

# Management Report

## Page

- 39 Adjusted sales at prior-year level
- 40 Depressed margins impact earnings before depreciation, amortization and exceptional items
- 40 Net earnings reflect operating performance and combined effect of exceptional items
- 42 Cognis Group maintains high liquidity after early repayment of bank loans
- 43 Currency translation effects and loan repayments cause 11% reduction in total assets
- 44 Number of employees reduced
- 45 Capital expenditures geared to restructuring and increasing efficiency
- 46 Greater process orientation in quality and environmental management
- 46 Research and development with new market-led technologies and processes
- 49 Oleochemicals maintains sales level against strong competition
- 50 Care Chemicals grows faster than the market
- 51 Nutrition & Health consolidates market presence with sights set on sustainable growth
- 52 Functional Products successfully shifts emphasis to technology-based, integrated solutions
- 53 Process Chemicals impacted by developments in end consumer markets
- 54 Key business risks and risk management
- 55 Events after the balance sheet date
- 55 Outlook for 2004

### Adjusted sales at prior-year level

In fiscal 2003, the Cognis Group realized sales of € 2,950 million, thus falling 5.6% short of the prior-year figure. The main contributory factors in this regard were foreign exchange effects caused by the weakness of the US dollar together with generally declining selling prices. The persistently unfavorable economic climate, particularly in Europe, significantly exacerbated these influences. Moreover, in the Asia region the situation was further impacted by structural changes in the chemical industry, with new production capacities being developed and production relocations from Europe to Asia. After adjusting for foreign exchange (currency translation) effects and the influence of acquisitions and divestments, however, the organic business again generated sales at the level of the previous year. The maintenance of our overall sales volumes underlines the global competitiveness of the Cognis Group.

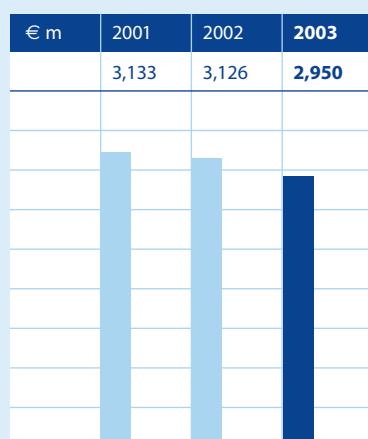
The organic growth achieved in the strategic business units Care Chemicals, Nutrition & Health and Functional Products underlines the validity of our strategic alignment to the global trends of wellness and sustainability. The strongest increase was achieved by Care Chemicals with +4.4%. Functional Products, additionally strengthened in spring 2003 by the successful acquisition and integration of Laporte Performance Chemicals, likewise produced an impressive performance with organic growth amounting to +1.9%. Nutrition & Health exceeded the adjusted sales level of the previous year (+0.6%) and enjoyed an excellent start in the new CLA business (conjugated linoleic acid – a product capable of reducing body fat as a percentage of total weight) on the basis of an exclusive license agreement with Natural ASA. A decline in sales revenue at Oleochemicals (–0.2%) and particularly Process Chemicals (–6.0%) compared with the previous year resulted from difficult underlying economic and structural conditions. Sales from Other Activities fell owing to the divestment of our fragrances business in spring 2003.

The regional picture after adjusting for foreign exchange effects reveals positive development in the growth regions of Asia-Pacific (+8.7%) and Latin America (+10.2%). While North America reported an increase of +0.7%, sales in the core region of Europe were 3.3% down on the level of the previous year due to cyclical economic factors. Acquisitions, divestments and other structural changes resulted in a net increase in revenue amounting to € 52 million, thus contributing +1.7% to sales growth as compared with the previous year.



Asia – an attractive growth market with outstanding prospects for Cognis: more > page 25

### Sales: Cognis Group



### Sales by strategic business unit

€ millions	2003	2002
<b>Total</b>	<b>2,950</b>	<b>3,126</b>
Oleochemicals	967	1,042
Care Chemicals	547	554
Nutrition & Health	263	276
Functional Products	695	684
Process Chemicals	431	497
Other Activities	47	73



Vitamin E – the health booster:  
more > page 31

**Depressed margins impact earnings before depreciation, amortization and exceptional items**

In 2003, the Cognis Group reported earnings before depreciation, amortization and exceptional items (recurring EBITDA) of €312 million (previous year: €393 million). Currency translation effects depressed earnings by €19 million while acquisitions and divestments made a positive net contribution of €5 million. The return on sales for 2003 related to the recurring EBITDA figure fell to 10.6% (previous year: 12.6%). This decline essentially resulted from significantly higher material costs which, owing to the global competitive situation and prevailing market prices, were not fully passed on to our customers. This was particularly the case with the Oleochemicals business. In addition, this SBU was especially impacted by the Iraq war, with sales in oilfield chemicals drastically declining due to major cutbacks in drilling activities. Since the middle of 2003, moreover, the Oleochemicals business has had to contend with a continuous price decrease in the European glycerin market. Shifts in the foreign exchange rates between the US dollar and the euro also led to increased pressure on export sales margins (particularly relevant in the case of our Mining Technology, Sterols, Surfactants and Vitamin E segments).

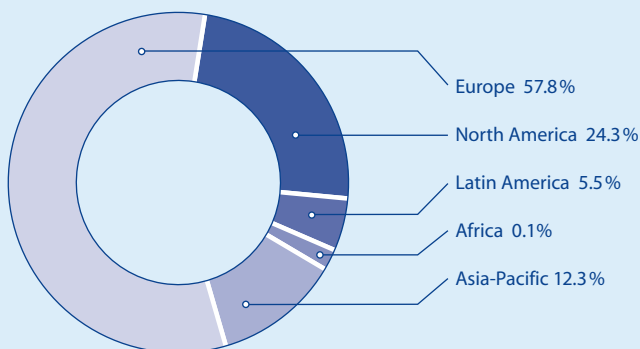
Thanks to the World Class Manufacturing Program and the comprehensive production site efficiencies implemented, manufacturing costs were reduced as compared with 2002, despite increasing energy prices. Further optimization programs and primary cost savings led to a reduction in structural costs to below the prior-year level. This compensated out the usually expected rise caused by factor costs such as wage and salary adjustments – despite the takeover of Laporte Performance Chemicals, the replacement of Henkel business supply agreements through the development of in-house resources, and the establishment of new companies in Poland, Russia, Austria and Chile.

