

SCHWARZ

P H A R M A

Annual Report 2002

2	Financial Overview SCHWARZ PHARMA-Group
3	Stock Information / Financial Calendar
4	Letter to the Shareholders
6	Report of the Supervisory Board
8	Our Identity – What we stand for
10	The Financial Year 2002 in Overview
16	Consolidated Financial Statements and Management's Discussion and Analysis
17	Consolidated Statement of Income
18	Consolidated Balance Sheets
19	Consolidated Statement of Cash Flows
20	Management's Discussion and Analysis
35	Segment Reporting
42	Risk Management
44	Notes to Consolidated Financial Statements
76	SCHWARZ PHARMA Affiliates
77	Leading SCHWARZ PHARMA Products
78	Supervisory Board and Executive Board
80	SCHWARZ PHARMA-Group Addresses

This Annual Report is published on the
Internet: www.schwarzpharma.com

Financial Overview SCHWARZ PHARMA-Group

	1998	1999	2000	2001	2002
From the Consolidated Statement of Income (€ in thousands)					
Net sales	681,644	705,883	736,192	767,728	963,534
Gross margin	458,332	412,072	431,583	466,018	638,469
Selling, general and administrative expense	267,034	293,223	301,012	313,195	378,509
Research and development expense	59,225	77,064	91,482	106,982	124,236
Operating profit	103,925	(29,820)	(3,613)	16,552	74,936
Net income	60,349	8,254	13,624	40,505	48,393

From the Consolidated Balance Sheet (€ in thousands)					
Cash and cash equivalents	26,533	35,603	23,993	32,282	161,324
Other current assets	234,077	261,295	219,433	258,974	280,802
Property, plant and equipment	132,655	164,867	179,526	193,034	171,997
Goodwill and other intangible assets	399,107	339,178	320,340	348,738	295,240
Long-term investments and other assets	20,785	66,055	73,664	71,921	107,281
Short and long-term debt	159,750	173,851	128,209	174,875	146,306
Other current liabilities	128,792	165,756	153,933	145,492	288,372
Accruals and other long-term liabilities	30,479	38,142	36,165	41,294	51,582
Shareholders' equity	494,136	489,249	498,650	543,288	530,384
Total	813,156	866,999	816,957	904,949	1,016,644

From the Consolidated Statement of Cash Flow (€ in thousands)					
Cash flow from operating activities	82,450	39,022	103,227	71,176	190,395
Depreciation / amortization (incl. impairment)	61,387	106,388	72,836	62,421	61,535
Cash flow from investing activities	(107,230)	12,125	(41,505)	(95,611)	(11,105)
Investments	(128,973)	(115,962)	(64,007)	(97,120)	(30,183)
Cash flow from financing activities	24,006	(42,637)	(74,364)	31,844	(35,566)

Key Figures

Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA)*	in € million	160.4	76.9	66.8	80.0	140.8
Earnings Before Interest and Taxes (EBIT)*	in € million	99.0	14.2	(3.7)	18.9	82.3
Earnings per share (Basic)	in €	1.34	0.19	0.31	0.92	1.10
Dividend per share	in €	0.64	0.13+0.39	0.28	0.30+0.30	0.60
Cash flow per share (cash flow from operations)	in €	1.83	0.87	2.35	1.62	4.31
Equity ratio	in %	60.8	56.4	61.0	60.0	52.2
Employees (annual average)	heads	3,101	3,347	3,233	3,428	3,739

* adjusted for one-time effects

** cash flow from operations

Stock Information/Financial Calendar

Per Share Information

		1998	1999	2000	2001	2002
Earnings per share	€	1.34	0.19	0.31	0.92	1.10
Cash flow* per share	€	1.83	0.87	2.35	1.62	4.31
Dividends per share	€	0.64	0.13+0.39	0.28	0.30+0.30	0.60
Book value per share	€	10.96	11.12	11.34	12.35	12.01
Market capitalization (12/31)	€ million	1,106	706	592	632	1,549
Number of shares (weighted average)	in thousands	45,080	44,964	43,987	43,987	44,172
Number of shares (weighted average, diluted)	in thousands	45,080	44,964	43,987	43,987	44,449
Number of shares (12/31)	in thousands	45,080	43,989	43,987	43,987	44,725

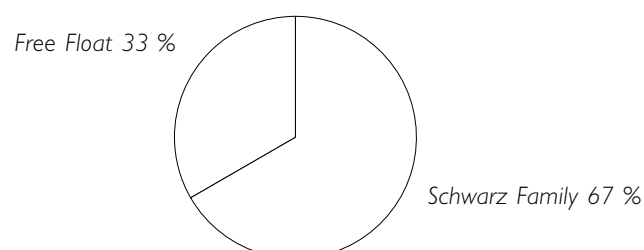
Security code no. 722 190
ISIN no. DE 0007221905
Number of shares re-based:
1:2 share split July 15, 2002

*Cash flow from operating activities

Financial Calendar

February 19, 2003	4th Quarter Report 2002, Press Conference, Analysts' Meeting
April 30, 2003	1st Quarter Report 2003
May 13, 2003	Annual Meeting of Shareholders in Duesseldorf
July 28, 2003	2nd Quarter Report 2003
October 27, 2003	3rd Quarter Report 2003
February 2004	4th Quarter Report 2003, Press Conference, Analysts' Meeting
May 26, 2004	Annual Meeting of Shareholders in Duesseldorf

Shareholder Structure SCHWARZ PHARMA AG



Letter to the Shareholders

Dear Shareholders and Friends
of SCHWARZ PHARMA,

The 2002 financial year was a successful year for us. We not only increased sales and net income significantly, but also achieved an important milestone for the SCHWARZ PHARMA Group with the market launch of generic omeprazole in the U.S. Earnings from this business will help to enhance our transformation into an innovative pharmaceutical company.

In addition, the year 2002 was characterized by decisive progress in the development of our pipeline projects.

The SCHWARZ PHARMA Group increased sales by 25.5% in 2002 to € 963.5 million. The operating result improved significantly by € 58.4 million to € 74.9 million. This development was due to the market introduction of generic omeprazole in December 2002. The net income for the year rose by 19.5%, or by 200.6% on an adjusted basis, to a total of € 48.4 million. We are therefore proposing an annual dividend of € 0.60 per share.

The development pipeline of SCHWARZ PHARMA is focused on the therapeutic areas neurology and urology and now consists of two projects in phase III, three projects in phase II b as well as one project in clinical phase I. We achieved the following milestones in 2002:

The international phase III clinical study program with the Parkinson's patch rotigotine CDS for the treatment of Parkinson's disease is making good progress. The results should be available in the first quarter of 2004.

In a phase II study with rotigotine CDS for the indication of restless legs syndrome (RLS), it was demonstrated that rotigotine CDS produced a dose dependent reduction in symptoms.

In November 2001 we licensed the Japanese development and marketing rights for rotigotine CDS to Otsuka Pharmaceutical Co. of Tokyo, Japan.

The results of the phase II project with harkoseride for the treatment of neuropathic pain are very promising: A study to treat the chronic pain caused by diabetic neuropathy showed a significant reduction of pain symptoms with good tolerability.

The results of a phase II study in epilepsy with harkoseride as adjunctive therapy indicated a reduction of epileptic seizures by more than 50% in a third of all patients as well as good tolerability.

Our compound, fesoterodine, is under development for the indication of overactive bladder/urinary incontinence. Results of the phase IIb study demonstrated a dose-related reduction in symptoms and good tolerability. Consequently, fesoterodine is now entering clinical phase III.

In June 2002, SCHWARZ PHARMA also acquired a new urology project involving the compound pamirosin, an α -receptor-blocker for the treatment of benign prostate hyperplasia, in clinical phase I.

For the fiscal year 2003, we are expecting a significant sales expansion to € 1.9 billion, at current US-Dollar exchange rates. Net income will rise to € 250 million.

Earnings from the sales of generic omeprazole represents a unique opportunity. We plan to use this cash flow within our strategy to assure and expand the earnings potential of SCHWARZ PHARMA on a sustainable basis. We will strengthen and expand our development pipeline and will search for suitable product acquisitions. These activities will be focussed in the U.S. and the preferred therapeutic areas are neurology and urology.

At this point we would like to thank all our employees for their impressive commitment and skills which they use for the benefit of the customers and shareholders of SCHWARZ PHARMA.

We would also like to thank our customers, business partners and shareholders for their confidence and loyalty to SCHWARZ PHARMA.

Patrick Schwarz-Schütte
Jürgen Baumann Prof. Dr. Iris Löw-Friedrich
Detlef Thielgen Dr. Klaus Veitinger

Monheim, March 2003

Report of the Supervisory Board

In the course of five meetings with the Executive Board in the fiscal year 2002, the Supervisory Board received in-depth information on the business development of the SCHWARZ PHARMA-Group. In addition to the most recent sales analysis, the focus of the meetings was on quarterly earnings analysis as well as the net asset and financial position of the company and its subsidiaries. There were also five meetings of the personnel committee of the Supervisory Board, responsible for management staff affairs. The Supervisory Board received a report about these meetings.

Regular reporting by the Executive Board and analysis by the Supervisory Board included:

- the progress and market introduction status of development projects, especially the further expansion of the development pipeline (e.g., inlicensing of the urology project SPM969, an alpha blocker for the treatment of benign prostate hyperplasia) and partnerships for development and marketing (e.g., with Otsuka Pharmaceutical, Japan, for the Parkinson patch rotigotine CDS, for the Japanese market);
- the improvement of the market position of the affiliates in the key markets of Europe and the U.S., including strategic product sales;

- development of the lawsuit and the market introduction of the generic version of the gastrointestinal drug omeprazole by KUDCo in the U.S. and
- the mid-term development strategies of the SCHWARZ PHARMA-Group, on which the Supervisory Board received continuous updates.

The finance, investment and personnel plans submitted by the Executive Board were reviewed and the Supervisory Board examined fundamental questions of corporate planning, which especially included the analysis of developments that deviated from previously reported targets. The Supervisory Board analyzed the corporate cost structure and compared it with industry standards. Last but not least, the examination of the Supervisory Board included the risk management system of the SCHWARZ PHARMA-Group and the associated procedural rules and processes.

Other matters for Supervisory Board resolutions were the Executive Stock Option Program 2000 (3rd tranche) with the associated creation of contingent capital, as well as issuing employee shares. The Supervisory Board suggested resolutions to the Annual Meeting of Shareholders concerning the renewal of the authorization to purchase and utilize its own shares, the renewal of the authorization to issue convertible and/or warrant-linked bonds and the creation of contingent capital, as well as a restructuring of the share capital (share split 1:2 as of July 15, 2002). A list of transactions and measures that require the prior approval of the

Supervisory Board was also ratified, and forms part of the internal regulations. Finally, the Supervisory Board passed a resolution about the Declaration of Conformity pursuant to § 161 of the Stock Corporation Act together with the German Corporate Governance Code.

The financial statements and the management report for SCHWARZ PHARMA AG and the consolidated financial statements for 2002 were audited and given an unqualified audit certificate from the auditors Ernst & Young, Deutsche Allgemeine Treuhand AG, Wirtschaftsprüfungsgesellschaft, Düsseldorf, who were retained by the Supervisory Board in October 2002 to audit the annual accounts with specific focus on defined areas. The financial statements, including the Auditor's Report, were presented to the Supervisory Board for examination in good time. The Supervisory Board acknowledged and approved the results of the audit and the audit conclusions as submitted by the auditor who attended the meeting of the Supervisory Board on March 20, 2003. There were no objections following the Supervisory Board's review of the final results. The Supervisory Board approved the financial statements of SCHWARZ PHARMA AG submitted by the Executive Board and the consolidated financial statements for the 2002 fiscal year and thereby adopted them. It will propose a cash dividend of € 0.60 per share to the Annual Meeting of Shareholders.

The Supervisory Board accepted the resignation of the Executive Board member, Mr. Klaus Langer, effective July 1, 2002. Mr. Detlef Thielgen was appointed as deputy member of the Executive Board on February 1, 2002 and became a full member of the Executive Board with responsibility for Finance, Controlling and Corporate Information Management on October 8, 2002. Mr. Jürgen Baumann and Dr. Klaus Veitinger were reappointed as members of the Executive Board for another three years by a resolution of December 9, 2002.

The Supervisory Board would like to express its gratitude and appreciation to the Executive Board members, Works Council members, senior managers and employees for their efforts during the year 2002.

Dr. Hans-Dietrich Winkhaus
Chairman of the Supervisory Board

Monheim, March 2003

Our Identity – What we stand for

During recent years SCHWARZ PHARMA has changed significantly. This was driven by the international expansion of the company as well as by the focus of SCHWARZ PHARMA on developing innovative products for use in therapeutic areas such as neurology and urology. Therefore, it was important that our strategy and corporate culture were defined in a clear and definitive statement that integrates our existing values and the way we see ourselves.

Our Mission

SCHWARZ PHARMA is a multinational pharmaceutical company.

We strive to serve unmet medical needs by developing and marketing innovative products for specialty markets.

We are committed to providing excellent services to our customers and creating significant value for our investors.

Our Values

Our values are based on our common strengths that have made SCHWARZ PHARMA the company it is today. At the same time these values empower us to live up to the expectations of the future. They also set standards for all our activities and provide consistent guidelines for the fulfillment of our mission.

A characteristic element of our value system – besides our customer orientation – is the freedom for everybody to responsibly work in an entrepreneurial way. This feature clearly differentiates SCHWARZ PHARMA from other corporations, but is also seen by our employees as an important motivating factor. Comparable to athletes, who compete with each other within the framework of a fair competition, other values such as integrity, fairness and respect, are important features of the way we perceive ourselves.

An important requirement for a mutual corporate culture is not only to communicate it verbally but also to find a way to let everybody experience it. We chose the figurative world of sports to illustrate our values in an unmistakable and emotive way. The images and their esthetic impressions are symbols for our values – they are 'ambassadors' mediating between the values and the people who fill them with life every day.

Entrepreneurship

As entrepreneurs we constantly strive for innovation of our products, improvement of services to our customers, and creation of sustainable value for our investors.

We rely on our competence and our commitment to our tasks and to each other:

We have the freedom to act and to take entrepreneurial decisions.

Accordingly we take responsibility for our actions.

We admit mistakes and learn from them.

Customer Orientation

We are dedicated to meeting our customers' needs and expectations.

For each of our customers, we go the extra mile and offer the extra smile.

Our customers are always right.

Integrity

We say what we mean and we do what we say. We are ethical in what we do.

All that we do could be explained to our families as well as to the public.

Fairness and Respect

We respect the unique personality of every individual and appreciate diversity.

We value the ability to listen and to consider each other's point of view as key to good teamwork and fair relationships.

We build our relationships on mutual trust.

The new Look of SCHWARZ PHARMA

The change of our company, driven by the international expansion and the transformation to an innovative pharmaceutical company demanded not only a new formulation of the Corporate Identity, but also a revision of the visual appearance, in order to internally and externally express the corporate change. The new visual identity works as a mediator between the company, its customers, partners and the public. It provides orientation in an environment which is often distracting in its confusion. It combines all our various activities by creating one common denominator that integrates them all and enables us to communicate in a clear and consistent way.

In developing the new Corporate Design we deliberately tried to avoid radical or only short-term changes. In fact, we wanted to show the development of the company, while trying to incorporate our visual tradition. Therefore the new Corporate Design expresses both our history as well as our future and thereby communicates reliability and stability as well as authenticity and well-planned evolution.

The Financial Year 2002 in Overview

- The SCHWARZ PHARMA Group increased its sales by 25.5% to € 963.5 million.
- The net income of SCHWARZ PHARMA rose significantly to € 48.4 million. We propose a dividend of € 0.60 per share.
- The development pipeline has made significant advances: it includes now two phase III projects and all phase II projects have demonstrated proof of concept.

Sales development 2002

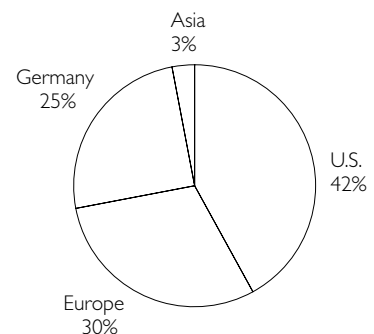
The SCHWARZ PHARMA Group increased sales by 25.5% in 2002 to € 963.5 million. After adjustments for currency fluctuations, the sales increase was 28.6%. The development of sales in the pharmaceutical business was as follows:

Europe

The German marketing organization achieved a 6.0% increase of sales to € 222.7 million. The products with the highest sales contribution were the gastrointestinal agent Rifun[®] (pantoprazole, € 36.1 million; +7.7%), the anti-asthmatic drug Atmadisc[®] (salmeterol xinafoate, € 28.0 million; +75.2%) and the anti-hypertensive drug Provas[®] (valsartan, € 24.5 million; +45.4%).

In other European markets, sales increased by 3.7% to a total of € 281.6 million. Sales developments varied in different markets: In Italy, sales rose by 3.2% to € 58.9 million. In France, the decline in sales was reduced over the course of the year and fared better than expected with a decline of -1.6% to € 56.2 million. The Spanish market is still under the influence of state-mandated price reductions and SCHWARZ PHARMA sales declined by 5.4% to € 41.9 million. Sales in United Kingdom decreased by 3.3% to € 30.7 million. The Polish affiliate realized a double-digit sales growth of 15.6% to € 27.7 million. Sales in Eastern Europe and export sales expanded by a similar growth rate (+15.4%) with a sales volume of € 66.2 million.

Breakdown of sales by region



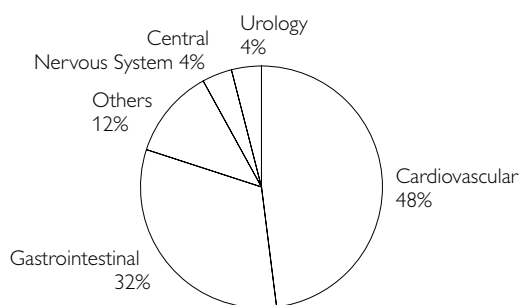
USA

Driven by the launch of the KUDCo's generic omeprazole, U.S. sales expanded by 75.2% to € 404.5 million. In U.S. Dollars, the growth rate was 84%. The generic drug omeprazole attained sales of € 176.3 million. On the branded side, the cardiovascular products Univasc®/Uniretic® (moexipril, € 62.5 million; +9.6%) and Verelan® PM (verapamil HCL, € 36.9 million; +10.2%) were important sales contributors.

Asia

The affiliates in Asia were able to continue their positive sales trend and increased sales by 40.4% to € 24.8 million.

Breakdown of sales by indication



Earnings Development 2002

Gross profit for 2002 rose by 37.0% to € 638.5 million – a faster growth rate than sales. This was due to an improved product mix (higher margin products achieved a larger percentage of sales) driven especially by the introduction of generic omeprazole.

Selling, general and administrative expense increased at a lower pace than sales. The increase by 20.9% to € 378.5 million was driven by legal expenses and licensing fees associated with generic omeprazole, higher personnel costs and increased insurance premiums.

Research and development expense increased by 16.1% to € 124.2 million. This reflects the development activities of the SCHWARZ PHARMA Group in 2002: Almost 3,000 patients were included in clinical studies in more than 400 clinical centers in over 25 countries.

Amortization of intangible assets declined by 10.9% to € 34.2 million, primarily as a result of the discontinuation of amortization of goodwill under US-GAAP since January 2002. In addition, amortization for several product rights have expired. Impairment expense pursuant to FAS 142/144 included depreciation of product rights both in 2001 and 2002 as well as depreciation for investment in a company for 2002.

Other operating income and expenses showed expenditures in the amount of € 23.5 million, after a positive figure of € 10.4 million in the previous year. This is primarily due to third party payments by KUDCo for its omeprazole generic.

The 2002 operating result significantly exceeded the 2001 operating result of € 16.5 million and rose to € 74.9 million.

The Financial Year 2002 in Overview

The financial result in the amount € –9.1 million reflects the normal use of debt in 2002, whereas the 2001 figure contained substantial interest payments from Axcan. Such interest payments will no longer be received, since AXCAN Pharma Inc., Canada fully paid off the remaining purchase price for all shares in the joint venture AXCAN SCHWARZ LLC at the end of June 2001.

Other operating income and expenses fell significantly, as the remaining purchase price in the amount of € 42.9 million for AXCAN SCHWARZ LLC had been reflected in the previous year. Adjusted for these non-recurring earnings, other operating income and expenses increased from € 10.1 million to € 14.6 million. The sale of product rights which are no longer part of the strategic focus of the SCHWARZ PHARMA Group, in Spain, Italy and the U.S., as well as revenues from the sale of marketable securities were the reason for this increase.

The income before taxes in 2002 was € 80.4 million. This is € 15.3 million or 23.5% more than in the previous year. Due to the higher profits which were taxable in the U.S., taxes on income increased by 29.2% to € 32.0 million. Consequently, net income was € 48.4 million, which represents an increase of 19.5%.

