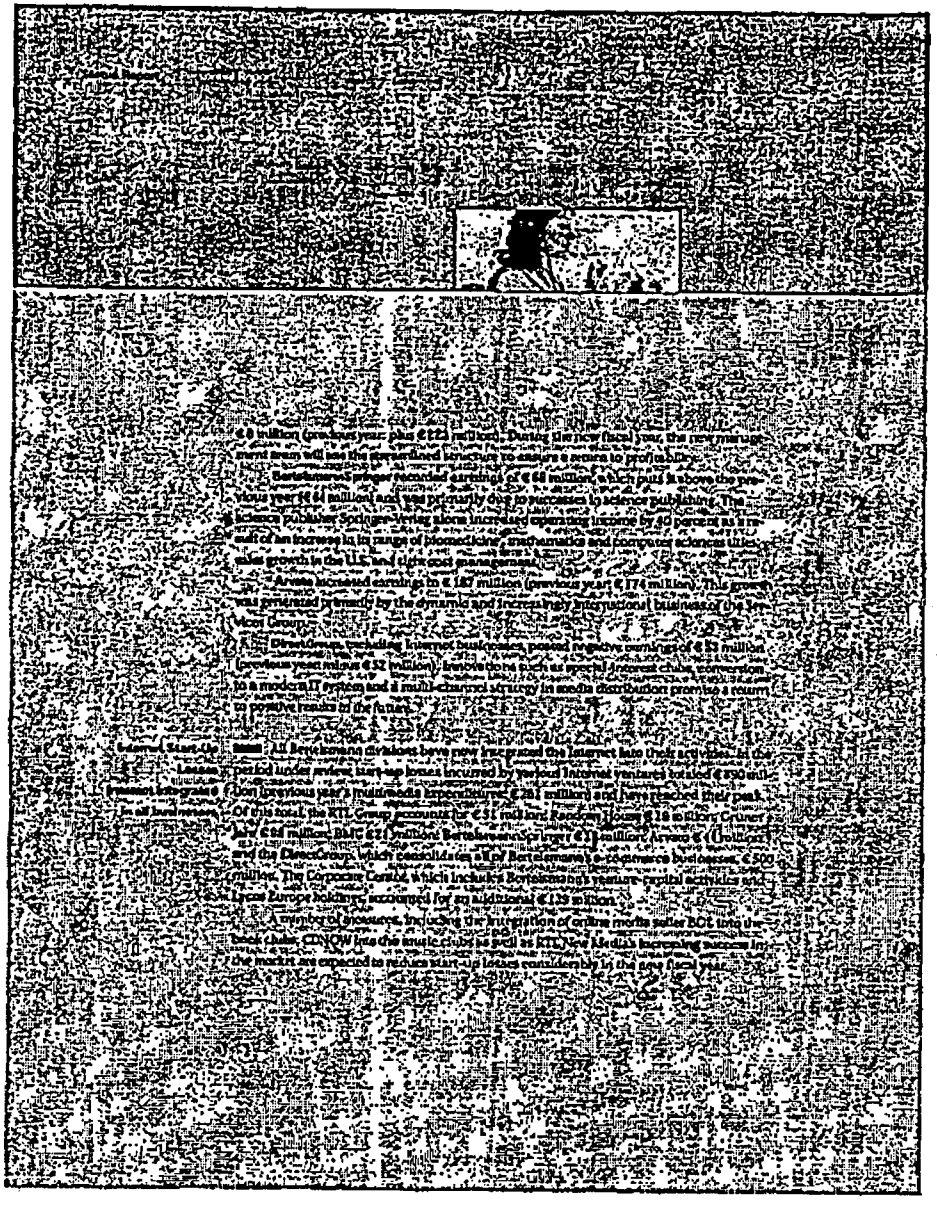
Random House book publishing division showed a disproportionate growth in earnings, to € 180 million (comparable previous year's figure: € 85 million). This was achieved primarily through operating improvements in English-language publishing and the successful integration of the book publishing businesses.

Gruner + Jahr registered economic and publishing successes that were offset by weak advertising markets, a steep increase in paper prices and publishing investments (primarily in the U.S.). These factors brought divisional earnings down to € 294 million (previous year: € 384 million). However, Gruner + Jahr contributed the second-largest share of profits to consolidated divisional results.

BMG earnings reflect not only the overall weakness in the music market, but also weaknesses in the company's development in recent years. Operating income was minus

Analysis of Net Income

€ in millions	2000/01	
RTL Group	537	[illegible]
Random House	180	85
Gruner + Jahr	294	384
BMG	(1)	[illegible]
BertelsmannSpringer	64	[illegible]
Arvato	107	114
Direct Group	(53)	(52)
Divisional earnings before interest, taxes and amortization (EBITA)	1,207	1,248
Corporate items	(119)	(60)
One-time charges	(530)	0
Internet start-up losses	(509)	(261)
Capital gains	1,003	[illegible]
Earnings before interest, taxes and amortization	2,167	1,770
Goodwill amortization	(562)	(139)
Net interest without yields of securities	(313)	(71)
Results from ordinary business activities	2,291	1,560
Income taxes	(1,322)	(428)
Consolidated net income	970	672



€0 million (previous year: plus €122 million). During the new fiscal year, the management team will use the streamlined structure to ensure a return to profitability.

Bertelsmann's proper recorded earnings of € 68 million, which puts it above the previous year's € 64 million and was primarily due to successes in science publishing. The science publisher Springer-Verlag alone increased operating income by 60 percent as a result of an increase in its range of pharmaceutical, mathematics and computer sciences titles, sales growth in the U.S. and tight cost management.

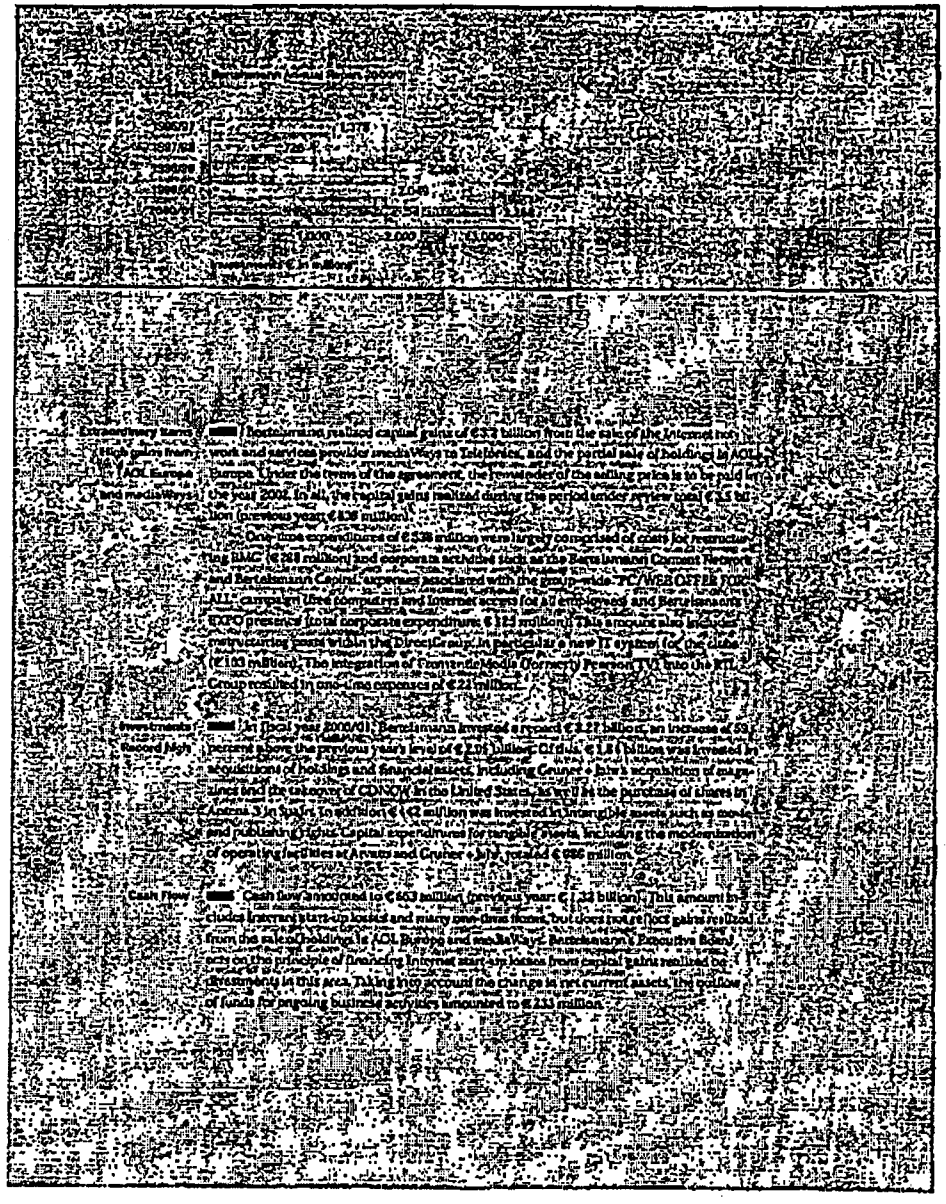
Arvato increased earnings to € 187 million (previous year: € 174 million). This growth was generated primarily by the dynamic and increasingly international business of the Arvato Group.

DirectGroup, including Internet businesses, posted negative earnings of € 53 million (previous year: minus € 32 million). Innovations such as special Internet clubs, conversion to a modern IT system and a multi-channel strategy in media distribution promise a return to positive results in the future.

Internet Start-Up Losses Present Integration in all Businesses

All Bertelsmann divisions have now integrated the Internet into their activities. In the period under review, start-up losses incurred by various Internet ventures totaled € 190 million (previous year's multimedia expenditures: € 281 million) and have reached their peak. Of this total, the RTL Group accounts for € 51 million; Random House € 18 million; Gruner + Jahr € 64 million; BMG € 21 million; Bertelsmann Springer € 31 million; Arvato € 11 million and the DirectGroup, which consolidates all of Bertelsmann's e-commerce businesses, € 500 million. The Corporate Center, which includes Bertelsmann's venture capital activities and Lycos Europe holdings, accounted for an additional € 129 million.

A number of measures, including the integration of online media sales BOL into the book clubs, CDNOW into the music clubs as well as RTL New Media's increasing success in the market are expected to reduce start-up losses considerably in the new fiscal year.



Extraordinary Earnings (High gains from AOL Europe and mediaWays)

Bertelsmann realized capital gains of € 3.3 billion from the sale of the Internet network and services provider mediaWays to Telefónica, and the partial sale of holdings in AOL Europe. Under the terms of the agreement, the remainder of the selling price is to be paid in the year 2002. In all, the capital gains realized during the period under review total € 3.5 billion (previous year: € 1.9 billion).

One-time expenditures of € 538 million were largely comprised of costs for restructuring BMG (€ 248 million) and corporate activities such as the Bertelsmann Cement Network and Bertelsmann Capital, expenses associated with the group-wide PC/WEB OFFER (€ 103 million), company-wide computers and Internet access for all employees and Bertelsmann's EXPO presence (total corporate expenditure: € 183 million). This amount also includes restructuring costs within the DirectGroup, in particular a new IT system for the clubs (€ 103 million). The integration of Frontline Media Germany Pearson TV into the RTL Group resulted in one-time expenses of € 22 million.

Investments: Record High

In fiscal year 2000/01, Bertelsmann invested a record € 3.21 billion, an increase of 59 percent above the previous year's level of € 2.01 billion. Of this, € 1.6 billion was invested in acquisitions of holdings and financial assets, including Gruner + Jahr's acquisition of magazines and the takeover of CDNOW in the United States. As well as the purchase of shares in Arvato, 3 in 3/Vivo, to a total of € 42 million was invested in intangible assets such as music and publishing rights. Capital expenditures for tangible assets, including the modernization of operating facilities at Arvato and Gruner + Jahr, totaled € 986 million.

Cash Flow

Cash flow amounted to € 863 million (previous year: € 1.22 billion). This amount includes Internet start-up losses and many one-time items, but does not reflect gains realized from the sale of holdings in AOL Europe and mediaWays. Bertelsmann's Executive Board acts on the principle of financing Internet start-up losses from capital gains realized by divestments in this area. Taking into account the change in net current assets, the outflow of funds for ongoing business activities amounted to € 233 million.

Expenditures for investments reached an all-time high of € 3.21 billion (previous year: € 2.05 billion). At € 4.42 billion, income from disposals of fixed assets increased significantly (previous year: € 684 million). This is due primarily to proceeds from the sale of mediaWays and the partial sale of holdings in AOL Europe. Including these divestments, investment activities yielded cash flow totaling € 1.15 billion (previous year: outflow of funds totaled € 1.60 billion).

Cash flow finances the outflow of funds from ongoing business activity and dividend payouts, which totaled € 375 million (previous year: € 288 million). Financial debt was reduced by € 238 million (previous year: increased by € 814 million). Profit distribution to minority shareholders during the fiscal year amounted to € 211 million (previous year: € 124 million), dividends on profit participation certificates amounted to € 76 million (previous year: € 76 million) and payouts to shareholders reached € 88 million (previous year: € 68 million). The Bertelsmann Foundation received approximately 70 percent of the latter sum, corresponding to its shareholding in Bertelsmann AG.

Consolidated Statement of Cash Flows
€ in millions

	2000/01	1999/00
Cash Flow	663	€ 1,317
Net cash used/provided by operations	(223)	1,291
Net cash provided/used by investing activities	1,166	(1,495)
Net cash used/provided by financing activities	(588)	500
Change in cash and marketable securities	325	298
Cash and marketable securities at end of year	826	494
Net financial debt at end of year	1,881	2,149

The full consolidated statement of cash flows is found on page 72.

Assets and Financial Structure in percent

Property, plant and equipment
Intangible assets and investments
Current assets
Cash and marketable securities
Equity capital
Provisions for pensions
Other provisions
Other liabilities
Financial debt

Total Assets / Stable asset structure despite strong growth

At the end of the fiscal year, assets totaled € 17.6 billion, which represented a 20 percent increase from the previous year (€ 14.7 billion). The principal factors behind this increase are acquisitions, the merger with FremantleMedia (formerly Pearson TV), currency exchange fluctuations and the increase in liquid assets. The assets structure, however, has changed only marginally. Stockholders' equity increased by € 803 million to € 6.50 billion; the equity ratio rose to 25.6 percent (previous year: 24.8 percent). Financial debt was down by 3 percentage points to 15 percent of assets.

Key Financial Indicators

The Group's financial objectives mainly relate to its capital structure and financial debt. At 25.6 percent, the equity ratio was above the target of 25 percent – despite the high growth in total assets.

Net of liquid funds, financial debt was reduced by 12 percent to € 1.88 billion (previous year: € 2.15 billion). In keeping with the Group's defined targets, financial debt should not amount to more than 2.5 times the annual cash flow. This year's cash flow is extraordinarily low since it includes Internet start-up losses and one-time expenditures while ignoring gains from divestments. Therefore, the financial debt payback factor, which is the ratio of net financial debt to cash flow, is for the moment above target at 2.8 years.

Bertelsmann Value Added Contribution doubled

During 2000/01 the key economic indicators to assess the return on investment were changed from the past key indicators (which were the "operating results" and "total return on assets") to EBITA (earnings before interest, taxes and amortization) and the Bertelsmann Value Added (BVA). The BVA is the difference between EBITA and the capital costs on invested capital, which is calculated at 15 percent. During the past fiscal year, Bertelsmann increased BVA to € 1.3 billion (previous year: € 520 million).

The Launch of the Bertelsmann Excellence Initiative (BEX)

Bertelsmann launched the Bertelsmann Excellence Initiative (BEX) as a long-term, group-wide program to improve all work processes. The benefits of increased cooperation, innovation, realization of synergies and process optimization are expected to be more attractive media products and services for customers. Bertelsmann will concentrate more than before on powerful brands and on meeting rapidly changing consumer interests. Excellence in corporate management and performance is the goal. The BEX initiative is intended to raise the Group's return on revenues to 10 percent within the next three years.

More appealing products and services

higher net yield

Employees

At the end of the fiscal year, the number of employees totaled 82,162, an increase of 5,905 or eight percent over the previous year's figure of 76,257. Acquisitions and newly consolidated companies (including Pearson/Arista, formerly Pearson TV) accounted for 3,861 new employees, while 2,044 new jobs were created by existing businesses. The media service provider Arvato (especially the Services Group) had the biggest increase, adding 1,781 new jobs during the period under review. At the end of the fiscal year, Bertelsmann had 784 trainees.

Continued growth in Germany and abroad/locally

The Status of Bertelsmann AG

Bertelsmann AG is a management holding company without any operating business of its own. It has changed its fiscal year to the calendar year end (therefore applied a stub period from July 1 to December 31, 2000). Certified financial statements were prepared as of December 31, 2000.

The AG's major income items are the dividend payouts and proceeds from services provided by the subsidiaries. Total stockholders' equity amounted to €2.41 billion and is equivalent to 35 percent of the fixed assets.

16.51 Percent Dividend on Profit Participation Certificates

of the first time since their stock market debut dividends exceeded 15 percent

In fiscal 1999/00, employees shared in the Group's success through profit participation certificates (SIN 522 994) with a nominal value of approximately €15 million. The nominal value of profit participation capital rose to €516 million, including the premium. Profit participation capital amounted to €706 million as of June 30, 2001.

The return on total assets for fiscal 2000/01 was 17.51 percent. This percentage is calculated as the ratio of the Group's income before income taxes, profit sharing disbursements in Germany and goodwill amortization to average total assets on the balance sheet. When the return on assets exceeds 16 percent, the payout, according to the conditions governing Profit Participation Certificates 1992, is one percentage point higher than the return on assets. This results in a dividend rate of 16.51 percent on the face value both for the new Profit Participation Certificates 2001 and for any Profit Participation Certificates 1992 that were not traded in. Profit Participation Certificates 2001 stipulate that the target dividend of 15 percent on the face value is paid out whenever the consolidated net income and liquidity

Calculation of Return on Assets

€ in Thousands

	2000/01*	
Net income	868,520	872,220
+ Goodwill amortization	102,562	401,987
+ Income taxes	1,322,059	428,387
+ Profit sharing in Germany	23,975	138,496
Profit	2,322,136	1,641,070
Total assets at the beginning of the fiscal year	14,591,582	10,000,277
Total assets at the end of the fiscal year	17,651,372	14,893,161
Average total assets	16,121,477	12,336,877
Profit / Average total assets	2,822,136 / 16,121,477	
Return on total assets	17.51 %	13.4 %
Dividend on profit participation certificates	16.51 %	15.0 %

mann AG's net income are available in a sufficient amount. For fiscal years up to December 2002, owners of Profit Participation Certificates 2001 also will receive a dividend payout exceeding 15 percent when the conditions governing the previous profit participation certificates result in an accordingly higher dividend. Pursuant to the Profit Participation Certificate Terms & Conditions, the calculation of the dividend and the payout were reviewed and certified by the independent auditor.

Thus, the target dividend of 15 percent was exceeded for the first time since the profit participation certificates were introduced to the stock exchange in 1986. On October 16, 2001, the dividend paid out for both kinds of profit participation certificates totaled €85 million.

Profit participation capital was converted from Deutschmark to the euro in the spring of 2001. Bertelsmann had offered owners the option of trading in their previous profit participation certificates for profit participation certificates with partially changed conditions. More than 90 percent of the owners took advantage of this offer. The reason for the change is that Bertelsmann AG introduced new key economic indicators on which profit participation certificate payouts are based.

Risk Management The year under review saw a continuation of the process of integrating the extensive risk determination, assessment, control and monitoring systems already in place in the various divisions into a single, all-inclusive corporate system. The idea is that the new corporate system should continue to give representation to reporting structures that have changed due to restructuring measures. This circumstance in particular made it clear that the risk management system implemented by Bertelsmann AG is highly adaptable.

For Bertelsmann AG, risk management is not an end in itself. While maintaining our philosophy of corporate responsibility, we have begun work on establishing a permanent risk monitoring system based on specific key business indicators. In so doing, we are also striving to safeguard our corporate success in an increasingly difficult competitive environment. This requires proactive entrepreneurial decisions based on reliable information.

No changes were made year on year regarding Bertelsmann AG's existing rotational risk reporting, which is based on the pyramid principle. Rather, during the year under review, the focus was on refining and perfecting existing structures.

During the fiscal year just ended, the existing risk management system was again reviewed extensively by the Bertelsmann AG Corporate Audit and Consulting Division and by the independent auditing company KPMG.

The following are risks identified as a result of the risk inventory: At BMG, the task ahead for the newly appointed executive team is to stabilize the business and solve structural problems. Management will also concentrate on measures to counteract increasing unauthorized digital distribution and piracy of its products.

The DirectGroup noted the continuing potential threat to the book club business of the negative trend in market developments (consumer behavior) and competition. The measures already taken are proving effective and management is giving top priority to the traditional line of business. DirectGroup management is also focused on the overall restructuring of online businesses and the integration of BOL into the book clubs, along with the introduction of a consistent member care system.

After Year's End After the close of the fiscal year, Bertelsmann AG strengthened its book business. Random House and the magazine and book publisher Arnoldo Mondadori SpA (Milan) jointly established the Grupo Editorial Random House Mondadori Holding SL (RMH). Based in Barcelona, it is now the second biggest publisher of Spanish-language literature. EU antitrust authorities have approved the project.

Random House succeeded in a bidding competition for Golden Books Family Entertainment. However, authorization for this acquisition from regulators is still pending. Golden Books Family Entertainment is one of the leading U.S. children's book publishers and has extensive rights to family entertainment properties (e.g. the rights to Lassie).

The Bertelsmann Direct e-Commerce unit acquired Napster, the digital music Locker offering customers a virtual, customized music archive on the Internet. Napster was integrated into the music downloads company BeMusic, which also includes the online music vendor CDNOW and the music club BMG Music Service.

On July 1, 2001 Bertelsmann AG became the sole shareholder of the French book club France Loisirs, which previously was operated as a 50-50 joint venture with Vivendi Universal. In return, Vivendi Universal included Bertelsmann AG's shares in the online music site Getmusic, formerly operated as a joint venture in the clubs, the development of a new IT network was accelerated. It will give the book clubs a unified database system for targeted marketing management, which will be able to address customers individually.

In August, Whitney Houston, one of the biggest stars in pop music, extended her long-standing contract with the BMG Arista label. Random House publisher Alfred A. Knopf obtained the rights to the memoirs of former U.S. President Bill Clinton, scheduled for publication in 2001.

Outlook — Bertelsmann AG plans to continue its growth as a major competitor in content business and to align its portfolio to changing conditions. The Group focus is on expanding the content business, expanding the services sector and developing a multi-channel strategy. Other strategic priorities include exploiting synergies and improving operational excellence.

Bertelsmann AG is conducting its business in a difficult market environment. The economic repercussions of the terrorist attacks of September 11, 2001 are worsening the Group's prospects, particularly on the Christmas season being the most important for Bertelsmann AG companies, as well as on attracting advertising. The development of the total results in the stub year also depends on the extent of extraordinary proceeds. During the stub year, the financial statements will be prepared, for the first time, in compliance with International Accounting Standards (IAS).

Employees and Society

Bertelsmann is a media enterprise that values leadership in partnership and puts a high premium on the interpersonal aspects of its corporate culture. During the year under review, the corporation introduced an initial new approach to cultivating its corporate culture. Along with financial reporting, company managers are now required to report on activities and systems which were introduced and introduced in the various companies in order to foster a corporate culture based on partnership. The new element will help highlight approaches developed in individual countries, allow for sharing experiences and provide individual companies with feedback on how they are performing compared with the rest of the Group.

Founding From 1835 to 1971, Bertelsmann became one of the first German companies to introduce regular surveys of its employees. With careful attention to privacy and anonymity, the results are broken down by departments and groups for each company, and used to help find ways to improve. During the first half of 2001 the questionnaire was adapted for international use. This pages involved 60 focus groups in ten countries and intensively expert consultation. During the second half of the year, 15 companies from all corporate divisions are implementing it in five countries. All of this is in preparation for Bertelsmann's first worldwide employee survey, scheduled for autumn 2002.

A part element of Bertelsmann's corporate culture is to permit all employees to share in the company's profit and capital. This has now been achieved for more than half of all employees. Complexity which has led other regulations in the various countries in which we operate has proved to be a major challenge for the program.

During the year under review, our American companies BOOKS-PAN and Random House Direct have introduced a profit-sharing plan or reduced the parameters for pay. In 2001, most of Bertelsmann's other American companies took the basic steps necessary to implement such programs beginning in fiscal 2002.

Personal Computers — Bertelsmann has offered all its employees a free PC with Internet access for their personal use. Computers were delivered during the year under review and in the second half of 2001. The campaign is intended to foster the use of PCs among employees and their families. It makes it easier for them to master Internet, E-Mail and promote the use of the numerous new options for information and communication. As we go to press, more than 50,000 Bertelsmann employees in over 400 companies from some 30 countries have already received Bertelsmann PCs.

The planet-wide portal was created specially as an entry point to the Internet for our employees as part of the TOWER OFFER FOR ALL program. It offers employees and their families information about Bertelsmann and our companies in five languages, along with free e-mail services, tutorials and links to other Bertelsmann websites. It also provides an easy way to submit suggestions for improvement. The portal passed its first critical test in the wake of the September 11 terrorist attacks in the U.S. when Bertelsmann employees all over the world sent e-mails through a special "planet B" forum expressing solidarity with their approx. 18,000 American colleagues, many of whom used the forum to write about their experiences.

Parallel to this, most employees in 40 different countries are now linked to "BeNet", Bertelsmann's International Intranet. "BeNet" has daily breaking news bulletins, access to facts about Bertelsmann, employee labor-management contracts, pension schedules and service offers. Other elements include news on personal

Bertelsmann's Major Countries by No. of Employees

	Employees June 30, 2001	% June 30, 2001	Employees June 30, 2000	% June 30, 2000
Germany	32,143	39.1	30,984	40.8
USA	17,980	21.9	16,823	22.1
France	8,071	9.8	7,580	9.9
Great Britain	4,980	6.1	3,351	4.3
Spain	3,527	4.3	2,852	2.1
Netherlands	1,742	2.1	1,488	2.0
Italy	1,502	1.8	1,521	2.0
Austria	1,236	1.6	1,067	1.4
Poland	815	1.1	865	1.1
Switzerland	800	1.0	677	0.9
Other countries	9,207	11.2	9,141	12.0
Total	82,162	100.0	76,257	100.0

changes and in-house job postings. During live Q&A sessions on "BeNet," members of the Executive Board field questions on important current events pertaining to the company.

We have extended the Town Hall Meetings, a long-standing corporate tradition in Germany, to other countries. At these meetings, which take place at the company's principal locations, the Chairman & CEO personally informs employees of the results of the business year just past and about current developments. Town Hall Meetings are currently held in Barcelona, Gütersloh, Hamburg, London, Munich, New York and Paris.

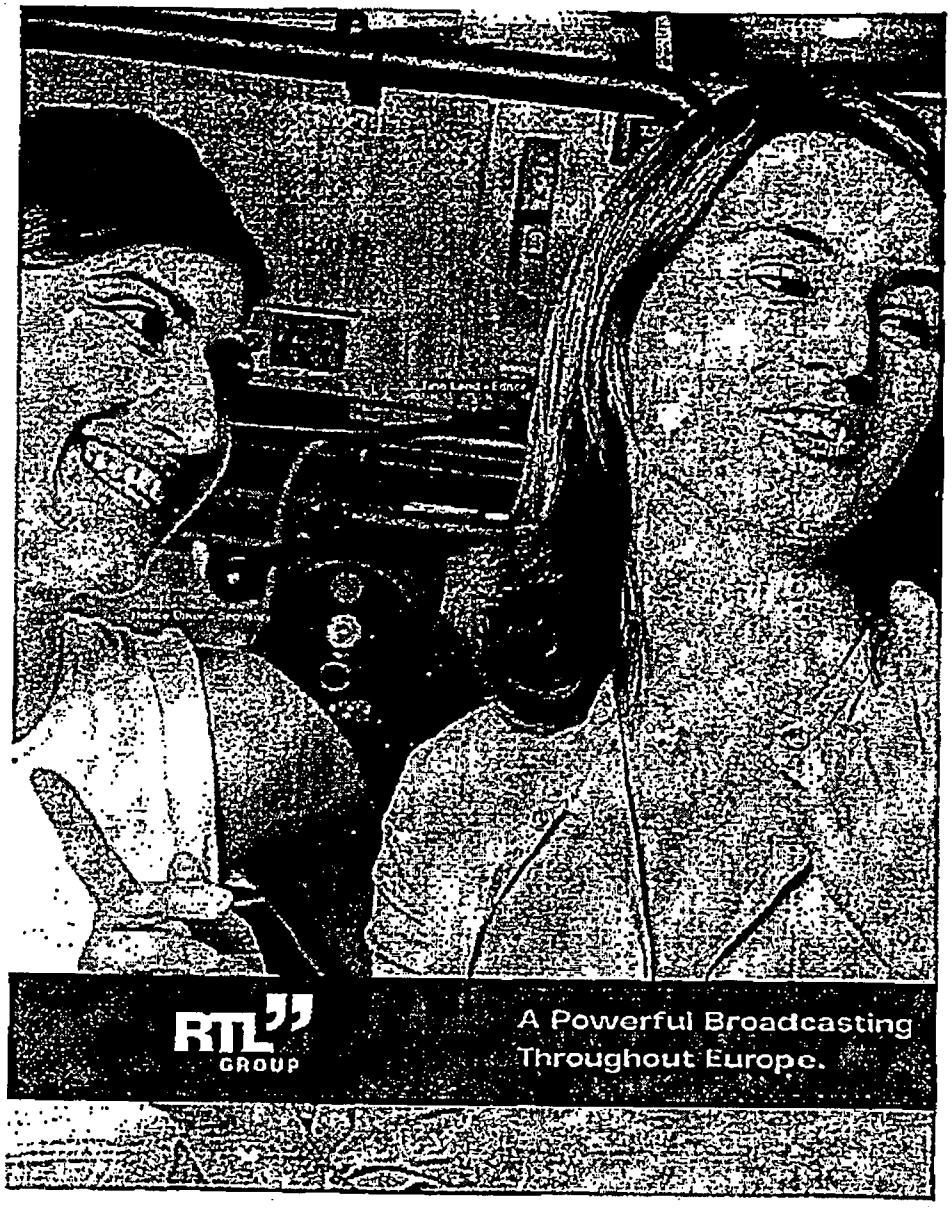
Finding and Nurturing Young Talent

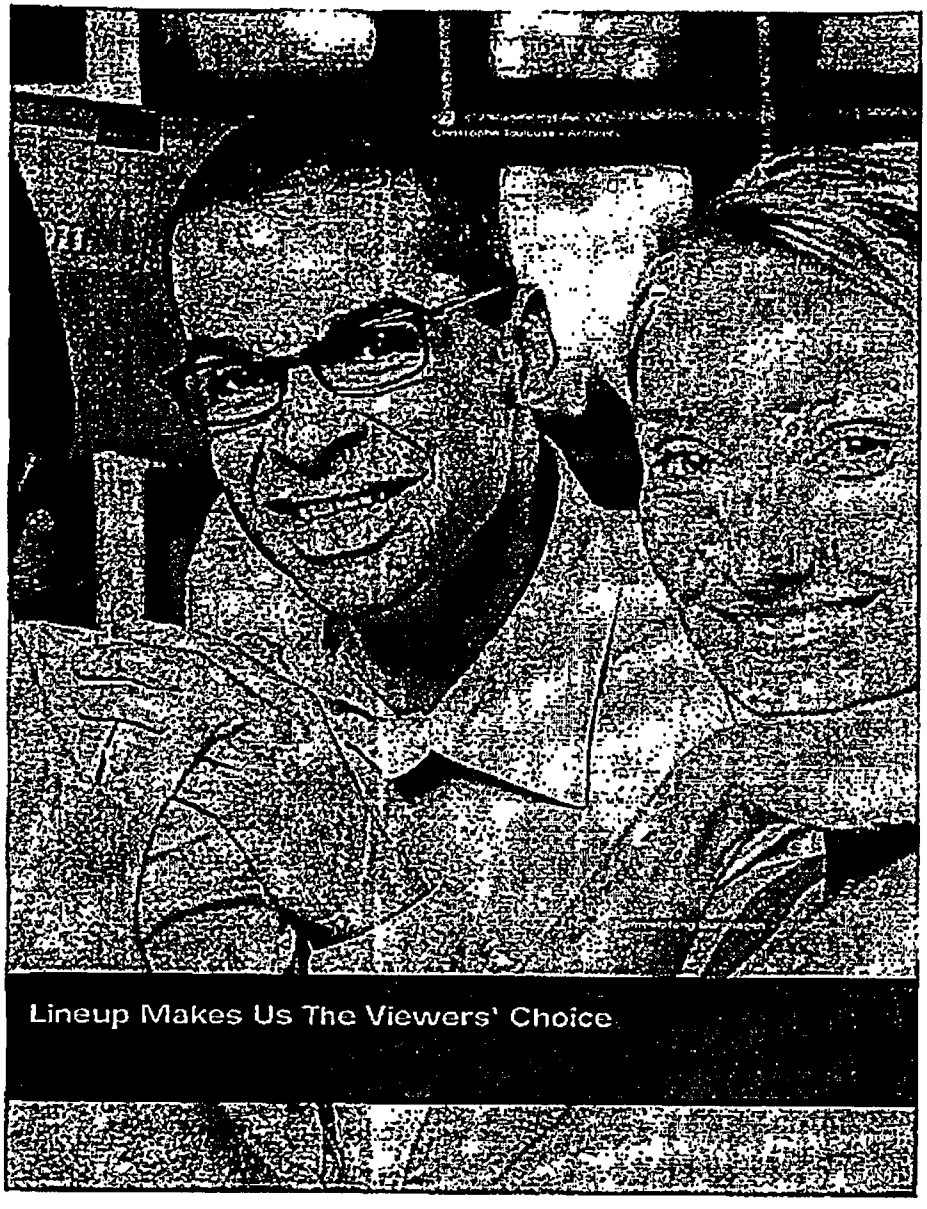
One of Bertelsmann's primary concerns is to recruit and nurture potential new talent. The Corporate Management Development offices in Gütersloh and New York support the recruiting process locally, especially through numerous events at colleges and universities. Bertelsmann is the first German company to offer the "Bachelor of International Management" program in cooperation with a German university. It incorporates professional training and an "Industrial Manager" degree. The company's newly designed job and career web site, myfuture.bertelsmann.de, and our innovative Internet job applicant management system "BeCruiter" are enjoying excellent response. The "Reinhard Mohn Fellowship," set up by Bertelsmann on the occasion of Reinhard Mohn's 80th birthday, provides talented, upcoming leaders from all sectors of society with new opportunities for learning by doing and gives them first-hand experiences in leadership, entrepreneurial action and social responsibility.

Number of Employees Rises to 82,162 More Than 7,000 New Jobs

On June 30, 2001, Bertelsmann had 82,162 employees (previous year: 76,257). Net of newly acquired companies, we created 2,044 new jobs, a quarter of them in Germany. Most new jobs were created in the expanding services sector, but also in the content businesses of Gruner + Jahr, Random House and Bertelsmann Springer.

This report includes only selected aspects of our personnel-related activities in keeping with the scope of the annual report. The information serves as an example and is not intended to present a fully representative picture of development unfolding in Bertelsmann companies.





Europe's Market Leader in Popular Entertainment and Premium Quality Information

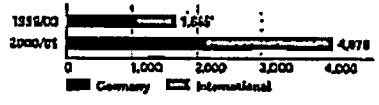
During fiscal 2000/01 Europe's largest broadcaster and TV producer generated € 4.1 billion in revenue (previous year: € 1.7 billion, consolidated over six months). Revenue posted by RTL Group in the Bertelsmann fiscal year 2000/01 rose 32.4 percent. These figures, calculated on a 12-month basis, include the acquisition of FremantleMedia, formerly known as Pearson TV. RTL Group, Bertelsmann's only publicly traded division, recorded an all-time high of € 527 million in EBITA (earnings before interest, taxes and amortization). The return on revenue was 12.8 percent. As of June 30, 2001, RTL Group employed 6,901 people.

Overview Established in 2000, RTL Group operates in 10 European countries, the United States, Australia and South Africa. On April 7, 2000, the company's shareholders announced the merger of CLT-UFA and Pearson TV and the formation of RTL Group. The EU Commission approved the merger on June 30, 2000. Since July 14, 2000 10.3 percent of the new company's share capital has been listed on the London Stock Exchange. RTL Group shares are also listed on the Brussels and Luxembourg stock exchanges. Television plays a pivotal role in the future strategy of Bertelsmann and consequently Bertelsmann raised its stake in RTL Group to 67 percent as of July 2, 2001. As a result of the transaction, which was accomplished through a stock swap, Bertelsmann now directly holds 30 percent of the share capital of RTL Group and another 37 percent indirectly through the intermediary holding company BW TV. The Belgian-Canadian investment group Groupe Bruxelles Lambert (GBL) transferred its 30 percent interest in RTL Group to Bertelsmann and received 25.1 percent equity in Bertelsmann AG in return, 0.1 percent of which was in the form of non-voting stock. The London-based Pearson Group has a 22 percent shareholding in RTL Group. Another 11 percent is widely held.

Our established TV broadcasters showed significant improvement in profitability in 2000 and newer broadcasters reached the break-even point. The advertising markets in which RTL Group operates posted only moderate growth in the first half of 2001, with some of them recording slight declines. Early in 2000, the radio business also benefited from growth in advertising sales. The RTL Group consolidated its market leadership in the production, film and sports syndication businesses. In the new media segment, the group advanced to become one of the premiere providers of online services in Europe.

Business Built on Four Pillars TV, radio, content and new media

Today, RTL Group is Europe's largest broadcasting enterprise, with stakes in 23 television and 17 radio properties. Ranked first in the European content industry in 2000, the company produced over 200 programs in 35 countries for a total of more than 10,000 hours of programming. Merging with FremantleMedia was a logical step toward hitting the company's



Total Revenues € in millions

*Pro-forma consolidation from fiscal year 1999/2000 for the period January 1, 2000 to June 30, 2000.

strategic targets, which include acquiring a majority stake in the U.K.-based television broadcaster Channel 5, expanding our content business through television production companies and their worldwide operations, and making an entrance into the southern European market by way of acquiring an interest in Spanish TV broadcaster Antena 3.

Television, radio, content and new media comprise the group's four pillars. Our objective of meeting European needs along with the leading positions our broadcasting companies enjoy on the European markets provides RTL Group with a solid economic foundation. We benefit from powerful brand names as we pursue a strategy of evolving continuously through organic growth, expanding new businesses and making attractive acquisitions.

Television
Horizontal synergies through families of TV stations and vertical integration

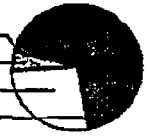
Fiscal 2000 was a period of outstanding achievement for the group. In the first half of 2001, however, overall advertising growth rates slowed in Europe, showing more moderate increases or declines. But on most markets – notably Germany and France, which are the largest – the group continues to outperform the competition in terms of viewer and advertising market shares. Our family strategy allows us to achieve horizontal synergy. Furthermore, vertical integration provides for cross-promotional opportunities between content producers, broadcasters and the Internet. This approach has yielded success in Germany, France, Belgium and the Netherlands.

Expansion of the group's family of broadcasters has helped to fuel growth in Germany's highly fragmented market. In 2000 RTL Group acquired the 49.9 and 24.9 percent stakes in VOX previously held by News Corp. and Canal+ respectively, raising the RTL Group's ownership to 99.7 percent. RTL Group subsidiary IP Deutschland now provides marketing services for four successful TV stations: RTL, RTL II, Super RTL and VOX.

RTL Group bolstered its position in France by increasing its ownership in the television station M6. Our equity in France's No. 2 player rose to 43.8 percent by the end of 2000. Net income of M6 was up 34 percent over the 1999 level, the result of a 23.6 percent increase in advertising volume and an 18 percent increase in revenue. Spring and summer ratings and advertising income both rose significantly, thanks to the outstanding success of the reality show Loft Story.

RTL Group increased its presence in the Dutch market as well, becoming the sole shareholder of HMC (Holland Media Groep), with the acquisition of the remaining 35 percent of shares not already owned. This enabled RTL Group to leverage effectively synergies produced by a family of broadcasters consisting of RTL 4, RTL 5 and Veronica (renamed Veria in April 2001). In early 2001 we began to see positive benefits from a joint venture between Pearson TV and HMC. Our goal is to establish Holland Media House, a joint TV production enterprise domiciled in the Netherlands.

New Media	1.5
Radio	5
Content	28.5
Television	67



Revenues by Category in percent

In the U.K., the group lifted its interest in Channel 5 to 65 percent as a result of the merger with FremantleMedia. Channel 5 improved both ratings and technical reach. RTL Group increased equity in Spain's successful TV broadcaster Antena 3 from 18.23 percent to 17 percent.

RTL Klub grew its share of viewers in Hungary and saw advertising revenues climb, resulting in an impressive 39.2 percent primetime audience share in the desirable 18 to 49 demographic target. Averaged over the year, RTL Klub was profitable for the first time in 2000. RTL 7 in Poland continues to face a difficult situation.

Radio
Appealing advertising packages

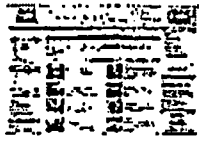
The RTL Group family strategy also fosters opportunities for growth in our radio business. This is particularly so in France, where our three stations offer complementary program styles that appeal to a full demographic target spectrum, and are thus well suited to attractive advertising package offerings. The downward trend at the flagship RTL at the end of 2000 was halted quickly. Formidable results were reported by the music station RTL 2 and, especially, by the youth-oriented Fun Radio.

In Germany, RTL Group defended its position as the country's radio-group revenue leader. Our two Berlin radio stations, 104.8 RTL and Berliner Rundfunk, remained the market leaders for their respective target groups. Radio NRW, which has been Germany's most successful private radio station for the last decade, underlined its impressive record in 2000 by capturing 10.2 percent of the audience. RTL Radio – Die Größten Oldies, the classic hits station transmitted from Luxembourg, nearly doubled its listening audience in 2000 and now reaches an average of 6.9 million people – the largest audience among all private German radio stations. RTL Radio Lützebuerg defended its No. 1 position in Luxembourg with a market share of 75 percent. In Belgium, Bel RTL and Radio Contact again posted extraordinarily positive results.

Content
Paving the way for tomorrow's ratings successes

RTL Group commands the No. 1 position in European content production. Series, shows and productions by FremantleMedia and UFA Film & TV Produktion are sold in over 100 countries and reach hundreds of millions of viewers. RTL Group is the largest independent TV marketer outside of the United States. In the light entertainment segment, the game show Greed was a major contributor to revenue growth and is now produced in 20 countries.

An important strategic move was the acquisition and marketing of valuable packages of film, television and sports rights that enable the RTL Group to achieve excellent results throughout Europe in 2000. In May 2001, management signed an agreement in principle for the merger of UFA SPORTS and Groupe Jean-Claude Darmon with Sports+, a subsidiary of the French-based Canal+ Group. The formation of one of the largest sports rights marketing enterprises in Europe is pending approval from the EU Commission.



New Media
A leading player in the European online market

An integrated strategy to market content over the Internet, television and radio in various markets is the basis for success of the New Media division, the fourth pillar of RTL Group. We have 85 websites across Europe generating about 400 million page impressions per month. As of July 2001 our sites were used by up to six million unique visitors on a regular basis. These successes make RTL Group one of the premiere players in the European online arena.

Management built several new businesses over the course of the year 2000, including RTL Newmedia in Germany, RTL Net in France and RTL iMedia in the Netherlands. With the emergence of the first pan-European Internet advertising marketing agency, IP Webnet, the group will optimize its position in the high-revenue fields of e-commerce and webvertising.

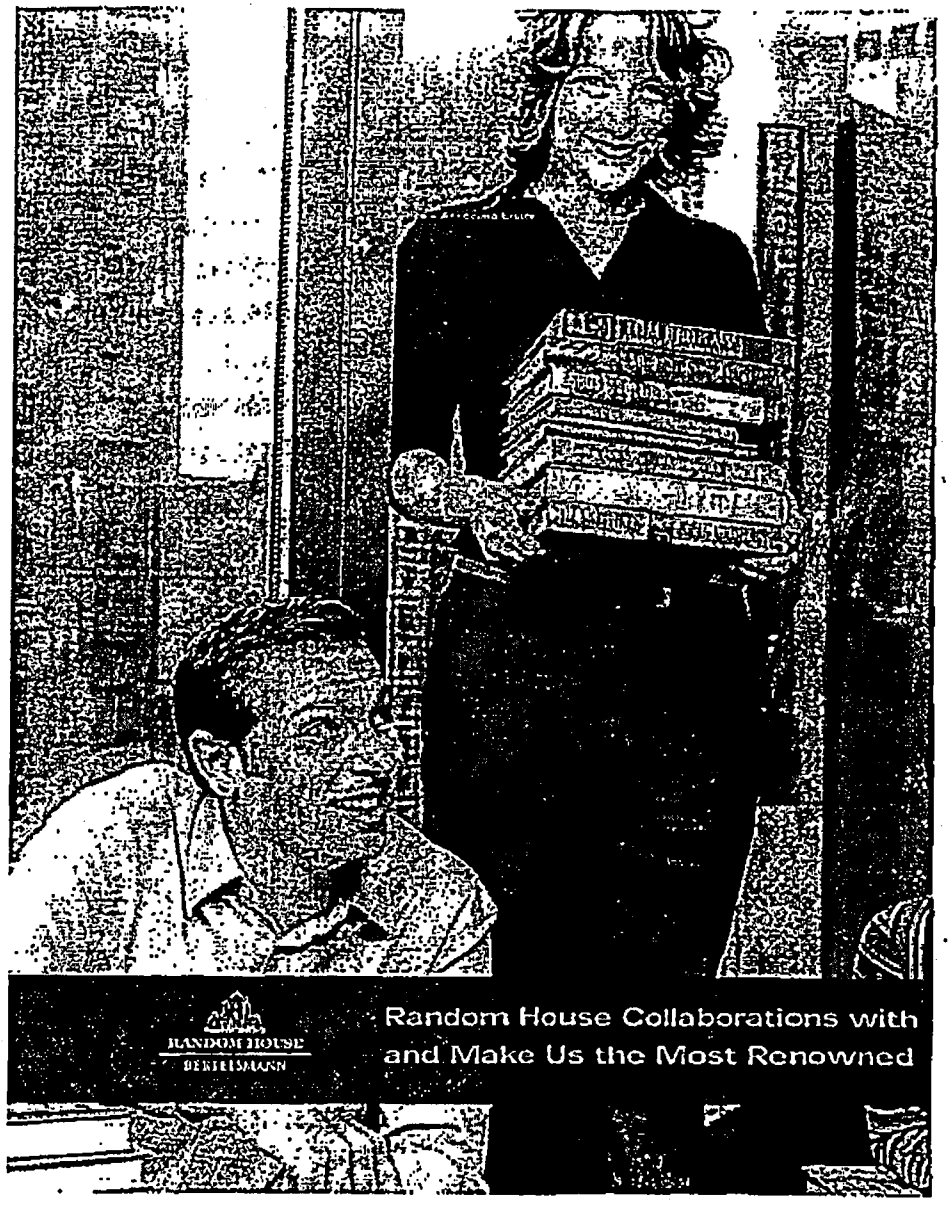
Outlook

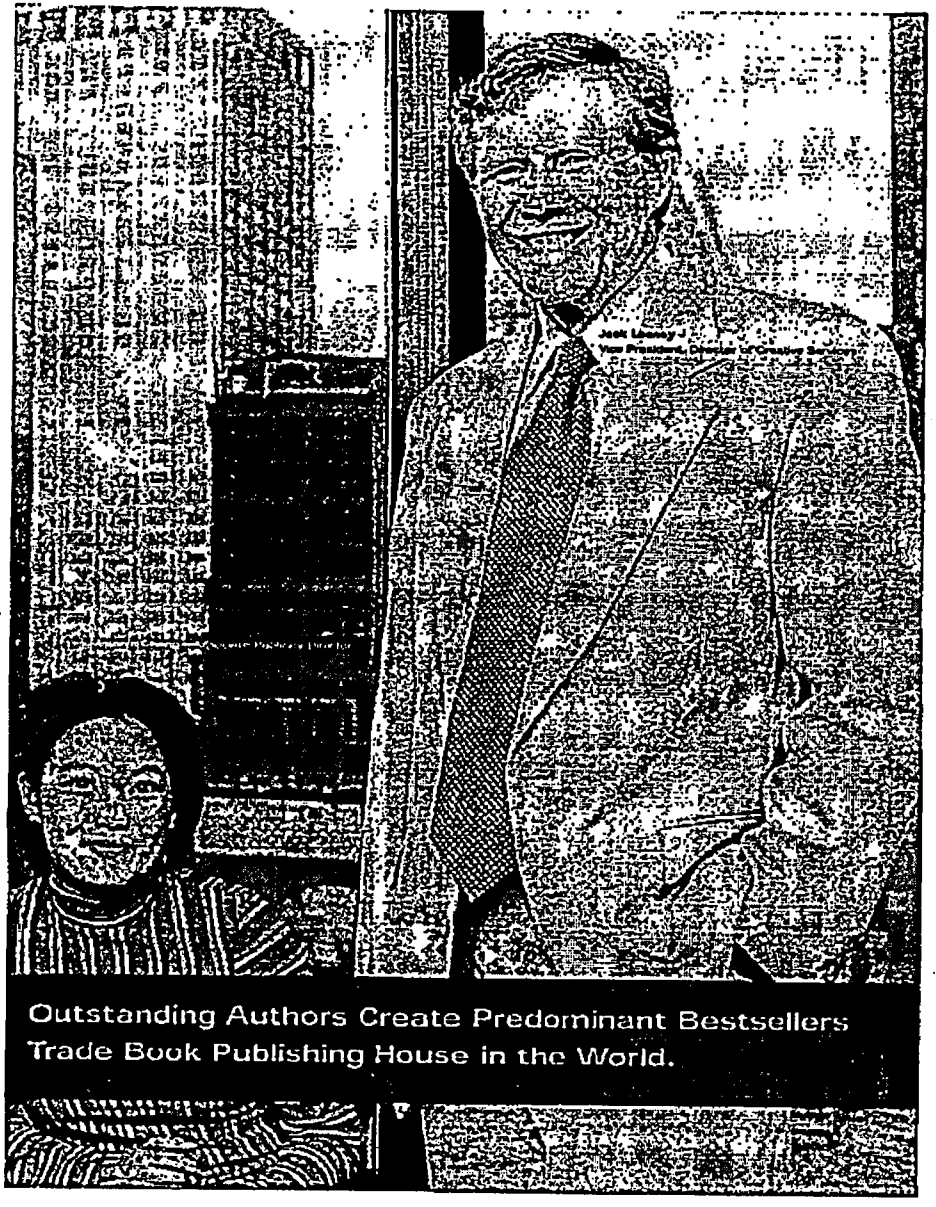
RTL Group derives its core strength from our pan-European structure, unrivaled positions in key markets, minimized risk through a widely diversified portfolio of business, the power of the individual companies' well-established brands, and opportunities for rapid growth in new markets and geographic regions.

Despite a slowdown in advertising growth rates in all European markets in 2001, RTL Group continued to outperform the competition in ratings and advertising revenues in most markets, thanks to our powerful brands and content. Our core business has again demonstrated its importance, particularly in the two major markets in Germany and France, where RTL Group generated nearly 70 percent of aggregate revenues in 2000/01. RTL Group is in a strong financial position and has a unique, integrated European portfolio at its disposal. Continued cost management and the creation of further synergies among business units will help the group hit its strategic targets. RTL Group is well positioned to benefit once advertising markets recover.

Highlights

■ RTL Group is Europe's largest broadcasting enterprise with stakes in 23 TV and 17 radio stations ■ No. 1 in the European ad business ■ In 2000, RTL Group produced more than 300 programs in 35 countries and more than 10,000 hours of programming ■ European market leader in sports rights trading ■ Our 85 websites generate about 400 million page impressions and attract up to six million unique visitors ■ RTL Television is Germany's ratings leader and the European advertising leader





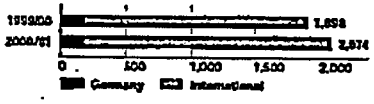
World Market Leader – Books With a Great Future

In FY 2000/01, Random House enhanced its status as the world's leading trade book publishing group despite a significant slowdown in the worldwide marketplace. The United States book market had a decline of 2.7 percent in 2000 and the German book market posted a mere 0.8 percent increase. Despite worsening conditions in important markets, the group increased revenues by 9.3 percent to € 2.1 billion, on the strength of a record number of bestsellers and a strong U.S. dollar and British pound. Earnings before interest, taxes and amortization (EBITA) grew significantly to € 180 million, representing a return on sales of 8.7 percent. Random House has 6,235 employees (June 30, 2001) in 13 countries.

Overview As of April 1, 2001, all Bertelsmann AG book-publishing activities were reorganized. The trade book publishing houses of Bertelsmann Buch AG were grouped within Random House with headquarters in Times Square in New York City. This alignment of the organization reflects the shifting magnitude of our businesses; the most important market, North America, contributed 70.8 percent of the total revenue while the German language regions contributed 8.9 percent of revenue. The overall philosophy of our publishing group has remained constant: independent, editorially diverse publishing houses, supported by aggressive corporate investment in emerging technology and state-of-the-art operational services, with the opportunity to expand each local publishing portfolio through the development of new authors, acquisitions, alliances and joint ventures.

English Language Our best bestseller year ever With its wide-ranging adult and children's publishing programs, Random House, Inc., Random House's U.S. division, produced outstanding fiscal year sales and revenue results. The company enhanced its domestic market supremacy by placing a record-setting 168 of its titles on the The New York Times bestseller lists from July 2, 2000 to June 24, 2001, the best bestseller performance ever recorded by a single publishing group.

Twenty-two of these titles were No. 1 bestsellers, including such novels as From the Corner of his Eye by Dean Koontz (Bantam); Breaking Ruth by Christina Schwartz (Doubleday); Seabiscuit, the biography of the legendary racehorse, by Laura Hillenbrand (Random House); and The O'Reilly Factor (Broadway), the provocative musings of television news personality Bill O'Reilly. Mr. O'Reilly's book was one of 28 Random House, Inc. titles that shipped at least one million copies during the fiscal year. The company's top-selling newly published hardcover was The Painted House by John Grisham (Doubleday), the best-reviewed novel of Mr. Grisham's decade-long career.



Total Revenues € in millions

The Bantam Dell division celebrated the publication of the fiftieth book by Danielle Steel, who once again achieved multi-million copy sales with several new hardcovers and paperbacks, with a nationwide book promotion that generated enormous coast-to-coast media attention. The Harry Potter audio editions are now among Random House, Inc.'s signature franchises. With 1.8 million copies of the four titles distributed, it is the biggest and fastest-selling children's audiobook series in history. Harry Potter and the Goblet of Fire, the latest volume published by Random House Audio's Listening Library imprint and read by Jim Dale, won the 2000 Grammy for "Best Children's Recording."

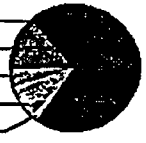
Random House, Inc.'s commercial preeminence was complemented by numerous major literary awards for its books. The company was privileged to publish books that won the Pulitzer Prize for Fiction, The Amazing Adventures of Kavalier and Clay by Michael Chabon (Random House), and for History, Founding Brothers by Joseph Ellis, (Knopf). Of the ten "Notable Books of 2000" selected by the editors of The New York Times Book Review, two were Random House, Inc. titles.

Random House, Inc. broadened its publishing opportunities with the April acquisition of Prima Communication Inc., a California-based publisher, and has integrated Prima's market-leading video game strategy guide series and lifestyle and health titles with its existing publishing divisions. Random House Ventures, LLC, the company's media/venture capital subsidiary, acquired an equity stake in eBrary, a unique online information research resource.

Substantial investment was also committed to the continuing buildup of the digital infrastructure of Random House, particularly a digital archive for newly published and backlist editorial content. This enables us to offer expediently next-generation e-books, print-on-demand and other developing editorial platforms to booksellers and readers worldwide. These new-technology applications also will be enabling forces for the Random House companies in other English-language markets.

Canada Random House of Canada was voted "Publisher of the Year" for an unprecedented second consecutive year by the Canadian Booksellers Association. Notwithstanding the upheaval in Canada's retail marketplace, the unit posted 195 national bestsellers, 27 of them No. 1 titles. Sixty-seven were by Canadian authors, including David Adams Richards, co-winner of the prestigious Giller Prize for Fiction for Mercy Among the Children (Doubleday Canada). The fiscal year also marked the successful beginning of the company's alliance with venerable literary publisher McClelland & Stewart through a 25 percent minority ownership stake and service alliance.

North America (USA/Canada)	70.8
Great Britain/Australia/New Zealand/South Africa	14
Spanish Language Region	4.8
Germany/Austria/Switzerland	8.9
Other Countries	1.5



Revenues by Region in percent.

United Kingdom The Random House Group elevated its position as the leading publisher in the United Kingdom with growth figures from the Random House UK and Transworld Publishers UK divisions outperforming a declining marketplace. Among our 13 No. 1 bestselling titles on The Sunday Times of London lists were The Painted House and The Rainmaker by John Grisham (Century, Arrow); Bush and Thief of Time by Terry Pratchett (Doubleday); and Down Under by Bill Bryson (Doubleday).

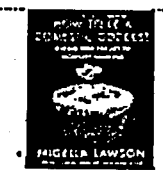
The Random House Group's titles won 37 literary prizes during the fiscal year. The company united all its books for young readers into the new Random House Children's Book division, which will publish an impressive array of internationally acclaimed, bestselling authors and artists, together with a strong backlist of classic titles.

Random House Australia was named "Publisher of the Year 2000" and Random House New Zealand was voted "Distributor of the Year". Random House South African author Antjie Krog won two of his country's leading literary prizes.

German Language
A new era for a great publishing tradition

Beset by a flat book marketplace, market leader Verlagsgruppe Random House concluded the first months of corporate repositioning with a broad range of bestsellers and a new strategic focus for several of its publishing programs. Among the major bestseller successes were Der Bärenschwindel by Günter Ogger, Hurokind by Christine Grün and Hitlers Frauen und Mätressen by Guido Knopp (C. Bertelsmann); Liebesleben and Mann und Frau by Zeruya Shalev (Berlin Verlag); Die Rosenschlucht by Charlotte Link and Die Söhne der Wüste by Tanja Kinkel (Blanvalet); Schlangenhaut by Minette Walters (Goldmann); Alter weiß ich später by Iris Berben (Droemer); Pfauenaugen Lulea by Günter de Bruyn (Siedler); and Russendisko by Wladimir Kaminer (Manhattan).

The German publishing group focused its efforts on repositioning and further developing its publishing programs. Verlagsgruppe Random House restructured its how-to book business after acquiring the outstanding 30 percent of Falken Verlag. The Mosaik, Falken, Orbis, and Bertelsmann imprints were brought together under unified publishing management in a single location, thereby strengthening the respective imprints' publishing activities. The company also began extensive preparation for several new publishing programs, including the debut of the Berliner Taschenbuchverlag BVT, a sophisticated literary and nonfiction imprint. Goldmann, Irb and Blanvalet strengthened their leading positions in the paperback market. The Verlagsgruppe began publishing Pep eBooks from Prima Electronic Publishing and offering print-on-demand titles from its Impressions imprint.



Spanish Language Joint venture with Mondadori

Grupo Editorial Random House, comprised of the publishing groups Plaza & Janés Editores and Sudamericana, continued to improve performance in Spain and Latin America and established the strategic foundation to increase its presence in its principal markets through two important initiatives. Random House purchased the remaining 40 percent equity in Latin America's revered Sudamericana publishing group that it did not already own. Random House and Mondadori signed an agreement in July 2001 to unite their respective worldwide Spanish-language book publishing operations in a newly created joint venture to be called Grupo Editorial Random House Mondadori. Upon signing the definitive agreement and EU approval, it will become the world's second-largest publisher of trade books in Spanish, with a publishing presence in Spain, Mexico, Argentina, Chile, Uruguay, Venezuela and Colombia.

In Spain, Grupo Editorial Plaza & Janés, placed 25 titles on the bestseller lists, accounting for nearly 20 percent of all hardcover and paperback titles. Among the authors contributing to the outstanding success of our publishers are Isabel Allende, John le Carré, Amy Tan, Helen Fielding, Pilar Urbano, Salvador Pániker, and Sylvia de Béjar. Among the many distinctions earned by Grupo Editorial Plaza & Janés authors over the year was the awarding of the two most important literary prizes in Spain: Premio Príncipe de Asturias awarded to Doris Lessing and the Premio de la Crítica to Juan Marsé.

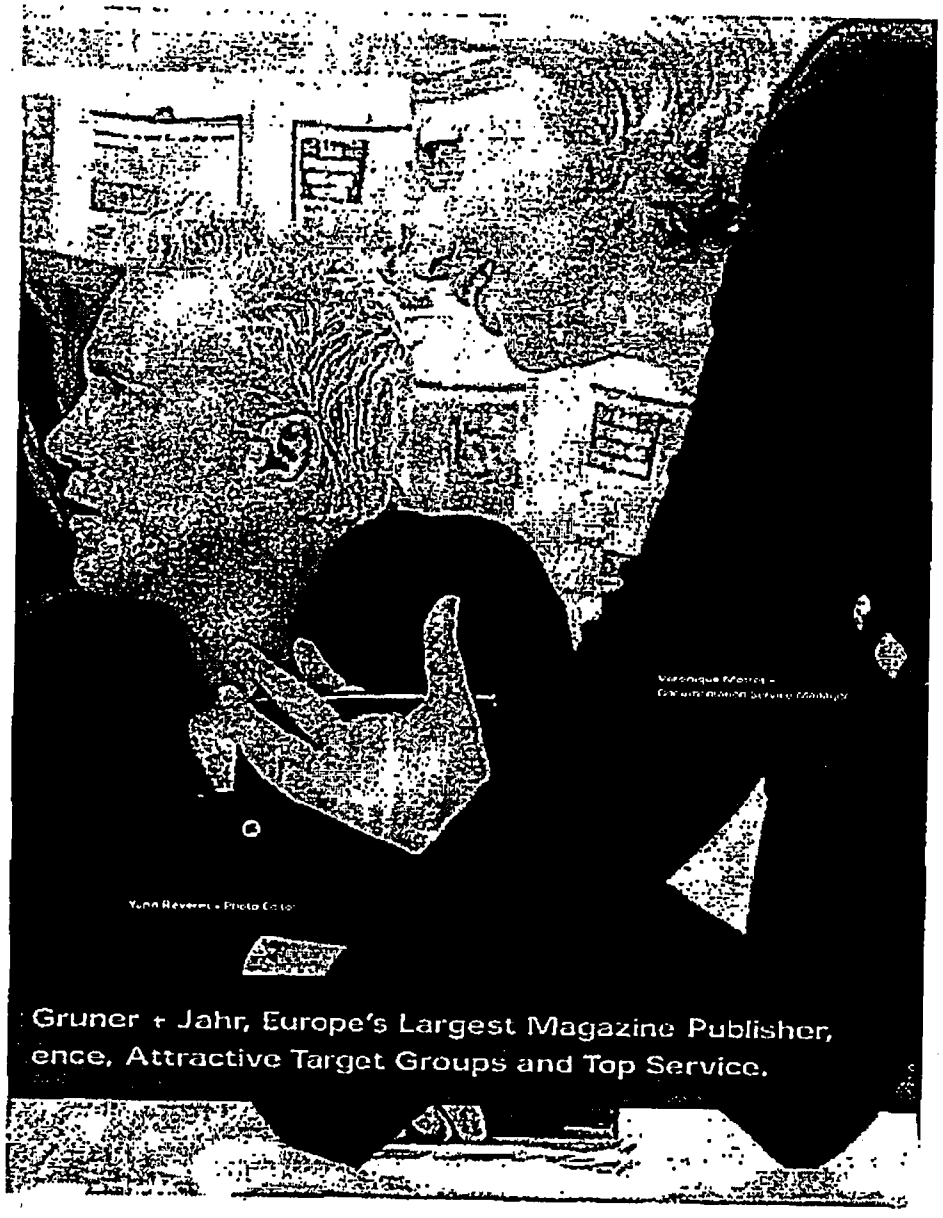
In its paperback operations, Grupo Editorial Plaza & Janés ended its joint-venture partnership with Planeta for publishing and distributing mass-market paperback books, and retained the imprint Debolsillo, which is the market leader and continued to improve its market share during the year. Editorial Sudamericana succeeded in placing between three to five titles on the bestseller lists in Latin America each week, which contributed to a solid financial performance despite increasingly adverse market conditions.

Outlook

In the coming fiscal year, Random House will meet the enormous challenges of economically weak marketplaces, heightened consumer selectivity, and increased costs for new title acquisitions with powerful lists of attractive new books, highly focused marketing of its deep backlists, and a disciplined approach to cost management. We remain enormously bullish on the future of print books and we are confident that, through new technology, we can reposition the physical book for the demands of an ever-changing society.

Highlights

■ 100 titles on The New York Times bestseller list: single-year record for any trade book publishing group ■ Over 30 titles worldwide – 25 in the U.S. – shipped more than one million copies ■ Two Pulitzer Prize winners: Founding Brothers by Joseph Ellis (history) and The Adventures of Kavalier and Clay by Michael Chabon (fiction) ■ Two million Harry Potter audio editions sold: most successful children's audio series in publishing history ■ Co-creation with Mondadori of second-largest publisher of Spanish-language trade books, Grupo Editorial Random House Mondadori



Investments in the Most Important Print Markets Worldwide Secure the Future of Gruner + Jahr

Europe's largest magazine publisher increased revenues for fiscal 2000/01 by € 94 million to € 3.02 billion, or 3.3 percent. Despite heavy investment expenses, a steep rise in paper costs and a marked downturn in advertising revenues in the first half of 2001, Gruner + Jahr had an EBITA (earnings before interest, taxes and amortization) of € 284 million. Gruner + Jahr employed a total of 12,958 people in 34 countries at the end of the fiscal year.

Overview

Developments in fiscal 2000/01 were affected by a cyclical downturn, especially in the core markets of Germany and the United States, as well as uncertainty over future economic trends.

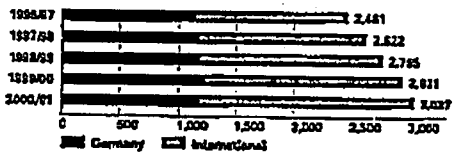
Gruner + Jahr reinforced its position as the world's most international periodical publishing enterprise with over 100 magazines and newspapers in 14 countries. International revenue accounted for 62 percent of the group's total, up from 58 percent in the previous financial year. The portion of revenue contributed by advertising is now 43 percent, up chiefly as a result of acquisitions made in the U.S. At 28 percent, the contribution from distribution operations declined, mostly because of the company's withdrawal from the U.K. magazine market. Printing now contributes 20 percent.

Magazines in Germany: Innovative concepts yield publishing success

Following a record 10 percent growth in the boom year of 1999/2000, revenues in the German Magazine division were stable at about € 840 million in fiscal 2000/01. G+J defended its position as the undisputed advertising leader. Moreover, G+J managed to grow market share in the face of persistently declining circulation trends. Operating income fell short of the prior year as a result of weakening advertising markets beginning in early 2001, along with the company's far-reaching investments, but matched levels of preceding years.