**Net earnings reflect operating performance and combined effect of exceptional items**

The EBIT figure for 2003 amounted to €50 million (previous year: €142 million). Aside from the negative effects resulting from the high pressure on margins, there were also numerous exceptional items that took a heavier toll on earnings than was the case in the previous year.

Of the net charge of €57 million arising from exceptional items, €54 million relates to restructuring costs. Of this latter figure, €47 million resulted from early retirement, severance pay and pre-retirement part-time employment plans arising from job cuts, implemented in a socially compatible manner,

Sales by region



Sales by region

€ millions	2003	2002
<b>Total</b>	<b>2,950</b>	<b>3,126</b>
Europe	1,703	1,724
North America	716	835
Latin America	162	174
Africa	5	5
Asia-Pacific	364	388

at our German company. Further restructuring costs emanated from personnel reductions in Spain, the USA and Japan, plus a number of plant closures. Also among the exceptional items of fiscal 2003 was a charge of €19 million due primarily to costs arising from the development and implementation of our own IT systems in the wake of our separation from Henkel.

The year under review also saw goodwill impairment charges of €17 million and exceptional write-downs on property, plant and equipment amounting to €19 million. These value depletions are essentially attributable to developments in raw material prices and the market prices for fatty acids and glycerin in the Oleochemicals SBU, plus the devaluation of the US dollar, which particularly impacted the Functional Products unit.

Exceptional items having a positive effect on earnings included income from the release of pension provisions in the USA, where Cognis Corporation implemented adjustments to its retirement plans and post-retirement healthcare plans, and a gain of €20 million from the sale of our fragrances business.

The net financing costs line improved compared with the prior-year figure by €31 million to a negative balance of €152 million. The net interest expense fell by €8 million as a result of senior loan repayments. In addition, charges arising from derivative hedging instruments fell by €14 million.

A major portion of the net financing costs is in the form of interest on senior and subordinated loans amounting to €111 million (previous year: €122 million). Of this figure, €48 million relates to subordinated loans and only becomes payable once the senior loans have been redeemed. A further €32 million results from the interest expense arising from pension provisions (previous year: €29 million), which likewise constitutes a non-cash item.

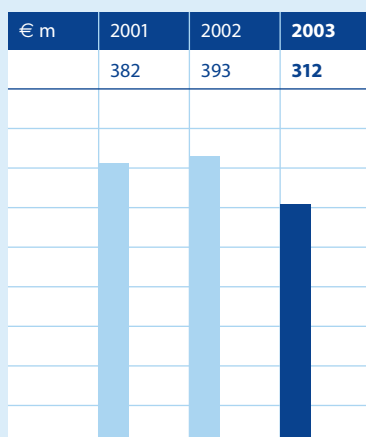
Profit before tax in fiscal 2003 amounted to a negative €102 million (previous year: negative €41 million). Overall, tax proceeds rose by €21 million to €38 million. The reason for the increase lies in the €9 million lower current tax expense combined with an increase of €12 million in deferred tax proceeds arising from loss carry-forwards and timing differences between the commercial IFRS balance sheet and the tax balance sheet. The tax rate fell from 42% in 2002 to 37% in the year under review.

At €64 million, the net loss (before minority interests) for 2003 shows an increase of €40 million compared with the prior-year figure (2002 net loss: €24 million).

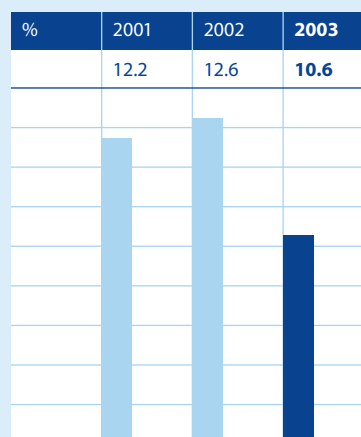


Interview with Joachim Söhngen, Chief Financial Officer until February 29, 2004: > page 21

#### Recurring EBITDA



#### Return on sales





Prioritizing financial reporting:  
[more > page 24](#)

### Cognis Group maintains high liquidity after early repayment of bank loans

During the financial year, the Cognis Group achieved a cash inflow from operating activities of € 315 million. The reason for the decrease as compared with the prior-year figure of € 367 million was the significantly lower EBIT. However, this effect was partially offset by a further reduction in working capital.

Investment expenditure increased from € 85 million in the previous year to € 130 million in 2003. Aside from a higher capital outlay on property, plant and equipment, this is attributable in particular to the introduction of a standard, group-wide SAP system (€ 13 million) and capitalized development costs (€ 4 million). Expenditure on acquisitions amounted to € 87 million, due in particular to the purchase of the British care chemicals company Laporte Performance Chemicals. These outgoings were offset by proceeds from the sale of the fragrances business (€ 35 million) and divestment of the business units Synco (pigments for plastics) and Protina Lactovit (spice additives). Further inflows amounting to € 34 million resulted from a retroactive purchase price adjustment in connection with the Cognis buy-out.

The net outflow of funds from financing activities at the Cognis Group in 2003 amounted to € 290 million (previous year: € 179 million). The significant increase was due particularly to senior loan repayments, albeit with lower interest payments producing a degree of offset. Further outgoings arose from an allocation of € 34 million to pension funds in the USA implemented to prefinance future pension entitlements.