Adjusted for the 2001 Axcan non-recurring earnings, which had a net positive effect of € 24.4 million, SCHWARZ PHARMA was able to triple its net income to € 48.4 in 2002 compared to the amount of € 16.1 million in the previous year.

Corresponding earnings per share for 2002 were € 1.10. The proposed dividend is € 0.60 per share.

The number of shares doubled as a result of a stock split on July 15, 2002 (ratio 1:2) to 43.987 million. Additional shares from the stock option program and shares from own holdings were floated. As a result 44.752 million shares are outstanding. The average number of shares outstanding in 2002, used for the calculation of the earnings per share 2002, was 44.172 million shares.

Earnings per share



Financial Situation in 2002

Cash flow from operating activities increased by 167.5% to € 190.4 million. This was primarily driven by the launch of the generic product omeprazole.

Net cash flow used in investment activities was € 11.1 million, compared to € 95.6 million in the previous year. SCHWARZ PHARMA invested € 21.9 million in property, plant and equipment, compared to € 32.9 million in 2001. Investments for intangible assets were 8.2 million (2001: € 60.7 million) primarily invested in software and product rights. This was compensated by the sale of product rights in Spain, Italy and the U.S., and by the proceeds from the sale of securities amounting to € 19.0 million.

Investments (€ million)	2001	2002
Intangible Assets	60.7	8.2
Property, plant and equipment	32.9	21.9
Investments in		
Marketable Securities	3.6	0.0
Total	97.2	30.1

Cash flow used in financing activities amounted to € 35.6 million compared to € 31.8 million in the previous year. Cash flow from the base business was used to reduce short-term debt.

Compared to the status on January 1, 2002, the liquid funds of the SCHWARZ PHARMA Group on December 31, 2002 had increased by € 161.3 million. The financial structure of the SCHWARZ PHARMA Group has experienced a positive change as of December 31, 2002. Short-term debt has been reduced while long-term debt has been simultaneously increased. Thus, SCHWARZ PHARMA is taking advantage of the current favorable interest rates and has achieved increased planning security for the future. Since the funds from the omeprazole market launch were only received on the financial statement deadline, no other debt has been reduced.

Exchange rate effects have led to a slight equity capital reduction by 2.4%. As a result, the equity ratio was 52.2% compared to 60.0% at the end of 2001. The balance sheet total on December 31, 2002 increased by 12.3% to € 1,016.6 million.

Employees 2002

In addition to the re-definition of our mission and our values we developed new leadership guidelines, which became an important feature of our leadership. The combination of ambitious as well as realistic objectives which can be found in these leadership guidelines will provide orientation and direction. They create an environment where people like to work and want to do their best. They also help to develop and empower individuals and teams.

In 2002, the number of employees increased by 202 to 3,744. The average over the year increased by 311 to 3,739. The new employees were primarily hired in marketing and sales in Germany, Eastern Europe and Asia and in clinical development.

Employees by sectors

Marketing & Sales	48%
Production	26%
Service	15%
Research & Development	11%

By regions

Germany	41%
Europe	32%
USA	19%
Asia	8%

The Financial Year 2002 in Overview

Research & Development 2002

In place of cost-intensive basic research which carries a high degree of risk, SCHWARZ PHARMA seeks co-operations with partners at universities and in research companies within the biotechnological and pharmaceutical sectors. All development projects are coordinated globally from bases in Germany, Ireland, USA and Japan. The group undertakes worldwide search activities, as well as pre-clinical, pharmaceutical and clinical drug development. The work focuses on the therapeutic areas of neurology and urology.

Six promising development projects

Four projects are undergoing studies in clinical development in the area of neurology: the project to treat Parkinson's disease with rotigotine CDS is in phase III. In addition, we are working on a phase II project with rotigotine CDS for the indication of Restless Legs Syndrome (RLS) as well as two other phase II projects for the treatment of epilepsy and neuropathic pain with the compound harkoseride.

In urology, fesoterodine for the treatment of overactive bladder and urinary incontinence is now in phase III, while the compound pamirosin for the treatment of benign prostatic hyperplasia is in clinical phase I.

Neurology: Parkinson Project in Phase III, Three further Projects in Phase II b

The phase III studies on the treatment of Parkinson's disease with the Parkinson patch rotigotine CDS are making good progress: the studies have already enrolled more than 1,000 patients. Overall, more than 1,200 patients in early and advanced stages of Parkinson's disease are expected to be treated in the double blind and placebo controlled studies. The aim is to demonstrate efficacy and safety of the new dopamine agonist rotigotine CDS, which is applied to the skin once a day as a patch.

Parkinson's disease is a functional disorder of the central nervous system. The patients suffer from a lack of dopamine, a messenger substance in the central nervous system, which is responsible for the co-ordination of movement. In contrast to dopaminergic agents in tablet form, transdermal administration of rotigotine results in stable plasma levels which may lead to consistent efficacy and improved tolerance. This could be a milestone in improving the quality of life of patients who suffer from this disabling disease. The results of the phase III studies should be available in the first quarter of 2004. The projected future sales potential is approximately € 350 million per annum.

Otsuka Pharmaceutical Co. Ltd., of Tokyo, Japan acquired the exclusive development and marketing rights for rotigotine CDS in Japan in November 2002. SCHWARZ PHARMA receives milestone payments under this agreement and has established a collaboration with an established and renowned Japanese pharmaceutical company.

In a phase II study with rotigotine CDS for the indication of Restless Legs Syndrome (RLS), it was demonstrated that rotigotine CDS produced an apparent dose-related reduction in symptoms. A double blind, placebo-controlled phase IIb study involving 250 subjects is scheduled to begin in the second quarter of 2003. Up to 9% of the population suffers from this illness which is characterized by an unpleasant hyperkinesia of the legs, occurring primarily in the evening and at night. Dopamine agents are thought to be an effective treatment for the condition. The potential sales potential is € 200 million per annum.

The results of a phase II study for the treatment of epilepsy with the compound harkoseride as a supplementary therapy demonstrated a 50% reduction of epileptic seizures in more than a third of all patients. Harkoseride was well

tolerated by the patients. International, double blind and placebo-controlled phase IIb studies are in progress to confirm these results. A study enrolling a total of 500 patients commenced in February 2002. The expected sales potential is € 300 million per annum.

The results of the phase II project with harkeroside for the treatment of neuropathic pain are very promising: a study on diabetic neuropathic pain, a very common chronic pain, has demonstrated a significant reduction of pain symptoms with very good tolerance. Phase IIb trials will start in the fourth quarter of 2003. Currently there is hardly any drug approved for the treatment of neuropathic pain, a serious and underserved disease. However, anti-convulsant drugs are often used by physicians and patients to relieve this pain. The sales potential for harkoseride is estimated to be € 400 million per annum.

**Urology: Incontinence Project in Phase III;
One Further Project in Phase I**

The results of the double blind, placebo-controlled phase IIb study with fesoterodine, the compound for the treatment for overactive bladder/urinary incontinence, demonstrated a significant dose-related reduction of symptoms.

Fesoterodine was well tolerated by patients. Once these promising results became available in February 2003, fesoterodine entered clinical phase III. The anti-muscarinic agent fesoterodine is a patent protected new chemical entity developed by SCHWARZ PHARMA. It is characterized by its known mechanism of action and the expected sales potential is in the magnitude of € 450 million per year.

In June 2002, SCHWARZ PHARMA acquired the development and marketing rights for the new compound pamirosin for the treatment of benign prostatic hyperplasia from the Indian pharmaceutical company Ranbaxy Laboratories Ltd. pamirosin is expected to offer patients fast and effective relief from symptoms and will be developed and marketed by SCHWARZ PHARMA in the U.S., European and Japanese markets. More than 51 million men suffer from the condition in these regions. Pamirosin is a uroselective alpha-blocker, an established compound class for the treatment of benign prostatic hyperplasia. The project is already in clinical phase II in India, but is still in phase I in Europe and the USA. Phase IIb clinical studies involving more than 400 subjects are scheduled to begin in the first quarter of 2004. The projected sales potential is approximately € 450 million p.a.

Development pipeline

	Neurology	Urology
Phase III	Rotigotine CDS Parkinson's disease	Fesoterodine Overactive bladder/ urinary incontinence
Phase IIb	Harkoseride Epilepsy Harkoseride Diabetic neuropathic pain Rotigotine CDS Restless legs syndrome	
Phase I		Pamirosin Benign prostate hyperplasia

Consolidated Financial Statements and Management's Discussion and Analysis

The accompanying consolidated financial statements were prepared in accordance with the United States Generally Accepted Accounting Principles (U.S. GAAP). The consolidated statements of income, shareholders' equity and statement of cash flows were prepared for the years ended December 31, 2002, 2001 and 2000. The consolidated balance sheets were prepared as of December 31, 2002 and 2001.

In order to comply with § 292a German Commercial Code (HGB), the consolidated statements were prepared in Euro and supplemented with Management's Discussion and Analysis and further explanations. Therefore, the consolidated financial statements comply with the Fourth and Seventh Directive of the European Community.

The complete consolidated financial statements of SCHWARZ PHARMA AG – established in Euro – shall be published in the Bundesanzeiger and deposited with the Handelsregister (Commercial Register) of the Amtsgericht (Local Court) of Düsseldorf.

Independent 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 SCHWARZ PHARMA AG for the business year from January 1 through December 31, 2002. The preparation and the content of the consolidated financial statements are the responsibility of the Company's Executive Board. Our responsibility is to express an opinion whether the consolidated financial statements are in accordance with United States Generally Accepted Accounting Principles (U.S. GAAP) based on our audit.

We conducted our audit of the consolidated financial statements in accordance with German auditing regulations and generally accepted standards for the audit of financial statements promulgated by the Institut der Wirtschaftsprüfer (IDW). 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 eco-

nomical 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 of the Group and the cash flows for the business year in accordance with U.S. GAAP.

Our audit, which also extends to the Management Discussion and Analysis prepared by the Executive Board for the business year from January 1 through December 31, 2002 has not led to any reservations. In our opinion, on the whole the Management's Discussion and Analysis together with the other disclosures in the consolidated financial statements 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 Management's Discussion and Analysis for the business year from January 1 to December 31, 2002 satisfy the conditions required for the Company's exemption from its obligation to prepare consolidated financial statements and the Management's Discussion and Analysis in accordance with German law. We conducted our audit of the required consistency of the group accounting and the Seventh EU Directive for the exemption from the requirement for consolidated accounting pursuant German commercial law on the basis of the interpretation of the Directive by the European Commission's Contact Committee on Accounting Directives.

Düsseldorf, February 24, 2003

Ernst & Young
Deutsche Allgemeine Treuhand AG
Wirtschaftsprüfungsgesellschaft

signed Beyer signed Lewe
Wirtschaftsprüfer Wirtschaftsprüfer

Consolidated Statement of Income

SCHWARZ PHARMA AG and Subsidiaries

For the business year from January 1 to December 31 (€ in thousands; except per share amounts)	Notes	2000	2001	2002
Net sales		736,192	767,728	963,534
Cost of goods sold		304,609	301,710	325,065
Gross profit		431,583	466,018	638,469
Selling expense		244,209	254,078	293,175
General and administrative expense		56,803	59,117	85,334
Research and development expense		91,482	106,982	124,236
Amortization and depreciation of intangible assets		46,354	38,413	34,236
Impairment loss (according to FAS 142)		2,326	1,329	3,062
Other operating income (expense) – net		5,978	10,453	(23,490)
Operating income (loss)		(3,613)	16,552	74,936
Interest and similar income		15,509	3,613	2,499
Interest expense		8,939	8,036	11,637
Other income (expense) – net	8	14,820	52,985	14,605
Income before income taxes and minority		17,777	65,114	80,403
Income tax	9	4,369	24,822	32,032
Minority interest		(216)	(213)	(22)
Net income		13,624	40,505	48,393
Earnings per share (basic) in €	17	0.31	0.92	1.10
Earnings per share (diluted) in €		0.31	0.92	1.09

Consolidated Balance Sheets

SCHWARZ PHARMA AG and Subsidiaries

December 31 (€ in thousands)	Notes	2001	2002
ASSETS			
Current assets			
Cash and cash equivalents		32,282	161,324
Marketable securities		12,013	3,712
Accounts receivable, less allowances (2001: 1,874; 2002: 2,208)		125,694	147,998
Inventories	10	87,267	94,063
Prepaid expenses and other current assets		8,129	9,755
Deferred income taxes	9	25,871	25,274
Total current assets		291,256	442,126
Property, plant and equipment			
Land and buildings		132,275	125,946
Machinery and equipment		182,116	185,267
Construction in progress		11,145	2,478
Less accumulated depreciation		132,502	141,694
Total property, plant and equipment	11	193,034	171,997
Goodwill and other intangible assets			
net of accumulated amortization (2001: 275,691; 2002: 286,836)	11	348,738	295,240
Long-term investments and other assets			
Deferred income tax – non current	9	24,003	37,363
Total assets		904,949	1,016,644
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities			
Short-term debt	13	56,289	50,860
Current portion of long-term debt	13	73,431	11,667
Accounts payable		55,195	53,570
Accrued liabilities and other current liabilities		75,617	185,849
Income and other tax liabilities		14,680	48,953
Total current liabilities		275,212	350,899
Long-term debt	13	45,155	83,779
Pensions	15	19,682	21,089
Other accrued and non-current liabilities		21,199	30,102
Minority interests		413	391
Shareholders' equity			
Common stock			
(authorized 86,820,000 shares, issued 45,080,000 shares in 2001 and 45,217,580 in 2002)		58,604	58,783
Additional paid-in capital		141,327	144,034
Retained earnings		277,099	299,100
Treasury stock; at cost (1,093,000 shares in 2001 and 493,000 in 2002)		(17,813)	(8,032)
Accumulated other comprehensive income ¹⁾		84,071	36,499
Total shareholders' equity	16	543,288	530,384
Total liabilities and shareholders' equity		904,949	1,016,644

¹⁾ OCI = "Other Comprehensive Income" according to FAS 130 "Reporting Comprehensive Income".

Consolidated Statement of Cash Flows

SCHWARZ PHARMA AG and Subsidiaries

Year ended December 31 (€ in thousands)	2000	2001	2002
Cash Flow from Operating Activities			
Net income	13,624	40,505	48,393
Adjustments to reconcile net income to net cash:			
Depreciation and amortization	70,510	61,092	58,473
Impairment loss	2,326	1,329	3,062
Loss (Gains) on sales of tangible and intangible assets	(605)	1,153	(8,284)
Loss (Gains) on sales of long-term investments	(8,509)	0	(2,053)
Undistributed earnings of affiliates	6,862	3,385	(1,239)
Deferred income taxes	(5,501)	(7,108)	(15,284)
Net changes in assets and liabilities:			
Accounts receivable	(4,230)	(15,139)	(29,163)
Inventories	48,353	(4,669)	(13,475)
Other assets	(2,303)	(2,858)	(25,919)
Accounts payable	(1,606)	(681)	485
Accrued domestic and foreign taxes	(4,573)	(4,408)	37,596
Pensions	(4,282)	554	939
Other accrued liabilities	(6,839)	(1,979)	136,864
Net Cash Provided by Operating Activities	103,227	71,176	190,395
Cash Flow from Investing Activities			
Capital expenditures	(40,883)	(32,852)	(21,938)
Acquisition of businesses and intangible assets, net of cash acquired	(18,143)	(60,679)	(8,205)
Proceeds of sales of property, plant and equipment and intangible assets	11,285	1,509	12,736
Purchase of investments and marketable securities	(4,980)	(3,589)	(40)
Proceeds from sales/maturities of marketable securities	11,316	0	6,342
Net Cash Provided by (Used in) Investing Activities	(41,405)	(95,611)	(11,105)
Cash Flow from Financing Activities			
Net change in short-term borrowings	(20,736)	19,564	(5,430)
Proceeds from long-term debt	27,503	53,956	58,518
Repayments of long-term debt	(58,626)	(29,579)	(74,928)
Issuance (purchase) of treasury stock	(15)	0	9,780
Increase of capital stock/additional paid-in capital	0	0	2,886
Dividends paid	(22,490)	(12,097)	(26,392)
Net Cash Provided by (Used in) Financing Activities	(74,364)	31,844	(35,566)
Effects of exchange rate changes on cash and cash equivalents	932	880	(14,682)
Change in cash and cash equivalents	(11,610)	8,289	129,042
Cash and cash equivalents at beginning of period	35,603	23,993	32,282
Cash and cash equivalents at end of period	23,993	32,282	161,324

Management's Discussion and Analysis

Discussion of Statement of Income

The Consolidated Statement of Income summarizes the SCHWARZ PHARMA Group's operating performance over the last three years.

Net sales

SCHWARZ PHARMA Group increased net sales by 25.5% to € 963.5 million in 2002.

In 2001, sales growth of € 31.5 million (+4.3%) to € 767.7 million was recorded. In 2002 exchange rate effects decreased sales with € 23.7 million, as compared to the positive effect in the amount of € 8.4 million in 2001 and € 34.7 million in 2000.

International sales grew by 35.5% in 2002 to € 723.4 million (+6.6% in 2001 and 9.2% in 2000, respectively), whereas sales of the German distribution organization increased by +6.0% to € 222.7 million (as compared to +5.7% in 2001). This is less than the average German market growth of 8.2%. International sales accounted for approximately 75.1% of the Group sales in 2002 as compared to 69.6% in 2001 and 68.0% in 2000. The U.S. accounted for 55.9% of these foreign sales in 2002 (43.2% in 2001 and 43.5% in 2000). Europe accounted for 40.7% as compared to 53.5% in 2001 and 54.2% in 2000, and Asia for 0.4% (0.3% in 2001 and 2000).

In 2002 the twenty-five top selling products accounted for 75.9% of total SCHWARZ PHARMA Group sales. The absolute top seller in 2002 was the generic drug omeprazole (a gastrointestinal drug) which was launched on the U.S. market in December. With sales of € 176.3 million, it replaced the previous top selling product Moexipril® (single compound: Univasc®/Femipres® and combined compound:

Uniretic®/Femipres Plus®), which posted sales of € 73.8 million for the year 2002 (+9.9% compared to previous year).

Additional top selling products in 2002 continued to include nitrates (cardiovascular products: Isoket® and Elantan®), which achieved a total sales volume of € 98.6 million for SCHWARZ PHARMA. The Group was able to post sales of € 42.2 million for Prostavasin®, a drug for the prevention of peripheral arterial occlusive diseases in 2002, which is equivalent to an increase of 4.2%. Sales of Deponit®, a glycerol trinitrate patch for medicating coronary heart disease also rose to € 37.0 million.

Sales of the calcium antagonist Verelan® PM, a drug for the treatment of hypertension registered in the U.S. market, increased by 10.2% to € 36.9 million in 2002 compared to € 33.5 million in prior year. Verelan® PM is closely followed in the top product list by the gastrointestinal drug Rifun®, which achieved sales of € 36.1 million and consequently an increase of 7.7% over previous year.

The most important products licensed in 2000 again continued to perform well in 2002: sales of the anti-asthma drug Atmadisc® rose to € 28.0 million, while the A2-antagonist Provas® achieved sales of € 24.5 million. This represented increase rates of 75.2% (Atmadisc®) and 45.5% (Provas®) respectively, compared to 2001.

Gross profit margin was 66.3% of sales in 2002 as compared to 60.7% in 2001 and 58.6% in 2000. In absolute amounts, the increases in gross profit margins were more than proportional (+37% or € 172.5 million) as compared to previous year. These increases were primarily the result of launching the new generic drug omeprazole on the U.S. market (a product with a high share of net sales revenue, but a relatively small share of production cost), selling products with higher profit margins (e.g. Univasc®/Uniretic® and Verelan® PM) as well as optimizing the production units.

Selling expenses include promotion expenses, sales force expenses and other marketing expenses. As a percentage of sales, selling expenses decreased to 33.1% in 2001 from 33.2% in 2000, and only amounted to 30.4% of sales in 2002. An important factor in this reduction was the launch of omeprazole in the USA, which only required minor selling activities, thus resulted in low selling expenses. The absolute increase in selling expenses by € 39.1 million compared to previous year is primarily due to profit sharing agreements associated with the marketing of omeprazole. Further, sales force cost rose as a consequence of taking over external Atmadisc® sales representatives in Germany, while promotion expenses for various products in Germany, France, and Spain could be reduced.

Even though several products were launched and the sales force expanded in 2001, selling expenses remained nearly on the same level as in 2000 at 33.1% of sales. Nexxair®, a drug for the treatment of asthma was introduced in France and Bactil®, a product against allergies was launched in Spain. SCHWARZ PHARMA strengthened its position in the Polish cardiovascular market by introducing Cardin®. Furthermore, the sales force was expanded in several markets where SCHWARZ PHARMA is very successful (e.g. Germany, Poland and Asia).

In 2000, the anti-asthma drug Atmadisc® was introduced in Germany. With Clivarina® and Primesin®, SCHWARZ PHARMA reinforced its position on the Italian cardiovascular market during the year.