G+J's established magazine brands – the powerful Stern, Brigitte, Capital, Geo, Schöner Wohnen, RTL and Eltern – have been market leaders in their respective segments for many years and in some cases even decades. All of the titles developed continuously, defending and, in certain instances even improving their market positions. Stern further extended its lead as Germany's weekly news magazine circulation leader. With stable circulation, advertising revenues remained high at Brigitte, augmenting its share of a declining market for traditional women's magazines.

Capital suffered from the cyclical downturn and a stock market slump. Nevertheless, the title maintained revenue overall by switching to a 14-day publication schedule at the be-



Total Revenues € in millions

growing of 2000. Innovative magazine concepts at Capital, Geo Saison, Impulse and Brigitte are enabling G+J to grow large market shares among business periodicals.

The successful launch of National Geographic helped maintain the strength of the Geo family of titles, which includes Geo Saison, Geo Special, Geo Wissen, Geo Epoche and the children's title Geolino. Introduced in Germany in the fall of 1998, National Geographic strengthened its advertising position as circulation remained constant. With the Geo family, National Geographic, the RTL Group and Art, G+J dominates the knowledge magazine segment, which serves desirable high-income, highly educated audiences.

The risk and cost of introducing new magazines have become increasingly high in today's fiercely competitive environment. The main criterion for success is an innovative concept. In the fall of 2000, G+J successfully launched Living at Home. With sales of 221,000 copies and extremely positive reception by advertisers, the title has exceeded expectations. The Living at Home online platform integrates the Internet offerings of Schöner Wohnen, Essen & Trinken, Wissen und Flora.

G+J successfully established itself in the growing celebrity magazine market with Gala. The title countered the general market trend by continuing its upward circulation trend and posting over 20 percent growth in advertising revenues.

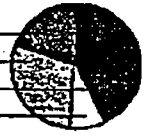
International Magazines USA: Nearing the top of our industry

The International Magazine division enthusiastically entered the new millennium with a series of far-reaching strategic moves. Management began an active investment program in the United States by acquiring Inc. Magazine and Fast Company and editorially revamping nearly all its periodicals. In the medium term, G+J is determined to enhance its position on the world's largest magazine market, where it now ranks fifth. Improving market positions of existing titles and entering the business press segment are the cornerstones for achieving this ambitious goal. Not surprisingly, the economic slowdown and high investment cost depressed results in the U.S. for the fiscal year.

The International Magazine division lifted revenues by about six percent to € 1.05 billion, despite our exit from the U.K. market. Earnings fell below the year-earlier level due to substantial investments in the U.S. and ongoing startup costs incurred in connection with the recent launches of European titles such as Jaca in Italy, Capital in Spain and National Geographic in the Netherlands.

Once again, our European core businesses reported excellent results and returns on revenue. In France, Prisma Presse defended its rank as the second largest magazine publisher with a consistently high profit margin. Revenue produced by circulation activities remained stable against the backdrop of another market decline, while advertising revenues advanced

Printing	20
Distribution	29
Advertising	43
Other	8



Revenues by Category in percent

five percent. At the beginning of the new fiscal year, G+J expanded its roster of titles in Russia and Poland with the introduction of editions of Gala. Geo Russia increased its performance by about 50 percent.

Newspapers
FTD: "One Brand – All Media"

The Newspaper division recorded further growth in Eastern Europe during 2000/01 and additional investment in the development of Financial Times Deutschland, which was launched in February 2000. Weak advertising markets as well as the considerable increase in paper costs depressed earnings. The division responded by making significant cost reductions without impacting editorial quality.

The market introduction of FTD has now been successfully concluded. By increasing circulation more than 40 percent to over 72,000 copies, and by attracting a desirable readership demographic, FTD has built a firm foundation as a premiere nationwide daily newspaper. Dubbed "One Brand – All Media," this innovative concept is setting the standard for its segment. The online issue, which was introduced simultaneously with the print daily, has become one of Germany's most successful financial websites. FTD.de provides information that can be viewed on all mobile devices, running the gamut from Palm and WAP-enabled devices to PDA and the Rocket eBook. The FTD is also available through additional marketing channels including print-on-demand, SMS, radio and books.

As it extended its readership, Berliner Zeitung also substantially strengthened its leadership position as the capital city's largest subscription newspaper. In spite of relentlessly unfavorable economic conditions in Eastern Germany, Leipziger Zeitung and Morgenpost Sachsen registered additional editorial accomplishments and posted very gratifying positive operating results.

Eastern European operations were augmented with the acquisition of a 49 percent stake in BLIC, publisher of the largest tabloid paper in Yugoslavia. Working with several partners, Gruner + Jahr publishes Evenimentul Zilei, a Romanian tabloid with the country's highest newspaper circulation, Nepszabadsag, Hungary's largest subscription newspaper; and Novy CAS, the leading newspaper in the Slovak Republic. All of our Eastern European titles generated positive, and in some cases outstanding, results under difficult underlying conditions.

Printing
Cost management offsets decline in earnings

The Printing division exceeded profit target despite substantial price reductions, but did not reach the level of the preceding year. Earnings fell as a result of the unexpectedly severe economic downturn, which was most pronounced in the U.S. The declines were largely offset by strict cost management and a further increase in print volume. The Itzehoe print shop in

the greater Hamburg area increased overall print volumes from the previous year despite the declining magazine volumes and print runs. Revenues at the Dresden printing center increased 11 percent and operating results improved by 43 percent, following the 32 percent rise of the previous year.

Multimedia
Strong G+J brands leverage online offerings

The Multimedia division's fiscal year was characterized by high investment spending, but also by unavoidable corrections. Strategic planning is focused on integrated online offerings that benefit from Gruner + Jahr's strong brands and can leverage cross-media strengths. The G+J Multimedia division was established on November 1, 2000 to help us capitalize on internal and external synergies. Effective May 2001, the division also assumed technical and commercial responsibility for the online operations of G+J magazines. Handyde the class leader among German mobile communications portals, has been part of the Gruner + Jahr family since February of 2001 (51 percent). Handyde reaches customers with high-quality content, powerful online brands and pay-for-use value-added services anytime and anywhere.

Handyde

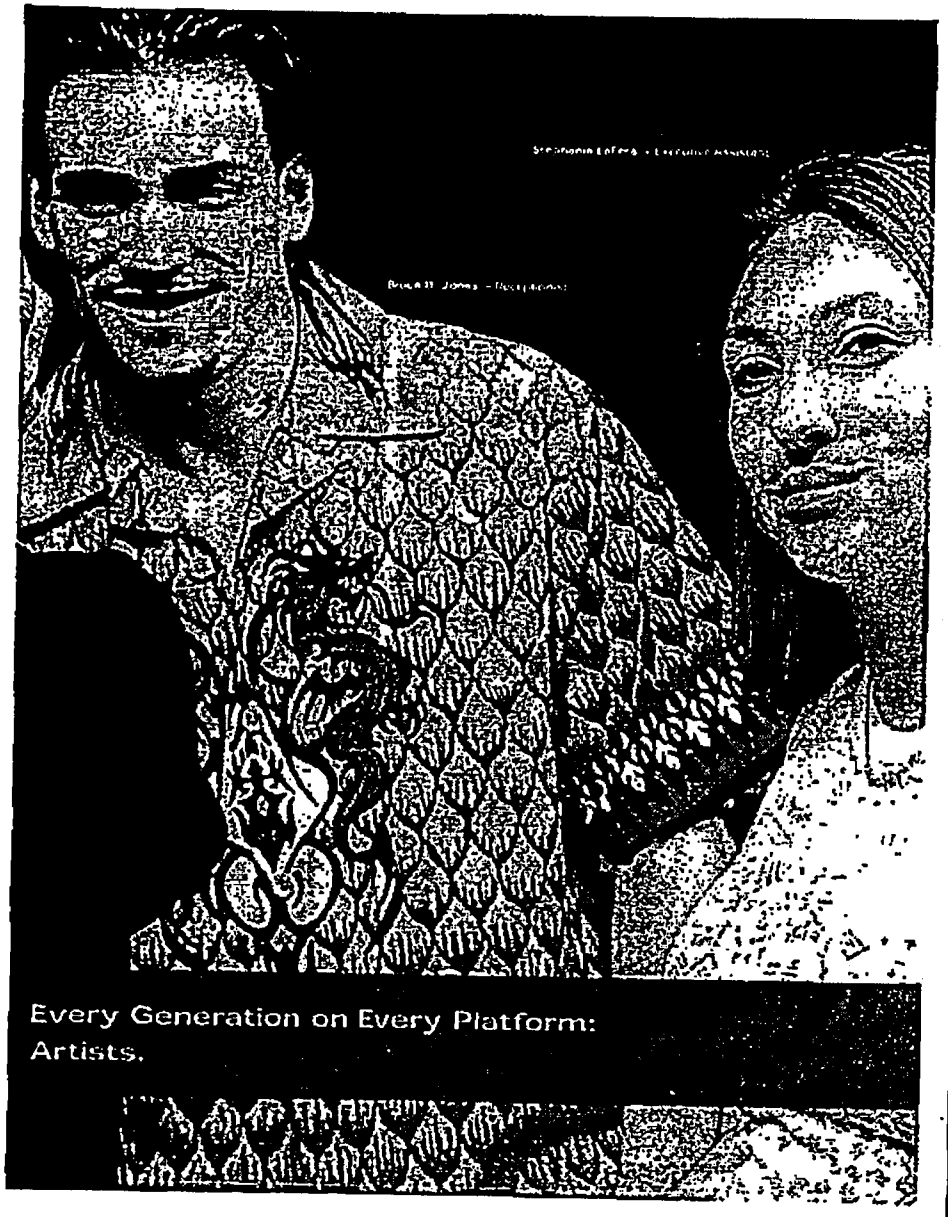
Outlook

The goal of Gruner + Jahr's German Magazine division is to extend leadership in existing market segments. At the same time, we intend to tap new, attractive areas in which G+J can use its competitive advantages to create high quality journalism and marketing programs. Following the significant investments to improve our position in the U.S. and the launch of several titles in Europe, our international efforts are now focused on optimizing existing businesses. Gruner + Jahr will continue an intensive development program for its established brands in the newspaper sector as well. The investment program for the Printing division, initiated in 1999/2000, has a budget of almost € 500 million and will be continued through the end of fiscal 2001. The Multimedia division is resolutely pressing ahead with the integration of print and online services under the motto "One Brand – All Media."

Highlights

■ With over 100 magazines and newspapers in 14 countries, Gruner + Jahr is Europe's largest and the world's second largest periodicals enterprise ■ Germany: G+J regains magazine advertising market leadership ■ USA: Nearing the top of the magazine industry ■ Successful magazine licenses with Gala in Poland and Russia, Capital in Spain and National Geographic in the Netherlands ■ Stern bolsters its news weekly leadership position ■ Financial Times Deutschland achieves firm footing among premium national dailies ■ Living at Home launched simultaneously in print and on the Web

BMG
BERTELSMANN
Music for Every Taste and
BMG is the Home of the


Every Generation on Every Platform:
Artists.

Focusing on Our Core Competencies

BMG occupied the No. 1 or No. 2 market share positions in five countries during fiscal 2000/01. BMG artists were on charts throughout the world and took home more than 100 awards, with sixteen artists each selling over one million albums. Despite these successes, sales and earnings reflected both adverse market conditions and structural weaknesses. Revenues were down 7.6 percent to € 3.7 billion, while EBITA (earnings before interest taxes and amortization) amounted to a negative € 6 million. BMG employed 8,507 people at the end of the fiscal year.

Overview

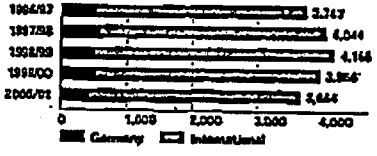
Fiscal 2000/01 was a year of challenges and new beginnings for Bertelsmann Music Group. A planned merger with the British music company EMI was not realized for regulatory reasons. Among the major challenges were weak market conditions in most territories around the world and the impact of various forms of piracy. BMG's new executive team reorganized the group's structure and business units to focus the company on our core competencies – fostering artistic talent and marketing music. BMG's music clubs were transferred to Direct-Group Bertelsmann as of July 1, 2000, with the Storage Media division shifting to service provider Arvato at year-end. The goal of the new leadership and our streamlined structure is to achieve a turnaround in earnings in the new fiscal year.

Recorded Music BMG North America

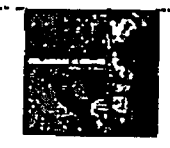
Artists Recorded' new President and CEO Antonio "LA" Reid was successful in resigning famous artists including Whitney Houston, Kenny G and Santana, and also reinvigorating the label with new talent including Boyz II Man, Blu Cantrell, Pink, Babyface and Adama. More than 10 artists achieved platinum or multi-platinum status, most notably the debut album Ilo Angel from Dido, which sold more than nine million units worldwide. In addition, OutKast's eagerly awaited fourth album, Stankonia, went triple-platinum in the U.S.

BMG Music Canada responded to challenging market conditions through targeted promotional spending and strategic alliances with partners like Bell Telecommunications, New Line Films, General Mills, Kellogg's and Post. The result was another profitable year with platinum releases from local label VIK artists Love Inc., The Guess Who and Treble Charger.

BMG Distribution finished calendar year 2000 as the No. 2 distributor of Overall Albums for the first time. The company was also the No. 1 distributor of Singles for the first six months of 2001. In the United States a total of 54 BMG distributed albums achieved



Total Revenues € in millions



*Adjusted for group-internal reorganizations

platinum or multi-platinum status in 2000/01. In addition, six albums distributed by BMG achieved No. 1 on the Billboard 200 Chart during 2000/01.

The creation of J Records, the joint venture between legendary music executive Clive Davis and BMG Entertainment, founded in August 2000, made history as the largest new label ever launched. Platinum selling albums included releases from O-Town and Luther Vandross. In addition, Alicia Keys debuted at No. 1 on the Billboard Album Chart with Songs in A Minor. #yourdo.com

RCA Records marked its 100th anniversary with a string of artistic and marketing successes. The fourth studio album of Dave Matthews Band sold 800,000 copies in its first week, making it the top-selling debut during the first half of 2001. RCA's relationship with Matthews's ATO label led to another triumph, as David Grey's White Ladder sold 1.5 million units in the U.S. The label also continued the multi-layered worldwide marketing of Christina Aguilera with her first album in Spanish, Mi Reflejo.

In an overall flat market for country music sales, RLG/Nashville enjoyed its best year ever, with platinum releases from Alan Jackson, Kenny Chesney, Brooks & Dunn, Sara Evans, Lonestar, Brad Paisley and Martina McBride. RLG/Nashville topped the Billboard Country Chart for 11 weeks with Ain't Nothing 'Bout You by Brooks & Dunn and I'm Already There by Lonestar. #rcaviclasgroup.com

During Fiscal Year 2000/01 BMG North America formed the RCA Victor Group, specializing in the adult music market and comprising RCA Red Seal, RCA Victor, Windham Hill, Private Music and Bluebird. Highlights from the group's first year include the release of the Broadway soundtrack of SLAST, Etta James' Matriarch of the Blues, Jim Brickman's My Romance, Cesaria Evora's São Vincente, and the celebration of Windham Hill's 25th anniversary. #rcavicgroup.com

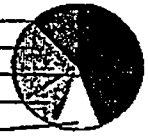
BMG Special Products' Premiums & Incentives unit built national programs for such clients as General Mills, M&M/Mars, McDonald's, Visa, and Aiwa. Buddha Records, a new BMG Special Products label, introduced its first active artist title, Prisoner of Love, by country legend Ray Price. #bmgsp.com

BMG Europe

Beginning in January 2001, the regional organization BMG CSA/EE (Germany/Switzerland/Austria/Eastern Europe) as well as BMG U.K./Central Europe were consolidated into a single European unit. Despite an industry-wide decline in the second half, due in part to mass CD-R copying, the year was still a profitable one for BMG.

The success story in the U.K. centered on two international top-sellers: Dido was brought into the BMG fold with the purchase of Cheeky Records in September 2000, and the second album from Westlife, Coast to Coast, sold more than two million in the U.K. and five million worldwide.

Germany/Austria/Switzerland	12.3
Other European Countries	22.3
North America	44.6
Latin America	9.8
Asia/Pacific	10.9



Revenues by Region in percent

BMG's German unit maintained its leadership in local repertoire. Contributing to this success were ATC, Modern Talking and Die Flippers, as well as comedian Michael Mittermeier. With a production celebrating his 30th year in the music business rock legend Peter Maffay extended his unbroken series of Platinum successes with studio albums into the 21st century. BMG Germany was also the most successful European major with eight artists receiving the prestigious ECHO awards.

In Italy, Eros Ramazzotti's album Stilolibero sold more than three million copies. Spanish group Estopa topped sales of one million units.

BMG Asia/Pacific

In a year that saw many of the region's economies in sharp decline, BMG Asia Pacific remained profitable in markets where competitors did not. Westlife and Misia were strong sellers once again, with both artists selling more than two million units in the region and Westlife selling more than one million in Indonesia alone. In Australia, John Farnham enjoyed triple-platinum sales and a sold out national tour.

BMG Latin America

BMG's restructuring effort in Latin America helped to produce both critical and sales successes despite unstable economic conditions and increasing piracy. Among the top sellers were releases from Jerry Rivera, Rocio Durcal, Leonardo, Cristian, Ana Carolina and Juan Gabriel, and international stars Estopa, Dido and Westlife. Mi Reflejo, the debut album in Spanish by superstar Christina Aguilera, won critical acclaim and enjoyed strong sales throughout the region.

Music Publishing Record sales with "Platinum" artists

BMG Music Publishing broke new ground, reporting record revenues, achieving a major presence on the worldwide charts, and raising the company's online profile. Key signings in 2000/01 were Nelly, whose debut album sold more than seven million copies, and U.K. pop star Robbie Williams. Additional signings included a North American catalogue administration deal with Kenny G and a contract extension with Italy's Gigi D'Alessio.

Among the highlights for 2000/01 were the debut album of Coldplay and Dido's multi-platinum No Angel, for which BMG songwriter Rollo composed and produced five songs. Important acquisitions for the company during the year included Fiction Songs, the Elvis Costello's catalogue, and a major key interest in Editions Salabert.

Storage Media The BMG Storage Media business year was marked by a consistent expansion policy and strong investments in IT, logistics and global key account management. Despite weak music and IT markets worldwide, each of the group's companies – Sonopress, topec and Digital World Services – increased market share. As a highlight of the year in the United States and Europe, sonopress signed a major contract with Microsoft for the replication, packaging and distribution of DVD software for the company's new Xbox™ game console.

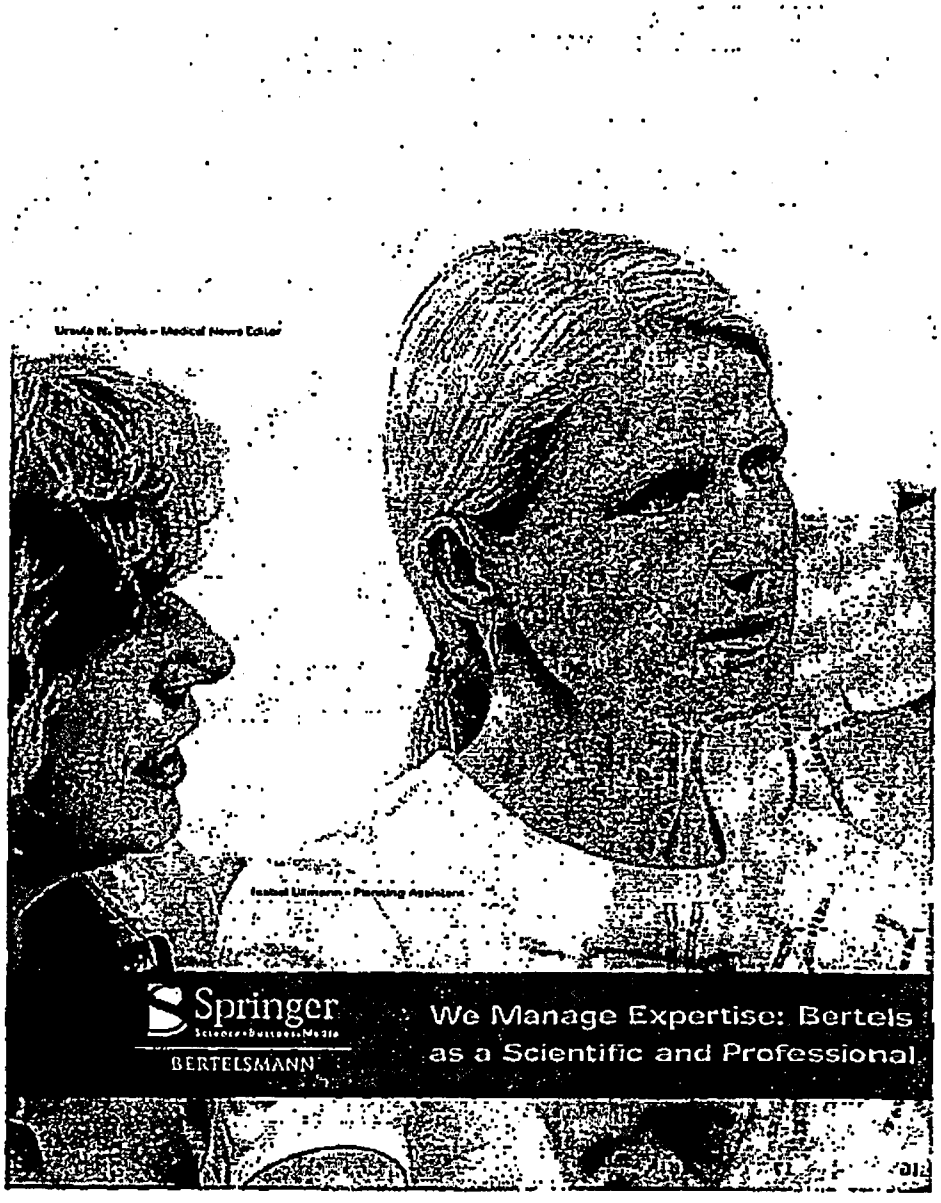
Slow CD demand led to a substantial fall off in sales for the entire CD replication industry. The Sonopress Group countered the trend and added new production sites in France and Singapore. To meet strong DVD demand, the Group increased its DVD production considerably to 400,000 units daily.

In October 2000, the specialty printer topec MultimediaPrint acquired all shares of German printing company Manck GmbH in Lüdenscheid and integrated the company successfully. Digital World Services expanded rapidly to become the leading company for tailored Digital Rights Management Solutions and the secure distribution of digitized content over the Internet. Among other projects, the company is developing key components for the launch of Napster's new legal music subscription service.

Outlook Following a number of personnel and structural changes, BMG's music business faces the future with new confidence and a focus on its mission to find and market the world's best music. Several of BMG's most successful international artists will release new albums in coming months. BMG is also developing several new, young and promising artists. BMG is investing in a broad spectrum of repertoire. We are bundling our creativity to maximize the marketing of artists throughout the world. In addition to organic growth, the management also sees opportunities for expansion through acquisitions and partnerships.

Highlights

■ Over 200 labels in 44 countries ■ BMG artists win more than 100 music awards worldwide ■ No. 1 or No. 2 in five countries ■ 16 BMG artists sell over one million albums each ■ BMG Music Publishing posts record revenues ■ BMG licenses its catalogue to MusicNet, the world's first legal digital music distribution platform ■ Sonopress USA and Europe signed a major contract with Microsoft for the replication, packaging and distribution of DVD software for the new Xbox™ game console


Ursula N. Davis – Medical News Editor
Isabel Ullmann – Planning Assistant
Springer
Science+Business Media
BERTELSMANN
We Manage Expertise: Bertels
as a Scientific and Professional

mannSpringer is World-Renowned Publisher.

Strong and Profitable: The Condition of Our Professional Publishing Group is Good

BertelsmannSpringer is one of the world's leading professional publishing groups and the uncontested No. 1 competitor in this field in Germany. Consolidated revenues were up 8.5 percent to € 348 million year-on-year. EBITA (earnings before interest, taxes and amortization) was € 58 million and the return on revenues was nine percent. The employee head-count rose to 5,284 at end of fiscal year.

Overview

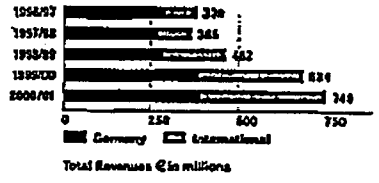
Profits remained stable at BertelsmannSpringer for 2000/01. Although economic conditions were extremely precarious in the industrial sectors that are of relevance to our publishing group, our core businesses managed again to post high returns on revenue. Efficient cost control and product management enabled the Science division to increase profits substantially. The Springer group improved earnings by 40 percent. BertelsmannSpringer once again grew its share of the U.S. market primarily in biomedicine, mathematics and computer science. The Professional division fared well, owing to its resolute focus on the customer and an active portfolio policy.

Despite adverse conditions in the construction sector, market share again increased while profits remained stable, due in part to the acquisitions of the profitable Swiss publishing company Schöck Sarna AG and of German-based Sauerzap. Our construction industry publishing firms in Belgium and Eastern Europe advanced through acquisitions to become undisputed leaders in their respective markets. In the transportation information sector, the German-language driving school business exceeded expectations despite market stagnation. Consequently, the impact of one-time charges stemming from Internet-related investments was easily absorbed. The group completed a strategic repositioning of e-commerce operations. As a result of the resolute integration of online services in the core businesses of our publishing houses, our market presence is now uniform and startup losses have been minimized.

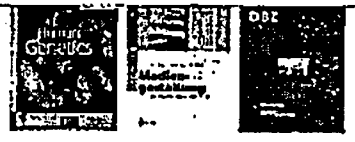
Science, Technology, Medicine (STM): Top-notch Information for scientists and professionals

BertelsmannSpringer's largest division – Science, Technology, Medicine (STM) – generated more than € 473 million in revenues, a growth of 8.7 percent.

Our Science Group made more effective use of resources and optimized costs, measures that had clearly positive effects on profits. The mathematics segment had an outstanding year and in this field BertelsmannSpringer is the world's uncontested leader. Our properties cover the entire spectrum, running the gamut from financial-related mathematics products at Springer to college course material at the Berkley-based publisher Key Curriculum. LINK, the Internet service offering the digitized content of over 500 scientific periodicals, grew its market share, especially in the United States. Over 90 percent of U.S. research libraries have usage agreements with LINK.



Total Revenues € in millions



The vocation-related media of the Professional division grew, especially in the field of technology publications at Vogel and business-related publishing at Hüthig. Internet offerings – newly combined under the roof of BertelsmannSpringer Medizin Online – are the undisputed leaders today in the markets for medical online information services.

Business-to-Business

Stability despite stagnating markets

B2B operations were challenged by stagnating markets. Moreover, investments required by new e-commerce activities caused profits to drop. Nevertheless, Construction Group revenues grew in the year under review. With the acquisition of the venerable construction publisher Bauverlag in Wallau, we now have coverage in the entire value-added chain of the construction sector. The group became market leader in Switzerland and Belgium thanks to carefully targeted acquisitions. With a double-digit return on sales, the construction publisher AM Building in the United Kingdom achieved outstanding results.

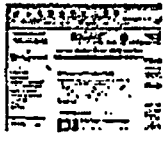
Several of the Traffic and Transport Group product lines also exceeded profit expectations, despite weak markets. Notably, the German driving school business of the publishing company Heinrich Vogel retained its position as the undisputed No. 1 player, with a market share exceeding 10 percent.

Outlook

In line with realignment of our programs and distribution worldwide, the Science, Technology, Medicine (STM) division will focus on further expanding its international product portfolio in the medium term. Significant strategic importance has been attached to supplementing print products with Internet offerings. Customer orientation and complete services will be the primary focus of the Professional division. The Business-to-Business segment will resolutely strengthen its customer-driven business models for specific occupation groups. BertelsmannSpringer growth objectives will be supported by additional acquisitions to provide comprehensive product lineups in targeted fields.

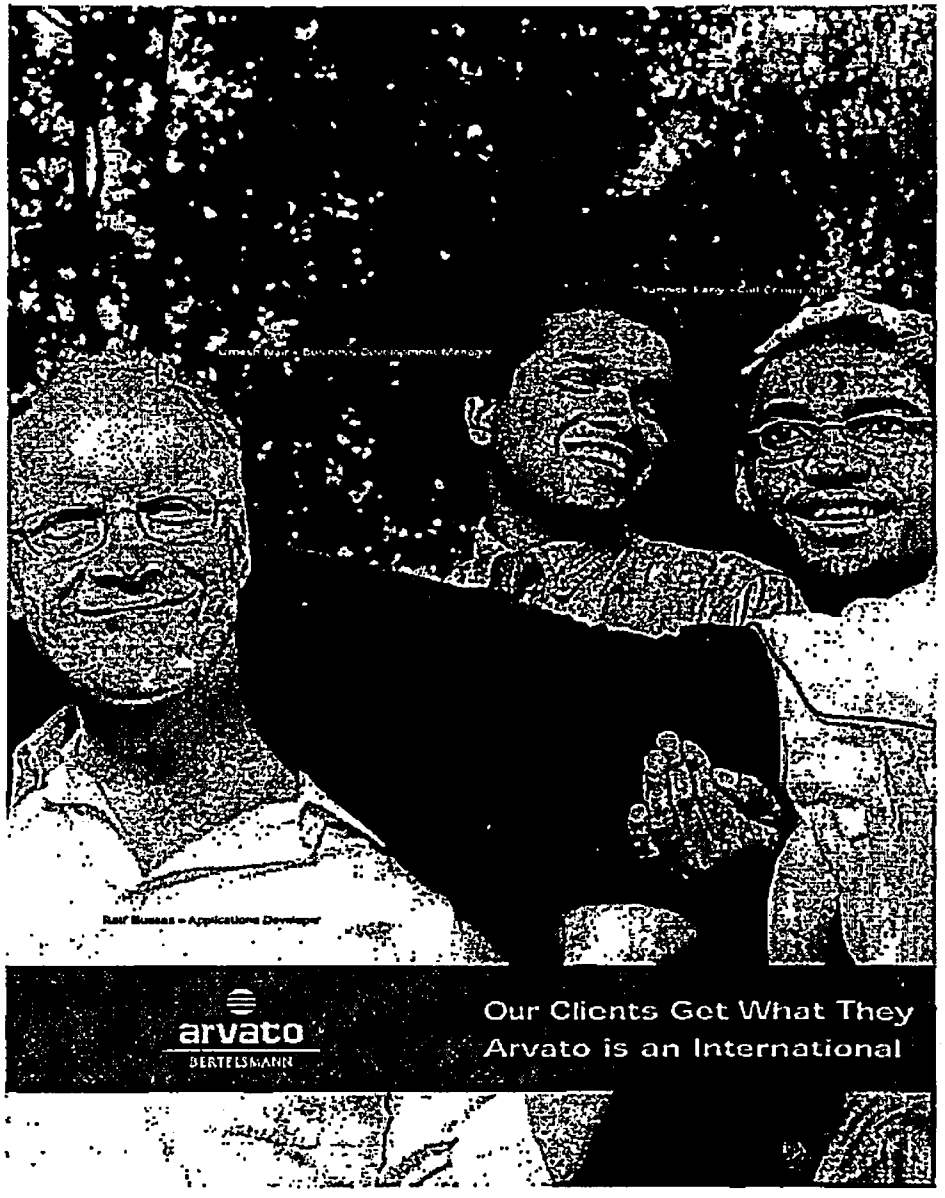
Highlights

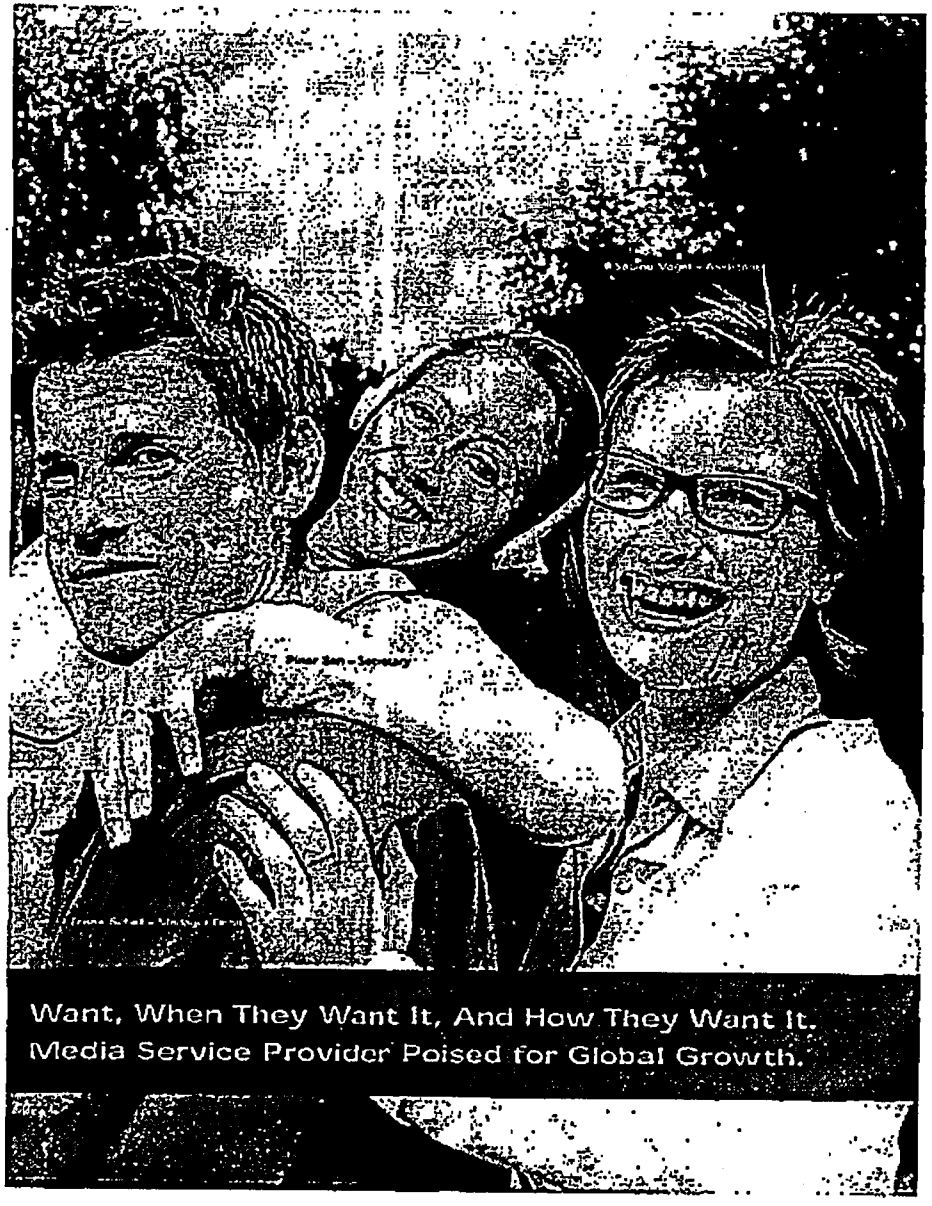
BertelsmannSpringer Medizin Online is Germany's largest Internet-based professional publisher with six million page impressions and 140,000 registered users One million copies sold of Sonnen's Dubbel paperback on mechanical engineering Scientific e-service LINK licenses information on 12,000 libraries worldwide 400,000 articles online at Hüthig BauDatenbank make it the premier electronic order platform for the German construction industry



Scientific Publications	45
Business-to-Business	28
Professional Literature	17
Printing	9

Revenues by Category in percent




Want, When They Want It, And How They Want It.
Media Service Provider Poised for Global Growth.

Quantum Leap: Arvato Develops through Internal Growth and Investments into New Dimensions

Arvato AG, Bertelsmann's internationally networked media services provider, developed in new dimensions in fiscal 2000/01. The employee head-count grew to 24,100. Revenues increased to approximately € 3 billion. EBITA (earnings before interest, taxes and amortization) rose by about 7.5 percent to € 187 million. Overall investment more than doubled, while funds used to acquire companies and increase existing stakes advanced to a new record level. With the completion of its expansion program, Arvato has now entered a phase of consolidation designed to optimize the rate of return over the long term.

Overview

The increase in revenues of 17.1 percent can be attributed to strong internal growth recorded by the core businesses as well as acquisitions. As a result of a targeted expansion program in the printing, services and special publishing segments, the number of countries in which Arvato operates rose from 17 to 23 worldwide.

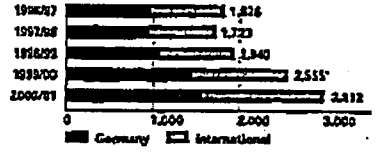
Internet operations developed as planned. Associated startup costs totaled € 44 million in fiscal 2000/01. These nascent businesses enhance our ability to link online with brick and mortar activities and thereby more effectively meet customer needs. The value added chain has improved and Arvato continues its tradition as the technology leader.

Printing
Multimillion-euro investments enhance capacity

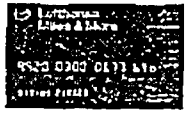
The Printing division focused on upgrading and enlarging capacity both in Germany and internationally. The company invested several million euros to expand this part of the business significantly. Over the course of the year, underlying conditions worsened – in part due to global economic weakening and a rapid increase in paper costs. Moreover, new competitors in Eastern Europe and rising energy costs compounded the situation.

Spain/Portugal

At the beginning of 2001, Arvato acquired in Spain the printing group Novo Systems including Rotadis and Cobrhi. These web offset printing plants specialize in the production of magazines and ad inserts. The new Madrid facilities in the immediate vicinity of Spain's largest publishing companies enable Arvato to optimize service to its customers on the Iberian Peninsula. Arvato is extending its existing market lead and tapping new potential with its business part-



Total Revenues € in millions



*Adjusted for group-internal reorganization

nors. Another indication of this trend is the construction of a new printing plant for Printer Portuguesa in Lisbon, which came on stream mid-2000.

Italy Launched at the end of last fiscal year, our joint venture with Italy's publishing house Rizzoli has made Arvato the premier provider of magazine printing services in Italy.

USA The acquisition of Coral Graphic Services (Westminster, NY) early 2001, which gives us the ability to manufacture multi-colored protective book coverings, was consistent with Arvato's long-term U.S. strategy of broadening the range of products and services. Coral Graphic supplements the comprehensive printing and related services of Berryville Graphics printing operations, Offset Paperback and Dynamic Graphic Finishing, providing everything from a single source.

Russia Arvato increased its interest in the Jaroslawl printing plant to 51 percent. This move fortifies the group's position in a market that management believes holds substantial potential for growth in the foreseeable future.

Services
Internationalization through new locations

Bertelsmann Services Group concentrated on international expansion, opening new sites in the Netherlands, Singapore, Australia and India. We plan expansion in the United Kingdom, and have set a goal of vigorous growth for our successful French operations. Other notable developments include the strong performance of core businesses and the integration of Bertelsmann media Systems.

Bertelsmann AG's IT service provider BmS, which until the end of August 2000 was part of the former Multimedia Division, adjusted quickly and solidified its position as a profit center by increasing sales to external clients. BmS has now linked its activities to Arvato's international media services network, an achievement that enhances the company's value-added chain. BmS offers an impressive array of services, extending from software development and SAP consulting to the operation of computing centers, customer relationship management (CRM) services and Web hosting.

The Bertelsmann Services Group is the European market leader in customer retention systems. In mid-October 2000, the group acquired a 70 percent stake in Munich-based webmiles AG. Webmiles is No. 1 in European cross-industry online incentive systems and has become a large, powerful player in the loyalty program sector.

Printing	46.7
Services	40.5
Special Publishers	12
arvato.com	2.8

Revenues by Category in percent

Arvato strengthened its traditional logistics sector business by adding two Web-based operations. We acquired an equity stake in medicforma.com, a business-to-business operator of an electronic marketplace for the European healthcare sector, and we established Infoxia, a provider of online platforms and tools for secure payment transactions in e-commerce.

Specialty Publishers
Strategic realignment

**As part of the realignment of the Bertelsmann book business, the encyclopedia publisher Lexmedia ONE) was integrated into Arvato on July 1, 2000. As it joined the Arvato Group, lexmedia ONE) realigned its business strategically. The group's publishing companies are now integrated with the Web portal wissen.de. The new alignment also places all brand direct marketing operations under uniform management. It also provides for the rapid and comprehensive development of content.

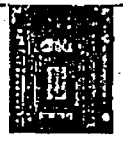
Here, too, Arvato has a long-term outlook. We are creating synergy, opening the door to new opportunities for growth and fully employing our business potential. We are benefiting customers and strengthening both our traditional business lines and the newly established lexmedia ONE) by linking Arvato's existing specialty publishers for calendars and supplements with B2B Web operations through wissen.de, and with general publishing houses and direct marketing organizations.

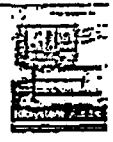
Arvato's calendar division rounded off its full-service offerings in the promotional sector with the acquisition of a 60 percent majority stake in the Solingen-based Prisenta Promotion International GmbH, effective January 1, 2001. The move also enlarges the range of services and products offered to German and international business partners.

Breakdown of Revenues
Growth in all divisions

**All three divisions – Printing, Services and Specialty Publishing – made substantial progress. Revenues of the Services division more than doubled to € 1.3 billion. Specialty Publishing operations revenues increased to € 298 million, while Printing grew to € 1.4 billion. In relative terms, the portion of total revenues accounted for by Printing activities was reduced significantly (from 55 percent in the previous year to 47 percent in fiscal 2000/01). By contrast, Services posted another significant proportional gain (from 31 to 41 percent).

Revenue developments by region were notable as well. Excluding Germany, European activities increased from 16 percent to 19 percent, and the United States increased from 12 percent to 15 percent, growing faster than German operations, where the proportion of aggregate revenues dropped from 72 percent to 65 percent. These developments, and our first ventures into Asia, have extended Arvato's international reach – a logical response to the needs of customers that operate globally.





Outlook In the new business year Arvato will concentrate on the integration and networking of new businesses with existing operations, on rapidly and comprehensively optimizing processes, and on growth strategies in selected markets.

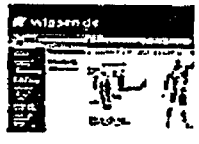
An example of this is the integration of the Bertelsmann Storage Media division, which began in the middle of 2001. This division includes Sonopress, the world's leading manufacturer of CDs and DVDs; the multimedia-printing operation topas; and Digital World Services, the forerunner in Internet digital rights management. The division formerly was part of BMG.

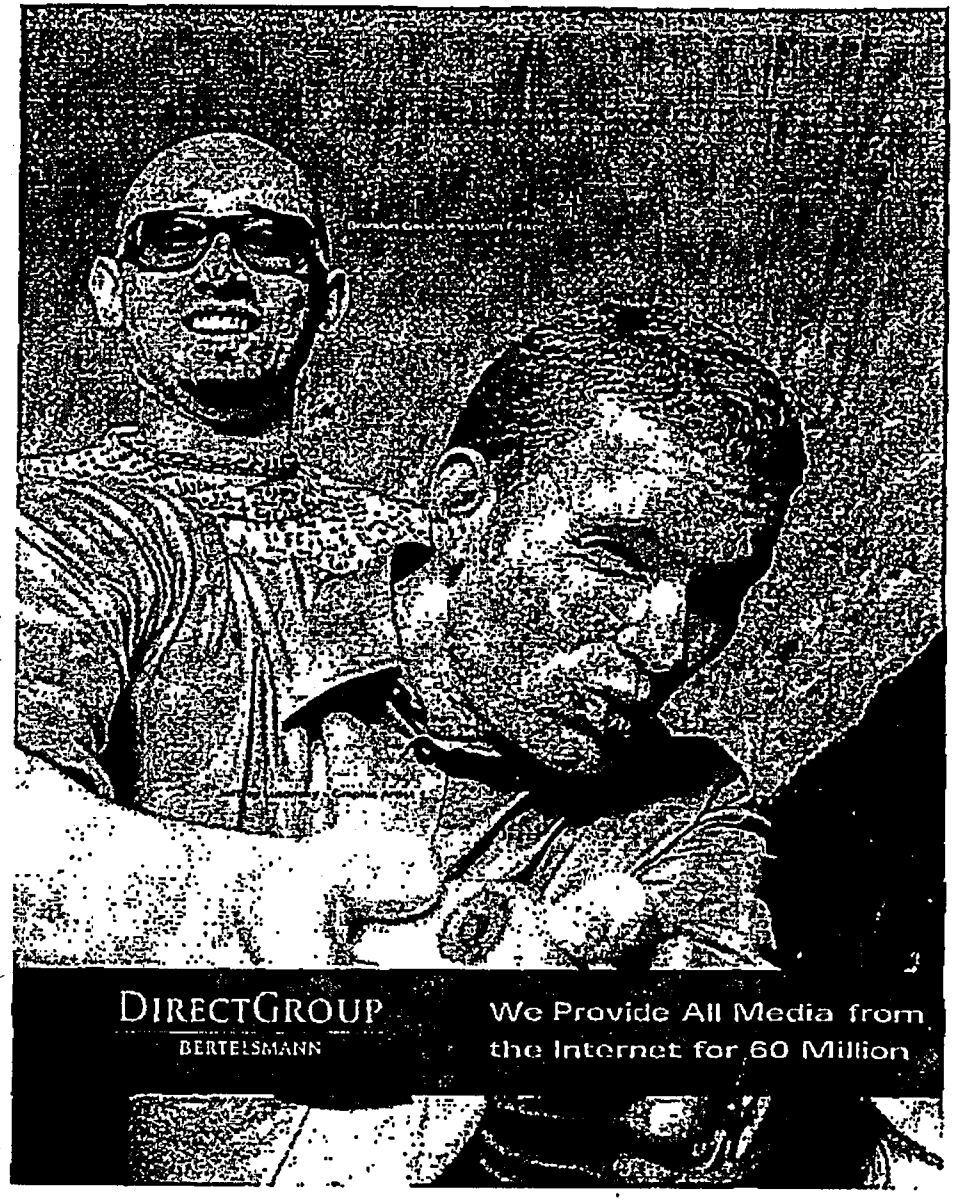
At the corporate level, these changes take into account the Bertelsmann structure of three strategic business fields – content, media services and end-user businesses. At the Arvato level, Storage Media supplements the group with services and products that permit even stronger market presence, a more intensive utilization of synergies and clearly enhanced customer service.

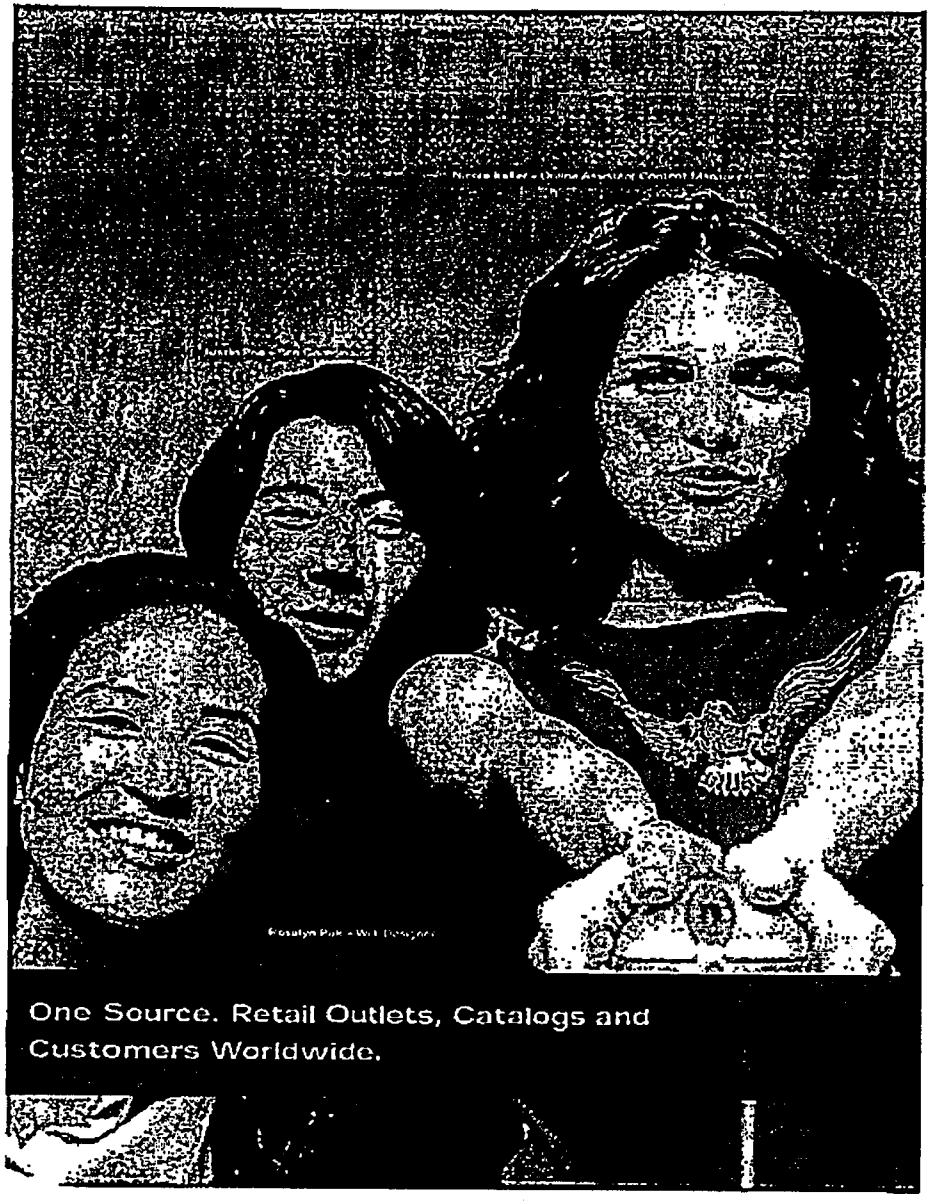
Arvato places great emphasis on expanding digital technologies in the new and old economies, on expanding service-oriented businesses, further strengthening existing customer relations and building new partnerships. We are mindful of an increasingly difficult economic environment characterized by sustained higher energy costs. We also take into account the impact on our business of global economic trends, which are intensified by a further rise in over-capacity. We believe Arvato is well equipped to meet these challenges.

Highlights

■ Arvato AG revenues increase to about € 3 billion ■ Printing capacity up 30 percent ■ 24,100 employees in 23 countries ■ New facilities in the Netherlands, Singapore, Australia and India extend international reach ■ New Madrid printing plant optimizes customer service on the Iberian peninsula ■ Acquisition of Coral Graphics Services complements comprehensive printing and service operations in the U.S. ■ 70 percent stake acquired in wakenbo ■ Bertelsmann media Systems and Immedia Oral integrated




DIRECTGROUP
BERTELSMANN
We Provide All Media from the Internet for 60 Million



DirectGroup Bertelsmann – Global Trend Setter for the Integrated Distribution of Media Products

The corporate strategy of DirectGroup Bertelsmann is to provide a full range of media products from a single source over all available distribution channels. The division was created at the beginning of fiscal 2000/01 through the consolidation of all Bertelsmann AG consumer operations. We offer our media products through retail outlets, via direct response catalogs, using personal sales consultants and via the Internet. DirectGroup provides nearly 50 million customers and members worldwide with premium quality products tailored to their every listening, reading and viewing need. DirectGroup Bertelsmann has 15,182 employees in 22 countries (June 30, 2001). The division generated sales of € 3.8 billion in its first year of operation and showed a loss in earnings before interest, taxes and amortization (EBITA) of € 53 million.

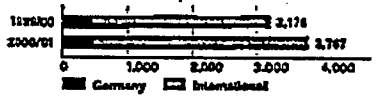
Overview

DirectGroup Bertelsmann has combined our company's traditional strengths in direct marketing and program expertise with the online distribution of books and music to form a global powerhouse. DirectGroup ranks first among book and music clubs, with more than 43 million enrolled members who regularly shop at our companies. Augmenting this customer base are nearly 20 million registered users and customers of e-commerce operations and online services.

USA: Our Biggest Market Over 40 specialty clubs

In its first fiscal year, DirectGroup operations had sales in the United States of about € 2 billion, or more than 50 percent of all group revenue. The U.S. is our largest market, followed by Europe. BOOKSPAN, a joint venture of Doubleday Direct and the Book-of-the-Month Club, is the leading book club direct marketer in the U.S., with more than nine million members. Our four well-established general-interest clubs have high levels of brand name recognition: Book-of-the-Month Club, The Literary Guild, Quality Paperback Book Club, and Doubleday Book Club. Moreover, we have established more than 40 specialty book clubs that meet the needs of specific target groups. One Spirit, for example, specializes in spiritual issues and wellness. Black Expressions has a repertoire of contemporary and classical African-American authors, while Mystery Guild serves the who-done-it fans.

In December 2000, DirectGroup acquired ZOOBA.com, which specializes in e-mail marketing. Registered users receive e-mails with editorial content on topics of their choice, as well as tailored media offerings. This enables specialty clubs to draw attention to their offerings and maintain member loyalty.



Total Revenues € in millions

BeCG: Music on the Net integrating all distribution platforms

Operating chiefly from New York, the Bertelsmann eCommerce Group (BeCG) integrates platforms for digital and physical distribution of media content over the Internet and via broadband and wireless networks. Companies in the BeCG group had about € 1 billion in sales in fiscal 2000/01. There were 2,050 employees (June 30, 2001).

Building the largest Web-based music distribution business in the U.S. is of strategic significance to the division. Established in July 2001 as part of BeCG, the goal of BeMusic is to cover the entire online and offline value-added music distribution chain. BeMusic's Web pages serve 8.5 million unique visitors in America, approximately 50 percent of the Internet's "Music Retail" category (MMXI, June 2001).

The network is comprised of the following enterprises:

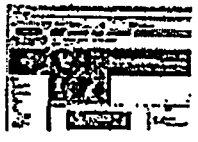
■ EMG Music Service, the premiere direct response and Internet-based music club, with more than 12 million active members in the U.S.; ■ CDNOW, the leading U.S. marketer of music CDs on the Net (acquired in September 2000), serving five million customers; ■ In May 2001, BeCG announced its intention to acquire the pioneer company myplay Inc. with 6.5 million registered users. Myplay.com provides Internet users digital storage space for music files.

In October 2000 BeCG formed a strategic alliance with Napster, one of the world's largest music exchanges. Bertelsmann provides financing to Napster and supports the development of a business model that serves the justified interests in intellectual property of musicians and record companies, and fulfills the wishes of music aficionados and the Napster community as well. Parts of the software for the secure exchange of music are being developed by Digital World Services, a joint venture of BeCG and Bertelsmann's Arvato division.

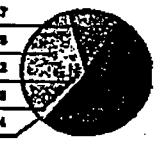
BeCG is also involved in the dynamically developing e-commerce market in the United States. Bertelsmann has a 34 percent stake in publicly traded barnesandnoble.com, America's No. 2 online distributor of books and media which has shown substantial growth in sales and share of market.

Europe: Restructuring 16 million club members

Exclusive offerings and reliable service have created the loyalty of some 16 million DirectGroup club members in Europe. Our expertise in selecting content and skill in the direct marketing of media products are responsible for the success of such high-profile brand name clubs as France Loisirs (France, Belgium, Switzerland and Canada), BCA (Great Britain), Círculo de Lectores (Spain), Círculo de Leitores (Portugal), Der Club (Germany), Mondolibri (Italy), Swiat Kalazki Club (Poland) and Donauland (Austria).



Germany	12.7
Other European Countries	31.9
North America	53.2
Asia	0.8
Other Countries	1.4



Revenues by Region in percent

Numerous exclusive club premieres – books that were available to club members prior to release in bookstores – have become bestsellers. Among these titles are Die Vergebung by Tim Griggs in Germany (358,745 copies sold) and the novel Feu de Glace by Nicci French in France (490,000 copies sold). Underscoring both our skill in title selection and the international scope of our club business, a novel Palast der Königin by Mireille Calmel is being released in the fourth quarter of 2001 as an exclusive club premiere in seven European countries simultaneously. Topicality and clear price advantages, along with exclusivity, are the chief strengths of our European clubs.

Throughout Europe, the clubs operate more than 600 retail outlets that were remodeled in fiscal 2000/01 and equipped with additional services enabling them to become full service centers. Club catalogs were updated to reflect current marketing trends. Today, the Web is an integral component of the division's core businesses and we have expanded our Internet presence. The clubs generated up to nine percent of their worldwide sales via the Internet in the 2000/01 and acquired 1.4 million new members through the Web.

BOL Bertelsmann Online Integration into club operations

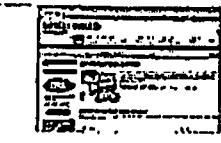
DirectGroup companies are well prepared for further growth on the Internet, in part due to the restructuring of our European and Asian e-commerce and club activities. In May 2001, about two years after its launch, the international media and entertainment shop BOL was integrated into the regional club operations. Online and offline businesses are being networked, since customers shop on the Internet as well as by mail order and in stores.

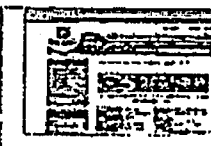
BOL International had dynamic growth in fiscal 2000/01. Sales rose 185 percent to nearly € 100 million year-on-year. The growth rate in Germany of 163 percent was well above the sector average of 129 percent. Internationally, the BOL customer base grew by 140 percent to 2.5 million. In Europe and Asia BOL secured strong No. 2 positions in e-commerce media product markets. BOL suspended its activities in Norway, Denmark, France and Spain because of adverse market environments. In Japan, BOL activities are operated in cooperation with e-commerce provider BKI.

Asia Promising market

DirectGroup expanded business operations in Asia. The Shanghai book club registered strong growth and now has over 1.5 million members, about 60 percent of them under the age of 34. The company has customers in China's other major cities.

BOL China has been operating since December 19, 2000, and was one of the first international platforms for the distribution of media products in China. Customers can choose from 60,000 book titles, which BOL ships throughout the country. At present, some





50,000 customers visit BOL China's website each day. This represents a 10 percent share of the Chinese online book market. BOL China is aiming to become the leading provider in the near future.

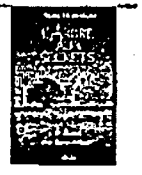
There also were positive developments in the South Korean market. Launched in January 2000, the Korean book club already has more than 230,000 members. Sales grew five-fold over the previous year. A new website to handle Internet-based activities was launched in December 2000. Approximately 40,000 members were acquired via the Internet in fiscal 2000/01and sales generated through e-commerce account for close to 10 percent of total revenue.

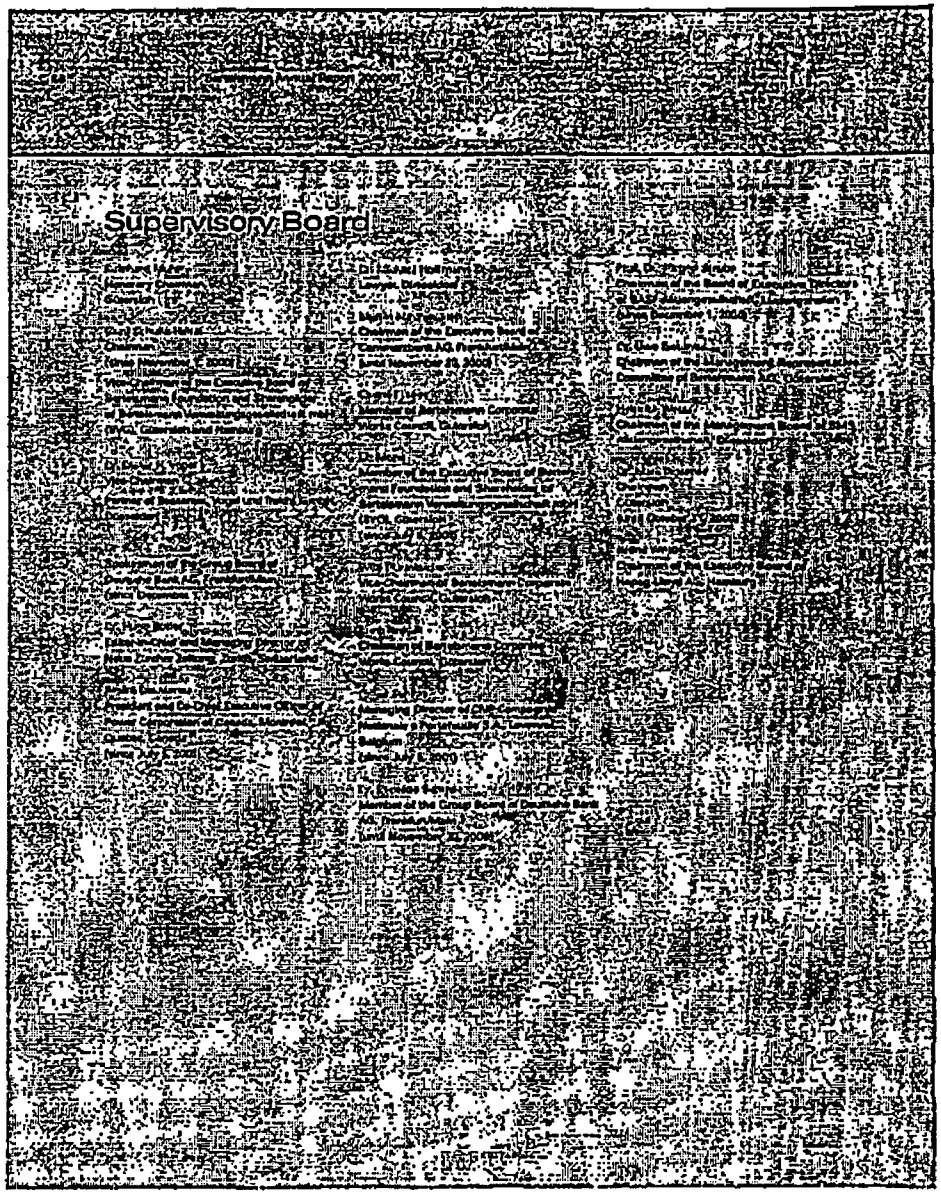
Outlook The borders between the online and offline worlds continue to dissolve. DirectGroup Bertelsmann will continue to transition our business from clubs primarily aimed at single customers to those serving larger communities of interest. In December 2000 we began the installation of sophisticated new information systems. These technologies support the strategic approach of DirectGroup to enhance product offerings to clearly defined target groups. Experience gained at our specialty clubs in the U.S. and U.K. is being adapted and applied to club operations in Europe. A first test of a specialized club in Germany – Moments – began in July 2001. A special product offering for detective novel fans is being introduced in France in the fall of 2001.

In the music sector, Bertelsmann will be one of the first media enterprises in the world to give customers the ability to listen to music on CD as well as in digital form via the Internet. The future path of DirectGroup is well defined: We will provide the full range of media over all distribution channels from a single source.

Highlights

■ DirectGroup serves about 60 million customers and members worldwide – One of the world's largest media communities. ■ About 160 media clubs in 19 countries belong to DirectGroup ■ Book clubs sell 170 million books every year ■ Twelve percent of new club members came to us through the Internet last year ■ About 20 million users visit DirectGroup's e-commerce offerings monthly. ■ Unique visitors to DirectGroup clubs and servers in the U.S. account for 28 percent of the American Web-based book market ■ BertMusic ships 150 million CDs to customers each year, making it the largest direct response CD company in the U.S.





Gerd Schulte-Hillen
Chairman of the Supervisory Board
Bertelsmann AG

Report of the Supervisory Board

The Supervisory Board received regular written and oral reports on business developments and operations, the state of the Corporation and plans for major investments. The Supervisory Board reviewed significant business transactions with the Executive Board and monitored management of the company.

The consolidated financial statements of Bertelsmann AG as of June 30, 2001 and the group status report for the fiscal year 2000/01 were audited by KPMG Deutsche Treuhand-Gesellschaft Wirtschaftsprüfungsgesellschaft, Frankfurt/Main, and received an unqualified auditor's opinion.

The auditor attended the financial review meeting of the Supervisory Board and submitted and explained his report. The Board took note with approval of the examination's result. After its own final scrutiny of the consolidated financial statements and the group status report, the Supervisory Board also raised no objections. It therefore approves the consolidated financial statements as submitted by the Executive Board.

The composition of the Supervisory Board underwent the following changes during the fiscal year: Dr. Mark Wössner, who had been Chairman since November 1, 1993, resigned effective October 31, 2000. The Supervisory Board expresses its gratitude to Dr. Wössner for his committed work for the benefit of Bertelsmann in all of his leadership positions. Dr. Wössner was succeeded as Chairman effective November 1, 2000 by Gerd Schulte-Hillen, who relinquished his position as Deputy Chairman of the Executive Board of Bertelsmann AG. New appointments to the Supervisory Board include Dr. Rolf-E. Breuer, Spokesman of the Group Board of Deutsche Bank AG, and Professor Dr. Jürgen Strube, Chairman of the Board of Executive Directors of BASF AG (both as of December 1, 2000). Retired from the Board are Dr. Martin Kohlhaussen, Chairman of the Executive Board of Commerzbank AG, and Dr. Ronaldo Schmitz, member of the Group Board of Deutsche Bank AG (both as of November 30, 2000). The Supervisory Board thanks its exiting members for their many years of service.

Other changes occurred after the end of the business year. Because Groupe Bruxelles Lambert S.A. (GBL) joined the circle of Bertelsmann AG shareholders, the Bertelsmann AG Supervisory Board was expanded from 12 to 15 members effective July 1, 2001. New appointees were Lia Mohn, member of the Executive Board of Bertelsmann Foundation and shareholder of Bertelsmann Verwaltungsgesellschaft mbH (BVG); André Desmarais, President and Co-Chief Executive Officer of the Power Corporation of Canada; and Gilles Samyn, Managing Director of CNP Compagnie Nationale à Portefeuille.

Four new members were appointed to the Bertelsmann Executive Board: Rolf Schmidt-Holtz effective July 1, 2000; Bernd Kundrun effective November 1, 2000; Arnold Bahlmann and Rudi Gassner effective January 1, 2001; and Peter Olson effective April 1, 2001. Following the sudden death of Rudi Gassner and of December 2000, Rolf Schmidt-Holtz additionally took on the management of Bertelsmann Music Group (BMG) in January 2001. Hartmut Ostrowski was appointed Deputy Board Member effective October 1, 2001. On September 1, 2002 he will become a Board Member.

The wide-ranging and sometimes radical transformation of markets in which Bertelsmann is active continued during 2000/01. Bertelsmann has once again taken advantage of this environment and used it as an opportunity to shape the future of the company and secure continued profitable growth. In keeping with its strategic objectives, Bertelsmann has further strengthened key business areas through high investments and has optimized our portfolio through new alliances and divestments. The Supervisory Board was actively involved in these ongoing developments. It is with great appreciation that the Supervisory Board recognizes and honors the accomplishments of the company's Executive Board, managers and employees.

Gütersloh, October 31, 2001

Gerd Schulte-Hillen

Corporate Governance at Bertelsmann

"Corporate Governance" has been a focal point of business and economic discussions in recent years. As the Anglo-American investment community continues to articulate its expectations concerning effective and transparent corporate governance, an extensive debate on corporate governance reform has ensued in Germany.

Model for Foster Corporate Governance

At Bertelsmann, an important management responsibility has always been the continued refinement of the corporate constitution in order to create an efficient system for managing and governing the company. In this respect, the German Stock Corporation Act has established the legal parameters for Executive Board and Supervisory Board responsibilities at Bertelsmann. Our company has sought to meet the demands for effective corporate governance within these guidelines. Accordingly, assuring effective corporate governance is part of the corporate culture of Bertelsmann. Following principles established by Reinhard Mohn, Bertelsmann has always played a lead role in supporting modern and active Supervisory Board oversight. As an actively involved body obliged to conduct an independent scrutiny, the Supervisory Board at Bertelsmann AG operated on a model of cooperative enterprise and corporate monitoring as early as the 1980s.