After adjusting for foreign exchange effects (negative € 4 million), the flow of funds from operating activities, investing activities and financing activities led to a decrease of € 109 million in cash and cash equivalents. In the balance sheet as at December 31, 2003, the Cognis Group therefore shows cash and cash equivalents amounting to € 190 million. During 2003, the financial ratios covenanted with the financing banks were consistently maintained with a good margin of safety.

### Condensed cash flow statement

€ millions	2003	2002
Cash earnings	256	327
Cash flows from operating activities	315	367
Cash flows from investing activities	-130	-85
Cash flows from financing activities before repayment of borrowings	-176	-151
Effect of exchange rate changes on cash and cash equivalents	-4	-1
<b>Change in cash and cash equivalents before repayment of borrowings</b>	<b>5</b>	<b>130</b>
Repayment of borrowings	-114	-28
<b>Change in cash and cash equivalents (after repayment of borrowings)</b>	<b>-109</b>	<b>102</b>

### Currency translation effects and loan repayments cause 11% reduction in total assets

Total assets at the Cognis Group decreased from €2,948 million to €2,619 million due to currency translation effects and loan repayments during the fiscal year.

The fixed assets total decreased from €1,358 million to €1,227 million. An increase in capital expenditures and changes in the Group were more than canceled out by a higher amount resulting from amortization, depreciation and disposals; currency translation effects also resulted in a decrease in the fixed assets total.

Deferred tax assets rose during the year to €219 million. The main reason for this lay in the capitalization of deferred taxes owing to loss carry-forwards and timing differences between the commercial IFRS balance sheet and the tax balance sheet.

Thanks to efficient working capital management, the balance of inventories and trade accounts receivable fell by a total of €71 million compared with the previous year.

Cash and cash equivalents decreased in 2003 by €109 million. This is due in particular to the repayment of the senior loans.

Shareholder's equity increased to €246 million. During the year under review, the shareholder loan of €375 million was converted into equity. Higher derivative market values resulted in a further €9 million equity increase without affecting income. Countereffects reducing equity arose from currency translation losses amounting to €62 million and the net loss for the year (including minority interests) amounting to €71 million.

Primarily as a result of foreign exchange effects, minority interests fell in 2003 to €43 million.

Provisions for pensions and similar obligations were significantly reduced due particularly to the restructuring of the retirement plans and post-retirement healthcare plan of Cognis Corporation, USA (€37 million) plus currency translation effects (€23 million).

Borrowings decreased in 2003 as a result of the conversion of the shareholder loan into equity (in a nominal amount of €330 million) and senior loan repayments (amounting to €117 million). In contrast, the loan from Henkel KGaA (vendor note) increased by €26 million owing to interest accruals. Overall, borrowings were reduced by €474 million.

Trade accounts payable increased by €17 million, due primarily to extended payment terms.

### Balance sheet

€ millions	Dec. 31, 2002	Dec. 31, 2003	Dec. 31, 2003	Dec. 31, 2002
	2,948	<b>Assets 2,619</b>	<b>2,619 Shareholder's equity and liabilities</b>	2,948
	1,358	Fixed assets <b>1,227</b>	289 Shareholder's equity and minority interests	55
			632 Provisions	716
	199	Deferred tax assets <b>219</b>	34 Provisions for deferred tax liabilities	43
	1,391	Current assets <b>1,173</b>	1,664 Liabilities	2,134



For more on transparency in all our change processes, see interview with Helmut Heymann, Chief Administration Officer: > page 16

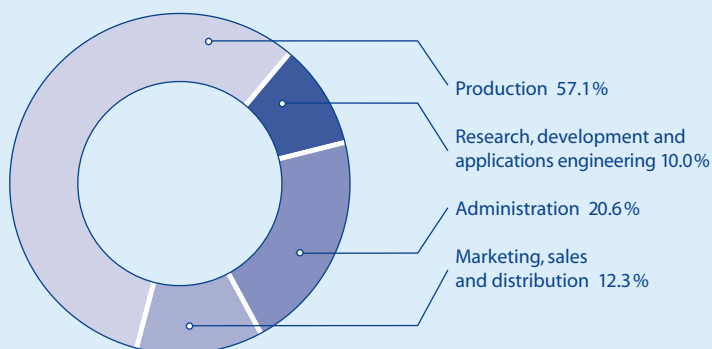
**Number of employees reduced**

At December 31, 2003, the total number of employees at the Cognis Group worldwide was 8,660 (core workforce excluding apprentices, trainees and internees). This represents a decrease of 286 as compared with the closure date of the previous year. The cause for the decline lies in restructuring measures that were either ongoing or additionally introduced in 2003.

At the end of the year, the number of employees in Germany was down 106. There were reductions in workforce not only at our main Düsseldorf site but also as a result of the reorganization at the Grünau site and the closure of a plant in Siegburg. The number of employees in the other European countries rose by 193 due to the integration of Laporte Performance Chemicals (UK), but was down after adjusting for this acquisition. The decrease in personnel arising from the divestment of the plastic pigments business unit and the sale of our 100% holding in a French subsidiary was offset by an increase in staffing levels resulting from the organizational build-up in our newly established companies in Poland, Russia, Austria and Chile.

In North America, the shutdown of production in Hoboken and further restructuring measures at other sites led to a loss of 84 jobs. While in Latin America the number of employees remained virtually constant, workforce levels in Asia-Pacific decreased significantly – by 286 employees. The restructuring measures implemented in Indonesia alone led to a reduction of 116 jobs.

**Workforce structure at balance sheet date**



**Workforce structure at balance sheet date**

Number	2003	2002
Production	4,947	5,205
Research, development and applications engineering	870	926
Administration	1,782	1,550
Marketing, sales and distribution	1,061	1,265
<b>Total</b>	<b>8,660</b>	<b>8,946</b>

**Capital expenditures geared to restructuring and increasing efficiency**

Capital expenditure in 2003 was aligned to optimizing our global manufacturing network and increasing productivity at individual sites by expanding capacity and introducing improved manufacturing processes. Some production operations were either relocated or completely discontinued (Germany and the USA).