General and administrative expenses with a percentage of sales of 8.9%, were slightly higher than in the two previous years (2001: 7.7%; 2000: 7.7%). In addition to increased insurance premiums and higher personnel cost, this rise was caused by costs associated with the sales of the generic drug omeprazole (particularly legal consulting and other expenses) in the USA.

As a percentage of sales, general and administrative expenses amounted to 7.7% in 2001. Despite unfavorable exchange rate effects, this level could still be maintained as a result of the re-organizational measures initiated in 1999. The results of these measures created newly defined and more efficient organizational units and implemented a strict worldwide cost savings program.

Research and development expenses increased by 16.1% or € 17.3 million to € 124.2 million in 2002. As a percentage of sales, 12.9% have been spent for research and development expenses, compared to 13.9% in 2001 and 12.4% in 2000. This decrease is the result of the successful marketing of omeprazole. Without omeprazole sales the share of research and development expenses would have been 15.8%. This increase over previous year reflects the development activities of the SCHWARZ PHARMA pipeline, since all projects advanced further during the reporting year.

Over 2.900 subjects were treated as part of clinical studies in more than 413 clinical centers in over 29 countries. The development pipeline currently includes five projects in advanced stages of clinical development as well as the new urology project SPM969 in phase I which was licensed in June. The description below is limited to the most important clinical projects.

Clinical development in neurology to find drugs for Central Nervous System diseases (CNS) is proceeding with four projects: rotigotine CDS

Management's Discussion and Analysis

for the therapy of Parkinson's disease and restless legs syndrome, and harkoseride for the treatment of epilepsy and neuropathic pain.

The project rotigotine CDS (Parkinson patch) is proceeding as scheduled. More than 1.000 subjects suffering from Parkinson's disease have already been admitted to the three phase III studies. Results should be available in the first quarter of 2004.

In a phase II study with rotigotine CDS for the indication of restless legs syndrome (RLS), it was demonstrated that the dopamine agonist rotigotine CDS can bring about a clinically significant, dose-related reduction in symptoms. The successful completion of the first clinical phase II study now allows for studying rotigotine CDS in longer treatment periods as part of phase II. The phase IIb studies are scheduled to begin in the second quarter of 2003.

An open phase II tolerability study with the compound harkoseride for the treatment of epilepsy was conducted with 86 subjects suffering from epilepsy. A first analysis of the results demonstrated over 50% reduction of seizures in a third of the patients. Harkoseride was well tolerated by patients. SCHWARZ PHARMA is confident that the scheduled clinical phase IIb international studies will confirm these results. The clinical trials of phase III are set to begin during the course of 2004.

In the indication of urology, SCHWARZ PHARMA has two promising development programs with fesoterodine and the newly licensed urology project SPM969, which is currently in phase I.

The results of the multinational clinical phase IIb studies on fesoterodine, a compound for the treatment of urinary incontinence, are expected during the first quarter of 2003.

At the end of June 2002, the Group purchased the development and marketing rights for a new drug for the treatment of benign prostate hyperplasia (internal project name: SPM969) from the Indian pharmaceutical company Ranbaxy Laboratories Ltd. This secures the exclusive rights for the leading pharmaceutical markets USA, Europe and Japan for SCHWARZ PHARMA. The Group will take over clinical development for these markets. If the project is successful, SCHWARZ PHARMA will pay a total of US\$ 42.0 million to Ranbaxy over the next five to six years. This already includes the upfront-payment of US\$ 6.3 million that was payable at the time of entering into the agreement.

Study plans are currently being developed and we are in the process of preparing the phase I studies scheduled to begin in early 2003. The project is already in phase II in India.

The global BPH market reached a sales volume of US\$ 2.2 billion in 2001. In the U.S., Europe and Japan, the market had a total sales volume of US\$ 2.0 billion with double-digit growth rates.

Essential new development cooperation agreements

Otsuka Pharmaceutical Co. Ltd., of Tokyo, Japan purchased the exclusive rights for developing and marketing rotigotine CDS in Japan in November 2002. As a result of this agreement, Otsuka now holds the Japanese rights for all indications and potential applications. For these rights, SCHWARZ PHARMA receives installments and milestone payments, which totaled € 8.0 million in 2002.

Amortization and depreciation of intangible assets

Amortization of intangible assets declined by € 3.4 million in 2002, primarily as a result of the discontinuation of amortization of goodwill according to FAS 142 "Goodwill and Other Intangible Assets" since January 1, 2002. In addition, amortization for product rights, patents and other rights declined slightly by € 0.8 million.

In 2000, the human growth formulations Nutropin AQ® and Nutropin Depot® were in the process of being registered with the European authorities (EMEA). Nutropin AQ® was registered in January 2001, whereas for Nutropin Depot® it became clear towards the end of the first quarter of 2001 that the approval process would be delayed. As a result of these delays, in 2000 SCHWARZ PHARMA AG recorded an extraordinary depreciation charge of € 7.8 million related to previously capitalized pre-payments.

As the project would have required more resources than expected and marketing Nutropin AQ® without Nutropin Depot® did not appear feasible, the exclusive development and marketing rights, purchased in January 1999, were sold back to Genentech Inc., USA, in June 2001.

Impairment loss according to FAS 142 (until 2001: FAS 121)

In 2002 the Group recorded impairment losses according to FAS 142 in the overall amount of € 3.1 million. This included a product right in Germany with € 2.0 million and the investment of SCHWARZ BIOSCIENCES Inc. in the U.S. company Alviva Inc. of € 1.1 million. These write-downs were determined as the difference between the book value of the product right or the investment and their corresponding market value, which reflects discounted future cash flows.

As future sales of Mizollen®, a product marketed in the United Kingdom for the relief of allergies, are expected to be below future expectations, an impairment loss according to FAS 121 (FAS 142) of € 1.3 million was recorded in 2001.

Upon termination of the "C-Peptide" project (SPM 933) in 2000, the Company fully depreciated € 2.3 million of non-marketable securities of our contractual partner Creative Peptides AB, Sweden. The carrying value of these securities could not be justified any longer due to the termination of the project.

The largest portion of the **other operating** income in 2002 came from an upfront-payment in the amount of € 5.0 million as well as the first milestone payment in the amount of € 3.0 million from Otsuka Pharmaceuticals Ltd., of Tokyo, Japan for the exclusive development and marketing rights for rotigotine CDS in Japan. In addition, SCHWARZ PHARMA received a final settlement payment from Genentech Inc., USA for Nutropin (€ 0.8 million). Compared to previous year, **other operating expense** showed a sharp increase. This is primarily due to expenses for profit sharing agreement with

Management's Discussion and Analysis

Genpharm and Andrx. In exchange, the contract partners had waived their claims to the exclusive marketing rights of the generic drug omeprazole for the first 180 days after the verdict.

Other operating income in 2001 includes a € 4.4 million gain from the disposal of ASES Technology as well as a € 1.9 million gain that our French affiliate achieved by selling some minor product rights. In addition to this, included here are reimbursements from the former AXCAN-SCHWARZ LLC Joint venture for selling and administration expenses as well as marketing support for Verelan® from Elan Corporation.

Interest and similar income amounted to € 2.5 million in 2002 as compared to € 3.6 million in 2001 and € 15.5 million in 2000. One essential reason for the income decrease in 2002 compared to previous years is the absence of interest income of € 2.0 million in 2001 due on the outstanding principal payment for the sale of the joint venture AXCAN-SCHWARZ LLC. AXCAN Pharma Inc. of Canada had repaid the outstanding principal from the sale of the joint venture in full on June 30, 2001.

The decline in interest and similar income in 2001 as compared to 2000 mainly resulted from the fact that marketable securities were sold in 2000 for an amount of € 9.0 million. In addition to this, interest income generated from the outstanding principal payments due from AXCAN Pharma, Inc. upon the divestiture of the joint venture AXCAN-SCHWARZ LLC, was lower in 2001. Interest income on the outstanding principal decreased by € 2.9 million as compared to 2000 (2001: € 2.0 million; 2000: € 4.9 million).

Interest expense amounted to € 11.6 million in 2002, which was significantly above the previous year's expenses of € 8.0 million. This increase reflects the normal use of debt in the business year 2002. The use of debt especially increased in the U.S., as the U.S. subsidiary acquired two product rights at the end of 2001. Short-term debt was reduced while long-term debt was simultaneously increased. Thus, SCHWARZ PHARMA is taking advantage of the current favorable long-term interest rates, even though they are above interest rates for short-term debt. The debt of the SCHWARZ PHARMA Group could only be reduced in the last quarter of 2002 by means of cash flow from operating activities. Consequently, the total interest loss increased to € -9.1 million compared to € -4.4 million in the previous year. This was primarily due to the absence of interest income from Axcan and higher average use of debt in the reporting year than in 2001.

Interest expenses in 2001 amounted to € 8.0 million and were slightly below the expenses of 2000 of € 8.9 million. This decrease in 2001 was due to a reduced use of normal debt and low interest rates. Compared to 2000 the net interest result went down by € 1.9 million, since interest income from AXCAN PHARMA Inc., Canada, decreased in 2001 (net interest expenses in 2001: € 4.4 million; 2000: € 2.5 million). The aforementioned net interest expenses for 2000 (€ 2.5 million) is already reduced by the income of € 9.0 million that had been achieved by selling current asset securities.

The significant reduction of **other income** in 2002 compared to 2001 is primarily the consequence of the one-time principal payment by AXCAN Pharma Inc., Canada, in 2001 in the amount of € 42.9 million. Adjusted for this effect, the remaining income even shows an increase of € 4.5 million. This income is primarily due to the disposal of product rights in Spain (€ 6.3 million), Italy (€ 2.6 million) and in the U.S. (€ 1.2 million) as well as the income from

the joint venture HOYER-MADAUS of € 3.6 million, which overall represents an increase of € 1.3 million compared to 2001. In addition, this item includes gains and losses on the disposal of fixed assets, exchange rates and other non-operative expenses and income.

Other income (expense) – net increased in 2001 primarily as a result of the premature payment by AXCAN Pharma Inc., Canada, of the remaining principal from the 1999 divestiture of the AXCAN-SCHWARZ LLC Joint venture. This income amounted to € 42.9 million. As AXCAN U.S. was a highly leveraged entity, the non-cash portion of the gain on the original transaction was deferred and set off against the underlying purchase price receivable until such time AXCAN U.S. has enough cash flow available to make payments. The Company has recognized the gain as principal payments were received. In addition, an accrual, originally set up in 1999 for past-registration risks, was reversed in 2001 (€ 10.2 million).

In the reporting year 2000, other income had amounted to € 14.8 million. In addition to the equity portion in net income of the investment in the Joint venture HOYER-MADAUS amounting to € 1.4 million, other income had been positively impacted by scheduled gains from the divestiture of the AXCAN-SCHWARZ LLC Joint venture in the USA (€ +10.1 million as compared to previous year) as well as gains from the disposal of product rights (€ 5.8 million).

The **income tax rate** in 2002 is slightly above the level of previous year with 39.8% (2001: 38.1%; 2000: 24.6%), since a large portion of the income is taxable in the USA and various operating expenses are not tax deductible in a number of countries.

After the tax rate could be reduced in 2000 primarily by diversification of taxable income from Germany to other countries where income is subject to lower tax rates, it increased in 2001. This is mainly due to the non-operating one-time gain from the remaining principal payments received from the divestiture of the AXCAN-SCHWARZ LLC Joint venture in the USA, which is taxed at approximately 43%.

Net income increased by 19.5% to € 48.4 million in 2002, whereas in 2001 it increased by 197% to € 40.5 million as compared to 2000. Exchange rate effects influenced net income differently in the considered reporting periods. Net income was negatively impacted by exchange rates with an amount of € 2.6 million in the reporting year, while exchange rates had slightly increased net income by € 1.6 million in prior year. In 2000, exchange rate effects also had increased net income by about € 1.4 million. Adjusted for currency effects, net income increased in 2002 by 26%, in 2001 by 185%, and in 2000 by 48.4%. Net income as a percentage of sales was 5.0% in 2002, compared to 5.3% in 2001 and 1.9% in 2000. Significant changes in 2002 and 2001 pre-tax income related to:

2002:

- Income from the sale of exclusive marketing rights for rotigotine CDS in Japan of € 8.0 million
- Gains on disposal of product rights of € 10.0 million
- Impairment loss of € 3.1 million according to FAS 142
- Increased research and development expenses by € 17.3 million

Management's Discussion and Analysis

2001:

- Income of € 42.9 million from of an early payment of the purchase price for the divestiture of the AXCAN-SCHWARZ LLC Joint venture
- Impairment loss of € 1.3 million according to FAS 121
- Increase of research and development expenses of € 15.5 million
- Gains on disposal of the ASES Technology of € 4.4 million
- Gains on disposal of product rights of € 1.9 million
- Income of € 10.2 million out of the reversal of an accrual for potential risks incurring after registration

Production

Production quantities and use of capacities

Both the production quantities and the use of production capacities have increased at the European sites over the past year. The only exception is the Spanish production facility, where a slight reduction of quantities was recorded as a consequence of special effects in the domestic market, which could not be compensated with contract manufacturing agreements.

Among the established products, an especially positive development was achieved with FERRO Duodenal. This compound for the therapy of iron deficiency diseases has experienced such strong growth domestically and recently also in foreign markets that the Company decided in favor of a significant capacity expansion at the Zwickau site.

An equally positive growth in drug production was recorded at the production sites in Poland and Ireland, which in turn was reflected in the increased quantities processed at the packaging facility in Monheim. In contrast, the department of compound synthesis has shown a declining tendency, which is primarily due to excess capacities on the global market and increasing competition from the Asian region.

The production company in the USA also achieved higher production quantities and increased capacity use during the reporting year. Due to the production of omeprazole, up to 100% of capacities were used in some cases. SCHWARZ PHARMA Manufacturing produced in one to three shifts, six days a week.

Machinery/equipment/processes

Investments in machinery and equipment amounted to a total of € 2.4 million at the European sites and € 5.7 million at the U.S. production site (primarily related to omeprazole).

The successful completion of a renovation project at the Monheim site, which included the implementation of a new space concept within the existing assembly facility, represented an essential step toward modernization. This also involved renovation measures for the efficient use of open spaces for the production of clinical trial compounds. The renovations passed the subsequent mandatory inspection by the authorities without qualifications. Projects for process improvement and simultaneous enhancements of the production standards were also implemented in Poland and Ireland. A modern distribution warehouse for export goods became operational in Langenfeld, which significantly shortened the previously existing processes and made them more efficient.

The new nitrate plant in Ireland has taken up regular production and will successively take over supply services to all nitrate customers, in accordance with authority permits. This also involved setting up a new facility for manufacturing retarded-release pellets, which has made it possible to stop utilizing an older building that is located outside of the actual company grounds. The new facilities in Ireland, including the new nitration plant, successfully passed an inspection by the U.S. Food and Drug Administration (FDA).

One special initiative of the past year pertained to the start of a supply chain management project, which is expected to yield significant efficiency increases and decreases in warehousing cost due to shorter through-put times.

Outlook

The expected cash inflow from the successful marketing of the generic drug omeprazole represents a positive change for the growth potential of the SCHWARZ PHARMA Group. The Company again expects a significant sales and earnings contribution from the USA in the current business year 2003. Based on the current exchange rate of the U.S. dollar, sales may reach € 1.8 billion. As a consequence, net income for 2003 may be as much as € 200 million.

In contrast, the effects of reforms in the public health care systems may lower the profit margin for important products and may affect sales and net income of the Company. Uncertainty about future market approval and successful launching of the projects in the development pipeline represents a central and decisive factor in the assessment of the future development of the SCHWARZ PHARMA Group and may significantly impact the business development of the coming years.

The cash inflow from marketing the generic drug omeprazole in the United States will be used to strengthen and expand the development pipeline of the SCHWARZ PHARMA Group with a focus on the indications neurology and urology. Additional investment projects would be examined in the context of existing and proven investment criteria.

SCHWARZ PHARMA may also be able to generate additional income opportunities by acquiring suitable products and licenses worldwide. In conjunction with innovative marketing strategies, these products might be able to contribute to corporate growth and support the development strategy in the mid- and long term.

Plans for fiscal year 2003 do not provide for additional debt or equity. However, should acquisitions or major product purchases constitute a need for major funding, SCHWARZ PHARMA AG could cover these requirements with its gross cash flow, by issuing common shares, non-voting preferred shares or convertible debentures. The Company also has committed lines of credit available.

Management's Discussion and Analysis

Discussion of Balance Sheet

The Consolidated Balance Sheet shows the Company's financial position at year-end in comparison to previous year-end. This statement provides information to assist in assessing factors such as the Company's liquidity and financial resources.

The overall effect of currency rate changes during the year caused a € 47.2 million (-2.4%) decrease in the foreign currency translation adjustments' equity account. These exchange rate changes also resulted in decreases in assets, particularly in goodwill, property, plant and equipment as well as in accounts payable and various accrual accounts.

As of December 31, 2002, the **liquid funds** of the SCHWARZ PHARMA Group increased considerably to € 161.3 million compared to the amount of € 32.3 million at the end of prior year. This increase is primarily attributable to the receipt of payments of the omeprazole sales in December 2002. Since the majority of receivables of these sales were paid only shortly before the end of the period, the now available liquid funds could not be used for a further debt reduction until the balance sheet date.

Marketable securities include the shares of the former joint venture partner AXCAN Pharma Inc. of Canada. 443,900 shares were sold during the fiscal year 2002, leading to a decrease in the amount of marketable securities to € 3.7 million as compared to € 12.0 million in previous year.

Accounts receivable increased to € 148 million by the end of the reporting year, compared to € 125.7 million in 2001. Again, this increase is primarily due to the sales of omeprazole, which were not completely settled with payments on balance sheet date. In addition, an increased sales volume in Asia led to increased receivables levels, while some companies were able to reduce their receivables at December 31.

Inventories grew by € 6.8 million to € 94.1 million on December 31, 2002 (2001: € 87.3 million). This was mainly associated with an increase of inventory for omeprazole and higher inventories of merchandise goods at SCHWARZ PHARMA Manufacturing Inc. Furthermore the inventory of semi-finished products at Sifa Ltd. was increased temporarily. In contrast, some companies were able to reduce their inventories at the end of the year by improving their inventory management practices.

Prepaid expenses increased slightly by € 1.6 million to € 9.8 million in the reporting year. As in prior year, this increase reflects the prepayments of SCHWARZ BIOSCIENCES Inc. to contract research organizations for certain clinical studies. Furthermore, this balance sheet item includes a one-time payment of the German sales company to the "Association of pharmaceutical research companies" (VFA) as a consequence of an agreement between the Federal German government and the pharmaceutical industry, which is due in installments over two years.

Fixed assets, net of accumulated depreciation, decreased by 10.9% to € 172.0 million. The main reason for this reduction in fixed assets is the negative current exchange rate difference in the amount of € 11.4 million as well as depreciation in the amount of € 22.2 million. This reduction in fixed assets was not compensated by investments during the reporting year which

totaled € 15.6 million. Additions to fixed assets are primarily related to the expansion of manufacturing capacities for omeprazole in the U.S. production company as well as computer and vehicle purchases for the sales representatives of various affiliates.

Goodwill and other intangible assets decreased together with fixed assets. They amounted to € 295.2 million on December 31, 2002 (2001: € 348.7 million). Again, this reduction is primarily due to exchange rate decreases (€ -27.8 million) and the depreciation of € 38.2 million effected during the current fiscal year. This includes an asset impairment loss according to FAS 142 on a product right of SCHWARZ PHARMA Deutschland GmbH. Investments in the amount of € 8.1 million refer to the acquisition of various product rights and licensing a number of software products (sales representative equipment, customer relationship management project, risk management software, laboratory software etc).

Long-term investments and other assets increased from € 47.9 million in 2001 to € 69.9 million by December 31, 2002. This increase essentially reflects the capitalization of derivative financial instruments associated with the Company's stock appreciation right programs. Furthermore, the increase is the result of a long-term claim from the disposal of the Nascobal product rights in the USA. Also, this line item includes impairment losses according to FAS 142, which were effected on an investment held by SCHWARZ BIOSCIENCES Inc. in the amount of € 1.1 million.

Total debt (short-term and long-term) considerably decreased from € 174.9 million in 2001 to € 146.3 million on December 31, 2002. Especially in the last quarter, debt was significantly reduced with the help of cash flow from current operations. Financing needs also declined due to decreased investments in fixed assets as well as intangible assets.

Accrued liabilities and other current liabilities increased significantly from € 75.6 million in 2001 to € 185.8 million in 2002. The reasons for this increase were provisions set up for profit sharing agreements, legal consulting fees, discounts, litigation cost and other obligations associated with the marketing of omeprazole. The item also contains provisions for outstanding invoices of the research division, which had not been submitted to the Company at the balance sheet date.

Tax liabilities increased significantly in 2002 by € 34.3 million to € 49.0 million mainly as a consequence of the profit contributions of the omeprazole business taxable in the USA.

