2005 was a strong year for DSM on many counts. Conditions for DSM products were generally good in most markets.

Financial

net sales and supplies

x € million	Net sales 2005	Net sales 2004	Supplies 2005	Supplies 2004
Life Science Products	**1,479**	1,484	**1,531**	1,582
DSM Nutritional Products	**1,914**	1,899	**1,946**	1,910
Performance Materials	**2,447**	2,007	**2,459**	2,013
Industrial Chemicals	**1,687**	1,570	**1,899**	1,747
Other activities	**485**	474	**498**	485
intra-group supplies	**-**	-	**-321**	-303
Total, continuing operations	**8,012**	7,434	**8,012**	7,434
Discontinued operations	**183**	398	**183**	398
Total DSM	**8,195**	7,832	**8,195**	7,832

Sales by core activity
excl. discontinued activities

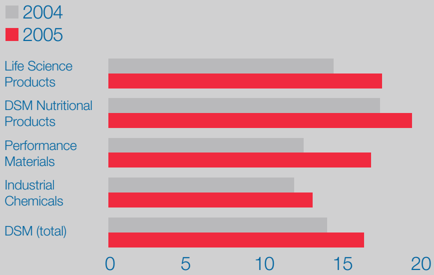
operating profit plus depreciation and amortization (EBITDA)

x € million	2005	2004
Life Science Products	**266**	226
DSM Nutritional Products	**376**	330
Performance Materials	**410**	249
Industrial Chemicals	**246**	207
Other activities	**-3**	24
Total, continuing operations	**1,295**	1,036
Discontinued operations	**16**	31
Total DSM	**1,311**	1,067

operating profit (EBIT)

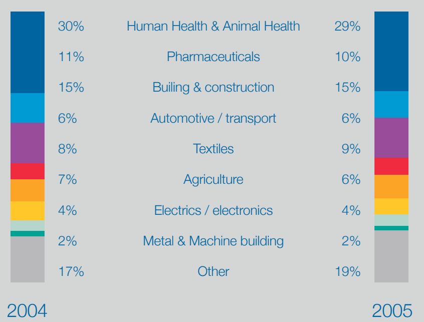
x € million	2005	2004
Life Science Products	**126**	79
DSM Nutritional Products	**252**	202
Performance Materials	**305**	165
Industrial Chemicals	**165**	120
Other activities	**-49**	-20
Total, continuing operations	**799**	546
Discontinued operations	**9**	16
Total DSM	**808**	562

EBITDA / supplies 2004 and 2005
excl. discontinued activities

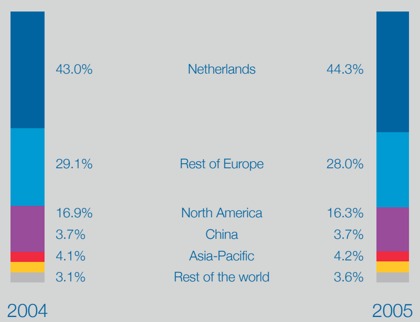


Markets

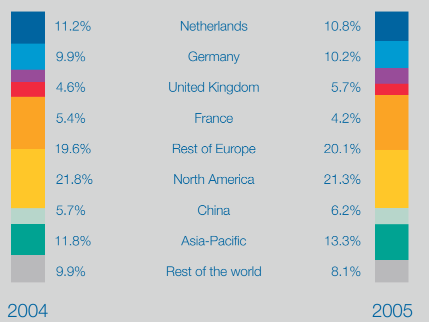
End-use markets



Sales by origin
excl. discontinued activities



Sales by destination
excl. discontinued activities



Developments in 2005

Group review

2005 was a strong year for DSM on many counts. Conditions for DSM products were generally good in most markets. Despite high and volatile oil and energy prices, which were further influenced in September by the hurricanes in the USA, industrial production in most sectors relevant to DSM developed at favorable levels. The situation in the American automotive industry, however, gave some cause for concern. Demand growth in Asia maintained its high momentum, while in Europe economic growth was still lagging behind the rest of the world, although it showed signs of strengthening. In these conditions DSM successfully managed to consolidate the high sales volumes achieved in 2004, while margins were widened due to strong pricing and the favorable effects of various cost-control initiatives. Volatility on the currency markets was relatively limited in 2005.