Since that time, the Bertelsmann Executive Board and Supervisory Board have sought through intensive and critically constructive dialogue to reconcile the requirements of an effective corporate review structure with the need for an expedient and streamlined decision-making process. Consequently, beginning in the mid-1980s, certain duties and functions of the Supervisory Board were increasingly delegated to board committees. From the beginning we established specific criteria and qualifications for the selection of members of the Supervisory Board. The fact that the employees of Bertelsmann are viewed as indispensable partners in the effort to meet enterprise goals is a fundamental feature of our corporate culture. One illustration of this is that representatives of the employee and executive staffs are voting members of the Bertelsmann AG Supervisory Board, even though the company, as a so-called "Ideological Enterprise" (Tendenzbetrieb), is exempted from the requirements of Germany's co-determination laws and therefore not required to have such representatives on the board.

The procedures and structures set forth for corporate governance in the internal rules of procedure of the Supervisory Board of Bertelsmann AG exceed the statutory requirements. To the largest extent possible they meet the demands of modern, pro-active corporate governance standards that have emerged in recent corporate governance debates.

Evaluation is a Continuing Process

Bertelsmann continuously evaluates the work of the Executive and Supervisory boards and improves corporate governance standards. The demands made on the Supervisory Board have risen dramatically in the increasingly complex environment of the media and communication industry. As a result, our Executive and Supervisory boards have further intensified discussions concerning strategy and the corporate principles of Bertelsmann. The regular pursuit of main tasks and continued improvement in transparent between the responsible bodies have become established practice. This, for example, should problems occur that were identified too late or were not sufficiently addressed, a process would begin for reviewing and then developing information, reporting and management solutions.

As part of this transformation, the duties of the Supervisory Board committees were reorganized in the recently completed fiscal year. With respect to the work of the Personnel Committee, Audit and Finance Committee, Strategy and Investment Committee, and the Working Group of Employee and Management Representatives, areas of responsibility or specialization were restructured, interlocking these activities with the Supervisory Board. In that connection, more emphasis has been placed on the delegation of authority. Responsibilities of the committees have been expanded and approval levels for investment projects have been increased. At the same time, the committees' reporting duties to the Board have been more carefully defined. The decision-making authorities of the committees within specific limitations are designed to provide the Board with more time to focus on fundamental topics and issues. As a consequence of Bertelsmann's exchange of shares with Groupe Bruxelles Lambert, the Supervisory Board was expanded from 12 to 15 members at the beginning of July 2001, thereby paving the way structurally for Bertelsmann to prepare for a possible initial public offering in the coming years. In addition, we expect the Supervisory Board to have a more international mix.

The Executive and Supervisory boards of Bertelsmann AG are currently reviewing the company's corporate governance standards in light of the recent recommendations of the "Government Commission on Corporate Governance" of July 2001. In order to meet the demands of international investors seeking greater transparency, a commission of experts of the German Federal Government plans to introduce a "Corporate Governance Code" for German enterprises in early 2002. The Executive and Supervisory boards of Bertelsmann AG welcome the initiative and intend to follow its standards and also to expand and disclose the central corporate governance standards and procedures specific to Bertelsmann AG. As an international media company, Bertelsmann will continue to address the topic of corporate governance intensively and, above all, the specific demands on publicly listed companies.

Gerd Schulte-Hillen

Financial Statements

July 1, 2000 to June 30, 2001

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Consolidated Balance Sheet

Assets	June 30, 2001 € in millions
Fixed Assets	
Intangible assets	[illegible]
Property, plant and equipment	2,787
Investments	[illegible]
	8,419
Current Assets	
Inventories	[illegible]
Receivables and other assets	[illegible]
Marketable securities	[illegible]
Cash	[illegible]
	[illegible]
Prepaid Expenses	211
Total Assets	[illegible]

Stockholders' Equity and Liabilities	June 30, 2001 € in millions
Stockholders' Equity	
Capital stock	[illegible]
Profit participation certificates	[illegible]
Retained earnings	[illegible]
Dividends of Bertelsmann AG	[illegible]
Minority interests	[illegible]
	4,501
Provisions	
Provisions for pensions and similar commitments	[illegible]
Other provisions	[illegible]
	[illegible]
Financial Debt	2,706
Other Liabilities	[illegible]
Deferred income	[illegible]
Total Stockholders' Equity and Liabilities	[illegible]

Consolidated Statement of Income

	2000/01 € in millions
Revenues	[illegible]
Change in inventories	[illegible]
Other manufacturing costs capitalized	[illegible]
Total Operating Income	[illegible]
Other operating income	4,612
Cost of materials	[illegible]
Royalty and license expenses	[illegible]
Personnel costs	[illegible]
Amortization/depreciation of intangible assets and property, plant and equipment	(1,419)
Other operating expenses	[illegible]
Income on investments (net)	(451)
Net financial income	[illegible]
Income from Ordinary Business Activities	2,292
Income taxes	(1,322)
Net income	[illegible]
	[illegible]
Allocation of profit	
Income applicable to minority shareholders	(263)
Losses applicable to minority shareholders	[illegible]
Change in retained earnings	(441)
Dividends of Bertelsmann AG	[illegible]
Holders of profit participation certificates	(35)
Other shareholders	[illegible]

Consolidated Statement of Income · Consolidated Statement of Cash Flows

Consolidated Statement of Cash Flows

	2000/01 € in millions	
Operations		
Net income	970	672
Depreciation of fixed assets	1,844	1,121
Increase in profit participation certificates and long-term provisions	308	[illegible]
Other cash and non-cash items	(2,069)	(559)
Cash flow according to DVFA/SG	643	1,317
Result from disposal of fixed assets	(33)	(11)
Change of inventories	(88)	13
Increase in receivables, other assets and prepaid expenses	(421)	(557)
Change in short-term reserves	(21)	210
Change in other liabilities and deferred income	(327)	1,318
Net Cash used/provided by Operations	(233)	1,191
Investing Activities		
Payments for investing activities	(3,288)	(2,049)
Proceeds from disposal of fixed assets	4,414	64
Net Cash provided/used by Investing Activities	1,146	(1,498)
Financing Activities		
Change of Stockholders' Equity	25	(46)
Dividends paid	(313)	(256)
Change in financial debt	(234)	314
Net Cash used/provided by Financing Activities	(588)	300
Change in Cash and Marketable Securities	325	298
Effect of exchange rate changes on cash and marketable securities	6	(2)
Cash and marketable securities at beginning of year	494	200
Cash and Marketable Securities at End of Year	825	494

Gerstemann Annual Report 2000/01

Notes

The Consolidated Financial Statements of Bertelsmann AG are prepared in accordance with the accounting and valuation principles as required by the German Commercial Code. Euro-based accounting principles have not yet been adopted. However, the Consolidated Financial Statements and the Group Status Report have been converted into euro. Amounts disclosed are shown in millions of euro.

For a clear presentation, some positions of the Consolidated Balance Sheet and Statement of Income have been summarized. These positions are detailed in the Notes to the Consolidated Financial Statements.

The Consolidated Statement of Income is presented by applying the method of total cost.

For tax reasons, Bertelsmann AG and its affiliated German subsidiaries have changed from a fiscal year to a calendar year, effective December 31, 2000. For most companies included in the Consolidated Financial Statements the fiscal year ends on June 30, 2001. In order to be included in the Consolidated Financial Statements, those companies that transitioned to the calendar year as of December 31, 2000, as well as companies that have a different fiscal date due to local or other reasons, have prepared interim financial statements as of June 30, 2001.

Summary of Significant Accounting Policies

The accounting and valuation rules applied are consistent with the prior year.

The Consolidated Financial Statements of Bertelsmann AG (holding company) and its affiliates have been prepared by applying uniform accounting principles. These accounting principles are based on rules that are applicable to Bertelsmann AG. In case of deviations due to different local requirements, the individual financial statements of the entities to be consolidated are adjusted to comply with the principles and format of the holding company. However, if the deviations are immaterial, the financial statements of the associated companies have not been changed.

Intangible assets are carried at acquisition cost, tangible assets are carried at either acquisition or production cost.

The straight-line depreciation method is applied to fixed assets.

Low-value assets are immediately expensed in the year of acquisition.

Investments are carried at acquisition cost. Any risks identified are recorded through devaluation to the appropriate value.

Long-term loans are valued with their nominal value or lower discounted value depending on the interest rate involved.

Investments in associated companies are carried as assets according to the book value method with their pro-rata equity capital (at equity).

Inventories are valued by applying the lower of cost or market method. Inventories purchased from consolidated affiliates are stated at Group production costs or at appropriate lower values. Risks from obsolete and slow-moving inventories are recorded through value adjustments following the net realizable value principle. Film rights are valued at acquisition or production cost minus the amount of capital asset consumption.

Value adjustments have been provided for all foreseeable risks with regard to receivables and other assets. A general allowance for doubtful accounts has been recognized to consider general collection risks.

Marketable securities are stated at the lower of either acquisition cost or market value as of the closing date.

The Chief Committee of Experts of the Institute of Auditors has commented on the treatment of equity in its Recommendation No. 1/1994. Pursuant to its comments, the profit participation certificates meet the criteria set forth therein and are disclosed as a separate item under stockholders' equity. According to the economic approach, the return on profit participation certificates is therefore disclosed as an appropriation of net income.

Provisions for pension plans and similar commitments have been stated at their actuarially computed present values discounted at the rate of 6 percent for Bertelsmann AG and consolidated domestic affiliates. Similar valuation procedures have been applied to foreign subsidiaries considering local practice. The interest included in the allocation to pension provisions is reported as interest expense.

Provisions for taxes and other accrued liabilities are valued at the amount required based on sound business judgment. Interest on taxes as well as tax proceeds affecting the Consolidated Statement of Income are disclosed as "income taxes".

The method of calculating provisions for impending losses on contracts is that of variable costs.

Liabilities, including debt, are stated at their redemption value.

Consolidation Scope

[redacted] The Consolidated Financial Statements comprise 1,074 companies including Bertelsmann AG, compared with 824 companies last year. The Consolidated Financial Statements include all German and international subsidiaries with the exception of 154 companies. The latter do not have any material business activities and have not been included in the Consolidated Financial Statements because of their minor importance. Within the scope of the full consolidation of the RTL Group, 37 companies were included by a proportionate consolidation. Fifty of the 175 associated companies were valued at equity. This method was not applied to the remaining companies because of their minor economic importance. However, these investments were valued at their acquisition cost.

The major newly acquired consolidated companies included the television production company Fremantle Media (formerly Pearson TV) in Great Britain, the e-commerce company CDNOW in the United States, the U.S. business magazine first Company, the BS Fachmedienguppe in Germany, and the printing operation Coral Graphics in the U.S. When balanced against the companies divested, there was a net addition of 250 companies to the group of consolidated companies.

For the first time, the RTL Group was fully consolidated for the entire fiscal year in the previous year, this group was reported at equity for a six-month period. In the previous year, €1,633 million of revenues generated by RTL Group were consolidated. RTL Group comprises the activities of the former CLT-UFA as well as Pearson TV, which was acquired in July 2000 and now operates as Fremantle Media. It accounted for €789 million in revenue in fiscal 2000/01.

The list of the investments will be submitted to the commercial register at the district court of Gütersloh (Department B No. 3.100).

Principles of Consolidation

[redacted] Capital consolidation has been performed according to the book value method since July 1, 1987. First-time consolidation is performed at the date of acquisition.

Goodwill that is remaining from the capital consolidation of former years has been included in goodwill according to the legally prescribed transition rules. Goodwill is amortized via the Consolidated Statement of Income with an effect on net income over periods ranging from 5-20 years. Divergent from this and pursuant to Paragraph 309, Section 1, Sentence 3, German Commercial Code, goodwill in the amount of €815 million from the newly acquired companies Fast Company and CDNOW was offset against reserves or minority interests during the fiscal year just ended.

Goodwill amortization from capital consolidation in the amount of €366 million and from individual financial statements in the amount of €116 million is stated in the Consolidated Statement of Income under depreciation and amortization (note 22). Goodwill amortization of €20 million resulting from an equity valuation is stated under income on investments (net) (note 24). The total amount of €502 million is used as a basis for determining the total return on assets using the profit participation certificate formula.

Consistently with the German Commercial Code, negative goodwill in the amount of €12 million resulting from the capital consolidation has been netted against goodwill.

Intercompany receivables and payables have been eliminated. Intercompany profits resulting from intercompany sales of goods and services have been eliminated in the areas of fixed and current assets.

The amount of tax-layered reserves is divided into the equity portion and deferred tax accruals and disclosed in the appropriate positions.

Deferred taxes are not stated in the Consolidated Financial Statements. The deferred tax assets resulting from the individual financial statements exceed the summary of the deferred tax liabilities from the individual financial statements and the balance of deferred tax assets from the consolidation entries. The company elected the option of not stating this surplus amount in the financial statements.

Provisions, depreciations and value adjustments, which were established in individual financial statements concerning intercompany risks, have been reversed to income if no third-party risk was involved.

Foreign Currency Translation

[redacted] Foreign currency receivables are valued at the lower of the exchange rate as of the date of the business transaction or the closing date. In contrast, foreign currency payables are valued with the higher of the exchange rate as of the date of the business transaction or the closing date. Where foreign exchange positions have been hedged, the underlying instruments are valued at the rate so covered.

Individual balance sheets of non-German companies are translated using the exchange rate as of the closing date. The statements of income of non-German companies as well as fixed asset transactions are translated using the average exchange rate for the fiscal year. The difference between the converted net income and the average exchange rate is recorded to retained earnings.

The Consolidated Financial Statements were presented in euros as of June 30, 2001. This was done by translating the corresponding DM amounts reported in the previous and reporting year using the fixed euro exchange rate.

Notes to the Consolidated Balance Sheet

	June 30, 2001	
	€ in millions	€ in millions
Intangible Assets		
Patent and similar rights, licenses	975	845
Goodwill	1,195	1,703
Advance payments	71	209
	4,241	2,857

The patent rights and advance payments balances include rights arising from (co) productions, along with audiovisual and sports rights owned by the RTL Group, which are sold to broadcasting stations as part of a licensing procedure. These rights are valued at acquisition cost.

Write-downs are determined based on estimated total proceeds, which means the acquisition costs are written down in line with the ratio of net proceeds generated to total estimated proceeds. Estimated net proceeds are regularly reviewed and adjusted. If they fall below the rights' acquisition costs, a value adjustment is accrued to ensure that the rights' book value corresponds to future estimated net proceeds.

10 Property, Plant and Equipment

	June 30, 2001 € in millions
Land, land titles and buildings	843
Technical equipment and machinery	1,071
Other equipment, factory and office equipment	512
Advance payments and construction in progress	360
	2,787

11 Investments

	June 30, 2001 € in millions
Investments in affiliated companies	60
Loans to affiliated companies	2,017
Investments in associated companies	343
Loans to associated companies	10
Other investments	485
Loans to other investments	33
Non-current securities	8
Other loans	497
	1,451

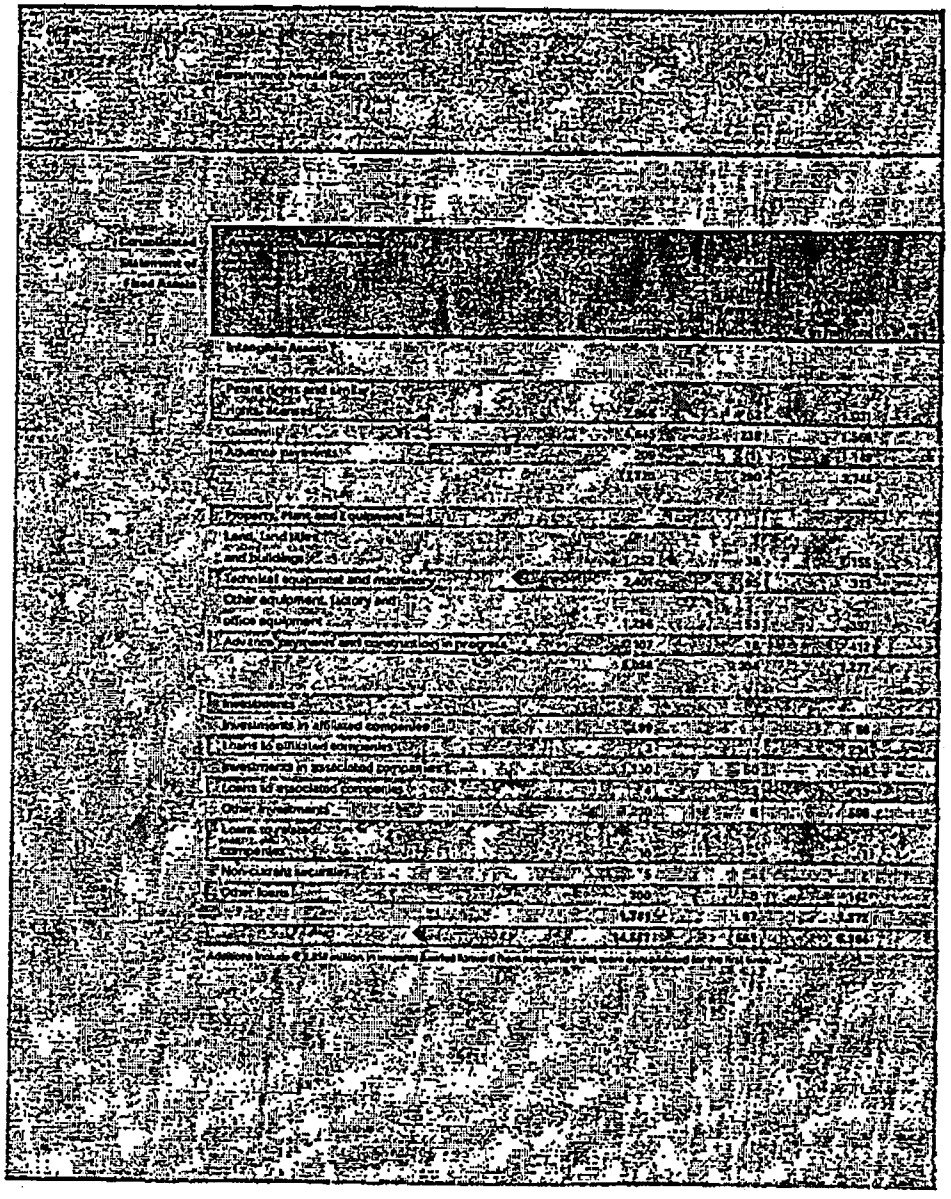
Investments in affiliated companies relate to companies without any major business activity, which are not included in the Consolidated Financial Statements.

Investments in associated companies comprise the original investments and other additions, as well as the proportionate net income and net profit distributions, capital repayments and depreciation. The marked decline is due to the reclassification of AOL Europe as a current asset at fixing management's intention to divest the operations in 2002.

Where it has been determined that profits will be distributed in the following year, these profits are posted as receivables on the Consolidated Balance Sheet.

The rise in other investments is primarily due to the RTL Group's acquisition of a stake in the Spanish company Antena 3.

As of June 30, 2001, € 42 million of goodwill remained from the equity consolidation process (previous year, € 54 million). The additions during the fiscal year amounted to € 20 million.



	Gross values June 30, 2001 € in millions	Accumulated depreciation/ amortization June 30, 2001 € in millions	Net book values June 30, 2001 € in millions
[illegible]	2,920	1,945	975
[illegible]	8,322	3,127	3,195
[illegible]	8,313	5,072	4,241
[illegible]	1,436	493	943
[illegible]	2,904	1,902	902
[illegible]	1,544	1,032	512
[illegible]	6,195	3,428	2,767
[illegible]	127	67	60
[illegible]	233	32	201
[illegible]	778	389	389
[illegible]	10		10
[illegible]	752	267	485
[illegible]	6	-	6
[illegible]	303	6	297
[illegible]	2,212	751	1,461
[illegible]	13,720	9,251	4,469

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Inventories

	June 30, 2001 € in millions
Raw materials and supplies	211
Work in process	258
Finished goods and merchandise	1,693
Advance payments	50
	2,212

The finished goods amount primarily relates to the RTL Group's movie rights to be sold or broadcast on television. The capitalized costs associated with quiz, game and music shows, sports events, "soaps" and documentaries are fully reflected in the Consolidated Statement of Income upon their first broadcast. Children's films are depreciated at a minimum of 50 percent at first broadcast; the remainder is depreciated at second broadcast. All other formats are depreciated at a minimum of 67 percent at first broadcast, with the remainder depreciated at second broadcast.

Receivables and Other Assets

	June 30, 2001 € in millions
Receivables from sales of goods and services	3,249
Receivables from related companies	78
Other assets	2,487
	5,822

As in the previous year, other assets primarily include royalty advances to artists and authors in the amount of € 1,174 million and € 453 million in tax claims.

Cash and Marketable Securities

	June 30, 2001 € in millions
Marketable securities	125
Cash	700
	825

Prepaid Expenses

	June 30, 2001 € in millions	
Prepaid expenses	233	[illegible]

Prepaid expenses include various discounts totaling € 1 million.

Development of Group Stockholders' Equity

				Minority Interests € in millions	
June 30, 1999	[illegible]	[illegible]	144	456	[illegible]
Profit distributions			(144)	(124)	[illegible]
Consolidated net income	[illegible]		164	243	672
Contribution to capital/capital reduction	(205)			159	(44)
Currency translation	49			3	52
Other changes	43			537	494
June 30, 2000	[illegible]	[illegible]	164	1,376	[illegible]
Profit distributions			(164)	(211)	[illegible]
Consolidated net income	641		149	184	970
Contribution to capital				25	25
Increase in profit participation certificates		10			10
Immediate offset of goodwill	(509)			(106)	[illegible]
Currency translation	90			21	[illegible]
Other changes	[illegible]			687	728
June 30, 2001	1,774	708	146	1,876	[illegible]

Capital Stock

	June 30, 2001 € in millions	
Capital stock	463	[illegible]
Capital earmarked to be called-in		[illegible]
	463	[illegible]

As of June 30, 2001, Bertelsmann AG shareholders are as follows:

Reinhard Mohn Verwaltungs GmbH	[illegible]
Johannes Mohn GmbH	48.34 %
ZEIT-Stiftung Eberhard und Gerd Bucerius	[illegible]
	100.00 %

Pursuant to an Executive Board resolution passed on March 13, 2000, the company called in 3,360 shares of Bertelsmann AG stock that had been purchased from the ZEIT-Stiftung for DM 400 million (€ 205 million). The called-in shares correspond to DM 33,600,000 (€ 17 million) in capital stock. Thus, Bertelsmann AG's capital stock is now at DM 944,800,000 (€ 463 million).

The company's initial capital consists of 94,480 shares at DM 10,000 per share.

Profit Participation Certificates

	June 30, 2001 € in millions	
Nominal value	536	605
Premiums	190	182
	306	[illegible]

The previous profit participation certificates governed by terms established in 1992 (referred to in the following as "profit participation certificates 1992") were converted to euros effective January 8, 2001. The nominal value of each individual profit participation certificate was determined to be € 0.01. In January 2001, Bertelsmann offered the owners of profit participation certificates 1992 the option of trading them in on a one to one basis for profit participation certificates with partially changed terms (referred to in the following as "profit participation certificates 2001"). The key distinguishing feature of the profit participation certificate 2001 is a new dividend provision. It stipulates that the dividend shall always be 15 percent provided that the consolidated net income and net income of Bertelsmann AG, as defined in the Profit Participation Certificate Terms and Conditions, are available in a sufficiently high amount. The profit participation certificates 2001 have a nominal value of € 10.00. At June 30, 2001, 90.3 % of all profit participation certificate owners had accepted the trade-in offer.

The employee profit-sharing scheme in fiscal year 1999/2000 reflected an increase in profit sharing capital based on the profit participation certificates 2001. The face value of the profit participation certificates increased by € 11 million, while the premium rose by € 8 million.

Retained earnings

	June 30, 2001 € in millions	
	1,371	1,044

The retained earnings balance comprised not only the reserves of Bertelsmann AG, including capital reserves of € 17 million and the legally required reserves of € 45 million, but also the profits and losses of the consolidated subsidiaries as well as adjustments resulting from the consolidation procedure.

Minority interests

	June 30, 2001 € in millions	
	1,876	1,218

Minority interests in the equity of consolidated companies mainly comprise stakes held by outsiders in the capital of RTL Group, Gruner + Jahr, BertelsmannSpringer and France Loisirs.

Provisions

	June 30, 2001 € in millions	
Pensions and similar commitments	1,537	1,444
Obligations for taxes	1,100	282
Other provisions	3,012	2,637
Thereof long-term	166	141
Thereof short-term	2,846	2,511
	5,709	4,364

The increase in the provisions for taxes is primarily a result of the sale of AOL Europe and mediaWays. Other long-term provisions principally refer to employee profit sharing and jubilee provisions. Other short-term provisions include obligations to the pension and social area, personnel Christmas bonuses, outstanding pension not vacation claims and royalty or license obligations.

Financial Debt

	June 30, 2001 € in millions	
Bonds	374	813
Promissory notes	256	256
Due to banks	1,542	2,236
Other financial debt	536	1,317
	2,708	4,622

The debt amounting to € 2,708 million results in a net debt of € 1,891 million when offset against cash and marketable securities amounting to € 823 million.

Bond Obligations Are	June 30, 2001 € in millions	
Bertelsmann U.S. Finance Inc. Wilmington		
3.375 % USD 200 million bond 1998/2004	200	200
4.375 % € 200 million bond 1999/2009	218	191
4.5 % DM 200 million bond 1998/2003	213	188
4.5 % DM 150 million bond 1997/2002	147	131
0.01 % JPY 1,000 million bond 1999/2001	USD 8.8 million	10
0.1 % JPY 1,000 million bond 1999/2004	USD 8.2 million	9
CLS/UFA		
6.375 % LUF 2,500 million bond 1993/2000	LUF 2,500.0 million	62
3.125 % LUF 2,500 million bond 1997/2007	LUF 2,500.0 million	62
Bertelsmann AG, Gütersloh		
10 % € 60 million bond 2000/2000	€ 60 million	60
	874	813

Bertelsmann U.S. Finance bonds that were not issued in U.S. dollars economically result in a U.S. dollar liability as well, due to swap agreements.

The financial debts were not secured.

Other Liabilities

	June 30, 2001 € in millions	[illegible]
Advances received	116	[illegible]
Trade accounts payable	2,488	2,473
Notes payable	22	27
Liabilities to associated companies	63	[illegible]
Liabilities to related companies	60	[illegible]
Miscellaneous liabilities		
taxes	375	555
social benefits	78	77
other	1,038	372
	4,239	1,734

The increase in other liabilities is mainly attributable to the strategic alliance with TerraLycos and the [illegible] Group's purchase of FremantleMedia (formerly Pearson TV).

The other liabilities were not secured.

Deferred Income

	June 30, 2001 € in millions	[illegible]
	336	318

As in the previous year, deferred income primarily includes prepaid magazine subscriptions.

Contingent Liabilities

	June 30, 2001 € in millions	[illegible]
Notes endorsed and discounted	27	23
Guarantees	770	747
Indemnity agreements	47	35
	844	805

Derivatives

	June 30, 2001 € in millions	[illegible]
Foreign currency hedging	2,154	2,909
Interest hedging	550	[illegible]
	2,704	4,081

Interest hedging consists of the following remaining life:

	€ in millions	[illegible]
under 3 years	544	[illegible]
more than 5 years	6	[illegible]
	550	[illegible]

Interest and currency fluctuations imply a risk that is difficult to estimate. Derivatives are entered into in order to reduce these risks from the operational business or financial transactions. These include foreign currency forward and option contracts, combined interest rate and currency swaps and pure interest rate swaps and options. Such transactions are only entered into with banks of first-class solvency. Contraction and documentation are subject to strict internal control. The transaction risks as of the balance sheet date have been taken into account. The presentation is stated in nominal values.

Other Financial Obligations		June 30, 2001 € in millions	[illegible]
	Rental and leasing contracts	1,044	[illegible]
	Other obligations	2,874	2,283
		3,918	4,121

Other obligations are primarily due to RTL Group, of which € 2,803 million are attributable to rights agreements, (co-) productions and programs.

Factoring Besides leasing, factoring is employed as a financial instrument. According to the principles of Bertelsmann AG, however, factoring is used only in precisely stipulated exceptional cases, usually of receivables from installment transactions with consumers in the encyclopedia business. As of June 30, 2001, the amount of outstanding receivables factored was approximately € 337 million (previous year: € 416 million).

Notes to the Consolidated Statement of Income		2000/01 € in millions	[illegible]
① Revenue	Germany	6,139	[illegible]
	Other European countries	6,308	4,721
	USA	6,446	5,586
	Other countries	1,142	1,173
		20,036	18,834

The above table discloses the regional breakdown of revenue. For revenues by corporate division, please refer to the Status Report.

② Change in Inventories and Other Manufacturing Costs Capitalized		2000/01 € in millions	[illegible]
	Change in inventories of finished goods and work in process	421	58
	Other manufacturing costs capitalized	1	
		422	60

③ Other Operating Income		2000/01 € in millions	[illegible]
	Gains on disposal of fixed assets	3,471	[illegible]
	Income from the reversal of accruals	332	[illegible]
	Other income	809	852
		4,612	[illegible]

The increase in profits from the disposal of fixed assets is primarily attributable to the divestitures of holdings in AOL Europe and mediaWays. Other income includes refunds, rent and lease income, foreign exchange gains and income from the reversal of redundant value adjustments. An amount totaling € 42 million is attributable to prior years.

④ Cost of Materials		2000/01 € in millions	[illegible]
	Cost of raw materials, supplies and merchandise	2,702	2,414
	Cost of services received	4,609	2,757
		7,311	5,171

⑤ Royalty and License Expenses		2000/01 € in millions	[illegible] € in millions
		1,840	1,812

Personnel Costs

	2000/01 € in millions	[illegible]
Wages and salaries	4,016	2,122
Social security charges	551	454
Cost of pension plans	116	77
Cost of social support	62	47
Employee profit participation	65	55
	4,382	2,355

The interest included in the allocation to pension provisions is disclosed under interest expenses.

Number of Employees by Division

			2000/01 Total	[illegible]
RTL Group	2,223	4,289	6,512	2,898
Random House	628	5,498	6,026	5,778
Gruner + Jahr	6,851	5,863	12,716	11,878
BMG	7,000	2,758	9,758	12,032
BertelsmannSpringer	2,186	2,022	5,208	4,965
Arvato	14,011	9,299	22,310	19,864
DirectGroup	1,834	13,800	15,634	13,068
Corporate Services	1,546	429	1,975	918
Total annual average	32,779	48,060	81,239	71,289

The total includes 574 employees from partially consolidated companies.

To improve comparability, changes in the re-composition of the company's divisions were also taken into account in the previous year's figures.

Depreciation and Amortization

	2000/01 € in millions	[illegible]
Amortization of intangible assets	102	581
Depreciation of property, plant and equipment	617	385
	1,419	946

Amortization of intangible assets includes an amount totaling € 182 million (previous year: € 255 million) representing the amortization of goodwill from individual financial statements and capital consolidation. Amortization of goodwill resulting from equity-based valuation is disclosed under the caption Income on Investments (net).

Other Operating Expenses

	2000/01 € in millions	[illegible]
Other operating expenses	6,473	6,134
Including other taxes	84	71

Other operating expenses primarily relate to advertising expenses of € 1,888 million, distribution and selling expenses of € 1,127 million and administration expenses of € 2,016 million.

Income from investments (Net)

	2000/01 € in millions	
Income from associated companies	73	[illegible]
Losses from associated companies	(205)	(142)
Income from related companies	29	112
Losses from related companies	(1)	(7)
Write-downs of investments (including € 20 million of goodwill amortization) from equity valuation (previous year: € 350 million)	(245)	(239)
	(349)	(37)

The clear decline in income from associated companies is a result of the first-time full consolidation of RTL Group for the full twelve-month period. In the previous year, the group was accounted for using the equity method for a six-month period. Also as a result of its IPO, Lycos Europe contributed a high income in the previous year. This year, Lycos Europe's negative results led to an increase in losses from associated companies.

The reduction in the amortization of goodwill from the equity valuation is due to the complete amortization of the goodwill of Barnesandnoble.com in the previous year.

Net interest income

	2000/01 € in millions	
Interest and similar income	177	126
Interest and similar expenses	(394)	(223)
Interest cost components of pension expense	(65)	(81)
	(282)	(178)

The interest included in the allocation of provisions for pensions and similar commitments is disclosed under the net interest income in the prior year.

Income taxes

	2000/01 € in millions	
Income taxes	1,322	238

The income tax burden rose markedly in absolute figures, as did the associated tax ratio, which rose to 37.7 percent from the previous year's 28.9 percent. This reflects fully taxable gains on disposals and the fact that tax loss carry forwards, primarily in the United States, were built up.

Exemption of domestic companies from audit and disclosure

The exemption notices of Paragraph 264, Section 3, of the German Commercial Code, applicable to the supplemental rules concerning their corporations in their preparation of annual financial statements and reviews of operations as well as their audits and disclosure, were applied to the following companies for the first time as of December 31, 2000:

Bertelsmann Immobilien GmbH, Gütersloh
Verlag Ullstein GmbH, Gütersloh
Medien Dr. phil. Egon Müller Service GmbH, Verl
Gütersloher Verlagshaus GmbH, Gütersloh
Reinhard Mohn GmbH, Gütersloh
Arabella Marketing GmbH, Munich
Bertelsmann Medien Service GmbH, Gütersloh
MSN Marketing Service Northwest GmbH, Gütersloh
AZ Bertelsmann Direct GmbH, Gütersloh
Drucklung, Grossdruck, Bücher- und Musikversand Gesellschaft mit beschränkter Haftung, Munich
Bertelsmann Multimedia GmbH, Gütersloh
Media Log Spedition GmbH, Gütersloh
BMG Music International Service GmbH, Munich
Bertelsmann Interactive Studios GmbH, Gütersloh
Verlag Heinrich Vogel GmbH, Feldkirchen, Munich
Wilhelm Goldmann Verlag GmbH, Munich
Bertelsmann Korea Beteiligungs GmbH, Gütersloh
Hotel & Gastronomie Gütersloh GmbH, Gütersloh
Mohn Media Grossdruck GmbH, Berlin
Crossmedia Marketing GmbH, Munich
BB Industriebeteiligungs GmbH, Gütersloh
UFA International Gesellschaft mit beschränkter Haftung, Munich
Vivendi Bertelsmann Verlag Gesellschaft mit beschränkter Haftung, Munich
Union-Verlagsgesellschaft mit beschränkter Haftung, Munich
Musik Edition Discotex Gesellschaft mit beschränkter Haftung, Munich
Bertelsmann Verlag Gesellschaft mit beschränkter Haftung, Munich
FUNKE Gesellschaft mit beschränkter Haftung, Cuxhaven
Arvato Storage Media GmbH, Gütersloh
FUCHSBRIEFE Dr. Hans Heinz GmbH, Berlin
Verlag Aktuelle Informationen Gesellschaft mit beschränkter Haftung, Frankfurt
Orbit GmbH, Berlin
Mediengesellschaft für Medienwirtschaftsdienste mbH, Hamburg
Bertelsmann Event Media GmbH, Gütersloh
Prestige Professional Banking GmbH, Gütersloh
Main Media Twenty GmbH, Gütersloh
MSW Marketing Service Southwest GmbH, Stuttgart
Bertelsmann Marketing Service Dortmund GmbH, Dortmund
Dunar Verlag GmbH, Kirchenweg
PSG Print Service Center GmbH, Osnabrück
RM Buch und Medien Vertrieb GmbH, Gütersloh
Bertelsmann Arena Aktiengesellschaft, Gütersloh
Bertelsmann Music Group GmbH, Gütersloh
Verlagsgruppe Random House GmbH, Gütersloh
BMG Deutschland GmbH, Gütersloh
Main Media Sales GmbH, Gütersloh
Main Media Print GmbH, Gütersloh
Sonopress Data Replication Gesellschaft für Informationsträgervervielfältigung mbH, Gütersloh
BMG Berlin Musik GmbH, Berlin
Bertelsmann Distribution GmbH, Gütersloh
Bertelsmann Training Service GmbH, Gütersloh
Bertelsmann Direct Marketing Media GmbH, Gütersloh
Bertelsmann Marketing Service GmbH, Gütersloh
Bertelsmann Services GmbH, Gütersloh
Bertelsmann Marketing Service Neuwinster GmbH, Neumünster
Bertelsmann Marketing Service Wuppertal GmbH, Wuppertal
Bertelsmann Marketing Service Munich GmbH, Munich
Bertelsmann Online Beteiligungsgesellschaft mbH, Gütersloh
Bertelsmann Online International GmbH, Gütersloh
Bertelsmann Valley Growth, Gütersloh
BeGone AG, Berlin
Mohn Media Group GmbH, Munich
IntroDUNE GmbH, Gütersloh
BmS Holding GmbH, Gütersloh
Druckhaus Maack GmbH, Lüdenscheid
Bertelsmann Corporate Networks GmbH, Hamburg
BS Autofilme Medien GmbH, Walldorf
Arvato Direct Verlagsgesellschaft mit beschränkter Haftung, Wiesloch
BB Gesellschaft für Beteiligungsverwaltung mbH, Wiesloch
Beteiligungs Gesellschaft mit beschränkter Haftung, Wiesloch
Bertelsmann Event Media GmbH, Gütersloh
Bertelsmann Multimedia Verlagsgesellschaft mbH, Munich
Bertelsmann Buch Auslieferungsgesellschaft, Gütersloh
B.C. Telecom Consultants mit beschränkter Haftung, Wiesbaden
Bertelsmann Springer Science+Business Media GmbH, Gütersloh
Dr. Bahner Orthopädie GmbH, Gütersloh
GGP Media GmbH, Pößneck
The exemption notices of Paragraph 264 b of the German Commercial Code were also claimed for the following companies for the first time as of December 31, 2000:

1990 FUTURA Vermögensverwaltungs mbH & Co. KG, Munich
Aufer Bertelsmann Verlag GmbH & Co. KG, Gütersloh
Bertelsmann Online-Dienst GmbH & Co. KG, Berlin
Verlag für Jugendschutz und Jugendpflege GmbH & Co. KG, Munich
BERTELSVERLAG GmbH & Co. KG, Berlin
Tessloff Verlag GmbH & Co. KG, Nuremberg
Bertelsmann Game Channel GmbH & Co. KG, Hamburg
Dr. L. Müller Verlag GmbH & Co. KG, Leipzig
ANGOLO GmbH & Co. KG, Gütersloh
Bertelsmann Broadband Group GmbH & Co. KG, Gütersloh
BS GmbH & Co. Schwung + Dutzi KG, Walldorf
BMG Arista Müller GmbH & Co. KG, Duisburg
The exemption notices of Paragraph 264 b of the German Commercial Code were also claimed for the following companies for the first time as of June 30, 2001:

Berliner Verlag GmbH & Co. KG, Berlin
PORSE OHLINE Verlag GmbH & Co. KG, Munich
"Business Transfer" Verlag GmbH & Co. KG, Hamburg
Dresdner Druck- und Verlagshaus GmbH & Co. KG, Dresden
eCTB market place GmbH & Co. KG, Hamburg
Dreiter & Sohn GmbH & Co., Bamberg
Co.Medien Verlag GmbH & Co. KG, Hamburg
STARLINE Commercial Vermögensverwaltungs mbH & Co. Drei KG, Frankfurt am Main KG, Berlin
The Verlag GmbH & Co. KG, Berlin

Remuneration Paid to the Supervisory Board and to the Executive Board

[redacted] The remuneration paid to the Supervisory Board amounted to € 638,558 plus VAT for fiscal 2000/01. The Executive Board received payments amounting to € 63,999,880 of which € 50,299,847 was paid by Bertelsmann AG. Former Executive Board members and their beneficiaries received € 12,506,107 in disbursements (retirement pensions and severance pay), which was paid by Bertelsmann AG. The provision for pension obligations to former members of the Executive Board of Bertelsmann AG totaled € 28,000,631. For a list of members of the Supervisory Board and the Executive Board, please refer to pages 66 and 8-9 of the Annual Report.

Proposed Profit Distribution

[redacted] Total retained earnings of Bertelsmann AG amounted to DM 483,119,000 (€ 206 million) of which DM 186,668,414 (€ 33 million) will be distributed as dividends on profit participation certificates. This distribution is due on October 18, 2001 and is 18.51 percent of the par value of the profit participation certificates totaling DM 1,008,473,333.36 (€ 516 million).

The Executive Board proposes in the Annual General Meeting to appropriate the remaining retained earnings of DM 216,450,586 (€ 111 million) after distribution to the holders of profit participation certificates as follows:

Dividends to stockholders	97,791,036 DM	(€ 50 million)
Carry forward to new fiscal year	118,659,550 DM	(€ 61 million)
	216,450,586 DM	(€ 111 million)

Gütersloh, October 12, 2001

Bertelsmann Aktiengesellschaft
The Executive Board

Thomas Middelhoff | Arnold Bahlmann | Klaus Eierhoff | Bernd Kundrun | Siegfried Luther

Peter Olson | Hartmut Ostrowski | Rolf Schmidt-Holtz | Günter Thielen

Independent Auditors' Report

We have audited the consolidated financial statements and the group status report prepared by the Bertelsmann Aktiengesellschaft, Gütersloh, for the business year from July 1, 2000 to June 30, 2001. The preparation of the consolidated financial statements and the group status report in accordance with German commercial law and supplementary provisions in the articles of association agreement are the responsibility of the Company's management. Our responsibility is to express an opinion on the consolidated financial statements and the group status report based on our audit.

We conducted our audit of the consolidated annual financial statements in accordance with § 312 HGB ("Handelsgesetzbuch: German Commercial Code") and the generally accepted German standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (in Germany) (IDW). These standards require that we plan and perform the audit such that misstatements materially affecting the presentation of the net assets, financial position and results of operations in the consolidated financial statements in accordance with German principles of proper accounting and the group status report are detected with reasonable assurance. Knowledge of the business activities and the economic and legal environment of the Company and evaluations of possible misstatements are taken into account in the determination of audit procedures. The effectiveness of the internal control system relating to the accounting system and the evidence supporting the disclosures in the consolidated financial statements and the group status report are examined primarily on a test basis within the framework of the audit. The audit includes assessing the annual financial statements of the companies included in consolidation, the determination of the companies to be included in consolidation, the accounting and consolidation principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements and the group status report. We believe that our audit provides a reasonable basis for our opinion.

Our audit has not led to any reservations.

In our opinion, the consolidated financial statements give a true and fair view of the net assets, financial position and results of operations of the Group in accordance with German principles of proper accounting. On the whole the group status report provides a suitable understanding of the Group's position and suitably presents the risks of future development.

Gütersloh, October 15, 2001

KPMG Deutsche Treuhand-Gesellschaft
Aktiengesellschaft
Wirtschaftsprüfungsgesellschaft

Reinke
Wirtschaftsprüfer
(German Public Auditor)

Kämpf
Wirtschaftsprüfer
(German Public Auditor)

Corporate Structure and Companies

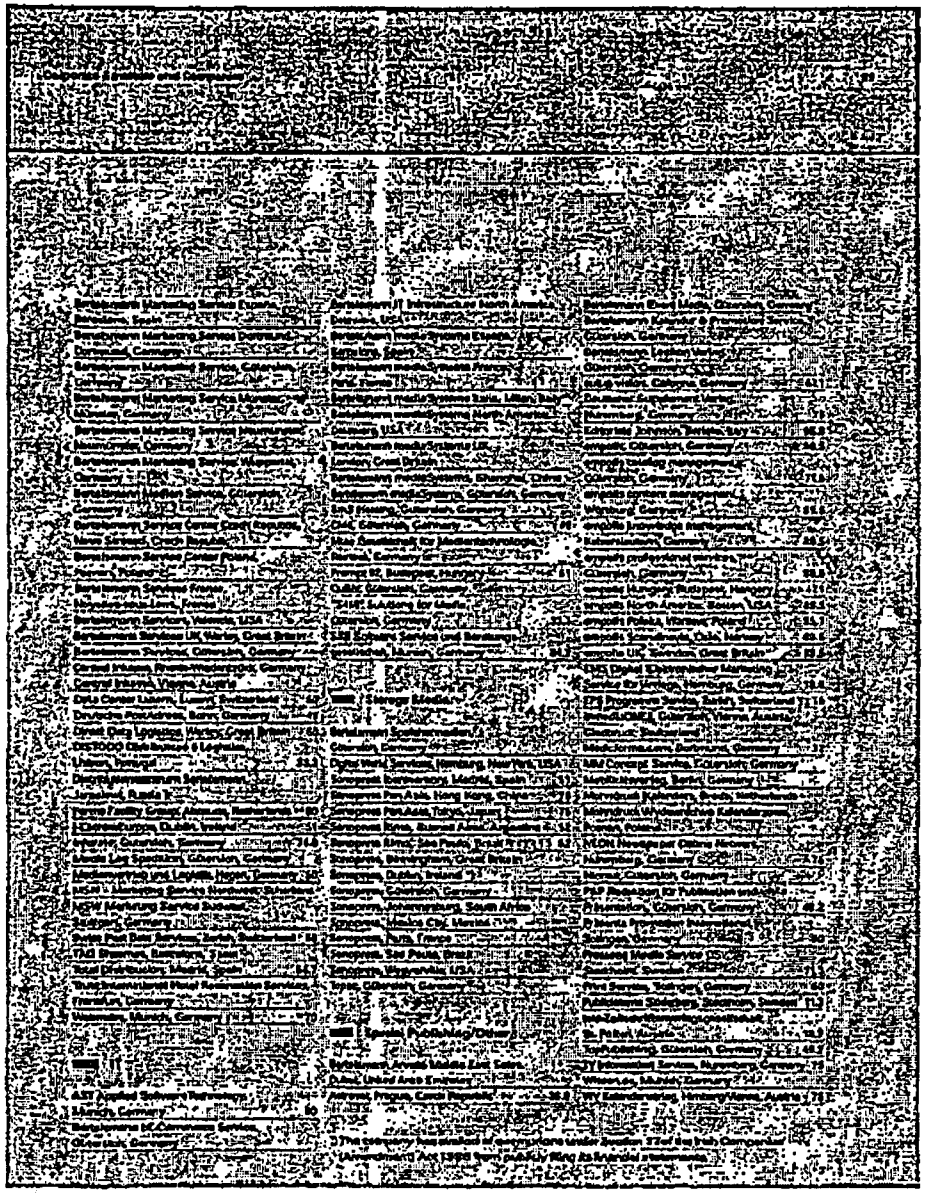
RTL Group

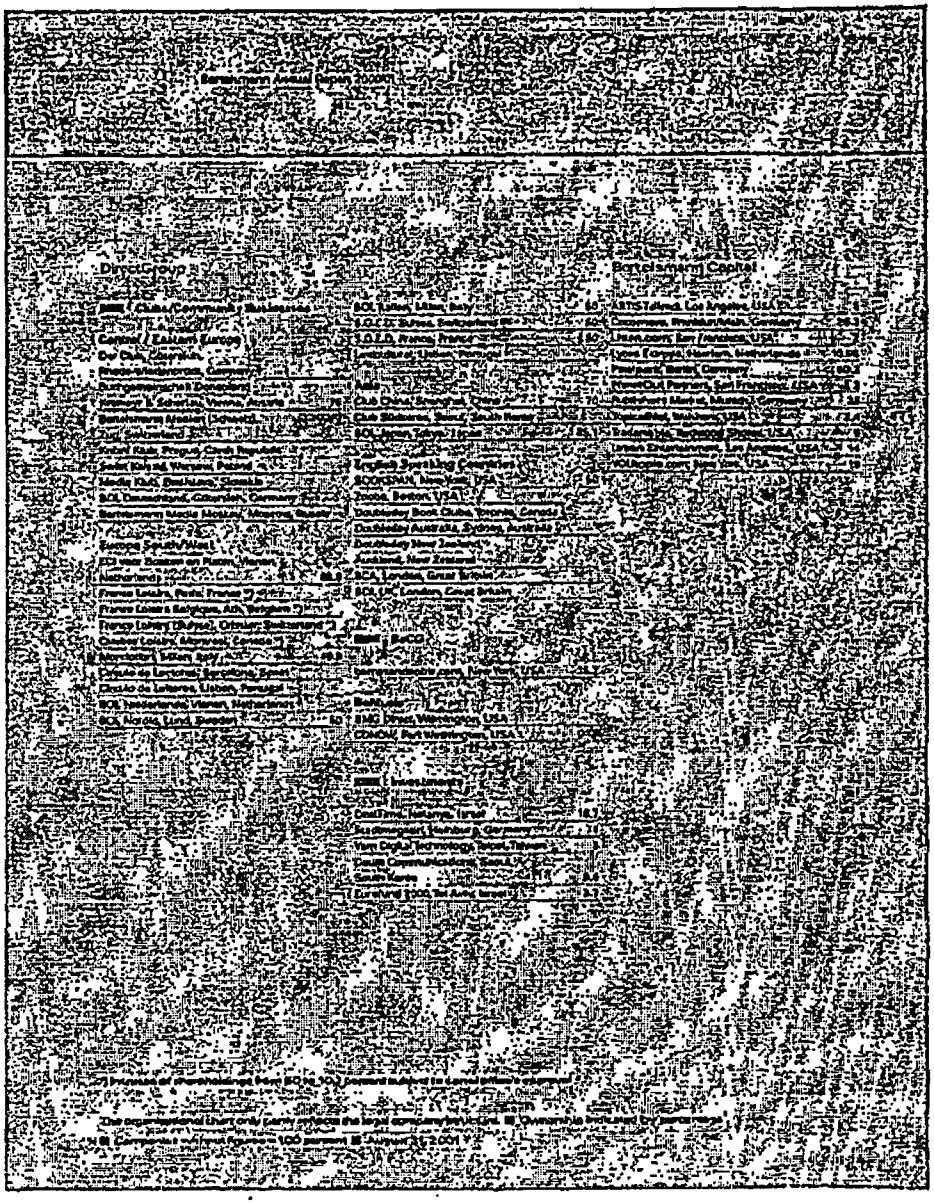
Random House

Gruner + Jahr

BMG

BertelsmannSpringer





Our Mission

Bertelsmann is an international media corporation providing information, education and entertainment around the globe. Throughout the enterprise, our focus is on creative excellence, good customer relations and strong return on capital. We strive to be leaders in the markets we serve. Our purpose is to contribute to the advancement of society. We are committed to the continuity and progress of our Corporation. We will provide fair working conditions that will help motivate our employees.

We seek to engage in dialogue with all who have an interest in Bertelsmann: holders of profit participation certificates, journalists, analysts, business partners, and potential new personnel. We would like to provide you with the best information possible on the Bertelsmann organization – from late-breaking news to insightful commentary. We invite inquiries or comments by e-mail, postal mail or telephone. We look forward to hearing from you.

You can find current information on Bertelsmann at:

// bertelsmann.com

For further information please contact:

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Imprint

Editing and Coordination: Corporate Communications/Media and Financial Information
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Photography: Marek Vogel, Munich, Germany (Cover, pages 1, 10, 13, 14 (photo left), 15-23, 20/21, 32/33, 38/39, 41/43, 50/51, 54/55, 60/61)
Production: Top Publishing GmbH, Gütersloh, Germany
Printed by: MOHN Media - Mohndruck GmbH, Gütersloh, Germany

EXHIBIT CO 0924

Gorillaz

Trace Adkins

Jermaine Dupri

Sean Paul

Kanye West

Robbie Williams

KT Tunstall

Rolling Stones

Coldplay

Daniel Powter

Kelly Clarkson

Keith Urban

Natasha Bedingfield

Paul McCartney

EMI

EMI Group plc
Annual Report 2006

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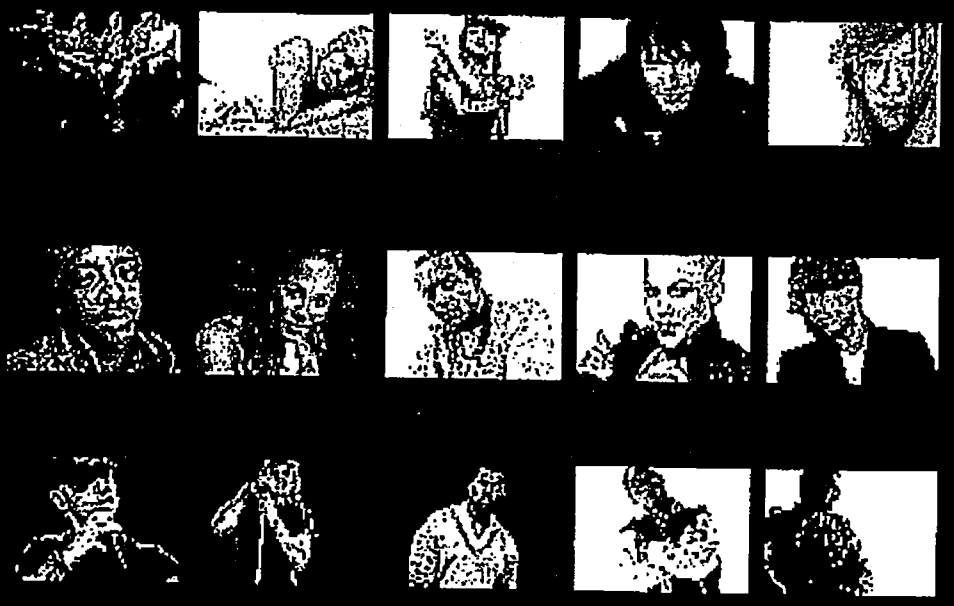
EMI Music

EMI Music is the recorded music division of EMI, and has a diverse roster of artists from across the world as well as an outstanding catalogue of recordings covering all music genres. Below are EMI Music's top-selling artists and albums of the year.*

* All sales figures shown are for the 12 months ended 31 March 2008. Three EMI Music artists each had two albums selling more than one million copies. In addition to their records shown above, Coldplay had *A Rush Of Blood To The Head* (1.2m), RBD had *Nuestro Amor* (1.1m) and Robbie Williams had *Greatest Hits* (1.1m).

EMI Music Publishing

EMI Music Publishing represents songwriters and their work, and owns the copyright to the best-performing catalogue of songs in the world. Below are some of EMI Music Publishing's most successful writers and songs of the year.



* EMI Music Publishing represents Black Eyed Peas band members Fergie and George Pajon.

Investing over 20% of revenues in musicians and music in more than 50 different countries every year

The world's biggest-selling album in 2005, both digital and physical, with Coldplay's *X&Y*

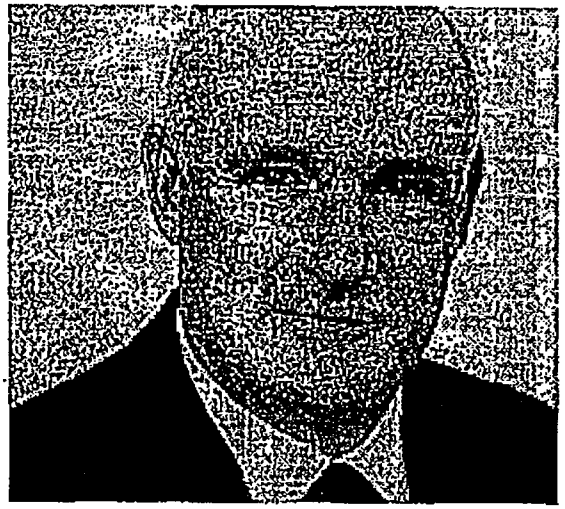
Leading the way in digital, with hundreds of new business partnerships around the world

20 million-plus selling albums in 2005 from 6 different countries

Publisher of the year for the past 12 years

32 Grammy Awards in 2006

Chairman's statement



Eric Nicoli
Chairman, EMI Group

EMI has had an excellent year.

I am pleased to report that both our recorded music and music publishing divisions outperformed the rest of the industry delivering growth in Group revenues of 3.9% (2.1% at constant currency) and a strong improvement in Group underlying profit before tax of almost 13%. Group digital revenues of £112.1m represent a 139% increase on the previous year's level and account for 5.4% of total Group revenues.

EMI Music enjoyed considerable creative success gaining market share on a global basis and in almost every region of the world including the US market. At constant currency, the division reported revenue growth of some 1.9% with digital sales almost tripling in value. This strong performance reflects EMI Music's continuing commitment to creative excellence with successful releases from a broad range of artists which included 20 album releases selling more than 1m units in the year. Topping the list was Coldplay's *X&Y* which sold nearly 10m units making it the world's biggest selling album of 2005 in both physical and digital format.

EMI Music Publishing remained the world's leading music publisher delivering constant currency revenue growth of approximately 2.6%. Digital revenues were an important contributor to this division's growth and accounted for almost 5% of total revenues in the year.

I believe these results provide further evidence of the validity of our strategy and the effectiveness of our management approach. Whilst we are operating in a marketplace clearly in transition, it is heading in a positive direction and presents us with exciting growth opportunities in the future.

Our strategic approach over the last five years has involved refocusing EMI on the needs and desires of the modern consumer; aligning our interests more closely with our artists in what is a rapidly changing distribution landscape; investing in our people, skills and technological capabilities; and ultimately setting as our guiding principle the selection and development of and investment in unique long-term artists and musical content.

Our well planned programme of transformational change has resulted in the removal of more than £150m of fixed costs with a further £30m planned and ensures we operate effectively and efficiently in the new, dynamic digital consumer-driven environment. These cost savings have been achieved whilst continuing our investment in artist development in both divisions and building our technological and management capability. Our systems development programme is well advanced, our management skill set has strengthened and broadened considerably while our creative performance has flourished. This strategy has allowed EMI to remain agile, flexible, progressive and at the forefront of adapting business practices.

Our unflinching commitment to creative excellence has produced an encouraging blend of established and emerging global and local stars and impressive global reach.

The top-selling artists at EMI Music in the year reflect our A&R strategy in practice, with superstars like Coldplay, Robbie Williams, Gorillaz, the Rolling Stones and Keith Urban topping the charts around the world, while a number of our breaking acts enjoyed tremendous success on their home ground including Dem Franchize Boyz, Trace Adkins and Dierks Bentley in the US, Radja in Indonesia, Raphael and Diam's in France, RBD in Latin America and, Magic Numbers, KT Tunstall and Corinne Bailey Rae in the UK.

We believe that our on-going commitment to investing in local repertoire not only provides greater consumer choice but presents significant business opportunities. Local repertoire features highly on our top 20 best-selling albums with Radja, Raphael and RBD selling over 1m units each. Indeed, RBD's sales, over four releases, totalled more than 3m units in this financial year.

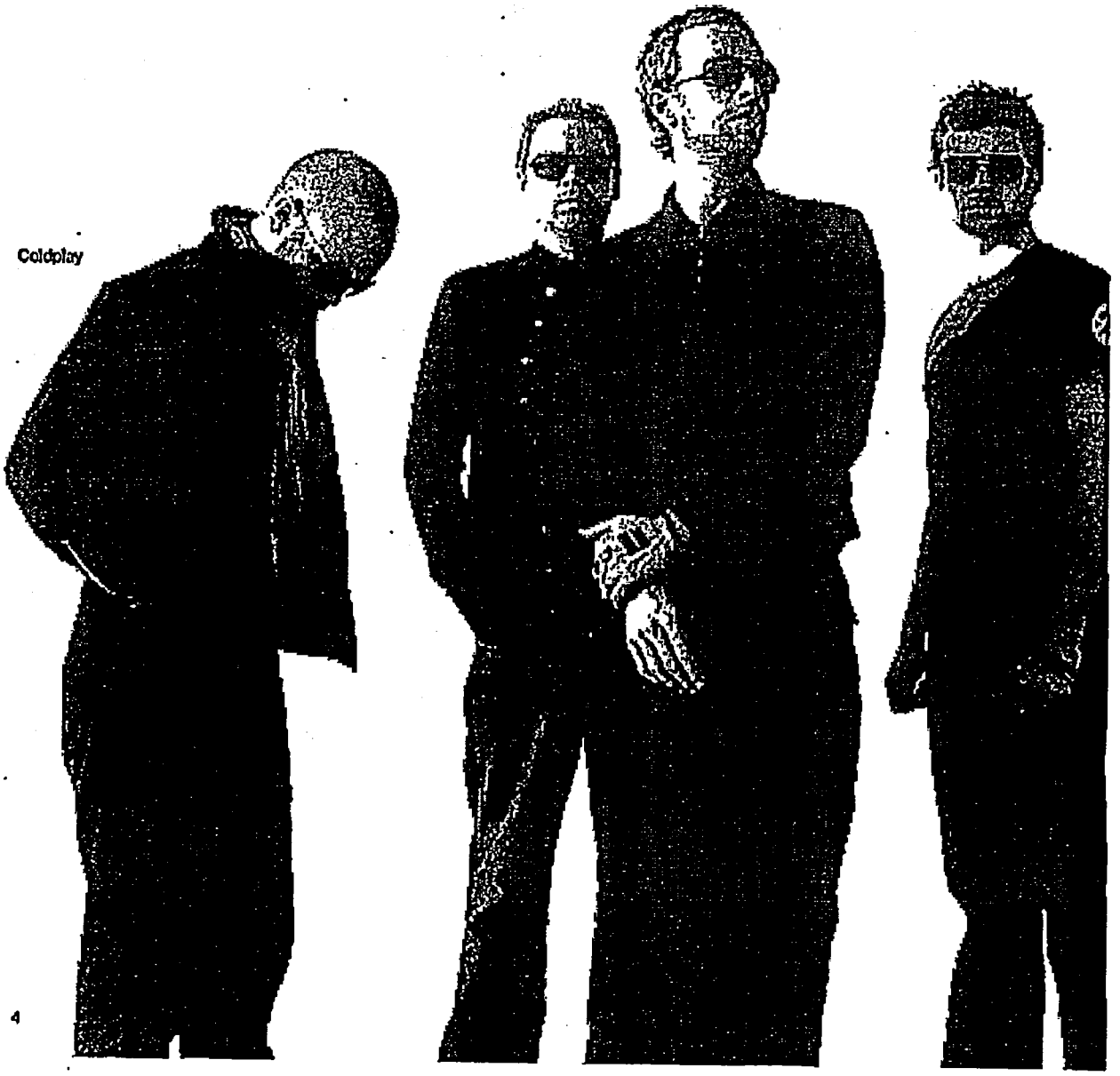
As well as our international credentials, we strive for musical diversity. Our recent performance demonstrates an impressive breadth of style and repertoire which includes pop, rock, urban, Latin, country and jazz music. We also continue to excel in classical and Christian music.

In addition to the successes among our active roster of artists, our rich and deep back catalogue – which includes The Beatles, the Rolling Stones, Queen, Pink Floyd, the Beach Boys and Frank Sinatra – continues to provide a recurring revenue stream through intelligent marketing and innovative re-presentations.

Creative excellence is also the principal driver of EMI Music Publishing's success. This division is the home to many of the world's best songwriters including Guy Chambers, Cathy Dennis, Eminem, Alicia Keys, Kanye West and Usher and some notable additions during the year such as Arctic Monkeys, James Blunt and Kelly Clarkson. This fantastic artist roster – coupled with our management's highly regarded ability to gain exposure for, and usage of, these songs – has allowed our publishing business to prosper, diversify and create new revenue streams. All of this has helped the division establish a strong platform from which to grow faster as the market recovery continues.

Looking ahead, we continue to believe that the increasing demand for digital music will return the global market to growth in the near future.

We have been, and intend to remain, at the cutting edge of the rapidly advancing digital marketplace by partnering with a host of digital content distributors and facilitating the development of a broad range of business models. With online downloading now well established and growing fast, and the arrival of exciting new offerings such as subscription, legal peer to peer and wireless, our vision of having the ability to present our content to all music fans, everywhere in the world, all of the time is now a reality.



Coldplay

Legitimate digital sales now represent a meaningful proportion of our business and they are growing at an exciting rate. Indeed for the industry, this growth in digital revenue has almost offset the decline in physical sales during the year. Of course, we must continue to take steps to discourage theft of our intellectual property and our efforts in that direction will not diminish. With a combination of education, technology and, where necessary, legal process, we are confident that piracy can be contained and that we can motivate the vast majority of consumers to enjoy legal content.

Of course, our achievements during the year were only possible because of the extraordinary dedication and commitment of all of my colleagues across the EMI world. People are the lifeblood of any business and at EMI we are well served by a world class Board and senior management team which has delivered creative and commercial success in extraordinarily challenging market conditions in recent years. We also have immensely accomplished staff across the Group covering the full range of functional skills and disciplines necessary to compete effectively in our rapidly changing world.

And just as we take pride in our people, we take our social and environmental responsibilities seriously and we work hard to contribute to the health and development of the communities in which we operate. Our independent music education charity, the EMI Music Sound Foundation, has continued its support for music students, teachers and schools. To date, it has awarded in excess of £2.5m in grants and we look forward to its tenth anniversary next year. In addition, we were pleased to be able to lend our support to the remarkable Live 8 concerts of last summer, where a number of our artists also performed, and to a number of other important charitable causes.

Our results show that EMI is thriving in its own right and, I believe, that we have created a strong platform from which to pursue the possible acquisition of Warner Music Group Corp. (Warner Music).

As was announced on 3 May 2006, we made an approach to Warner Music on 1 May 2006 in connection with a proposed offer to acquire all of the outstanding shares of Warner Music for US$28.50 per share, in a combination of cash and EMI shares. Subsequently, on 2 May 2006, Warner Music informed EMI that it did not wish to enter into discussions regarding this proposal.

We continue to believe that an acquisition of Warner Music would be very attractive to the shareholders of both companies. The industrial logic of a combination is compelling and the available synergies would unlock significant additional value.

EMI shareholders can be assured that we will only pursue a transaction with Warner Music if it delivers meaningful earnings accretion and value enhancement for them.

Overall, we have enjoyed a year of strong performance and solid achievement and we look forward with confidence to making further progress and participating fully in the music market's recovery.

Eric Nicoli
Chairman
22 May 2006

Operating and Financial Review

This Operating and Financial Review has been prepared for and only for the members of the Company, as a body, and no other persons. It should not be relied upon by any other party for any purpose.

This Operating and Financial Review contains forward-looking statements that are subject to risk factors associated with, among st other things, the economic and business circumstances occurring from time to time in the countries, sectors and markets in which the Group operates. These and other factors could adversely affect the outcome and financial effects of the plans and events described. By the nature, forward-looking statements are involve a number of risks, uncertainties and assumptions because they relate to events and/or depend on circumstances that may or may not occur in the future and could cause actual results and outcomes to differ materially from those expressed in or implied by the forward-looking statements. It is believed that the expectations reflected in these statements are reasonable but they may be affected by a wide range of such variables. No assurances can be given that the forward-looking statements in this Operating and Financial Review will be realised. The forward-looking statements reflect the knowledge and information available at the date of preparation and will not be updated during the year.