Additions to assets in 2003 amounted to €122 million, €24 million up on the prior-year figure (€98 million). This rise is due in part to IT investments and development costs capitalized.

We invested in all our strategic business units with a view to optimizing and rationalizing our network of production sites and facilities. In Spain, our ethoxylation and sulfonation operations were concentrated at a single site to achieve greater economies of scale. In the USA, a similar process of consolidating our exothylation activities was also begun, with completion scheduled for the first quarter of 2004. Investments in the sulfonation sector in the USA enabled the closure of one site. In Düsseldorf, the largest production site within the Cognis Group, the construction of a central filling center has yielded significant improvements in the overall logistics of the packaging and completion operation to give us greater efficiency and enhanced quality assurance. In Malaysia, a plant for the production of fatty acid fractions was taken on stream. Fractions continue to be regarded as growth products in the difficult environment surrounding the fatty acids market. The new plant will serve to increase the workload and thus improve the efficiency of the upstream process stages.

Investments were made for the specific purpose of increasing our surfactant production capacity in Thailand. The construction of a second production line is in keeping with the regional growth strategy of Cognis and carries a significance that goes well beyond Thailand's frontiers. In Poland, a new plant for the production of food additives was constructed. This means that it will now be possible to supply this growth market in Eastern Europe from within the immediate region. In Spain, a plant was built for supplying the cosmetics industry with advanced solutions: the core technologies employed here involve the manufacture of proliposomes and also the micro-encapsulation and coating of particle surfaces for special product formulations.

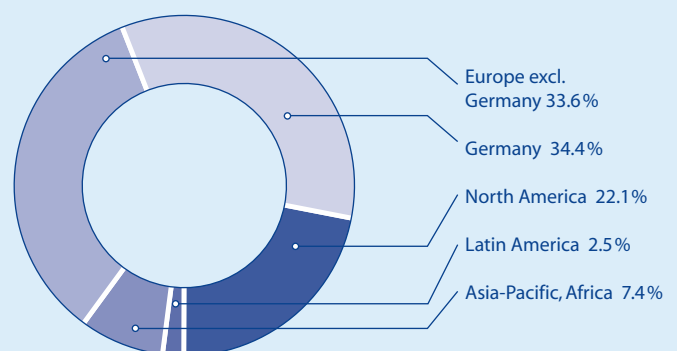


Higher efficiency and enhanced customer alignment – for more, see interview with Dr. Antonio Trius, Chief Executive Officer: > page 07

**Capital expenditures by region**

€ millions	2003	2002
Europe excl. Germany	41	32
Germany	42	28
North America	27	26
Latin America	3	4
Asia-Pacific, Africa	9	8
<b>Total</b>	<b>122</b>	<b>98</b>

**Capital expenditures by region**



### Greater process orientation in quality and environmental management

Following the successful restructuring of the SHEQ management system (Safety, Health, Environment and Quality), the focus of our work in 2003 lay on achieving greater process orientation. All our SHEQ activities were thoroughly examined for their support of the essential operating processes at Cognis. To this end, the Internal Auditing function, among other things, was completely revamped within the framework of a new corporate audit program so that, in addition to the requirements of matrix certification to ISO 9001 (Quality) and ISO 14001 (Environment), internal audits are increasingly carried out with a view to supporting the business strategies and corporate goals of the Company.

A further milestone was passed with the issue of the new "Corporate Integrated Manual" in which the essential processes and strategies of Cognis are explained and illustrated. The manual forms the basis for all system audits and provides a fast and comprehensive overview of Cognis' process landscape.

Our GMP activities (Good Manufacturing Practices) were expanded with a view to further safeguarding product quality. This program involves the preparation of HACCP analyses (Hazard Analysis of Critical Control Points) for selected product groups. We also proceeded with the cross-site harmonization of our product quality and grading systems.

In the environment domain, Cognis continued the global certification process initiated in previous years. As a result, the last of Cognis' major production sites – Boussens (France), Castellbisbal (Spain) and Fino Mornasco (Italy) – together with Avellaneda (Argentina) – were certified for the first time to ISO 14001. Preparations are also underway to deal with the important issue of emission certificate trading in Europe.

The subject of occupational and plant safety carries a permanently high priority at Cognis. A raft of measures has resulted in the number of accidents constantly falling year on year, with the Company continuing to make progress to its self-imposed zero-incident target.

### Research and development with new market-led technologies and processes

2003 saw the third conferral of Innovation Awards on three selected teams of Cognis employees. The shortlist numbered 21 projects from nine countries, involving a total of 107 employees. The criteria for candidacy are originality and creativity, know-how, customer orientation and market success. The competition is open to all our divisions and business units worldwide.

#### Expenditure on R & D/Technical Service

€ millions	2003	2002
<b>Total</b>	<b>101</b>	<b>116</b>
Research and Development	61	76
Technical Service	40	40

The gold award carrying a prize of €25,000 went to a team comprising employees from France, Germany and the USA who had developed a process by which plant-based sterols (phytosterols) are produced from the by-products of our methyl ester production. Worldwide demand for phytosterols is constantly growing due to their ability to offer high benefits – for example as cholesterol-reducing additives in margarine – and their generally wide range of applications. Cognis is one of the world's leading suppliers of phytosterols.

The silver award went to a team from the USA who had made a breakthrough in the field of environmentally friendly thickening agents for paints. The newly developed associative thickener, free of solvents and of alkylphenol alkoxylates, is already being successfully marketed by Cognis worldwide. It permits the manufacture of particularly environmentally friendly paints, dispersion adhesives and also professional trade and industrial coatings. The 30-percent increase in efficacy offered by the Cognis product DSX® 3075 compared to conventional solutions brings significant cost savings to paint manufacturers.