Other accrued and non-current liabilities increased by a total of € 8.9 million to € 30.1 million as compared to € 21.2 million in 2001. This increase is the consequence of the deferral of gains from the disposal of Nascobal product right in the USA, which will be deferred until such time when payments will be received.

While **common stock** increased by € 0.2 million, **additional paid-in capital** rose by € 2.7 million. These equity capital changes are the result of converting 137,580 stock option rights into shares.

Management's Discussion and Analysis

Discussion of Cash Flows

The Consolidated Statement of Cash Flows reflects cash inflows and outflows from the Company's operating, investing and financing activities. After a moderate rise in cash and cash equivalents in the previous year (€ 8.3 million) to € 32.3 million, cash and cash equivalents rose by € 129.0 million to € 161.3 million in fiscal year 2002.

Cash Flow from Operating Activities

Cash flow from operating activities in 2002 increased significantly compared to the previous year by € 119.2 million to € 190.4 million. This is the highest cash flow from operating activities in more than five years. Net income improved by 19.5% to € 48.4 million. Depreciation and amortization amounted to € 58.5 million, which represents a reduction from prior year by € 2.6 million. Net change in other assets and liabilities led to an inflow of € 83.5 million. This development was mainly caused by accrued taxes in the amount of € 37.6 million, which was primarily the result of revenue generated in the USA. Furthermore, several extensive provisions relating to the marketing of omeprazole (profit sharing agreements, legal consulting fees, discounts, litigation cost and other liabilities) had to be set up. This development was countered by the rise in receivables (€ 29.2 million) and an expansion of other long-term assets by € 25.9 million.

During fiscal year 2001, cash flow provided by operating activities had decreased by 31.0% to € 71.2 million as compared to 2000. Net income rose to € 40.5 million in 2001 (2000: € 13.6 million). Depreciation and amortization amounted to € 61.1 million and were therefore € 9.4 million lower than the previous year's amount. Net change in other assets and liabilities led to an outflow of € 29.2 million. This included an increase in accounts receivable of € 15.1 million and a slight increase in inventories of € 4.7 million.

During 2000, cash flows provided by operating activities more than doubled to € 103.2 million. Beside the improvement of the consolidated net income of 65.1% to € 13.6 million, the successful reduction of inventory levels contributed cash flows of € 48.4 million. Depreciation and amortization amounted to € 70.5 million, which exceeded the previous year amount by € 7.8 million. Net accounts receivable and payables were reduced by € 23.8 million in total.

Cash Flow from Investing Activities

After intensive investment activities in 2001, which had resulted in a cash outflow of € 95.6 million, cash outflow from investing activities amounted to € 11.1 million during 2002. The principal investments included equipment for the sales force (computers, vehicles), expansion of the production capacities of the U.S. production company for manufacturing omeprazole as well as various product rights and software licenses. Significant cash inflow during the reporting year resulted from the divestment of product rights in Spain, Italy and the USA (€ 12.7 million) and the disposal of shares in AXCAN Pharma Inc. of Canada (€ 6.3 million).

In 2001, net cash used in investing activities was € 95.6 million. Of these investments € 32.9 million were spent for tangible assets. In addition to the investment in project-oriented production facilities in the USA, the new construction of the pharmaceutical manufacturing plant in Ireland, which was under construction for several years, was mostly completed. Approximately € 60.7 million was spent to acquire product rights and other intangible assets. This includes the acquisition of two product rights in the U.S. (€ 33.5 million), the contingent purchase price paid for the Spanish subsidiary, which was purchased in 1999 (€ 21.7 million) and business participations in several research and development partners (€ 3.6 million).

In 2000, net cash flow used in investing activities was € 41.4 million. The Company acquired € 64.0 million of gross investments and realized € 22.6 million of proceeds from asset disposals. Investments in tangible fixed assets of € 40.9 million mainly related to the new nitration plant in Ireland and the increasing capacities in the U.S. production facility. The acquisition of product rights and other intangible assets amounted to € 18.1 million (e.g. Atmadisc®). SCHWARZ PHARMA also acquired € 5.0 million of shares in one of its cooperation partners. Proceeds amounting to € 22.6 million from the disposal of marketable securities as well as product right disposals were recorded.

Cash Flow from Financing Activities

In 2002 portions of the cash flow from operating activities were used to reduce debt. While short-term bank loans were decreased by € 5.4 million, net long-term debt was reduced by € 16.4 million. The dividend for the fiscal year 2001 amounted to € 26.4 million. Due to the sale of treasury stock, a cash inflow of € 9.8 million was realized. In contrast to previous years, the strong increase in the exchange rate

of the EURO against the U.S. dollar had a negative impact on cash and cash equivalents (€ -14.7 million). Still, there is a significant increase of cash and cash equivalents by € 129.0 million to € 161.3 million at year-end.

During the fiscal year 2001, the positive cash flow from operating activities was not sufficient to cover investment activities. The financial gap was bridged by increasing short- and long-term loans by € 44.0 million. These loans were also used to pay the 2000 year dividend (€ 12.1 million). Cash and cash equivalents rose by € 8.3 million to € 32.3 million.

In 2000, the positive cash flow from operating activities was also used to reduce short- and long-term loans by € 51.9 million and to pay the 1999 year dividend (€ 22.5 million). Cash and cash equivalents were cut down by € 11.6 million to € 24.0 million.

The dividend payout ratio, which represents cash dividends paid per common share divided by basic earnings per common share, amounted to 54.5% in 2002, compared to 65.2% in 2001 and 89.3% in 2000.

In summary, based upon the Company's past performance and current expectations, the Board believes the cash flows generated from future operating activities, combined with the Company's world-wide financial capabilities, will provide adequate funds to support planned growth and continued improvements in the Company.

Management's Discussion and Analysis

Discussion of Segment Reporting

The SCHWARZ PHARMA Group is engaged in research, development, approval, manufacturing and marketing of a broad and diversified line of pharmaceutical products and services. The Company focuses on the treatment of diseases in cardiovascular, central nervous system (CNS), gastrointestinal, and urological indications. The majority of products are prescription-only and are sold primarily through pharmaceutical wholesalers.

The Company has adopted FAS Statement No. 131 "Discussions about Segments of an Enterprise and Related Information" according to U.S. GAAP. FAS 131 contains regulations for segment reporting on the basis of internal management, controlling and reporting ("Management Approach").

Management responsibilities have been modified within the SCHWARZ PHARMA Group during the reporting year to implement better controlling and to accommodate the spin-off of research and development activities into separate units. Consequently, the internal organizational structure of the SCHWARZ PHARMA Group is now as follows:

Europe

This segment includes the production and marketing of pharmaceutical products of all indications as well as local research and development activities in Europe.

USA/Asia

This segment focuses on the production and marketing of SCHWARZ PHARMA products on the North American and Asian market. In addition, some companies are involved in research and development activities for their local markets.

SCHWARZ BIOSCIENCES

SCHWARZ PHARMA has combined the development expertise, project management and the controlling of approval processes into one umbrella organization. This includes the global "search" activities as well as pharmaceutical and clinical drug development. The involved sites are Monheim, Germany as well as Research Triangle Park, North Carolina, USA.

Holding

The "Holding" segments bundles all administrative activities that pertain to multiple sites, but are centralized, such as financial and other holding activities.

Based on this differentiated presentation of Company activities, the Executive Board is the principal decision body to direct the business operations of the SCHWARZ PHARMA Group. The comparative figures from previous years (2000 and 2001) have been adjusted accordingly to reflect this change in the internal management and reporting structure.

Furthermore, FAS 131 requires information that is structured by regions and products, and specifies geographic segmentation into domestic and foreign categories.

The accounting methods used in the internal reporting by operating segment and geographic area comply with the accounting policies described in Note (1) of the consolidated financial statements.

Based on the aforementioned information, the segments are as follows:

Management's Discussion and Analysis

Segment Reporting by Operating Segment

Years ended December 31 (€ in thousands)	2000	2001	2002
Net Sales:			
Europe	567,336	557,845	580,844
USA/Asia	229,394	248,504	429,302
SCHWARZ BIOSCIENCES	0	0	0
Holding	54,964	56,452	56,358
Inter-segment elimination	(115,502)	(95,073)	(102,970)
Net Sales	736,192	767,728	963,534
Operating income (loss) before unallocated corporate expenses:			
Europe	93,436	82,129	70,748
USA/Asia	11,404	12,042	80,899
SCHWARZ BIOSCIENCES	(77,691)	(62,988)	(57,673)
Holding	(11,073)	10,524	3,497
Inter-segment elimination	4,286	(857)	1,582
	20,362	40,850	99,053
Unallocated corporate expenses (a)	(23,975)	(24,298)	(24,117)
Operating income (loss)	(3,613)	16,552	74,936
Identifiable Assets:			
Europe	377,128	406,434	399,939
USA/Asia	309,834	354,367	344,266
SCHWARZ BIOSCIENCES	15,873	31,150	35,283
Holding	217,355	232,586	236,992
Inter-segment elimination	(160,933)	(191,393)	(188,851)
	759,257	833,144	827,629
Corporate Assets (b)	57,700	71,805	189,015
Identifiable Assets	816,957	904,949	1,016,644
Long-lived Assets:			
Europe	219,140	227,138	210,335
USA/Asia	225,842	261,522	223,767
SCHWARZ BIOSCIENCES	1,128	8,649	11,558
Holding	77,739	67,485	68,596
	523,849	564,794	514,256
Corporate Assets (b)	11,065	10,728	10,349
Long-lived Assets	534,914	575,522	524,605
Additions to Tangible and Intangible Assets (c):			
Europe	35,589	18,967	15,437
USA/Asia	13,605	44,853	11,400
SCHWARZ BIOSCIENCES	1,205	3,027	2,763
Holding	3,983	5,799	3,445
Additions to Tangible and Intangible Assets	54,382	72,646	33,045
Depreciation and Amortization (d):			
Europe	26,047	26,479	25,878
USA/Asia	23,132	21,901	22,117
SCHWARZ BIOSCIENCES	122	1,370	2,291
Holding	21,209	12,671	10,188
Depreciation and Amortization	70,510	62,421	60,474

Management's Discussion and Analysis

Segment Reporting by geographic area

Years ended December 31 (€ in thousands)	2000	2001	2002
Net Sales , excluding inter-area sales:			
Germany	291,839	289,241	304,747
Europe (excluding Germany)	214,959	229,983	229,485
USA	217,885	230,851	404,512
Asia	11,509	17,653	24,790
Net Sales	736,192	767,728	963,534
Long-lived Assets:			
Germany	142,548	132,001	135,480
Europe (excluding Germany)	154,331	168,071	151,797
USA	222,466	260,231	223,815
Asia	4,504	4,491	3,164
	523,849	564,794	514,256
Corporate Assets (b)	11,065	10,728	10,349
Long-lived Assets	534,914	575,522	524,605

The above overview segments net sales and long-term assets of the Group by region. According to FAS 131.38, all values were determined with the same method as the published consolidated data. The total sums of the segmented data therefore correlate with the consolidated values.

- (a) Unallocated corporate expenses primarily relate to the Executive and the Supervisory Board, general counsel as well as expenses of the legal department, business development, international marketing and finance.
- (b) Corporate assets comprise cash and cash equivalents, short- to long-term marketable securities, fixed assets of the headquarter facilities as well as tangible assets held for sale.

- (c) Additions to tangible and intangible assets do not include assets acquired in a business combination and exchange rate effects.
- (d) Depreciation and amortization include those of tangible and intangible assets.

Sales between geographic areas are effected at cost plus a proportionate share of profit. During 2002, 2001 and 2000 no customer accounted for more than 10% of consolidated net revenue.

Within their respective operating segments, net sales and operating income are broken down as follows:

Management's Discussion and Analysis

Segment Reporting

Segment: Europe

(€ million)	2000	2001	2002
Net sales	567.3	557.8	580.8
Operating result	93.4	82.1	70.7

Sales development in Europe

After a sales decrease in 2001, sales in the European market were increased by as much as 4.1 %. The sales organizations in Germany, Italy, Poland and other Eastern European countries were able to solidify their market position with sales increases in 2002.

Germany

The German sales company was able to continue the positive trend of the previous year in spite of difficult economic circumstances. While the sales increase had been a slight 2.1% in 2001, 2002 resulted in a robust growth of 6.0%.

The trend that had become apparent in the product portfolio of SCHWARZ PHARMA Deutschland GmbH was again evident in 2002. While the sales development on non-patented products tended to be stagnant, sales of newly introduced patent-protected products (Provas[®], Atmadisc[®]) showed very positive results.

The best selling drug of SCHWARZ PHARMA Deutschland GmbH in 2002 was again the gastrointestinal drug Rifun[®] (pantoprazole); sales rose to € 36.1 million (+7.7%). The anti-asthma drug Atmadisc[®] (salmeterolfluticason), which had been newly introduced in September 2000, showed the largest absolute and relative growth with sales of € 28.0 million (+75.2%). Atmadisc[®] is followed by the cardiovascular drugs Prostavasin[®] (alprostadil), for peripheral arterial occlusive disease, and Provas[®] (valsartan), launched in 1999. Sales amounted to € 27.2 million (-1.9%) and € 24.5 million (+45.4%), respectively. Although sales of the established compound Isoket[®] (Isosorbid dinitrate) for the treatment of coronary heart disease suffered a sales setback of 14.8% to € 22.9 million, it continues to rank among the five best-selling products in Germany.

Italy

Sales in Italy as compared to the previous year rose by 3.2% to € 58.9 million. As in prior year, Deponit[®] (glycerol trinitrate), a compound patch for the treatment of angina pectoris, and Lorans[®] (lorazepam), a compound for anxiety disorders were the best-selling products with sales of € 14.8 million (+0.3%) and € 8.4 million (-12.8%) respectively. The cardiovascular drug Clivarina[®] (reviparin sodium) and Primesin[®] (fluvastatin) that had been newly licensed in 2000 were able to continue the positive sales development of the previous year. While Clivarina[®] rose to third place in the list of best-selling products with the highest absolute sales increase to € 8.2 million (+53.1%), Primesin[®] boasted the highest percentage sales increase by 289.4% to € 3.8 million.

Management's Discussion and Analysis

Segment Reporting

France

The French sales company was narrowly able to keep its sales at the level of the previous year with a volume of € 56.2 million (-1.6%). As in 2001, the best selling products again were the migraine medication Seglor® (dehydroergotamine) with € 11.3 million (-4.7%) and the anti-hypertensive drug Kerlone® (betaxolol) with € 8.9 million (+5.3%). The sales development of Edex® (alprostadil) for the treatment of erectile dysfunction (+40.8% to € 4.6 million) and Oracilline® (phenoxymethyl penicillin), an anti-infective drug (+11.8% to € 4.5 million) exceeded all expectations. A direct sales initiative to pharmacies had a positive impact on the sales development during the last months of the fiscal year.

Spain

Business in Spain was slightly down in 2002. Compared to previous year, annual sales declined by 5.4% to € 41.9 million. The development of the best-selling product Norpramin® (omeprazole), a drug for the treatment of stomach ulcers, was negatively affected by state-mandated price reductions and intense competition from generic products. Sales declined by 28.6% to € 13.3 million. In contrast, the launch of the anti-hypertensive drug Miten®/Miten Plus® (valsartan), which had been licensed in November 2001, was a good success. The product was able to achieve a sales volume of € 3.5 million in its first year.

Great Britain

Sales in Britain declined slightly, but stayed above budget for 2002 with a volume of € 30.7 million (-3.3%; currency adjusted: -2.4%). The slightly declining sales development was caused by intense competition from generic products. This applied in particular to the bestselling products Tylex® (paracetamol, codeine), a pain killer, and Elantan® (isosorbid mononitrate), for the treatment of angina pectoris, which suffered sales declines of 8.7% (currency adjusted: -7.9%) to € 14.2 million and 9.2% (currency adjusted: -8.5%) to € 8.0 million respectively. However, Dioctyl® (docusate sodium), a drug for the treatment of constipation, achieved sales increases of 40.4% (currency adjusted: +42%) to € 3.3 million.

Poland

Sales rose by 15.6% to € 27.7 million (currency adjusted: +21.2%). While sales of the best-selling product Effox® (isosorbid mononitrate), a tried and proven cardiovascular compound, slightly declined in group currency to € 11.5 million (-1.8%), while a moderate gain of 2.7% could be achieved in local currency. The most significant sales increase was recorded for Cardin® (simvastatin), a drug for the treatment of coronary heart disease. Thus, the sales volume of Cardin® was increased by 421.7% (currency adjusted: 450.9%) to € 6.2 million. The cardiovascular compound Ticlo® (ticlopidine), which had been newly licensed in 2000, also contributed to the positive sales development with a sales volume increase of 20.5% (26.5% in local currency) to € 3.8 million.

Eastern Europe and "Rest of the World"

Sales in other European countries, where SCHWARZ PHARMA is represented with sales offices, its own sales force (Russia, Czech Republic, Bulgaria) or by license partners, also rose significantly by 12.9% to € 72.9 million. As in previous year, the best-selling products were the medication for the treatment of coronary heart disease: Isoket® (isosorbid dinitrate) with € 15.4 million (+23.7%), Elantan® (isosorbid mononitrate) with € 14.4 million (-10.5%) and Deponit® (glycerol trinitrate) with € 12.3 million (+8.0%).

Operating result Europe

The European segment was able to post a positive operating result in fiscal year 2002. After reaching € 93.4 million and € 82.1 million in the business years 2000 and 2001 respectively, the past fiscal year ended with an operating income of € 70.7 million. While two subsidiaries closed the year with a negative operating result, all other European affiliates reached positive operating results. The distributing companies in Italy and Great Britain increased their positive operating income figures compared to the previous year.

Segment: USA/Asien

(€ million)	2000	2001	2002
Net sales	229.4	248.5	429.3
Operating result	11.4	12.0	80.9

Sales development USA/Asia

After a sales increase of 8.3% in 2001, the sales volume was further increased for the USA/Asia segment in the past fiscal year (+72.8%). This growth was primarily achieved by the U.S. affiliates, but sales in Asia also increased significantly.

USA

The U.S. business posted a sales volume increase of 75.2% (currency adjusted: 84.4%) to € 404.5 million. Sales in the USA were dominated by the approval of the gastro-intestinal drug omeprazole. The omeprazole formulation of Kremers Urban Development Company, a wholly owned subsidiary of SCHWARZ PHARMA, is a bio-equivalent generic version of AstraZeneca's medication that is sold in the USA under the brand name Prilosec®. Prilosec® is prescribed for the treatment of stomach and duodenal ulcers, reflux esophagitis (GERD) and erosive esophagitis. It was the second best-selling drug in the USA in 2001 with a sales volume that exceeded US\$ 3.7 billion.

Omeprazole immediately reached a sales volume of € 176.3 million. This makes omeprazole the top selling product of SCHWARZ PHARMA, not just in the USA, but worldwide.

Management's Discussion and Analysis

Segment Reporting

Omeprazole was followed in sales rank by the ACE inhibitor Univasc®/Uniretic® (moexipril) with sales of € 62.5 million (+9.6%) and the calcium antagonist Verelan® PM (Verapamil HCL) with € 36.9 million (+10.2%). Adjusted for currency, the sales increases for the two compounds are even more evident: +15.5% for Verelan® PM and +15.5% for Univasc®/Uniretic®. In contrast, the sales development of the gastrointestinal product lines Levsin® as well as Colyte® showed differing results with a decline of –19.8% to € 19.5 million (currency adjusted: –16.8%) and an increase of +5.4% to € 17.1 million (currency adjusted: +11.1%), respectively.

Asia

The positive development of the past two business years was consistently expanded in 2002. With € 24.8 million (+40.4%), the sales development in Asia exceeded all expectations. China generated the largest sales volume in the Asian region, followed by Korea and the Philippines. The top seller was the established drug Isoket® (isosorbid dinitrate), for the treatment of coronary heart disease, which achieved an annual sales volume of € 8.3 million (+9.3%).

Operating result USA/Asia

The operating income of the USA/Asia segment rose from € 11.4 million in 2000 to € 12.0 million in 2001. During the past fiscal year 2002, this income was increased to more than six times the figure of the previous year. The reason for this increase is primarily the market launch of omeprazole in the USA. In addition to the outstanding operating income of the U.S. subsidiary, the Asian companies were also able to post a significant increase to their positive operating income figures of previous year.

Segment: Biosciences

(€ million)	2000	2001	2002
Net sales	0	0	0
Operating result	(77.7)	(63.0)	(57.7)

The "Biosciences" segment combines the global research activities of SCHWARZ PHARMA. The research pipeline of SCHWARZ PHARMA currently includes six projects in the indications urology and neurology, which are in various stages of clinical trials.