The Operating and Financial Review discusses the following areas:

1. Description of operations p6
2. Long-term strategy and business objectives p9
3. Results for the year ended 31 March 2006 p10
4. Key performance indicators p10
5. Performance review for the year ended 31 March 2006 p11
6. Financial review for the year ended 31 March 2006 p18
7. Future outlook p22
8. Risks and uncertainties p23
9. Resources p27
10. Environmental matters p28
11. Social and community issues p28
12. Critical accounting policies and use of estimates p28

1. Description of operations

EMI Group is composed of two divisions:

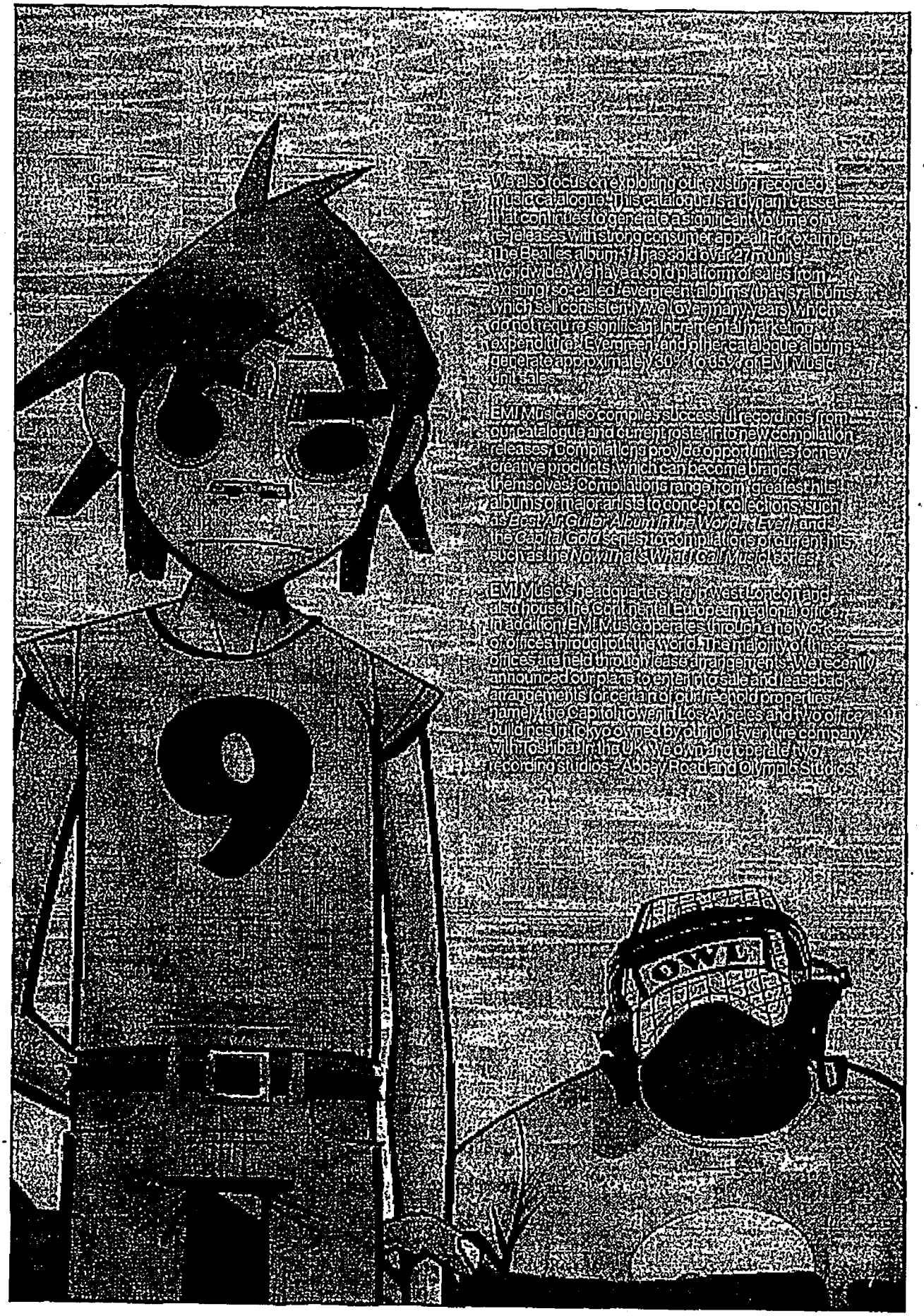
- recorded music: EMI Music; and
- music publishing: EMI Music Publishing.

EMI Music

EMI Music is one of the largest music businesses in the world. We have one of the world's most extensive catalogues of recordings, with over 3 million individual tracks. Of these tracks, approximately 600,000 are currently in active release on nearly 60,000 albums. Our record labels include Angel, Astralwerks, Blue Note, Capitol, Capitol Nashville, EMI, EMI Classics, EMI CMG, EMI Latin, Music Mute, Narada, Parlophone and Virgin and are home to a diverse roster of some 1,600 artists who encompass a wide range of musical genres from classical, jazz, country and Christian music to alternative rock, pop, rap/urban and dance music. For the year ended 31 March 2006, EMI Music generated revenue of £1,660.3m and operating profit before exceptional items and amortisation (EBITA) of £115.1m.

EMI Music identifies potentially successful recording artists, signs them under recording contracts, collaborates with them to produce recordings of their work, markets the finished recordings to consumers and radio and sells the releases into the retail trade in a variety of formats, primarily CDs, but increasingly in various digital formats. We strive to achieve a balance across genres between new releases and catalogue, across distribution channels and among the repertoire sources.

Although the primary source of global popular repertoire has historically been the United Kingdom and the United States, we are also focused on developing local repertoire that appeals to consumers' tastes in each of our local territories. We continually invest in local repertoire in most of our territories and, where there is opportunity, seek to transfer repertoire from one region to another.



We also focus on exploiting our existing recorded music catalogue. This catalogue is a dynamic asset that continues to generate a significant volume of re-releases with strong consumer appeal. For example, The Beatles album 1 has sold over 27m units worldwide. We have a solid platform of sales from existing, so-called, evergreen albums (that is, albums which sell consistently well over many years) which do not require significant incremental marketing expenditure. Evergreen and other catalogue albums generate approximately 30% to 35% of EMI Music unit sales.

EMI Music also compiles successful recordings from our catalogue and current roster into new compilation releases. Compilations provide opportunities for new creative products which can become brands themselves. Compilations range from greatest hits albums of major artists to concept collections, such as *Best Air Guitar Album in the World (Ever)*, and the *Capital Gold* series, to compilations of current hits, such as the *Now That's What I Call Music!* series.

EMI Music's headquarters are in West London and also house the Continental European regional office. In addition, EMI Music operates through a network of offices throughout the world. The majority of these offices are held through lease arrangements. We recently announced our plans to enter into sale and leaseback arrangements for certain of our freehold properties, namely the Capitol Tower in Los Angeles and two office buildings in Tokyo owned by our joint venture company with Toshiba. In the UK, we own and operate two recording studios – Abbey Road and Olympic Studios.

In December 2005, we sold our former manufacturing plant in Gotemba, Japan to a consortium led by Memory-Tech Corporation. This deal completed the outsourcing of all of EMI Music's worldwide manufacturing operations apart from a small facility in Canada. We carry out our own distribution activities in a number of territories, notably the UK, Ireland, US, Hong Kong, Thailand and Singapore. In other territories, such as Japan, Australia, New Zealand, South Korea, Malaysia, Taiwan and Scandinavia, we have entered into distribution joint-venture arrangements with other music companies. In certain territories, such as Latin America, Indonesia, India, Philippines, Benelux, France, Germany, Italy, Spain and Portugal, distribution services are carried out on our behalf by third parties.

EMI Music Publishing

Our other principal division is EMI Music Publishing, which is the world's largest music publisher in terms of revenues. Our roster of active songwriters is responsible for many of the hit songs of today, and the songs they create are added to our valuable catalogue comprising over 1m copyrights in musical compositions which we own, control or administer. For the year ended 31 March 2006, EMI Music Publishing generated revenue of £419.6m and EBITA of £105.4m.

Music publishing is the business of acquiring, protecting, administering and exploiting rights in musical compositions. It is a business based on the songs themselves as distinct from the recordings, films, commercials or other media in which they are used. Music publishers earn their revenue from licensing the right to use their songs.

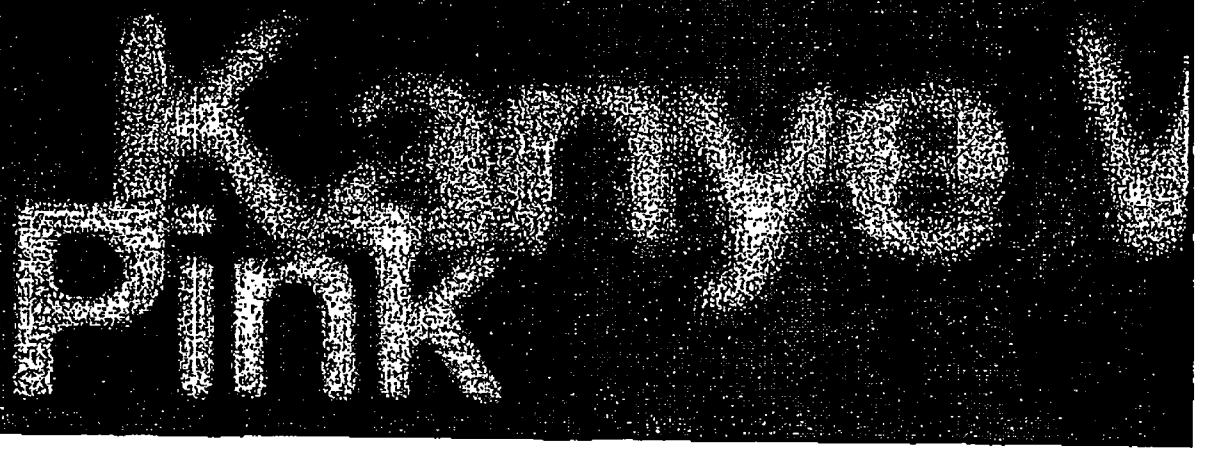
Our publishing catalogues include SBK (CBS Songs, MGM and United Artists), Filmtrax (Columbia Pictures and Television), Screen Gems, Virgin, Jobete (Motown) and a substantial part of the Windswept Pacific catalogue.

EMI Music Publishing acquires copyrights or a share of the copyrights in musical compositions, or enters into agreements to administer copyrights or a share of copyrights, and exploits the compositions by licensing them for inclusion on records, film, television and other media, seeking new uses for the compositions, and administering and collecting the proceeds generated. In return for providing these services, we are entitled to a percentage of the royalty income, which varies from contract to contract. EMI Music Publishing is constantly refining its collection of songs with a view to having the finest songs on offer to those who use musical compositions.

EMI Music Publishing derives its revenues from:

- mechanical royalties, primarily from the sale of music in CD format, but also from DVDs, audio cassettes, online downloads and items such as music boxes and player pianos (45% of EMI Music Publishing revenue in the year);
- performance royalties paid for the performance of a song on radio or television broadcasts, webcasts, cabarets, live concerts, sporting events, shops and restaurants (27% of EMI Music Publishing revenue in the year);
- synchronisation royalties, derived from the use of songs in visual works such as television programmes, films, advertisements, computer games or karaoke (17% of EMI Music Publishing revenue in the year); and,
- other uses, which include ring tones, ring tunes, ring backs, stage productions, sheet music, merchandise and music from our background library (11% of EMI Music Publishing revenue in the year).

EMI Music Publishing has its worldwide headquarters in New York. In addition, it operates through regional and local offices, most of which are held on leasehold arrangements, in key markets throughout the world.



2. Long-term strategy and business objectives

EMI Group's strategy is to create shareholder value by developing the best musical content at both our recorded music business, EMI Music, and our music publishing business, EMI Music Publishing, and to exploit fully this valuable content on a global basis through all economically attractive channels.

Our investment in artists and repertoire (A&R) is fundamental to our ability to create new, exciting music. At the core of our A&R strategy is the identification and development of artists and songwriters with the potential to enjoy long-term commercial success across multiple releases and revenue streams. Focusing on long-term career artists has favourable economics, driving increased sales and profitability. By replicating this process across geographies and musical genres, we have assembled in EMI Music and EMI Music Publishing exceptional portfolios of music content which exhibit strength, breadth and depth.

EMI's overriding goal is to maximise the value of these content assets and a key element of this is successful marketing and promotion. Our presence in over 50 countries enables us to exploit the valuable local opportunities as well as giving us a powerful global network. At EMI Music, specialised local marketing teams work alongside our dedicated international marketing team to share best practice and also to promote local A&R successes into global superstars. Ultimately we seek to maximise revenues at a local and a global level.

EMI Music Publishing is creative in proactively marketing its songs for increased and new uses. The business has dedicated teams that develop and maintain relationships with, for instance, advertising agencies, film and television producers and video-game makers. This has resulted in a broadening of EMI Music Publishing's client base and increased revenue generation.

Digital technology is multiplying the ways in which we can monetise our music assets and our key strategic priority is to continue to position the business to capitalise fully on the expanded revenue and profit opportunity that this brings. We are making our music content available on all economically attractive platforms, formats and services to ensure the widest consumer reach and we currently have relationships with almost 400 digital partners for products and services ranging from a la carte audio and video downloads to ring tones, ring tunes, subscription and legalised peer to peer services.

One of our priorities is to establish the optimal infrastructure to operate most successfully in the digital world. We are making a significant investment in new technology to equip us for the new landscape, including the development of global marketing tools and royalty and payment systems. At EMI Music Publishing, we are driving the industry's efforts to implement appropriate payment and collection structures for the new digital revenue streams. Most recently, EMI Music Publishing signed a heads of agreement with the UK and German collection societies to establish a pan-European licensing and collection mechanism for mobile and online digital rights.

In summary, EMI's strategy is to create, develop and realise fully the value of high quality music content. In combination with an on-going focus on costs and cash generation, EMI's management believes that this strategy should deliver improved financial performance and growing shareholder returns.

3. Results for the year ended 31 March 2006

- Group revenue increased by 3.9% on a reported basis and by 2.1% at constant currency, with both EMI Music and EMI Music Publishing outperforming the global recorded music industry.
- This strong performance reflects creative excellence across both divisions and, in particular, the ability to successfully develop new artists.
- Group digital revenue more than doubled in the year, increasing by £65.2m to £112.1m.
- Group operating margin increased by almost a full percentage point to 12.0% from 11.2%. This improvement was driven by higher revenues, a greater proportion of revenues from digital, and the delivery of previously announced cost savings.
- Underlying profit before tax increased by 12.9% to £159.3m from £141.1m.
- Underlying diluted earnings per share increased by 19.8% to 15.7p from 13.1p.
- The full-year dividend is maintained at 8.0p per share.

Financial summary

	Year ended 31 March 2006 £m	Year ended 31 March 2005 £m
Revenue	2,078.9	2,001.2
EBITDA (i)	275.8	250.2
Underlying Group profit from operations (EBITA) (ii)	250.5	225.1
Underlying PBT (iii)	159.3	141.1
Total profit before taxation	118.1	98.8
Underlying diluted earnings per share (iv)	15.7p	13.1p
Basic earnings per share	10.9p	9.6p
Dividend per share	8.0p	8.0p
Return on sales (v)	12.0%	11.2%
Interest cover (vi)	3.0x	2.9x

(i) EBITDA is Group profit from operations before depreciation and operating exceptional items and amortisation.
(ii) Underlying Group profit from operations (EBITA) is before operating exceptional items and amortisation.
(iii) Underlying profit before taxation (PBT) is before exceptional items and amortisation.
(iv) Underlying diluted earnings per share is before exceptional items and amortisation.
(v) Return on sales is defined as Group profit from operations before operating exceptional items and amortisation as a percentage of Group revenue.
(vi) Interest cover is defined as the number of times EBITDA is greater than Group net finance charges.

Exceptional items include operating exceptional items and finance exceptional items. Operating exceptional items include impairment of goodwill and music copyrights and intangibles, gains (losses) on disposal of property, plant and equipment and remeasurement of listed investments. Finance exceptional items include remeasurement of financial assets and liabilities to be included within finance charges and exceptional refinancing costs.

4. Key performance indicators

The Board and management of EMI use a number of key performance indicators to assess the on-going performance of the business, of which the principal ones are disclosed in the table on the right. We believe it is important to look at performance on both a Group and divisional basis. Given the changing nature of the industry in which we operate, we believe it is most instructive to assess EMI's performance relative to the overall industry performance where possible. At this early stage of the digital market's development, we believe that there is no single measure on which one can assess the Group's digital business performance.

	2006	2005
Group		
Earnings per share (diluted, underlying EPS)(i)	15.7p	13.1p
Operating free cash conversion(ii)	93.8%	112.5%
EMI Music		
EMI Music market share(iii)	13.1%	12.9%
EMI Music operating margin(iv)	8.7%	7.8%
EMI Music Publishing		
EMI Music Publishing revenue growth(v)	2.6%	4.9%
EMI Music Publishing operating margin(vi)	25.1%	24.9%

Notes

(i) Earnings per share (diluted, underlying EPS)

Definition: Underlying Earnings (£m)/Diluted Shares (m).
Calculation: Underlying Earnings is profit from continuing operations after taxation, adjusted for exceptional items, amortisation, finance exceptional items, minority interests and convertible bond interest. Diluted Shares is the weighted average number of Ordinary Shares in issue, adjusted for dilutive share options and convertible bond options.
Purpose: To assess the progression of underlying profit generation within the Group.
Source: Internal Company data and audited Financial statements.

(ii) Operating free cash conversion

Definition: Operating Free Cashflow (£m) / Underlying EBITA (£m).
Calculation: Operating Free Cashflow is calculated by taking underlying Group Profit from operations (EBITA), adding back depreciation and other non-cash movements and deducting net capital expenditure and net working capital movements. This is divided by underlying Group EBITA to reach a cash conversion percentage.
Purpose: To assess the ability of the Group to convert operating profits into cash.
Source: Internal Company data and audited Financial statements.

(iii) EMI Music market share

Definition: EMI Music global market share (%).
Calculation: EMI Music revenue divided by recorded music industry sales.
Purpose: To assess how EMI Music is performing in its particular market.
Source: EMI internal estimates based on official data received from the global recording industry association, the IFPI. Official IFPI data is used as it is the most reliable independently calculated estimate. EMI measures its revenues for market share purposes following the guidelines used by the IFPI to measure the recorded music market in order to ensure comparability.

(iv) EMI Music operating margin (EBITA % margin)

Definition: EMI Music EBITA after corporate costs (£m) / EMI Music revenue (£m).
Calculation: EMI Music EBITA is stated after the deduction of Group central costs (allocated on a share of revenue basis) but before exceptional items and amortisation. This is then divided by EMI Music revenue to obtain an operating margin percentage.
Purpose: To assess the progression of underlying profitability within EMI Music.
Source: Internal Company data and audited Financial statements.

(v) EMI Music Publishing revenue growth

Definition: Constant currency revenue growth (%).
Calculation: Revenue growth is presented at constant currency. The effect of currency fluctuations is eliminated by translating local currency data into Sterling at the same rate in both years.
Purpose: To assess EMI Music Publishing revenue progression, in the absence of third-party market share data.
Source: Internal Company data and audited Financial statements.

(vi) EMI Music Publishing operating margin (EBITA % margin)

Definition: EMI Music Publishing EBITA after corporate costs (£m)/EMI Music Publishing revenue (£m).
Calculation: EMI Music Publishing EBITA is stated after the deduction of Group central costs (allocated on a share of revenue basis) but before exceptional items and amortisation. This is then divided by EMI Music Publishing revenue to obtain an operating margin percentage.
Purpose: To assess the progression of underlying profitability within EMI Music Publishing.
Source: Internal Company data and audited Financial statements.

5. Performance review for the year ended 31 March 2006

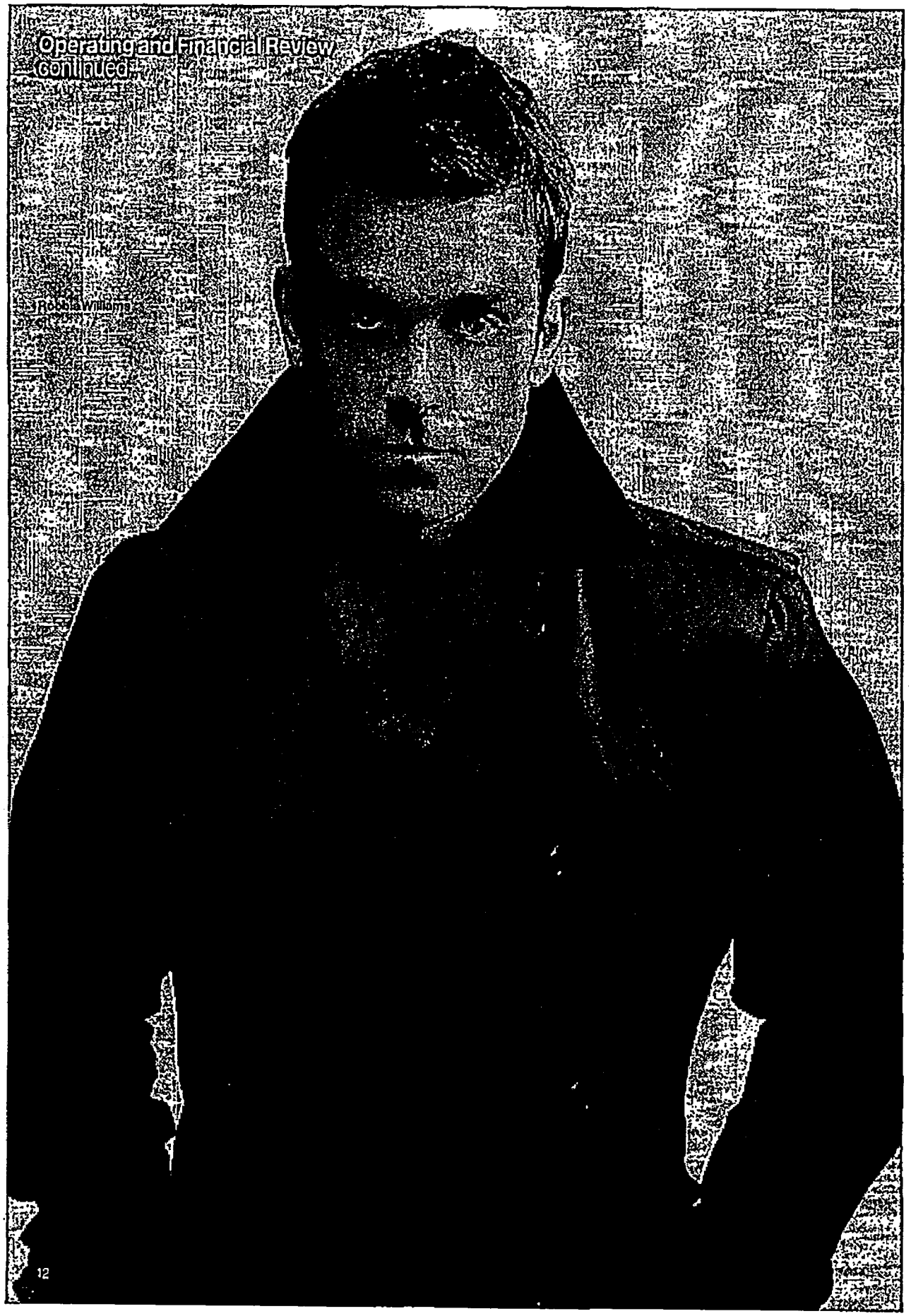
Recorded music industry

Our two divisions continue to operate in a marketplace that is undergoing significant change, primarily driven by the rapid development of digital music. The industry's digital sales more than doubled in value over the year, with both mobile and fixed line platforms enjoying rapid growth. This strong digital growth significantly mitigated the 5.3% decline in physical sales, resulting in an overall industry decline of 0.9% for the period.

The digital environment is proving to be extremely dynamic with new entrants, new services and new devices and functionality appearing all the time. Globally, according to IFPI statistics for 2005, there were 335 legal digital music services, up from 50 just two years previously.

In this past year alone, we have seen the first legal peer to peer agreement signed, iTunes expand to over 20 countries, the launch of portable subscription services, such as Napster To Go and Yahoo Music Unlimited, and the introduction of a la carte music video services. Consumers are now able to access up to 2m tracks and 165,000 albums in a legitimate digital environment.

The industry has also continued to make progress in combating both physical and digital piracy. Notable legal victories against illegal peer to peer sites Grokster (US), KaZaa (Australia), Kuro (Taiwan) and Soribada (South Korea) have improved the business landscape for legitimate music sales.


Robbie Williams

EMI Music

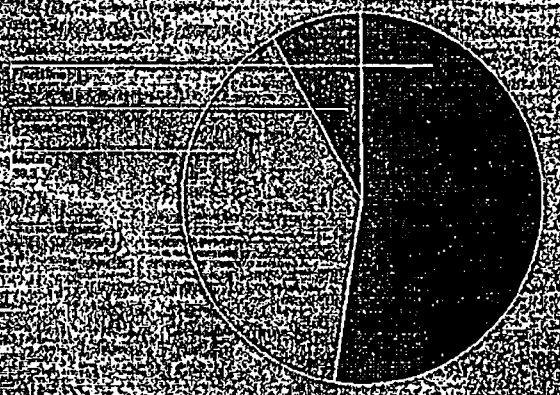
EMI Music's strong performance in the year demonstrates both its creative excellence as well as its position at the forefront of the rapidly evolving digital landscape. The division's revenues increased by 11% at constant currency, significantly outperforming the global recorded music industry. Within this, EMI Music's digital revenues grew to £92.4m, increasing by 169% at constant currency.

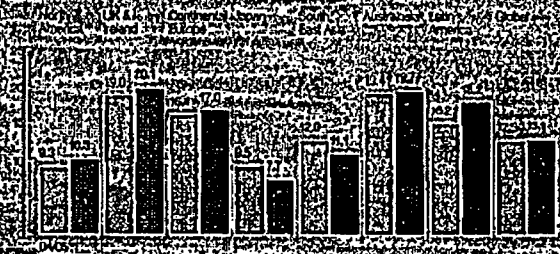
Operating profit (EBITA) grew by 156% to £15.1m, resulting in a substantial improvement in the operating margin to 8.7%. This improved profitability was driven by the flow-through of profits from the growth in revenues, an increased proportion of revenues from digital sales and delivery of the remaining £15m of costs, which were announced in March 2004.

EMI Music's distinctive approach to the development of its roster focuses on making consistent investments in artists with long-term career potential and is designed to maximise both local and global sales. This has shown clear results in the year with the division's sales coming from a broad range of artists including releases from established superstars Coldplay, Gorillaz, The Rolling Stones, Keith Urban and Robbie Williams, breakout acts Corinne Bailey Rae, Dem Franchize Boyz and Kristinia DeBarge and local artists RBD (EMI Mexico), Radja (EMI Indonesia) and Raphael (EMI France).

EMI Music is focused on creating the most attractive music content for consumers and making it available where they want it, when they want it and in the format they want it. In this way, we aim to maximise demand for our artists' works and, importantly, our financial return. The creation of new products, formats, distribution channels and partnerships is now a routine part of our business and our energies are focused on harnessing these new possibilities to create additional revenue streams. Over the year we secured over 220 new partnerships, further strengthening our digital footprint across both online and mobile platforms, bringing our total digital partnerships to almost 400 and making our music now available in 86 countries. EMI Music has reached pioneering digital deals around the world, for example in Europe with GNAB for peer-to-peer services, in China with Sohu for digital music and in the US with Sprint for over-the-air mobile downloads.

In addition to establishing market relationships on the right terms, we are at the forefront of the industry in exploiting the new product formats and windowing possibilities that digital enables. For example, our innovative approach to content bundling and windowing meant that Coldplay's X&Y was the first ever album available on iTunes as a pre-order and US downloads included video interviews and a digital booklet and two bonus tracks. In fact, X&Y went on to become the best-selling full digital album download on iTunes as well as the highest selling album worldwide in 2005. This initiative gives us a flavour of the way that EMI Music is actively exploiting future new opportunities that digital brings.





EMI Music geographic review

North America

During the year the North American market declined by 15% with strong growth in digital sales substantially offsetting declines in physical sales.

Against this backdrop, our North American business showed strong sales growth, gaining significant market share. Releases from Keith Urban, Diana Bentley, Trace Adkins and Kenny Chesney in combination with the effective marketing and promotion of international releases from Coldplay, Gorillaz and The Rolling Stones drove this performance. Virgin's Dem Franchize Boyz was established as one of the most exciting new urban bands in the US with the release of the debut album *Hip Hop Hoorah*. Demand for sales of ring tones of tracks from this album have topped 2m, the ring tone purchases of the album itself which has been certified as gold release in the US.

EMI Music's digital sales in North America almost tripled over the year. Our revenues from mobile products grew at the fastest rate, increasing by a factor of nine times, as the likes of Verizon and Sprint launched new mobile music services. Online downloads continued to represent the largest digital segment, accounting for almost 70% of our digital sales in the region. The proliferation of new digital products and services continues at a fast pace with, for example, iTunes introducing online music video downloads during the year. EMI Music has consistently been an innovator of new products and services, most recently becoming the first major music company to trial advertiser-funded music video content for consumers' mobiles.

We continue to focus on further strengthening our US business and during the year appointed Jason Flom as Chairman and CEO of Virgin Records. Jason has 26 years of experience in the music industry and, as founder of Lava Records, he discovered, signed and developed multi platinum selling artists such as Kid Rock, matchbox twenty and The Corrs. With his exceptional A&R and business leadership skills, we believe that Jason is well placed to improve further upon Virgin's performance to date.

UK & Ireland

In the UK market, physical sales declined by an estimated 4.9%, with digital sales increasing by 170% to give a total industry decline of 3.0% over the financial year. Weakness in compilation sales, particularly over the key Christmas period, accounted for the decline in industry sales.

The strength and depth of our UK artist roster was again demonstrated this year, with our business delivering an increase in revenues and gaining significant market share in the UK and Ireland. New album releases from international superstars delivered strong performances. Coldplay's *X&Y* sold almost 10m units across both physical and digital formats and was the biggest-selling album across the global industry in 2005. Albums from Gorillaz and Robbie Williams sold in excess of 5m units each worldwide. A number of new UK artists also broke through to success during the year, including KT Tunstall, Corinne Bailey Rae and The Magic Numbers. KT Tunstall's debut album *Eye to the Telescope* met with critical and commercial success, earning her the title of 'Best British Female Solo Artist' at the industry's Brit Awards and selling 2.6m units during the financial year alone. Corinne Bailey Rae's self-titled debut album was released in February and entered the UK album chart at number 1.

Our digital sales in the UK grew by 170% over the year with fixed-line downloads tripling over the period. In exploring the new opportunities which digital delivery brings for capturing new revenue streams, EMI Music will participate in a unique 18-month partnership between T-Mobile and Robbie Williams. T-Mobile was able to offer their consumers exclusive content as well as making certain content available to them earlier than its general release. For EMI, the partnership proved to be an effective and innovative platform from which to launch the album.

Continental Europe

Market conditions in Continental Europe were mixed over the year, with total industry sales declining by 3.7%. Trends varied across the region, with France, Spain and Italy showing an improving environment versus the prior year. Germany remained a challenging market. The industry's digital sales virtually tripled in value over the year.

EMI Music had another highly successful year, gaining significant market share across the region with particularly strong performances from EMI Music France, Spain and Germany. These share gains came from a broad range of established and new artists including Raphael, Souchon, Diam's, Camille, Wir Sind Helden, Bebe and Amaral, in combination with effective marketing and promotion of our international repertoire.

We have seen enormous growth in our digital revenues in Continental Europe during the year, with sales increasing by 245%. Mobile revenues represent a larger portion of digital sales in Continental Europe compared to the US and the UK but fixed-line sales still account for the majority of digital sales in Europe. We are at the forefront of digital development in the region and continue to be innovative in the digital products, formats and services that we create. For example, for the launch of Placebo's album *Meds*, we partnered with SFR to offer consumers a series of 'mobisodes' along with standard product offerings such as ring tunes and over the air tracks. The mobisode was specifically designed for use on a mobile and the content was targeted to the profile of a Placebo fan. The campaign generated huge interest and *Meds* entered the French album chart at number 1. The album has sold almost 1m units worldwide since its March release.

Japan

The Japanese market recovered during the financial year and, taking physical and digital together, grew by an estimated 6%.

While we saw success from artists such as Tokyo Jihen, Noriyuki Makihara, Tomoyasu Hotei, Coldplay and the Rolling Stones, our Japanese business lost market share in the year reflecting a lack of local releases. In April 2006, we announced a major restructuring of this business to improve the efficiency of our operations, to reinvest a proportion of these savings in the key areas of A&R and marketing, and to introduce a new multi-label organisational structure. We believe that these initiatives will create a company which is better positioned to increase revenues and profits in the coming years. In conjunction with this restructuring, we recently announced our plans to enter into a sale and leaseback of our two Tokyo freehold properties, with a substantial cash inflow expected from the transaction. We sold our former manufacturing plant in Japan to a consortium led by Memory-Tech Corporation on 26 December 2005.

EMI Music's digital sales showed strong growth, rising by 130%. Mobile products continue to be the most popular platform in Japan and have again shown robust growth, almost doubling in value. August's launch of iTunes has helped to fuel growth in the online sector and we have been extremely active in promoting our content on this platform, with our online digital sales increasing by a factor of over six times during the year.

South East Asia
The major markets in South East Asia experienced a significant decline in physical sales as physical and digital piracy continued to take their toll. Rapid digital revenue growth across the industry partly mitigated this impact, to bring the overall market decline to 3.7%.

Despite major releases from Indonesia's Radja, whose album *Langkah Baru* sold over 1m units in the financial year, as well as releases from S.H.E., Ada Band and The Flowers, EMI Music lost market share across the region. We saw strong growth in digital revenues across all platforms, with mobile comprising the largest portion of our digital sales.

Australasia
Market conditions in Australasia worsened towards the end of the financial year, with an overall industry decline of 6%. EMI Music gained market share versus the prior period, driven by releases from local superstar Missy Higgins as well as international releases from Coldplay, Korn and Ben Harper.

Latin America
The industry's sales in Latin America enjoyed good growth, rising by 6.1% over the year. Argentina and Colombia saw the strongest growth rates across the region.

Our Latin American business had a very strong year, showing robust revenue and profit growth. EMI gained market share in every Latin American territory, with the largest out-performance in Brazil. Local superstars RBD had a terrific year, with total sales of over 3m units across four album releases. Releases from local artists Marissa Monte, Quintanilla III, Intocable and Thalia, as well as releases from international artists Coldplay and Robbie Williams, drove sales in the region. In July 2005, we announced a major new joint venture with Grupo Televisa S.A., the largest media company in the Spanish-speaking world, to develop and exploit new Latin music both in Latin America and the US.

EMI Classics
EMI Classics had a strong year and grew its global share with particular successes in Continental Europe and Japan. Notable achievements were the success in Japan and many other countries of *Best Classics 100*, and the release of *Mozart's 100* which reached a number 5 position in the French pop chart. Such recordings illustrate the considerable value of EMI's extensive classical catalogue.

One of EMI Classics most important releases during the year was the critically acclaimed studio recording of Wagner's *Tristan and Isolde* with Placido Domingo and Nina Stemme, the distinguished Swedish soprano who has recently signed to the label.

Virgin Classics also had a good year producing some excellent new recordings, particularly with the world renowned coloratura soprano, Nathalie Dessay, and the young Mexican tenor, Rolando Villazon.

Note: All industry and share data are EMI internal estimates based on official data received from the global recording industry association, the IFPI. EMI measures its revenues for market share purposes following the guidelines used by the IFPI to ensure comparability with the market data.

Depeche Mode

Sean Paul

Pharrell Williams

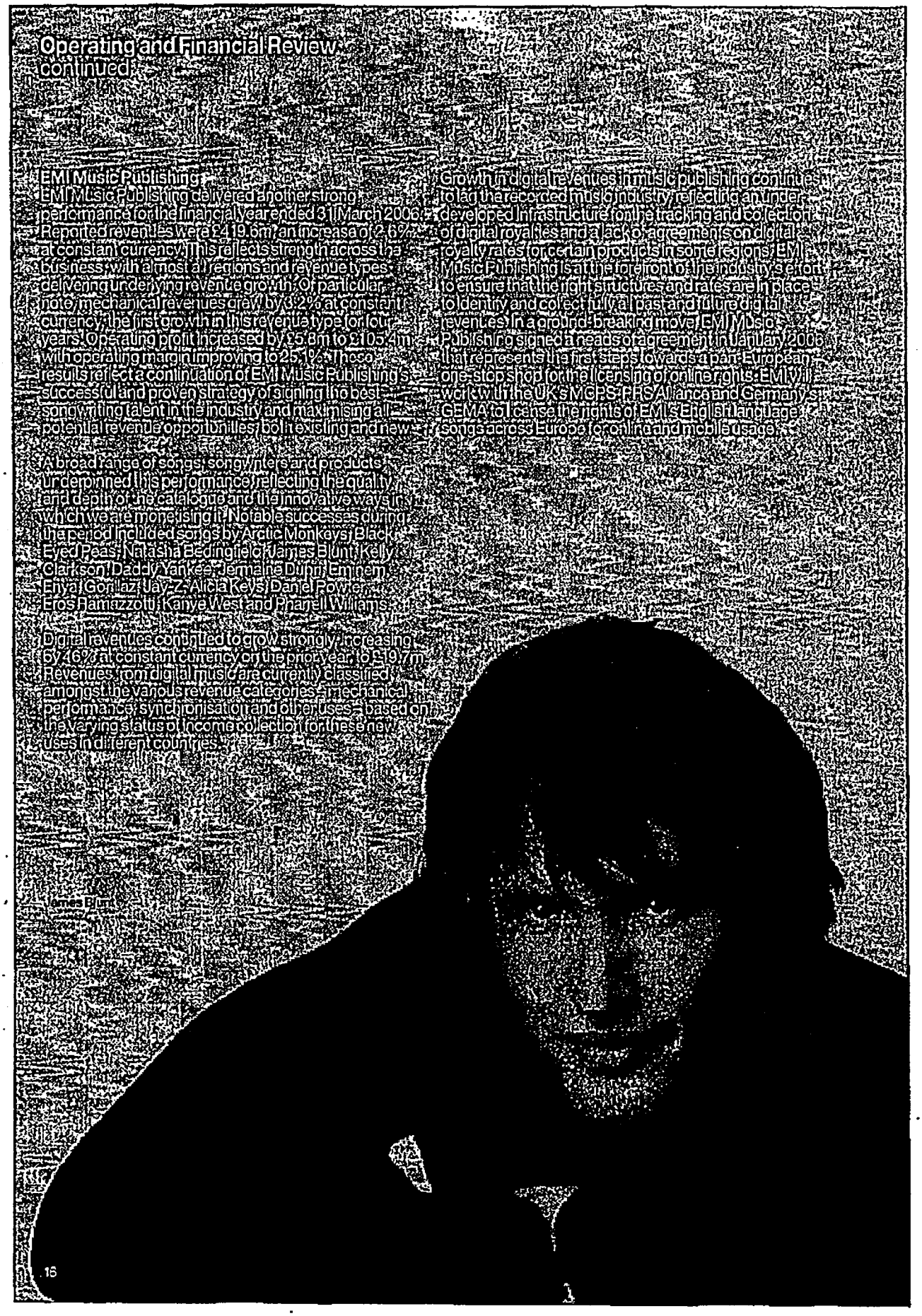
EMI Music Publishing

EMI Music Publishing delivered another strong performance for the financial year ended 31 March 2006. Reported revenues were £419.6m, an increase of 2.6% at constant currency. This reflects strength across the business with almost all regions and revenue types delivering underlying revenue growth. Of particular note, mechanical revenues grew by 8.2% at constant currency, the first growth in this revenue type for four years. Operating profit increased by £5.8m to £105.4m with operating margin improving to 25.1%. These results reflect a continuation of EMI Music Publishing's successful and proven strategy of signing the best songwriting talent in the industry and maximising all potential revenue opportunities, both existing and new.

A broad range of songs, songwriters and products underpinned this performance, reflecting the quality and depth of the catalogue and the innovative ways in which we are monetising it. Notable successes during the period included songs by Arctic Monkeys, Black Eyed Peas, Natasha Bedingfield, James Blunt, Kelly Clarkson, Daddy Yankee, Jermaine Dupri, Eminem, Enya, Gorillaz, Jay-Z, Alicia Keys, Daniel Powter, Eros Ramazzotti, Kanye West and Pharrell Williams.

Digital revenues continued to grow strongly, increasing by 46% at constant currency on the prior year to £19.7m. Revenues from digital music are currently classified amongst the various revenue categories – mechanical, performance, synchronisation and other uses – based on the varying status of income collection for these new uses in different countries.

Growth in digital revenues in music publishing continues to lag that recorded in music industry reflecting an underdeveloped infrastructure for the tracking and collection of digital royalties and a lack of agreements on digital royalty rates for certain products in some regions. EMI Music Publishing is at the forefront of the industry's efforts to ensure that the rights structures and rates are in place to identify and collect fully all past and future digital revenues. In a ground-breaking move, EMI Music Publishing signed a heads of agreement in January 2006 that represents the first steps towards a pan-European one-stop shop for the licensing of online rights. EMI will work with the UK's MCPS-PRS Alliance and Germany's GEMA to license the rights of EMI's English language songs across Europe for online and mobile usage.


James Blunt

The use of songs in mobile phone products remains the most significant early digital revenue contributor for EMI Music Publishing and continues to enjoy very strong growth. For the revenue from mobile products, we have seen the percentage contribution from ring tunes increase significantly during the year, whilst the contribution from ring tones has decreased, a trend we would expect to see as the marketplace becomes more developed. Revenues from digital downloads and other newer products, such as video downloads, have also grown strongly yet remain relatively small. Recently, EMI Music Publishing announced an agreement with the global Internet communications company Skype. The deal, which was the first of its kind, opens up an important new channel for the delivery of music in the ever-expanding digital arena. It enables the licensing of song copyrights from our catalogue for downloading, subscription and ring tunes across Skype's online retail store on a worldwide basis.

Mechanical revenue

Our mechanical revenues, which are derived from the sale of recorded music, reported growth for the first time in four years, increasing by 3.2% at constant currency despite the global recorded music market continuing to show year-on-year declines during the same period. Mechanical revenues now represent 45% of total divisional sales on a constant currency basis. On a regional basis, our mechanical revenues were particularly strong in the US, reflecting income tracking initiatives that have been taken to ensure collections are maximised.

Performance revenue

Performance revenues, earned when a song is performed live on stage, played in a bar or other public venue or broadcast on the radio or television, grew by 8.4% at constant currency for the year and now represent 27% of divisional revenues on a constant currency basis. Key drivers of growth in this business are the chart success of songs from our roster of active songwriters and the proliferation of new media channels, especially across Europe. On a regional basis, performance income was particularly strong in the UK, reflecting the faster flow of royalties from the PRS, in the US, with a general increase in income from ASCAP and BMI, in Spain, where we saw favourable TV income, and in Germany, where a new tariff and income type for discos was introduced.

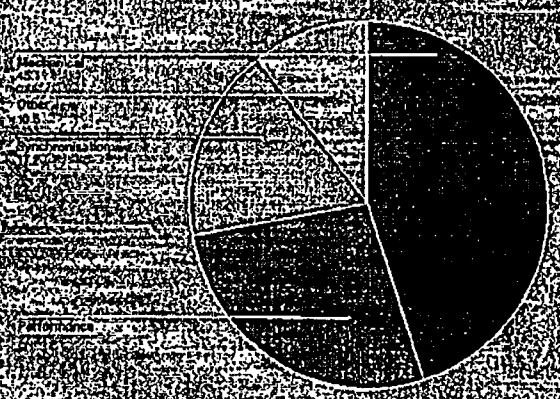
Synchronisation revenue

Synchronisation revenue, which is generated by the use of songs in audiovisual works such as advertisements, television programmes, films, computer games and in mobile phones, increased by 5.4% at constant currency, representing more than eleven years of consecutive growth and now contributes 17% to divisional revenues. From the high level achieved in 2004/05, EMI Music Publishing was able to drive meaningful growth in synchronisation by gaining greater penetration in commercials and video, particularly in the US. Significant licences were issued worldwide for a number of major advertising campaigns, including Coca-Cola, the Automobile Association, Fuji, Fiat and American Express as well as for TV programmes such as *American Idol*, *Supernanny*, *Gilmore Girls*, *Nip Tuck*, *Crossing Jordan*, *Scrubs* and *Lost*.

Other revenue

Other revenue typically represents about 10% of revenues, although the absolute amount can vary significantly from year to year. An important driver of the growth in other revenue in recent years has been revenue gained from stepped up efforts in enforcing proper use of our copyrights. By their nature, these revenues tend to be irregular and unpredictable, accounting for the overall decline on a constant currency basis in this revenue category. Excluding these items, the underlying growth in other revenue was strong at over 20%, largely driven by increased background library income.

EMI Music Publishing revenue mix (%)



6) Financial review for the year ended 31 March 2005

Revenue

Reported Group revenue increased by 3.9% or £78.7m to £2,079.9m. Underlying revenue excluding the impact of currency movements was 2.1% or £41.5m. The favourable exchange movement was largely driven by a decline in the weighted average rate of the US Dollar against Sterling from $1.85 last year to $1.78 in 2005/06.

At constant currency revenue in EMI Music grew by 1.9% with notable increases in North America, UK and Ireland and Latin America.

At constant currency revenue in EMI Music Publishing was up on the prior year in all major territories apart from Italy and France and by 2.6% at a divisional level. The increase in revenue was driven by strong growth in mechanical, performance and synchronisation revenues.

Group digital revenue increased to £112.1m, up 165% from the prior year at constant currency. Digital revenue represented 5.4% of total Group revenue for the year.

Costs

During the course of the year costs in both divisions were tightly controlled. The underlying gross margin after distribution costs improved from 36.4% to 37.2%.

Royalty and copyright costs, manufacturing and distribution costs, together with marketing and promotion costs have increased modestly in total in absolute terms in the year reflecting the increase in revenue. However, these costs in aggregate have declined as a percentage of total revenue from the prior year. During the year we delivered the remaining £15m of cost savings from our restructuring initiatives announced in March 2004, taking the total annualised savings from this programme to £50m. These savings were largely reflected in reduced manufacturing and distribution costs and overheads.

Group corporate costs were lower in comparison to the prior year in spite of increased legal, regulatory and consultancy costs.

Profit from operations

Group profit from operations (EBITA) increased by £25.4m or 11.3% from £225.1m to £250.5m. Excluding exchange, the increase in EBITA was £21.6m or 9.6%.

Group operating margin increased from 11.2% to 12.0%.

EMI Music delivered EBITA of £145.1m, an improvement of £18.1m or 14.4% at constant currency on the prior year. This increase in EBITA was largely driven by particularly good performances in Continental Europe, UK and Ireland and Latin America. Operating margin improved from 7.8% to 8.7%.

EMI Music Publishing generated EBITA of £105.4m, a growth of 8.5% at constant currency on the prior year. Operating margin improved from 24.9% to 25.1%, reflecting improved republishers share and continued strong overhead control.

The Group's share of profit in its associated company investments reduced from £1.1m in 2004/05 to £1.0m in 2005/06. Consequently, the underlying profit from operations for the Group increased from £226.2m in the prior year to £251.5m this year.

Underlying Group finance charges rose by £7.1m to £92.2m. The largest items contributing to this increase were the interest rate rises in both Europe and the US, two of our major funding territories, a lower gain from the amortisation of the 2003 swap unwind and higher average net borrowings over the year, offset only partly by savings from the refinancing of our revolving credit facility completed earlier in the year.

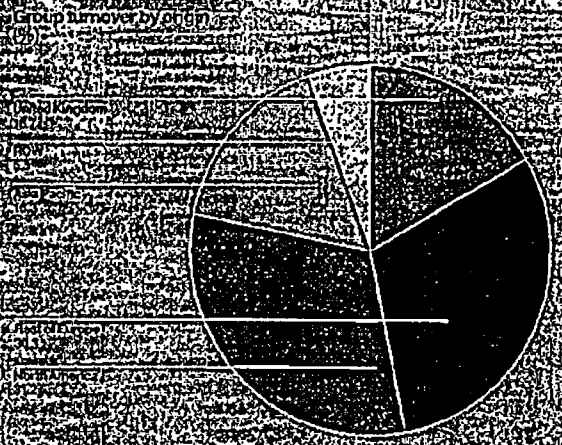
Underlying profit before tax increased by 12.9% from £141.1m to £159.3m, reflecting both the increase in revenue and the continued tight cost control.

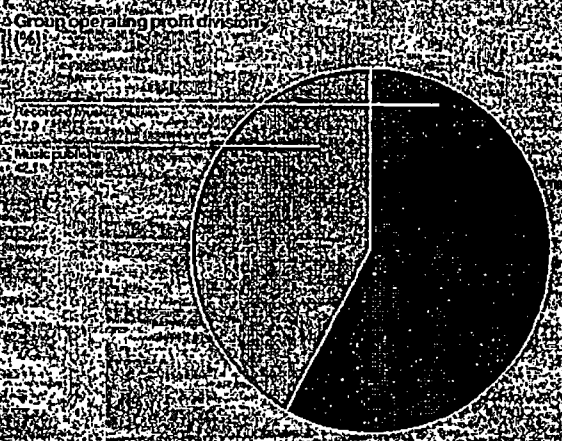
The underlying Group tax rate was 17.6% against 22.3% in the prior year. The reduced rate reflected a movement in profitability towards countries where there were brought forward tax losses available for offset. The rate has been further reduced due to the settlement of prior liabilities at a lower amount than expected.

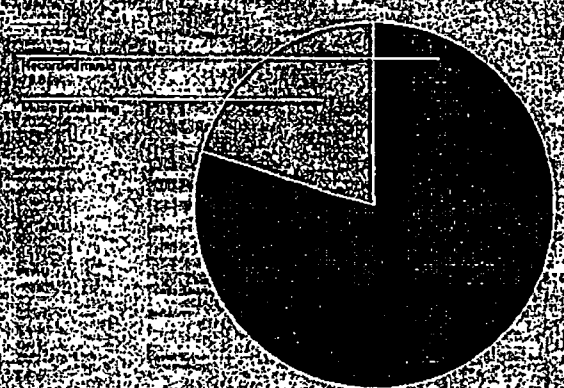
As a result of the above, the Group's underlying profit after taxation increased from £109.6m to £131.2m, an increase of 19.7%.

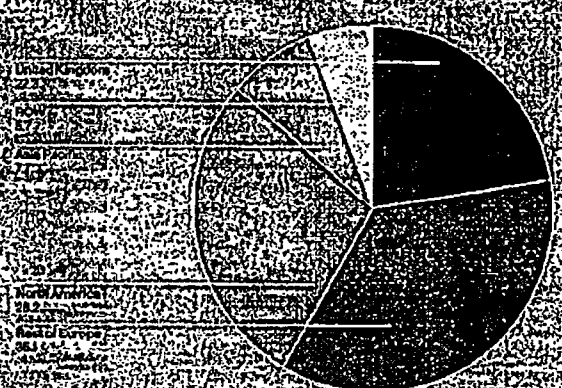
Underlying basic earnings per share[1] were 16.2p, an increase of 2.8p from the prior year. Underlying diluted earnings per share, the calculation of which includes the impact of the potential conversion of convertible bonds (and related bond interest) together with the possible exercise of dilutive share options, increased from 13.1p to 15.7p.

Notes:
(i) Group profit from operations (EBITA) before exceptional items and amortisation and before share of profit in associated
(ii) Before exceptional items and amortisation









Other items affecting earnings
Exceptional items and amortisation comprise operating exceptional costs, finance exceptional costs and amortisation of music copyrights and intangibles.

The Group is reporting operating exceptional income of £4.0m compared with costs of £17.5m in the prior year. Operating exceptional income is net of property impairment charges of £1.1m in the UK in 2005/06 (2004/05: £18.5m charge in Japan). The remaining operating exceptional income of £5.1m includes gains on property disposals, the gain on disposal of our manufacturing operation in Japan and fair value adjustments to listed investments. The prior-year charge included income of £1.0m in respect of the same components.

The Group is reporting finance exceptional net income relating to remeasurements and refinancing costs of £4.7m compared to net income of £23.2m last year. This primarily relates to the gain on revaluation to fair value of the convertible bond derivative of £4.1m (2004/05: £31.2m gain), the gain on revaluation of the Eurobond embedded call feature of £8.2m (2004/05 £0.2m loss) and the foreign exchange loss on Euro borrowings of £4.1m (2004/05: £9.5m loss). The finance exceptional net income for 2005/06 includes exceptional refinancing costs of £5.2m in connection with the refinancing programme carried out in July 2005 (2004/05: £nil).

Amortisation of music copyrights and other intangibles and impairment of goodwill amounted to £49.9m in comparison with £48.0m last year.

The minority interest cost has increased from a credit of £0.5m in the previous year to a charge of £3.9m this year. This is largely the consequence of increased profitability and the absence of a property impairment charge in our EMI Music business in Japan in which there is a 45% minority.

Profit attributable to members of the Company was £86.1m in comparison with an attributable profit last year of £75.4m.

The Board is recommending a final dividend of 6.0p per share, maintaining a full-year dividend of 8.0p per share and reflecting our strong performance for the year and our continued confidence in the outlook for the business.

Reported results
Total Group profit from operations (including share of associates) was £205.6m in comparison with £160.7m last year. This increase was entirely due to improved trading and reduced property impairment charges.

Total profit before taxation was £118.1m as against £98.8m in the prior year. This increase reflected the improvement in Group profit from operations, partly offset by the reduction in finance exceptional net income.

Cash flow and net borrowings
Improvement in cash conversion and overall cash management remains a key area of focus for the Group. The net cash inflow from operating activities was £188.3m, a small reduction from last year's inflow of £189.0m.

After the net cash inflow from operating activities, we had cash outflows of £2.6m for investment activity and £246.9m for financing activity including £61.2m for dividends. Taking into account the loss on exchange of foreign currency denominated borrowings of £42.8m, year-end net debt has increased by £22.0m from £857.5m to £879.5m.

The net cash inflow from operations after investing activities has approximated the operating result of both divisions in recent years.

Funding and liquidity
At 31 March 2006, the equity of the Group was £558.5m (2005: £557.9m). Equity comprises the aggregate of the fully paid Ordinary Shares of 14p and the share premium account. Further details of the equity are provided in Note 27 of the Financial statements.

With total net debt of £879.5m at 31 March 2006 (2005: £857.5m), the ratio of debt to equity was 157.5% (2005: 153.7%).

Our cash requirements in excess of cash generated by operations are largely funded by borrowings under arrangements with commercial banks and debt raised in the capital markets.

Current funding arrangements include:
- US$500m 8.375% Guaranteed Notes due August 2009;
- £325m 8.25% (stepped up to 9.75%) Sterling Bonds due May 2008;
- €425m 8.625% Senior Notes due October 2013;
- US$243.3m 5.25% Guaranteed Convertible Bonds, due 2010 unless previously redeemed, converted or purchased and cancelled; and,
- a five-year £450m bank facility arranged in July 2005.

We seek to have sufficient facilities available to meet the anticipated needs of the Group for the period covered by the Group's budget and Medium-Term Plan. Facility levels in 2005/06 averaged £1.5bn. The £450m revolving credit facility enables us to manage the seasonal requirements of the business when borrowings are likely to peak. Net borrowing peaked at £1,305.6m at the end of November 2005.

If appropriate, debt is refinanced prior to maturity. This may be to take advantage of improved terms in financial markets or to match a change in revenue streams generated by the business.

On 21 July 2005, the Group signed a new five-year £450m credit facility with a group of banks, allowing EMI to take advantage of more favourable terms in the marketplace. The five-year facility replaced a revolving credit facility (£250m), a 364-day facility (£100m) and a private placement (US$123.8m). In addition, two bilateral facilities (£40m) were not renewed. More information is given in Note 19 of the Financial statements. With this exception, the Group's funding sources have not changed during the year, following the major restructuring in the Autumn of 2003.

The average term of the net debt at 31 March 2006 was 5.4 years against 6.7 years as at the last year end.

Treasury policy
Treasury activity is carried out under a framework of policies and guidelines approved by the Board. The Audit Committee reviewed and approved the policy framework during the year. Control and authority is delegated to the Treasury Management Committee, chaired by the Group Chief Financial Officer.

The Group's Treasury activity is managed by a specialised team based at Group headquarters in London. All debt negotiations and cash management initiatives are directed by this team. Borrowings raised centrally are lent to operating subsidiaries on commercial terms. Where appropriate, cash pooling and sweeping systems are in place to make use of surplus cash in local bank accounts and ensure maximum efficiency in the use of cash resources across the Group.

Financial instruments held by the Group comprise derivatives, borrowings, cash and liquid resources and other financial assets and liabilities, their purpose being to raise finance for the Group's operations. Treasury policies prohibit their use for speculative purposes.

Interest rate risk management
The Group borrows in various currencies and uses swaps, caps and collars to manage interest rate exposure. The Group policy is that a minimum of 25% of the Group's term borrowings should be at fixed/capped rates.

At 31 March 2006, the following interest instruments were in place:

- A US$500m interest rate swap where EMI receives an 8.375% fixed rate and pays a floating rate of three-month LIBOR + 4.65%, maturing in August 2009. This is a fair value hedge of the US$500m 8.375% Guaranteed Notes, due August 2009.
- A €425m interest rate swap where EMI receives an 8.625% fixed rate and pays a floating rate of three-month LIBOR + 4.40%, maturing in October 2013. This is a fair value hedge for the €425m 8.625% Senior Notes, due October 2013.

After taking into account the above instruments, 58.6% (2005: 55.0%) of the Group's gross debt is at floating interest rates and is, therefore, exposed to the risk of increased interest rates. Floating rate debt arises largely from the two swap instruments mentioned above. The effect of a 1% increase in interest rates for all of the Group's floating rate debt would result in an annual increase of approximately £6.9m in the Group's net finance charge (excluding post retirement benefit finance costs).

Further detail of interest rate instruments is provided in Note 15 of the Financial statements.

Foreign currency risk management
The Group faces currency exposure from exchange rate fluctuations against Sterling. Balance sheet exposures are hedged to the extent that overseas liabilities, including borrowings, provide a natural hedge. Group policy is neither to undertake additional balance sheet hedging measures nor to hedge profit and loss account translation exposure. Transaction exposures are hedged, where there are material items that have a high probability of occurring, with the use of forward exchange rate contracts.

The Group's profit and cash flows are denominated in many currencies across the world, the most significant outside the UK being the US Dollar, the Euro and the Japanese Yen. The income statement is translated at weighted average exchange rates for the financial year. In the year ended 31 March 2006, the rates were US$1.78/£ (2005: US$1.85/£), €1.47/£ (2005: €1.46/£) and ¥203.69/£ (2005: ¥198.32/£).

Our debt is structured to match revenue streams in local currency, thereby providing natural currency hedges. Our main committed banking facilities are provided in the UK and the US.

At 31 March 2006, the Group's gross debt was split 38.6% US Dollars (2005: 40.8%), 30.4% Sterling (2005: 29.2%), 30.2% Euro (2005: 29.3%) and 0.8% other currencies (2005: 0.7%). Further details of the currency mix of the Group's gross debt are given in Note 19 of the Financial statements.

Credit risk management
Details of our credit risk management are provided in Note 15 of the Financial statements.

Pensions
The Group operates a number of pension schemes throughout the world. The main scheme, which covers employees in the UK, is the EMI Group Pension Fund (the UK Fund). The UK Fund is of the defined benefit type, as are the Group's pension schemes in Germany and Japan. With the exception of these schemes, the other defined benefit schemes operated on behalf of the Group are not material in size. Staff engaged in other countries are covered by local arrangements which are usually of the defined contribution type.

The UK Fund was closed to new entrants on 1 November 2005. At that date, there were 900 active members of the Fund, together with approximately 22,000 pensioners and deferred pensioners. UK employees who wish to join a pension plan after that date, have the opportunity to join a new stakeholder administered defined contribution plan.

As a consequence of the triennial actuarial valuation of the UK fund as at 31 March 2003, the Group resumed annual contributions in respect of future service to the UK Fund with effect from 1 April 2004. This resulted in a cash outflow of approximately £9.0m in 2005/06. These contributions will continue until the outcome of the next triennial valuation is known. This valuation is as at 31 March 2006 but will not be finalised until the second half of the 2006/07 financial year.

Full reporting of the Group's pension fund costs and the adequacy of funding of its major plans is given in Note 26 of the Financial statements.

7. Future outlook
The recorded music market is undergoing significant change as it becomes increasingly digitised. At this early stage, it is impossible to predict accurately how the market will evolve. However, our analysis, based on recent industry trends, EMI's performance to date and proprietary econometric research, leads us to believe that the global recorded music industry will return to growth in due course driven by consumer demand for digital music products of all types. In this context, we anticipate declining physical sales and have structured our business accordingly. Given the current growth rate of digital music and our future expectations based on this analysis, we continue to believe that digital music sales could represent up to 25% of total global music sales by 2010.

We will continue to invest significantly in A&R, marketing, and in our systems' infrastructure so that we remain positioned at the forefront of the industry in capitalising on the exciting opportunities arising from the market's evolution.

In April 2006, we announced a series of restructuring initiatives aimed at further strengthening our business. These initiatives will involve most regions and will be focused on improving and re-aligning resources to ensure the organisation remains flexible and progressive. A particular area of focus is EMI Music's Japanese business where new skills and a new organisational structure will be introduced to enable the re-allocation of resources into the key areas of A&R and marketing whilst maintaining an aggressive approach to digital business development. These initiatives together are expected to generate £30m of annualised cost savings. We expect that not less than £10m of these savings will be achieved in the financial year ending in March 2007, with the full run rate achieved by the end of the following financial year. In conjunction with these restructuring initiatives, EMI Music plans to enter into sale and leaseback arrangements for its two Tokyo properties and the Capitol Tower in the US. The lease costs that will be incurred as a result of these agreements have already been taken into account in our planned delivery of a net £30m of annualised cost savings.

In the current financial year, EMI Music is planning releases from Chingy, Tiziano Ferro, Janet Jackson, Norah Jones, Stacie Orrico, RBD, Renaud, Joss Stone, KT Tunstall, Keith Urban, Hikaru Utada and Robbie Williams. EMI Music Publishing expects to benefit from releases from artists including Audioslave, Kelly Clarkson, Diddy, Embrace, Janet Jackson, Jewel, Pink, Scissor Sisters, The Zutons, Tool, Usher, Kanye West and Pharrell Williams.

On 3 May 2006, we announced that on 1 May 2006 the Group made an approach to Warner Music Group Corp (Warner Music) in connection with a proposed offer by EMI to acquire all of the outstanding shares of Warner Music for US$28.50 per share, in a combination of cash and EMI shares. Subsequently, Warner Music informed us that it did not wish to enter into discussions regarding our proposal. We continue to believe that an acquisition of Warner Music by EMI would be very attractive to both sets of shareholders but we will only pursue a transaction that delivers enhanced value and earnings accretion to our shareholders.

8. Risks and uncertainties

Our business faces a number of risks and uncertainties. The principal risks and uncertainties are discussed below. We believe that we have in place a robust process for identifying and managing these risks. In 2003, we appointed a full-time dedicated Group Risk Director who steers an annual process of identifying risks to our business, assessing the severity of each of the risks identified and developing and installing controls within the business to eliminate or alleviate the risks where practicable. The Group Chief Financial Officer chairs a Risk Management Steering Committee which is drawn from executive management in all sectors and disciplines within our business. The findings and assessments of the Risk Management Steering Committee are brought to the attention of the Board's Audit and Executive Committees for discussion and approval on an annual basis.

Declining recorded music sales

The value of the worldwide market for recorded music has declined by about 20% since 2001 according to data from the IFPI (the worldwide recording industry association). Economic recession, physical piracy, illegal downloading and growing competition for discretionary consumer spending and retail shelf space have all contributed to this decline. Whilst we believe that new digital music products and services will drive a return to overall industry growth, there are no assurances of the timing or the extent of any improvement in the industry. A continuing decline in sales of physical products could, if not offset by increasing digital revenues, result in reduced revenues and profits in our recorded music division. Additionally, it may have a negative impact on our music publishing business which generates a significant portion of its revenues from mechanical royalties, primarily from the sale of music in CD and other recorded music formats.

Our business is in transition

We are positioning our business to capitalise on the opportunities and to meet the challenges presented by the digital distribution of music content. Legitimate digital product and service offerings are still in the early stages of development and their ultimate impact on our business cannot be predicted with certainty. These new business models may not develop in a way which generates significant profits for our business or they may result in lower or less profitable sales for us than comparable physical sales. It may also be difficult for us to obtain transparency of revenues generated by our digital partners. There are many and varied structures for exploiting music digitally and some of the value chain models can be opaque. The transition to new digital business models requires significant investments in areas such as IT infrastructure and management systems and also requires many new business relationships to be established and managed.

Piracy

Organised commercial physical piracy, the existence of illegal internet file sharing networks and the ubiquity of technological devices which enable unauthorised consumer copying of music content, all represent risks to our business. The IFPI estimates that the physical market for pirated product was worth US$4.6bn in 2004. Internet technology has made it possible for computer users to share unauthorised digital versions of music recordings without the permission of the copyright owners and without paying royalties to holders of applicable intellectual property or other rights. As a result, a large portion of our content is potentially subject to widespread dissemination on the internet without an economic return to us. We are working to control these problems by lobbying governments, by supporting legitimate digital distributors and through collective legal action by the music industry against unauthorised uploaders of music files. Successes in legal proceedings against illegal peer to peer websites, such as Grokster in the US and KaZaa in Australia, are beginning to reduce the availability of unauthorised free music downloads on the internet but online theft continues to be at high levels. We remain dependent on the introduction of stronger copyright protection laws and more stringent enforcement of current laws. Advances in technology mean that new ways to disseminate unauthorised copies of our music content continue to emerge and hence the challenge of combating piracy is on-going. Our results from operations and our financial position may suffer if efforts to stem piracy are not effective or succeed only partially.

Industry structure and competitive environment
The industry in which we operate is highly competitive. Competition amongst record labels for artists and amongst music publishers for songwriters could result in higher royalty payments or failure to attract and retain key talent. The intense competition amongst record companies for shelf space and retailer promotion could result in lower prices and/or higher marketing expenses. Declining prices for competing entertainment products such as DVDs and video games, as well as the emergence of totally new products, could result in reduced demand for music content. Each of these issues could have a negative impact on our revenues and profits from operations.

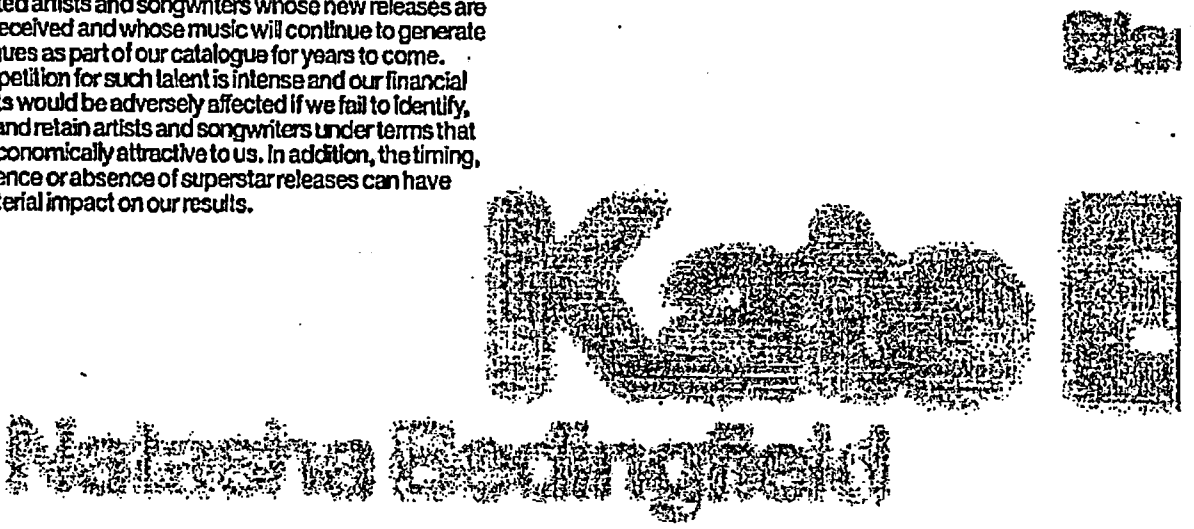
Retail environment
There has been a significant shift in the retail environment for music. In many countries, mass merchandisers have been taking increased retail market share in physical sales. This has given them significantly greater negotiating leverage and hence resulted in downward pressure on our revenues and profits. Specialist music retailers have been losing market share which has, in certain circumstances, resulted in a significant weakening of their businesses. This could have an adverse impact on our business through factors such as reduced availability of our catalogue at physical retailers and increased bad debts. The retail landscape for digital music sales is in the very early stages of development and it is difficult to predict with certainty how this will evolve over time and the impact that this will have on our business. The market for online music downloads is currently dominated in many countries, notably the US and UK, by Apple Computer, Inc.'s iTunes service, although other digital retailers are emerging over time.