The bronze award went to a German team that had developed an especially gentle care emollient with an exceptional performance profile for hair and skin care products. Today's consumers demand that such products be both multifunctional and satisfy high sensory requirements: sun protective formulations, for example, are required not only to block out UV radiation but also to moisturize and make the skin soft and smooth. Modern formulations of care products are therefore reliant on ingredients that are functional while at the same time providing a gentle care effect. With Cetiol® CC, Cognis is able to offer an emollient that satisfies these requirements like no other product – and one that is equally suited to both skin and hair care applications.

#### **New technology for biological skin analysis**

A new, effective ingredient for cosmetic products offering a comprehensive DNA protective effect has been developed to commercialization under the name DN-AGE LS 9653. Using a newly developed special biological technique, the French research team responsible was able to demonstrate how, with this new active ingredient, the DNA damage rate in keratinocytes caused by UV-B radiation can be reduced, with effective protection also being afforded to the mitochondrial DNA of these cells. This new technology has made it possible to analyze the biological targets in the DNA.

#### **Molecular efficiency, and calcium soaps of conjugated linoleic acid**

One of the main areas of developmental activity conducted by the Process Technology department in 2003 involved increasing molecular efficiency in oleochemical production at the Düsseldorf site. By recording production process data and performing simulations and experiments in the laboratory and the development center, our scientists are able to identify areas of potential improvement for increasing yield and reducing process costs arising from, for example, energy input and plant occupancy times. In this procedure, the control standards are provided by the latest processes either offered by various suppliers or developed in-house. As a result of these investigations, 2004 will see a new and advanced plant built for the production of unsaturated fatty acids and their derivatives.

A further major R&D activity involved the successful expansion of a new, specialized process for the manufacture of ruminant feed additives on the basis of conjugated linoleic acid (CLA). In one subproject, the large-scale manufacture of calcium soaps of CLA for animal nutrition was successfully achieved within a very short development time. Thus, thanks to the close cooperation that exists between our technologists and process engineers, Cognis now has at its disposal a production process of major standing.



**New phytosterol production process wins gold award for innovation: [more > page 08](#)**



**Environmentally compatible paint thickener wins silver award for innovation: [more > page 06](#)**



**Care emollient gains worldwide success and bronze award for innovation: [more > page 09](#)**

#### **Amazontex fabric conditioner**

The new fabric conditioner Amazontex is synthesized from cupuaçu butter, a natural triglyceride extracted from the seeds of the cocoa-like Amazon plant cupuaçu (*Theobroma grandiflorum*). The product is an environmentally friendly surfactant that is completely biodegradable. It was developed by a Brazilian team of researchers for application in the finishing processes applied to towels and other cotton fabrics. Previously, this application was the exclusive domain of silicone-based products.

#### **New enzyme process for products manufactured from crude tall oil**

Crude tall oil (CTO) is extracted from black liquor, a by-product produced by the paper industry, and has three main constituents: fatty acids, oleoresins and unsaponifiable steroid-containing matter. Now, a newly developed enzymatic process developed by a German-Brazilian team eliminates numerous stages and the associated intermediate products to enable easier distillation and extraction of the valuable substances required.

#### **Lubricants for wind power turbines**

Since the energy crisis of the 1970s, the search for renewable energy sources has been the subject of much endeavor and discussion. The harnessing of wind power has resulted in enormous growth rates in the associated plant and equipment over the last few decades. The size and number of wind farms and also the dimensions of the turbines used are constantly increasing. This means that the market potential for specialty lubricants for these applications can also be expected to grow further in the coming years.

The technology incorporated in wind turbines is complex and the costs arising from machine failures and repairs are high. In order to combat some of the problems associated with inadequate lubrication, Cognis is currently working on the development of two new technologies. The aim is to enable designers and operators of these turbines to achieve performance improvements in terms of both service life-time and satisfying environmental criteria.

The first of these developments involves a so-called "generation fluid" that has already undergone extensive field tests. The second relates to improving the ecological properties of the lubricants used while still assuring the extremely high tribological performance levels required.

#### **Patents**

In 2003, around 80 new patents were submitted by Cognis pending evaluation, with roughly the same number also being granted.



**Formulated for top performance – for more on our lubricants: > page 34**

### Oleochemicals maintains sales level against strong competition

The Oleochemicals segment is responsible for our activities in the fields of oleochemical basestocks (fatty acids, glycerin and oilfield chemicals), primary surfactants, fatty alcohols and the silicates business (water glass). In 2003, this strategic business unit generated sales of € 967 million. The decline in sales revenue compared with 2002 (-7.2%) essentially resulted from unfavorable movements in the US dollar exchange rate versus the euro. Despite the difficult underlying economic conditions, however, organic sales at the SBU came close to the level of the previous year (-0.2%).

The Basic Oleochemicals unit lost market shares in the face of strong competition and was unable to maintain sales at the level of the previous year. In particular, business performance with respect to fatty acids in North America and Europe was characterized by heavy competitive pressures so that sales at the end of the year were 1.5% down on the prior-year figure before foreign exchange effects. In Europe, the prices for glycerin fell as a result of surpluses being generated as a by-product from biodiesel production. Biodiesel manufacturing is promoted by subsidies from the European Community so there is currently little prospect of any major recovery in price levels within the glycerin market. Thanks to a good first half year and long-term contracts at a still favorable price level, Cognis was able to exceed its currency-adjusted glycerin sales of the previous year, achieving a plus of 6%. Follow-up contracts will, however, be aligned to a significantly lower price level with the result that a downturn in sales revenue is inevitable.

The Oilfield Chemicals business was heavily impacted by the Iraq war in the year under review due to a drastic cut-back by potential customers in the development of new wells. Consequently, sales almost halved compared with the previous year.

In contrast, the Primary Surfactants business was able to gain market share within a difficult economic environment. Sales in this subsegment thus increased by 1.2% after adjusting for foreign exchange effects. Our relative performance in the heavily contested markets of America and Europe was particularly good. Although developments in selling prices resulted a decline in revenues in North America, the prices achieved in Europe enabled sales to remain steady.