At € 8,195 million, net sales increased by almost 5%, which was exclusively due to higher sales prices, as overall sales volumes were flat and the effects of currency fluctuations on sales as well as the net effects of acquisitions and divestments were both close to zero.

Bottom-line results improved significantly in 2005. EBITDA increased by 23% to € 1,311 million, and the operating profit increased to € 808 million (up 44% from 2004) – which represents the highest operating profit in DSM's history, surpassing the previous record level (€ 751 million) achieved in 2000. It is important to note that, while the 2000 results were recorded mainly on the back of a cyclical peak in earnings of DSM's petrochemical activities, results in 2005 were for the greater part achieved with specialty businesses. The inherent quality of DSM's current profit profile is undoubtedly higher than when the previous record was set. In 2005 all clusters contributed to these improved results. DSM created substantial value, with its CFROI of 9.1% clearly exceeding the company's WACC.

Business review per cluster

In the Pharma-related activities of the Life Science Products cluster, the effects of restructuring projects to address the unfavorable market conditions in both custom manufacturing and anti-infectives yielded clearly improved profitability. Conditions in both markets more or less stabilized in 2005. Further profit improvement actions from DSM will be necessary in order to attain the desired profitability levels. This will involve completion of the ongoing restructuring projects at DSM Anti-Infectives and at the Linz site (Austria), and further reduction of the asset base of DSM Pharmaceutical Products. Also, the development of partnerships with North China Pharmaceuticals Corporation is in process. Significant progress was achieved in 2005 with this project.

With regard to the food-related activities of the Life Science Products cluster, DSM Food Specialties once again recorded strong results, hinging on the innovative portfolio of ingredients developed by this business group. The successful divestment of the below-average-performing activities of DSM Bakery Ingredients contributed to the improved overall performance of this cluster, yielding an overall EBITDA over sales margin from ongoing activities of 18.0% in 2005, compared to 15.2% in 2004.

DSM Nutritional Products further improved on its already strong performance of 2004. Top-line growth was limited as the net effect on sales of autonomous volume growth was more or less equal to the effects of continuing price pressure for some more mature products in the portfolio. Bottom-line results improved further, however, thanks to an improving product mix and the lowering of cost levels resulting from the activities undertaken in the framework of the *VITAL* program. Significant steps were taken to structurally strengthen the position of Vitamin C, for instance, by concentrating production on the site in Scotland (UK) and closing the plant in New Jersey (USA). The competitive position for this basic product will be further strengthened when the envisaged cooperation with North China Pharmaceutical Group Corporation (NCPC) in China commences. Besides improving the efficiency of operations, much emphasis was placed on developing innovative tailor-made formulations and new ingredients for the various market segments in which DSM Nutritional Products is active.

Overall EBITDA over sales from ongoing activities of DSM Nutritional Products amounted to 19.6% in 2005, compared to 17.4% in 2004.

The Performance Materials cluster posted very good results in 2005. Of the total top-line growth of 22% compared to the previous year, 12% was attributable to the inclusion of NeoResins, acquired at the beginning of February 2005 and now part of the DSM Coating Resins business group. Moreover, Chinese resins manufacturer Syntech was acquired at year-end 2005.

Bottom-line results of the Performance Materials cluster further benefited from good demand for DSM's products, which enabled a substantial margin improvement despite generally high and volatile raw material prices. The overall product mix improved due to strong growth of specifically in-house-developed products such as Dyneema®, various engineering plastics and special grades of composite resins. In addition, the ongoing efforts to streamline business processes in the framework of the Operational Excellence program and the successful restructuring at DSM Elastomers contributed clearly to the strong performance of this cluster. Overall, the EBITDA over sales margin from ongoing activities amounted to 16.8% in 2005, compared to 12.4% in 2004.