Management of artist and songwriter roster and release schedule
We are dependent on identifying, signing and retaining talented artists and songwriters whose new releases are well received and whose music will continue to generate revenues as part of our catalogue for years to come. Competition for such talent is intense and our financial results would be adversely affected if we fail to identify, sign and retain artists and songwriters under terms that are economically attractive to us. In addition, the timing, existence or absence of superstar releases can have a material impact on our results.

Management talent
The success of our business depends upon the continuing contributions of our executive officers and other key operating personnel. Although we plan for management succession, should these officers or key employees not remain with us, our operations could be adversely affected until suitable replacements with appropriate experience can be found.

Geographic spread
We operate on a global basis, and are thus subject to a range of risks, such as currency fluctuation, capital repatriation, varied regulatory and tax regimes, tariffs, duties and other trade barriers, higher interest rates, recessionary trends, political or financial instability, varying commercial trade terms and different legal protection and enforcement of intellectual property rights. The failure to comply with applicable laws, rules and regulations in these jurisdictions may result in legal proceedings. Additionally, changes in government policy, legislation or regulatory interpretation in any of the markets in which we operate may adversely affect our results.

Legal and regulatory environment
Certain government bodies or agencies may instigate inquiries or investigations into companies operating within the music industry. Such inquiries or investigations may divert the time and resources of management and produce unfavourable results which may adversely affect our revenues and profitability.



Legislation could be enacted or interpreted which could affect our relationships with certain artists or could enable some artists to recapture rights in certain recordings. In the US, there have been attempts in recent years to modify or reinterpret existing legislation that would limit the length of relationships that record companies can have with recording artists or that would enable recording artists to terminate licences or assignments of rights in their copyrighted works. Whilst these legislative initiatives have not progressed, there can be no certainty that legislation will not be formulated which could negatively affect our business.

Whilst the period of copyright protection has been increased for sound recordings in the US and for musical works (i.e. compositions) in the US and in the European Union, the period of protection for sound recordings in the European Union and many other countries outside the US remains at 50 years. As a consequence, over time a portion of our catalogue within Europe will become out of copyright (or in the 'public domain'). This will become increasingly significant over time as some of the major 'evergreen' recordings in our catalogue were recorded in the 1960s. When recordings fall into the public domain, we no longer have the exclusive right to exploit them and third parties will have the ability to market and sell those same sound recordings in direct competition with us and without financial compensation to us or our artists. We are actively lobbying governments and legislators to increase the period of copyright protection beyond current levels, but there can be no certainty that such efforts will succeed. As a result, our ability to exploit our back catalogue and, therefore, our results of operations and cash flows may be adversely affected in future years.

Impact of external bodies
External bodies, such as government entities, industry associations or local third-party collection societies, have significant influence on some of our revenues. The two largest sources of income of EMI Music Publishing are mechanical and performance royalties. In the US, mechanical royalty rates are subject to negotiation under the US Copyright Act and outside the US are typically negotiated on an industry-wide basis. Performance rates are usually set by performing rights societies in our major territories and may be subject to challenge by licensees of those performing rights. These processes of setting mechanical and performance royalties may result in the setting of rates at levels lower than we would wish and may, therefore, adversely affect our ability to increase the profitability of our music publishing business.

For our recorded music business, mechanical royalties are a significant expense, whilst revenues from the US satellite radio industry have been driven by a compulsory licence. Changes to the rates or the nature of compulsory licence agreements or the speed of licensing and collection of monies by these third parties could negatively affect our revenues, profitability and cash flows.

Risk of supply interruption
In certain major territories, particularly the US, Europe, Japan and Australia, we source our physical product through one primary manufacturer. Although the industry for CD manufacture has excess supply, our physical product flow could be interrupted if one of our manufacturing partners had difficulty meeting our requirements. For digital products, we utilise a third party for some of the digitisation and other supply chain elements used to provide digital retailers with our music. If the digital supply chain partner had difficulty meeting our requirements, our dissemination of digital music could be hindered. In some key territories, the distribution of our CDs and DVDs is handled by a sole distributor. Whilst we have the ability to terminate these arrangements and switch supplier if the existing distributor fails to meet its obligations, this could lead to a temporary interruption in the supply of our physical product to our customers.

Fluctuation in results of operations and cash flows may affect our ability to service our indebtedness
Our revenues and profits, like those of other companies in the music business, are driven by the number and quality of products that our recording artists and songwriters release and the consumer demand for these releases. We also make non-returnable advance payments to artists and songwriters that impact on our operating cash flows. The timing of releases, associated marketing expenditures and advance payments are largely based on business considerations and other reasons rather than the timing of financial reporting periods. As a result, there may be significant fluctuations from reporting period to reporting period.

A substantial fluctuation or sustained period of lower than expected revenues or profit performance may constrain our ability to service the costs of our capital structure. Our debt facilities of £1.6bn are sizeable and long term in nature with an average maturity of 6.4 years. The interest costs associated with our debt levels are considerable and portions of the debt will need to be repaid over time. We have also distributed a significant dividend to our shareholders twice each year. If our cash flows from operations are negatively affected by industry or business performance, we may have difficulty in meeting the costs of servicing our debt and in making dividend distributions to our equity holders.

We conduct some of our operations through joint ventures.

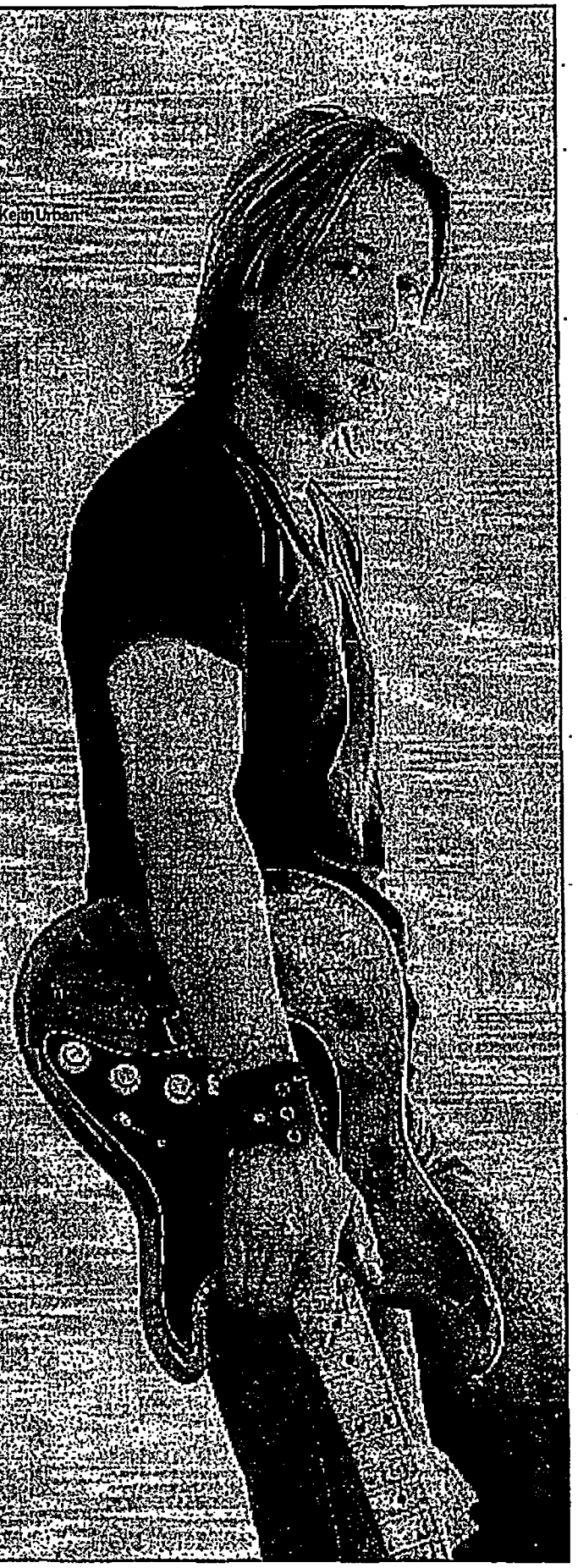
We currently have interests in a number of joint ventures and may in the future enter into further joint ventures as a means of conducting our business. We cannot fully control the operations and the assets of our joint ventures, nor can we make major decisions with respect to our joint ventures unless our joint venture partners agree. Accordingly, although we may have the ability to veto decisions with respect to our joint ventures, we are not in a position to make unilateral decisions. This may constrain the ability of our joint ventures to take action. In addition, we structure certain of our relationships with artists and song writers as joint ventures.

Pension fund valuations.

We maintain certain defined benefit plans around the world, the largest of which is our UK pension plan. The asset values of our pension funds may rise or fall over time depending on a variety of factors, including in particular increases or declines in share prices. Pension funding requirements are dependent upon various factors including interest rate levels, asset returns, regulatory requirements and changes to pension plan benefits. Absent favourable changes to these factors, we may have to satisfy any underfunded amounts of our pension plans through cash contributions over time.

Currency exchange rate fluctuations.

The reporting currency for our financial statements is Sterling. We have substantial assets, liabilities, revenues and costs denominated in currencies other than Sterling. To prepare our consolidated financial statements, we must translate those assets, liabilities, revenues and expenses into Sterling at applicable exchange rates. Consequently, increases and decreases in the value of Sterling versus other currencies will affect the amount of these items in our consolidated financial statements, even if their value has not changed in their original currency. These translations could therefore result in apparent significant changes to our results of operations from period to period.


Keith Urban

9 Resources

The Group has the following key resources which assist it in the pursuit of its key objectives:

- A deep and diverse portfolio of music assets generating strong results on a consistent basis

  We have built an extensive bank of content in terms of internal global scope, breadth of musical styles and genre and quality. In sport of 100 music recordings and musical compositions enjoys strong demand each year. EMI Music has a catalogue of music recordings comprised of over 9m tracks including classics by The Beatles, The Rolling Stones, Pink Floyd, Frank Sinatra, Queen and the Beach Boys as well as new releases by artists including Robbie Williams, Kylie Minogue, Coldplay, Gorillaz and Norah Jones. These recordings continue to produce strong cash flows with limited incremental marketing costs. EMI Music Publishing has the world's largest and most extensive catalogue of musical compositions with over 1m copyrights owned, controlled or administered. Both our historic and current catalogues consistently generate high levels of uses and produce recurrent cash flows year after year.

  Both EMI Music and EMI Music Publishing are continuously adding content to our catalogues to ensure they remain dynamic and growing resources.

- Long-term artist and songwriter agreements

  Our contracts with our recording artists and songwriters generally give us the right to the creative output of those recording artists and songwriters over several years. As a result, when they are successful we continue to share the future financial benefits of that success and to recover our initial investment many times over. We regularly enter into new contracts with our best artists and songwriters even when they have fulfilled all of their contractual obligations to us. In 2002, Robbie Williams resigned to EMI Records in the UK in a ground breaking multi-album multi-million deal. Our catalogue contains recordings by The Rolling Stones just released over 30 years ago and the band continues to record for us today. In addition to EMI Music Publishing's roster of writers, established songwriters such as Sting, Enya and Carly Dennis remain active creatively and enjoy success in terms of both their back catalogue and more recent releases. Equally important, our contracts provide us with flexibility such that if success does not occur or diminishes, we can end the relationship with relatively minimal cost.

- Established global position

  EMI is one of the oldest, most established music companies in the world. We are a global business with a presence in more than 50 countries and with revenues spread across all geographic regions of the world. Based on revenue our recorded music business is one of the largest in the world and our music publishing business is the world's largest music publisher. Our balanced portfolio of international businesses creates a more stable platform for us as macroeconomic trends in one country are balanced and mitigated by trends in other parts of the world.

  Our success in breaking new artists and promoting and sustaining the careers of our superstars ensures that we remain one of the leading music companies in the world.

- Our management and employees

  We enjoy great depth of management expertise at both the corporate and the operating levels. The managements of EMI Music and EMI Music Publishing are widely regarded as among the best in the music business. Alain Levy, CEO of EMI Music, has more than 30 years experience in the industry. During this period he built PolyGram (now part of Universal Music Group) into the industry leader in recorded music. Alain joined EMI in October 2001. Martin Bandier, CEO of EMI Music Publishing, also has more than 30 years experience in the music industry. Martin co-founded SBK Entertainment World in 1984, which now forms the core of our music publishing business. Roger Faxon (previously the Group's CFO) became co-CEO of EMI Music Publishing on 1 April 2006. Roger also has extensive experience both within EMI and the entertainment industry.

  We are committed to maintaining superior management and creative executives at the regional and local levels as well. We focus on ensuring that we have highly capable leaders throughout the organisation and use our talent identification and performance review processes to develop and expand upon our team of creative and business minded professionals. The strength of the EMI name enables us continually to attract the best musical and executive talent. For two years running EMI Music UK was named as one of the 100 Best Companies to Work For in an annual survey by *The Sunday Times*. More information on our employees is included on page 62.

- Trademarks

  Our trademarks and trade names are important to our business. We register our major trademarks and trade names in each country where we believe it is necessary for the effective protection of our business. Our major trademarks that are owned worldwide include EMI, Capitol, Blue Note, Hemisphere, Now Now that's what I call Music, Best, Eye of Faraphone and Angel. The Virgin trademark and the Virgin signature trademark have been licensed independently exclusively to us by the Virgin Group for use worldwide in connection with the music business. We monitor and defend against activities that might impinge upon our trademarks and trade names.

10. Environmental matters

We recognise that our businesses have an impact on the physical environment and we have identified our key issues as energy use and carbon management, other resource use, and waste management. We have policies and reporting procedures in place to ensure that we measure these impacts and work to minimise them. In the UK, for example, close to 100% of our electricity requirements are met through renewable energy sources. During 2005/06, on a like-for-like basis, our worldwide energy use decreased by 5.7%; this was almost entirely due to the sale of our manufacturing plant in Japan at the end of December. Associated carbon dioxide emissions dropped 6.9% in absolute terms and 13% when related to revenue.

We are also subject to environmental laws and regulations in the countries in which we operate and believe that our existing businesses are compliant with all relevant legislation. In connection with former operations we have been, and may become again, responsible for the costs of investigating or clearing up contaminated properties; to date, any such costs have not been material.

More information on our performance in environmental management is included on page 35 and in our annual social responsibility reports, which can be viewed at www.emigroup.com/social.

11. Social and community issues

EMI's responsibilities as a business also extend to the communities in which it operates. We are committed to fair treatment of all our stakeholders – artists, employees, shareholders, customers, suppliers, governments and society at large. We have a range of policies in place to support this, including a Standards of Business Conduct policy for employees which underlines the importance of integrity, ethics, objectivity and accountability in our dealings with others.

Any social and ethical issues that could cause risk to the business are taken into account as part of the annual risk review process (see section 8). While these issues are important, we do not think that they pose any significant risk.

EMI has an active and on-going community investment programme. Globally, the main causes we support are youth and education, arts and culture, and health and welfare. At Group level, we focus on promoting music education and access to music. This ensures that our community investment activities are aligned with our core business; we believe it is also the way in which the business can best utilise its energy, creativity and expertise to deliver long-term benefits to the community. Our flagship initiative is the EMI Music Sound Foundation which has, to date, awarded over £2.5m to boost music education in the UK. Other key partnerships include London's Roundhouse, Teach First, Music House for Children and education work with the London Sinfonietta, the California Institute of the Arts and Skidmore's Summer Jazz Institute.

EMI is included in the FTSE4Good and the Dow Jones Sustainability Index, both of which assess companies' social, environmental and ethical policies and performance.

More information on social and community issues can be found on pages 32 to 35 and in our annual social responsibility reports, which can be viewed at www.emigroup.com/social.

12. Critical accounting policies and use of estimates

Our discussion and analysis of the Group's financial position and results of operations are based upon our consolidated Financial statements, which have been prepared in accordance with International Financial Reporting Standards (IFRS). This is the first Annual Report of the Group to be prepared in accordance with IFRS, as adopted by the European Union. The transition date for the application of IFRS is 1 April 2004. The comparative figures for year ended 31 March 2005 have been restated accordingly, except where the Group has taken the option under IFRS 1 *First-time adoption of IFRS* as follows:

- the requirements of IFRS 3 *Business Combinations* have been applied prospectively from 1 April 2003;
- certain properties were held at revalued amounts as at 31 March 2004. On conversion, these revalued amounts were frozen and deemed cost in the case of these properties;
- all actuarial gains and losses in respect of defined benefit pension and post-retirement schemes have been recognised in full in equity from 1 April 2004;
- cumulative translation differences relating to net investments in overseas companies that arose prior to 1 April 2004 have been set to zero and will not be included in any subsequent calculation of profit or loss on disposal;
- only those employee share options granted after 7 November 2002 that had not vested as at 1 January 2005 have been remeasured at fair value; and
- the Group has chosen to adopt IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement* from 1 April 2004.

The preparation of the Financial statements requires our management to make estimates and judgements that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities.

On an on-going basis, we evaluate our estimates, including those related to sales returns, bad debts, intangible assets, income taxes, and contingencies and litigation. Historical experience and various assumptions that we believe to be reasonable under the circumstances form the basis for making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Our significant accounting policies are detailed in full on pages 63 to 65 of the Financial statements. The key policies are summarised in this section.

Revenue recognition
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue is recognised after making provision in respect of expected future returns of goods and services supplied by the Group prior to the balance sheet date (see below).

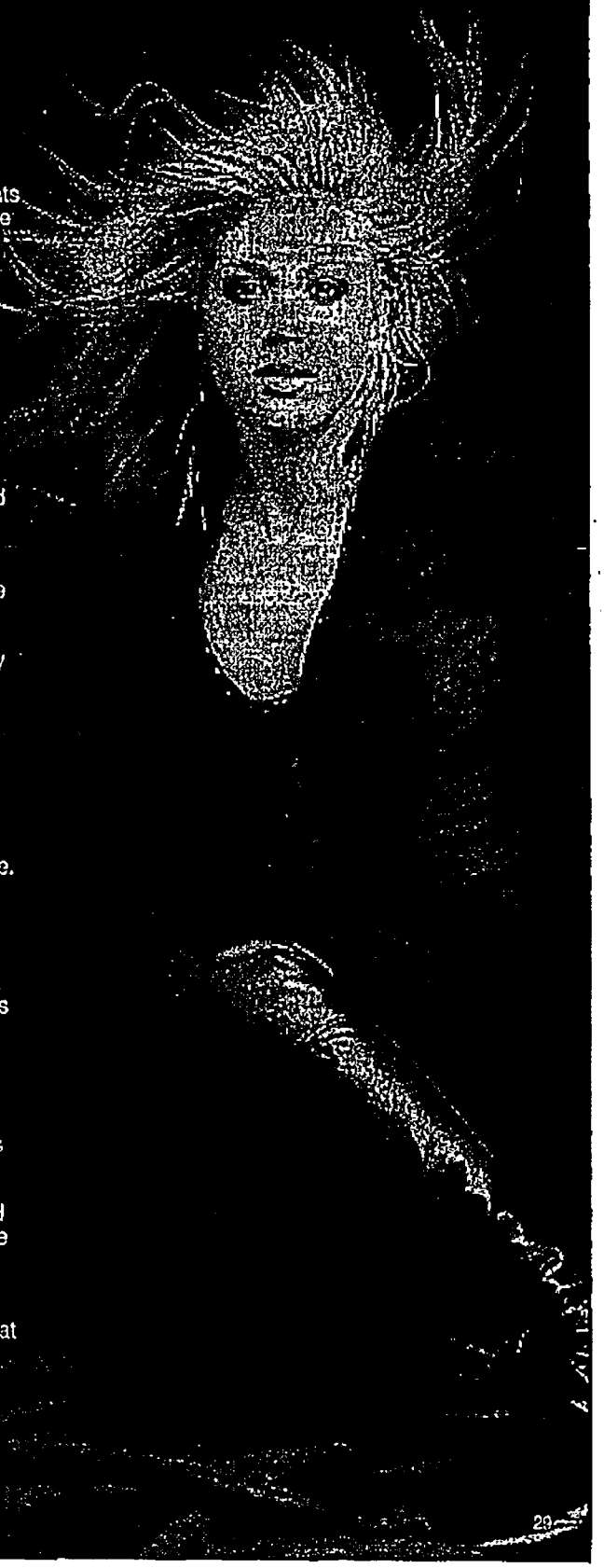
Licence income is recorded on an accruals basis where reliable estimates can be made of future receivables relating to income for the current financial year. Where such reliable estimates cannot be made, income is only recorded once received.

Another area of judgement affecting reported revenue and net income is management's estimate of product sales that will be returned. In determining the estimate of product sales that will be returned, management analyses historical return patterns, current economic trends, changes in customer demand and acceptance of our products, as well as changes in our terms of trade. Based on this information, management reserves a percentage of product sales that provide the customer with the right of return.

Accounting for jointly controlled operations
The Group has a number of jointly controlled operations where there is no separate legal entity. An example of such an arrangement is the Now albums which use content from a number of music companies.

The expenses that the Group incurs, and the share of the income that the Group earns from the sale of goods by these jointly controlled operations, are included in the Income statement. Where EMI distributes the joint product, our share of the revenue and costs associated are reported line by line in the Income statement. Where EMI does not distribute the product, the net profit attributable to EMI is reported within revenue.

The assets that the Group controls, and the liabilities that the Group incurs, in respect of these jointly controlled operations are included in the balance sheet.



Accounting for advances to artists, writers and repertoire owners
In the ordinary course of business, the Group pays advances, and other expenses recoupable from future royalties, to performing artists, songwriters, producers and third-party repertoire owners. One area of judgement affecting our income statement is management's estimate of the recoverability of those advances on future royalties paid to artists, songwriters, producers and third-party repertoire owners.

Advances are initially capitalised on our balance sheet to the extent that our management believes them to be recoverable. This assessment of recoverability is based upon the current and past popularity of the artists, the initial commercial acceptability of the product, the current and past popularity of the genre of music to which the product belongs, and projected revenue performance. Based on this information, management expenses the portion of such advances that it believes is not recoverable. Our policy is to provide at least 80% of the net account balance in those cases when an artist does not have a proven track record.

As revenue is generated by the product against which an advance was made, we expense through cost of sales the portion of the capitalised advance which has been recouped. Management regularly reviews the recoverability of capitalised advances and will make a provision to the extent that it no longer believes an advance to be recoverable.

Accounting for pensions and other post-retirement benefits
The Group operates three major defined benefit pension schemes. The cost of providing benefits under the schemes is determined separately for each scheme using the projected unit actuarial valuation method.

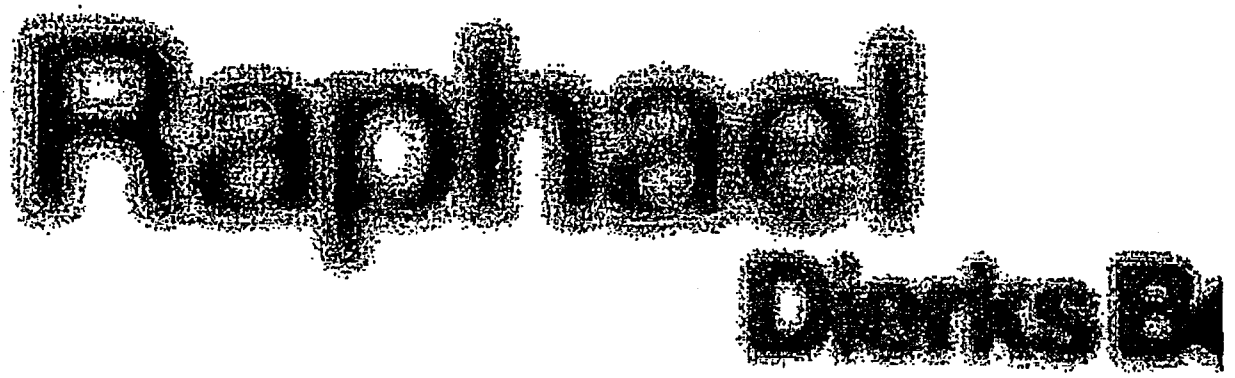
In reaching the valuations, actuaries must use judgement about uncertain events including, but not limited to, discount rates, expected rate of return on plan assets, participation levels, salary increases and expected healthcare cost trend rates.

The actuarial valuations and the judgements therein form the basis for:

- the service cost charged against profit;
- the expected long-term returns on defined benefit scheme assets and the interest on the defined benefit obligation included as net finance charges in the income statement;
- actuarial gains and losses charged or credited directly to reserves through the statement of recognised income and expense; and,
- actuarially calculated surpluses or deficits on the defined benefit schemes included within the consolidated balance sheet.

All these amounts are sensitive to the assumptions made by the actuaries.

Under IFRS, actuarial valuations of our principal defined benefit pension schemes for accounting purposes are required to be carried out every year. The latest actuarial valuation for our UK pension plan for funding purposes has commenced and will be completed during 2006/07.



Intangible assets
Intangible assets include music copyrights and other intangibles. Intangible assets acquired separately are capitalised at cost, whilst those acquired as part of a business acquisition are capitalised at fair value at the date of acquisition.

Following initial recognition, intangible assets with finite lives are amortised on a systematic basis over their economic useful lives. Intangible assets are tested for impairment if events or changes in circumstances indicate that the carrying value may be impaired. Useful lives are examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

Intangible assets created within the business that cannot be distinguished from the cost of developing the business as a whole are not capitalised. Any relevant expenditure is charged against profit from operations in the period in which the expenditure is incurred.

Share-based payments
The share option programme allows certain Group employees to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The expense is spread over the period during which the employees become unconditionally entitled to the options.

A 'binomial lattice' model is used by actuaries to calculate the fair value of the share option at the grant date. In applying the model, actuaries must use judgement about uncertain events including, but not limited to, interest rates, the dividend yield, the volatility of the share price over the expected term of the option (based on historic volatility up to the date of grant), staff turnover and the probability of early exercise of the options.

Judgement also exists in determining the point at which employees become 'unconditionally entitled' to the options. These include the Group's best estimate of the number of awards that will ultimately vest and satisfaction of relevant performance criteria.

Measurement of financial derivatives
Under IFRS, certain debt and related derivative instruments are remeasured to fair value, with the change in fair value shown in the income statement within finance charges or through reserves where the Standards allow.

The Group has debt and derivative instruments that require fair valuing at each balance sheet date. The various elements are:

- the remeasurement of debt to market value offset by the remeasurement of applicable interest rate swaps to market value (where hedge accounting can be adopted);
- the remeasurement of the conversion option within our US$243m convertible bond;
- the remeasurement of the Eurobond embedded call feature; and,
- the remeasurement of foreign currency denominated debt using exchange rates at the balance sheet date. Where the borrowing hedges a net investment, the change in fair value is booked to reserves. The change in fair value of any additional borrowing is recognised through the income statement.

The remeasurement of these elements can give rise to significant amounts within finance charges in the income statement. Factors that affect the remeasurements include changes in interest rates, EMI credit spread, exchange rates and the EMI share price. The above adjustments have no cash impact.

Radja

Daddy Yankee

Social responsibility is as relevant to the music industry as any other sector, and EMI is committed to playing a constructive role in society and in the safeguarding of the environment. Our social responsibility programme began in the early 1990s and has evolved over time to reflect our business and the expectations of our stakeholders.

We continue to be included in the Dow Jones Sustainability Index and FTSE4Good, and we are a founding and active member of the UK's Media CSR Forum. More detailed information on our programme can be found in our annual social responsibility reports, which are available on our website (www.emigroup.com/social).

Employment

The music business relies on creative and motivated people. We work hard to inspire and reward our employees and provide opportunities for personal and career development. This ensures that we continue to recruit and retain the very best people.

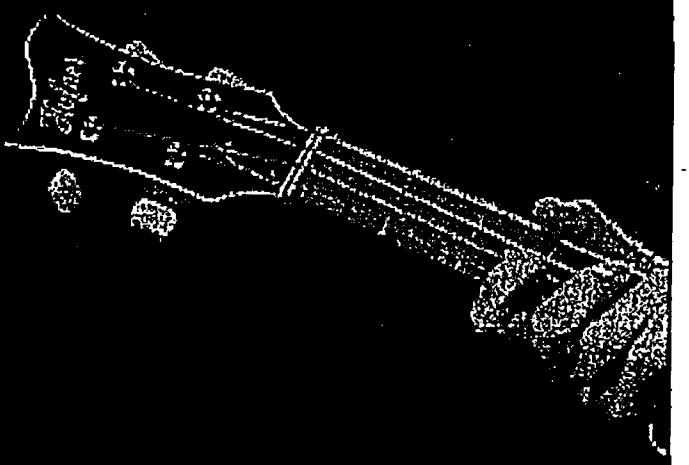
In 2005, we launched a global employee survey to gather the views of our workforce. The music industry has changed dramatically in recent years and the survey is an important step in understanding how EMI employees are responding to the changes. The findings will help determine the future direction of our workplace and enable us to respond to the changing needs and expectations of our staff. The survey had a high response rate, at 78%. Results have been shared with employees and some new initiatives have already been implemented, for example in the area of internal communications.

We continue to equip our management with the skills they need to drive the business forward through our worldwide management development programme. Targeted development and support means our senior managers are better able to compete in an industry that is undergoing such rapid and fundamental change. We believe this type of long-term investment is critical to our success. Business training is, of course, important at all levels of the organisation and globally EMI companies provide opportunities for staff to develop or enhance their skills. Increasingly, development needs are identified and agreed through the performance appraisal systems that are being rolled out throughout the Group. Last year 29% of the total workforce received some form of skills training, a 16% increase on the previous year.

In the UK and Australia, we have been able to offer all employees a flexible benefits package which they can customise to fit their personal circumstances. The benefits offered by the package include the ability to buy and sell annual holiday entitlement, discounted private medical and dental insurance and savings on childcare.

In 2005/06, women made up 48% of all staff, compared to 47% the previous year; however, the number of women in management decreased from 25% to 23%. Ethnic minorities (excluding Asia and Latin America) made up 14% of all staff and 9% of management; this compares to 15% and 5% respectively in the previous year. The level of staff with self-reported disabilities remained broadly stable, at 0.3% of staff and 0.5% of management.

During the year, there were 17 reportable injuries/illnesses (2.9 per 1,000 employees) based on the UK standard measure; this is an improvement on the previous year when there were 19 (4.4 per 1,000 employees). Days' absence from illness per employee was higher, at 3.9 days compared to 3.3 days.



Community

The focus for our community investment programme is music education and we continued our support for a range of initiatives to enable young people to benefit from wider access to music. EMI Music Sound Foundation is our main initiative to boost music education in the UK and Ireland. Established by EMI in 1997, the independently-governed Foundation is based at our head office and shares a very close working relationship with the business. To find out about the work of the Foundation, which will be celebrating its 10th anniversary next year, please visit its website at www.emimusicsoundfoundation.com.

Together with the Brit Trust, EMI and the EMI Music Sound Foundation once again collaborated on a project to enable schools across the UK to benefit from workshops run by the London Sinfonietta, Britain's premier contemporary classical music ensemble. This year's project was based on Karlheinz Stockhausen, the godfather of electronica, whose music has influenced a number of popular EMI artists, including The Beatles, Goldfrapp and Kraftwerk.

In the US, music education was at the heart of two projects which EMI continued to support. For the third year, we were involved in the Grammy Jazz Ensembles programme which enables talented high school students to meet, share experiences and perform with Grammy-nominated artists, including a recording session at the Capitol Studios in Los Angeles. We also continued our partnership with the California Institute of Arts to give music students the opportunity to record, produce and release their original work, working with Capitol Studios' staff.

In the UK, EMI is a founding corporate partner of London's Roundhouse, a dynamic performing arts venue which includes a state-of-the-art community media resource providing young people with an opportunity to develop their creative skills. We have funded a music studio there and during the year we continued our support by hosting a reception in aid of the Roundhouse for music industry professionals and press, running an in-house fundraising campaign, and offering professional help in a number of areas including equipping the music studio and advice on human resource issues.

Another important partnership is with Teach First, which recruits top graduates to teach for two years before taking their skills and experiences into the business world; to date about 50% of participants have opted to stay in teaching for at least a third year. Our support has primarily been funding the recruitment and training of music teachers; by September 2006, secondary students at 10 London schools will be benefiting from better music education. We also recruit senior EMI staff members to act as coaches to the teachers, organise summer placements and host events.

Our individual operating companies are free to direct their community efforts in a very local way, and for many years EMI Music's UK business has played a key role in helping to improve safety in its area of West London. This year, EMI has been a driving force in a new initiative to encourage young people to contribute to their neighbourhoods which, in turn, would reduce the fear of crime. The Safer Neighbourhoods Annual Challenge asked 11–19 year olds to identify problems in their neighbourhood and suggest, and then implement, solutions; these ranged from cleaning up public spaces to organising film evenings for local youth.

CalArts

EMI Music Sound Foundation

Live 8

Roundhouse

Teach First

Dow Jones Sustainability Index

Benefit CDs are a unique way in which our industry can contribute to the community, whether in aid of a specific charity or in response to a disaster. Following Hurricane Katrina and the devastation it caused in New Orleans, EMI Music in the US produced a number of albums to raise money for the relief effort. Our jazz label, Blue Note, released the recording of *Higher Ground*, the Hurricane Relief Benefit Concert at New York's Lincoln Center which was produced by EMI artist and New Orleans native Wynton Marsalis. Parlophone released Dr John's *Sippiana Hericane* and EMI's Christian Music Group collaborated on the album *Songs of Hope*. EMI also worked in partnership with the rest of the music industry to release *Hurricane Relief: Come Together Now*, a multi-artist album which included EMI stars such as Coldplay and Norah Jones.

2005 was also the year of Live 8, which drew attention to third-world poverty through a series of free music concerts around the world. EMI helped make the concerts on 2 July possible with its major financial contribution (together with a very generous royalty rate) in return for the worldwide DVD rights. Funds from the DVD will be utilised by the Band Aid Trust for the relief of hunger and poverty in Africa.

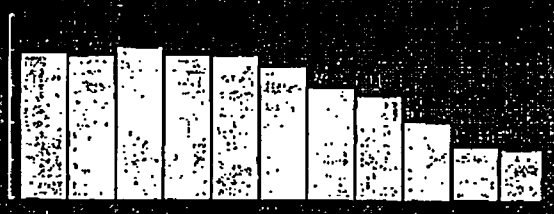
EMI's worldwide charitable cash contributions for the year were £0.9m; this was complemented by additional community investment from participation in industry fundraising events around the world, arts sponsorship, and donations of both staff time and gifts in kind. In the UK, for the sixth consecutive year, EMI was a member of the PerCent Club, which recognises a community investment level of 1% or more of pre-tax profits.

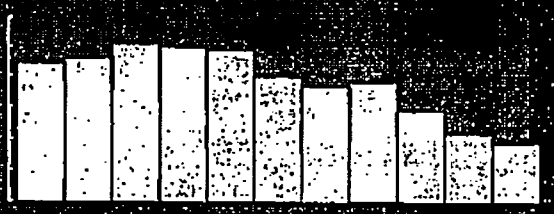
Environment

Following our withdrawal from manufacturing in the US and Europe in 2004, the sale of our CD plant in Japan at the end of 2005 marked a further reduction in the environmental impacts that we manage directly. However, we continue to ask our major product suppliers to report on key environmental performance indicators with the aim of ensuring responsible environmental management in our supply chain.

EMI offices, distribution centres and studios globally continue their efforts to find ways to reduce energy and resource consumption and cut office and product waste in line with our environmental policy.

Our carbon dioxide emissions dropped by 6.9% in absolute terms last year and by 13% when related to turnover. This decline is almost entirely due to the sale of the Japanese factory. The decrease in absolute energy use during the year was 5.7%. Globally we source just over 21% of our electricity demand from renewable sources.





Board of Directors
Executive Directors

Eric Nicoll (55)
Chairman

Eric Nicoll was appointed to the Board in 1993 as a Non-executive Director, becoming executive Chairman in July 1999. Until April 1999, he was Group Chief Executive of United Biscuits (Holdings) plc (UB), which he joined from Rowntree Mackintosh in 1980. He was appointed to the UB Board in 1989 and became Chief Executive of UB in 1991.

Mr Nicoll is: Non-executive Chairman of The Tussauds Group Ltd; Chairman of The PerCent Club, The EMI Group Archive Trust and of the Trustees of the EMI Music Sound Foundation; and a director of Creative and Cultural Industries Ltd. He is co-Chairman of BASCAP, an international initiative to stop counterfeiting and piracy, and he also sits on the UK government's Creative Industries Forum on Intellectual Property.

Roger Faxon (58)
President and Co-Chief Executive Officer, EMI Music Publishing

Roger Faxon became joint CEO of EMI Music Publishing and rejoined the Board on 1 April 2006. He will become sole CEO of EMI Music Publishing on 1 April 2007.

Mr Faxon joined EMI in 1994, initially as Senior Vice President, Business Development & Strategy, EMI Music and, in April 1999, became Executive Vice President and Chief Financial Officer, EMI Music Publishing. On 1 February 2005, after three years as the Chief Financial Officer and an Executive Director of EMI Group plc, Roger Faxon returned to EMI Music Publishing as President and Chief Operating Officer.

Prior to 1994, Mr Faxon held finance, operations and general management positions. These posts included five years with Sotheby's, latterly as Managing Director, Sotheby's Europe and, previously, as Chief Operating Officer, Sotheby's North and South America. This followed ten years in the motion picture industry and six years on the staff of the US Congress.

Mr Faxon is a director of Music Choice Inc. and the American Society of Composers, Authors and Publishers.

Alain Levy (59)
Chairman and Chief Executive Officer, EMI Music

Alain Levy joined EMI and was appointed to the Board in October 2001.

Mr Levy joined CBS International (now Sony Music) in 1972 and, after 12 years, moved to PolyGram (now Universal Music Group), where he became President and CEO in 1991. In both companies he held various posts involving manufacturing, logistics, marketing and management. Mr Levy remained with PolyGram until it was sold to Seagram in 1998.

Mr Levy is a director of David Linley & Co. Ltd and Ilchester Investments Ltd. He also sits on the advisory board of Schroder Venture Partners LLC (formerly Schroder Ventures) in the US and on the European advisory board of Wharton Business School.

Martin Stewart (42)
Chief Financial Officer (CFO)

Martin Stewart, who is a Chartered Accountant, was appointed CFO and became a member of the Board in February 2005, having joined EMI in January 2005.

Before joining EMI, Mr Stewart was Chief Financial Officer of British Sky Broadcasting Group plc. He held this post from 1998 until 2004, having joined that company in 1996. Between 1991 and 1996, Mr Stewart was employed by PolyGram, latterly as Finance Director of PolyGram Filmed Entertainment.

John Gildersleeve (61)
Deputy Chairman and Senior Independent Non-executive Director

John Gildersleeve joined the Board in 2004 when he also became Deputy Chairman and Senior Independent Non-executive Director.

Until 2004, Mr Gildersleeve was the Commercial and Trading Director of Tesco plc. He joined Tesco in 1965 and became an executive director in 1984.

Mr Gildersleeve is also Non-executive Chairman of Gallaher Group plc and of The Carphone Warehouse Group PLC.

Sly Bailey (44)

Sly Bailey joined the Board in 2004.

Mrs Bailey is Chief Executive of Trinity Mirror plc, the UK's largest newspaper publisher. Between 1989 and 2003, Mrs Bailey held various executive posts with the IPC Media Group, joining the Board in 1994 and becoming Chief Executive of IPC Media in 1999. She led the sale of IPC to AOL Time Warner in 2001. From 1984 until 1989, Mrs Bailey worked in sales management for The Independent and The Guardian newspapers.

Mrs Bailey is a non-executive director of The Press Association Ltd. She is also the President of Newstraid, a charity for the distribution and retail news trade, and is a board member of the NSPCC Stop Organised Abuse Appeal.

Kevin Carton (62)

Kevin Carton joined the Board on 1 February 2006.

It is envisaged that, in due course, Mr Carton will become Chairman of the Audit Committee, succeeding Kathleen O'Donovan.

Mr Carton retired as a senior partner of PricewaterhouseCoopers LLP in June 2004 after 38 years. He was the Global Leader of the Entertainment & Media practice based in New York and became a partner of Price Waterhouse in 1977.

Mr Carton serves on the boards of Russell Reynolds Associates and Good Shepherd Services and is on the Board of Advisors at BrainShield Technologies Inc. He was previously a member of the International Council of The Museum of Television & Radio.

Peter Georgescu (67)

Peter Georgescu joined the Board in 2002.

Mr Georgescu is Chairman Emeritus of Young & Rubicam Inc., a network of commercial communications companies, having served as that company's Chairman and CEO from 1994 until 2000.

In addition, Mr Georgescu is a director of Levi Strauss & Co. and International Flavors & Fragrances Inc. He is also Vice Chairman of the directors of New York Presbyterian Hospital and is a member of the US Council on Foreign Relations.

David Londoner (69)

David Londoner joined the Board in 2003.

Mr Londoner, who is a Chartered Financial Analyst, is the General Partner of The North River Company, L.P., a family investment partnership. He spent most of his career at Schroder & Co. Inc., joining a predecessor firm, Wertheim & Co., in 1972 and leaving when it was sold in 2000.

Additionally, Mr Londoner is a director of Meredith Corporation and Wintergreen Fund. He is also a trustee emeritus of the Museum of the Moving Image in the US.

Kathleen O'Donovan (49)

Kathleen O'Donovan joined the Board in 1997 and has chaired the Audit Committee since 1999. She will conclude her third three-year term as Non-executive Director of the Company and retire as a Director on 20 November 2006.

Ms O'Donovan is a non-executive director of Prudential plc, the senior independent non-executive director of Great Portland Estates PLC and serves on the audit committees of both companies. She is also chair of the Invensys Pension Fund. In addition, she was a non-executive director of O_2 plc until its acquisition in January 2006 and subsequent delisting, as well as being a director of the Court of the Bank of England and chair of its audit committee until 2005 when her second three-year term of office ended.

Business review
The information that fulfils the requirements of the Business Review can be found in the Operating and Financial Review on pages 6 to 31 which is incorporated in this Directors' report by reference.

Dividends
An interim dividend of 2.0p per Ordinary Share was paid on 3 April 2006. The Board is recommending a final dividend of 6.0p per Ordinary Share, making a total of 8.0p (2005: 8.0p). The final dividend will be paid on 2 October 2006 to Ordinary Shareholders on the register as at the close of business on 21 July 2006, with the shares going ex-dividend on 19 July 2006.

Scrip Dividend Scheme
The Company's Scrip Dividend Scheme permits shareholders to enter into a continuing mandate for the receipt of shares in place of cash dividends with the ability to cancel such mandate at any time. It is the Board's intention to apply the Scheme to the final dividend proposed to be declared at the AGM. However, in accordance with Article 159 of the Company's Articles of Association, the Board has the right to amend, suspend or withdraw the application of the Scheme to any particular dividend at any time prior to the allotment of the related shares.

Share capital
Changes in the Company's share capital during the year, and details of the authority for the Company to purchase its own Ordinary Shares as at 31 March 2006, are set out in the Notes to the Group and Company Financial statements on pages 82 and 96.

Substantial shareholders
As at 18 May 2006, the Company had been notified of the following interests of 3% or more in its Ordinary Shares:

	No. of shares	% of capital held
The Capital Group Companies, Inc.	40,512,803	5.11
Deutsche Bank AG	49,278,472	6.22
FMR Corp./Fidelity International Ltd	114,065,999	14.39
HBOS plc/Insight Investment Management Ltd	40,609,739	5.12
Legal & General Investment Management Ltd	27,687,735	3.49
Prudential plc group of companies	37,310,271	4.70
Wellington Management Company, LLP	74,460,205	9.39

Analysis of Ordinary Shareholdings at 18 May 2006

Range	Number of holdings	%	Balance as at 18 May 2006	%
1 to 500	9,720	49.95	1,923,604	0.24
501 to 1,000	4,243	21.80	3,100,499	0.39
1,001 to 10,000	4,648	23.89	10,864,585	1.37
10,001 to 100,000	434	2.23	15,502,961	1.96
100,001 to 1,000,000	291	1.50	101,194,240	12.76
1,000,001 and over	123	0.63	660,339,675	83.28
	19,459	100.00	792,925,564	100.00

Employment policies
Information on the Group's employment policies is given in the Operating and Financial Review on page 27.

Supplier payment policy
The Company negotiates payment terms with its suppliers on an individual basis, with the normal spread being payment at the end of the month following delivery plus 30 or 60 days. It is the Company's policy to settle the terms of payment when agreeing the terms of each transaction, to ensure that the suppliers are made aware of the terms, and to abide by them. The Company makes payments to its suppliers through its subsidiary, EMI Records Ltd. The number of days' purchases outstanding at 31 March 2006 is calculated at 74 days (2005: 48 days).

Charitable and political expenditure
Charitable, sponsorship and fundraising activities carried out during the year within the Group contributed £0.9m (2005: £1.0m) to charitable organisations and communities around the world. These included UK charitable donations amounting to £0.3m (2005: £0.3m) and £nil (2005: £nil) elsewhere in the European Union ('EU'). These donations were given to support charitable organisations and community initiatives in youth and education, arts and culture, and health and welfare. Further details are contained in the Social responsibility report on pages 32 to 35.

It is the Group's policy not to make any donations to political parties or to incur any political expenditure, as those terms are defined in the Political Parties, Elections and Referendums Act 2000 ('PPERA'). No such donations were made, nor was such expenditure incurred, either in the UK, the rest of the EU or elsewhere during the year (2005: £nil).

Research and development ('R&D')
During the year, Group expenditure on R&D totalled £347,000 (2005: £40,000).

Directors
The present Directors of the Company are named on pages 36 and 37. Mr K K Carton and Mr R C Faxon were appointed as Directors on 1 February and 1 April 2006, respectively. As required by the Company's Articles of Association, both of them will stand for election by shareholders at the 2006 Annual General Meeting ('AGM'). All the other Directors served throughout the year, including Mr M N Bandier, who ceased to be a Director on 31 March 2006.

The changes in the Directors outlined above relating to Messrs. Bandier and Faxon have been made pursuant to the succession plan for the Company's music publishing division announced on 6 January 2005. Under this plan, Mr Faxon left the Board on 1 February 2005 and returned to EMI Music Publishing in New York to become its President and Chief Operating Officer, reporting to Mr M N Bandier. As from 1 April 2006, when Mr Faxon rejoined the Board, he became joint Chief Executive Officer (CEO) of EMI Music Publishing with Mr Bandier. At that time, Mr Bandier, who continues as Chairman of EMI Music Publishing, ceased to be a Director of the Company. From 1 April 2007, Mr Faxon will become sole CEO of EMI Music Publishing, with Mr Bandier remaining as full-time Chairman of the division until 31 March 2008.

Mr E L Nicoll and Mr D J Londoner retire at the AGM pursuant to Article 112(B) of the Company's Articles of Association having been last re-elected or elected in 2003 and, being eligible, offer themselves for re-election.

Ms K A O'Donovan will retire on 20 November 2006 following the completion of three three-year terms as a Non-executive Director. It is intended that Mr K K Carton will succeed her as Chairman of the Audit Committee.

Biographical information relating to the Directors to be elected or re-elected at the AGM is set out on pages 36 and 37.

No Director had a material interest in any contract of significance subsisting at the end of, or during, the year involving any Group company, other than by virtue of having a service contract or letter of appointment. In addition, all Directors benefit from a letter of indemnity in respect of Directors' liabilities these being introduced following a change in company law made during 2005; this is more fully explained in the following paragraph. Details of Directors' interests in the shares of the Company are set out in the Remuneration report on pages 52 to 55.

From 6 April 2005, UK company law was relaxed to permit companies to indemnify directors against liability, including costs and damages, awarded in court proceedings brought by third parties (a 'qualifying third party indemnity provision'). Article 177 of the Company's Articles of Association (both before 14 July 2005 and as amended on that date) provides that, insofar as permitted by law, every Director is entitled to be indemnified by the Company against costs and liabilities incurred in the execution and discharge of the Director's duties and the Company has been advised that, as such, Article 177 provides the benefit of a qualifying third party indemnity provision.

On 14 October 2005 the Company, pursuant to the power conferred by Article 177 (as amended on 14 July 2005) granted to each of the then Directors a separate and express indemnity which constitutes a qualifying third party indemnity provision and which includes provisions relating to the notification of any relevant third party claims and the conduct of the Director's defence. Such indemnities were also granted to Messrs Carton and Faxon on their appointment as Directors.

Disclosure of information to the auditor
So far as each Director is aware, there is no relevant audit information (as defined in S244ZA(3) of the Companies Act 1985) of which the Company's auditors are unaware, and each Director has taken all steps that he or she ought to have taken as a Director in order to make himself or herself aware of, and to establish that the auditors are aware of, any relevant audit information.

Auditor
Resolutions to reappoint Ernst & Young LLP as the Company's auditor and authorising the Directors to determine its remuneration will be put to the forthcoming AGM.

Annual General Meeting
The 2006 AGM of the Company will be held at 2.30pm on Thursday, 13 July 2006 at Deutsche Bank, 75 London Wall, London EC2N 2DB. The Notice of AGM accompanies this Annual Report. In addition to the ordinary business of the meeting, resolutions will be put to shareholders to give authority to the Directors to allot shares, give authority to the Directors to disapply pre-emption rights and to give authority to the Company to purchase its own shares. Also, so as to avoid an inadvertent breach of the law, resolutions will be put to shareholders seeking approval for political donations and expenditure by the Company and its principal UK subidiaries. Further explanations of these matters are provided in the letter to shareholders that accompanies the Notice.

Electronic Proxy Appointment ('EPA')
EPA will again be available for this year's AGM. CREST members may also use the CREST electronic proxy appointment service. Further information regarding EPA is provided in the Notice of AGM and on the Proxy Form.

By Order of the Board
C P Ashcroft
Secretary
22 May 2006

Corporate governance

EMI is committed to high standards of corporate governance. The Board considers that the Company has complied throughout the year with the Code provisions set out in section 1 of the revised Combined Code on Corporate Governance which was issued in July 2003 ('the Code'), except as regards the length of Directors' service contracts, which is discussed in the Remuneration report on pages 47 and 48, and the combination of the roles of Chairman and Chief Executive which is discussed below.

Ernst & Young LLP has reviewed the Company's statement as to its compliance with the Code, in so far as it relates to those parts of the Code which the UK Listing Authority specifies for review by the external auditor, and its report is set out on page 57.

The remainder of this section, together with the Remuneration report, provides an explanation of how EMI applies the principles of good governance as set out in the revised Code.

The Board

As at 31 March 2006, the Board of EMI Group plc comprised ten Directors of whom four were Executive Directors. There were five Non-executive Directors in office throughout the year, until 1 February 2006, when Kevin Carlon was also appointed. As part of the succession plan for EMI Music Publishing, Martin Bandier retired as a Director on 31 March 2006 when he was replaced by Roger Faxon.

All of the Non-executive Directors are considered to be independent of management and free from any business or other relationship that could materially interfere with the exercise of their independent judgement. The Nomination Committee has conducted an annual review as to whether the Non-executive Directors remain independent applying the criteria set out in the Code. As reflected in their biographies, which appear on pages 36 and 37, the Directors have a wide and balanced range of experience in multinational and consumer-orientated businesses, as well as an appropriately international spread.

Eric Nicoli is executive Chairman of the Company, which position incorporates the role of chief executive officer. Day-to-day executive responsibility for the running of the Company's two main businesses lies with Alain Levy, as Chairman and CEO, EMI Music, and Martin Bandier, as Chairman and joint CEO, EMI Music Publishing, who each report to Eric Nicoli. Roger Faxon became joint CEO of EMI Music Publishing with Martin Bandier on 1 April 2006.

In recent years, and as explained in previous Annual Reports, the Board has concluded that EMI has been best served by having separate CEOs of the recorded music and music publishing businesses with each of them reporting to an executive chairman who complements their music industry experience and expertise. The Board has further concluded that the interposition of another senior executive between the Chairman and the business CEOs would lead to unnecessary duplication, and diffusion of responsibility.

The Board believes that, for the present, the structure outlined above is the most effective for EMI and is in the best interests of both the Company and its shareholders. Furthermore, the Board considers that the nature and level of matters reserved for decision, either to the Board as a whole or to standing committees of the Board, appropriately limit the authority of the Chairman and reflect the combination of the posts of chairman and chief executive officer in one person.

It is the Board's policy that, so long as the Chairman is also the chief executive officer of the Company, the independent Non-executive Directors should comprise a numerical majority of the Board and that the senior independent Non-executive Director should also be either sole or joint Deputy Chairman.

Apart from EMI, Eric Nicoli's only other significant commitment during the year was the chairmanship of The Tussauds Group Limited, a private company.

The Board as a whole considers the appointment of Directors to, and executive appointments within, the Board, based on recommendations from the Nomination Committee which follows a formally approved selection process. The Articles of Association include a requirement that all Directors should submit themselves for election by the shareholders at the AGM immediately following their appointment and for re-election at least once every three years thereafter.

The Board meets at least eight times each year, with additional meetings or contact between meetings as necessary. The programme for each year is approved by the Board in advance. Currently, the programme includes reviews of strategy together with the operations and results of the two main business units, as well as the approval of annual budgets and regular presentations on key business developments, major projects and strategic issues. Actual results for the Group and its two business units are reported to all Directors each month. In the year ended 31 March 2006, the Board met 11 times, including a strategy 'away day' in June and a strategy review as part of its October meeting in New York. In the year ended 31 March 2006, the Board met twice outside the UK to allow closer contact with local management and intends to continue this practice in coming years.

These procedures, together with other regular and ad hoc reports, aim to ensure that the Board is supplied in a timely manner with information that is appropriate to the discharge of its duties.

The Board's programme also includes management development and succession planning, reviews of the effectiveness of the Board and its principal committees, and an assessment of the performance of the Executive and Non-executive Directors. Additionally, the Board's programme provides for at least two meetings a year between the Chairman and the Non-executive Directors, as well as at least one meeting of the Non-executive Directors alone.

During the year, the effectiveness of the Board and its principal committees was assessed through each Director completing a questionnaire prepared by the Company Secretary and approved by the Chairman and Deputy Chairman. The results were then presented to the Board by the Company Secretary and, following discussion by the Board, agreed changes were implemented. A similar process was applied during the year by each of the Audit, Nomination and Remuneration Committees with the effectiveness questionnaire being approved by the respective Committee Chairmen. The review of the performance of the Executive Directors and Non-executive Directors was conducted by the Chairman and Deputy Chairman, through completion of an appraisal form, and the results were communicated to the Directors concerned. The review of the Chairman's performance is led by the Deputy Chairman. The Deputy Chairman's performance is reviewed by the Chairman after he has consulted all of the other Directors.

Tailored induction programmes are provided for new Directors. In addition to briefings by the Chairman, Company Secretary and Chief Financial Officer, meetings are arranged with a range of corporate and business executives as well as the external auditors and other advisers. Inductions also now include modular sessions covering the key characteristics of, and operating risks faced by, the recorded music and music publishing businesses. The Board has also instituted a programme of ongoing professional development for Directors with modular sessions approved in advance by the Board.

The Board has delegated certain matters to standing committees, details of which are set out below. However, to ensure its overall control of the Company's affairs, the Board has reserved certain matters to itself for decision. These include the Group's strategic plans and annual operating budgets; major acquisitions or disposals of companies, businesses or assets, and significant contractual commitments or items of expenditure; together with policies relating to the Group's treasury function, pensions, material litigation, employee share schemes, and environmental and ethical issues. The delegated authorities, together with each Committee's terms of reference and the schedule of matters reserved to the Board for decision, are reviewed each year.

All Directors have access to the services and advice of the Company Secretary, who is appointed by, and may only be removed by, the Board. The Company Secretary advises the Board on all governance matters, through the Chairman. There are also procedures for Directors, in appropriate circumstances, to obtain independent professional advice at the cost of the Company.

The Executive Directors are permitted to take external appointments as non-executive directors but usually only one such appointment may be with another publicly quoted company. They may retain the remuneration from such appointments. All appointments must be approved by the Board to ensure that they do not give rise to conflicts of interest.

The attendance by individual Directors at scheduled and ad hoc meetings of the Board and its Committees in the financial year ended 31 March 2006 was as follows:

Director	Board	Audit	Remuneration	Nomination	Executive
E L Nicoli	11(11)	6*	7*	4(4)	12(12)
M N Bandier[a]	11(11)	n/a	n/a	n/a	10(12)
A M J I Levy	11(11)	n/a	3*	n/a	12(12)
M D Stewart	11(11)	6*	n/a	n/a	11(12)
J Gildersleeve	11(11)	4(6)	7(7)	4(4)	n/a
S Bailey	9(11)	4(6)	6(7)	3(4)	n/a
K K Carlon[b]	2(2)	1(1)	1(1)	1(1)	n/a
P A Georgescu	10(11)	5(6)	6(7)	3(4)	n/a
D J Londoner	10(11)	5(6)	7(7)	4(4)	n/a
K A O'Donovan	11(11)	6(6)	6(7)	2(4)	n/a

Figures in brackets denote the maximum number of meetings that each Director could have attended.

* Not Committee members, but invited to attend all or part of the number of meetings indicated.

[a] Resigned on 31 March 2006.
[b] Appointed on 1 February 2006.

Board committees
The principal committees of the Board are the Audit, Remuneration, Nomination and Executive Committees. Reflecting the important role played by the independent Non-executive Directors in ensuring high standards of corporate governance, all the Non-executive Directors are members of the Audit, Remuneration and Nomination Committees.

Each committee has written terms of reference and levels of authority which have been amended so as to ensure compliance with the revised Code; these can be viewed on the Group's website, www.emigroup.com, or obtained on request from the Company Secretary. Except in the case of the Remuneration Committee, minutes of meetings are circulated to all Directors.

Remuneration Committee
The role of the Remuneration Committee, which is chaired by John Gildersleeve, is described on page 44. It meets at least three times each year. The Remuneration report on pages 44 to 55 gives information about the Directors' remuneration.

The main responsibilities and activities of the other three principal Committees are as follows:

Audit Committee
The Audit Committee is chaired by Kathleen O'Donovan and comprises all the Non-executive Directors. The Committee meets at least four times each year and its meetings are normally attended by the Executive Chairman, the Chief Financial Officer, the Group Financial Controller, the external auditor and the Head of Internal Audit. In addition, the Company Secretary & Group General Counsel attends in his capacity as secretary to the Committee. Separate meetings are held by the Committee with both the external auditor (at least twice each year) and the Head of Internal Audit (at least once each year) without the presence of Executive Directors or other management. Following each meeting the Committee Chairman reports to the Board any matter of particular importance.

The Committee is authorised to investigate any matter within its terms of reference and, where necessary, to obtain external legal or other independent professional advice. The Committee's responsibilities, which it has carried out during the year, include:

- reviewing, and assessing the effectiveness of, the Group's internal financial controls together with its internal control and risk management systems;
- making recommendations to the Board with regard to: the appointment, removal and remuneration of the external auditor; overseeing the Company's relations with the external auditor; monitoring the external auditor's independence and objectivity; and the effectiveness of the audit process;
- reviewing the internal audit plan for the year; monitoring and reviewing the effectiveness of the internal audit function; ensuring appropriate co-ordination between the internal audit function and the external auditor; providing adequate resources for the internal audit function and ensuring that it has appropriate standing; and approving the appointment or termination of appointment of the head of the internal audit function; and,
- reviewing the half-year and annual financial statements with particular reference to accounting policies; significant estimates and financial reporting judgements; and the disclosures made therein.

For each year, the Committee adopts a formal programme which is structured to coincide with key events in the Company's financial reporting cycle. The programme also includes other regular items, for example: a review of the Committee's own effectiveness and a periodic review of the internal audit function; a continuing programme of post-investment reviews; the Company's policy for the provision of non-audit services by the external auditor; reviews of material litigation to which the Group is party; reviews of treasury policies and the Group's main pension plans; regular reviews of the IFRS adoption project which ceased on the announcement of the restatement in July 2005; and the review and supervision of the Group's worldwide 'whistleblowing' arrangements. In addition, the Committee's programme during the last year has included regular reports on the effective use of working capital within the recorded music and music publishing businesses.

Each year, the Committee reviews the independence and objectivity of the external auditor with a view to confirming that, in its opinion, the maintenance of objectivity on the one hand and value for money on the other have been kept appropriately in balance. During the past year, the Committee has reconfirmed its detailed and formal policy regarding the provision of non-audit services by the external auditor. Services for which the external auditor may be considered under this policy include supporting and reporting on financial representations in public documentation and general advice on accounting and financial reporting matters. Services for which the external auditor may not be engaged, without the prior approval of the Audit Committee, include employee tax services and consulting services, and the Committee oversees the provision of any tax planning advice by external auditors. Employee tax services for Board members or senior executives may not be undertaken by the external auditor.

Further details of the Committee's role in relation to the annual assessment of the Group's internal control framework are set out below under 'Internal control'.

Nomination Committee
Chaired by John Gildersleeve, the Committee comprises all the Non-executive Directors and the Chairman. The Committee makes recommendations to the Board on the appointment of Directors and the reappointment of Non-executive Directors on the expiry of their three-year terms of appointment. In addition, the Committee is responsible for making recommendations to the Board regarding plans for succession for both Executive and Non-executive Directors.

A formal process has been adopted by the Committee to make recommendations on both the appointment of new Directors and the re-election of existing Directors. This involves an evaluation of the skills, knowledge and experience of the Board as a whole, consideration of the need for the progressive refreshing of the Board and agreement of a description of the role and capabilities required for an anticipated new appointment. The selection process is led by the Chairman in close consultation with the Non-executive Deputy Chairman and all Directors are offered the opportunity to meet a potential appointee before the Committee meets to discuss the proposed recommendation.

In addition, the Committee reviews the structure, size and composition of the Board, and oversees the process for reviewing the effectiveness of the Board and its principal committees as well as the performance of individual Directors.

The Committee meets at least twice a year and otherwise when required. During the financial year ended 31 March 2006, the Committee met four times and recommended the appointment of Kevin Carton as a Non-executive Director with effect from 1 February 2006.

Executive Committee
Chaired by the Chairman, the Executive Committee comprises the CEO, EMI Music and Joint CEOs, EMI Music Publishing, together with the Chief Financial Officer. The Committee is responsible for the approval of acquisitions, divestments, capital expenditure and contractual commitments below the level that the Board has reserved to itself for decision, and for certain operational, administrative and other routine matters.

The Committee also regularly reviews and reports to the Board on the performance of the Group's businesses. At least eleven meetings are held by the Committee each year and senior Group executives frequently attend by invitation.

Directors' responsibilities
The Directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable United Kingdom law and those International Financial Reporting Standards as adopted by the European Union. The Directors are required to prepare financial statements for each financial year which present fairly the financial position of the Group and the Company and the financial performance and cash flows of the Group for that period. In preparing those financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- provide additional disclosures when compliance with the specific requirements in IFRSs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity's financial position or financial performance; and,
- state that the Group has complied with IFRS as adopted by the European Union, subject to any material departures disclosed and explained in the financial statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time, the financial position of the Group and the Company and enable them to ensure that the financial statements comply with the Companies Act 1985 and, in respect of the Group, Article 4 of the IAS Regulation. They are also responsible for safeguarding the assets of the Group and the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Going concern
The Directors believe that, after making enquiries they consider to be appropriate, the Group has adequate resources to continue in operational existence for the foreseeable future. For this reason, they continue to adopt the going concern basis in preparing the financial statements.

Internal control
The Board is responsible for the Group's system of internal controls and for reviewing its effectiveness. The system of internal control is based on what the Board considers to be appropriate to the Group's activities, to the materiality of the financial and other risks inherent in those activities and to the relative costs and benefits of implementing specific controls. It is designed to manage, rather than eliminate, the risk of failure to achieve business objectives and, as such, provides reasonable, but not absolute, assurance against material misstatement and loss.

The full Board meets regularly throughout the year and the matters specifically reserved for its approval ensure that the Directors maintain control over significant strategic, financial and compliance matters.

The Group has an established organisational structure with clearly defined lines of responsibility and reporting. The Board has devolved to executive management responsibility for implementing and maintaining the Group's system of internal control. Each business unit operates in accordance with policies and procedures applicable to all of the Group's units.

The Group operates comprehensive annual planning, financial reporting and forecasting processes. The Board formally approves strategic plans and annual budgets. The Group's performance is monitored against budget on a monthly basis and all significant variances are investigated. There are defined authorisation procedures in respect of certain matters including capital expenditure, investments, the granting of guarantees and the use of financial instruments. The Audit Committee also receives, twice yearly, a review of all material litigation undertaken by, or against, the Group's companies and considers the associated risks.

The strength of an internal control system is dependent on the quality and integrity of management and staff. Those executives at senior levels are informed of their responsibilities as to the maintenance of sound systems of internal control. A routine and Group-wide process, which requires key executives and managers to certify their compliance with the Group's policies and procedures, reinforces this integrity.

The internal audit function operates as one Group-wide internal Audit Department which monitors and supports the internal control system and reports to both the Audit Committee and the Group's senior management. The responsibilities of the internal audit function include recommending improvements in the control environment and ensuring compliance with the Group's policies and procedures. The Audit Committee reviews the audit plan prepared by the Internal Audit Department.

Ongoing processes for identifying, evaluating and managing the significant risks faced by the Group were in place for the year under review and up to the date of this Report. These processes are regularly reviewed by the Audit Committee on behalf of the Board and accord with the requirements of Internal Control: Revised Guidance for Directors on the Combined Code issued by the Financial Reporting Council in October 2005.

During the year to 31 March 2006, significant potential risks facing the Group have been assessed and graded in a process managed by the Group Risk Director and involving line and functional management throughout the Group. The controls in place to manage or mitigate each risk were reviewed for adequacy and the processes to monitor and inform the Board about control performance were confirmed.

This assessment is overseen and supervised by the Group Risk Management Steering Committee. This Committee is chaired by the Chief Financial Officer and its members include representatives of the two operating businesses as well as the heads of relevant central functions. The assessment is reviewed by the Audit Committee and is repeated annually. The risk and control assessment is also shared with senior management throughout the Group.

The Board is aware of the disclosure guidelines on social responsibility issued by the Association of British Insurers, and an update on social, ethical and environmental (SEE) issues is part of the Board's annual programme. Annual performance in these areas is already monitored and publicly disclosed through the Group's Social Responsibility reporting programme.

As part of the annual risk review process and the presentation of those results to the Board, account is taken of any issues arising from SEE matters that could cause risk to value; no significant risks of this nature were identified during the year under review. Appropriate SEE matters are included in the induction programme for Non-executive Directors.