As a result of the generally buoyant demand for the products of our Fatty Alcohols unit, segment sales in North America and Europe were maintained while the figure in Asia actually increased resulting in an overall currency-adjusted rise of 5.5% compared with the previous year.

The Silicates business (water glass) remained stable, achieving a growth rate of 3.4%.

### Sales: Oleochemicals

€ millions	2003	2002
<b>Total</b>	<b>967</b>	<b>1,042</b>
Care Surfactants*	553	576
Fatty Acids, Silicates, Oilfield Chemicals, Other	414	466

\*Primary Surfactants, Fatty Alcohols



For more on Care Chemicals' marketing concepts: > page 12



"Next Generation APG®": Luxuriant lathering capacity – for more on our sugar-based surfactants (APG®): > page 28

**Care Chemicals grows faster than the market**

Care Chemicals supports its customers around the world with innovative products, formulations and marketing concepts for home and personal care, and also industrial cleaning applications. In 2003, the relevant markets were characterized by a low level of growth (approx. 1%), price pressures arising from an increase in the market share of the trade's private labels at the cost of branded goods, and further consolidation among the international brands manufacturers.

Operating in a difficult economic environment, Care Chemicals achieved sales of € 547 million, representing at current exchange rates a decline of 1.3 % compared with the previous year. Divestments outside the core business had a negative effect on sales amounting to € 2 million. At comparable foreign exchange rates, sales improved by 4.4 %. This means that Cognis exhibited significantly stronger growth in the home and personal care segments than that shown by the market as a whole. This growth was equally well supported by the two business units Care Specialties (+5.7 %) and Specialty Surfactants (+3.3 %).

The Care Specialties segment succeeded in further expanding its excellent international standing in the field of care ingredients: a light oil component launched in 2002 developed into a world benchmark, further extending its penetration in 2003 in various segments of the world's personal care market. The unit's operational spectrum in the field of cosmetic polymers was supplemented through the addition of products offering outstanding benefits in terms of both emulsion performance and sensory properties. The Specialty Surfactants segment further increased its market penetration with its product group of sugar-based surfactants (APG®). The launch of a new generation of pearl shine agents and opacifiers consolidated and further expanded the leading international position that the unit enjoys in the associated market sectors.

In regional terms, Care Chemicals was able to generate organic growth in Asia-Pacific, North and South America and Southern Europe. In Asia-Pacific and America, it succeeded in more than compensating for the currency-related disadvantages arising from its dependence on imports from the euro region. Moreover, measures designed to develop local production centers in these regions were also introduced in 2003.

The Asia-Pacific region profited from a positive general economic trend that was boosted particularly in China and Thailand by improved market development. Growth at comparable foreign exchange rates amounted to 12.2 %.

In North and South America, a strengthening of the regional marketing and sales organizations served to both reinforce and expand the regional position enjoyed by Care Chemicals. The organic growth

**Sales: Care Chemicals**

€ millions	2003	2002
<b>Total</b>	<b>547</b>	<b>554</b>
Care Specialties	254	253
Specialty Surfactants	293	301

rates achieved were 7.7% and 9.1% respectively. In Europe, the Care Chemicals segment succeeded in further extending its market leadership, achieving an organic growth rate of 4%. Business developed particularly well in Turkey, Italy and Poland.

#### **Nutrition & Health consolidates market presence with sights set on sustainable growth**

The Nutrition & Health strategic business unit unites Cognis' competencies in the fields of food technology and dietary supplements. The Food Technology subsegment is responsible for, among other things, the production and worldwide distribution of emulsifiers, whisking agents, enzymes, fats and fat powders for baked confectionery, desserts and meat products, plus specialty fats and antioxidants for all areas of nutrition. Falling under the scope of the Dietary Supplements unit are the development and production of natural vitamin E and phytosterols, plus products manufactured from natural-source carotenoids and plant extracts. Cognis has also developed a wide range of ingredients based on natural raw materials for the pharmaceutical industry. With the onset of 2004, therefore, Cognis has begun aggregating its activities within the pharmaceuticals sector and allocating them to this unit.

The underlying economic conditions also impeded the aggressive growth planned for 2003 at the Nutrition & Health SBU following its realignment in 2002. Because over 60% of its worldwide revenue was exposed to the enormous pressure of the de facto dollar devaluation, sales fell from € 276 million in 2002 to € 263 million in fiscal 2003. After adjusting for currency influences, however, the picture looks quite different: on the basis of the 2002 foreign exchange rates, sales rose by 1.1% to € 279 million.

An analysis of the regional development at comparable exchange rates reveals a slight downturn in sales for Europe emanating from results at the Dietary Supplements subsegment and also, to a degree, from the sale of our spice additives business in France. Lower sales in Germany, influenced by the trend in the baking trade away from craft skills to more industrially manufactured bakery goods, sterol ester sales fixed at US dollar prices, and adverse developments in the export sector, were largely offset by improvements in the sales figures of other countries, particularly Turkey.

The Dietary Supplements business succeeded in further expanding its market share in Europe through product innovations. In North America, the continuing price war surrounding vitamin E and tocopherols led to increasing production volumes accompanied by declining sales revenues, while our carotenoids and Tonalin® CLA range performed exceptionally well. The sales figures in the Asia-Pacific region likewise developed well, with the increase achieved in the Food Technology subsegment worthy



**Creamy light enjoyment  
straight from the chiller –  
for more on our Lamequick  
whisking agent:  
> page 30**

#### **Sales: Nutrition & Health**

€ millions	2003	2002
<b>Total</b>	<b>263</b>	<b>276</b>
Food Technology	105	116
Dietary Supplements	158	160



For more on our Tonalin® CLA marketing concept: > page 13

of particular mention. More intensive market development in the field of plant extracts also led to a doubling of the sales revenue achieved in this new market segment.