Rotigotine CDS – Parkinson's disease

The Parkinson patch with rotigotine CDS (Continuous Delivery System) combines the advantages of continuous transdermal release over 24 hours with the benefits of the latest generations of dopamine agonists and dopamine D3/D2 receptors. The patch is applied once a day and replaced after 24 hours. In contrast to dopamine agonists that are prescribed as tablets, the transdermal release of rotigotine CDS leads to constant plasma levels over 24 hours. This allows for continuous efficacy and better tolerability.

The results of a study involving the use of the Parkinson's patch rotigotine CDS in early-stage Parkinson's patients were presented at the 54th Congress of the American Academy of

Neurology (AAN) in Denver, USA on April 16, 2002. The study was able to provide evidence of improvements in symptoms and daily life activities, as measured by the Parkinson's Disease Rating Scale (UPDRS), parts I and II. 316 subjects were involved in the study.

The international phase III study program of SCHWARZ PHARMA on rotigotine CDS has begun in November 2001. More than 1,000 subjects in early and advanced stages of Parkinson's disease have already been admitted to the three studies of phase III. First study results should be available in the first quarter of 2004.

On November 14, 2002 SCHWARZ PHARMA and Otsuka Pharmaceuticals Co. Ltd. of Tokyo, Japan, signed an agreement that transferred the exclusive development and marketing rights for the Japanese market rotigotine CDS to Otsuka. Otsuka holds the rights for all indications and potential applications. In compensation, SCHWARZ PHARMA will receive installment payments. Japanese sales of products associated with Parkinson's disease currently total US\$400 million a year with rising tendency.

About 4 million people suffer from the symptoms of Parkinson's disease worldwide. The neurological disorder progresses continually and leads to a number of paralytic symptoms and motor disorders such as tremors, muscular rigidity, speech problems, dementia and incontinence. Especially with a view toward the demographic development of the population, the treatment of Parkinson's disease takes on a special urgency.

Rotigotine CDS –

Restless-Legs-Syndrome (RLS)

Up to 10% of the population suffers from restless legs syndrome. It is characterized by an unpleasant urge to move the legs that occurs primarily in the evening and at night and stands in the way of restful sleep. RLS is a chronic and slowly progressing disease that occurs with the same frequency as migraines and diabetes.

The most recent phase II clinical study with rotigotine CDS for the indication RLS has shown that the dopamine agonist rotigotine CDS can provide relief for restless legs syndrome. The final results of the study that began in November 2001 and ended on April 30, 2002 demonstrated that rotigotine CDS can bring about a clinically significant dose-related reduction in symptoms.

The efficacy of rotigotine CDS in comparison to a placebo was analyzed in a double blind randomized and controlled study. The seven-day study involved 68 subjects at nine German study centers. In addition to significant dose-related reductions in symptoms, considerable improvements in daily life activities were observed. The highest dosage was able to reduce the symptoms defined by the "International Restless Legs Syndrome Study Group Rating Scale" by more than 50%.

Due to the successful completion of the first phase II clinical study, rotigotine CDS will now be analyzed for the indication RLS in additional more comprehensive studies over longer treatment periods. This study program will begin in spring 2003.

Management's Discussion and Analysis

Segment Reporting

Fesoterodine – incontinence

The anti-muscarinic agent fesoterodine is a new, patent-protected compound for the treatment of incontinence. It was developed by SCHWARZ PHARMA and is characterized by a well-known efficacy principle. The compound will offer patients good efficacy with fewer side effects than comparable medications. The multinational phase IIb study has been in progress since October 2001, with results to become available in the first quarter of 2003.

Harkoseride – epilepsy

An open phase II tolerability study was conducted with the compound harkoseride for the treatment of epilepsy in the years 2001 and 2002. A first analysis of the study results demonstrated a 50% reduction of epileptic seizures in a third of all patients. 86 patients suffering from epilepsy took part in the study. International, double blind and placebo-controlled phase IIb studies will now be conducted to confirm these results.

Harkoseride – neuropathic pain

The compound harkoseride is also being tested for the indication neuropathic pain. The results of the double blind, placebo-controlled clinical phase II study will be published in the first quarter of 2003.

SPM969 – benign prostate hyperplasia

In June 2002, SCHWARZ PHARMA acquired the developing and marketing rights for a new compound for the treatment of benign prostate hyperplasia from the Indian company Ranbaxy Laboratories Ltd. While SCHWARZ PHARMA now holds exclusive rights for the leading pharmaceutical markets USA, Europe and Japan, Ranbaxy retains the rights to all other markets.

Additional phase I tests will be necessary for clinical development in the USA, Europe and Japan. In India, the compound is already in phase II of clinical development. If the development is successful, SCHWARZ PHARMA will pay a total sum of US\$ 42 million to Ranbaxy over the next 5 to 6 years.

The compound SPM 969 is a uro-selective alpha-blocker and is part of the latest generation of alpha-blockers that are used for the treatment of benign prostate hyperplasia. The goal is to develop a once-a-day formulation with quick symptom relief (for instance, decreased nightly micturition frequency), few side effects and good patient tolerability.

More than 51 million men over 40 suffer from the consequences of benign prostate hyperplasia in the USA, Europe and Japan. The market shows double-digit growth rates with a volume of approx. US\$ 2 billion in these regions.

Operating result Biosciences

The operating result of the "Biosciences" segment has continuously improved from € -77.7 million in 2000 to € -63.0 million in 2001, and to € -57.7 million for the reporting period in spite of steadily rising research expenditures. The main reason for the improved result in 2002 is the installment received from Otsuka Pharmaceuticals Ltd. in exchange for the exclusive marketing rights of rotigotine CDS in Japan. Another reason for this development is income from a R&D cost contribution agreement that slightly increases every year for those companies that are most likely to benefit from the marketing of the maturing projects/ products in the future.

Segment: Holding

(€ million)	2000	2001	2002
Net sales	55.0	56.5	56.4
Operating result	(11.1)	10.5	3.5

Net sales in the Holding segment reflect the supplies provided to the European, Asian and American subsidiaries. After a positive operating income figure in 2001, the operating income in 2002 declined by 66.7%. The main reason for this decline was the increase of intercompany charges from other segments to the Holding segment.

Management's Discussion and Analysis

Risk Management

Risk Management System

For an internationally operating Company, risk management is an essential and indispensable part of corporate management and controlling. In this context, the Company has further developed its systems for the recognition and monitoring of risks in 2002. The project for setting up a new risk management based on an EDP system has been completed and is integrated into the regular reporting system. Reporting is a central element for monitoring the economic risks of current operations. It assures that the business development of the individual affiliates is represented in accordance with uniform standards and forwarded to the Group headquarters. In addition to the data the external reporting is based on, the companies regularly submit internal reports in order to inform the Executive Board and various management levels as early and comprehensively as possible about potential risks.

SCHWARZ PHARMA is exposed to business risks, the most important of which are discussed below by risk categories.

Sales risks

Numerous European countries and the United States with its "managed care" system are making attempts at reducing the cost of health care. This includes exerting increasing price pressure, also innovative, patented compounds that become subject to price cuts, or as is the case in Germany, state-mandated discounts. SCHWARZ PHARMA responds to this development with continuous measures to improve cost efficiency and by developing new sales markets, such as Eastern Europe or Asia.

Every research company, especially in the pharmaceutical industry, has to assume the general risk that development projects fail to lead to the expected yield because of the results of pre-clinical and clinical studies. SCHWARZ PHARMA maintains project assessment systems and a project management organization to counter this risk.

Production and procurement risks

As a manufacturer, the Company is subject to procurement risk, which means that the raw materials and precursors that are necessary for manufacturing our products are not or only insufficiently available in the required quality/quantity. We continually assess our vendors and develop supplier alternative if required.

State authorities regularly monitor the facilities and process technologies for the production of pharmaceutical products for their compliance with GMP standards (GMP = Good Manufacturing Practices). SCHWARZ PHARMA supports the compliance with these standards with the corresponding quality control and assurance procedures. The Company intends to minimize or even eliminate the risk of production downtimes with safety measures and maintenance plans. In addition, the Company develops internal or external contingency capacities.

Financial risk

In addition to securing currency exchange and interest risks, derivative financial instruments were also used to hedge the Company's Stock Appreciation Rights programs of the Company. Details can be found in the Notes to the consolidated financial statements.

Legal risks

Legal disputes are underway in several parts of the Group. This includes primarily the omeprazole lawsuit in the USA, which is currently pending at the Court of Appeals in Washington D.C. In the first instance, the District Court of Southern New York had decided in favor of KUDCo. KUDCo is the corporate affiliate that implemented the development of generic omeprazole in the USA. The suit will take about 18–24 months to be tried at the Court of Appeals. The final result of the court case cannot be predicted with absolute certainty, as legal disputes are always subject to incalculable factors. The verdict of the District Court of Southern New York in conjunction with the legal opinions had enabled KUDCo to decide in favor of launching the product on the market on December 9, 2002.

Monheim, February 2003

The Executive Board

Notes to Consolidated Financial Statements

€ in thousands
unless otherwise noted

1. Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of SCHWARZ PHARMA AG and its majority-owned subsidiaries ("SCHWARZ PHARMA" or "the Company"). All material inter-company balances and transactions have been eliminated (receivables and payables as well as income and expense). Investments in corporate joint ventures are accounted for according to the equity method.

Revenue Recognition

Revenues are generally recognized when finished products are shipped or services have been rendered to unaffiliated customers. Project related milestone payments are expensed upon progress of projects and in accordance with contractual agreements. Unless business partners' payments are uncertain to be received, outstanding accounts receivable are deferred until payment is made.

Research and Development

Research and development costs consist of expenditures incurred during the course of planned research and investigation aimed to discover new knowledge which will be useful in developing new products or processes, or significantly enhancing existing products or production processes, and the implementation of such through design or testing of product alternatives. All research and development costs are expensed as incurred.

Cash and Cash Equivalents

The Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents. Cash and Cash equivalents consist primarily of commercial papers, certificates of deposit, bank repurchase agreements and money market fund investments carried at cost, which approximate fair value at the corresponding reporting dates.

Inventories

Inventories are stated at the lower of cost or market. Cost is generally determined in accordance with the average cost method. Certain foreign companies determine cost using the LIFO method ("last-in, first-out"). Provision for potentially obsolete or slow-moving inventory is made based on management's analysis of inventory levels and future sales forecasts.

Accounts receivable and liabilities

Accounts receivable are accounted for at their nominal value, which approximate fair value. Liabilities are booked at repayment amounts, which correspond to fair values.

Property, Plant and Equipment and Depreciation

Property, plant and equipment are recorded at cost. Depreciation is provided principally using the straight-line method based on estimated useful lives of the assets as follows:

Buildings	20 to 40 years
Machinery and equipment	3 to 15 years

Improvements which extend the useful life of property are capitalized, whereas maintenance and repairs are expensed as incurred.

Intangible Assets

The excess of the cost over the fair value of net assets of purchased business has been recorded as goodwill and was amortized using the straight-line method over 15 years to 40 years until fiscal year 2001. Since January 1, 2002 goodwill is no longer amortized due to revised U.S. GAAP accounting rules (FAS 142 "Goodwill and Other Intangible Assets"). Hidden reserves, which have been disclosed when acquired, do not fall under FAS 142 and therefore are amortized further. In addition, other intangibles including trademarks, tradenames and distribution rights, are valued at acquisition cost and are being amortized using the straight-line method with estimated lives of 5 to 40 years, unless they are not deemed to have indefinite useful lives. In this case, intangible assets are not being amortized regularly but tested for impairment on an annual basis.

Investments in Marketable Securities

The Company classifies its investments as either available-for-sale or held-to-maturity. Investments available-for-sale consist of marketable equity securities and are carried at fair value. Net unrealized gains and losses on investments available-for-sale, net of related income taxes, are reported as a separate component of shareholders' equity. These investments are classified as non-current when it is management's intention to keep the securities on a long-term basis.

Investments in Joint venture companies, in which ownership is 50%, are stated at cost plus the Company's equity in undistributed earnings as required under the equity method of accounting.

Long-Lived Assets

The Company periodically evaluates the carrying value of property, plant and equipment as well as intangible assets in accordance with FAS 144 "Accounting for the Impairment or Disposal of Long-Lived Assets" and FAS 142 "Goodwill and Other Intangible Assets". Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss according to FAS 142 (FAS 121 for the years until 2001) would be recognized when the expected undiscounted cash flows derived from the asset are less than its carrying value. The Company recorded an impairment loss of € 3.1 million in 2002, € 1.3 million in 2001 and € 2.3 million in 2000. The 2002 impairment loss related to a product right of SCHWARZ PHARMA Deutschland GmbH and an impaired investment of SCHWARZ BIOSCIENCES Inc. in a former cooperation partner.

As the 2002 impairment loss, the 2001 impairment expense equally related to a product right.

The 2000 impairment loss related to non-marketable securities of one of the Company's cooperation partners after a joint project had been ceased. In addition, an extraordinary depreciation has been recognized on prepayments amounting to € 7.8 million for the project "Human Growth Hormone". The capitalization was reversed with respect to prudence considerations as the product launch had been delayed. This project was given back to its original licensor in 2001.

Notes to Consolidated Financial Statements

Income Taxes

Income taxes are provided based upon income for U.S. GAAP financial reporting purposes. Deferred income taxes reflect future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The Company assumes that undistributed earnings of certain foreign subsidiaries will be permanently reinvested in their operations. Accordingly, no provision is made for additional income taxes that might be payable on the distribution of such earnings.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries are translated into EURO at current exchange rates at the balance sheet date, whereas income and expenses are translated using weighted average exchange rates during the period. The effects that arise from translating these items differently are reported as a separate component of shareholders' equity. Exchange gains and losses from business transactions in a currency other than the local currency of the entity involved are included in income (loss of € 1.3 million in 2002, income of € 0.2 million in 2001 and a loss of € 1.6 million in 2000).

The currency exchange rates used in preparation of the consolidated financial statements were as follows:

In foreign currency per EURO:	Exchange rate at December 31,	Annual average exchange rates				
		2001	2002	2000	2001	2002
China	RMB	7.30	8.62	7.46	7.24	7.63
Great Britain	GBP	0.61	0.65	0.61	0.62	0.63
Hong Kong	HKD	6.88	8.13	7.18	6.98	7.35
Philippines	PHP	45.61	55.56	40.54	45.63	48.48
Poland	PLZ	3.51	4.01	4.00	3.66	3.84
Switzerland	CHF	1.48	1.45	1.56	1.51	1.47
USA	USD	0.88	1.04	0.92	0.89	0.94

Use of Estimates

The preparation of financial statements, in conformity with generally accepted accounting principles, requires management to make estimates and use assumptions that affect certain reported amounts and disclosures. Actual results could differ from these estimates.

Earnings per Share

Basic earnings per common share are computed by dividing net income by the weighted average number of common shares outstanding. For the first time in 2002, common stock equivalents had dilutive effects for the period reported ("Diluted Earnings per Common Share") due to the current development of SCHWARZ PHARMA shares.

The average number of shares outstanding was 44,172 thousand in 2002, 43,987 thousand in 2001 and 2000 after effected stock split on July 15, 2002. The weighted average number of common shares and common stock equivalents for "Diluted Earnings per Common Share" calculations was 44,449 thousand in 2002.

New Accounting Pronouncements

In December 2002, the FASB issued FAS 148 "Accounting for Stock-Based Compensation – Transition and Disclosure". FAS 148 represents an amendment of FAS 123 "Accounting for Stock-Based Compensation". This new financial statement regulates accounting for stock-based compensation (i.e. stock option programs as well as stock appreciation right programs) when a company chooses to change from applying the intrinsic value method to the application of the fair value method according to FAS 123. As in previous years, SCHWARZ PHARMA applied APB 25 "Accounting for Stock Issued to Employees" with respect to accounting for its stock option programs. All required disclosures under FAS 148 are comprised in Note No. 17.

In July 2001, the FASB issued FAS 141 "Business Combinations" and FAS 142 "Goodwill and Other Intangible Assets", which change the accounting treatment of business combinations as well as goodwill and intangible assets. Since January 1, 2002, SCHWARZ PHARMA applies these standards. The new guidelines comprise among others the abolishment of the "Pooling-of-Interest-Method". In the future, every business combination is accounted for according to the purchase method. Following FAS 142 accounting treatment of goodwill was also changed. Goodwill will no longer be amortized on a regular basis, but its value will be reviewed on a test basis within the scope of a so-called "Impairment Test". Usually, SCHWARZ PHARMA tests its goodwill and other long-lived assets during the 3rd quarter of each year. Impairment losses may be recorded only in certain circumstances. The effect on net income due to goodwill no longer being amortized since January 1, 2002 would have been T€ 2,355 for 2001 and T€ 1,597 for 2000.

In addition to these standards, the FASB issued FAS 144 "Accounting for the Impairment of Disposal of Long-Lived Assets" in August 2001, which establishes new standards for accounting of long-lived assets. SCHWARZ PHARMA applies FAS 144 since January 1, 2002. Impairment tests for long-lived assets are undertaken – in accordance with the necessary impairment tests for goodwill – regularly during the 3rd quarter of each year.

Notes to Consolidated Financial Statements

In June 1998, the FASB issued FAS 133, "Accounting for Derivative Instruments and Hedging Activities", which establishes accounting and reporting standards for derivative instruments and for hedging activities. In the meantime, this standard has been specified by FAS 137 and FAS 138. It requires that an entity recognizes all derivatives as either assets or liabilities in the statement of financial position and measures those instruments at fair value. Gain or loss from hedging transactions may be wholly or partially recorded in earnings or comprehensive income, depending upon the classification of the hedge transaction. Gain or loss on a derivative instrument not classified as a hedging instrument is recognized in earnings in the period of realization. FAS 133 has become effective for the Company beginning in fiscal 2001. Therefore, upon initial application a liability was recorded that reduced earnings by € 0.2 million.

Reclassifications

Some positions of 2000 financial statements have been reclassified to be consistent with the current year. These changes had no impact on previously reported results of operations or shareholders' equity.

There has been a change in the presentation of software beginning of 2002: In the past, software was grouped together with hardware as tangible assets as the amount of "software" was minor. Since January 1, 2002 software is presented as intangible assets. The reclassification does only refer to additions to software (i.e. intangible assets) of the current and future reporting periods. Due to relatively short depreciation periods no retrospective changes and reclassifications have been undertaken. This reclassification does not have considerable impact on previous' years financial situation.

2. Consolidated Companies

The breakdown of all share ownership has been deposited with the Local Court of Düsseldorf under HRB 45462 in accordance with § 313 (4) German Commercial Code (HGB). As a matter of principle, all subsidiaries in which SCHWARZ PHARMA AG directly or indirectly holds the majority of voting rights or which are subject to its uniform control are included in the consolidated accounts. Nine German and twenty-three foreign companies are included together with SCHWARZ PHARMA AG in the consolidated financial statements. The joint venture company HOYER-MADAUS GmbH & Co. KG was accounted for under the equity method.

Eleven subsidiaries have been omitted owing to their relatively minor importance for the net worth, financial position and result of operations of the Group; their sales volume accounts for less than 1% of group sales.

The group of consolidated companies changed as follows during the reporting period:

Additions:

Kremers Urban Inc., Milwaukee, USA

Kremers Urban Inc. was founded on October 28, 2002 in the USA. The company's purpose is to sell generic products in the USA, including SCHWARZ PHARMA's generic omeprazol, which received final FDA approval in November 2002. Omeprazol was launched on the U.S. market in December 2002.

Dissolved:

SCHWARZ PHARMA Nordic A/S, Hellerup, Denmark

As of January 10, 2002 the liquidation of SCHWARZ PHARMA Nordic A/S, Denmark was finalized and the entity ceased to exist. This company had been founded in May 2000 in order to market pharmaceutical products. The main purpose of SCHWARZ PHARMA Nordic was to distribute the growth hormone product Nutropin in northern European countries. However, as the exclusive development and marketing rights for Nutropin were sold back to Genentech Inc., USA, in June 2001, it was not necessary to keep this company.