The Group has in place a social responsibility policy as well as specific ethics and environmental policies. An ethics policy (Standards of Business Conduct) is issued each year. Compliance with the policy is monitored by means of self-certification by senior and middle management and through checks made by the Internal Audit Department. A Social responsibility report is published in respect of each financial year and briefer reviews of such matters are included in the Operating and Financial Review on page 28 and elsewhere in this Annual Report on pages 32 to 35.

The Audit Committee receives additional assurance on the operation of internal control systems around the Group, primarily from reviews by the Internal Audit Department, which presents the conclusions of its reviews twice a year. The external auditor also takes internal financial control into consideration as part of its audit. In addition, incidences of control failure and the internal control implications of significant business issues are recorded in a central Control Issues Register, from which a summary report is prepared for the Audit Committee. A report is also prepared for distribution to senior management throughout the Group and appropriate actions are taken to rectify any control failures. Any significant new issues and material changes to the risk environment are reported at the next Board meeting.

Investor relations

The Group is committed to regular and open dialogue with investors. The Chairman and Executive Directors have held, and will continue to hold, discussions with institutional shareholders and analysts. The senior independent Non-executive Director is also available to meet investors, if so requested, and met with investors on two occasions during the year. In addition, there are general presentations to investors and analysts after the announcement of the half-year and annual results which are simultaneously webcast. From time to time, more tailored presentations on specific areas of importance are given.

Individual shareholders have the opportunity to question the Chairman and other Directors at the AGM and can meet them informally after the AGM. Results announcements and other press releases are made available on the Group's website as soon as possible after their publication.

Actions taken to develop an understanding amongst Directors of the views of major shareholders about the Group include reports to the Board on investor relations. Twice each year, these reports are supplemented by more detailed reviews by the Senior Vice President, Investor Relations, supported by the Company's brokers.

Remuneration report
for the year ended 31 March 2006

Remuneration Committee

The Board has delegated to the Remuneration Committee the approval of the remuneration and employment terms of the Executive Directors and certain other senior executives.

The Committee comprises the Non-executive Directors, all of whom are considered to be independent, and its membership during the year was as follows:

Committee Chairman
John Gildersleeve – *Non-executive Deputy Chairman and senior independent Non-executive Director*

Committee Members
Sly Bailey – *Non-executive Director*
Kevin Carlton – *Non-executive Director* (since his appointment on 1 February 2006)
Peter Georgescu – *Non-executive Director*
David Londoner – *Non-executive Director*
Kathleen O'Donovan – *Non-executive Director*

Terms of reference
The key terms of reference of the Committee are as follows:

- to provide the policy framework for the remuneration of Executive Directors, the Company Secretary and other senior executive and operational management (currently approximately 100 individuals in total);
- subject to the policy framework and the Code, to review in detail and approve all aspects of the terms and conditions of employment of each Executive Director and the Company Secretary, including their incentive arrangements, pension rights and any compensation payments;
- to review and approve the base salaries of the most senior direct-line reports to the Executive Directors, together with their remuneration packages, incentive arrangements, pension rights and any compensation payments;
- to determine targets for any performance-related incentive arrangements operated by the Company;
- to ensure the effective administration of any other long-term or share-based remuneration arrangements for employees;
- to ensure that regulations and codes on the disclosure of remuneration are adhered to by the Group; and,
- to review major changes in Group employee benefit structures.

The Committee is also authorised, where necessary, to obtain external independent professional advice.

The full terms of reference of the Committee can be obtained on request from the Company Secretary and are set out on the Company's website at www.emigroup.com.

Attendance at meetings and advisers
During the year, the Committee continued to use New Bridge Street Consultants LLP which it has appointed as its adviser. This firm has provided material advice to the Committee to assist it in developing and monitoring policies for remunerating senior employees throughout the Group. The major areas for advice were Executive Directors' remuneration, determining competitive levels and forms of pay for Executive Directors and senior executives, reviewing incentive arrangements for that group, reviewing all share-based and long-term incentive plans and advising the Committee of developments and best practices for remuneration and applicable corporate governance requirements. New Bridge Street Consultants LLP has not, during the year, provided any other services to the Group. The letter of appointment in respect of New Bridge Street Consultants LLP can be viewed on the Group's website, www.emigroup.com, or obtained on request from the Company Secretary.

The Committee schedules three meetings during each year but also holds additional meetings as and when material matters arise for discussion. During the last financial year, the Committee met on seven occasions.

Only Committee members are entitled to attend meetings of the Committee as of right, although the Executive Chairman (the 'Chairman'), the Director of Human Resources (Joe McCollum), the Human Resources executive charged with supporting the Committee (Carol Separovich as Vice President, Rewards Management), together with the Company Secretary & Group General Counsel (in his capacity as Committee Secretary) and the Committee's adviser from New Bridge Street Consultants LLP are generally invited to attend so as to assist and advise the Committee on matters under consideration. Other executives may be invited to attend in respect of specific issues where their guidance may be of assistance to the Committee. In this regard, during the last financial year the Chairman & Chief Executive Officer of EMI Music ('CEO EMI Music') and the Vice Chairman, EMI Music attended three meetings and one meeting, respectively, to provide material assistance and advice with regard to their division. None of these attendees participated in any discussion relating to his or her own remuneration.

In monitoring the level and mix of remuneration packages, the Committee has access to a number of music and general industry remuneration surveys, covering both local and international data. The Committee takes into account factors such as the nature, size, complexity and international profile of the surveyed companies relative to EMI; it also seeks such specific advice from external consultants as it considers appropriate.

Policy statement on Directors' remuneration

Background
The Committee recognises that, as a major UK-listed company, EMI should comply with the highest standards of corporate governance and, wherever it is appropriate to do so having regard to the wider interests of shareholders, UK remuneration best practices. Accordingly, the Committee periodically reviews the Group's remuneration practices against such standards and practices while recognising that the achievement of success in the highly competitive worldwide music market depends critically upon the Group's ability to compete for the management talent necessary to secure, develop and promote successful recording artists, composers and songwriters. The Group's remuneration policies, therefore, will continue to reflect the need to attract, retain and motivate top-calibre international management in the context of remuneration levels and practices in the international music and entertainment industry, many of which are set in the US, the indigenous repertoire of which, in the year ended 31 March 2006, amounted to 43.5% of worldwide record sales.

The Group's remuneration policies also recognise that the music publishing and recorded music businesses operate in distinct market places. The level and form of remuneration will continue to be tailored to the different market places in which the Group competes and to recognise the importance of creative talent to the overall success of the Group.

The remuneration packages of the Executive Directors have been designed to help them attain, and encourage them to retain, long-term interests in EMI's shares, and thereby align their interests with those of shareholders. Performance-related elements, in the form of annual bonuses and share-based long-term incentives, represent a significant proportion of the total annual remuneration opportunity, typically providing at least two thirds of potential remuneration for the achievement of stretching performance targets.

Overview
During the year, the Committee reviewed the policy under the Group's Executive Share Incentive Plan ('ESIP') and annual bonus plan. No changes to the general policy reported in the Annual Reports for the last three years have been made but, as described below, some changes to the detail of performance targets have been made, to ensure that they remain appropriate in the context of the Group's key business objectives. The Group believes pay should be closely linked to performance.

Base salary
Base salary levels are determined by the Committee having regard to the experience and performance of the individual executive, the performance of the Group as a whole over the preceding year, data regarding external salary levels for comparable positions, internal relativities and wage inflation elsewhere in the Group. The Committee seeks to ensure that, in respect of industry-specific roles, base salaries are generally set no higher than the median for the music industry and, in the case of non-operational roles, appropriate regard is given to general industry data while also targeting the median level.

Recognising the requirements of good corporate governance and a desire to constrain fixed costs to the advantage of all shareholders, base salaries for certain operational executives, most notably for the CEO EMI Music, have been kept below industry market levels. In these instances, in order to deliver competitive overall levels of pay, the balance of the overall remuneration is weighted more significantly towards long-term incentives than is the case with EMI's major competitors.

On 1 April 2006, Roger Faxon became joint Chief Executive Officer, EMI Music Publishing with Martin Bandier and was reappointed as an Executive Director of EMI Group plc, coincident with Martin Bandier ceasing to be a director. As from 1 April 2007, Mr Faxon will become sole Chief Executive Officer of EMI Music Publishing and, as from 1 April 2008, he will also become Chairman of the division. In connection with his appointment to these roles and to his previous position as President and Chief Operating Officer, EMI Music Publishing, Mr Faxon's employment agreement was revised as of 1 February 2005.

The base salary rates for each Executive Director on 1 April 2006 were as follows:

E L Nicoli	£750,400 pa
R C Faxon	US$1,500,000 pa
A M J I Levy	£1,057,000 pa
M D Stewart	£525,000 pa

Salaries are revised annually with any increases generally taking effect on 1 April, for Mr Levy and Mr Faxon, and 1 July for Mr Nicoli and Mr Stewart. Other than Mr Stewart, the Executive Directors received an increase in the range of 3% to 4.4% in 2005 which was consistent with the overall increase for other executives and staff. Mr Stewart's first review will take effect from 1 July 2006.

Annual bonus
For the Chairman, CFO and the joint CEO EMI Music Publishing (i.e. Roger Faxon), the maximum bonus opportunity is 100% of base salary and 50% of bonus is payable at target performance (with straight-line interpolation between the target and maximum points). For the CEO EMI Music, the maximum bonus is 300% of base salary. These bonus opportunities are paid in cash following the approval of the accounts for the relevant year.

The performance criteria are tailored to individual positions and to ensure that bonuses are appropriate in all the circumstances. Subject to the Committee's discretion and within the limits described above, bonuses for the year ended 31 March 2007 will be determined as follows:

- for the Chairman and the CFO, 65% of the bonus opportunity will be determined by reference to Profit After Tax targets, with the balance by reference to pre-set strategic objectives. These targets reflect a prime focus, at a Group level, on profit growth, whilst maintaining an optimum cash flow;
- for the joint CEO EMI Music Publishing, the annual bonus will be based on pre-set targets relating to the division's economic profit (i.e. taking into account the value of the investment in the business) from year to year, reflecting EMI Music Publishing's objective of achieving sustained profit growth while providing an adequate return on invested assets; and,
- for the CEO EMI Music, two thirds of the bonus opportunity will be measured by reference to pre-set operating profit margins, with the other third determined by the division's sales performance relative to the recorded music market. These targets reflect the objectives for EMI Music of growing its market share while maintaining or improving profit margins.

Details of the bonuses achieved during the year by individual Executive Directors are set out on page 51.

Long-term incentive arrangements
Under the terms of the ESIP approved by shareholders in 2003, regular annual awards of both share options and performance shares have been made each year.

Following a review of the policy under the ESIP, the Committee proposes to change the mix between share options and performance shares for 2006 grants and to make some changes to the performance conditions. The proposed policy takes account of the following:

- the objective of the review was further to improve the link between reward and performance, whilst still maintaining a strong alignment between the interests of executives and shareholders;
- the need to address the impact of International Financial Reporting Standard 2 - *Share-based Payment* on the income statement; and,
- the objective of reducing share usage and dilution since the current policy, weighted in favour of share options, has resulted in relatively heavy share usage.

Therefore, for 2006, ESIP awards will be made on the following basis:

- Eric Nicoli and Martin Stewart will be granted performance share awards over shares worth 167% of salary. Awards will vest as to two thirds by reference to Group earnings per share (EPS) growth and as to the remaining one third by reference to Group total shareholder return (TSR) performance.

- In the case of Alain Levy and Roger Faxon, reflecting their roles as divisional CEOs, the performance conditions for awards made in 2006 will be a mix of Group and divisional performance. Over a three-year grant programme, the split between Group-level, as opposed to divisional-level, targets will be approximately 70:30. The Committee believes this split provides an appropriate focus on the overall Group results, thus ensuring alignment with shareholders' interests whilst also providing a focus on long-term divisional performance and an alignment with their key divisional executives.

- For Roger Faxon, the 70:30 split will be achieved as follows. He will receive a performance share award over shares worth 200% of base salary in 2006 and 150% of base salary in 2007 and 2008. His performance share award for 2006 will vest as to three quarters by reference to a range of economic profit targets relating to EMI Music Publishing (i.e. taking into account the value of the investment in the business). For awards in 2006, vesting will be by reference to growth in the division's economic profit over the three years to 31 March 2009. No part of the award will vest until a threshold of 5% pa compound growth in economic profit has been achieved. Thereafter, the award will vest on a straight-line basis from 0% to 100% at a maximum of 10% pa compound growth in economic profit over the three years. Vesting of the remaining one quarter of the award will be by reference to Group TSR performance. The awards for 2007 and 2008 will vest as to two thirds by reference to Group EPS growth and as to one third by reference to Group TSR performance.

- Alain Levy will be granted options over shares worth 300% of base salary and he will receive a performance share award over shares worth 150% of base salary. Three quarters of a grant of share options will vest by reference to a range of targets relating to earnings growth before interest and tax for EMI Music with the balance vesting by reference to Group EPS. Performance share awards will vest as to two thirds by reference to Group EPS growth and as to the remaining one third by reference to Group TSR performance.

Performance conditions will be measured over a fixed three-year period with no retesting opportunity.

Since the ESIP was introduced in 2003, the Group EPS performance condition has been based on adjusted (i.e. normalised) EPS growth, over the three years following grant (with no retesting opportunities). In order for one third of an award to vest, normalised EPS growth must exceed an average of the increase in the Retail Prices Index ('RPI') plus 3% pa; two thirds of an award will vest if normalised EPS growth exceeds an average of RPI plus 5% pa; and all of an award will vest if normalised EPS growth exceeds an average of RPI plus 7% pa (with straight-line interpolation between the points).

For the current year, the Group EPS growth test has been amended slightly so as to measure EPS growth performance on an aggregate basis over the three-year performance period i.e. the Company's actual EPS for each year of the three-year performance period will be added together to arrive at an aggregate EPS performance. For the threshold vesting condition to be achieved, aggregate EPS must exceed a target calculated by taking the EPS of the financial year immediately prior to grant (the 'base EPS') and adding together the three years' EPS that would be achieved on a cumulative aggregate growth of RPI plus 3%. For full vesting to apply, aggregate EPS growth must exceed a target calculated by taking the base EPS and adding together the three years' EPS that would be achieved on a cumulative aggregate growth of RPI plus 7%. This approach has been adopted so that all financial years in the performance period will be taken into account, reducing the volatility and rewarding sustained EPS performance. For those of Alain Levy's share options where the performance condition relates to the growth in the earnings before interest and tax of EMI Music, the same growth targets and vesting schedule will apply.

The EPS measure is diluted EPS adjusted to take account of items which are reported as 'Exceptional Items and Amortisation' in the published accounts of the Group.

TSR is a measure of the return to a shareholder (in terms of share price appreciation, assuming reinvestment of any dividends) over a fixed period. 25% of the shares subject to an award will vest if the Company's TSR, relative to the companies in the FTSE 250 Index (excluding investment trusts) as at the date of award, is at least at the median of that group. This will increase, on a straight-line basis, to full vesting if the Company's TSR is at least at the upper quintile (i.e. within the highest 20%) of that group. The share price used for calculating both the opening and closing TSR of the Company and each company in the comparator group for the three-year period will be assessed using three-month average figures. In addition to satisfying the TSR performance condition, awards will only vest to the extent that the Committee considers that the Company's TSR performance reflects the underlying performance of the Company over the period.

The EPS growth targets were chosen because profit growth (as measured through EPS) is currently considered to be the most appropriate measure of financial performance. The EPS growth condition aligns with the first of the Group's key performance indicators (KPIs) described in the Operating and Financial Review. The TSR condition is included to align the interests of Group executives with the interests of the shareholders.

The FTSE 250 Index was chosen as the TSR comparator group as there have been no, or insufficient, similarly sized independently quoted music companies to provide a more bespoke comparator group and, therefore, it was felt appropriate to compare the performance of EMI with the constituents of the FTSE 250 Index on the basis that, from an investor perspective, shareholders have the choice of investing in EMI as compared with other UK-quoted companies of a similar size. If the Company becomes a constituent of the FTSE 100, the constituents of that Index would be used for subsequent grants.

In all the circumstances, the Committee considers these two Group measures, taken together, to be the most appropriate method of assessing the success of EMI over the medium term and, accordingly, views them as appropriate performance conditions. The Committee reviews these targets each year, prior to awards being made, to determine whether they remain appropriate.

For the CEO EMI Music, measuring an element of long-term performance by reference to the earnings growth of EMI Music is felt to provide a clear focus on long-term divisional performance which would be expected to flow through strongly to the Group's results (as EMI Music revenue accounts for approximately 80% of that of the Group). Market share and operating margin are the Group's KPIs for EMI Music, as described in the Operating and Financial Review, because their achievement is considered to be the principal driver in the overall performance of the division. These KPIs are key to the achievement of the earnings' growth targets included in the long-term incentive performance conditions for Alain Levy.

For the joint CEO Music Publishing, the economic profit approach has been a key performance measure in the division and the target range has been designed to stretch growth significantly ahead of historic norms. Revenue growth and operating margin are shown as the KPIs for EMI Music in the Operating and Financial Review because their achievement is considered to be the principal driver in the overall performance of that division. The economic profit approach adopted in setting the long-term performance target takes both of those KPIs into account. It also gives a weighting to balance sheet management which, while being important at the divisional level, is covered by the Operating Free Cash Conversion KPI at the Group level, as described in the Operating and Financial Review.

In the case of both of these executives, the fact that the majority of the incentive programme will be based on Group targets and the fact that all awards will be share based means that the package still provides a very strong alignment with the interests of shareholders.

The performance targets (both Group and divisional) are considered to be both demanding and stretching over the medium term in light of the prevailing business climate.

EMI's performance against the EPS and TSR targets will be monitored by the Committee, which will assess the extent to which the targets have been achieved. The EPS calculations will be confirmed by the Company's external auditor while the TSR calculations will be undertaken by New Bridge Street Consultants LLP. The basis for calculating EPS has been affected by the move from UK GAAP to International Accounting Standards. The Committee has, therefore, taken steps to ensure that any EPS performance conditions are measured on a consistent basis and as originally intended. Specifically, in order to calculate EPS in relation to awards made prior to 31 March 2004, the Group's results will be restated so as to reflect UK GAAP prior to the adoption of International Accounting Standards. For awards made on or after 1 April 2004, EPS will be calculated by reference to International Accounting Standards.

The Committee also confirms that the Company has at all times complied with the share dilution limits as previously agreed with shareholders.

All UK-based Executive Directors are entitled to participate in the Group-wide ShareSave scheme on the same terms as other UK-based Group employees. Shareholder consent was obtained at the 2004 AGM for the renewal of the ShareSave scheme and also to introduce another tax-sponsored all-employee plan, the Share Incentive Plan (SIP). The operation of these plans will be at the discretion of the Committee, although Executive Directors will be eligible to participate on the same basis as other staff. No grants under the SIP were made during the year.

Details of the awards granted to Executive Directors under the ESIP and ShareSave scheme are contained in the section on Current long-term incentive schemes on page 53. Details of share options and other share awards granted in previous years in accordance with the schemes then applying and the performance criteria attaching to those grants are contained in the section on Closed long-term incentive schemes on pages 54 and 55.

Benefits in kind
Benefits and perquisites are based on general industry practice and typically include a car or car allowance together with life assurance, retirement, disability and healthcare plans. Further details are set out on page 51.

Pension arrangements
For the current UK-based Executive Directors, the policy is to provide pension benefits through a 'final salary' arrangement with an accrual rate of 1/30th. All the current UK-based Executive Directors are subject to the earnings cap (£105,600 in 2005/06) within the final salary scheme and separate arrangements have been in place in relation to pension benefits relating to base salary in excess of the earnings cap. Except in the case of the CFO, an unapproved defined contribution scheme has been utilised to provide benefits with the level of contribution being set by reference to an actuarial assessment of the value of a 1/30th arrangement. For the CFO, a pension allowance is provided, initially at the rate of 40% of annual earnings above the earnings cap but increasing by 1% per year until it reaches 50% of annual earnings above the cap. Benefits are based on base salaries only and specifically exclude bonuses. From 1 November 2005, the final salary scheme has been closed to new entrants, including Executive Directors, and a new defined contribution plan has been established for future pension benefits. Under the new policy, any new Executive Directors joining the defined contribution plan will, in normal circumstances, receive annual Company contributions to the plan of 40% of their base salary and the Executive Directors will be required to make annual contributions of 5% of their base salary as a member contribution.

For the US-based joint CEO EMI Music Publishing, pension contributions are also made with respect to base salary only.

Response to Finance Act 2004 – New Pension Regime
In response to the new pension regime which came into effect on 6 April 2006, the Company has revised its pension arrangements to ensure that UK executives can effectively manage the level of their pension benefits within the new Lifetime Allowance. The new arrangements do not involve additional costs for the Company. In particular, the tax effect of the new regime is borne by executives rather than by the Company. Specific details of the pension arrangements for Executive Directors after 6 April 2006 are provided on page 50.

Directors' service contracts
The Code recommends that notice or contract periods should be set at one year or less. It is the Group's policy to achieve that, where possible.

The Committee endorses the principle of mitigation of loss on early termination of a service contract and recognises the advantage of service contracts including an explicit calculation, subject to mitigation, of compensation payable upon early termination, other than for misconduct or in other circumstances justifying summary termination. The Committee's policy is that such compensation should generally be calculated by reference to base salary, annual bonus at target level and other benefits, including pension contributions, for the notice period or unexpired term of the service contract. The contract should also include an explicit obligation to mitigate and to offset earnings from alternative employment undertaken during the notice period or unexpired term of the contract against all or part of the compensation payment.

However, the Committee is conscious that fixed-term contracts of three or more years are common for senior executives in the global entertainment industry and such agreements often include no (or only a limited) obligation to mitigate. The Committee, therefore, considers that it is in the best interests of EMI and its shareholders to retain the flexibility to compete for top executive talent, where necessary, through the ability to offer contract terms in excess of one year. However, as an alternative, the Committee may agree compensation payments calculated without mitigation in order to limit contract terms or notice periods to one year.

As disclosed in last year's annual report, Martin Bandier's service contract provided two years' severance on termination without cause. It was considered that these terms were appropriate in view of competitive practice in the US, where he remains resident and where EMI Music Publishing continues to be headquartered, and the fact that the service contract was intended to secure his services until age 69. Mr Bandier ceased to be a Director on 31 March 2006. Following his retirement, all Executive Directors' service contracts are based on one year's severance.

Chairman and CFO – Eric Nicoli and Martin Stewart
The service contracts of Mr Nicoli and Mr Stewart, dated 11 April 2003 and 5 January 2005, respectively, are terminable by the Company on one year's notice.

In the case of gross misconduct or other circumstances justifying summary dismissal, the Company may terminate their service contracts without payment of compensation. Termination by the Company in other circumstances, without the required notice being given, entitles the departing executive to compensation, calculated on:

- his then base annual salary (currently £750,400 pa for Mr Nicoli and £525,000 pa for Mr Stewart) for one year; plus,
- the value of retirement benefits and either the continued enjoyment of, or the value of, benefits in kind provided to him for one year (the accrued value of such retirement contributions and the benefits in kind would have been £443,028 for Mr Nicoli and £217,161 for Mr Stewart had either one of them been dismissed on 31 March 2006); plus,
- a sum in respect of lost annual bonus opportunity, being 50% of his maximum bonus for the period from the date of his departure to the end of the contractual notice period.

Their entitlement to such compensation is subject to both a duty to mitigate and, also, offset for any earnings which they derive from other employment during the unworked part of the notice period for which they have been compensated.

CEO EMI Music – Alain Levy
Mr Levy's service contract, which commenced on 15 October 2001 and was amended as of 1 April 2004, allows the Company to terminate his employment at any time without notice. If termination is for cause (as defined in the contract), no compensation is payable. If termination is without cause, or Mr Levy terminates the agreement for good reason (for example, breach by EMI), he is entitled to a lump-sum severance payment based on one year's pay, calculated using:

- his then base annual salary (currently £1,057,000 pa); plus,
- the value of retirement benefits and either the continued enjoyment of, or the value of, benefits in kind provided to him (the accrued value of such retirement contributions and the benefits in kind would have been £558,243 had he been dismissed on 31 March 2006); plus,
- the average annual bonus earned by him over the last three financial years (£1,428,981 in respect of years ended on or before 31 March 2006).

Mr Levy accepted a basic contract term of one year, which is significantly less than competitive music industry practice, as well as a base salary and potential cash bonus at levels lower than those for equivalent positions in other major record companies. In recognition of this, there is no obligation on Mr Levy to mitigate or to offset against the compensation payment any earnings from alternative employment following termination.

Joint CEO EMI Music Publishing – Roger Faxon
Roger Faxon was reappointed as a Director on 1 April 2006. His employment agreement, which is effective as of 1 February 2005, allows EMI to terminate the contract at any time on 30 days' notice. If termination is for cause (as defined in the contract), no compensation is payable. If termination is without cause or Mr Faxon terminates the agreement for good reason (for example, breach by EMI), he is entitled to compensation based on one year's pay, as follows:

- continued payment of his base annual salary (US$1,500,000 pa as from 1 April 2006) for one year; plus,
- continued provision of retirement benefits and the continued enjoyment of benefits in kind provided to him for one year (the annual value of such retirement contributions and the benefits in kind would have been US$622,580 had he been dismissed on 1 April 2006); plus,
- a lump sum equal to his target annual bonus opportunity for the next following financial year, being not less than 50% of his base salary in effect immediately prior to termination.

In the light of competitive music industry practice, and in recognition of Mr Faxon's agreement, when he was promoted to Group CFO on 2 February 2002, to reduce his basic contract term from two years to one year, there is no obligation on him to mitigate, or to offset against the compensation payment any earnings from alternative employment during the year following termination. However, the Company's obligation to continue to provide insurance benefits will cease to the extent that similar benefits are provided by another employer during the 12 months following termination.

Non-executive Directors
Non-executive Directors do not participate in the Group's bonus scheme or long-term incentive plans and are not eligible for membership of any of the Group's pension plans. Their fees are payable wholly in cash.

In view of the greater responsibilities of Non-executive Directors under the Combined Code and more recent legislation together with their strategic contribution and increased time commitment, annual fees, which were last reviewed on 1 January 2004, were increased on 1 January 2006 from £50,000 pa to £55,000 pa. These fees will next be reviewed on 1 January 2008. John Gildersleeve, the Deputy Chairman and senior independent Non-executive Director, received an additional £40,000 pa, which was increased to £45,000 pa on 1 January 2006, reflecting his larger role and his chairmanship of the Remuneration and Nomination Committees. Kathleen O'Donovan received an additional £10,000 pa, which increased to £15,000 pa on 1 January 2006, for chairing the Audit Committee. No other additional fees are payable for membership of Committees or otherwise.

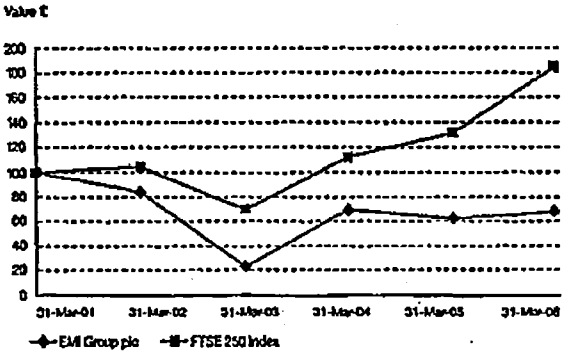
The Non-executive Directors have letters of appointment from the Company which are available for inspection at the Company's registered office or on request and are also provided on the Company's website at www.emigroup.com. Each Non-executive Director is appointed for a specified term of an initial period to the next AGM after appointment and, subject to election at that Meeting, for a further period ending at the third AGM held thereafter. Subsequent reappointment is subject to endorsement by the Board and to re-election by the shareholders. Each Non-executive Director's date of appointment as a Director and his or her most recent date of re-election at an AGM is shown below:

	Date of appointment as a Non-executive Director	Date of letter of appointment	Date of last election or re-election at AGM
J Gildersleeve	28.2.04	25.4.05	13.7.04
S Bailey	2.4.04	25.4.05	13.7.04
K K Carton	1.2.06	24.1.06	n/a
P A Georgescu	1.9.02	25.4.05	14.7.05
D J Londoner	13.5.03	25.4.05	9.7.03
K A O'Donovan	21.11.97	25.4.05	13.7.04

Their appointments may be terminated at any time or in the event that they are not elected or re-elected by shareholders in accordance with the Company's Articles of Association. On termination, a Non-executive Director is entitled to any accrued but unpaid Directors' fees, but not to any other compensation. The Articles, which were adopted by shareholders at the Company's 2005 AGM, provide that a Director will retire, if so agreed, earlier than three years from the date of last reappointment and also, if agreed, will not stand for re-election. This ensures that the Company can, where appropriate, reappoint Non-executive Directors for periods which reflect corporate governance guidelines and that there will be consistency between the terms of appointment and the relevant provisions of the Articles.

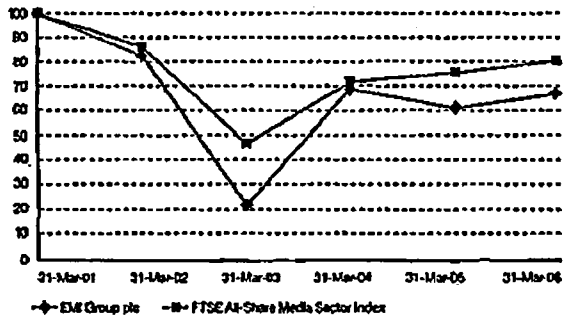
Total shareholder return performance graphs
Under the Directors' Remuneration Report Regulations 2002, UK-listed companies are required to include a graph indicating their TSR (i.e. share price growth assuming reinvestment of any dividends) performance over the last five years relative to a recognised equity index. Consistent with the approach adopted last year, in the absence of suitable comparators, the Committee has again elected to show EMI's performance relative to the FTSE 250 Index. The FTSE 250 Index (excluding investment trusts) was the comparator group for the TSR performance condition for last year's awards under the ESIP and will continue to be so for this and subsequent years unless the Company re-enters the FTSE 100.

Total shareholder return
Source: Thompson Financial



Additionally, the Committee is including the equivalent graph as against the FTSE All-Share Media & Entertainment Sector Index. This illustrates the volatility of the various indices particularly as, at the beginning of the five-year period, UK media stocks were at a relative peak as compared to other sectors.

Total shareholder return
Source: Thompson Financial



The graphs above look at the value, at the end of March 2006, of £100 invested in EMI Group plc on 31 March 2001 compared with the value of £100 invested in the FTSE 250 and FTSE All-Share Media & Entertainment Sector Indices. The other points plotted in the graphs are the values at intervening financial year ends.

Policy on outside appointments
Executive Directors are permitted to take external appointments as non-executive directors but usually only one such appointment may be with another publicly quoted company. The remuneration from such appointments is retained by the Director and the table below sets out such amounts for the year ended 31 March 2006. All appointments must be approved by the Board to ensure that they do not give rise to any conflicts of interest.

	Name of Company	Fees received £
Executive Directors:		
EL Nicoll	The Tussauds Group Ltd	75,575
M N Bandier*	National Music Publishers' Association	1,348
A M J I Levy	Schroder Venture Partners LLP	14,045

* Retired as a Director on 31 March 2006.

Share ownership guidelines
The Committee has adopted a formal policy that requires Executive Directors to hold shares in EMI worth at least two times their respective base salaries. Executive Directors are required to build up this shareholding by retaining shares with a value of at least 25% of the after-tax gain arising on the maturity of any long-term incentive awards.

Pensions
During the year, all the UK-based Executive Directors were executive members of the EMI Group Pension Fund (the Fund) which provides them, on normal retirement at age 60, with a pension of between 1/60th and 1/30th of the earnings cap for each year of membership, depending upon benefits built up prior to joining the Company. Members contribute 4% of the cap. On death, there is a spouse's pension of two thirds of the member's pension (ignoring the impact of any exchange of pension for a lump sum on retirement), plus child allowances if applicable. An early retirement pension may be paid on leaving but the pension is reduced by 1/3% for each month that pension starts earlier than age 60. Subject to the Company's (or, in the case of Executive Directors, the Committee's) consent, the reduction applied may be less.

Transfer values for all members of the Fund are calculated on a basis that assumes the pension would be drawn at the earliest date where no reduction would apply and with allowance for future pension increases (both before and after pension commences) to reflect the past practice of granting discretionary increases, when appropriate, taking account of the financial position of the Fund.

Pensions in payment are subject to annual increases at the lower of the increase in the RPI in the previous year and 5%. As all of the UK-based Executive Directors joined the Company after 5 April 1997, there is no Guaranteed Minimum Pension (GMP) element included in their pensions. (The GMP is that part of the pension which replaces State Earnings-Related Pension.)

The table below sets out the transfer value at 31 March 2006 of each Executive Director's accrued deferred pension at that date as well as the movement in that transfer value over the period. The transfer values are liabilities of the EMI Group Pension Fund and reflect both the age of the Executive Director and his length of service and membership of the Fund.

	Age at 31.3.06 Years	Accrued pension[a] at 31.3.06 £pa	Accrued pension[a] at 31.3.05 £pa	Increase in accrued pension during the year net of inflation[a] £pa	Transfer value of accrued pension[b] at 31.3.06 £	Transfer value of accrued pension[b] at 31.3.05 £	Directors' contributions during the year £	Increase in transfer value over the year net of Directors' contributions £pa
Executive Directors:								
E L Nicoll	55	12,173	10,058	1,843	217,811	160,783	2,464	54,564
A M J I Levy	59	7,773	5,808	1,608	176,871	115,851	2,464	58,556
M D Stewart	42	4,107	667	3,525	31,425	4,059	2,464	24,902

[a] The accrued pensions are the amounts which would be paid if the Director left service at the relevant date.
[b] The transfer values have been calculated in accordance with guidance note GN11 published by the Institute of Actuaries and Faculty of Actuaries.

Following the introduction by the Finance Act 2004 of the Lifetime Allowance, from April 2006 Executive Directors were given the choice of continuing as executive members of the Fund or of receiving a supplement to their salary. Both Mr Nicoll and Mr Levy have chosen not to continue as members of the Fund and, in lieu, receive a cash allowance equal to 35% of the pension cap.

Up to 31 March 2006, Fund members joining the Fund after 1989, had their pensionable salary for Fund purposes restricted to an earnings cap (as defined in the Finance Act 1989). In respect of earnings in excess of the earnings cap (£105,600 in the year), for executive members affected by the earnings cap, other than the CFO, the Company was contributing to a separate defined contribution arrangement linked to salary in excess of the earnings cap.

The Finance Act 2004 removed the earnings cap. However, in common with many pension schemes, a scheme-specific cap was introduced to the Fund from April 2006 equal to what the earnings cap would have been but for its removal. At April 2006, the scheme-specific cap was £108,600.

Reacting to other changes introduced by the Finance Act 2004, from April 2006 no further contributions are being made to the defined contribution arrangement referred to above. Instead, an equivalent salary supplement is being paid. The after-tax value of contributions, expressed as a percentage of base salary in excess of the cap, which the Company paid to the defined contribution plan in respect of Executive Directors during the year to 31 March 2006, was:

E L Nicoll	33.42%
A M J I Levy	30.00%

The CFO receives a pension allowance, as described on page 47 and, therefore, does not participate in the defined contribution plan. This allowance amounted to £168,808 for the year to 31 March 2006 and is included in 'Benefits' in the table on page 51.

Money purchase contributions in the year to 31 March 2006

	FURBS[a] £	Tax compensation £	Total £
Executive Directors:			
E L Nicoll	213,384	140,017	353,401
A M J I Levy	277,920	188,420	466,340
M D Stewart	–	–	–

[a] Funded unapproved retirement benefits scheme.

These contributions are set at levels which, based on actuarial advice, are likely to deliver comparable benefits to the capped final salary element.

The table below sets out the contributions made to US money purchase pension arrangements in respect of the US-based Executive Director who served during the year.

	Contributions by Group %	Contributions by Group US$	Contributions by Director %	Contributions by Director US$	Total US$
Executive Director:					
M N Bandier[a]	38.6% of base salary[b]	2,314,578	6.9% of pay[b]	411,514	3,094,181

[a] Retired as a Director on 31 March 2006.
[b] Consistent with US practice, pay for this purpose includes the value of annual cash bonuses.

There were no retirement benefits paid to former Directors in excess of those to which they became entitled when such benefits first became payable to such former Directors.

Compensation to former Directors not previously reported
There were no compensation payments or other awards made to former Directors. As referred to above, Martin Bandier continues as an employee of EMI Music Publishing following his retirement as a Director and has received no compensation for loss of office.

Payments to third parties for making the Directors' services available
No payments have been made to third parties for making any Director's services available to the Company.

As required by the Directors' Remuneration Report Regulations, those items from the 'Pensions' heading on page 49 to page 55 inclusive have been subject to audit.

By Order of the Board
John Gildersleeve
Deputy Chairman
19 May 2006

Remuneration details

Annual remuneration[a]

	Base salary or fees £'000	Compensation for loss of employment £'000	Expenses £'000	Benefits[b] £'000	Incentive[c] remuneration £'000	2006 Total in year £'000	2005 Total in year £'000
Executive Directors:							
EL Nicoll	743.2	–	–	67.4[d]	725.4	1,536.0	1,135.6
MN Bandier (retired 31.3.06)	1,871.7	–	–	46.0	1,497.4	3,415.1	3,146.7
AMJI Levy	1,032.0	–	–	69.7	2,435.5	3,537.2	2,050.7
MD Stewart	525.0	–	–	217.2[e]	507.5	1,249.7	171.1
Non-executive Directors:							
J Gildersleeve	92.6	–	–	–	–	92.6	90.0
S Bailey	51.2	–	–	–	–	51.2	49.9
KK Carton (appointed 1.2.06)	9.2	–	–	–	–	9.2	–
PA Georgescu	51.2	–	–	–	–	51.2	50.0
DJ Londoner	51.2	–	–	–	–	51.2	50.0
KAO'Donovan	62.5	–	–	–	–	62.5	60.0
Former Executive Director:							
RC Faxon (resigned 31.1.05 and reappointed 1.4.06)	–	–	–	–	–	–	832.3
Former Non-executive Director:							
H Einsmann (retired 13.7.04)	–	–	–	–	–	–	14.2
Total 2006	4,489.8	–	–	400.3	5,166.8	10,055.9	–
Total 2005	4,218.6	–	–	461.0	2,970.9	–	7,650.5

[a] Excludes retirement contributions and tax compensation (see table on page 50) and the value of share awards ceasing to be contingent, as reported in the table shown below.

[b] The nature of the non-cash benefits provided to Executive Directors who held office during the year was as follows:

EL Nicoll: -provision of a car allowance plus use of a Company pool car and driver;
-private healthcare; and,
-personal accident insurance.

MN Bandier: -a car allowance of US$36,000 pa; and,
-participation in the Group's US executive medical plan, life, health (hospital, major medical and dental) and accident insurance.

AMJI Levy: -use of a Company pool car and driver;
-private healthcare; and,
-personal accident insurance.

MD Stewart: -a car allowance plus use of a Company pool car and driver;
-private healthcare; and,
-personal accident insurance.

[c] Bonuses paid to the Executive Directors reflect achievement against the performance targets referred to in last year's Annual Report. Bonuses for Mr Nicoll and Mr Stewart reflect partial achievement of the profit target, full achievement of the cashflow target and the Committee's assessment of their performance against strategic objectives. In Mr Levy's case, EMI Music's operating profit margin was at approximately two thirds of the scale set in his employment contract and its sales performance relative to the overall music market was strong. The economic profit achieved by EMI Music Publishing resulted in Mr Bandier achieving his maximum bonus opportunity of 80% of base salary.

[d] The 2006 benefits figure for Mr Nicoll is higher than that for the equivalent period in 2005 as the payments in respect of Mr Nicoll's private healthcare and personal accident insurance for both 2004 and 2005 were accounted for in the period ended 31 March 2004.

[e] For Martin Stewart, this includes the pension allowance which is more fully described on page 47 in the Remuneration Report.

Remuneration from prior-year share awards ceasing to be contingent

	Awards No. of shares	2006 Total value[a] £'000	Awards No. of shares	2005 Total value[a] £'000
Executive Directors:				
EL Nicoll	112,870	285,561	–	–
MN Bandier (retired 31.3.06)	1,415,625[b]	3,581,531	155,625[b]	391.3
AMJI Levy	–	–	–	–
MD Stewart	–	–	–	–
Former Executive Director:				
RC Faxon	–	–	298,250	704.6
Total	1,528,495	3,867,092	453,875	1,095.9

[a] The value is based on the share price on the date awards ceased to be contingent.

[b] This figure includes 155,625 shares in respect of a restricted share award totalling 662,500 shares. Whilst in certain circumstances the restricted share award might have lapsed or been released before the vesting date, a proportion of its value was included in reported remuneration each year to match remuneration costs more accurately to the time period in which these shares were earned. The full restricted share award vested on 31 March 2006.

Directors' interests

Directors' interests (all beneficial) in the Company's Ordinary Shares of 14p each[a,b,c]

	Non-contingent share awards[d]	Directly held shares	As at 31.3.06 Total shares held	As at 1.4.05 or date of appointment if later Total shares held
Executive Directors:				
EL Nicoli	66,260	68,732	134,992[e]	203,408
MN Bandier (retired 31.3.06)	–	379,760	379,760[e]	379,760
AMJI Levy	–	775,000	775,000	775,000
MD Stewart	–	–	–	–
Non-executive Directors:				
J Gildersleeve	–	1,377	1,377	1,377
S Bailey	–	1,250	1,250	1,250
KK Carlon (appointed 1.2.06)	–	5,000	5,000	–
PA Georgescu	–	102,323	102,323	100,000
DJ Londoner	–	10,000	10,000	10,000
KA O'Donovan	–	2,000	2,000	2,000

[a] The Company's Register of Directors' Interests is available for inspection in accordance with the provisions of the Companies Act 1985.

[b] No Director had any interest in either shares or debentures of any subsidiary of the Company.

[c] As potential beneficiaries under the EMI Group General Employee Benefit Trust ('EBT'), the Executive Directors are deemed to be interested in the entire shareholding of the EBT which at 31 March 2006 amounted to 3,391,922 shares.

[d] Non-contingent share awards shown in this column are also included as incentive awards in the table on page 54. Such awards, made under the now-closed Senior Executive Incentive Plan, arise from the deferral of annual cash bonuses into shares. The awards are subject to an additional 1:3 matching award if deferred for three years from the date of the award, or an additional 2:3 award if deferred for six years from the date of the award.

[e] The total of shares held does not include incentive, performance or restricted share awards of 112,870 shares and 1,912,500 shares, respectively, that vested during the year on 31 March 2006 as the shares could not be transferred to Mr Nicoli and Mr Bandier until after the end of the close period for Directors' share dealings on 23 May 2006.

Current long-term incentive schemes

Directors' outstanding performance share awards under the Executive Share Incentive Plan[a,b]

	Date of award	Earliest normal vesting date	Lapse date	As at 1.4.05	Vested in year	Awarded in year	Lapsed in year	As at 31.3.06
Executive Directors:								
E L Nicoll	14.7.03	14.7.06	13.1.07	515,294	–	–	–	515,294
	18.6.04	18.6.07	17.12.07	313,153	–	–	–	313,153
	17.6.05	17.6.08	16.12.08	–	–	281,648[c]	–	281,648
Total				828,447	–	281,648[d]	–	1,110,095
M D Stewart	7.1.05	7.1.08	6.7.08	259,558	–	–	–	259,558
Total				259,558	–	–	–	259,558

[a] Exercise is subject to the performance target set out in the policy section of this report in respect of performance share awards for Mr Nicoll and Mr Stewart, namely based on the Company's Total Shareholder Return ('TSR'), compared to FTSE 250 companies excluding investment trusts, over a fixed three-year period.

[b] The rules of the ESIP originally provided that a participant was required to pay a nominal sum of £1 on the exercise of a share award, unless such sum was waived by the Remuneration Committee. Since 31 March 2005, the Remuneration Committee has determined that, so as to ease the administration of such awards if and when they vest, the payment of this nominal amount should be waived or removed.

[c] The closing mid-market share price on the date of the award was 254.25p.

[d] The share awards/option grants made during the year ended 31 March 2006 and set out above, were in accordance with the policies set out in the Remuneration report for the year ended 31 March 2005.

Directors' outstanding share options over Ordinary Shares of 14p each under the Executive Share Incentive Plan[a]

	Date granted	Earliest normal exercise date	Lapse date	Exercise price	As at 1.4.05	Exercised in year	Granted in year	Lapsed in year	As at 31.3.06
Executive Directors:									
E L Nicoll	14.7.03	14.7.06	13.7.13	119.250p	1,030,589	–	–	–	1,030,589
	18.6.04	18.6.07	17.6.14	223.660p	626,307	–	–	–	626,307
	17.6.05	17.6.08	16.6.15	256.170p	–	–	563,297	–	563,297
Total					1,656,896	–	563,297[b]	–	2,220,193
M D Stewart	7.1.05	7.1.08	6.1.15	252.833p	519,116	–	–	–	519,116
Total					519,116	–	–	–	519,116

[a] Exercise is subject to the performance target set out in the policy section of this report in respect of grants of share options, namely the Company's Earnings Per Share ('EPS') growth over a fixed three-year period.

[b] The share awards/option grants made during the year ended 31 March 2006 and set out above, were in accordance with the policies set out in the Remuneration report for the year ended 31 March 2005.

Directors' outstanding share options over Ordinary Shares of 14p each under the ShareSave scheme

	Date granted	Earliest normal exercise date	Lapse date	Exercise price	As at 1.4.05	Exercised in year	Granted in year	Lapsed in year	As at 31.3.06
Executive Directors:									
E L Nicoll	19.6.03	1.9.08	28.2.09	96p	16,588	–	–	–	16,588
Total					16,588	–	–	–	16,588
A M J I Levy	19.6.03	1.9.08	28.2.09	96p	16,588	–	–	–	16,588
Total					16,588	–	–	–	16,588

[a] ShareSave options are normally exercisable for a six-month period following completion of savings towards a three-year or a five-year ShareSave contract and are not subject to additional performance conditions.

Closed long-term incentive schemes

Directors' outstanding share awards under long-term incentive plans

	Date of award	As at 1.4.05			During year			As at 31.3.06
		Incentive[a]	Performance[b]	Restricted[c]	Matching awards	Vested	Lapsed	
Executive Directors:								
E L Nicoll	31.5.00	67,722	–	–	45,148	(112,870)[d]	–	–
	31.5.01	66,260	–	–	–	–	–	66,260
Total		133,982	–	–	45,148	(112,870)	–	66,260
M N Bandier[e]	28.9.01	–	1,250,000[f]	–	–	(1,250,000)	–	–
	28.9.01	–	–	662,500[f]	–	(662,500)	–	–
Total		–	1,250,000	662,500	–	(1,912,500)	–	–

[a] Incentive share awards are not contingent on future performance and/or are no longer subject to forfeiture. Such awards, made under the now-closed Senior Executive Incentive Plan, arise from the deferral of annual cash bonuses into shares. The awards are subject to an additional 1:3 matching award if deferred for three years from the date of the award, or an additional 2:3 award if deferred for six years from the date of the award.

[b] Shows total potential award.

- The total of the eventual award depends on the achievement of Group or business unit performance against profit targets set by the Remuneration Committee in respect of a performance period that terminates on 31 March in the third year after the date of the award. The eventual award is subject to an additional 1:3 matching award if vesting is deferred for a further three years from the vesting date. In certain circumstances, for example upon a change of control of EMI, awards could be released before the normal vesting date.
- In 2001, in place of overlapping annual share awards based on three-year performance cycles, Mr Bandier was granted a one-time performance share award which requires 2% pa growth in the music publishing division's economic profit for the entire performance period to 31 March 2006, at which level one sixth of the shares accrue, with maximum payout at 7% pa growth (with straight-line vesting between these two points).

[c] Mr Bandier's restricted share award vested on 31 March 2006 but could not be transferred to him until after the end of the close period for Directors' share dealings on 23 May 2006. The award was in lieu of additional base salary and was not, therefore, subject to performance requirements. The aim of the award was to bring Mr Bandier's basic annual remuneration into line with competitive practice in the US, where he is based, whilst aligning his interests more closely with those of the shareholders and providing him with a strong incentive to remain with the Group. No further awards of this nature are envisaged. A proportion of this award was included in remuneration each year so as to match remuneration costs more accurately to the time period in which the shares are earned.

[d] The closing mid-market share prices on the dates of the award (31 May 2000) and vesting (31 March 2006) were 569p and 253p per share, respectively.

[e] Retired as a Director on 31 March 2006.

[f] As reported in previous years and referred to in Note b above, Martin Bandier had a one-off long-term incentive arrangement covering the period from April 2001 to 31 March 2006. This performance share award vested in full on 31 March 2006, the maximum performance target having been achieved. The award could not be transferred to Mr Bandier until after the end of the close period for Directors' share dealings on 23 May 2006.

With the exception of Mr Bandier's awards, on termination of employment in certain circumstances, for example, as a result of death, disability, sale of the relevant business unit, normal retirement, or termination without cause, and if the performance criteria are on target for achievement, a proportion of the awards may become exercisable prior to normal vesting. If the performance criteria are not on target for achievement, the whole award lapses if it has not reached its normal vesting date. Upon a change of control, all awards vest, or can be exchanged for an equivalent value of awards in the acquiring entity, with identical terms to the original awards.

Mr Bandier's outstanding share awards would have vested, in whole or in part, if he was dismissed (other than for cause) or following a change of control of EMI. Both his performance share and restricted share awards would have lapsed if, prior to the vesting date of 31 March 2006, Mr Bandier had resigned voluntarily or his employment agreement had been terminated by EMI for cause. However, if Mr Bandier's employment had been terminated without cause by EMI, he would have received the proportion of his restricted share award which he would have earned had he remained in employment for a further two years. Under these same circumstances, he would also have received a proportion of his performance share award pro-rated to the date of termination, subject to the achievement of the relevant performance criteria. In the event of a change of control of EMI, all the restricted share award would have vested together with a proportion of the performance share award pro-rated to the date of the change of control as well as an additional 625,000 shares up to the maximum award of 1.25m shares. Vesting would have taken place on the earlier of one year after the date of the change of control or the termination of his employment without cause.

Directors' outstanding share options over Ordinary Shares of 14p each[a,b]

	Date granted	Earliest normal exercise date[c,d]	Lapse date	Exercise price	As at 1.4.05	Exercised in year	Granted in year	Lapsed in year	As at 31.3.06
Executive Directors:									
E L Nicoll	3.6.99	3.6.02	2.6.09	440.000p	60,000	–	–	–	60,000
	21.6.02	21.6.05	20.6.12	243.300p	838,471	–	–	–	838,471
Total					898,471	–	–	–	898,471
M N Bandier[e]	25.8.95	25.8.98	24.8.05	590.315p	253,084	–	–	(253,084)	–
	23.8.96	23.8.99	22.8.06	734.500p	60,000	–	–	–	60,000
	6.6.97	6.6.00	5.6.07	575.000p	52,144	–	–	–	52,144
Total					365,228	–	–	(253,084)	112,144
A M J I Levy[f]	15.10.01	15.10.04	14.10.11	300.000p	3,000,000	–	–	–	3,000,000
	15.10.01	15.10.04	14.10.11	400.000p	3,000,000	–	–	–	3,000,000
	15.10.01	15.10.04	14.10.11	500.000p	2,000,000	–	–	–	2,000,000
	15.10.01	15.10.04	14.10.11	700.000p	2,000,000	–	–	–	2,000,000
	2.1.02	2.1.05	1.1.12	357.300p	2,000,000	–	–	–	2,000,000
	19.12.02	19.12.05	18.12.12	148.050p	2,000,000	–	–	–	2,000,000
	19.12.02	18.12.06	18.12.12	153.750p	2,000,000	–	–	–	2,000,000
	19.12.02	17.12.07	18.12.12	269.050p	2,000,000	–	–	–	2,000,000
	19.12.02	9.12.08	18.12.12	233.800p	2,000,000	–	–	–	2,000,000
Total					20,000,000	–	–	–	20,000,000

[a] No Directors' share options were exercised in the year. Therefore, the total gain made on the exercise of share options was £nil (2005: £nil). The closing mid-market share price on 31 March 2006 was 253p. The range of closing mid-market share prices during the year was 207p and 266p.

[b] All of the options were granted for nil consideration.

[c] Executive Directors' share options are normally exercisable during the period commencing no earlier than three years and ending no later than ten years from the date granted.

[d] Share options were granted to Executive Directors in previous years in accordance with the relevant Executive Share Option Scheme rules and market practice at the time. The table above sets out information on the current Executive Directors' grants of such share options. The performance criteria relating to these grants are as follows:

- For the period from 25 August 1995 to 9 December 1999, the criterion was that the Company's TSR over the relevant calculation period compared to the TSR of the companies in the FTSE 100 at 1 April prior to the date of grant is at least equal to the median of that group. TSR is the percentage growth of the share price, assuming reinvestment of any dividends paid, over the calculation period. The initial calculation period commences on 1 April immediately preceding the date of grant and ends on 31 March three years later and, thereafter, calculations are made at each quarter end for the preceding three-year period until the performance criterion is met or the option lapses.
- For the period from 10 December 1999 to 8 July 2003 (excluding Mr Levy's grants – see footnote f) below), the criterion was that the increase in the Group's adjusted, fully diluted EPS over a three-year period following the date of grant should exceed an average of the UK retail prices index (RPI) plus a rate ranging between 2% and 3% pa.

The Committee chose the relevant performance criteria as they were considered to be challenging and in accordance with the then existing market practice, while aligning Executive Directors' interests with those of shareholders.

[e] Retired as a Director on 31 March 2006.

[f] As reported in previous years and summarised in this note below, Alain Levy had a one-off long-term incentive arrangement covering the period from October 2001 to 31 March 2006. As part of the amendment to his service agreement, Mr Levy will participate in the ESIP from 1 April 2006.

On appointment, Mr Levy was granted options over 10m shares at prices between 300p and 700p. On 2 January and 19 December 2002, Mr Levy was granted additional options over 10m shares which represent his entitlement to options in respect of the five financial years up to and including, but ending on, 31 March 2006. The exercise prices for these options were determined after the announcement of the interim results for the respective financial years, using a five-day average share price. Exercise of all the options is generally conditional on the Company's adjusted diluted EPS growing by at least an average of RPI plus 2.5% pa over the period from 31 March 2002 to the 31 March following the relevant vesting date with retesting throughout the option's life. The terms of Mr Levy's contract prescribe the impact of a cessation of employment or a change of control of EMI on the share options granted under his contract. If Mr Levy's appointment were terminated by EMI without cause or by Mr Levy with good reason (as defined in the contract), the options over 10m shares granted on 15 October 2001 would vest and could be exercised without regard to the performance conditions.

If Mr Levy's appointment is terminated in the circumstances described in the preceding paragraph, the options granted on 2 January and 19 December 2002 will vest and may be exercised without regard to the performance conditions. The exercise of options vested under the preceding paragraph must be undertaken within 12 months of the date of termination. On a change of control of EMI, Mr Levy's options will be treated as if his employment had been terminated by EMI without cause with the result that they may be exercised without regard to performance conditions, but the exercise period will be limited to six months. A termination resulting from Mr Levy's death or disability will be treated in the same manner as a termination by the Company without cause.

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Group auditor's report

Independent auditor's report to the members of EMI Group plc
We have audited the Group financial statements of EMI Group plc for the year ended 31 March 2006 which comprise the Group consolidated income statement, Group consolidated balance sheet, Group consolidated statement of recognised income and expense, Group consolidated cash flow statement and note, Group accounting policies and the related notes 1 to 33. These Group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of EMI Group plc for the year ended 31 March 2006 and on the information in the Remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors
The Directors are responsible for preparing the Annual Report and the Group financial statements in accordance with applicable United Kingdom law and International Financial Reporting Standards (IFRSs) as adopted by the European Union as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the Group financial statements give a true and fair view, the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation and that the information given in the Directors' report is consistent with the financial statements.

We also report to you if, in our opinion, we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the Corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group financial statements. The other information comprises only the Chairman's statement, the Operating and Financial Review and the Corporate governance statement. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group financial statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group financial statements, and of whether the accounting policies are appropriate to the Group's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the Group financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the Group financial statements.

Opinion
In our opinion:
- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 March 2006 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' report is consistent with the Group financial statements.

As explained in Note 33 to the Group financial statements, the Group, in addition to complying with its legal obligation to comply with IFRSs as adopted by the European Union, has also complied with the IFRSs as issued by the International Accounting Standards Board.

In our opinion the Group financial statements give a true and fair view, in accordance with IFRSs, of the state of the Group's affairs as at 31 March 2006 and of its profit for the year then ended.

Ernst & Young LLP
Registered auditor
London
22 May 2006

Group consolidated income statement
for the year ended 31 March 2006

	Notes	Total £m
Revenue	1	2,079.9
Group profit from operations before exceptional items and amortisation	1	250.5
Exceptional items and amortisation	8	(45.9)
Share of profit from associates		1.0
Profit from operations*	1&2	205.6
Finance charges:		
Finance income	5&8	71.4
Finance costs	5&8	(158.9)
Total net finance charges		(87.5)
Profit (loss) before taxation		118.1
Overseas		(33.1)
UK		5.0
Total taxation	6	(28.1)
Profit (loss) from continuing operations after taxation		90.0
Attributable to:		
Equity holders of the parent		86.1
Minority interest		3.9
*The following items are included within Profit from operations		
Cost of sales		(1,280.3)
Distribution costs		(75.0)
Gross profit		724.6
Administration expenses		(533.5)
Other operating income, net		13.5

Earnings per share (EPS)

		Year ended 31 March 2006
Basic earnings per Ordinary Share	9	10.9p
Diluted earnings per Ordinary Share	9	10.5p
Underlying basic earnings per Ordinary Share	9	16.2p
Underlying diluted earnings per Ordinary Share	9	15.7p

Underlying earnings are included as they provide a better understanding of the trading performance of the Group on a normalised basis.

Average exchange rates for the year

	Year ended 31 March 2006
US Dollar to £1	1.78
Euro to £1	1.47
Yen to £1	203.69

The results for the year of subsidiaries reporting in foreign currencies have been translated into Sterling at the appropriate average exchange rates.

** Exceptional items and amortisation include operating exceptional items and amortisation and finance exceptional items. See the Group accounting policies section of these financial statements for definitions of these terms and for examples of the types of transactions that may fall into each category.

Year ended 31 March 2006			Year ended 31 March 2005	
Exceptional items and amortisation[1] £m	Underlying £m	Underlying Restated £m	Exceptional items and amortisation[1] Restated £m	Total Restated £m
–	2,079.9	2,001.2	–	2,001.2
–	250.6	225.1	–	225.1
(45.9)			(65.5)	(65.5)
–	1.0	1.1	–	1.1
(45.9)	251.5	226.2	(65.5)	160.7
14.0	57.4	58.6	32.9	91.5
(9.3)	(149.6)	(143.7)	(9.7)	(153.4)
4.7	(92.2)	(85.1)	23.2	(61.9)
(41.2)	159.3	141.1	(42.3)	98.8
–	(33.1)	(38.5)	7.6	(30.9)
–	5.0	7.0	–	7.0
–	(28.1)	(31.5)	7.6	(23.9)
(41.2)	131.2	109.6	(34.7)	74.9
				75.4
				(0.5)
(49.9)	(1,230.4)	(1,201.8)	(45.8)	(1,247.6)
–	(73.0)	(70.3)	–	(70.3)
(49.9)	774.5	729.1	(45.8)	683.3
(1.1)	(532.4)	(506.8)	(20.7)	(527.5)
5.1	8.4	2.8	1.0	3.8

Year ended 31 March 2006 Restated
9.6p
6.1p
13.4p
13.1p

Year ended 31 March 2005
1.85
1.45
198.32

Group consolidated balance sheet
at 31 March 2006

	Notes	At 31 March 2006 £m	At 31 March 2005 Restated £m
Assets			
Non-current assets			
Music copyrights and intangibles	10	389.3	404.6
Goodwill	11	43.0	35.1
Property, plant and equipment	12	196.8	200.0
Investments in associates	13	8.8	8.5
Other investments	14	15.0	17.6
Deferred taxation	24	22.8	29.9
Financial derivatives	15	41.3	39.0
Other receivables	17	4.4	6.6
		721.4	741.3
Current assets			
Inventories	16	37.2	28.2
Advances	17	330.1	336.0
Trade receivables	17	408.5	300.1
Corporation tax recoverable	17	16.7	21.2
Other receivables	17	110.6	109.7
Investments: liquid funds		1.6	1.5
Cash and cash equivalents	18	190.9	240.8
		1,095.6	1,037.7
Total assets		1,817.0	1,779.0
Liabilities			
Non-current liabilities			
Borrowings	19	(1,049.4)	(1,068.7)
Other payables	23	(9.5)	(10.2)
Deferred taxation	24	(5.1)	(8.2)
Pension provisions	26	(31.1)	(100.1)
Financial derivatives	15	(100.3)	(92.8)
		(1,195.4)	(1,280.0)
Current liabilities			
Borrowings	19	(22.6)	(31.3)
Other payables	22	(1,149.0)	(1,060.1)
Current tax liability		(143.1)	(160.3)
Other provisions for liabilities and charges	25	(33.5)	(43.6)
		(1,348.2)	(1,295.3)
Total liabilities		(2,543.6)	(2,575.3)
Net liabilities		(726.6)	(796.3)
Equity			
Capital and reserves			
Share capital	27	110.7	110.6
Share premium account	27	447.8	447.3
Capital redemption reserve	28	495.8	495.8
Foreign exchange reserve	28	(17.1)	3.8
Other reserves	28	206.4	204.0
Retained earnings	28	(2,019.0)	(2,107.1)
Equity attributable to equity holders of the parent		(775.4)	(845.6)
Minority interests (equity)		48.8	49.3
Total equity		(726.6)	(796.3)

Year end exchange rates

	At 31 March 2006	At 31 March 2005
US Dollar to £1	1.73	1.89
Euro to £1	1.43	1.45
Yen to £1	204.68	202.11

The balance sheets of subsidiaries reporting in foreign currencies have been translated into Sterling at the appropriate year end exchange rate.

Eric Nicoli
Martin Stewart
Directors
22 May 2006

Group consolidated statement of recognised income and expense for the year ended 31 March 2006

	Year ended 31 March 2006 £m	Year ended 31 March 2005 £m
Income and expense recognised directly in equity		
Revaluation of music copyrights and intangibles	4.8	–
Exchange difference on retranslation of foreign operations	(21.2)	0.2
Pension funds: actuarial gains and losses	58.3	4.7
Gains (losses) on the revaluation to fair value of available-for-sale investments	(0.9)	–
Net income directly recognised in equity	41.0	4.9
Profit for the year	90.0	74.9
Total recognised income and expense for the year	131.0	79.8
Attributable to:		
Equity holders of the parent	126.4	92.7
Minority interest	4.6	(12.9)
Balance at 31 March	131.0	79.8

Group consolidated cash flow statement and note
for the year ended 31 March 2006

	Notes	2006 £m	2005 Restated £m
Cash flows from operating activities			
Cash receipts from operations		1,992.4	1,984.7
Cash used in operations		(1,754.3)	(1,763.0)
Tax paid		(39.8)	(32.7)
Net cash generated from operating activities	a	188.3	189.0
Cash flows from investing activities			
Purchase of businesses, net of cash acquired		(6.9)	(6.8)
Deferred consideration paid		(0.9)	(64.1)
Purchase of associates	13	(0.3)	(2.1)
Disposal of associates		–	0.1
Purchase of music copyrights and intangibles	10	(4.1)	(6.0)
Disposal of music copyrights and intangibles		7.3	0.2
Purchase of property, plant and equipment	12	(30.2)	(29.9)
Disposal of property, plant and equipment		16.3	3.3
Purchase of other investments		–	(3.1)
Dividends received from associates		1.0	–
Disposal of other investments		5.9	1.1
Interest received		9.3	5.2
Net cash (used in) investing activities		(2.6)	(102.1)
Cash flows from financing activities			
Issue of Ordinary Share capital		0.6	1.7
Purchase of own shares		(0.5)	(0.3)
Equity dividends paid		(61.2)	(62.9)
Dividends paid to minorities		(2.5)	(1.3)
Management of liquid funds		(0.6)	(0.8)
Financing:			
New loans		207.8	128.9
Loans repaid		(277.6)	(127.1)
Capital element of finance lease repayments		(0.6)	(0.8)
Interest paid		(111.6)	(105.5)
Interest element of finance lease repayments		(0.7)	(0.5)
Net cash (used in) financing activities		(246.9)	(168.6)
Net (decrease) in cash and cash equivalents		(61.2)	(81.7)
Cash and cash equivalents at the beginning of the year		227.3	310.2
Exchange gains (losses) on cash and cash equivalents in the year		2.6	(1.2)
Cash and cash equivalents at the end of the year		168.7	227.3
Cash and cash equivalents at the end of the year comprise of:			
Cash at bank and in hand	18	188.3	239.1
Overdrafts	19	(19.6)	(11.8)
		168.7	227.3

a) Reconciliation of Group profit from operations to net cash flow from operating activities

	Notes	2006 £m	2005 Restated £m
Group profit from operations (before share of profit in associates)	1	204.6	159.6
Depreciation charge	12	25.3	25.1
Property impairment charge	8 & 12	1.1	18.5
Gain on disposal of property, plant and equipment and music copyrights and intangibles		(9.4)	(0.8)
Amortisation and impairment of music copyrights and intangibles	10	49.9	45.8
Impairment of goodwill	11	–	2.2
Remeasurements – revaluation to fair value of investments at fair value through profit and loss		(2.6)	–
Share-based payment transactions	29	4.9	2.3
Amounts provided		18.2	15.0
Provisions utilised		(36.1)	(75.7)
(Increase) decrease in inventories		(7.3)	(0.1)
(Increase) decrease in receivables		(74.1)	39.1
Increase (decrease) in payables		53.6	(9.3)
Net cash generated from operations		228.1	221.7
Tax paid		(39.8)	(32.7)
Net cash generated from operating activities		188.3	189.0

Group accounting policies

Basis of preparation
The consolidated financial information comprises the accounts of the Company and its subsidiaries which have been prepared in accordance with applicable accounting standards. Following a regulation adopted by the European Parliament, the consolidated financial information has been prepared in accordance with International Financial Reporting Standards (IFRS). The Group's principal accounting policies under IFRS are set out below. The transition date for the application of IFRS is 1 April 2004, and the comparative figures for year ended 31 March 2005 have been restated accordingly.

IFRS 1 *First-time adoption of IFRS*
When preparing its IFRS balance sheet as at 31 March 2006, the Group has taken the following options available under IFRS 1 in applying IFRS:

- The requirements of IFRS 3 *Business Combinations* have been applied prospectively from 1 April 2003;
- Certain properties were held at revalued amounts as at 31 March 2004. On conversion, these revalued amounts were frozen and deemed cost in the case of these properties;
- All actuarial gains and losses in respect of defined benefit pension and post-retirement schemes have been recognised in full in equity from 1 April 2004;
- Cumulative translation differences relating to net investments in overseas companies that arose prior to 1 April 2004 have been set to zero and will not be included in any subsequent calculation of profit or loss on disposal;
- Only those employee share options granted after 7 November 2002 that had not vested as at 1 January 2005 have been remeasured at fair value; and
- The Group has chosen to adopt IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement* from 1 April 2004.

Basis of consolidation
The consolidated financial statements comprise the financial statements of EMI Group plc and its subsidiaries for the year ended 31 March 2006.

All intercompany balances and transactions, including unrealised profits and losses arising from intra-group transactions, have been eliminated in full.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which EMI Group plc has control.