Owing to foreign exchange effects and the sale of our spice additives business, Food Technology reported a drop in sales of 2.3% for fiscal 2003. This development was also influenced by the continuing weakness of the South American economy, softer demand in the countries of Eastern Europe and the negative effects of the Iraq war on the industrial markets of the Middle East and North Africa. The Dietary Supplements subsegment performed well: sales at comparable prior-year exchange rates rose by 8.3%, although performance at the individual product groups was mixed – Vitamin E, Tocopherols and Botanicals managed to do no more than defend their market positions against continuing price pressures, while Natural Carotenoids, Sterols and CLA (conjugated linoleic acid) gained considerable market share.

In order to consolidate and further expand its market leadership, Cognis decided to construct an additional production facility at its Illertissen site. This laid the foundation for further sustainable growth at the Nutrition & Health business unit. The exclusive license agreement that came into force in February 2003 for the production and sale of Tonalin® CLA also opens up growth opportunities. The sales revenue achieved with this product group in 2003 indicates that there are also good prospects for expansion of our market leadership in this market segment.

**Functional Products successfully shifts emphasis to technology-based, integrated solutions**

The Functional Products segment supports its customers in defining an ideal performance profile for their products. This takes place on the basis of a wide technological platform that enables the unit to offer innovative and ecologically superior solutions on a customer-specific basis. The four business units Polymers, Coatings and Inks (PCI), Synlubes, AgroSolutions and Mining Technology have organized and aligned their technological platforms to their specific market objectives.

In 2003, Functional Products generated sales of € 695 million, so achieving an organic growth rate compared with the previous year of 1.9%, despite overall economic weakness. Owing to the regional weighting, in no business segment was the impact of the unfavorable foreign exchange rates as heavy as in the case of Functional Products (-10.8%).

In 2003, significant steps were taken at the business unit with a view to securing future growth. These included processes to ensure the successful integration of the Laporte Performance Chemicals acquisition,

**Sales: Functional Products**

€ millions	2003	2002
<b>Total</b>	<b>695</b>	<b>684</b>
PCI	365	319
Synlubes, AgroSolutions	279	255
Other*	51	110

\*incl. Mining Technology

which is expected to strengthen particularly the strategic positions of the PCI and Synlubes subsegments. In fiscal 2003, the Laporte business contributed € 68 million in sales and almost € 10 million in profits (recurring EBITDA) to the results of the Functional Products SBU. Specific measures and initiatives were also instituted, which are expected to bring measurable successes as the business continues to develop in the future.

In the PCI subsegment, within which the activities of the Performance Monomer Technology (PMT) and Coatings businesses have been merged, there was a decline in both sales and profits owing to overcapacity in customer markets and the weakness of the construction and automotive sectors. A significantly better cost structure is expected for the dimer product portfolio in the coming year (2004), with consolidation and optimization of the production facilities for this species now having been completed. In the Emulsion Polymerization and Coating Additives subsegments, our inherent technological strengths led to a successful sales performance.

The Synlubes business was also unable to avoid the effects of the global economic situation. Two major customers suffered a considerable decline in business. In addition, the truck market in the USA, in which the Synlubes business has a large market share, did not grow as had initially been anticipated. The focus on technology-based integrated solutions for other customers did, however, pay off. As a result, the Synlubes unit was able to gain further market share in the rapidly growing coolants and refrigerants business and also in the high-performance lubricants segment.

Despite a downturn in the market, our AgroSolutions business generated further organic growth. Its policy of concentrating on certain key accounts and positioning itself as a strategic supplier and partner brought tangible rewards. Here, too, the availability of interlinked technological competence is having a promotional effect on business and promises significant success in the future. The Quality Trait Analysis (QTA) business was also further developed. The Canadian Grain Commission has recognized QTA as a standard method for corn analysis. And a contract was also signed with a leading food processing company.

The Mining Technology business was able to consolidate its position as global leader in the field of copper solvents and achieved significant advancements in the development and introduction of phase transfer catalysts as well as other auxiliary products.

#### **Process Chemicals impacted by developments in end consumer markets**

The **Process Chemicals** strategic business unit realized sales of € 431 million in fiscal 2003. Included in this figure are the activities of the subsegments Textile Technology, Plastics Technology and Leather Technology. The additives manufactured in this unit are used to support production processes throughout the value chain in the textile, plastics and leather industries.

The decline in sales compared with the previous year of 13.3% essentially resulted from the unfavorable development in foreign exchange rates compared with the euro. After adjusting for these currency impacts, sales were 6.3% down on the 2002 figure. The sluggish economic environment led to a slow-down in the development of the markets served by this business unit. In regional terms, our businesses in Europe and North America in particular underwent a decline compared with the previous year, while in Latin America sales measured in local currency showed an encouraging increase. In Asia, on the other hand, there was no continuation of the exceptionally positive business performance of 2002.

The **Textile Technology** unit reported a downturn in sales of 6.3% compared with the previous year after adjusting for foreign exchange effects. The weakness of the markets in Southern Europe was partially offset by encouraging developments achieved in Turkey, these being predominantly attributable to good performance in the export sector. In Germany, the strength of the euro adversely affected earnings from exports to the dollar region, while our East European business performed well. As a result of the introduction of new products and concepts, we gained market share in various segments of the North American market against the background of a generally low level of business activity. In Latin America, we achieved an organic growth rate of 3.7%. Our business in Brazil was a major contributor to this achievement, with Cognis enjoying above-average participation in a positive phase of local market development. Mexico, on the other hand, suffered from the weakness on the export side of the national textile industry. Within an expansive market environment, Asia was able to continue the very good performance of 2002.