Therefore, during the fiscal year 2002 the following companies have been consolidated:

Purchase method:

SCHWARZ PHARMA AG, Monheim

SCHWARZ PHARMA Deutschland GmbH, Monheim

SCHWARZ PHARMA Produktions-GmbH & Co. KG, Monheim

Hoyer GmbH & Co., Monheim

Melusin SCHWARZ GmbH, Monheim

Sanol GmbH, Monheim

SCHWARZ & Co. Immobiliengesellschaft

Zwickau beschränkt haftende OHG, Zwickau

SCHWARZ & Co. Industriegebäudegesellschaft

Zwickau beschränkt haftende OHG, Zwickau

SCHWARZ BIOSCIENCES GmbH, Monheim

SCHWARZ PHARMA S.p.A., Milano/Italy

SCHWARZ PHARMA Ltd., Chesham/GB

SCHWARZ Pharmaceutical Ltd., Chesham/GB

Medo Pharmaceutical Ltd, Chesham/GB

SIFA Chemicals AG, Liestal/Switzerland

SIFA Ltd., Shannon/Ireland

Laboratoires SCHWARZ PHARMA S.A., Boulogne/France

SCHWARZ PHARMA Holdings Inc., Wilmington/USA

SCHWARZ PHARMA Manufacturing Inc., Seymour/USA

SCHWARZ PHARMA Inc., Milwaukee/USA

CPM Properties Inc., Wilmington/USA

SRC Properties Inc., Wilmington/USA

Kremers Urban Development Comp. Inc., Milwaukee/USA

Kremers Urban Inc., Milwaukee/USA

SCHWARZ PHARMA Poland Sp.zo.o., Warsaw/Poland

Zhuhai SCHWARZ PHARMA Comp. Ltd., PRC

SCHWARZ PHARMA Hong Kong. Ltd., PRC

SCHWARZ PHARMA Philippines Inc., Manila/Philippines

SCHWARZ PHARMA S.L., Barcelona/Spain

CEPA SCHWARZ PHARMA S.L., Madrid/Spain

IFE S.L., Madrid/Spain

SCHWARZ PHARMA Benelux B.V., Arnheim/The Netherlands

SCHWARZ BIOSCIENCES Inc., Durham/USA

Equity Method:

HOYER-MADAUS GmbH & Co. KG, Monheim

Notes to Consolidated Financial Statements

3. Acquisition of Products and Strategic Ventures

During 2002, the Company has entered into following partnerships in order to further develop its "Search & Development"-Pipeline.

Date	Partner	Rights	Project/Indication	Area
June	Ranbaxy Laboratories Ltd., India	Acquisition of exclusive development and distribution rights	Uroselective Alpha-Blocker SPM969/Urology (Benign Prostate Hyperplasia)	Europe, USA and Japan
November	Otsuka Pharmaceutical Ltd., Japan.	Sale of exclusive development and distribution rights	Rotigotine CDS / Parkinson, "Restless Legs Syndrome" and other potential indications and applications	Japan

SCHWARZ PHARMA was able to strengthen its urology pipeline with the new active ingredient SPM 969 for the treatment of benign prostate hyperplasia. In India, this ingredient is currently in clinical phase II. SCHWARZ PHARMA will undertake the clinical development as well as future marketing in Europe, USA and Japan. In order to do so, first of all clinical trials phase I need to be completed. In accordance with project progress, Ranbaxy will receive milestone payments from SCHWARZ PHARMA, which are part of research and development expenses.

In addition, the cooperation with Otsuka increases the pipeline's value. Since SCHWARZ PHARMA does not have its own marketing organization in Japan, the well established Japanese pharmaceutical company Otsuka takes over responsibility for clinical development and later on exclusive distribution of the active ingredient rotigotine CDS for the treatment of the Parkinson disease as well as for the treatment of restless legs syndrome in Japan. In accordance with project progress, SCHWARZ PHARMA will receive milestone payments, which are reported in the position "other operating income".

4. Cost of materials

	2000	2001	2002
Cost of raw materials, supplies and purchased goods	222,159	234,098	237,266
Cost of purchased services	6,322	7,310	9,368
Total	228,481	241,408	246,634

Cost of materials slightly increased from 2001 to 2002, although the increase remains behind sales increase. This positive development mainly results from an optimized cost structure. The successful

launch of omeprazole significantly contributed to this development as omeprazole's material expenses are relatively low in relation to sales.

5. Personnel expenses

	2000	2001	2002
Wages and salaries	155,215	174,220	190,670
Social security, welfare payments and pension schemes	37,244	42,554	57,493
<i>Thereof expenditure on retirement benefits</i>	<i>2,911</i>	<i>3,941</i>	<i>7,196</i>
Total	192,459	216,774	248,163

The increase in personnel expenses is mainly attributable to the increased number of employees.

In 2002, total remuneration paid to members of the Supervisory Board was T€ 277 and T€ 6,616 to members of the Executive Board, which includes payments of T€ 1,685 to a resigned member of the Executive Board. Fixed components of the Board's salary amounted to T€ 1,964, while variable components added up to T€ 4,425. In addition, T€ 226 were paid due to first time exercise within the Company's Stock Appreciation Rights program.

Moreover, members of the Executive Board have realized cash benefits of T€ 541 as a result of exercising parts of the Company's Executive Stock Option program.

Mr. Terence Eaves has been rewarded for consultancy services rendered beyond his appointment as Supervisory Board Member with T€ 89. Apart from this, no further members of the Supervisory Board received any rewards for services rendered beyond their functions as Supervisory Board members.

As of December 31, 2002, provisions were made for pension commitments to former Executive Board members amounting to T€ 6,232. Current payments to former members of the Executive Board were T€ 375. No loans were outstanding to members of the Executive Board at year-end.

6. Directors' Dealing

Without delay, a listed company shall report any transactions in its own stock carried out by Members of the Executive Board or the Supervisory Board.

SCHWARZ PHARMA AG has reported duly and without delay all transactions in securities of the Company as of December 31, 2002.

Notes to Consolidated Financial Statements

7. Number of employees (annual average)

	2000	2001	2002
Research and Development	316	352	410
Production	863	884	973
Administration and Sales	2,054	2,192	2,356
Total	3,233	3,428	3,739

The average number of employees increased by 311 to 3,739 in 2002. Among other factors, this growth is due to the enlargement of the sales force in Germany, Eastern Europe and Asia. Furthermore, employee capacities had to be

increased at the U.S. manufacturing company (SCHWARZ PHARMA Manufacturing Inc.) due to the launch of omeprazol. Moreover, the intensification of the research activities required to recruit more employees.

8. Other Income (Expense) – net

	2000	2001	2002
Income/(loss) from equity investments	1,438	2,400	3,614
Gain/(loss) from disposal of investments, tangible and intangible assets	4,694	63	5,749
Other income/(expense) – net	8,688	50,522	5,241
Total	14,820	52,985	14,604

Other income and expenses amount to T€ 14,604 in the reporting period 2002. Next to the gain from the sale of various product rights, which are no longer in the focus of the SCHWARZ PHARMA group (product rights were sold by affiliates in Spain, Italy and the USA), this position mirrors the gain (T€ 1,801) from the sale of shares, which SCHWARZ PHARMA Inc., USA, had owned in Axcan Pharma Inc., USA. The Joint venture Hoyer-Madaus contributed a gain of € 3.6 million to the group's result.

In 2001, other income improved due to an early repayment of the purchase price of € 42.9 million for the disposal of the Joint venture Axcan SCHWARZ LLC. Furthermore, the Joint venture Hoyer-Madaus – set up in 1999 – contributed € 2.4 million to the positive result.

In 2000, the gain from disposal of investments includes the gain from the divestiture of Liprevil® of € 5.8 million. The disposal of fixed assets at SCHWARZ PHARMA Manufacturing Inc., USA resulted in a loss of approximately € 0.7 million.

9. Income Taxes

Income tax expense includes the following:

	2000	2001	2002
Current:			
German federal	(1,764)	(1,013)	(3,838)
German state and local	1,376	389	(64)
Foreign	10,258	32,555	50,469
	9,870	31,931	46,567
Deferred:			
German federal	(4,272)	(4,872)	(4,660)
German state and local	(5,024)	(4,906)	(3,566)
Foreign	3,795	2,669	(6,309)
	(5,501)	(7,109)	(14,535)
Total	4,369	24,822	32,032

German and foreign operations contributed to pretax income as follows:

	2000	2001	2002
German	(20,652)	(28,380)	25,251
Foreign	38,429	93,493	55,152
Total	17,777	65,114	80,403

Deferred income taxes related to:

	2000	2001	2002
Liabilities:			
Property, plant and equipment	9,003	7,903	6,626
Intangible assets	0	0	0
Other	2,001	2,569	4,209
Total deferred tax liabilities	11,004	10,472	10,835

Notes to Consolidated Financial Statements

	2000	2001	2002
Assets:			
Intangible assets	4,126	5,933	7,629
Accounts receivable	8,304	11,097	12,348
Inventories	9,563	7,653	7,217
Pension accruals	3,206	3,488	3,388
Operating loss carry-forwards	18,239	22,469	31,613
Other	11,207	13,128	12,140
Subtotal	54,645	63,767	74,335
Valuation allowance	809	3,422	863
Total deferred tax assets	53,836	60,346	73,472
Net deferred tax assets (liabilities)	42,832	49,873	62,637
Current deferred income tax asset	23,775	25,871	25,274
Net long-term deferred tax asset (liability)	19,057	24,003	37,363

Deferred taxes are not provided for undistributed earnings of certain foreign subsidiaries of the Company, since they are considered to be indefinitely reinvested. The undistributed earnings amounted to approximately € 111.9 million, € 125.7 million and € 93.4 million at December 31, 2002, 2001 and 2000, respectively. Estimated taxes of approximately € 9.0 million, € 7.3 million and € 6.0 million would be payable upon remittance of all previously unremitted earnings at December 31, 2002, 2001 and 2000, respectively.

At December 31, 2002, all German companies had available net operating loss carry-forwards, which are not subject to expiration. Deferred tax assets of approximately € 29 million related to these loss carry-forwards. The tax loss carry-forwards of

foreign subsidiaries represented deferred tax assets of approximately € 2 million. The majority of these loss carry-forwards will expire at various dates through 2020. A valuation allowance has been established for the resulting deferred tax assets whenever the Company considers it more likely than not that some or all of the deferred income tax assets will not be realized. Cash paid for income taxes in 2002, 2001 and 2000 were € 13.2 million, € 37.2 million and € 16.8 million, respectively.

The reconciliation of income tax from continuing operations computed at the German federal statutory tax rate to the Company's effective income tax rate is as follows:

(in percent)	2000	2001	2002
German federal statutory rate	40.0	25.0	25.0
German local tax rate	16.8	0.6	0.7
Credit for dividend distributions	(15.4)	(6.8)	(5.6)
Foreign tax rate differences	(57.1)	7.5	11.7
Non-deductible expenses	33.8	11.1	11.0
Non-deductible goodwill amortization	11.8	4.1	1.2
Federal tax benefit on local taxes	(0.0)	(0.0)	(0.0)
Other	(5.3)	(3.4)	(4.2)
	24.6	38.1	39.8

Like in the previous year there were no tax rate changes in 2002 that would effect deferred taxes of the group. However, the difference between domestic and foreign income taxes rose from 7.5 percentage points to 11.7 percentage points, which is mainly due to the increase of earnings generated in the U.S. (high tax jurisdiction). Non-deductible expenses stay on a nearly unchanged high level. As a result of the discontinuation of goodwill amortization under U.S. GAAP since January 1, 2002, only non-deductible amortizations on hidden reserves remain.

During 2001, there were no tax rate changes which would effect deferred taxes of the group. However, in 2000 the German federal statutory tax rate to be used for deferred tax calculations was reduced by 13 percentage points due to a tax reduction law. Consequently, additional deferred tax income of € 1.8 million could be accounted for in the reporting period.

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

10. Inventories

Inventories at December 31 consisted of the following:

	2001	2002
Raw materials and Work in process	35,029	40,224
Finished products	27,906	26,124
Merchandise goods	24,332	27,715
	87,267	94,063

The SCHWARZ PHARMA group consistently optimized its inventory management in 2002. The increase in inventories is primary a result of the omeprazol production by SCHWARZ PHARMA Manufacturing Inc., USA and the temporary increase in inventories of Sifa Ltd., Ireland.

Inventories valued on a last-in, first-out basis comprised approximately 46% and 27% of total inventories at December 31, 2002 and 2001 respectively.

11. Property, plant and equipment, Intangible assets and Long-term Investments

Property, plant and equipment

	Land	Buildings	Plant and machinery	Technical equipment	Other - equipment, operational and office equipment	Advance payments and construction in progress	Total
Acquisition cost 31.12.2001	9,823	122,452	95,454	58,288	28,374	11,145	325,536
Currency change	-69	-7,051	-5,191	-1,587	-1,246	-1,579	-16,723
Acquisitions/disposals of businesses	0	0	0	0	-19	0	-19
Additions	0	931	872	7,494	1,525	9,900	20,722
Disposals	0	-1,610	-2,010	-5,129	-2,134	0	-10,883
Reclassifications	4	1,466	10,135	-1,335	1,603	-16,988	-5,115
Acquisition cost 31.12.2002	9,758	116,188	99,260	57,731	28,103	2,478	313,518
Depreciation 31.12.2001	0	30,459	41,290	43,266	17,487	0	132,502
Currency change	0	-1,223	-2,361	-938	-740	0	-5,262
Acquisitions/disposals of businesses	0	0	0	0	-19	0	-19
Depreciation 2002	0	4,517	10,243	6,741	2,736	0	24,237
Disposals	0	-256	-1,752	-4,384	-1,542	0	-7,934
Reclassifications	4	102	-470	-2,001	357	5	-2,003
Depreciation 31.12.2002	4	33,599	46,950	42,684	18,279	5	141,521
Book Value 31.12.2002	9,754	82,589	52,310	15,047	9,824	2,473	171,997
Book Value 31.12.2001	9,823	91,993	54,164	15,022	10,887	11,145	193,034

Additions in property, plant and equipment primarily relate to technology improvements and expansions of the U.S. manufacturing facility of € 5.7 million (construction in progress) and to divers production lines of the new nitration plant in Ireland of € 1.0 million.

Investments in technical equipment mainly account for computers and company cars for the Company's sales force. Recurrent capital expenditures were made in technical and manufacturing facilities in Germany of € 5.1 million.

Intangible assets

	Concession	Patents and similar rights	Trademarks	Licenses and similar rights	Goodwill	Advances paid on intangible assets	Total
Acquisition cost 31.12.2001	1,424	4,109	59,577	411,544	145,609	2,166	624,429
Currency change	-154	-573	-949	-37,115	-14,702	0	-53,493
Acquisitions/disposals of businesses	0	0	0	0	0	0	0
Additions	53	240	68	4,540	0	3,205	8,106
Disposals	-124	0	-1	-2,195	0	239	-2,081
Reclassifications	0	0	0	7,033	0	-1,918	5,115
Acquisition cost 31.12.2002	1,199	3,776	58,695	383,807	130,907	3,692	582,076
Amortization 31.12.2001	733	3,089	19,245	152,669	100,194	-239	275,691
Currency change	-102	-440	-490	-11,454	-13,217	0	-25,703
Acquisitions/disposals of businesses	0	0	0	0	0	0	0
Amortization 2002	163	244	5,386	30,444	0	0	36,237
Disposals	0	0	0	-1,630	0	239	-1,391
Reclassifications	0	0	0	2,002	0	0	2,002
Amortization 31.12.2002	794	2,893	24,141	172,031	86,977	0	286,836
Book Value 31.12.2002	405	883	34,554	211,776	43,930	3,692	295,240
Book Value 31.12.2001	691	1,020	40,332	258,875	45,415	2,405	348,738

Additions to intangible assets amounting to € 8.1 million mainly relate to the acquisition of product rights in Spain and the capitalization of various software (sales force, risk management software, research software). Prepayments on intangible assets mainly refer to a Customer Relationship Management System in the German sales organization.

Amortization on intangible assets recorded in 2002 comprise ordinary amortization amounting to € 36.2 million as well as an impairment loss according to FAS 142 on a product right of SCHWARZ PHARMA Deutschland GmbH. The value of this product right was no longer sustainable.

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

Long-term investments

	Investments in affiliated companies	Investments in associated companies	Long-term securities	Total
Acquisition cost 31.12.2001	1,369	35,066	10,020	46,455
Currency change	0	0	-174	-174
Acquisitions/disposals of businesses	0	0	0	0
Additions	3	4,217	40	4,260
Disposals	-222	0	-1,434	-1,656
Reclassifications	0	0	0	0
Acquisition cost 31.12.2002	1,150	39,283	8,452	48,885
Depreciation 31.12.2001	0	9,709	1,434	11,143
Currency change	0	0	-102	-102
Acquisitions/disposals of businesses	0	0	0	0
Depreciation 2002	0	2,978	1,062	4,040
Disposals	0	0	-1,434	-1,434
Reclassifications	0	0	0	0
Depreciation 31.12.2002	0	12,687	960	13,647
Book Value 31.12.2002	1,150	26,596	7,492	35,238
Book Value 31.12.2001	1,369	25,357	8,586	35,312

Investments in associated companies relate to the net development of the Joint venture HOYER-MADAUS established in 1999. According to FAS 142 an impairment of € 1.1 million was accounted for an investment

in a former co-operation partner of SCHWARZ BIOSCIENCES Inc., USA. Long-term investments are included in the balance sheet caption "Long-term investments and other assets".

12. Investments

Information regarding the Company's investment in debt and equity securities is as follows:

	2001	2002
Cost of trading equity securities	0	252
Cost of "available-for-sale" securities	15,866	8,332
Unrealized gains/losses	4,733	2,620
Fair value equity securities (available for sale + trading)	20,599	11,204

These investments are included in the position "Marketable securities" and "Long-term investments and other assets".

In 2002 SCHWARZ PHARMA Inc., USA realized 443,900 shares of AXCAN Pharma Inc.

With the establishment of the Joint venture AXCAN SCHWARZ in 1997, SCHWARZ PHARMA acquired 750,000 convertible bonds of Axcan Pharma for a price of € 6.6 million and additional € 1.3 million premium. Afterwards, each convertible bond had been exchanged into common shares of Axcan Pharma without any additional payment. Currently,

SCHWARZ PHARMA owns less than 5% of the outstanding common shares. In 2001, this investment has been reclassified from the position "available-for-sale securities" into the position "marketable securities".

In 2000 SCHWARZ PHARMA purchased 489,804 preferred shares of common stock of Discovery Therapeutics Inc., Richmond/USA (today: Aderis Inc.) for € 5.0 million. In 2001, SCHWARZ PHARMA has acquired further 200,000 shares of common stock of Discovery Therapeutic Inc. (today: Aderis Inc.) for an amount of € 2.5 million. This investment in common stock has been classified as available-for-sale.

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

13. Borrowings and Credit Arrangements

Long-term debt at December 31 consisted of:

	Range of %	Interest Rates	2001	2002
Domestic: Bank loans	4.2 – 6.8 (2001: 4.2 – 6.1)	2003-2007	55,872	65,105
Foreign: Bank loans	4.2 – 6.9 (2001: 3.6 – 6.9)	2005	57,973	27,683
Revolving credit	(2001: 2.3)		3,401	0
State loans	0	2003–2012	1,340	2,658
Total long-term debt			118,586	95,446
Less current portion of long-term debt			73,431	11,667
Long-term debt, net			45,155	83,779

Principal amounts of long-term debt payable during the five years ending December 31, 2003 through 2007 are T€ 11,667, T€ 11,867, T€ 20,947, T€ 9,747 and T€ 40,017 (thereafter, T€ 1,201 with a term of more than 5 years) respectively.

Certain long-term debt repaid in 2002 was secured by a mortgage lien of T€ 2,877, which has not been deleted at the balance sheet date 2002.

As of December 31, 2001, one of the Company's foreign subsidiaries borrowed € 3.4 million under a working capital revolving line of credit facility. This debt was completely cleared off in 2002.

The Company and certain subsidiaries have various unsecured bank loans, which all bear interest at fixed rates.

The Company has domestic and foreign line of credit agreements with banks totaling € 189.1 million, of which € 150.3 million were available at December 31, 2002. The interest on borrowings is based upon the terms of each specific arrangement and is subject to market conditions. Certain agreements contain a limitation on the Company's debt-equity ratios, specified net worth and interest coverage ratios relating to the SCHWARZ PHARMA group. The Company does not anticipate that future borrowings will be limited by the terms of these agreements.

Short-term debt include notes payable and bank overdrafts. The weighted average interest rate was 4.5%, 4.7% and 5.6%, respectively, at December 31, 2002, 2001 and 2000.

Cash paid for interest was € 12 million in 2002, € 8 million in 2001 and € 9 million in 2000.

14. Concentrations of Credit Risk

The Company periodically reviews the creditworthiness of counter-parties to foreign exchange and other agreements and does not expect to incur a loss from failure of any counter-parties to perform under the agreements. Concentrations of credit risk with respect to trade receivables are limited, due to the large number of customers comprising the Company's customer base. Ongoing credit evaluations of customers' financial condition are performed and, generally, no collateral is required.

15. Employee Benefits

Retirement Benefits

The Company has various noncontributory defined benefit pension plans covering eligible employees, including certain employees in foreign countries. Most of the plans provide benefits based on flat amounts depending on the years of service. In general, the Company's policy is to fund these plans only if it is legally required, or local practice or if it is beneficial from tax considerations. The Company also sponsors defined contribution plans and participates in government-sponsored programs in certain countries.

On June 30, 2000, the German operations of the Company terminated a defined benefit pension plan and benefit accruals for all eligible employees were frozen as of that date. Vested pension benefits from the old plan will be paid when the retirement requirements of the plan are being met.