Foreign currency translation
Sterling (£) is the functional currency of the parent undertaking and the presentational currency of the Group. The functional currency of subsidiaries, joint ventures and associated companies ('foreign operations') is the currency of the primary economic environment in which they operate.

Transactions in foreign currencies are initially recorded in the functional currency at the rate ruling on the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the functional currency rate of exchange ruling at the balance sheet date.

All differences are taken to the income statement with the exception of differences on foreign currency borrowings that provide a hedge against a net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the income statement. Tax charges and credits attributable to exchange differences on those borrowings are also dealt with in equity. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair values were determined.

The assets and liabilities of foreign operations are translated into Sterling at the rate of exchange ruling at the balance sheet date and their income statements are translated at the weighted average exchange rates for the period. The exchange differences arising on the translation of foreign operations are taken directly to a separate component of equity. On disposal of a foreign operation, the deferred cumulative amount recognised in equity relating to that particular foreign operation is recognised in the income statement.

Business combinations and goodwill
The purchase method of accounting is used to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired, and liabilities and contingent liabilities assumed, in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of the acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill.

Goodwill on acquisition is initially measured at cost. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Due to the adoption of IFRS 3 *Business Combinations* from 1 April 2003, goodwill on acquisitions from 1 April 2003 is not amortised and goodwill already carried in the balance sheet is not amortised from 1 April 2003. Goodwill is reviewed for impairment annually, or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

For an asset, such as goodwill, that does not generate largely independent cash flows, the recoverable amount is determined for the smallest identifiable group of assets including that asset that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets (a 'cash generating unit').

Intangible assets
Intangible assets include music copyrights and other intangibles. Intangible assets acquired separately are capitalised at cost, whilst those acquired as part of a business acquisition are capitalised at fair value at the date of acquisition.

Following initial recognition, intangible assets with finite lives are amortised on a systematic basis over their economic useful lives. These lives are estimated on an individual basis at periods of anything up to and including 20 years. Intangible assets are tested for impairment if events or changes in circumstances indicate that the carrying value may be impaired. Useful lives are examined on an annual basis and adjustments, where applicable, are made on a prospective basis.

Intangible assets created within the business that cannot be distinguished from the cost of developing the business as a whole are not capitalised. Any relevant expenditure is charged against profit from operations in the period in which the expenditure is incurred.

Property, plant and equipment
Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight line basis to write off the cost, less residual value, of assets over the estimated useful life of the asset. The annual rates used are:

Freehold buildings	2%
Property held under finance leases and leasehold improvements	Period of lease
Plant, equipment and vehicles	10–33⅓%

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Where an indicator of impairment exists, the Group makes an estimate of the recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount.

Assets are derecognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on derecognition of the asset (calculated as the difference between the net disposal proceeds and the carrying value of the asset) is included in the income statement in the period in which the item is derecognised.

Assets are held at historical cost with the exception that certain properties in the subsidiary undertaking Toshiba-EMI Limited are carried at revalued amounts that were frozen. This frozen carrying value was deemed cost in the case of these properties.

Leases
Assets which are held under a finance lease, which transfers to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease, with a corresponding liability being recognised for the fair value of the leased asset or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between finance charges and a reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the lease liability. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight line basis over the lease term.

Investments in joint ventures and associates
The Group's investments in its associates are accounted for using the equity method. The investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the associate, less any impairment in value or dividends received. The Group's share of the results after interest and tax of the associate are included in profit from operations. When an associate has recognised a change in net assets other than through the income statement, the Group recognises its share of the change and discloses it, when applicable, in the statement of recognised income and expense.

The Group has a number of jointly controlled operations where there is no separate legal entity. The expenses that the Group incurs, and the share of the income that the Group earns from the sale of goods by these jointly controlled operations, are included in the income statement. The assets that the Group controls, and the liabilities that the Group incurs, in respect of these jointly controlled operations are included in the balance sheet.

Other investments
All investments are initially recognised at cost, being the fair value of the consideration given and including acquisition charges associated with the investment. At acquisition, all investments are classified as either fair value through profit and loss, held-to-maturity or available-for-sale in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*.

Those investments classified as held-to-maturity or available-for-sale are designated as non-current assets. Unlisted held-to-maturity or available-for-sale investments are held on the balance sheet at cost less any impairment in value. Listed held-to-maturity or available-for-sale investments are held on the balance sheet at fair value, with any changes in fair value being recognised in equity.

Those investments classified as fair value through profit and loss are designated as current assets and are held on the balance sheet at fair value, with any changes in fair value being recognised in the income statement along with gains or losses on disposal.

Advances
In the ordinary course of business the Group pays advances and other expenses recoupable from future royalties to performing artists, songwriters, producers and third party repertoire owners. The amounts paid are carried at cost less recoupment and less an allowance for any unrecoupable amounts. The allowance is based on past revenue performance, current popularity and projected revenue.

Advances are recoupable during the business operating cycle. All advances are therefore reported as current assets, including advances recoupable more than 12 months after the balance sheet date.

Inventories
Inventories are valued at the lower of cost and net realisable value. Cost includes manufacturing overheads where appropriate.

Trade receivables
Trade receivables, which generally have 30-90 day terms, are recognised and carried at the originally invoiced amount less an allowance for any doubtful debts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

Cash and cash equivalents
Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits with an original maturity of three months or less. For the purpose of the Group consolidated cash flow statement, cash and cash equivalents consist of cash at bank and in hand, as defined above, net of outstanding bank overdrafts.

Borrowings
All loans and borrowings are initially recognised at the fair value of the consideration received net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs and any discount or premium on settlement. Gains and losses on derecognition are recognised in finance charges.

Hedge accounting is adopted where derivatives, such as 'fixed to floating' interest rate swaps, are held as fair value hedges against fixed interest rate borrowings. Under fair value hedge accounting, fixed interest rate borrowings are revalued at each balance sheet date by the change in fair value attributable to the interest rate risk being hedged.

Financial derivatives
The Group uses derivative financial instruments such as interest rate swaps and foreign currency contracts to hedge risks associated with interest and exchange rate fluctuations. Such derivative financial instruments are stated at fair value. The fair values of interest rate swaps and foreign currency contracts are determined by reference to market rates for similar instruments.

For the purpose of hedge accounting, hedges are classified as either: fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to variability in cash flows that is attributable to either a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges (e.g. fixed to floating interest rate swaps held as fair value hedges against fixed interest rate borrowings) which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

Guaranteed convertible bonds
The component of the guaranteed convertible bonds that exhibits characteristics of a liability is recognised as a liability in the balance sheet, net of issue costs. On issue of the guaranteed convertible bonds, the fair value of the liability component was determined using a market rate for an equivalent non-convertible bond. This amount is carried as a liability on an amortised cost basis until extinguished on conversion or redemption. As the convertible bonds are denominated in US Dollars but are convertible to Sterling shares, the remainder of the proceeds is allocated to the conversion option that is recognised and included as a derivative liability, net of issue costs. The value of the conversion option is revalued to fair value at each balance sheet date, with movements in fair value reflected as finance costs or finance income.

Issue costs were apportioned between the liability and derivative components of the guaranteed convertible bonds based on the allocation of proceeds to the liability and derivative components when the instruments were first recognised.

Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, when it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and when a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when the reimbursement is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money on the quantification of the provision is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Where discounting is used, the increase in the provision due to the passage of time is recognised as finance costs.

Pensions and other employee benefits

The Group operates three major defined benefit pension schemes, plus a number of smaller defined benefit pension schemes. The cost of providing benefits under the schemes is determined separately for each scheme using the projected unit actuarial valuation method.

Liabilities of the schemes are discounted by the current rate of return of an AA-rated corporate bond of equivalent term and currency to the liabilities. Assets of the schemes are measured at fair value at the balance sheet date. Actuarially calculated surpluses or deficits on the defined benefit schemes are included within the consolidated balance sheet. The current service cost of each of the schemes is charged against profit from operations. Expected returns on defined benefit scheme assets and interest on defined benefit scheme liabilities are included as finance income and finance costs, respectively. With effect from 1 April 2004, the Group has adopted the amendment to IAS 19 *Employee Benefits* that permits actuarial gains and losses to be charged or credited directly to equity through the statement of recognised income and expense.

In addition, the Group operates a number of defined contribution schemes. Contributions to defined contribution schemes are charged to the income statement as incurred.

Employee benefits, other than post-employment benefits, that can be carried forward if they have not been used are accrued as they are earned until the benefit is paid or used. Those employee benefits that are foregone if not taken at the time are expensed when incurred.

Revenue

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. The following specific recognition criteria must also be met before revenue is recognised:

- Sale of goods: revenue is recognised when the significant risks and rewards of ownership of the goods have passed to the buyer and can be reliably measured. Revenue is measured at fair value after making provision in respect of expected future returns of goods and services supplied by the Group prior to the balance sheet date;
- Royalty and other income: all royalty and other income is recognised when it has been earned and can be reliably measured.

Interest income is recognised when it has been earned and can be reliably measured.

Share-based payments

The share option programme allows certain Group employees to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and the expense is spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a binomial lattice model, taking into account the terms and conditions upon which the options were granted.

The amount recognised as an expense reflects the extent to which the vesting period has expired and the Group's best estimate of the number of awards that will ultimately vest. No expense is recognised for awards that do not ultimately vest, except for awards where the vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Employees of certain subsidiaries of the Group participate in the employee share incentive plans and the Group has an employee share trust to satisfy non-transferable options granted to executives and senior employees. Shares in the Group held by the employee share trust are treated as treasury shares and presented in the balance sheet as a deduction from equity.

The Group has taken advantage of the transitional provisions of IFRS 1 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested on or before 1 January 2005.

Finance charges

Finance costs comprise interest payable on borrowings calculated using the effective interest rate method, foreign exchange losses and losses on hedging instruments that are recognised in the income statement.

Finance income comprises interest receivable on funds invested calculated using the effective interest rate method, dividend income, foreign exchange gains and gains on hedging instruments that are recognised in the income statement.

Income tax

Income tax on the profit or loss for the period comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the period, using tax rates enacted or substantively enacted at the balance sheet date and any adjustment to tax payable in respect of previous periods.

Deferred tax is recognised for all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax base. The following temporary differences are not provided for: the initial recognition of goodwill or of assets or liabilities that affect neither accounting nor taxable profit that is not a business combination; and temporary differences relating to investments in subsidiaries, joint ventures and associates where the timing of the reversal of the temporary difference can be controlled and to the extent that it is probable that the temporary difference will not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantially enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised.

Segments

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those segments operating in other economic environments.

Exceptional items and amortisation

Exceptional items and amortisation are excluded from underlying results in order to provide a better understanding of the normalised trading of the Group. The Group considers that such items would fall into either of two categories: operating exceptional items and amortisation; and finance exceptional items.

The Group defines operating exceptional items and amortisation as items which derive either from events or transactions that it considers fall outwith the ordinary activities of the Group or from events or transactions that fall within the ordinary activities of the Group but which, individually or, if of a similar type, in aggregate, need to be disclosed separately by virtue of their size or incidence if the financial statements are to give a true and fair view. Similarly, the Group defines finance exceptional items as items which derive either from events or transactions that it considers fall outwith the ordinary financing activities of the Group or from events or transactions that fall within the ordinary financing activities of the Group but which, individually or, if of a similar type, in aggregate, need to be disclosed separately by virtue of their size or incidence if the financial statements are to give a true and fair view.

Events or transactions that the Group would consider as falling outwith its ordinary activities could include, but are not limited to: the revaluation and/or disposal of property, plant and equipment; the revaluation and/or disposal of held-to-maturity or available-for-sale investments or investments at fair value through profit and loss; the disposal and/or closure of a business, jointly controlled operation or associate; and the costs of a fundamental reorganisation or restructuring. Events or transactions that the Group would consider as falling within its ordinary activities but which need to be disclosed separately could include, but are not limited to: the amortisation and impairment of music copyrights and intangibles; the impairment of goodwill; and the impairment of the cost of an investment in a business, jointly controlled operation or associate. Events or transactions that the Group would consider as falling outwith its ordinary financing activities could include, but are not limited to: gains or losses on the revaluation of derivative financial instruments; gains or losses on the retranslation of foreign currency-denominated borrowings to the extent that they do not provide a hedge against foreign currency-denominated investments; and gains or losses from the ineffectiveness of the interest rate swaps hedge. Events or transactions that the Group would consider as falling within its ordinary financing activities but which need to be disclosed separately could include, but are not limited to, costs incurred as part of the Group's refinancing programmes.

Notes to the Group financial statements for the year ended 31 March 2006

1. Segmental analyses

At 31 March 2006, the Group was organised on a worldwide basis into two main business segments – Music and Music Publishing. These divisions are the basis on which the Group reports its primary segment information.

Results

	EMI Music £m	EMI Music Publishing £m	2006 Total £m	EMI Music Restated £m	EMI Music Publishing Restated £m	2005 Total Restated £m
Segment revenue	1,660.3	419.6	2,079.9	1,600.5	400.7	2,001.2
Group profit (loss) from operations before exceptional items and amortisation	145.1	105.4	250.5	125.5	99.6	225.1
Share of profit (loss) from associates	(0.1)	1.1	1.0	0.6	0.5	1.1
Segmental operating exceptional items and amortisation:						
Amortisation of music copyrights and intangibles	(3.6)	(46.3)	(49.9)	(3.0)	(42.8)	(45.8)
Gain on disposal of property, plant and equipment	0.6	(0.2)	0.4	(17.7)	–	(17.7)
Segmental result	142.0	60.0	202.0	105.4	57.3	162.7
Non-segmental operating exceptional items and amortisation			3.6			(2.0)
Group profit from operations			205.6			160.7
Total net finance charges			(87.5)			(61.9)
Profit (loss) before taxation			118.1			98.8
Taxation			(28.1)			(23.9)
Profit (loss) from continuing operations after taxation			90.0			74.9

Other segment items included in the income statement include:

Depreciation	22.1	3.2	25.3	22.0	3.1	25.1
Amortisation of music copyrights and intangibles	3.6	44.3	47.9	3.0	42.8	45.8
Impairment of music copyrights and intangibles	–	2.0	2.0	–	–	–
Impairment of goodwill	–	–	–	2.2	–	2.2
Impairment of property	0.9	0.2	1.1	18.5	–	18.5
Release of overprovision for reorganisation costs charged in prior years	(2.3)	–	(2.3)	(3.8)	–	(3.8)
Reorganisation costs	2.3	–	2.3	3.8	–	3.8

Assets and liabilities

	EMI Music £m	EMI Music Publishing £m	2006 Total £m	EMI Music Restated £m	EMI Music Publishing Restated £m	2005 Total Restated £m
Segment assets	926.3	578.0	1,504.3	813.4	586.8	1,400.2
Investments in associates	5.9	2.3	8.2	6.8	1.1	7.9
Unallocated assets			304.5			370.9
Consolidated total assets			1,817.0			1,779.0
Segment liabilities	(898.1)	(282.4)	(1,180.5)	(835.3)	(256.5)	(1,091.8)
Unallocated liabilities			(1,363.1)			(1,483.5)
Consolidated total liabilities			(2,543.6)			(2,575.3)

Other segment items included in the balance sheet include:

Capital expenditure	25.5	8.8	34.3	30.4	5.5	35.9
Average employees (No.)	5,672	640	6,312	6,043	629	6,672

Profit from operations is analysed instead of profit before taxation as finance charges are borne centrally and are not allocated to the operating businesses.

1. Segmental analyses (continued)

The Group's two business segments operate in six main geographic areas, even though they are managed on a worldwide basis.

	United Kingdom £m	Rest of Europe £m	Latin America £m	North America £m	Asia Pacific £m	Other £m	2006 Total £m
Segment revenue	348.0	630.2	84.4	649.1	338.8	29.4	2,079.9
Segment assets	267.1	288.5	58.8	657.5	155.6	76.8	1,504.3
Investments in associates	–	0.4	–	6.6	1.2	–	8.2
Unallocated assets	–	–	–	–	–	–	304.5
Consolidated total assets	267.1	288.9	58.8	664.1	156.8	76.8	1,817.0
Capital expenditure	15.3	6.9	0.6	8.7	2.2	0.6	34.3
Average employees (No.)	1,201	1,393	311	2,034	1,241	132	6,312

	United Kingdom Restated £m	Rest of Europe Restated £m	Latin America Restated £m	North America Restated £m	Asia Pacific Restated £m	Other Restated £m	2005 Total Restated £m
Segment revenue	339.6	633.9	55.8	581.2	366.3	24.4	2,001.2
Segment assets	257.1	291.5	34.2	605.7	145.5	66.2	1,400.2
Investments in associates	–	0.2	–	5.9	1.8	–	7.9
Unallocated assets	–	–	–	–	–	–	370.9
Consolidated total assets	257.1	291.7	34.2	611.6	147.3	66.2	1,779.0
Capital expenditure	17.3	6.1	0.6	9.8	1.6	0.5	35.9
Average employees (No.)	1,156	1,623	293	2,124	1,345	131	6,672

Unallocated assets and liabilities include financial derivatives, corporation tax, deferred tax and net borrowings. These items are managed centrally and not allocated to the operating businesses.

2. Profit from operations

The following items have been included in arriving at profit from operations:

	2006 £m	2005 Restated £m
Staff costs (Note 4)	370.5	347.3
Cost of inventories recognised as an expense (included in cost of sales)	252.2	245.8
Depreciation of property, plant and equipment:		
Owned assets	22.2	21.0
Leased assets	3.1	4.1
Amortisation and impairment of music copyrights and intangibles (included in cost of sales)	49.9	45.8
Impairment of goodwill (included in administration expenses)	–	2.2
(Gain) loss on disposal of property, plant and equipment	(1.5)	(0.8)
(Gain) loss on disposal of business	(1.0)	–
Operating lease rentals payable	29.5	31.6
Contribution to defined contribution pension schemes	5.7	5.8
Other investments:		
(Gains) losses on revaluation to fair value of investments at fair value through profit and loss	(2.6)	(0.2)
Net exchange differences on foreign currency borrowings less deposits	3.8	9.5

3. Fees to auditors

	2006 £m	2005 £m
Audit fees paid to Ernst & Young LLP	2.5	2.4
Audit fees paid to other firms	0.2	0.1
Other fees paid to Ernst & Young LLP:		
UK	0.9	0.1
Non-UK	0.5	0.4
	4.1	3.0

£0.6m (2005: £0.5m) of the Group audit fees shown above were paid in respect of the parent company.

Other fees include £0.4m (2005: £0.3m) paid to Ernst & Young LLP for tax compliance and planning services and £1.0m (2005: £0.2m) for regulatory and other assurance services.

In addition to the above services, Ernst & Young LLP acted as auditor to the EMI Group Pension Fund in the UK. The appointment of auditors to the Group's UK pension fund and the fees paid in respect of those audits are agreed by the trustees of the fund, who act independently from the management of the Group. The aggregate fees paid to Ernst & Young LLP for audit services to the pension fund during the year were £0.1m (2005: £0.1m).

4. Directors' and employees' costs

	2006 £m	2005 Restated £m
Aggregate emoluments paid to Directors	12.2	9.7
Wages and salaries	295.8	276.8
Social security costs	42.2	41.4
Other pension costs	20.3	19.4
Total	370.5	347.3

See Note 1 for average employee numbers.

Key management personnel

	2006 £m	2005 Restated £m
Salaries and short-term employee benefits	17.7	12.2
Post-employment benefits	–	–
Other long-term benefits	–	–
Termination benefits	–	–
Share-based payments	0.6	0.2
	18.3	12.4

As required by IAS 24 *Related Party Transactions*, key management includes Non-executive as well as Executive Directors, and also certain other senior managers. The details of each Director's remuneration, compensation for loss of office, pension entitlements, long-term incentive scheme interests and share options are included in the Remuneration report.

5. Finance charges

	2006 £m	2005 Restated £m
Finance costs:		
Interest payable on bank overdrafts and loans	92.8	83.8
Interest payable on other loans	7.4	11.3
Interest payable on finance leases	0.7	0.5
	100.9	95.6
Interest payable on defined benefit pension scheme liabilities	48.7	48.1
	149.6	143.7
Finance income:		
Interest receivable on bank balances	(2.1)	(2.2)
Other interest receivable	(0.3)	(0.6)
	(2.4)	(2.8)
Expected return from defined benefit pension scheme assets	(55.0)	(55.8)
Underlying net finance charges	(57.4)	(58.6)
Net finance charges	92.2	85.1
Finance exceptional items (Note 8 (ii))	(4.7)	(23.2)
Total net finance charges	87.5	61.9

6. Taxation

	2006 £m	2005 Restated £m
Current tax	23.8	28.4
Deferred tax (Note 24)	4.3	(4.5)
	28.1	23.9

The tax on the Group's profit before tax differs from the theoretical amount that would arise using the weighted average tax rate applicable to profits of the consolidated companies as follows:

Profit before tax	118.1	98.8
Tax calculated at domestic rates applicable to profits in the respective countries at 38.8% (2005: 40%)	45.8	39.6
Effects of:		
Income not subject to tax	(4.2)	(7.7)
Expenses not deductible for tax purposes	23.7	21.0
Utilisation of previously unrecognised tax losses	(42.3)	(37.9)
Tax losses for which no deferred income tax was recognised	16.9	15.8
Adjustment in respect of prior years	(11.8)	(6.9)
Current tax on profit (loss) before taxation	28.1	23.9

7. Dividends (equity)

	2006 Per share	2005 Per share	2006 £m	2005 Restated £m
Ordinary dividends:				
2005/2004 final dividend	6.0p	6.0p	47.2	47.1
2005/2004 interim dividend	2.0p	2.0p	15.7	15.8
Total	8.0p	8.0p	62.9	62.9

The interim dividend of 2.0p per share was paid on 1 April 2005 to shareholders on the register at the close of business on 4 March 2005. The final dividend of 6.0p per share was paid on 7 October 2005 to shareholders on the register at the close of business on 9 September 2005.

8. Exceptional items and amortisation

Exceptional items and amortisation are excluded from underlying results in order to provide a better understanding of the normalised trading of the Group, and include operating exceptional items and amortisation and finance exceptional items. See the Group accounting policies section of these financial statements for definitions of these terms and for examples of the types of transactions that may fall into each category.

(i) Operating exceptional items and amortisation

	2006 £m	2005 Restated £m
Net gain on sale of property, plant and equipment	1.5	0.8
Gain on disposal of business	1.0	–
Gain on revaluation to fair value of investments at fair value through profit and loss	2.6	0.2
Restructuring and reorganisation costs:		
Music: headcount reduction	(2.3)	(3.8)
Release of overprovision for reorganisation costs charged in prior years	2.3	3.8
Property impairment	(1.1)	(18.5)
Amortisation and impairment of music copyrights and intangibles	(49.9)	(45.6)
Impairment of goodwill	–	(2.2)
Total	(45.9)	(65.5)

The attributable taxation charge (credit) relating to operating exceptional items and amortisation is £nil (2005: £(7.6)m). The share of the operating exceptional items and amortisation attributable to minority interests is £0.1m (2005: £(5.1)m).

(ii) Finance exceptional items

	2006 £m	2005 Restated £m
Fair value revaluation of convertible bond derivative liability	4.1	31.2
Fair value revaluation of interest rate swaps	1.4	1.7
Fair value revaluation of Eurobond call feature derivative asset	8.2	(0.2)
Foreign exchange on unhedged Euro borrowings	(4.1)	(9.5)
Foreign exchange on unhedged foreign currency borrowings	0.3	–
Exceptional refinancing costs	(5.2)	–
Total	4.7	23.2

The attributable taxation charge relating to finance exceptional items is £nil (2005: £nil). See Note 19 for further details on exceptional refinancing costs.

9. Earnings per Ordinary Share (EPS)

	2006	2005 Restated
Earnings per Ordinary Share is calculated using the following:		
Earnings	£88.1m	£75.4m
Underlying earnings	£127.4m	£105.0m
Basic		
Weighted average number of Ordinary Shares	786.8m	785.8m
Diluted		
Adjusted weighted average number of Ordinary Shares	874.2m	872.8m

The adjusted weighted average number of Ordinary Shares used in the diluted earnings per share calculations, 874.2m (2005: 872.8m), is the weighted average number of Ordinary Shares, 786.8m (2005: 785.6m), plus adjustments for dilutive share options, 8.5m (2005: 8.4m), plus adjustments for convertible bond options, 78.9m (2005: 78.9m).

Reconciliation from basic to diluted earnings per Ordinary Share

	Year ended 31 March 2006		Year ended 31 March 2005 Restated	
	£m	Per Share	£m	Restated Per Share
Earnings/basic EPS	86.1	10.9p	75.4	9.6p
Dilutive adjustments:				
Convertible bond – attributable interest cost* and dilution	5.4	(0.3)p	(22.2)	(3.4)p
Dilutive share options – dilution	–	(0.1)p	–	(0.1)p
Earnings adjusted for effects of dilution/diluted EPS	91.5	10.5p	53.2	6.1p

* Including fair value revaluation of convertible bond derivative liability included within finance exceptional items.

Reconciliation from basic to underlying basic and underlying diluted earnings per Ordinary Share

	Year ended 31 March 2006		Year ended 31 March 2005 Restated	
	£m	Per Share	£m	Restated Per Share
Earnings/basic EPS	86.1	10.9p	75.4	9.6p
Exceptional items and amortisation:				
Operating exceptional items and attributable taxation	(4.0)	(0.5)p	9.9	1.3p
Amortisation of music copyrights and intangibles	47.9	6.1p	45.8	5.8p
Impairment of music copyrights and intangibles	2.0	0.3p	–	0.0p
Impairment of goodwill	–	0.0p	2.2	0.3p
Minority interest in operating exceptional items and attributable taxation	0.4	0.1p	(4.8)	(0.6)p
Minority interest in amortisation of music copyrights and intangibles	(0.3)	(0.1)p	(0.3)	0.0p
Finance exceptional items	(4.7)	(0.6)p	(23.2)	(3.0)p
Underlying earnings/underlying basic EPS	127.4	16.2p	105.0	13.4p
Dilutive adjustments:				
Convertible bond – attributable interest cost and dilution	9.5	(0.4)p	9.0	(0.2)p
Dilutive share options – dilution	–	(0.1)p	–	(0.1)p
Underlying earnings adjusted for effects of dilution/underlying diluted EPS	136.9	15.7p	114.0	13.1p

10. Music copyrights and intangibles

	2006 £m	2005 Restated £m
Cost		
Beginning of the year	776.4	785.8
Currency retranslation	57.6	(13.8)
Acquisition of businesses	3.7	0.2
Additions	4.1	6.0
Disposals	(4.6)	(1.8)
End of the year	837.2	776.4
Amortisation		
Beginning of the year	371.8	335.3
Currency retranslation	30.1	(7.7)
Charge for year	49.9	45.8
Disposals	(3.9)	(1.6)
End of the year	447.9	371.8
Carrying amount	389.3	404.6

11. Goodwill

	2006 £m	2005 Restated £m
Cost		
Beginning of the year	35.1	31.1
Currency retranslation	1.5	0.3
Acquisition of businesses	6.5	5.9
Disposals	(0.1)	–
Impairment in the year	–	(2.2)
End of the year	43.0	35.1

12. Property, plant and equipment

	Freehold property £m	Leasehold property £m	Plant, equipment and vehicles £m	Total £m
Cost				
At 31 March 2004 (restated)	132.9	80.0	208.6	421.5
Currency retranslation and reclassification	(13.5)	(0.9)	(24.5)	(38.9)
Acquisition of businesses	–	–	–	–
Disposal of businesses	–	–	(4.6)	(4.6)
Additions	2.5	1.8	25.6	29.9
Disposals	(6.1)	(0.4)	(12.8)	(19.3)
At 31 March 2005 (restated)	115.8	80.5	192.3	388.6
Currency retranslation and reclassification	2.5	1.7	11.7	15.9
Acquisition of businesses	–	–	–	–
Disposal of businesses	–	–	–	–
Additions	6.0	4.9	19.3	30.2
Disposals	(23.0)	(1.1)	(51.1)	(75.2)
At 31 March 2006	101.3	86.0	172.2	359.5
Comprising:				
At cost	101.3	86.0	172.2	359.5
At 31 March 2006	101.3	86.0	172.2	359.5
Accumulated depreciation and impairment				
At 31 March 2004 (restated)	29.6	16.1	155.2	200.9
Currency retranslation and reclassification	(2.6)	(0.4)	(33.4)	(36.4)
Disposal of businesses	–	–	(2.8)	(2.8)
Depreciation charge for year	2.3	4.1	18.7	25.1
Impairment	18.5	–	–	18.5
Disposals	(4.4)	(0.4)	(11.9)	(16.7)
At 31 March 2005 (restated)	43.4	19.4	125.8	188.6
Currency retranslation and reclassification	1.3	(0.7)	9.7	10.3
Disposal of businesses	–	–	–	–
Depreciation charge for year	2.0	3.2	20.1	25.3
Impairment	1.1	–	–	1.1
Disposals	(13.6)	(1.0)	(48.0)	(62.6)
At 31 March 2006	34.2	20.9	107.6	162.7
Carrying amount				
At 31 March 2006	67.1	65.1	64.6	196.8
At 31 March 2005	72.4	61.1	66.5	200.0

12. Property, plant and equipment (continued)

Freehold property includes land having a cost of £28.1m (2005: £31.6m) which is not depreciated.

The depreciation charge for the year includes depreciation of assets held under finance leases of £0.4m (2005: £1.2m).

The impairment charge in the year ended 31 March 2005 of £18.5m arose from a comparison of the carrying value of a number of properties held by the Group's Japanese subsidiary with the higher of net realisable value and value in use. The net realisable value was determined by independent valuers and was based on recent transactions for similar properties within the same market.

	2006 £m	2005 Restated £m
The carrying values shown above include the following:		
Finance lease assets	18.9	16.9
Assets in the course of construction	15.0	17.4

Properties held by Toshiba – EMI Limited were carried at a revalued amount prior to the implementation of IAS16 *Tangible Fixed Assets* in the year ended 31 March 2005. The revalued amount was based on third party expert valuation. Under the transitional arrangements of that standard, the carrying value of these properties has been frozen and carried forward as deemed cost. These properties are currently held at net book value of £30.4m (2005: £37.2m). The comparable amount under the historical cost convention would be £3.9m (2005: £14.3m).

13. Investments in associates

	2006 £m	2005 Restated £m
Beginning of the year	8.5	5.5
Currency retranslation	0.5	(0.1)
Additions and new loans	0.3	2.1
Share of profit (loss)*	1.0	1.1
Dividends	(1.0)	–
Disposals, provisions and loans repaid	(0.5)	(0.1)
End of the year	8.8	8.5

* Share of profit (loss) is after tax.

Investments in associates as at 31 March 2006 includes goodwill of £2.5m (2005: £2.4m). None of the Group's associates are listed.

The following table provides summarised financial information of the Group's share of its associates:

	2006 £m	2005 £m
Non-current assets	0.6	0.3
Current assets	4.7	3.3
Gross assets	5.3	3.6
Current liabilities	(3.2)	(2.7)
Non-current liabilities	–	–
Gross liabilities	(3.2)	(2.7)
Share of net assets	2.1	0.9
Revenue	14.8	12.4
Net profit (loss)	1.0	1.1

14. Other investments

	2006 £m	2005 Restated £m
Held-to-maturity investments	7.9	8.0
Available-for-sale investments	7.1	9.6
Investments at fair value through profit and loss	0.3	1.5
	15.3	19.1
Current portion:		
Investments at fair value through profit and loss	0.3	1.5
	0.3	1.5
Non-current portion:		
Held-to-maturity investments	7.9	8.0
Available-for-sale investments	7.1	9.6
	15.0	17.6

The held-to-maturity investments included above represent unlisted equity investments which are held by the Group for long-term return which is broadly determinable. They are valued at cost.

The available-for-sale investments included above represent both listed and unlisted equity investments which offer the Group the opportunity of return through dividend income. The fair values of the listed element of these investments are based on quoted market prices. Fair value gains and losses on these investments are charged directly to equity. The unlisted element of these investments is valued at cost.

The investments at fair value through profit and loss included above represent listed equity investments which offer the Group the opportunity of returns through dividend income and fair value gain. The fair values of these investments are based on quoted market prices. Fair value gains and losses on these investments are charged to profit and loss.

15. Financial derivatives

	2006 Assets £m	2006 Liabilities £m	2005 Assets £m	2005 Liabilities £m
Interest rate swaps – fair value hedge (excluding accrued interest)	11.0	(13.6)	16.9	(9.6)
Convertible bond derivative	–	(86.7)	–	(83.2)
€425m 8.625% senior notes embedded call feature	30.3	–	22.1	–
	41.3	(100.3)	39.0	(92.8)

Interest rate swaps
The notional principal amounts of the outstanding interest rate swap contracts at 31 March 2006 were £586.2m (2005: £557.7m). At 31 March 2006, the fixed interest rates vary from 8.38% to 8.63% (2005: 8.38% to 8.63%) and the main floating rates are three-month LIBOR + 465 basis points and three-month EURIBOR + 440 basis points (2005: three-month LIBOR + 465 basis points and three-month EURIBOR + 440 basis points). The fair value of the interest rate swaps is equal to the book value.

Convertible bond derivative
On issue of the guaranteed convertible bond, the fair value of the liability component was determined using a market rate for an equivalent non-convertible bond. As the convertible bond is denominated in US Dollars but convertible into Sterling shares, the remainder of the proceeds were allocated to the conversion option that is recognised and included as a derivative liability, net of issue costs. The value of the call feature is revalued to fair value at each balance sheet date, with movements in the fair value reflected as finance costs or finance income.

€425m 8.625% senior notes
On or after 15 October 2008, the Company may redeem all or part of the notes at redemption prices (plus accrued interest) fixed for the 12-month period starting at the date shown (15 October 2008, 104.3125%; 15 October 2009, 102.8750%; 15 October 2010, 101.4375%; and from 15 October 2011 at 100.0000%). At 31 March 2006, this embedded call feature had a fair value of £30.3m (2005: £22.1m) and is included as a derivative asset.

15. Financial derivatives (continued)

Net investments in foreign operations
In addition to the €425m 8.625% senior notes the Group had Euro and Yen denominated drawings under its £450m revolving credit facility. These drawings were fully repaid at 31 March 2006. During the year, the Euro borrowing had foreign exchange losses of £4.1m (2005: £9.5m loss) while the Yen borrowing had foreign exchange gains of £0.3m (2005: £nil). The foreign exchange loss on the Euro borrowing has been treated as a finance exceptional item and charged to the income statement. As the Yen borrowing is a partial hedge of the net investment in the Group's Japanese subsidiary, the foreign exchange gain on translation of the borrowing to Sterling at the balance sheet date was recognised in 'other reserves' in shareholders' equity to the extent that the borrowing provided a hedge against the net investment, the remainder of £0.3m (2005: £nil) being credited to the income statement.

Credit risk
The Group's principal financial assets are bank balances, cash and trade and other receivables.

The Group's credit risk is primarily attributable to its trade and other receivables. The amounts presented in the balance sheet are net of allowances for doubtful debts. Such an allowance is made where there is an identified loss event which, based on previous experience, is evidence of a reduction in the recoverability of the debt.

The credit risk on bank balances is limited because the counterparties are financial institutions with high credit ratings assigned by international credit rating agencies.

The Group has no significant concentration of credit risk, with exposure spread over a large number of geographically dispersed counterparties.

16. Inventories

	2006 £m	2005 £m
Raw materials and consumables	1.4	1.5
Work in progress	–	0.2
Finished goods	35.8	26.5
Total	37.2	28.2

17. Receivables

	2006 £m	2006 £m	2005 £m	2005 £m
Current receivables:				
Trade receivables		408.5		300.1
Advances		330.1		336.0
Corporation tax recoverable		16.7		21.2
Other receivables:				
Amounts owed by associates	1.1		0.5	
Other debtors (including current portion of other investments)	73.4		89.2	
Prepayments and accrued income	36.1		20.0	
		110.6		109.7
		865.9		767.0
Non-current receivables:				
Other receivables		4.4		6.6
Prepayments and accrued income		–		–
		4.4		6.6
Total		870.3		773.6

The Directors consider that the carrying amount of receivables due both within and after more than one year approximates to their fair value.

18. Cash and cash equivalents

	2006 £m	2005 £m
Cash at bank and in hand	188.3	239.1
Short-term deposits	2.6	1.8
	190.9	240.9

Cash at bank earns interest at floating rates based on daily bank deposit rates. Short-term deposits are ordinarily made for periods varying between one day and one month, although can extend to periods of up to three months, depending on the immediate cash requirements of the Group, and earn interest at the respective short-term deposit rates.

The Group has balances of cash and cash equivalents totalling £60.7m (2005: £113.1m) held with banks within the UK and £130.2m (2005: £127.8m) held with banks outside, but freely transferable to, the UK.

19. Borrowings

	2006 £m	2005 Restated £m
Non-current		
US$500m 8.375% guaranteed notes	287.7	273.8
£325m 8.25% Sterling bonds	323.1	322.1
US$123.8m 6.96% senior notes (by instalments)	–	48.7
US$243.3m 5.25% guaranteed convertible bonds	121.1	107.4
€425m 8.625% senior notes	300.0	301.6
Long-term commited facilities*	(1.5)	(1.9)
Term loan	2.0	1.1
Finance leases	17.0	15.9
	1,049.4	1,068.7
Current		
Overdrafts	19.6	11.8
Term loan	1.2	1.8
US$123.8m 6.96% senior notes (first instalment)	–	16.4
Finance leases	1.8	1.3
	22.6	31.3
Total borrowings	1,072.0	1,100.0

*Includes issue costs of syndicated loan facility of £1.3m (2005: £1.9m).

The fair value of publicly traded borrowings has been calculated using the appropriate market prices at the balance sheet date. For the borrowings which are not publicly traded, the fair value has been calculated by discounting their future cash flows at the appropriate market rate. The Directors estimate the fair value of the Group's borrowings to be as follows:

	Book value 2006 £m	Book value 2005 £m	Fair value 2006 £m	Fair value 2005 £m
Loans and overdrafts	19.6	11.8	19.6	11.8
US$500m 8.375% guaranteed notes	287.7	273.8	306.0	286.8
£325m 8.25% Sterling bonds	323.1	322.1	348.0	349.9
US$123.8m 6.96% senior notes	–	65.1	–	39.4
US$243.3m 5.25% guaranteed convertible bonds	121.1	107.4	133.5	123.1
€425m 8.625% senior notes	300.0	301.6	368.1	347.0
Long-term commited facilities	(1.5)	(1.9)	(1.5)	(1.9)
Term loan	3.2	2.9	3.2	2.9
Finance leases	18.8	17.2	18.8	17.2
	1,072.0	1,100.0	1,195.7	1,176.2

Year ended 31 March 2006

	Current coupon rate	Effective interest rate	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Non-current									
US$500m 8.375% guaranteed notes	8.375%	8.49%	–	–	–	287.7	–	–	287.7
£325m 8.25% Sterling bonds	9.75%	9.92%	–	–	323.1	–	–	–	323.1
US$123.8m 6.96% senior notes (by instalments)	8.46%	8.63%	–	–	–	–	–	–	–
US$243.3m 5.25% guaranteed convertible bonds	5.25%	9.30%	–	–	–	–	121.1	–	121.1
€425m 8.625% senior notes	8.625%	8.94%	–	–	–	–	–	300.0	300.0
Long-term committed facilities			–	–	–	–	(1.5)	–	(1.5)
Term loan			–	2.0	–	–	–	–	2.0
Finance leases			–	–	–	–	–	17.0	17.0
			–	2.0	323.1	287.7	119.6	317.0	1,049.4
Current									
Overdrafts			19.6	–	–	–	–	–	19.6
Term loan			1.2	–	–	–	–	–	1.2
US$123.8m 6.96% senior notes (first instalment)			–	–	–	–	–	–	–
Finance leases			1.8	–	–	–	–	–	1.8
			22.6	–	–	–	–	–	22.6
Total borrowings			22.6	2.0	323.1	287.7	119.6	317.0	1,072.0

19. Borrowings (continued)

Year ended 31 March 2005 (restated)

	Current coupon rate	Effective interest rate	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Non-current									
US$500m 8.375% guaranteed notes	8.375%	8.49%	–	–	–	–	273.8	–	273.8
£325m 8.25% Sterling bonds	9.75%	9.92%	–	–	–	322.1	–	–	322.1
US$123.8m 6.96% senior notes (by instalments)	8.46%	8.63%	–	–	48.7	–	–	–	48.7
US$243.3m 5.25% guaranteed convertible bonds	5.25%	9.30%	–	–	–	–	–	107.4	107.4
€425m 8.625% senior notes	8.625%	8.94%	–	–	–	–	–	301.6	301.6
Long-term commited facilities			–	–	(1.9)	–	–	–	(1.9)
Term loan			–	1.1	–	–	–	–	1.1
Finance leases			–	–	–	–	–	15.9	15.9
			–	1.1	46.8	322.1	273.8	424.9	1,068.7
Current									
Overdrafts			11.8	–	–	–	–	–	11.8
Term loan			1.8	–	–	–	–	–	1.8
US$123.8m 6.96% senior notes (first instalment)			16.4	–	–	–	–	–	16.4
Finance leases			1.3	–	–	–	–	–	1.3
			31.3	–	–	–	–	–	31.3
Total borrowings			31.3	1.1	46.8	322.1	273.8	424.9	1,100.0

In July 2005, the Group signed a new £450m revolving credit facility with a group of banks. This facility replaced a revolving credit facility (£250m), a 364 day facility, (£100m) and enabled a subsidiary to repay the US$123.8m 6.96% senior notes. In addition, two bilateral facilities (£40m) were not renewed. This resulted in exceptional refinancing costs of £5.2m (2005: £nil) of which £3.5m was in respect of issue and repayment costs of the US$123.8m 6.96% senior notes and £1.7m in respect of issue costs relating to the £250m revolving credit facility.

On 11 March 2003, Moody's Investor Service downgraded the Group's credit rating from Baa2 to Ba1. As a consequence, the coupon of the £325m 8.25% Sterling bonds was increased from 8.25% to 9.75% with effect from 20 May 2003 and the coupon of the US$123.8m 6.96% senior notes was increased from 6.96% to 8.46% with effect from 21 August 2003.

The Group holds equivalent US Dollar nominal value interest rate swaps matching the coupon and the term of the US$500m 8.375% guaranteed notes effectively converting the interest basis of the issue to floating rate (set in arrears). See Note 15 for the derivative portion of the borrowing.

The Group holds equivalent Euro nominal value interest rate swaps matching the coupon and the term of the €425m 8.625% senior notes effectively converting the interest basis of the issue to floating rate (set in arrears). See Note 15 for the derivative portion of the borrowing.

At 31 March 2006, the Group had available £437.1m (2005: £349.1m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

The term loan of £3.2m (2005: £2.9m) was raised in the period July 2004 to December 2005. Repayments will commence in August 2006 and will continue until January 2008. The loan carries a floating rate of interest at LIBOR + 1.5%.

Overdrafts are unsecured, repayable on demand, and are charged interest at variable rates.

For details regarding the Group's obligations under finance leases, see Note 21.

20. Convertible bond

The US$243.3m 5.25% guaranteed convertible bond, which was issued in October 2003, is repayable in October 2010. The bonds are convertible into US$1,000 Preference Shares of the issuer which will be exchangeable immediately upon issue for Ordinary Shares in the Company. The number of Ordinary Shares for which a Preference Share may be exchanged will be determined by dividing the paid-up value of the Preference Share, translated into Sterling at the fixed rate of US$1.5957, by the exchange price initially set at 193.38p per Ordinary Share. Conversion by the holder at 193.38p per Ordinary Share may occur after 11 November 2003 until seven days prior to the final redemption date. Conversion by the issuer, after 16 October 2007, of all but not part, may occur if the average price per Ordinary Share on at least 20 dealing days in any period of 30 consecutive dealing days has been 130p; or at any time if 85% or more of the aggregate principal amount has been previously purchased, redeemed or cancelled. Redemption by the issuer, after 16 October 2007, may occur if the same aggregate principal amount has been previously purchased, redeemed or cancelled. Redemption by the issuer, after 16 October 2007, may occur if the same conditions which apply to conversion by the issuer are met. Final redemption is on 2 October 2010 at 100% of principal and accrued interest.

21. Obligations under finance leases

	Minimum lease payments		Present value of minimum lease payments	
	2006 £m	2005 Restated £m	2006 £m	2005 Restated £m
Amounts payable under finance leases:				
Within one year	1.8	1.3	1.8	1.3
Between one and five years	7.8	5.8	7.2	5.2
After more than five years	12.9	14.1	9.8	10.7
	22.5	21.0	18.8	17.2
Less: future finance charges	(3.7)	(3.8)	n/a	n/a
Present value of lease obligations	18.8	17.2	18.8	17.2
Less: current portion (shown under current liabilities)	(1.8)	(1.3)	(1.8)	(1.3)
Non-current portion	17.0	15.9	17.0	15.9

In March 2004, the Group entered into a sale and leaseback scheme relating to a property in Rue Mont Cenis, Paris that is accounted for as a finance lease. The lease runs for a term of 15 years, although the Group has the option to repurchase the property at any time between years five and 12. If the Group opts not to take up this option, then ownership of the property will revert to the lessor at the end of the lease.

The rentals payable under the lease, along with the premium payable should the Group take up the option to repurchase, are set out in the lease agreement.

22. Other payables: current

	2006 £m	2005 Restated £m
Trade payables	228.6	205.5
Royalties and fees payable	658.5	607.7
Amounts owed to associates	0.6	0.6
Deferred consideration payable*	0.7	1.0
Other taxes including VAT and social security costs	22.4	16.1
Other payables	76.1	75.1
Interest payable	40.7	46.8
Accruals and deferred income	121.4	107.3
Total	1,149.0	1,060.1

* Deferred consideration payable includes £0.7m (2005: £0.9m) which is not conditional upon the satisfaction of future performance criteria.

23. Other payables: non current

	2006 £m	2005 Restated £m
Other payables	9.5	10.2
Total	9.5	10.2

24. Deferred taxation

The major deferred tax assets and liabilities recognised by the Group, and the movements thereon, during the current and prior reporting periods are as follows:

Deferred tax assets

	Accelerated tax depreciation £m	Fair value gains £m	Convertible bond £m	Other £m	Total £m
At 31 March 2004 (restated)	(2.6)	–	–	(21.5)	(24.1)
Charge (credit) to profit or loss for the year	1.8	(7.6)	–	1.0	(4.8)
Charge (credit) to equity for the year	–	–	–	1.8	1.8
Exchange differences	0.3	0.2	–	(3.3)	(2.8)
At 31 March 2005 (restated)	(0.5)	(7.4)	–	(22.0)	(29.9)
Charge (credit) to profit or loss for the year	(0.6)	–	–	6.3	5.7
Charge (credit) to equity for the year	–	–	–	–	–
Exchange differences	–	(0.1)	–	1.5	1.4
At 31 March 2006	(1.1)	(7.5)	–	(14.2)	(22.8)

24. Deferred taxation (continued)

Deferred tax liabilities

	Accelerated tax depreciation £m	Fair value gains £m	Convertible bond £m	Other £m	Total £m
At 31 March 2004 (restated)	5.6	–	–	(1.4)	4.2
Charge (credit) to profit or loss for the year	0.7	–	–	(0.4)	0.3
Charge (credit) to equity for the year	–	–	–	–	–
Exchange differences	(0.2)	–	–	3.9	3.7
At 31 March 2005 (restated)	6.1	–	–	2.1	8.2
Charge (credit) to profit or loss for the year	(0.2)	–	–	(1.2)	(1.4)
Charge (credit) to equity for the year	–	–	–	–	–
Exchange differences	(0.1)	–	–	(1.6)	(1.7)
At 31 March 2006	5.8	–	–	(0.7)	5.1

Certain deferred tax assets and liabilities have been offset. The following is the analysis of the deferred tax balances after offset for balance sheet purposes:

	2006 £m	2005 Restated £m
Deferred tax liabilities	5.1	8.2
Deferred tax assets	(22.8)	(29.9)

At the balance sheet date, the Group had unused tax losses of £441.5m (2005: £430.2m) available for offset against future profits. A deferred tax asset has been recognised in respect of £nil (2005: £nil) of such losses. No deferred tax asset has been recognised in respect of the remaining £441.5m (2005: £430.2m) due to the unpredictability of future profit streams. Included in the unrecognised tax losses are losses of £51.7m (2005: £51.6m) that will expire in 2022. Other losses may be carried forward indefinitely.

At the balance sheet date, the Group had net other deductible temporary differences of £28.3m (2005: £71.7m). No deferred tax has been recognised due to the unpredictability of future profit streams.

Temporary differences arising in connection with interests in associates and jointly controlled operations are insignificant.

25. Other provisions for liabilities and charges

	Trading £m	Employee benefits £m	Acquisition and integration £m	Disposal and fundamental reorganisation £m	Total £m
At 1 April 2005 (restated)	32.9	–	2.7	8.0	43.6
Currency retranslation	1.7	–	–	0.4	2.1
Provisions utilised	(13.8)	–	–	(7.3)	(21.1)
Charged (released)	8.4	0.3	2.4*	(0.7)	8.4
Transfer from pensions provision	–	0.5	–	–	0.5
At 31 March 2006	27.2	0.8	5.1	0.4	33.5
Current portion:					
At 1 April 2005 (restated)	32.9	–	2.7	8.0	43.6
At 31 March 2006	27.2	0.8	5.1	0.4	33.5
Non-current portion:					
At 1 April 2005 (restated)	–	–	–	–	–
At 31 March 2006	–	–	–	–	–
Total:					
At 1 April 2005 (restated)	32.9	–	2.7	8.0	43.6
At 31 March 2006	27.2	0.8	5.1	0.4	33.5

*Deferred consideration payable includes £2.4m (2005: £nil) which is not conditional upon the satisfaction of future performance criteria.

Trading
Trading provisions include royalty audit and other trading provisions charged through profit from operations before operating exceptional items and amortisation. They also include restructuring and reorganisation provisions charged through operating exceptional items (see Note 8).

Disposal and fundamental reorganisation
This provision relates to the reorganisation costs for the closure and/or sale of EMI's manufacturing businesses in North America and Europe.

Acquisition and integration
The provision relates to acquisition and integration costs that were created for earnouts.

Employee benefits
This provision relates to long term and termination benefits.

26. Pensions

The Group operates a number of pension schemes throughout the world. The nature of the Scheme in a particular country is usually in line with local custom and practice and is supportive of, and a key element of, the Group's overall human resources strategy. This operational philosophy results in the majority of the Group's schemes being of the defined contribution type. This has always been the case in, for example, the US.

In a limited number of countries of operation, the Group's local pension arrangements are entirely or partly of the defined benefit type. With the exception of the schemes in the UK, Germany and Japan, these defined benefit arrangements are not significant in size as confirmed by the following summary of the Group's total pension provisions. The schemes in these three countries are material in size and so full detail on each of them is given in the following narrative.

	Major Schemes		Other Schemes		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Pension provisions	(22.8)	(92.2)	(8.3)	(7.9)	(31.1)	(100.1)

The main scheme in the UK, which covers employees of both EMI Group plc and each of the Group's UK subsidiary companies, is the EMI Group Pension Fund (the UK Fund). Benefits provided by the UK Fund are based on final pensionable pay and include a pension which is guaranteed to increase each year by the lower of 5% and the increase in the cost of living. The UK Fund was closed to new entrants on 1 November 2005, on which date a defined contribution plan was started for the benefit of eligible new joiners to the Group's UK businesses. The combination of the launching of a flexible benefits programme to most of the Group's UK employees and the announced closure of the UK Fund to new entrants contributed significantly to an approximate 35% increase in Fund membership amongst eligible employees. This is the main reason for the increase in service cost from £9.0m in 2005 to £12.2m in 2006.

The Group operates two plans in Japan, the financial detail of which is reported in aggregate later in this Note. There were two significant changes to one of these plans, the employees plan, during 2006. The employees plan, whilst remaining a defined benefit scheme, was modified from a final salary scheme to a cash balance scheme on 1 April 2005. The impact of this Plan amendment is reported below. Later in the year, as part of the sale of the manufacturing division of the Group subsidiary to a third party, a significant number of employees transferred their employment to the purchaser. An appropriate quantum of assets was transferred from the Group's pension plan to that of the new employer, in line with the transfer of defined benefit obligation. These transfers are described as divestiture in the following narrative.

There were no significant changes in the German scheme during the year.

The assets and liabilities of these schemes as at 31 March are:

	United Kingdom		Germany		Japan		Total	
	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m	2006 £m	2005 £m
Fair value of scheme assets								
Equities	568.0	483.0	–	–	–	–	568.0	483.0
Bonds	391.0	329.0	–	–	–	–	391.0	329.0
Other	6.0	17.0	1.1	0.5	30.4	42.1	37.5	59.6
	963.0	829.0	1.1	0.5	30.4	42.1	994.5	871.6
Present value of defined benefit obligations	(951.0)	(885.0)	(35.5)	(32.8)	(30.8)	(46.0)	(1,017.3)	(963.8)
Net pension asset (liability)	12.0	(56.0)	(34.4)	(32.3)	(0.4)	(3.9)	(22.8)	(92.2)

The pension plans have not invested in any of the Group's own financial instruments or in properties or other assets used by the Group.

The amounts recognised in the Group consolidated income statement and in the Group consolidated statement of recognised income and expense for the year are analysed as follows:

Year ended 31 March 2006

	United Kingdom £m	Germany £m	Japan £m	Total £m
Recognised in the Group consolidated income statement				
Current service cost	12.2	0.3	1.7	14.2
Plan amendment	–	–	(5.0)	(5.0)
Divestiture	–	–	0.3	0.3
Recognised in arriving at profit from operations	12.2	0.3	(3.0)	9.5
Expected return on scheme assets	(54.2)	–	(0.9)	(55.1)
Interest cost on scheme liabilities	46.4	1.4	0.7	48.5
Recognised in arriving at total net finance charges	(7.8)	1.4	(0.2)	(6.6)

26. Pensions (continued)

	United Kingdom £m	Germany £m	Japan £m	Total £m
Taken to Group consolidated statement of recognised income and expense				
Actual return on scheme assets	(178.1)	(0.6)	(1.5)	(178.2)
Less: expected return on scheme assets	64.2	–	0.9	55.1
	(121.9)	(0.6)	(0.6)	(123.1)
Actuarial losses on defined benefit obligations	58.4	2.1	4.3	64.8
Actuarial (gains) and losses recognised in the Group consolidated statement of recognised income and expense	(63.5)	1.5	3.7	(58.3)

Year ended 31 March 2005

	United Kingdom £m	Germany £m	Japan £m	Total £m
Recognised in the Group consolidated income statement				
Current service cost	9.0	0.3	2.2	11.5
Recognised in arriving at profit from operations	9.0	0.3	2.2	11.5
Expected return on scheme assets	(54.0)	–	(1.1)	(55.1)
Interest cost on scheme liabilities	45.0	1.5	1.0	47.5
Recognised in arriving at total net finance charges	(9.0)	1.5	(0.1)	(7.6)
Taken to Group consolidated statement of recognised income and expense				
Actual return on scheme assets	(85.3)	(0.1)	0.4	(85.0)
Less: expected return on scheme assets	54.0	–	1.1	55.1
	(31.3)	(0.1)	1.5	(29.9)
Actuarial losses on defined benefit obligations	28.0	0.1	(3.2)	24.9
Actuarial (gains) and losses recognised in the Group consolidated statement of recognised income and expense	(3.3)	–	(1.7)	(5.0)

Pension contributions are determined with the advice of independent actuaries on the basis of valuations using the projected unit method. Scheme assets are stated at their market values at the respective balance sheet dates and overall expected rates of return are established by considering best estimates for the expected long-term rates of return from the main asset classes. The date of the last actuarial valuation of scheme assets and obligations was 31 March 2006.

	2006 %	United Kingdom 2005 %	2006 %	Germany 2005 %	2006 %	Japan 2005 %
Main assumptions						
Rate of general increase in salaries	4.80	4.75	3.50	3.50	1.30–2.00	2.00–3.70
Rate of increase to pensions in payment	2.80	2.75	2.00	2.00	–	–
Discount rate for scheme liabilities	4.95	5.40	4.50	4.50	2.00	2.00
Inflation	2.80	2.75	2.00	2.00	–	–
Expected rates of return on scheme assets:						
Equities	7.90	8.00	n/a	n/a	n/a	n/a
Bonds	4.40	4.80	n/a	n/a	n/a	n/a
Other	3.80	3.80	4.00	4.00	1.00	2.50

	2006 %	United Kingdom 2005 %	2006 %	Germany 2005 %	2006 %	Japan 2005 %
Mortality assumptions						
Current pensioners at 65 - male	20	20	18	17	n/a	n/a
Current pensioners at 65 - female	22	22	22	21	n/a	n/a
Future pensioners at 65 - male	22	22	22	17	n/a	n/a
Future pensioners at 65 - female	24	24	26	21	n/a	n/a

The post-retirement mortality assumptions allow for expected increases in longevity. The 'current' disclosures above relate to assumptions based on longevity following retirement at the balance sheet date, with 'future' being that relating to an employee retiring in 2035. As the plans in Japan provide a cash sum at retirement, no post-retirement life expectancy assumption is required.

Members contribute to the UK Fund at the rate of 4% (2005: 4%) except in the case of those members whose contributions are paid by the employer following the launch of a flexible benefits programme in 2005. There were no employee contributions to either the German fund or the Japanese fund in either 2005 or 2006. Employer contributions are made to the UK fund at the rate of 21% (2005: 21%) and to the Japanese fund as advised by the insurance company which administers the fund. Contributions to the plans were £13.3m (2005: £11.9m) and are expected to be £12.5m in 2007.

26. Pensions (continued)

Changes in the present value of the defined benefit obligation are analysed as follows:

	United Kingdom 2006 £m	United Kingdom 2005 £m	Germany 2006 £m	Germany 2005 £m	Japan 2006 £m	Japan 2005 £m	Total 2006 £m	Total 2005 £m
At 1 April	(885.0)	(850.0)	(32.8)	(31.4)	(46.0)	(52.5)	(963.8)	(933.9)
Service cost	(12.2)	(9.0)	(0.3)	(0.3)	(1.7)	(2.2)	(14.2)	(11.5)
Interest cost	(48.4)	(45.0)	(1.4)	(1.5)	(0.7)	(1.0)	(48.5)	(47.5)
Benefits paid	51.6	48.0	1.2	1.6	4.3	3.7	57.1	53.3
Actuarial gains and losses	(58.4)	(28.0)	(2.1)	(0.1)	(4.3)	3.2	(64.8)	(24.9)
Employee contributions	(0.6)	(1.0)	–	–	–	–	(0.6)	(1.0)
Plan amendment	–	–	–	–	5.0	–	5.0	–
Divestiture	–	–	–	–	12.1	–	12.1	–
Foreign currency differences	–	–	(0.1)	(1.1)	0.5	2.8	0.4	1.7
At 31 March	(951.0)	(885.0)	(35.5)	(32.8)	(30.8)	(46.0)	(1,017.3)	(963.8)

Changes in the fair value of scheme assets are analysed as follows:

	United Kingdom 2006 £m	United Kingdom 2005 £m	Germany 2006 £m	Germany 2005 £m	Japan 2006 £m	Japan 2005 £m	Total 2006 £m	Total 2005 £m
At 1 April	829.0	784.0	0.5	0.7	42.1	44.4	871.6	829.1
Expected return on scheme assets	54.2	54.0	–	–	0.9	1.1	55.1	55.1
Employer contributions	8.9	6.7	–	–	3.8	4.2	12.7	10.9
Contributions paid by employees	0.6	1.0	–	–	–	–	0.6	1.0
Benefits paid	(51.6)	(48.0)	–	(0.4)	(4.3)	(3.7)	(55.9)	(52.1)
Actuarial gains and losses	121.9	31.3	0.6	0.1	0.6	(1.5)	123.1	29.9
Divestiture	–	–	–	–	(12.4)	–	(12.4)	–
Foreign currency differences	–	–	–	0.1	(0.3)	(2.4)	(0.3)	(2.3)
At 31 March	963.0	829.0	1.1	0.5	30.4	42.1	994.5	871.6

History of experience gains and losses:

United Kingdom

	2006 £m	2005 £m	2004 £m
Fair value of scheme assets	963.0	829.0	785.0
Present value of defined benefit obligations	(951.0)	(885.0)	(850.0)
Surplus (deficit) in the scheme	12.0	(56.0)	(65.0)
Cumulative actuarial gains and losses at the beginning of the year	3.3	–	–
Actuarial gains and losses on scheme assets in the year	121.9	31.3	–
Actuarial gains and losses on defined benefit obligations in the year	(58.4)	(28.0)	–
Cumulative gains and losses at the end of the year	68.8	3.3	–

Germany

	2006 £m	2005 £m	2004 £m
Fair value of scheme assets	1.1	0.5	0.7
Present value of defined benefit obligations	(35.5)	(32.8)	(31.4)
Surplus (deficit) in the scheme	(34.4)	(32.3)	(30.7)
Cumulative actuarial gains and losses at the beginning of the year	–	–	–
Actuarial gains and losses on scheme assets in the year	0.6	0.1	–
Actuarial gains and losses on defined benefit obligations in the year	(2.1)	(0.1)	–
Cumulative gains and losses at the end of the year	(1.5)	–	–

Japan

	2006 £m	2005 £m	2004 £m
Fair value of scheme assets	30.4	42.1	44.4
Present value of defined benefit obligations	(30.8)	(46.0)	(52.5)
Surplus (deficit) in the scheme	(0.4)	(3.9)	(8.1)
Cumulative actuarial gains and losses at the beginning of the year	1.7	–	–
Actuarial gains and losses on scheme assets in the year	0.6	(1.5)	–
Actuarial gains and losses on defined benefit obligations in the year	(4.3)	3.2	–
Cumulative gains and losses at the end of the year	(2.0)	1.7	–

On transition to IFRS, the Group took the option available under IFRS 1 to apply IAS 19 such that all actuarial gains and losses arising on defined benefit pension and post-retirement schemes before 1 April 2004 were recognised in equity. The cumulative amount of actuarial gains and losses recognised since 1 April 2004 in the Group consolidated statement of recognised income and expense is £63.3m (2005: £5.0m).

27. Share capital and share premium

(i) Authorised

	2006 £m	2005 £m
Ordinary shares of 14p each	158.8	158.8
B shares of 114.5p each	479.8	479.8
Deferred shares of 0.0005p each	17.5	17.5
	656.1	656.1

(ii) Ordinary Shares in issue

	2006 Number	2005 Number	Share capital 2006 £m	Share capital 2005 £m	Share premium 2006 £m	Share premium 2005 £m
At beginning of year	789,698,747	788,599,755	110.8	110.4	447.3	445.8
Shares issued during the year on the exercise of options:						
Executive schemes	387,200	1,074,684	–	0.2	0.5	1.5
Savings-related scheme	96,228	24,308	–	–	–	–
Scrip Dividend scheme	710,917	–	0.1	–	–	–
At end of the year	790,893,092	789,698,747	110.7	110.6	447.8	447.3

All Ordinary Shares in issue have been allocated, called up and fully paid.

As at 31 March 2006, the Company had authority to purchase 78,970,403 of its Ordinary Shares; this authority will expire on 13 October 2006 or at the conclusion of the Annual General Meeting in 2006, whichever is the earlier.

(iii) Convertible bond

US$243.3m 5.25% guaranteed convertible bonds include options to convert into 78,859,870 14p Ordinary Shares.

(iv) Share premium account

The principal elements that make up the Group's share premium account arose as follows:

	Years arising	£m
Conversions to Ordinary Shares of 7% Convertible Redeemable Second Cumulative Preference Shares 1992/99 of £1 each	1989/90 and 1990/91	56.7
A placing of Ordinary Shares linked to the offer for Thames Television	1990/91	78.0
Issue of Ordinary Shares on exercise of subscription rights of warrants originally attached to 7 ¾% bonds due 1992; and	1991/92	67.1
the transfer from other reserves in respect of amounts paid for the warrants exercised	1991/92	10.2
Issue of Ordinary Shares on conversion of Convertible Unsecured Loan Stock to fund the acquisition of Virgin Music Group	1992/93	508.4
Issue of Ordinary Shares on conversion of 5¾% Guaranteed Redeemable Preference Shares 2004 of THORN EMI Capital NV	1993/94	126.0
Share capital reorganisation (including issue of Redeemable Preference B Shares)	1997/98	(501.2)
Other issues of Ordinary Shares		102.6
Balance at 31 March 2006		447.8

28. Reconciliation of movement in equity

	Share capital and share premium £m	Capital redemption reserve £m	Foreign exchange reserve £m	Other reserves £m	Retained earnings £m	Total £m	Minority interest £m	Total equity £m
At 1 April 2004 (restated)	556.2	495.8	–	202.6	(2,133.7)	(879.1)	64.5	(814.6)
Total recognised income and expenditure for the year	–	–	3.8	–	88.9	92.7	(12.9)	79.8
Shares issued								
Holding Company	1.7	–	–	–	–	1.7	–	1.7
Equity dividend	–	–	–	–	(62.9)	(62.9)	(1.3)	(64.2)
Acquisition of minority shareholdings	–	–	–	–	–	–	(1.0)	(1.0)
Purchase of shares by EBT	–	–	–	(0.3)	–	(0.3)	–	(0.3)
Share-based payment	–	–	–	–	2.3	2.3	–	2.3
ESOP reserve movements	–	–	–	1.7	(1.7)	–	–	–
At 31 March 2005 (restated)	557.9	495.8	3.8	204.0	(2,107.1)	(845.6)	49.3	(796.3)
Total recognised income and expenditure for the year	–	–	(20.9)	–	147.3	126.4	4.6	131.0
Shares issued								
Holding Company	0.5	–	–	–	–	0.5	–	0.5
Equity dividend	–	–	–	–	(62.9)	(62.9)	(2.5)	(65.4)
Scrip dividend	0.1	–	–	–	1.7	1.8	–	1.8
Acquisition of minority shareholdings	–	–	–	–	–	–	(2.6)	(2.6)
Purchase of shares by EBT	–	–	–	(0.5)	–	(0.5)	–	(0.5)
Share-based payment	–	–	–	–	4.9	4.9	–	4.9
ESOP reserve movements	–	–	–	2.9	(2.9)	–	–	–
At 31 March 2006	558.5	495.8	(17.1)	206.4	(2,019.0)	(775.4)	48.8	(726.6)

(i) Capital redemption reserve
The capital redemption reserve represents the reduction in distributable reserves for the amount paid to redeem preference B shares as part of the share capital reorganisation.

(ii) Foreign exchange reserve
The foreign exchange reserve is used to record exchange differences arising from the translation of financial statements of foreign subsidiaries and to record the effect of hedging net investments in foreign operations.

(iii) Other reserves
The balance held in other reserves is the share options reserve containing shares in the Employee Benefit Trust and the fair value of options granted under share-based payment schemes. For details regarding the Group's share-based payment charge, see Note 29. It also contains a special reserve which reflects the share premium account reduction of July 1988 and unrealised profits on disposals of investments.

The EMI Group General Employee Benefit Trust (EBT) was established to hedge the future obligations of the Group in respect of shares awarded under the Senior Executive Incentive Plans. The Trustee of the EBT, EMI Group EBT (Guernsey) Limited, purchases the Company's Ordinary Shares in the market with financing provided by the Company, as required, on the basis of regular reviews of the anticipated share liabilities of the Group. The EBT has since December 1998 waived any entitlement to the receipt of dividends in respect of all of its holding of the Company's Ordinary Shares. The EBT's waiver may be revoked or varied at any time.