Environmentally compatible paints and coatings to satisfy the highest demands: [more > page 37](#)



For more on the new communications concept of AgroSolutions: [> page 13](#)



Successful acquisition of Laporte Performance Chemicals brings strategic benefits: more > page 23

With sales of €151 million, **Plastics Technology** registered revenue below the level of the previous year. After adjusting for foreign exchange effects, sales fell by 1.4%. This decline was due to stagnating demand in the further processing sectors, and especially the construction, automotive and packaging industries. While lubricant volume sales remained at the level of the previous year, there was a significant decline in plasticizer quantities sold. PVC stabilizers were also unable to repeat the prior-year figures, with growth in calcium-zinc stabilizers insufficient to offset the decline in lead stabilizers. The Plastics Technology subsegment profited from the acquisition of Laporte Performance Chemicals (UK) and has successfully integrated the newly absorbed specialty plasticizers business. The Synco business (Italy) was sold in 2003 to British Vita.

Under the reporting unit "Other", the sales in local currencies recorded by the **Leather Technology** subsegment fell 9.3% below the level of the previous year. The encouraging growth in Asia was unable to compensate for the weakness of the South European markets. With the decrease in contract manufacturing, sales revenue from "Other Activities" also fell in comparison with 2002.

#### Key business risks and risk management

Opportunities and risks are part and parcel of entrepreneurial life. Cognis has therefore instituted a wide range of specifically targeted operational measures in order to minimize its exposure to the latter. In addition, the amount of scope available for risk-taking is constrained by the special financial structure of the Group (leveraged buy-out) and the underlying bank contract. Fulfilling the specified financial covenants is essential to the company's solvency.

The requirements of the German Law on Corporate Governance and Transparency (KonTraG – §91 (2) AktG [German Corporation Act]) have been fully taken into account in the risk strategy defined for the Group by the Management Board, as have the key criteria governing implementation of an active risk management system. Our risk managers are thus appointed by name, and we maintain a systematic risk inventory with individual risks being appropriately recorded and assessed. The efficacy of relevant measures introduced is also duly monitored and analyzed. The accepted remit is thus to maintain a comprehensive risk reporting capability that encompasses all individual operational and functional risks rather than just major risks with potential to jeopardize the position of the Company as a going concern. Only in this way is it possible to properly appraise individual risks and overall exposure and to identify at an early stage changes in risk tendencies (e.g. the advent of disruptive technologies, adverse legislative processes, changes in the market structure). These procedures are accompanied and supported by established management accounting systems.

#### Sales: Process Chemicals

€ millions	2003	2002
<b>Total</b>	<b>431</b>	<b>497</b>
Plastics Technology	151	162
Textile Technology	224	262
Other*	56	73

\*incl. Leather Technology

One example worthy of mention is the treasury management system designed to identify and eliminate financial risk. The functional efficiency of this regime with its attendant processes and procedures are regularly examined by our Internal Auditing department.

There is also an established central reporting system in which all the risks affecting the Group are comprehensively documented and extrapolated.

No risks came to light in 2003 which – either individually or in the context of the overall level of exposure – could endanger the continued existence of the Company as a going concern. Moreover, instituted value creation measures have led to verifiable corporate benefits being derived from the risk management system.

### Events after the balance sheet date

Cognis has decided to further prioritize customer alignment – thinking and acting from the customer's standpoint – by instituting a "Business Model Redesign" whereby central functions such as research and development, production and also parts of the supply chain are to be placed under the responsibility of the strategic business units. As a result, only administrative support services and parts of the purchasing operation will be managed on a corporate overhead basis. Production facilities and technologies will thus be more clearly dedicated. The matrix structure within the organization will also be significantly simplified. The number of employees is to be further decreased through restructuring measures geared in the medium term to achieving a balanced alignment, optimization and consolidation of our production sites around the world. This process is to be carried out in as socially compatible a manner as possible. In addition, further cost reduction programs are being prepared and implemented in order to actively accelerate improvements in the value chain. The charges for this restructuring program in fiscal 2004 are expected to amount up to € 80 million.

### Outlook for 2004

Fiscal 2003 was characterized by the weakness of the world economy and a similarly weak US dollar. The competitive environment for specialty chemicals toughened significantly, particularly in Europe, and this was reflected in the selling prices and margins achieved. Nevertheless, the validity of Cognis' strategic alignment to the mega-trends wellness and sustainability was seen to be confirmed. The strategic business units serving the associated markets, namely Care Chemicals, Functional Products and Nutrition & Health, were able to successfully consolidate their positions within a difficult environment. The general direction for our business in 2004 has thus been clearly signposted.

There are many challenges facing Cognis in 2004, of which the above-described "Business Model Redesign" is just one. For example, the Group intends to assume ownership of services previously provided in large measure by its former proprietor Henkel, and in particular to significantly advance the roll-out of its in-house SAP platform.

Taking its budget assumptions as a basis, the Cognis management anticipates an increase in sales for 2004. In view of the initiatives for improvement introduced in 2003, the Company expects to report a substantial improvement in operating profit accompanied by a stable cash flow. This will enable the Company both to make further loan repayments and to fund capital expenditures while at the same time readily fulfilling the financial covenants contained in the bank contract. These forecasts are based on the expectancy that the world economy will undergo a degree of growth corresponding to gross domestic product increases of 2% in Europe, 3% in the USA and 5% in the Asia-Pacific region.

The US dollar is expected to remain weak. Cognis therefore hedged a large proportion of its US dollar-based exposure budgeted for 2004. On the procurement side, Cognis generally anticipates lower market prices to prevail (Note of the Management Board: This estimation was based on our level of information as at February 26, 2004. At the date of our editorial deadline, however, a material increase in prices became apparent on the procurement side, especially for lauric oils and crude oil). On the sales side, we expect to see a price recovery in the case of fatty alcohols but continue to anticipate difficult conditions in the other oleochemicals segments. This applies particularly to glycerin prices, which may be influenced for some considerable time to come due to subsidized biodiesel production and the advent of new capacities, particularly in the Asia region.



Cognis has the right formulas for the worldwide wellness mega-trend – for more on the "wellness" phenomenon: > page 26 to 31



Future-oriented business model for markets in flux - for more on the "Sustainability" mega-trend: > page 32 to 37