Commencing July 1, 2000, a new defined benefit pension plan was created in Germany covering substantially all employees. The new plan has been instituted through a benevolent fund which is an independent organization. The fund is committed to purchase reinsurance annuity contracts for every individual participant in order to secure future retirement payments from the fund to those participants. The Company contributes 0.75 % of every participant's eligible salaries/wages to the plan (contribution 1). The participant may elect to contribute further amounts, yet not to exceed 0.75 % of their eligible salaries/wages to the plan (contribution 2). The Company will match the employee's election (contribution 2 only) up to the elected amount but not to exceed the predetermined maximum. In addition, the participants may further contribute at their discretion up to 0.75 % of their eligible salaries/wages to the plan (contribution 3). All contributions to the plan are vested immediately. The accumulated benefit obligation will generally be settled through lump-sum distributions at the time of retirement based on actuarial evaluations. The participant may elect to spread such distributions into up to five partial payments.

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

In 2002, the existing benefit pension plan of the German operations was modified. Henceforth there are two different models for standard wage employees and sales force representatives on the one hand and management on the other hand.

For standard wage employees and representatives the company contributes 0.75% of every participant's eligible salaries/wages to the plan (contribution 1). In addition, the employees can use the employer's contribution to tax deductible savings plans ("Vermögenswirksame Leistungen") to contribute to the plan (contribution 2). In case of settling contribution 2, the company will match the participant's contribution up to a predetermined maximum. If contribution 2 was paid, the participants may elect to renounce payment of certain or all parts of their vacation bonus and contribute the amount to the plan (contribution 3). Contribution 3 is added up by the Company with 13% of the participant's expended vacation bonus. Only if contribution 3 is completely exhausted, an additional amount can be converted within the scope of year-end bonus payment (contribution 4). All contributions to the plan are vested immediately.

For management there is merely a change in contribution 3 compared to the plan set up in July 2000: The participants can contribute at their discretion an amount of up to 4% of their gross base salary to the plan. All contributions to the plan are vested immediately, too.

After achieving a certain retirement age the employee can choose between three different pay-out models. The benefit obligation can either be paid as a one-time capital sum, spread into three to five partial payments or disbursed as a monthly pension.

In 2001, SCHWARZ PHARMA started paying contributions to a benevolent fund from which plan assets with an amount of T€ 3,634 resulted at year end 2002. These plan assets are netted against the discounted value of the pension commitments.

Pension cost for all plans were T€ 5,930, T€ 5,639 and T€ 5,481 for 2002, 2001, 2000, respectively. Pension plan information for fiscal years ending December 31, 2002 and 2001 was as follows:

	2001	2002
Change in benefit obligation		
Benefit obligation at beginning of year	19,685	21,159
Service Cost	1,345	2,012
Interest Cost	1,174	1,241
Amendments	0	0
Actuarial (gain)/loss	(338)	752
Business acquired	0	0
Businesses disposed	0	0
Benefits paid	(707)	(873)
Curtailments	0	0
Benefit obligation at end of the year	21,159	24,291

Change in plan assets		
Fair value of plan assets at beginning of year	0	1,809
Adjustments	0	902
Return on plan assets	60	223
Company's contribution	1,749	700
Fair value of plan assets at end of year	1,809	3,634
Funded status	(19,350)	(20,657)
Unrecognized net actuarial (gain)/loss	769	1,312
Unrecognized prior service cost	336	275
Additional minimum liability	(1,438)	(2,019)
Prepaid (accrued) benefit cost	(19,682)	(21,089)

Components of net periodic pension cost	2000	2001	2002
Service Cost	1,036	1,345	1,722
Interest Cost	1,185	1,174	1,241
Actual return on assets	0	(22)	(176)
Net amortization and deferral	61	21	9
Curtailment loss/(gain)	(603)	0	0
Net periodic pension cost	1,679	2,518	2,796

	2000	2001	2002
Weighted-average assumptions as of December 31,			
Domestic and other European plans:			
Discount rate	5.9%	6.0%	5.9%
Rate of compensation increase	2.5%	2.5%	2.5%
Expected rate of return on plan assets	—	6.5%	6.5%

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

Employee Savings Plan

The U.S. operations of SCHWARZ PHARMA have a defined contribution plan covering substantially all U.S. employees. Eligible employees can contribute a percentage of their earnings to the 401(k) savings feature of the plan. SCHWARZ PHARMA matched 50% of the first 6% of an employee's annual contribution. SCHWARZ PHARMA may elect to make additional discretionary profit sharing contributions in such amounts as may be determined by the Board of Directors of the U.S. operations. SCHWARZ PHARMA's matching contributions to the plan were approximately T€ 931, T€ 829 and T€ 922 for 2002, 2001 and 2000, respectively. The U.S. Board of Directors authorized additional discretionary contributions of T€ 1,720, T€ 1,613 and T€ 1,698 for 2002, 2001 and 2000, respectively.

Deferred Compensation Plan

Effective January 1, 1998, the U.S. company instituted a Deferred Compensation Plan (the "Deferred Plan") to permit certain key employees to defer receipt of current compensation in order to provide retirement benefits on behalf of such employees. The Deferred Plan does not enjoy tax benefits according to local legislation. This plan is intended to be unfunded and, therefore, all compensation deferred under the Deferred Plan is held by the U.S. company and commingled with its general assets. However, employee deferrals are deposited in U.S. company-owned life insurance contracts. Within these contracts the employees have the option of selecting a variety of investments. The return on these underlying investments will determine the amount of earnings credited to the employee's account.

Amounts charged to expense relating to the Deferred Plan were approximately € 1 million and € 2 million for the years ended December 31, 2002 and 2001, respectively. Included in other non-current liabilities in the accompanying consolidated balance sheets as of December 31, 2002 and 2001 was approximately € 3 million and € 2 million, relating to the Deferred Plan.

Also, SCHWARZ PHARMA AG initiated a deferred compensation plan effective January 1, 2002. This deferred compensation plan is addressed to those employees with a salary above the social security contribution ceiling of the federal pension insurance after consideration of all reward renouncements. The employee's capital contributions are paid into a fund. All realized gains, interest income and other returns are retained within the fund and increase the employee's pension claim, which is guaranteed by SCHWARZ PHARMA. Taxation on these parts of salary attributed to the deferred compensation plan is deferred until the employee reaches retirement age.

In 2002 the employees made contributions to the plan of T€ 290. As of December 31, 2002, a corresponding pension liability relating to the Deferred Compensation Plan was recorded.

16. Shareholders' Equity SCHWARZ PHARMA AG and Subsidiaries

	Common shares outstanding	Common stock outstanding	Additional paid in capital	Other compre- hensive income	Retained earnings	Total equity	Total compre- hensive income
Balance as of 31.12.1999	43,989	57,094	125,039	49,790	257,326	489,249	
Net income					13,623	13,623	13,623
Other comprehensive income							
Currency translation				15,635		15,635	15,635
Unrealized holding gains (losses) on securities arising during the period				2,783		2,783	2,783
Minimum pension liability adjustments				(135)		(135)	(135)
Total comprehensive income							31,906
Reclassification to common stock				(232)	232		
Dividend to shareholders					(22,490)	(22,490)	
Issuance of treasury stock	(2)	(1)	(14)			(15)	
Balance as of 31.12.2000	43,987	57,093	125,025	67,841	248,691	498,650	
Net income					40,505	40,505	40,505
Other comprehensive income							
Currency translation				14,199		14,199	14,199
Unrealized holding gains (losses) on securities arising during the period				1,927		1,927	1,927
Minimum pension liability adjustments				104		104	104
Total comprehensive income							56,735
Dividend to shareholders					(12,097)	(12,097)	
Balance as of 31.12.2001	43,987	57,093	125,025	84,071	277,099	543,288	
Net income					48,393	48,393	48,393
Other comprehensive income							
Currency translation				(47,168)		(47,168)	(47,168)
Unrealized holding gains (losses) on securities arising during the period				(1,092)		(1,092)	(1,092)
Minimum pension liability adjustments				(288)		(288)	(288)
Appreciation of non-vested SAR's				976		976	976
Total comprehensive income							821
Reclassification							
Dividend to shareholders					(26,392)	(26,392)	
Purchase of treasury stock	600	780	10,020			10,800	
Issue of common stock	138	179	1,688			1,867	
Balance as of 31.12.2002	44,725	58,052	136,733	36,499	299,100	530,384	

¹⁾ OCI = "Other Comprehensive Income" according to FAS 130 "Reporting Comprehensive Income".

²⁾ The total comprehensive income is equivalent to the sum of "Other Comprehensive Income" and the net income

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

The unrealized holding gains (losses), pension liability and reclassification adjustments are presented net of tax amounting to T€ 1,201, T€ 1,681 and T€ 1,182 for 2002, 2001 and 2000, respectively.

The Annual Shareholder's Meeting decided on May 15, 2002, to reclassify the share capital of SCHWARZ PHARMA AG. Each existing share of SCHWARZ PHARMA AG representing a portion of the share capital amounting to € 2.60 was replaced by two shares with a portion amounting to € 1.30 each.

The purpose of this transaction was to increase stock trading liquidity, SCHWARZ PHARMA AG did not receive new capital.

In October 1999, the Supervisory Board authorized the Executive Board to repurchase Company's stock. The Executive Board decided to repurchase up to € 0.51 million SCHWARZ PHARMA shares through December 31, 1999. The Company's repurchases of common stock are recorded as a separate item in shareholders' equity and reduces common stock as well as additional paid in capital according to the underlying treasury method.

Upon approval of the Supervisory Board the Company sold 600,000 treasury shares in 2002, whereas no shares were purchased or sold in 2001 and 800 treasury shares were purchased in 2000. The number of treasury shares sold to employees amounted to 10,630 in 2002, 21,000 in 2001 and 19,520 in 2000 (each number after stock split).

17. Stock Incentive Plans

Executive Stock Option Program 1997–1999

In 1997, the Company adopted a Executive Stock Option Program (ESOP), through which certain senior managers and other key employees became eligible to invest in fixed-rate debentures, which have a term of seven years and are convertible into shares of the Company's common stock after three years. Each debenture note (nominal value of one thousand DM) can be exchanged for 200 ordinary shares with payment of a premium. The exercise price for the shares upon conversion is based upon the share price at the time the debentures are issued (base exercise price), which is adjusted upward or downward for the relative change in price of the Company's shares compared to an industry stock index and is only exercisable, if at one of the specified potential measurement dates the Company's stock price increases by at least 8.5% per annum for the first 3 years and does not lag the industry index by more than 3% per annum.

During 2000 the Executive Board decided and the Supervisory Board acknowledged to repay the fixed-rate debentures at the discretion of each participating key employee in full or in part. The number of shares under option which were repaid was 6,000 in 2002 and 99,800 in 2001. At the end of 2002 all convertible bonds have been repaid.

Stock Option Program 2000

During 2000, the Company adopted the Executive Stock Option Program 2000 (ESOP 2000), through which certain senior managers and other key employees became eligible to invest in a 5.5% interest bearing fixed-rate debentures, which have a term of ten years and are convertible into shares of the Company's common stock. Each debenture (nominal value of € 2.60, after stock split € 1.30) can be exchanged for one ordinary share with the payment of a premium. The exercise price for the options upon conversion is based on an

average share price at the time the debentures are issued (reference price) plus an extra charge of 15% (exercise hurdle) of the reference price. After two and three years fifty percent of the covered shares will each become exercisable, but only if a participant's date of termination, death, disability or retirement has not occurred before the vesting date.

The following table summarizes stock option activity in 2001 and 2002 under the ESOP 2000 (number of shares in thousands after stock split):

	2001		2002	
	Number of shares under option	Average base exercise price per share (€)	Number of shares under option	Average base exercise price per share (€)
Outstanding at January 1	861	13.56	2,013	14.55
Granted	1,197	15.23	967	20.15
Exercised	0	–	(138)	13.56
Canceled	(45)	13.81	(126)	14.60
Outstanding at December 31	2,013	14.55	2,716	16.59
Exercisable at December 31	0		243	

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

Stock Appreciation Rights

Program 1999 (SAR Plan)

Effective September 1, 1999, the Executive Board adopted the SCHWARZ PHARMA Stock Appreciation Rights Plan 1999. Under the SAR Plan, which has a duration of 6 years, the Company, via a committee appointed by the Executive Board (the "Committee") may grant to eligible employees one or more stock appreciation rights ("SARs"). The Committee will specify the number of shares to be subject to each SAR granted to each participant and establish the grant price and grant date for each SAR granted. Under the terms of the SAR Plan, the grant price of the SAR granted shall be the fair market value of the common share of SCHWARZ PHARMA AG on the grant date.

Twenty five percent of covered shares of a participant's SAR will become exercisable on the first, second, third and fourth anniversary of the grant date, i.e. on September 1, 2003 all SARs will be fully exercisable, but only if a participant's date of termination has not occurred before the vesting date. In the event of a change in control, as defined in the SAR Plan, any unvested SAR held by a participant shall become fully vested and exercisable.

Upon exercise of a SAR, the participant shall receive cash equivalent to the appreciation of one share of stock under the SAR multiplied by the number of shares of stock as to which it is

then being exercised. The appreciation is measured by the excess of the fair market value of stock, as defined in the SAR Plan, on the exercise date over the grant price.

The SARs expire upon the earliest of the following:

- The sixth anniversary of the grant date or on August 31, 2005
- The seventh day following the participant's date of termination, if such termination occurs for reasons other than the participant's death
- The twelve months anniversary of the date of termination, if termination occurs by reason of the participant's death.

During the year ended December 31, 1999, 165,700 SARs (331,400 SARs after stock split) were issued to senior executives and key employees of the Company. No compensation expense was recognized during the year 1999 as the grant price (€ 19.32 after stock split) of all SARs issued exceeded the market value of the Company's stock at December 31, 1999. As 75% of the total SAR volume is vested as of December 31, 2002, the Company accrued compensation expense for € 4.0 million based on a SCHWARZ PHARMA share price of € 34.66.

The development of the SAR Plan throughout 2000, 2001 and 2002 was as follows (after stock split):

	2000	2001	2002
(SARs in thousands)	Number of SARs	Number of SARs	Number of SARs
Outstanding at January 1	487	388	373
Granted	0	0	0
Exercised	0	0	(12)
Canceled	(99)	(15)	(13)
Outstanding at December 31	388	373	347
Exercisable at December 31	97	186	261

**Stock Appreciation Rights
Program 2000 (SAR 2000 Plan)**

The Stock Appreciation Rights Program 2000 has been established on December 31, 2000. Under the SAR 2000 Plan, the Company may grant to eligible key employees an individually determined number of stock appreciation rights ("SARs"). The grant price of a SAR granted under this program will be € 20 (€ 10 after stock split). The overall duration of the SAR 2000 Plan is five years and ends on December 31, 2005.

Fifty percent of covered shares of a participant's SAR will become exercisable on the first and the second anniversary of the grant date, but only if a participant's date of termination has not occurred before the vesting date. In the event of a change in control, as defined in the SAR Plan, any unvested SAR held by a participant shall become fully vested and exercisable. Upon exercise of a SAR, the participant shall receive cash equal to the appreciation of one share of

stock under the SAR multiplied by the number of shares of stock as to which it is then being exercised. The appreciation is measured by the excess of the fair market value of stock over the grant price, as defined in the SAR Plan, on the exercise date.

As of December 31, 2000, 275,000 SARs (550,000 SARs after stock split) were issued to key employees of the Company. As the fair market value of the Company's stock exceeded the grant price of the SARs at December 31, 2000, compensation expense of € 1.8 million will have to be accrued over the vesting period of which € 1.3 related to 2001. As the total volume of the SAR 2000 is fully vested as of December 31, 2002, the Company accrued compensation expense for € 10.6 million based on a SCHWARZ PHARMA share price of € 34.66.

The development of the SAR Plan throughout 2000, 2001 and 2002 was as follows (after stock split):

	2000	2001	2002
(SARs in thousands)	Number of SARs	Number of SARs	Number of SARs
Outstanding at January 1	0	550	520
Granted	550	0	0
Exercised	0	0	(90)
Canceled	0	(30)	(14)
Outstanding at December 31	550	520	416
Exercisable at December 31	0	260	416

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

Hedging of SAR programs 1999 and 2000

In October 2002 SCHWARZ PHARMA decided to hedge potential risks occurring from the SAR 1999 and SAR 2000 plan by investing in Call options on its own stock. The options grant the right to the company (buyer) to claim for a cash settlement from a bank (seller) in case of exercise by the buyer.

This hedge transaction is accounted for in accordance with FAS 133 "Accounting for Derivative Financial Instruments and Hedging Activities". Therefore, the purchased options are included in other assets and are recognized at fair value at the balance sheet date. Fair value appreciation of the non-vested SARs as of December 31, 2002 amounting to T€ 976 has been recorded in the equity item "Other comprehensive income".

Fair values and acquisition costs of the options on December 31, 2002, are as follows:

- SAR 1999: Fair value € 6.2 million;
Acquisition cost € 2.5 million.
- SAR 2000: Fair value € 9.6 million;
Acquisition cost € 4.3 million.

When purchasing these options, the Company sold 600,000 treasury shares at a price of € 18.00 to the partner bank upon approval of the Supervisory Board.

Evaluation

The Company accounts for its stock compensation arrangements using the intrinsic value method. If the fair value method of accounting was applied as defined in FAS No. 123 "Accounting for Stock-Based Compensation", the Company's total and per share net income would have been as follows (in thousand €, per share amounts in € after stock split):

	2000	2001	2002
Net income			
As reported	13,624	40,505	48,393
Pro forma	12,112	35,383	37,173
Basic earnings per share			
As reported	0.31	0.92	1.10
Pro forma (basic)	0.28	0.80	0.84
Pro forma (diluted)	0.28	0.80	0.84

The weighted-average fair value per share for options granted in 2002, 2001 and 2000 were estimated at € 23.80, € 9.17 and € 7.60, respectively. The fair value was calculated using the Black-Scholes option pricing model, modified to reflect the pricing adjustments, based on the following assumptions:

	2000	2001	2002
Dividend yield	1.7%	3.4%	1.7%
Volatility	36.0%	50.0%	50.0%
Risk-free interest rate	4.9–5.4%	5.2%	4.43%
Expected term of options (in years)	5–10	10	10

18. Financial Instruments

Fair Value of Financial Instruments

FAS No. 107 "Disclosures about Fair Value of Financial Instruments", requires disclosure of the following information about the fair value of certain financial instruments for which it is practicable to estimate that value. For the purposes of this disclosure, the fair value of financial instruments is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. However, considerable judgement is necessary in interpreting market data to develop the estimates of fair value. Accordingly, the estimates presented are not necessarily indicative of the amounts that SCHWARZ PHARMA could realize in a current market exchange or the value that ultimately will be realized by SCHWARZ PHARMA upon maturity or disposition.

The financial instruments portfolio of SCHWARZ PHARMA includes cash and cash equivalents, as well as short- and long-term debt instruments. The most significant instrument, long-term debt, had carrying and fair values totaling T€ 83,779 and T€ 92,617 respectively at December 31, 2002. The corresponding amounts at December 31, 2001 were T€ 45,155 and T€ 45,382 respectively. The fair values of the other instruments approximated their carrying values in the aggregate.

The fair value of long-term debt has been estimated using the discounted cash flow method based on current borrowing rates, currency exchange rates and remaining maturities.

Derivative Financial Instruments

SCHWARZ PHARMA is an international corporation with operations in several countries. As a result, it is subject to foreign currency exposures related to buying, selling, and financing in currencies other than the local currency.

The Company enters into forward exchange and option contracts as well as interest rate swaps to hedge certain firm purchase and sales commitments and certain anticipated but not yet firmly committed transactions denominated in foreign currencies.

Additionally, in October 2002 the Company decided to hedge potential risks arising from the Stock Appreciation Rights Program 1999 and 2000 by purchasing Call options on its own share.

According to FAS 133 premiums paid or received on purchased or sold options are included in other assets and liabilities at fair value and changes in value of the derivative are recognized in earnings of the current period.

Is the hedging instrument attributable to a definite underlying transaction, changes in value of the derivative are recorded in "Other comprehensive income" if future cash flow fluctuations are hedged (Cash Flow Hedge). Deferred gains and losses on forward exchange or interest rate swap contracts are generally recognized in earnings when the future purchases and sales being hedged are recognized or when the foreign currency liability is settled. If already recognized assets or liabilities are hedged (Fair Value Hedge), changes in value of the derivative are immediately recognized in earnings.

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

At December 31, 2002, two option contracts had maturities of 36 months, two interest rate swaps a remaining maturity of 42 months and all other contracts had maturities within the next 12 months.

The following table presents the aggregate notional principal amounts, carrying and fair values of the Company's derivative financial instruments outstanding at December 31, 2002 and 2001.