EBT

	2006 Shares held in trust No.	2006 Cost £m	2005 Shares held in trust No.	2005 Cost £m
Beginning of the year	3,840,515	16.6	4,082,771	18.0
Shares purchased	226,513	0.5	142,721	0.3
Shares vested	(676,106)	(2.9)	(384,977)	(1.7)
End of the year	3,391,922	14.2	3,840,515	16.6

At 31 March 2006, the outstanding loan by the Company to the EBT to finance the purchase of Ordinary Shares was £14.6m (2005: £16.9m). The market value at 31 March 2006 of the Ordinary Shares held in the EBT, which are listed in the UK, was £8.6m (2005: £9.1m). All shares held in the EBT are either under option to employees or conditionally gifted to them.

29. Share-based payment

Equity-settled share option schemes

Subscription options
Options granted under the 1995 Executive Share Option Scheme ('ESOS') are normally exercisable no earlier than three years and no later than ten years following the date of grant and are subject to the achievement of performance requirements that must be met before the options normally become exercisable. Options granted under the 2003 Executive Share Incentive Plan ('ESIP'), if subject to a pre-vesting performance requirement, are normally exercisable between three and ten years following the date of grant but only if, and to the extent that, the pre-vesting target has been satisfied. Options granted with pre-grant conditions normally become exercisable in no fewer than four annual tranches commencing no earlier than the second anniversary of the grant date. There are no cash settlement alternatives for the schemes.

Transfer options
Transfer options have been granted to senior executives under the ESOS and the ESIP with the exercise price of the options being the average of the market price of the Company's Ordinary Shares in a period of three or five days prior to the date of grant. The proportion of each option that vests will be determined by the Group's average compound underlying diluted earnings per share growth over RPI from the base year to the end year of the performance period. The option will lapse if this target increase is not achieved within the three years from the date of grant. There are no cash settlement alternatives to receiving shares on the exercise of the option.

A detailed description of the performance conditions attached to the options is provided in the Remuneration report.

Employee Plan
Options granted under the 1994 and 2004 Savings-Related Share Option Schemes ('SRSOS') are normally exercisable for a six month period following completion of savings to either a three year or a five year savings contract. There are no performance criteria attached to these awards.

Details of the share options outstanding during the year are as follows:

	Subscription Options					Transfer Options
	Executive Share Option Schemes Number	Weighted average exercise prices £	1994 and 2004 Savings-Related Share Option Schemes Number	Weighted average exercise prices £	Executive Share Option Schemes Number	Weighted average exercise prices £
Outstanding at 1 April 2004	34,694,566	2.35	3,489,600	1.16	22,972,678	4.00
Granted	6,113,038	2.94	513,436	1.78	1,782,368	2.24
Exercised	(1,074,684)	1.46	(24,306)	0.96	–	–
Lapsed	(3,154,251)	2.51	(498,684)	1.87	(1,612,178)	4.89
Outstanding at 31 March 2005	36,578,669[1]	2.53	3,480,044[1]	1.15	23,142,868[1]	3.80
Granted	5,149,072	2.48	294,136	1.99	253,331	2.56
Exercised	(387,200)	1.23	(96,228)	1.51	–	–
Lapsed	(3,773,091)	3.43	(328,394)	1.61	(2,303,725)	3.53
Outstanding at 31 March 2006	37,567,450*	5.56	3,349,558	1.17	21,092,474**	3.81
Exercisable at the end of 31 March 2006	1,445,545	3.45	10,913	4.28	–	–
Exercisable at the end of 31 March 2005	1,168,080	6.73	5,053	3.83	–	–
Final exercise date	20 November 2015		28 February 2011		18 June 2015	

* Of which options over 14,519,893 shares were granted under the 2003 Executive Share Incentive Plan.
** Of which options over 8,017,822 shares were granted under the 2003 Executive Share Incentive Plan.

[1] Included within the following schemes are options that have not been recognised in accordance with IFRS 2 as the options were granted on or before 7 November 2002:
ESOS – subscription options over 22,142,557 shares (2005: 22,057,936 shares)
SRSOS – subscription options over 71,572 shares (2005: 178,476 shares)
ESOS – transfer options over 16,074,652 shares (2005: 18,378,377 shares)

These options have not been subsequently modified and, therefore, do not need to be accounted for in accordance with IFRS 2. The exemptions from IFRS 1 were in respect of employees who left before 1 January 2005.

The weighted average share price at the date of exercise for the following schemes are:
ESOS – subscription options £2.49 (2005: £2.26)
SRSOS – subscription options £2.43 (2005: £2.22)
ESOS – transfer options £nil (2005: £nil)

For the share options outstanding as at 31 March 2006, the weighted average remaining contractual life is 6.4 years (2005: 7.5 years).

29. Share-based payment (continued)

The actual expense recognised for equity settled share-based payment in respect of employee services received during the year to 31 March 2006 is £4.9m (2005: £2.3m).

The weighted average fair value of share options granted during the year was 85.6p (2005: 88.7p). The range of exercise prices for options outstanding at the end of the year was £7.35 – £0.96 (2005: £7.47 – £0.96). The weighted average fair value of options granted during the year, the exercise of which is subject to a performance condition, was 120.5p (2005: 95.9p) while the weighted average fair value of options granted under the SRSOS during the year was 89.5p (2005: 87.2p).

The fair value of equity-settled share options granted is estimated as at the date of grant using a proprietary binomial model taking into account the terms and conditions upon which the options were granted. The services received and the liability to pay for those services are recognised over the expected vesting period. Until the liability is settled, it is remeasured at each reporting date with any changes in fair value being recognised in the income statement.

For awards with market conditions attached, the modelling of the impact of this TSR condition is performed using a Monte Carlo model based on the history of weekly returns of the constituents of the FTSE 250 index.

The following table lists the variables used in the model for the years ending 31 March 2006 and 31 March 2005:

	Share options	Performance shares	2006 SRSOS
Weighted average share price at grant	254.3p	254.3p	249.0p
Weighted average share exercise price	255.7p	n/a	198.0p
Weighted average expected volatility	39%	39%	40%
Weighted average expected life (years)	4.8	3.5	4.3
Risk free rate	Range used is between 4.1% to 4.4%		
Weighted average expected dividend yield	3.2%	3.2%	3.2%

	Share options	Performance shares	2005 SRSOS
Weighted average share price at grant	238.6p	237.4p	225.0p
Weighted average share exercise price	231.7p	n/a	178.0p
Weighted average expected volatility	48%	48%	44%
Weighted average expected life (years)	4.3	3.3	4.4
Risk free rate	Range used is between 3.4% to 5.2%		
Weighted average expected dividend yield	3.4%	3.4%	3.6%

Expected volatility is the measure of the amount by which a price is expected to fluctuate during a period. The measure of volatility used in option pricing models is the annualised standard deviation of the continuously compounded rates of return on the share. For each grant the assumed volatility has been calculated over a period prior to grant commensurate with the expected life of the award. Adjustments have been made for historic events that are unlikely to recur in the future.

30. Financial commitments

The Group has commitments, which are largely performance-related, to pay advances to artists, repertoire owners and songwriters amounting to £496.7m at 31 March 2006 (2005: £388.4m). There are no capital commitments at the year end (2005: £nil).

Pursuant to a joint venture agreement with Mr Norman Cheng ('Project Typhoon') the Group has agreed to establish and fund new businesses in the People's Republic of China, Hong Kong and South Korea. The Group has an option to buy and Mr Cheng has an option to sell his equity interest in the joint venture in 2009 at a price determined by reference to earnings over a three-year period. Such a price can be limited to not more than $100m.

Annual commitments under operating leases at 31 March were as follows:

	2006 £m	2005 £m
Land and buildings:		
In the first year	24.3	24.6
In the second to fifth years inclusive	74.7	63.8
After the fifth year	108.8	110.7
Total	207.8	199.1
Plant, equipment and vehicles:		
In the first year	3.3	3.0
In the second to fifth years inclusive	3.2	6.2
After the fifth year	–	–
Total	6.5	9.2

31. Contingent liabilities

Save as described below, there are no legal or arbitration proceedings involving members of the EMI Group which, so far as the Company is aware, may have a material effect on the financial position of the Group:

(i) The Group, along with other companies in the music and broadcast industries, has received requests from the New York State Attorney General for information regarding practices in connection with the promotion of records on New York state radio stations. The Group has co-operated fully with this enquiry. EMI has a long-standing, strict, written policy prohibiting unlawful radio promotion practices, and that policy has been reaffirmed internally. Certain of the other companies have reached resolution with the Attorney General requiring the adoption of certain radio promotion practices. The Group has already adopted such practices and is currently engaged in discussions with a view towards a resolution with the Attorney General. EMI is not currently aware of any reason for believing that there will be a material financial impact on the Group;

(ii) The Group has also, along with other companies in the music industry, received requests from the New York State Attorney General and the United States Department of Justice for information regarding conditions and pricing of the online sale of music. The Group is co-operating fully with these enquiries. Arising out of these enquires, certain Group companies have been named, along with other companies in the music industry, in 14 separate lawsuits filed in various courts throughout the US. The cases are styled as class action suits on behalf of consumers, and the plaintiffs assert various federal and state law claims relating to allegations of unfair pricing and anti-competitive practices in connection with the online sale of music. Whilst the enquiries are at an early stage and the lawsuits have only recently been filed, on the basis of information presently available, EMI is not aware of any reason for believing that there will be a material financial impact on the Group;

(iii) Certain Group companies are defendants in legal proceedings brought in the New York and the English courts in connection with claims by Apple Corp., the entity that represents the interests of The Beatles, regarding alleged underpayment of royalties in respect of sales of Beatles' recordings. The cases are being vigorously defended and the Group believes that the claims are largely without merit.

The Group had provided the following guarantees at 31 March 2006:

(i) Following the demerger of the Thorn rental business in 1996, Group companies remained contingently liable in respect of guarantees given with regard to certain leases on properties occupied or previously occupied by the Thorn business though, as part of the demerger arrangements, Thorn Limited (formerly called Thorn plc) agreed to indemnify the Group against such liabilities. One of the Group companies so liable was sold to HMV Group as part of the 1998 sale and the Company agreed to indemnify HMV Group plc against any such liabilities. The current or former Thorn properties in respect of which the Group remained contingently liable number approximately 47 (2005:50) and the annual rental payments in respect of such properties total approximately £3.6m (2005: £3.6m). Following the insolvency of Thorn High Street Properties Limited and certain other companies, claims have arisen against the Group in respect of many of the guaranteed leases. Such claims have been met by Thorn Limited pursuant to its agreement to indemnify the Group;

(ii) As part of the sale in 1998 to HMV Group plc (HMV Group) of the companies and assets comprising HMV, the Group entered into an indemnity deed with HMV Group relating, among other things, to guarantees given by the Group in respect of property leases of which approximately 62 (2005: 75) remain outstanding. Under the deed, HMV Group agreed to indemnify the Group against any payments made under those property leases and certain other guarantees and indemnities. The aggregate annual rental payments under guaranteed leases are approximately £18.6m (2005: £20.7m), although they are subject to adjustment both up and down under certain circumstances. The guaranteed leases have terms which expire in 9 to 20 years (2005: 10 to 21 years) and 19 of the leases expire in years beyond 2016. The indemnity deed remains in force in respect of lease guarantees, and HMV Group has secured those obligations pursuant to a security deed, the Company's rights under which rank second behind banks which provide senior credit facilities to HMV Group;

(iii) Letters of credit and third party guarantees totalling £7.0m (2005: £8.9m) have been incurred by Group companies.

32. Related party transactions

(i) Associated undertakings

	2006 £m	2005 £m
Sales to associates for the year ended 31 March	–	–
Purchases from associates for the year ended 31 March	–	–
Amounts owed by associates as at 31 March	1.4	1.4
Amounts owed to associates as at 31 March	(0.5)	–

(ii) Compensation to key management personnel (including Directors)

See Note 4 for disclosures in respect of compensation to key management personnel.

(iii) Defined benefit pension plans

As per Note 26, the Group operates a number of pension schemes throughout the world. The main scheme, which covers employees in the UK, is the EMI Group Pension Fund (the UK Fund). The Group also operates significant defined benefit schemes in Germany and Japan. With the exception of these schemes, the other defined benefit schemes operated on behalf of the Group are not material. Further details are provided in Note 26.

33. Transition to IFRS

For all periods up to and including the year ended 31 March 2005, the Group prepared its financial statements in accordance with UK generally accepted accounting practice (UK GAAP). These financial statements, for the year ended 31 March 2006, are the first the Group is required to prepare in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union.

Accordingly, the Group has prepared financial statements which comply with IFRSs applicable for periods beginning on or after 1 January 2005 and the significant accounting policies meeting those requirements are described in the Accounting policies section of these financial statements. In preparing these financial statements, the Group has started from an opening balance sheet as at 1 April 2004, the Group's date of transition to IFRS, and made those changes in accounting policies and other restatements required by IFRS 1 *First-time Adoption of International Financial Reporting Standards* for the first time adoption of IFRS. This note explains the principal adjustments made by the Group in restating its UK GAAP balance sheet as at 1 April 2004 and its previously published UK GAAP financial statements for the year ended 31 March 2005.

The Group has classified its adjustments to IFRS under the following headings:
(i) Dividends;
(ii) Acquisitions;
(iii) Employee benefits;
(iv) Property and leases;
(v) Convertible bond;
(vi) Other financial instruments;
(vii) Tax; and
(viii) Reclassifications.

Exemptions applied
IFRS 1 *First-time Adoption of International Financial Reporting Standards* allows first-time adopters certain exemptions from the general requirement to apply IFRS as effective for 31 March 2006 year ends retrospectively. Details of the exemptions that the Group has taken under this allowance are included in the Accounting policies section of these financial statements under the heading 'IFRS 1 *First-time Adoption of IFRS*'.

Group reconciliation of profit (loss) after taxation for the year ended 31 March 2005

	UK GAAP £m	Acquisitions £m (ii)	Employee benefits £m (iii)	Property and leases £m (iv)	Convertible bond £m (v)	Other financial instruments £m (vi)	Tax £m (vii)	Reclassifications £m (viii)	IFRS £m
Revenue	1,942.8	–	–	–	–	–	–	58.4	2,001.2
Group profit from operations before exceptional items and amortisation	232.9	–	(7.5)	(0.3)	–	–	–	–	225.1
Exceptional items and amortisation	(50.7)	2.7	–	(18.5)	–	0.2	–	0.8	(65.5)
Share of profit from associates	0.9	0.2	–	–	–	–	–	–	1.1
Profit from operations*	183.1	2.9	(7.5)	(18.8)	–	0.2	–	0.8	160.7
Non-operating exceptional items	0.8	–	–	–	–	–	–	(0.8)	–
Profit before finance charges	183.9	2.9	(7.5)	(18.8)	–	0.2	–	–	160.7
Finance charges:									
Finance income	2.8	–	55.8	–	31.2	1.7	–	–	91.5
Finance costs	(94.9)	–	(46.3)	(0.5)	(2.0)	(9.7)	–	–	(153.4)
Total net finance charges	(92.1)	–	9.5	(0.5)	29.2	(8.0)	–	–	(61.9)
Profit (loss) before taxation	91.8	2.9	2.0	(19.3)	29.2	(7.8)	–	–	98.8
Taxation	(31.2)	–	–	–	–	–	7.3	–	(23.9)
Profit (loss) after taxation	60.6	2.9	2.0	(19.3)	29.2	(7.8)	7.3	–	74.9
* The following items are included within profit from operations									
Cost of sales	(1,225.3)	–	(0.1)	–	–	–	–	(22.2)	(1,247.6)
Distribution costs	–	–	–	–	–	–	–	(70.3)	(70.3)
Gross profit	717.5	–	(0.1)	–	–	–	–	(34.1)	683.3
Distribution costs	(69.6)	–	–	–	–	–	–	69.6	–
Administration expenses	(504.0)	2.7	(7.4)	(18.8)	–	–	–	–	(527.5)
Other operating income, net	38.3	–	–	–	–	0.2	–	(34.7)	3.8

33. Transition to IFRS (continued)

Group reconciliation of equity as at 1 April 2004

	UK GAAP £m	Dividends £m (i)	Acquisitions £m (ii)	Employee benefits £m (iii)	Property and leases £m (iv)	Convertible bond £m (v)	Other financial instruments £m (vi)	Tax £m (vii)	Reclassifications £m (viii)	IFRS £m
Non-current assets										
Music copyrights and intangibles	448.7	–	1.8	–	–	–	–	–	–	450.5
Goodwill	31.8	–	(0.7)	–	–	–	–	–	–	31.1
Property, plant & equipment	202.7	–	–	–	17.9	–	–	–	–	220.6
Investment in associates	5.4	–	0.1	–	–	–	–	–	–	5.5
Other investments	13.9	–	–	–	–	–	–	–	1.4	15.3
Deferred taxation	19.2	–	–	–	–	–	–	4.9	–	24.1
Financial derivatives	–	–	–	–	–	–	33.3	–	–	33.3
Other receivables	–	–	–	–	–	–	–	–	7.8	7.8
	721.7	–	1.2	–	17.9	–	33.3	4.9	9.2	788.2
Current assets										
Inventories	28.1	–	–	–	–	–	–	–	–	28.1
Advances	328.3	–	–	–	–	–	–	–	–	328.3
Trade receivables	345.3	–	–	–	–	–	–	–	–	345.3
Corporation tax recoverable	13.4	–	–	–	–	–	–	–	–	13.4
Other receivables	104.7	–	–	(0.3)	–	–	0.4	–	(9.2)	95.6
Investments: liquid funds	1.8	–	–	–	–	–	–	–	–	1.8
Cash and cash equivalents	343.4	–	–	–	–	–	–	–	–	343.4
	1,165.0	–	–	(0.3)	–	–	0.4	–	(9.2)	1,155.9
Total assets	1,886.7	–	1.2	(0.3)	17.9	–	33.7	4.9	–	1,944.1
Non-current liabilities										
Borrowings	(1,058.1)	–	–	–	(16.6)	18.6	(43.4)	–	–	(1,099.5)
Other payables	(12.9)	–	–	–	–	–	–	–	–	(12.9)
Deferred taxation	(5.7)	–	–	–	–	–	–	1.5	–	(4.2)
Pension provisions	(31.3)	–	–	(80.5)	–	–	–	–	–	(111.8)
Financial derivatives	–	–	–	–	–	(116.3)	–	–	–	(116.3)
	(1,108.0)	–	–	(80.5)	(16.6)	(97.7)	(43.4)	1.5	–	(1,344.7)
Current liabilities										
Borrowings	(35.8)	–	–	–	(1.3)	–	–	–	–	(37.1)
Other payables	(1,194.1)	62.8	–	(12.4)	(0.4)	–	32.4	–	–	(1,111.7)
Corporation tax liability	(159.4)	–	–	–	–	–	–	–	–	(159.4)
Other provisions for liabilities and charges	(105.8)	–	–	–	–	–	–	–	–	(105.8)
	(1,495.1)	62.8	–	(12.4)	(1.7)	–	32.4	–	–	(1,414.0)
Total liabilities	(2,603.1)	62.8	–	(92.9)	(18.3)	(97.7)	(11.0)	1.5	–	(2,758.7)
Net liabilities	(716.4)	62.8	1.2	(93.2)	(0.4)	(97.7)	22.7	6.4	–	(814.6)
Equity										
Capital and reserves										
Share capital	110.4	–	–	–	–	–	–	–	–	110.4
Share premium account	445.8	–	–	–	–	–	–	–	–	445.8
Capital redemption reserve	495.8	–	–	–	–	–	–	–	–	495.8
Foreign exchange reserve	–	–	–	–	–	–	–	–	–	–
Other reserves	255.7	–	–	0.6	(18.1)	–	–	–	(35.6)	202.6
Retained earnings	(2,091.7)	62.8	1.2	(88.5)	17.7	(97.7)	22.7	4.2	35.6	(2,133.7)
	(784.0)	62.8	1.2	(87.9)	(0.4)	(97.7)	22.7	4.2	–	(879.1)
Minority interests (equity)	67.6	–	–	(5.3)	–	–	–	2.2	–	64.5
Total equity	(716.4)	62.8	1.2	(93.2)	(0.4)	(97.7)	22.7	6.4	–	(814.6)

33. Transition to IFRS (continued)

Group reconciliation of equity as at 31 March 2005

	UKGAAP £m	Dividends £m (i)	Acquisitions £m (ii)	Employee benefits £m (iii)	Property and leases £m (iv)	Convertible bond £m (v)	Other financial instruments £m (vi)	Tax £m (vii)	Reclassifications £m (viii)	IFRS £m
Non-current assets										
Music copyrights and intangibles	402.8	–	1.8	–	–	–	–	–	–	404.6
Goodwill	33.2	–	1.9	–	–	–	–	–	–	35.1
Property, plant & equipment	183.1	–	–	–	16.9	–	–	–	–	200.0
Investment in associates	8.1	–	0.4	–	–	–	–	–	–	8.5
Other investments	14.8	–	–	–	–	–	0.1	–	2.7	17.6
Deferred taxation	17.7	–	–	–	–	–	–	12.2	–	29.9
Financial derivatives	–	–	–	–	–	–	39.0	–	–	39.0
Other receivables	–	–	–	–	–	–	–	–	6.6	6.6
	659.7	–	4.1	–	16.9	–	39.1	12.2	9.3	741.3
Current assets										
Inventories	28.2	–	–	–	–	–	–	–	–	28.2
Advances	336.0	–	–	–	–	–	–	–	–	336.0
Trade receivables	300.1	–	–	–	–	–	–	–	–	300.1
Corporation tax recoverable	21.2	–	–	–	–	–	–	–	–	21.2
Other receivables	125.3	–	–	(6.9)	–	–	0.6	–	(9.3)	109.7
Investments: liquid funds	1.6	–	–	–	–	–	–	–	–	1.6
Cash and cash equivalents	240.9	–	–	–	–	–	–	–	–	240.9
	1,053.3	–	–	(6.9)	–	–	0.6	–	(9.3)	1,037.7
Total assets	1,713.0	–	4.1	(6.9)	16.9	–	39.7	12.2	–	1,779.0
Non-current liabilities										
Borrowings	(1,042.0)	–	–	–	(15.9)	16.1	(26.9)	–	–	(1,068.7)
Other payables	(10.2)	–	–	–	–	–	–	–	–	(10.2)
Deferred taxation	(9.7)	–	–	–	–	–	–	1.5	–	(8.2)
Pension provisions	(31.9)	–	–	(68.2)	–	–	–	–	–	(100.1)
Financial derivatives	–	–	–	–	–	(83.2)	(9.6)	–	–	(92.8)
	(1,093.8)	–	–	(68.2)	(15.9)	(67.1)	(36.5)	1.5	–	(1,280.0)
Current liabilities										
Borrowings	(30.0)	–	–	–	(1.3)	–	–	–	–	(31.3)
Other payables	(1,132.4)	63.1	–	(11.4)	(0.8)	–	21.4	–	–	(1,060.1)
Corporation tax liability	(160.3)	–	–	–	–	–	–	–	–	(160.3)
Other provisions for liabilities and charges	(43.6)	–	–	–	–	–	–	–	–	(43.6)
	(1,366.3)	63.1	–	(11.4)	(2.1)	–	21.4	–	–	(1,295.3)
Total liabilities	(2,460.1)	63.1	–	(79.6)	(18.0)	(67.1)	(15.1)	1.5	–	(2,575.3)
Net liabilities	(747.1)	63.1	4.1	(86.5)	(1.1)	(67.1)	24.6	13.7	–	(796.3)
Equity										
Capital and reserves										
Share capital	110.6	–	–	–	–	–	–	–	–	110.6
Share premium account	447.3	–	–	–	–	–	–	–	–	447.3
Capital redemption reserve	495.8	–	–	–	–	–	–	–	–	495.8
Foreign exchange reserve	–	–	–	–	–	–	–	–	3.8	3.8
Other reserves	252.2	–	–	0.6	(17.4)	–	–	–	(31.4)	204.0
Retained earnings	(2,101.3)	63.1	4.1	(82.9)	16.3	(67.1)	24.6	8.5	27.6	(2,107.1)
	(795.4)	63.1	4.1	(82.3)	(1.1)	(67.1)	24.6	8.5	–	(845.6)
Minority interests (equity)	48.3	–	–	(4.2)	–	–	–	5.2	–	49.3
Total equity	(747.1)	63.1	4.1	(86.5)	(1.1)	(67.1)	24.6	13.7	–	(796.3)

Impact of IFRS on the consolidated financial statements

Below are explanations for each of the UK GAAP to IFRS accounting policy changes that give rise to the principal differences to net assets or profits on adoption of IFRS:

(i) **Dividends**

Under IAS 10 *Events After the Balance Sheet Date*, dividends proposed or declared cannot be recognised until they are authorised and no longer at the discretion of the Group. The effect of this on the Group is that the final dividend relating to any particular financial year cannot be accounted for until the following financial year. The impact of this change on the Balance Sheet and Equity is £62.8m as at 1 April 2004 and £63.1m as at 31 March 2005.

(ii) **Acquisitions**

The Group has taken the exemption granted by IFRS 1 and applied IFRS 3 for acquisitions after 31 March 2003. The key effect of the adoption of IFRS 3 upon the Group's accounting has been the Group ceasing annual goodwill amortisation and instead testing for impairment annually. The impact of this change in accounting policy is to reverse goodwill amortisation and so increase profit for the year ended 31 March 2005 by £2.9m.

33. Transition to IFRS (continued)

(iii) Employee benefits, including share-based payments

Under UK GAAP, pension costs, which were determined in accordance with SSAP 24 *Accounting for Pension Costs*, were charged to the profit and loss account so as to spread the cost of pensions over the working lives of the employees within the Group. Valuation surpluses or deficits were amortised over the expected remaining working life within the Group of the relevant employees.

The main impact of IAS 19 *Employee Benefits* is to bring the surpluses or deficits of the Group's defined benefit pension schemes onto the balance sheet. In addition, certain employee benefits earned but not yet paid or used need to be accrued on the balance sheet. The impact of this change in accounting policy on the income statement for the year ended 31 March 2005 is an additional charge to profit from operations of £(7.5)m and a net credit to finance charges of £9.5m. In addition, this has resulted in the inclusion on the balance sheet of a liability of £93.2m at 1 April 2004 and £86.5m at 31 March 2005.

IFRS 2 *Share-based Payment* requires an expense to be recognised where the Group buys services in exchange for shares or rights over shares ('equity-settled transactions'). The main impact of IFRS 2 on the Group is the expensing of employees' and Directors' share options and other share-based incentives at fair value over the vesting period of the award. The Group has taken advantage of the transitional provisions of IFRS 2 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested as at 1 January 2005. The impact of this change in accounting policy is to increase profit for the year ended 31 March 2005 by £0.1m.

(iv) Property and leases

Under IAS 16, the impairment on previously revalued property charged directly to the revaluation reserve under UK GAAP must now be expensed through the income statement. The impact of this is to decrease profit for the year ended 31 March 2005 by £18.5m.

Following the adoption of IAS 17 *Leases*, one lease entered into by the Group has been reclassified from an operating lease to a finance lease. In addition, a lease incentive is being released over the full lease term instead of the shorter period over which it was being released under UK GAAP. The impact of these changes in accounting policy is to decrease profit for the year ended 31 March 2005 by £0.8m, to include property on the balance sheet of £17.9m at 1 April 2004 and £16.9m at 31 March 2005, and to include a finance lease liability on the balance sheet of £17.9m at 1 April 2004 and £17.2m at 31 March 2005.

(v) Convertible bond

IAS 32 *Financial Instruments: Disclosure and Presentation* and IAS 39 *Financial Instruments: Recognition and Measurement* have significantly changed the accounting for borrowings, finance charges and other financial instruments. For the Group's convertible bond, amounts received from the issue have been split between debt and derivative components. The difference between the debt portion of the convertible and the principal is amortised as a finance charge over the life of the convertible. The impact of this change is to decrease profit for 2005 by £2.0m and reduce borrowings by £18.1m at 31 March 2005 (1 April 2004: £18.6m).

In addition, a derivative must now be recognised on the balance sheet at fair value for the eventual conversion of the debt into a fixed number of EMI Group plc Ordinary Shares (31 March 2004: £116.3m, 31 March 2005: £83.2m). Any movements in the fair value, excluding the impact of foreign exchange movements, are reported as finance charges (2005: £31.2m income).

(vi) Other financial instruments

Under IAS 32 and IAS 39, the principal accounting changes relate to the following financial instruments:

- Interest rate swaps: the Group has adopted hedge accounting in respect of 'fixed to floating' interest rate swaps held as hedges against fixed interest rate borrowings. The interest rate swaps are revalued to fair value with a corresponding adjustment to borrowings. A credit to finance charges of £1.7m for the year ended 31 March 2005 has been recorded due to a small amount of hedge ineffectiveness;
- Embedded derivative: on or after 15 October 2008, the Group may redeem all or part of the €425m 8.625% senior notes at redemption prices (plus accrued interest) fixed for the 12-month period starting at the date shown above. A financial derivative asset must be recognised on the balance sheet at the fair value of this embedded call feature (1 April 2004: £22.3m, 31 March 2005: £22.1m). Any movements in the fair value are reported as finance charges (2005: £0.2m charge);
- Swap unwind: in 2003, the Group unwound a swap position resulting in a gain of £55.6m, which was deferred and is being released over the scheduled remaining life of the borrowing. Under IFRS, this deferred gain has been reclassified from creditors to borrowings, resulting in an opening balance adjustment of £32.4m;
- Foreign exchange on borrowings: the Group's High Yield Euro bond cannot be classified as a net investment hedge under IFRS and hence the exchange loss on this borrowing of £9.5m for the year ended 31 March 2005 can no longer be recorded directly in reserves but, instead, is booked as a finance charge;
- Listed investments: those which have been designated as fair value through profit and loss have been revalued to fair value, with the increase in value of £0.2m for the year ended 31 March 2005 being booked to profit from operations.

(vii) Tax

Due to the introduction of IAS 12 *Income Taxes* and the changes in accounting policies from the introduction of IFRS, corresponding adjustments have occurred in the calculation of income taxes. The impact on tax of these changes in accounting policies is to increase profit after taxation for the year ended 31 March 2005 by £7.3m, £7.6m of which relates to the tax credit on the impairment of property.

No tax has been provided in respect of the gain on the convertible bond derivative of £31.2m, as tax legislation is not yet finalised.

(viii) Reclassifications

Under IFRS, the classification of Current Assets is defined as being the operating cycle of the company. As such, the Group has reclassified certain assets between current and non-current on the balance sheet. This includes a number of investments which have been classified, under the provisions of IAS 39, as either fair value though profit and loss, held-to-maturity or available-for-sale. Those investments classified as held-to-maturity or available-for-sale are deemed non-current, whereas those classified as fair value through profit and loss are deemed current. A number of classifications have also been made between reserves in order to show the foreign exchange reserve separately and to absorb the UK GAAP revaluation reserve, which is no longer required under IFRS, into retained earnings.

The expenses that the Group incurs and the share of the income that the Group earns from the sale of goods by the jointly controlled operations are included in the income statement. Under UK GAAP, the Group's share of profits from joint marketing arrangements was included within other operating income. The impact of this reclassification is to increase revenue by £58.4m, increase cost of sales by £(22.2)m, increase distribution costs by £(0.7)m and reduce other operating income by £(35.5)m.

Company auditor's report

Independent auditor's report to the members of EMI Group plc
We have audited the parent company financial statements of EMI Group plc for the year ended 31 March 2006 which comprises the Company balance sheet, Company accounting policies and the related notes 34 to 44. These parent company financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Remuneration report that is described as having been audited.

We have reported separately on the Group financial statements of EMI Group plc for the year ended 31 March 2006.

This report is made solely to the Company's members, as a body, in accordance with Section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an Auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors
The Directors are responsible for preparing the Annual Report, the Remuneration report and the parent company financial statements in accordance with applicable United Kingdom law and Accounting Standards (United Kingdom Generally Accepted Accounting Practice) as set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent company financial statements and the part of the Remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the parent company financial statements give a true and fair view, the parent company financial statements and the part of the Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and that the information given in the parent company Directors' report is consistent with the financial statements.

We also report to you if, in our opinion, the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent company financial statements. The other information comprises only the unaudited part of the Remuneration report, the Chairman's statement and the Operating and Financial Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements and the part of the Remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the parent company financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the parent company financial statements and the part of the Remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the parent company financial statements and the part of the Remuneration report to be audited.

Opinion
In our opinion:
- the parent company financial statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 March 2006;
- the parent company financial statements and the part of the Remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' report is consistent with the parent company financial statements.

Ernst & Young LLP
Registered auditor
London
22 May 2006

Company accounting policies

Basis of preparation
As used in the financial statements and related notes, the term 'Company' refers to EMI Group plc. The separate financial statements of the Company are presented as required by the Companies Act 1985. As permitted by the Act, the separate financial statements have been prepared in accordance with UK GAAP.

The financial statements have been prepared under the historical cost convention. The principal accounting policies adopted are set out below. By virtue of Section 230 of the Companies Act, the results for the years ended 31 March 2006 and 31 March 2005 represent continuing operations.

As permitted by section 230 of the Companies Act 1985, the Company has elected not to present its own profit and loss account for the year.

Restatement due to changes in accounting policy
The 2005 accounts previously reported have been restated for the adoption of FRS 20 *Share-based Payment*, FRS 21 *Events After Balance Sheet Date*, FRS 25 *Financial Instruments – Disclosure and Presentation* and FRS 26 *Financial Instruments – Measurement*.

Foreign currencies
Transactions denominated in foreign currencies are recorded at the rates of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated into Sterling either at year end rates or, where there are related forward foreign exchange contracts, at contract rates. The resulting exchange differences are dealt with in the determination of profit for the financial year.

Turnover
Turnover represents the invoiced value or contracted amount of goods and services supplied by the Company. Turnover is stated net of actual product returns and excludes value added tax and similar sales-related taxes. Provision is also made in respect of expected future returns of goods and services supplied by the Company and its subsidiaries prior to the balance sheet date.

Retirement benefits
Retirement benefits are accounted for under FRS 17 *Retirement Benefits*. The Company operates both defined benefit and defined contribution schemes for its employees. The Company is unable to identify its share of the underlying assets and liabilities of its defined benefit schemes and so, in accordance with FRS 17, the Company accounts for them as defined contribution schemes.

Tangible fixed assets
Assets are held at depreciated historical cost.

Depreciation of tangible fixed assets is calculated on cost at rates estimated to write off the cost, less the estimated residual value of the relevant assets, by equal annual amounts over their expected useful lives; effect is given, where necessary, to commercial and technical obsolescence. The annual rates used are:

Freehold buildings and long-term leasehold property	2%
Short-term leasehold property	Period of lease
Plant, equipment and vehicles	10–33⅓%

The carrying values of tangible fixed assets are reviewed for impairment in periods if events or changes in circumstances indicate the carrying value may not be recoverable.

Taxation
The Company has undertaken to discharge the liability to corporation tax of the majority of its wholly owned UK subsidiaries. Their UK tax liabilities are, therefore, dealt with in the accounts of the Company.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date, where transactions or events have occurred at the date that will result in an obligation to pay more tax, or right to pay less, or to receive more tax with the following exceptions:

- Provision is made for tax on gains arising from the revaluation (and similar fair value adjustments) of fixed assets, or gains on disposal of fixed assets, only to the extent that, at the balance sheet date, there is a binding agreement to dispose of the assets concerned. However, no provision is made where, on the basis of all available evidence at the balance sheet date, it is more likely than not that the taxable gain will be rolled over into replacement assets.
- Provision is made for gains which have been rolled over into replacement assets only to the extent that, at the balance sheet date, there is a commitment to dispose of the replacement assets. Provision is made for deferred tax that would arise from remittance of the retained earnings of overseas subsidiaries, associates and joint ventures only to the extent that, at the balance sheet date, dividends have been accrued as receivable.
- Deferred tax assets are recognised only to the extent that the Directors consider that it is more likely than not that there will be suitable taxable profits from which the underlying timing differences can be deducted.

Financial instruments
As described further in Note 37, financial instruments for the year ended 31 March 2006 are reported in accordance with FRS 26 *Financial Instruments: Measurement*. The accounting policies for both years are set out below:

The Company uses derivative financial instruments such as interest rate swaps and foreign currency contracts to hedge risks associated with interest and exchange rate fluctuations. Such derivative financial instruments are stated at fair value. The fair values of interest rate swaps and foreign currency contracts are determined by reference to market rates for similar instruments.

For the purpose of hedge accounting, hedges are classified as either: fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability; or cash flow hedges where they hedge exposure to variability in cash flows that is attributable to either a particular risk associated with a recognised asset or liability or a forecast transaction.

In relation to fair value hedges (e.g. fixed to floating interest rate swaps held as fair value hedges against fixed interest rate borrowings) which meet the conditions for hedge accounting, any gain or loss from remeasuring the hedging instrument at fair value is recognised immediately in the profit and loss account. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the profit and loss account.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the profit and loss account.

This policy has been applied retrospectively to the prior year financial statements.

Share-based payments
The share option programme allows certain Company employees to acquire shares of the Company. The fair value of options granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at grant date and the expense is spread over the period during which the employees become unconditionally entitled to the options. The fair value of the options granted is measured using a binomial lattice model, taking into account the terms and conditions upon which the options were granted.

The amount recognised as an expense reflects the extent to which the vesting period has expired and the Group's best estimate of the number of awards that will ultimately vest. No expense is recognised for awards that do not ultimately vest, except for awards where the vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

The Company has applied the requirements of FRS 20 *Share-based Payment* which is effective for accounting periods beginning on or after 1 January 2005 and, as such, has been applied to these accounts. Under FRS20, the cost of equity-settled transactions with employees is recognised in the profit and loss account over their vesting period by reference to the fair value of the date at which they were granted. The charge is only calculated on awards made after 7 November 2002 as a result of the transition option applied by the Company.

Events after the balance sheet date
FRS 21 is effective for accounting periods beginning on or after 1 January 2005 and as such has been applied for the first time to these accounts. Under FRS 21, the charge and liability for the final proposed dividend are not recognised in accounts until approved by the shareholders at the AGM. Previously, the dividend was recognised when proposed by the Directors.

Company balance sheet
at 31 March 2006

	Notes	2006 £m	2005 Restated £m
Fixed assets			
Tangible fixed assets	34	22.0	23.3
Investments: subsidiary undertakings	35	2,256.9	2,225.0
Investments: associated undertakings	35	0.6	0.6
Other fixed asset investments	35	0.2	0.3
		2,279.7	2,249.2
Current assets			
Debtors: amounts falling due within one year	36	2,523.8	2,507.6
Cash at bank and in hand and cash deposits		2.3	1.3
		2,526.1	2,508.9
Creditors: amounts falling due within one year			
Other creditors	38	(153.7)	(168.1)
		(153.7)	(168.1)
Net current assets		2,372.4	2,340.8
Total assets less current liabilities		4,652.1	4,590.0
Creditors: amounts falling due after more than one year			
Borrowings	37	(621.6)	(621.8)
Other creditors	38	(817.2)	(792.6)
		(1,438.8)	(1,414.4)
Provisions for liabilities and charges	40	(2.1)	(2.3)
Net assets		3,211.2	3,173.3
Capital and reserves			
Called-up share capital	41	110.7	110.6
Share premium account	41	447.8	447.3
Capital redemption reserve	42	495.8	495.8
Other reserves	42	403.1	400.7
Profit and loss reserve (including goodwill previously written off)	42	1,753.8	1,718.9
Equity shareholders' funds		3,211.2	3,173.3

Eric Nicoli
Martin Stewart
Directors
22 May 2006

Notes to the Company financial statements
for the year ended 31 March 2006

34. Tangible fixed assets

	Freehold property £m	Leasehold property £m	Plant, equipment and vehicles £m	Total £m
Cost at 31 March 2005	4.4	24.0	2.5	30.9
Additions	–	0.4	–	0.4
Disposals and transfers	–	–	–	–
Cost at 31 March 2006	4.4	24.4	2.5	31.3
Depreciation at 31 March 2005	0.8	4.9	1.9	7.6
Charge for the year	0.1	1.6	–	1.7
Disposals and transfers	–	–	–	–
Depreciation at 31 March 2006	0.9	6.5	1.9	9.3
Net book values at 31 March 2006	3.5	17.9	0.6	22.0
31 March 2005	3.6	19.1	0.6	23.3

35. Fixed asset investments

	2006 £m	2005 £m
Investments comprise:		
Subsidiary undertakings (i)	2,256.9	2,225.0
Associated undertakings (ii)	0.6	0.6
Other fixed asset investments (iii)	0.2	0.3
	2,257.7	2,225.9
Comprising:		
Unlisted investments	2,257.7	2,225.9
	2,257.7	2,225.9

(i) Investments in subsidiary undertakings

	Cost of shares £m	Loans £m	Provisions £m	Net book value £m
At 31 March 2005	2,027.0	318.5	(120.5)	2,225.0
Additions	–	32.2	–	32.2
Disposals, transfers and other movements	–	(0.3)	–	(0.3)
At 31 March 2006	2,027.0	350.4	(120.5)	2,256.9

The principal subsidiary undertakings set out below are those which were held by the Company at 31 March 2006 and, in the opinion of the Directors, significantly affected the Group's results and net assets during the year. Except where otherwise stated, the country of incorporation is England, the operations are within the United Kingdom, the shares are in equity share capital and the businesses are wholly owned.

EMI Music and EMI Music Publishing
Capitol-EMI Music, Inc. (USA)
Capitol Records, Inc. (USA)
Chrysalis Records Ltd
EMI Music Germany GmbH & Co. KG
EMI Entertainment World, Inc.
EMI Music Australia Pty Ltd
EMI Music France S.A.
EMI Music Italy SpA
EMI Music Publishing Ltd
EMI Records Ltd
Jobete Music Co., Inc. (USA)
Priority Records, LLC (USA)
Toshiba-EMI Ltd (Japan)(55% owned)
Virgin Records America, Inc. (USA)
Virgin Records Ltd

Corporate
EMI Group Finance Ltd*
EMI Group Finance (Jersey) Ltd*
EMI Group Holdings (UK) Ltd
EMI Group International Holdings Ltd
EMI Group North America Holdings, Inc. (USA)
EMI Group North America, Inc. (USA)
EMI Group Worldwide Ltd
Virgin Music Group Ltd*
*Held directly by the Company.

(ii) Investments in associated undertakings

	Cost of shares £m	Provisions £m	Net book value £m
At 31 March 2005	0.7	(0.1)	0.6
At 31 March 2006	0.7	(0.1)	0.6

The Company holds investments at cost, less provisions for diminution in value.

(iii) Other fixed asset investments

	Cost of shares £m	Provisions £m	Net book value £m
At 31 March 2005	2.5	(2.3)	0.2
Currency retranslation	–	–	–
Purchases	0.1	(0.1)	–
Disposals and reclassifications	–	–	–
At 31 March 2006	2.6	(2.4)	0.2

36. Debtors

	2006 £m	2005 Restated £m
Due within one year:		
Amounts owed by subsidiary undertakings	2,473.6	2,459.5
Financial derivatives	41.3	39.1
Other debtors	7.2	8.2
Prepayments and accrued income	1.7	0.8
Total	2,523.8	2,507.6

37. Borrowings

	2006 £m	2005 Restated £m
Non-current		
£325m 8.25% Sterling bonds	323.1	322.1
€425m 8.625% senior notes	300.0	301.6
Long-term committed facilities*	(1.5)	(1.9)
	621.6	621.8
Current		
Current borrowings	–	–
	–	–
Total borrowings	621.6	621.8

* Includes issue costs of syndicated loan facility of £1.5m (2005: £1.9m).

The fair value of publicly traded borrowings has been calculated using the appropriate market prices at the balance sheet date. For the borrowings which are not publicly traded, the fair value has been calculated by discounting their future cash flows at the appropriate market rate. The Directors estimate the fair value of the Company's borrowings to be as follows:

	Book value 2006 £m	Book value 2005 Restated £m	Fair value 2006 £m	Fair value 2005 £m
£325m 8.25% Sterling bonds	323.1	322.1	348.0	349.9
€425m 8.625% senior notes	300.0	301.6	368.1	347.0
Long-term committed facilities	(1.5)	(1.9)	(1.5)	(1.9)
	621.6	621.8	714.6	695.0

Year ended 31 March 2006

	Current coupon rate	Effective interest rate	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total £m
Non-current									
£325m 8.25% Sterling bonds	9.75%	9.92%	–	–	323.1	–	–	–	323.1
€425m 8.625% senior notes	8.625%	8.94%	–	–	–	–	–	300.0	300.0
Long-term committed facilities			–	–	–	–	(1.5)	–	(1.5)
			–	–	323.1	–	(1.5)	300.0	621.6
Current			–	–	–	–	–	–	–
Total borrowings			–	–	323.1	–	(1.5)	300.0	621.6

Year ended 31 March 2005

	Current coupon rate	Effective interest rate	Within 1 year £m	1–2 years £m	2–3 years £m	3–4 years £m	4–5 years £m	More than 5 years £m	Total Restated £m
Non-current									
£325m 8.25% Sterling bonds	9.75%	9.92%	–	–	–	322.1	–	–	322.1
€425m 8.625% senior notes	8.625%	8.94%	–	–	–	–	–	301.6	301.6
Long-term committed facilities			–	–	(1.9)	–	–	–	(1.9)
			–	–	(1.9)	322.1	–	301.6	621.8
Current			–	–	–	–	–	–	–
Total borrowings			–	–	(1.9)	322.1	–	301.6	621.8

In July 2005, the Group signed a new £450m revolving credit facility with a group of banks. This facility replaced a revolving credit facility (£250m), a 364 day facility (£100m) and enabled a subsidiary to repay the US$123.8m 6.96% senior notes. In addition, two bilateral facilities (£40m) were not renewed. This resulted in exceptional refinancing costs of £5.2m (2005: £nil) of which £3.5m was in respect of issue and repayment costs of the US$123.8m 6.96% senior notes and £1.7m in respect of issue costs relating to the £250m revolving credit facility.

On 11 March 2003, Moody's Investor Service downgraded the Group's credit rating from Baa2 to Ba1. As a consequence, the coupon of the £325m 8.25% Sterling bonds was increased from 8.25% to 9.75% with effect from 20 May 2003.

The Company holds equivalent Euro nominal value interest rate swaps matching the coupon and the term of the €425m 8.625% senior notes effectively converting the interest basis of the issue to floating rate (set in arrears).

Under their banking arrangements, overdraft and cash balances of the Company and of certain subsidiaries are pooled or offset and cross-guaranteed. Such pooling and offsets are reflected in the Company balance sheet as appropriate.

38. Other creditors: amounts falling due within one year

	2006 £m	2005 Restated £m
Amounts owed to subsidiary undertakings	11.2	11.4
Amounts owed to associated undertakings	0.6	0.6
Corporate taxation	13.8	25.3
Other taxes including VAT and social security costs	–	0.2
Financial derivatives	88.7	83.2
Other creditors	32.1	38.4
Accruals and deferred income	9.3	11.0
Total	153.7	168.1

39. Other creditors: amounts falling due after more than one year

	2006 £m	2005 £m
Amounts owed to subsidiary undertakings	817.2	792.6
Total	817.2	792.6

40. Other provisions for liabilities and charges

	Trading £m	Disposal and fundamental reorganisation £m	Total £m
At 31 March 2004	3.1	0.4	3.5
Provisions utilised	(0.8)	(0.4)	(1.2)
Charged against profit from operations	–	–	–
At 31 March 2005	2.3	–	2.3
Provisions utilised	(0.2)	–	(0.2)
Charged against profit from operations	–	–	–
At 31 March 2006	2.1	–	2.1

Trading
Trading provisions are charged through profit from operations before operating exceptional items and amortisation. They also include restructuring and reorganisation provisions charged through operating exceptional items.

Disposal and fundamental reorganisation
This provision related to property reorganisation costs.

41. Share capital and share premium

	Authorised 2006 £m	Authorised 2005 £m	Allotted, called-up & fully paid 2006 £m	Allotted, called-up & fully paid 2005 £m
Ordinary Shares of 14p each	158.8	158.8	110.7	110.6
B Shares of 114.5p each	479.8	479.8	–	–
Deferred Shares of 0.0005p each	17.5	17.5	–	–
	656.1	656.1	110.7	110.6

(i) Ordinary Shares in issue

	Number	Nominal value £m	Premium £m
At 31 March 2005	789,698,747	110.6	447.3
Shares issued during the year on the exercise of options:			
Executive schemes	387,200	–	0.5
Savings-related scheme	96,228	–	–
Scrip Dividend scheme	710,917	0.1	–
At 31 March 2006	790,893,092	110.7	447.8

As at 31 March 2006, the Company had authority to purchase 78,970,403 of its Ordinary Shares: this authority will expire on 13 October 2006 or at the conclusion of the Annual General Meeting in 2006, whichever is the earlier.

41. Share capital and share premium (continued)

(ii) Share options
Options to subscribe for the Company's Ordinary Shares were outstanding as follows (adjusted for the 1998 demerger and the 1997 share capital reorganisation, where appropriate):

Subscription Options

	Executive Share Option Schemes	1994 and 2004 Savings-Related Share Option Schemes
At 31 March 2005	36,578,669	3,480,044
Granted	5,149,072	294,138
Exercised	(387,200)	(96,928)
Lapsed	(3,773,091)	(328,394)
At 31 March 2006	37,567,450*	3,348,858
Option price per 14p share (range)	119.25–700p	119.25–700p
Final exercise date*	31 January 2015	28 February 2010

*Of which, options over 14,519,893 shares were granted under the 2003 Executive Share Incentive Plan.

Share options for the transfer of the Company's Ordinary Shares were outstanding as follows:

Transfer Options

	Executive Share Option Schemes
At 31 March 2005	23,142,868
Granted	253,331
Exercised	–
Lapsed	(2,303,725)
At 31 March 2006	21,092,474**
Option price per 14p share (range)	119.25-700p
Final exercise date*	17 June 2014

*Options granted under the 1995 Executive Share Option Scheme are normally exercisable no earlier than three years and no later than ten years following the date of grant, and are subject to the achievement of performance requirements that must be met before the options normally become exercisable. Options granted under the 2003 Executive Share Incentive Plan, if subject to a pre-vesting performance requirement, are normally exercisable between three and ten years following the date of grant but only if and to the extent that the pre-vesting target has been satisfied. Options granted with pre-grant conditions normally become exercisable in no fewer than four annual tranches commencing no earlier than the second anniversary of the grant date. Options granted under the 1994 and 2004 Savings-Related Share Option Schemes are normally exercisable for a six-month period following completion of savings to either a three year or a five year savings contract.
**Of which options over 6,017,822 shares were granted under the 2003 Executive Share Incentive Plan

(iii) Convertible bond
US$243.3m 5.25% guaranteed convertible bonds include options to convert into 78,859,870 14p Ordinary Shares.

(iv) Share premium account
The principal elements that make up the Company's share premium account arose as follows:

	Years arising	£m
Conversions to Ordinary Shares of 7% Convertible Redeemable Second Cumulative Preference Shares 1992/99 of £1 each	1989/90 and 1990/91	50.7
A placing of Ordinary Shares linked to the offer for Thames Television	1990/91	78.0
Issue of Ordinary Shares on exercise of subscription rights of warrants originally attached to 7¾% bonds due 1992; and	1991/92	67.1
the transfer from other reserves in respect of amounts paid for the warrants exercised	1991/92	10.2
Issue of Ordinary Shares on conversion of Convertible Unsecured Loan Stock to fund the acquisition of Virgin Music Group	1992/93	508.4
Issue of Ordinary Shares on conversion of 5¾% Guaranteed Redeemable Preference Shares 2004 of THORN EMI Capital NV	1993/94	126.0
Share capital reorganisation (including issue of Redeemable Preference B Shares)	1997/98	(501.2)
Other issues of Ordinary Shares		102.6
Balance at 31 March 2006		447.8

42. Reserves

	Capital redemption reserve £m	Other reserves £m	Profit and loss reserve £m
At 31 March 2004 – as reported	495.8	402.1	1,706.8
Prior year adjustment	–	(0.1)	(31.5)
At 31 March 2004 – restated	495.8	402.0	1,675.3
Profit attributable to members of the holding company	–	–	104.7
Equity dividend	–	–	(62.9)
Purchase of shares by ESOP	–	(0.3)	–
Share-based payment charge for year	–	–	0.8
ESOP reserve movements	–	1.7	(1.7)
Transfer of realised reserves	–	(2.7)	2.7

42. Reserves (continued)

	Capital redemption reserve £m	Other reserves £m	Profit and loss reserve £m
At 31 March 2005 (as restated)	495.8	400.7	1,718.9
Profit attributable to members of the holding company	–	–	93.4
Gains on foreign currency borrowings	–	–	4.5
Equity dividend	–	–	(62.9)
Scrip dividend	–	–	1.7
Purchase of shares by ESOP	–	(0.5)	–
Share-based payment charge for year	–	–	1.1
ESOP reserve movements	–	2.9	(2.9)
Transfer of realised reserves	–	–	–
At 31 March 2006	495.8	403.1	1,753.8

As permitted by section 230 of the Companies Act 1985, the Company has elected not to present its own profit and loss account for the year. EMI Group plc reported a profit for the financial year ended 31 March 2006 of £93.4m (2005: a profit of £104.7m). The auditor's remuneration for audit services to the Company was £0.6m (2005: £0.5m). Details of Executive and Non-executive Directors' emoluments and their interest in shares and options of the Company are included in the Remuneration report.

The actual expense recognised for equity settled share-based payment in respect of employee services received during the year to 31 March 2006 is £1.1m (2005: £0.8m).

Restatement due to change in accounting policy
The 2005 accounts previously reported have been restated for the adoption of FRS 20, FRS 21, FRS 25 and FRS 26 as follows: profit for the year has increased by £35.5m, The net impact is to increase 'shareholders' funds' as at 31 March 2005 by £2.7m.

(i) Capital redemption reserve
The capital redemption reserve represents the reduction in distributable reserves for the amount paid to redeem preference B shares as part of the share capital reorganisation.

(ii) Other reserves
Other reserves of the Company contain a special reserve which reflects the share premium account reduction of July 1988 and unrealised profits on disposal of investments.

The EMI Group General Employee Benefit Trust (EBT) was established to hedge the future obligations of the Group in respect of shares awarded under the Senior Executive Incentive Plans. The Trustee of the EBT, EMI Group EBT (Guernsey) Limited, purchases the Company's Ordinary Shares in the market with financing provided by the Company, as required, on the basis of regular reviews of the anticipated share liabilities of the Group. The EBT has, since December 1998, waived any entitlement to the receipt of dividends in respect of all of its holding of the Company's Ordinary Shares. The EBT's waivers may be revoked or varied at any time.

	2006		2005	
	Shares held in trust No.	Cost £m	Shares held in trust £m	Cost £m
Beginning of the year	3,840,515	16.6	4,082,771	18.0
Shares purchased	226,513	0.5	142,721	0.3
Shares vested	(675,106)	(2.9)	(384,977)	(1.7)
End of the year	3,391,922	14.2	3,840,515	16.6

At 31 March 2006, the outstanding loan by the Company to the EBT to finance the purchase of Ordinary Shares was £14.6m (2005: £16.9m). The market value at 31 March 2006 of the Ordinary Shares held in the EBT, which are listed in the UK, was £8.6m (2005: £11.3m). All shares held in the EBT are either under option to employees or conditionally gifted to them.

43. Pensions

As noted in the Company accounting policies, the Company is a member of the EMI Group Pension Fund (UK fund), a defined benefit pension scheme for EMI Group plc and its subsidiaries in the UK. As the Company is unable to identify its share of the underlying assets and liabilities of the UK fund, in accordance with FRS 17 it has accounted for it as a defined contribution scheme. The cost of contributions by the Company to the UK fund during the year was £1.0m.

As at 31 March 2006, the UK fund had Scheme assets with a fair value of £963m and a present value of defined benefit obligations of £951m resulting in a net pension asset of £12m. The date of the last actuarial valuation of scheme assets and obligations was 31 March 2006, and was based on the projected unit method.

The cost of contributions to defined contribution schemes during the year was £0.1m (2005: £nil).

44. Dividends (equity)

	2006 Per share	2005 Per share	2006 £m	2005 £m
Ordinary dividends:				
2005/2004 final dividend	6.0	6.0	47.2	47.1
2005/2004 interim dividend	2.0	2.0	15.7	15.8
Total	8.0	8.0	62.9	62.9

Group five year summary

Results for periods ending on or before 31 March 2004 have not been restated following the conversion to International Financial Reporting Standards on 1 April 2004. See Note 33 to the financial statements for details of the principal adjustments made to bring the UK GAAP results for the year ended 31 March 2005 in line with the accounting policy changes required for the Group to comply with IFRS.

	2005 £m	2005 Restated £m	2004 £m	2003 £m	2002 £m
Results					
Revenue	2,079.9	2,001.2	2,120.7	2,175.4	2,445.8
Group profit from operations before exceptional items and amortisation	250.5	225.1	249.3	254.7	190.9
Exceptional items	4.0	(17.5)	(138.3)	(21.1)	(242.4)
Amortisation and impairment	(49.9)	(48.0)	(50.9)	(42.8)	(51.3)
Share of profit from joint ventures	–	–	–	0.4	34.3
Share of profit from associates	1.0	1.1	(0.3)	0.2	(1.1)
Profit (loss) from operations:	205.6	160.7	59.8	191.4	(69.6)
Non-operating exceptional items:					
(Losses) on disposal or closure of business	–	–	(40.4)	(25.2)	–
Gains on disposal of fixed assets and investments	–	–	23.9	234.9	–
Profit (loss) before finance charges	205.6	160.7	43.3	401.1	(69.6)
Finance charges	(87.5)	(61.9)	(96.1)	(77.8)	(83.2)
Profit (loss) before taxation	118.1	98.8	(52.8)	323.8	(152.8)
Taxation	(28.1)	(23.9)	(19.7)	(83.2)	(38.2)
Profit (loss) after taxation	90.0	74.9	(72.5)	240.6	(191.0)
Operating assets					
Music copyrights and intangibles	389.3	404.6	448.7	451.2	518.2
Goodwill	43.0	35.1	31.8	56.2	34.0
Property, plant and equipment	196.8	200.0	202.7	289.4	277.3
Non-current investments	23.8	26.1	19.3	22.2	29.5
Inventories and receivables, excluding taxation and interest	932.1	819.6	797.0	973.9	919.6
Payables and provisions, excluding taxation, dividends and interest payable	(1,282.7)	(1,260.0)	(1,201.5)	(1,210.4)	(1,296.4)
Investment in HMV Group plc	–	–	–	–	(159.9)
Operating assets	302.3	225.4	298.0	582.5	322.3
Key statistics					
Net borrowings	879.5	857.5	748.7	859.8	1,057.9
Net cash inflow from operating activities	188.3	189.0	309.4	117.2	211.9
Capital expenditure	34.3	35.9	51.3	68.5	39.2
Earnings per Ordinary Share:					
Basic	10.9p	9.6p	(9.1)p	29.3p	(25.5)p
Underlying diluted	16.7p	13.1p	15.5p	15.7p	11.8p
Dividend per Ordinary Share	8.0p	8.0p	8.0p	8.0p	8.0p
Return on sales	12.0%	11.2%	11.8%	11.7%	7.8%
Effective tax rate (before exceptional items and amortisation)	17.6%	22.3%	19.9%	25.3%	30.0%
Interest cover, excluding joint venture (HMV Group plc - discontinued)	3.0x	2.9x	3.3x	3.9x	4.0x
Dividend cover	2.0x	1.6x	1.9x	2.0x	1.5x

Investor information

Financial calendar
Results announcements
Interim to 30 September 2006: 15 November 2006*
Final to 31 March 2007: 22 May 2007*

AGMs and Reports
2006 Annual General Meeting: 13 July 2006
2006 Interim Report: 24 November 2006*
2007 Annual Report: 8 June 2007*
2007 Annual General Meeting: 19 July 2007*

Dividend payment dates
2006 final: payable on 2 October 2006 to shareholders on the register of members at the close of business on 21 July 2006
2007 interim: payable on 2 April 2007* to shareholders on the register of members at the close of business on 12 January 2007*

*Proposed dates

Lloyds TSB Registrars
Questions about shareholdings, or changes of address or any other particulars, should be sent to: *Lloyds TSB Registrars, Shareholder Services, The Causeway, Worthing, West Sussex BN99 6DA, UK.* A helpline, available at local call rates in the UK only, operates during normal office hours on *0870 600 3984*. Shareholders outside the UK should call *+44 121 415 7060*.

www.shareview.co.uk
Lloyds TSB Registrars have a website at: *www.shareview.co.uk* where shareholders can view information about their shareholdings, as well as find information on how to register a change of name and what to do if a share certificate is lost. There are also facilities to download change of address, dividend mandate and stock transfer forms.

Multiple accounts
If shareholders receive multiple copies of the Group's Annual or Interim Reports, due to differing name and address details, they should write to Lloyds TSB Registrars requesting that their accounts be amalgamated.

Payment of dividends to UK bank or building society accounts
Shareholders who wish to have their dividends paid directly into their UK bank or building society account should request a dividend mandate form from Lloyds TSB Registrars or download the form from *www.shareview.co.uk*. An annual tax voucher will be sent to the shareholder's registered address at the time of the interim dividend payment in March or April each year. The voucher will list all of the dividends paid during the tax year. A tax voucher in respect of the final dividend paid on 6 October 2006 and the interim dividend to be paid on 2 April 2007 will, therefore, be sent to shareholders in April 2007.

Scrip dividend scheme
The Company offers a scrip dividend scheme which gives shareholders the opportunity, if they wish, to receive new Ordinary Shares instead of cash dividends. For more information and a mandate form, please write to: *Lloyds TSB Registrars, The Causeway, Worthing, West Sussex BN99 6DA, UK* or call *0870 241 3018 (+44 121 415 7047* if calling from outside the UK).

Payment of dividends to overseas shareholders
Arrangements can be made for shareholders in a range of countries outside the UK to have their dividends paid directly into their bank account in their local currency. To find out if such a service can be made available to you, please contact Lloyds TSB Registrars on *+44 121 415 7060*.

Share dealing service #
A telephone and internet dealing service has been arranged through Lloyds TSB Registrars which provides a simple way for UK-resident shareholders to buy or sell EMI Group plc shares. Commission is 0.5% with a minimum charge of £20 for telephone dealing and £17.50 for internet dealing. For telephone dealing call *0870 850 0852* between 8.30am and 4.30pm, Monday to Friday, and for internet dealing log on to *www.shareview.co.uk/dealing*. You will need your shareholder reference number shown on your share certificate.

ShareGift
If you have a small number of EMI Group plc shares, with a value that makes it uneconomic to sell them, you may wish to donate these to the charity ShareGift (registered charity 1052686) which accepts such holdings as charitable donations. Further information on ShareGift can be obtained from their website at *www.sharegift.org* or by calling *020 7828 1151*.

Individual Savings Accounts (ISA) #
Lloyds TSB Bank plc can provide a single company ISA for EMI Group plc Ordinary Shares. Details of this ISA, which is only available to UK-resident shareholders, may be obtained from Lloyds TSB Registrars by writing to them at: *The Causeway, Worthing, West Sussex BN99 6UY*, or by calling their ISA helpline on *0870 24 24 244*.

Monthly Purchase Plan (MPP) #
Lloyds TSB Bank plc provides an MPP for EMI Group plc Ordinary Shares. Information about this MPP may be obtained by writing to: *The Administrators – MPP, Lloyds TSB Registrars, PO Box 4605, Worthing, West Sussex BN99 6QY, UK*, or by calling their MPP helpline on *0870 60 60 268*.

American Depositary Receipts (ADRs)
The Company's ADRs trade on the Over-the-Counter market, with one American Depositary Share (ADS) representing two EMI Group plc Ordinary Shares. JPMorgan Chase Bank, N.A. is the Depositary for the Company's ADSs. Enquiries should be directed to: *JPMorgan Service Center, PO Box 3408, South Hackensack, NJ 07606-3408, USA*; Tel: *1-800-990-1135* (toll-free in the USA) or *1-201-680-6630*; Website: *www.adr.com*

£/US$ dividend conversion facility
This service enables the holders of Ordinary Shares who are resident in the US to receive their dividends in US Dollars rather than Sterling. Details of this facility may be obtained from: *DB Services Tennessee, Inc., PO Box 305050, Nashville, Tennessee 37230, USA*; Tel: *1-615 835 3000*.

UK capital gains tax information
The market value of the Ordinary Shares of EMI Group plc (then known as THORN EMI plc) held on 31 March 1982, as adjusted for subsequent capitalisation issues, was 408.15p per share.

The base cost of EMI Group plc Ordinary Shares acquired prior to the demerger of 19 August 1998 will need to be apportioned between EMI Group plc Ordinary Shares of 25p each and Thorn plc Ordinary Shares of 25p each in the proportion 78.8% to 21.2%.

The base cost of EMI Group plc Ordinary Shares of 25p each held prior to the share capital reorganisation of 21 July 1997 will then need to be apportioned between the new Ordinary Shares of 14p each and the former B Shares of 114.5p each in the proportion 89.4% to 10.6%.

Share price information
The market price of EMI Group plc's Ordinary Shares is available from the EMI Group website at the address shown under Website/general enquiries below. Within the UK, this price is also available on Ceefax and Teletext, or by calling the FT Cityline service on *0906 843 4214* or *0906 003 4214* (calls charged at 60p per minute).

Unsolicited mail/telephone calls
By law, the EMI Group plc share register has to be available for public viewing. If you wish to avoid receiving unsolicited mail from other organisations, please write to: *Mailing Preference Service, Freepost 22, London W1E 7EZ*, or call *08457 034599* for an application form. You can also register online at: *www.mpsonline.org.uk*

The Telephone Preference Service (TPS) can help you to make sure your telephone number is no longer available to organisations who may call you with offers and information that you do not wish to receive. You can register with the TPS by calling them on *0845 070 0707*, or by writing to: *Freepost 29 LON20771, London W1E 0ZT*. The TPS has a website at *www.tpsonline.org.uk*, or may also be contacted by email using *tps@dma.org.uk*

Annual and Interim Reports
Copies of the Group's previous Annual and Interim Reports are available from the Corporate Communications Department at the address shown below in italics or, for 2001 onwards, on the EMI Group website at the address shown under Website/general enquiries below.

Social Responsibility Report and information
The Group's Social Responsibility Report for 2005 is available on the EMI Group website at the address shown under Website/general enquiries below. Further information on social responsibility matters may be obtained from the Corporate Communications Department at the address shown below in italics.

Website/general enquiries
The EMI Group website provides news and financial information about the Group, as well as its music and music publishing businesses, together with links to its music labels.

General enquiries may be addressed to the Corporate Communications Department at: *EMI Group plc, 27 Wrights Lane, London W8 5SW, UK*; Tel: *020 7795 7000*. Callers from outside the UK should call: *+44 20 7795 7000*. Website: *www.emigroup.com*

The publication of the information in respect of the share dealing service, Individual Savings Accounts and the Monthly Purchase Plan has been approved, for the purposes of section 21(1)(b) of the Financial Services and Markets Act 2000, by Lloyds TSB Bank plc, part of the Lloyds TSB Group, which is regulated by the Financial Services Authority.

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Black Eyed Peas

James Blu

Daddy Yankee

Raphael

RBD

Clarks Bentley

Pharrell Williams

Kate Bush

Radja

Korn

Arctic Monke

Eros Ramazzotti

Alicia Key

Depeche Mode

Vasco Rossi

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England and Wales
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