	December 31, 2002		December 31, 2001	
	Notional Principal Amounts	Carrying (Fair) Values	Notional Principal Amounts	Carrying (Fair) Values
Forwards Contracts	23,726	(144)	14,402	401
Cross-Currency Swap	1,190	(89)	45,000	(238)
Options	–	–	21,931	17,738
Total	24,916	(233)	81,333	17,901

19. Commitments

Capital Leases

In 2002 certain non-cancelable leases relating to office equipment are classified as capital leases and are included in property, plant and equipment. Other leases are classified as operating leases and are not capitalized. Details of the capitalized leased assets are as follows:

	Dec. 31, 2001 T€	Dec. 31, 2002 T€
Other equipment	4,299	3,189
Less accumulated depreciation	2,105	1,615
Net capitalized leased assets	2,194	1,574

Depreciation of these capital lease assets are included in ordinary depreciation of the year.

At December 31, 2002 the future minimum lease payments under capital leases are as follows:

	T€
2003	1,044
2004	492
2005	111
Total minimum lease payments	1,647
Less amount representing interest	(73)
Present value of net minimum lease payments	1,574
Less current maturities	(1,012)
Long-term obligation	562

Operating Leases

The Company leases automobiles, certain equipment, office and warehouse facilities under various lease agreements. Rental expense under these leases were approximately T€ 17,045, T€ 15,661 and T€ 13,933 in 2002, 2001 and 2000, respectively. The Company has certain obligations related to future capital expenditures and other purchase commitments totaling T€ 11,747, as of December 31, 2002. Aggregate future minimum annual rental payments required under the operating leases at December 31, 2002, are as follows:

	T€
2003	8,173
2004	6,287
2005	4,255
2006	2,354
2007 and thereafter	3,515
Total	24,584

20. Contingencies

The Company is involved in various litigation arising in the normal course of business, including proceedings based on patent infringement and workers' compensation claims. The Company is self-insured for health care, workers' compensation, general liability and product liability up to predetermined amounts, above which third party insurance applies. Management regularly reviews the probable outcome of these proceedings, the expenses expected to be incurred, the availability and limits of the insurance coverage, and the established accruals for uninsured liabilities.

While the outcome of pending proceedings cannot be predicted with certainty, management believes that any liabilities that may result from these proceedings are not reasonably likely to have a material effect on the Company's liquidity, financial condition or results of operations.

21. Subsequent Events

Beyond the developments already described, no events occurred after December 31, 2002, which are of major significance for SCHWARZ PHARMA and would lead to a change in the assessment of the Group.

22. Business Segment Information

See the Management's Discussion and Analysis of this report.

23. Significant differences between German Commercial Code and U.S. GAAP

There are differences in a large number of individual items between U.S. GAAP accounting principles and German Commercial Code (HGB). The following items have particular relevance to SCHWARZ PHARMA:

Depreciation on property, plant and equipment and product rights

Movable property, plant and equipment are amortized in the Consolidated Financial Statements according to U.S. GAAP using the straight-line method without exception. Under HGB, in accordance with tax regulations, declining-balance depreciation is permissible to be used in Consolidated Financial Statements. In some cases, estimating longer useful lives for certain product rights following HGB leads to lower depreciation as compared to U.S. GAAP.

Notes to Consolidated Financial Statements

Notes to the Balance Sheet

Capitalization of direct internal personal expenses

In contrast to HGB but in accordance with U.S. GAAP (SOP 98-1), internal direct personal expenses which refer to intangible assets (software) have been included in acquisition costs for the first time in 2001.

Acquired goodwill

While the costs of purchasing participating interests in third parties and the market values of the identifiable goods (less liabilities) acquired can be netted against revenue or capital reserves under HGB, U.S. GAAP regulations require to record assets and liabilities at their fair values and to capitalize any remaining excess purchase price as goodwill. Following U.S. GAAP goodwill has been amortized over a period of 15 to 20 years (for acquisitions in 1999; earlier acquisitions over a period up to 40 years) until 2001. Since January 1, 2002 goodwill is no longer amortized on a regular basis due to adjusted U.S. GAAP rules, FAS 142 "Goodwill and Other Intangible Assets". As far as goodwill is capitalized under HGB, a useful life of 4 years or any other reasonable estimate is allowed.

Inventories / Cost of sales

Since 2001, not only direct material and production cost elements are considered when calculating production costs according to HGB, but also related overheads. Therefore, there are no longer evaluation differences between U.S. GAAP and HGB.

Provisions

In the Consolidated Financial Statements according to U.S. GAAP, all pension commitments of the SCHWARZ PHARMA Group are valued uniformly according to FAS 87 "Employer's Accounting for Pensions." In contrast, for consolidated accounting purposes under the HGB, the valuation used for domestic companies is based on German tax regulations and the valuation for foreign companies is based on the relevant local regulations.

Under German accounting rules, provisions for deferred maintenance may be recorded as of the balance sheet date if the maintenance measures will be executed within three months of that date. U.S. GAAP does not allow any provisions for such maintenance expenses. Furthermore, in contrast to U.S. accounting rules, reserves must also be recorded for contingent liabilities under German rules when the need for the same is sufficiently probable.

Research and development costs

SCHWARZ PHARMA has entered into development contracts with various biotechnology and other technology companies concerning projects at different stages of clinical development. In the majority of cases, down-payments become due at the time of concluding these contracts. According to HGB those payments are regularly capitalized in the balance sheet under intangible assets as purchased product rights. However, according to U.S. GAAP, these costs are in general recorded as ongoing research and development expenses in the income statement. Under HGB accounting rules, expense from these projects occur for the first time when depreciation start or the project is stopped and disposed of.

Declaration of Compliance under § 161 German Stock Corporation Act

Executive Board and Supervisory Board of SCHWARZ PHARMA AG hereby declare and confirm that the Company is in compliance with the Recommendations of the German Corporate Governance Kodex in the fiscal year 2002 and will be thereafter; however, subject to the following deviations:

Set up of an Audit Committee (No. 5.3.2 Kodex), specifications for an age limit of members of the Supervisory Board (No. 5.4.1 Kodex) and to the disclosure of earnings of affiliated companies (No. 7.1.4 Kodex), to Directors' Dealing disclosures and shareholdings' information in the notes to the Consolidated Financial Statements (No. 6.6 Kodex).

With regard to an Audit Committee Executive Board and Supervisory Board hold that due to the importance of the respective issues and tasks for an Audit Committee these respective issues and tasks should not be delegated into a committee but performed by the Supervisory Board in its entirety.

An age limitation seems not to be necessary and/or recommendable because knowledge, abilities and expert experience of the Members of the Supervisory Board are of higher importance and priority.

Disclosures of earnings of affiliated companies should not take place in order to avoid competitors' information on cost- / margin structures of the marketing and distribution organizations of SCHWARZ PHARMA in the regions and countries.

Disclosures and publications with regard to the subjects of No. 6.6 Kodex beyond the obligations under the applicable laws do not seem to be necessary. The company will make the respective disclosures as required by law.

Monheim, February 2003

Supervisory Board and Executive Board
SCHWARZ PHARMA AG

Declaration of Compliance and Directors' Dealing can be found in German and English on the Internet www.schwarzpharma.com – Investor Relations – Corporate Governance.

SCHWARZ PHARMA Affiliates

	Location	Equity		Total sales		Employees	
		2001 € m.	2002 € m.	2001 € m.	2002 € m.	2001 31.12.	2002 31.12.
Germany							
SCHWARZ PHARMA AG	Monheim	398.3	437.7	111.8	120.6	379	333
SCHWARZ PHARMA Deutschland GmbH	Monheim	7.4	6.7	179.7	190.5	510	557
SANOL GmbH	Monheim	0.3	0.3	0.0	–	–	–
SCHWARZ BIOSCIENCES GmbH	Monheim	1.2	0.9	–	–	114	255
SCHWARZ & Co. Immobiliengesellschaft	Monheim	0.1	0.1	0.4	0.4	–	–
SCHWARZ & Co. Industriegebäudegesellschaft	Monheim	3.3	3.1	1.7	1.7	–	–
SCHWARZ PHARMA Produktions-GmbH & Co. KG	Monheim	75.2	74.1	137.9	143.6	427	402
Foreign companies							
SCHWARZ PHARMA Limited UK	UK/Chesham	7.2	7.3	32.2	30.7	109	106
SCHWARZ PHARMA S.p.A.	I/Mailand	11.5	12.6	57.2	59.0	192	190
Sifa Chemicals AG	CH/Liestal	24.9	21.6	70.4	71.7	6	7
SIFA Ltd.	IR/Shannon	32.8	–37.0	32.2	34.1	228	257
Laboratories SCHWARZ PHARMA S. A.	F/Boulogne	12.6	11.2	57.1	56.2	201	199
SCHWARZ PHARMA Sp. zo.o.	PL/Warsaw	9.9	8.1	24.0	27.7	125	155
SCHWARZ PHARMA Group USA	USA/Wilmington	284.1	255.6	231.4	405.1	628	659
Zhuhai SCHWARZ PHARMA Company Ltd.	PRC/Zhuhai ¹⁾	3.0	2.4	8.9	9.8	158	218
SCHWARZ PHARMA Hong Kong Ltd.	PRC/Hong Kong	8.0	9.9	9.5	17.0	10	11
SCHWARZ PHARMA Co. Ltd.	JAP/Tokyo	0.1	0.1	–	–	–	–
SCHWARZ PHARMA Group Spain	ESP/Madrid	19.4	20.6	44.2	41.9	262	266
SCHWARZ PHARMA Philippines Inc.	PHI/Manila	0.2	0.2	2.1	2.3	68	65
SCHWARZ BIOSCIENCES Inc.	USA/Durham	2.9	5.0	–	–	35	61
Associated companies							
Hoyer-Madaus GmbH & Co. KG	Monheim ²⁾	–	–	30.2	31.2	60	60

The share in equity capital of the companies is 100% in all cases except for

¹⁾ Zhuhai SCHWARZ PHARMA Company Ltd: 75%

²⁾ Hoyer-Madaus GmbH & Co. KG: 50%

Earnings figures by subsidiary/associated company are not published due to competitive reasons.

Leading SCHWARZ PHARMA Products

Product Group/ Trademarks (all ®)	Component	Indication	Net sales	
			2001 € million	2002 € million
Cardiovascular				
Univasc / Femipres / Uniretic / Femipres Plus	Moexipril / Moexipril HCTZ	Hypertension	67.2	73.8
Isoket / Dilatrate	Isosorbide Dinitrate	Coronary Heart Disease	53.0	51.7
Elantan	Isosorbide Mononitrate	Coronary Heart Disease	48.7	46.9
Prostavašin	Alprostadil	Peripheral Arterial Occlusive Disease	40.5	42.2
Deponit	Glyceril Trinitrate (Patch)	Coronary Heart Disease	36.8	37.0
Verelan PM	Verapamil HCL	Hypertension	33.5	36.9
Provas / Miten	Valsartan	Hypertension	16.8	28.0
Nidrel / Baypress	Nitrendipine	Hypertension	13.0	10.6
Kerlone	Betaxolol	Hypertension	8.4	8.9
Liposcler	Lovastatin	Hypercholesterolemia	9.3	8.7
Clivarina	Reviparine Sodium	Venous Thrombosis	5.3	8.2
Tensobon / Cor Tensobon	Captopril	Hypertension, Heart Failure	11.0	8.0
Dynacil	Fosinopril	Hypertension, Heart Failure	7.6	7.5
Gastro-Intestinal				
Omeprazole (KUDCo)	Omeprazole	Gastro-Intestinal Ulcers, Reflux Esophagitis	–	176.3
Rifun	Pantoprazole	Gastro-Intestinal Ulcers, Reflux Esophagitis	33.5	36.1
Levsin	Hyoscyamine	Irritable Bowel Syndrome	24.3	19.5
Procto	Hydrocortisone	Dermatoses	19.9	18.0
Colyte	Polyethylene Glycol, Sodium Chloride	Bowel Cleansing Prior to Colonoscopy	16.2	17.1
Norpramin	Omeprazole	Gastro-Intestinal Ulcers, Reflux Esophagitis	18.6	13.3
Vogalene	Metopimazine	Nausea	8.6	7.5
Urology				
Viridal / Edex	Alprostadil	Erectile Dysfunction	10.7	11.1
Spasmo-Lyt	Trospium Chloride	Incontinence	5.2	5.7
Harzol	Beta-Sitosterol	Benign Prostatic Hyperplasia	3.9	3.6
Central Nervous System				
Tylex	Paracetamol, Codeine	Pain	15.6	14.2
Agit / Seglor	Dihydroergotamine	Migraine	13.2	12.5
Lorans	Lorazepam	Anxiety	9.6	8.4
Other				
Atmadisc	Salmeterol Xinafoate	Asthma	16.0	28.0
Ferro Sanol	Iron (II)-Glycine-Sulfate Complex	Iron Deficiency	16.0	18.0

Executive Board and Supervisory Board

Supervisory Board

Dr. Rolf Schwarz-Schütte
Honorary Chairman

Dr. Hans-Dietrich Winkhaus
Chairman

*Member of the shareholder committee
of Henkel KGaA*

*Member of the Supervisory Board
of Deutsche Telekom AG, Bonn*

*Member of the Supervisory Board
of BMW AG, Munich*

*Member of the Supervisory Board
of Degussa AG, Düsseldorf*

*Member of the Supervisory Board
of Deutsche Lufthansa AG, Cologne*

*Member of the Supervisory Board
of ERGO Versicherungsgruppe AG, Düsseldorf*

Ernst Friedlaender
Vice Chairman

*Former Chairman of the Board of Management
of Prym-Werke GmbH & Co. KG, Stolberg*

*Chairman of the Advisory Board
of Hasenkamp GmbH & Co., Cologne*

*Chairman of the Supervisory Board
of Penarroya Oxide S.A., Rieux, France*

*Member of the Advisory Board
of Prym-Werke GmbH & Co. KG, Stolberg*

*Chairman of the Advisory Board of Fulda Holding
Stabernack Jr. Partner GmbH, Fulda*

Heinrich Bergmeier*
Commercial Employee

Dr. Terence Eaves

*Former Member of the Board of GlaxoWellcome
Research and Development Ltd., London,
Great Britain*

*Former Member of the Board of GlaxoWellcome
Inc., North Carolina, USA*

Dr. Rüdiger Hauffe

*Member of the Supervisory Board
of DIREVO Biotech AG, Cologne*

*Chairman of the Advisory Board
of Genzyme GmbH, Neu-Isenburg*

*Member of the Advisory Board
of Covidence GmbH, Eschborn*

Klaus Klinkers*
Master Electrician, Technical Employee

Edda Neumann*
Medical Representative

* Employees' representatives

Executive Board

Jürgen Peddinghaus

*Chairman of the Supervisory Board
of MAY Holding GmbH & Co. KG, Erfstadt*

*Chairman of the Supervisory Board
of Faber-Castell AG, Stein*

*Member of the Supervisory Board
of Zwilling J. A. Henckels AG, Solingen*

*Member of the Advisory Board
of Norddeutsche Private Equity, Hamburg*

*Member of the Supervisory Board
of Jungheinrich AG, Hamburg*

*Chairman of the Supervisory Board
of Kühlhaus Zentrum AG, Hamburg*

*Member of the Advisory Board
of Severin Elektrogeräte GmbH, Sundern*

Dr. Kurt Rudolf Schwarz

Managing Director of Leifina GmbH, Munich

Patrick Schwarz-Schütte

Chairman

Jürgen Baumann

Europe

Prof. Dr. Iris Löw-Friedrich

Research & Development

Detlef Thielgen

Finance, Controlling and Information Management

Dr. Klaus Veitinger

U.S.A. and Asia

SCHWARZ PHARMA-Group Addresses

SCHWARZ PHARMA AG
Alfred-Nobel-Straße 10
40789 Monheim, Germany
Phone +49 2173 48 0
Fax +49 2173 48 1608
www.schwarzpharma.com

Germany

SCHWARZ PHARMA
Deutschland GmbH*
Phone +49 2173 48 0
Fax +49 2173 48 1608
www.schwarzpharma.de
Chief Executive:
Georg Noweski
Jürgen Willas

SCHWARZ PHARMA
Produktions-GmbH & Co. KG*
Phone +49 2173 48 0
Fax +49 2173 48 1608
Chief Executive: Peter Brunk

SCHWARZ BIOSCIENCES GmbH*
Phone +49 2173 48 0
Fax +49 2173 48 1608
Chief Executive:
Prof. Dr. Iris Löw-Friedrich
Detlef Thielgen

HOYER-MADAUS GmbH & Co. KG*
Phone +49 2173 48 3100
Fax +49 2173 48 3199
www.hoyer-madaus.de
Chief Executive:
Karl Heinz Lünghöner

Asia

SCHWARZ PHARMA
Hong Kong Ltd.
Regional Office
C.M.A. Building
24th Floor
64 Connaught Road Central
Hong Kong, P.R. China
Phone +852 2854 9333
Fax +852 2854 9111
www.schwarzpharmaasiapacific.com
Chief Executive Asia:
Reto Carl Rietmann
Chief Executive: Joel Leung

* Address is identical with that of
SCHWARZ PHARMA AG

Zhuhai SCHWARZ PHARMA
Shanghai Office
Rm 2101 – 2102, LT Square,
No. 500 Cheng Du Rd. (N)
Shanghai, 200003, P.R. China
Phone +86 21 6361 5980
Fax +86 21 6361 5468
www.schwarzpharmaasiapacific.com
Chief Executive: Klaus Bitterauf

SCHWARZ PHARMA
Philippines Inc.
c/o Zuellig Pharma Corporation
Zuellig Pharma Bldg., Annex II
Mulugay Street
Makati City, Philippines
Phone +632 894 2666
Fax +632 894 2630
www.schwarzpharmaasiapacific.com
Chief Executive: Pete Miranda

SCHWARZ PHARMA Japan K. K.
2-14, Nihonbashi Ohdemma-cho
Chuo-ku
Tokyo 103-0011, Japan
Phone +81 3 56422126
Fax +81 3 56422127
Representative Director:
Dr. Tohru Hirose

France

LABORATOIRES SCHWARZ
PHARMA S.A.
Le Mail du Point du Jour
235, Avenue Le Jour se Lève
92651 Boulogne Billancourt
Cedex, France
Phone +33 1 46106666
Fax +33 1 46212285
www.schwarzpharma-lab.fr
Chief Executive: Marie-Laure Pochon

Great Britain

SCHWARZ PHARMA Ltd.
Schwarz House
East Street, Chesham
Bucks HP5 1DG, Great Britain
Phone +44 1494 797500
Fax +44 1494 773934
www.schwarzpharma.co.uk
Chief Executive:
Konstantin von Alvensleben

Ireland

SIFA Ltd.
Shannon, Industrial Estate
Shannon, County Clare,
Republic of Ireland
Phone +353 61 714100
Fax +353 61 714101
Chief Executive:
Dr. Bernie Harten

Italy

SCHWARZ PHARMA S.p.A.
Via Gadames, 57
20151 Milano, Italy
Phone +39 02 300791
Fax +39 02 3086359
www.schwarzpharma.it
Chief Executive:
Dr. Giancarlo Civita

Poland

Schwarz Pharma Sp.zo.o.
Ul. Dolna 21
05-092 Lomianki, Poland
Phone +48 22 7511328
Fax +48 22 7518796
www.schwarzpharma.pl
Chief Executive: Peter Sperner

Russia / CIS

SCHWARZ PHARMA AG
Representative Office Moscow
Ul. Ussatcheva 33/2, Building 5
119048 Moskova, Russia
Phone +7 095 9330282
Fax +7 095 9330283
Representative Director:
Michael Marjadi

Switzerland

SIFA CHEMICALS AG
Industriestraße 7
4410 Liestal, Switzerland
Phone +41 61 9069050
Fax +41 61 9069044
www.sifachem.com
Chief Executive:
Werner J. Schnyder

Spain

CEPA SCHWARZ PHARMA, S.L.
Paseo de la Castellana, 141
15th Floor
28046 Madrid, Spain
Phone +34 91 5703444
Fax +34 91 5702962
www.cepaschwarzpharma.es
Chief Executive: Dr. Antonio Martin

Czech Republic/ Slovak Republic

SCHWARZ PHARMA AG
Representative Office Prague
Norbertov 130/3
16200 Praha 6, Czech Republic
Phone +420 224 315 238
Fax +420 224 316 240
www.schwarzpharma.cz
Representative Director:
Dr. Radim Petrás

U.S.A.

SCHWARZ PHARMA, Inc.
6140 West Executive Drive
Mequon, WI 53092, U.S.A.
Phone +1 262 2385400
Fax +1 262 2380311
www.schwarzpharma.com
Chief Executive:
Dr. Klaus Veitinger
President: Dr. Ron Stratton

SCHWARZ BIOSCIENCES, Inc.
4101 Research Commons Building
Suite 100
79 T.W. Alexander Drive
Research Triangle Park
NC 27709, U.S.A.
Phone +1 919 767 2555
Fax +1 919 767 2570
Chief Executive:
Prof. Dr. Iris Löw-Friedrich

SCHWARZ PHARMA
Manufacturing, Inc.
1101 "C" Avenue West
Freeman Field
Seymour, IN 47274, U.S.A.
Phone +1 812 523 3457
Fax +1 812 523 1887
Vice President Manufacturing:
Jeff Siefert