The Industrial Chemicals cluster also yielded strongly improved results in 2005, benefiting from favorable market conditions for fiber intermediates and for fertilizers. The overall tight supply/demand balance in these markets facilitated good margins, despite the high and volatile raw material prices. Results of fiber intermediates were held back in the second half of 2005 due to the prolonged shutdown of the caprolactam plant in Nanjing (China) in order to enable construction work for the planned doubling of capacity to 140,000 metric tons/year. DSM Melamine had to cope with some oversupply on the global markets, which prevented it from fully passing on the high feedstock prices, and consequently had a clearly weaker year. This was especially the case in the USA, above all due to the high natural gas and ammonia prices. DSM Agro achieved an even better performance than in the already strong 2004, driven mainly by high fertilizer prices.

Financials

DSM's financial position remained solid in 2005. The major credit rating institutions reconfirmed their Single A credit rating, with Moody's slightly upgrading their outlook to 'Stable' in May 2005. Net debt at year-end 2005 amounted to € 832 million (€ 339 million at year-end 2004), representing a gearing (defined as net debt/total capital) of 13%.

DSM generated healthy net cash provided by operating activities in 2005, totaling € 693 million, or 11.8% of net sales.

Capital expenditure (excluding acquisitions) amounted to € 401 million (2004: € 348 million), and was below depreciation level (€ 503 million), as planned. Major investment projects were e.g. the expansion of the fermentation capacities for arachidonic acid of DSM Food Specialties in Italy and in the USA, the construction of new production lines for Dyneema® and Dyneema®UD at the Greenville site in the USA, expansions of the sterile formulation facilities at the same site, new plants for various engineering plastics materials at sites in the Netherlands, and the doubling of capacity of the caprolactam plant in Nanjing (China).

Acquisitions (mainly NeoResins) and divestments (mainly DSM Bakery Ingredients and Styrene-Butadiene-Rubber (SBR)) on balance resulted in a net cash outflow of € 372 million in 2005.

In view of the favorable development of its share price, DSM decided in August 2005 to split its shares two-for-one. The earnings per share excluding exceptional items in 2005, calculated for the full year on the basis of the share split, increased to € 2.87, against € 2.09 in 2004. DSM paid its shareholders a total of € 183 million in dividends. The achievements of the past year were recognized by the financial markets, resulting in an increase in the DSM share price of 45% in 2005, clearly outperforming the market. With a Total Shareholder Return (TSR) of 49%, DSM also outperformed the average TSR of its European chemical peer group, which was 33% in 2005.

Strategy – looking back and ahead

Evaluation of *Vision 2005*

Towards the end of 2005 DSM completed its *Vision 2005: Focus & Value* strategy. The overriding goal of this strategy had been to transform DSM from the predominantly commodity chemicals-oriented company that it was in 2000 into a leading multi-specialty player. DSM wanted to accelerate its growth in the areas of life sciences and performance materials, while generating more stable earnings growth. The *Vision 2005* strategy objectives introduced in September 2000 have to a large extent been fulfilled.

- **Withdrawal from petrochemicals and accelerated growth of life science products and performance materials to approximately 80% of sales**
  M&A actions formed a crucial element in the transformation process and were planned and executed carefully and in phases. In 2001 DSM sold its profit rights in Energie Beheer Nederland (participations in gas and oil exploration) to the Dutch state and in 2002 it divested its petrochemical activities to SABIC. The total proceeds from these transactions amounted to € 3.2 billion net, which DSM used to finance the acquisition of the Vitamins & Fine Chemicals division from Roche in September 2003 (€ 1.75 billion), among other things. This division was renamed DSM Nutritional Products. A transformation and integration project, named *VITAL*, successfully integrated the businesses into the DSM organization, structurally improved their performance and prepared them for further growth. A fourth action was the acquisition of resins manufacturer NeoResins in February 2005, to expand the coating resins portfolio in the Performance Materials cluster (€ 523 million). Other adjustments of the portfolio were the acquisition of Catalytica in late 2000 and the divestments of DSM Engineering Plastic Products in 2001 and of DSM Bakery Ingredients (excluding Baking Enzymes) and the Styrene-Butadiene-Rubber (SBR) activities in 2005. As a result of the portfolio transformation, by 2005 almost 80% of DSM's sales came from its businesses in life science products and performance materials.

- **More stable and higher earnings**
  Cash flow (EBITDA) was stable yet at too low a level in the economically difficult period 2001-2003[1], but it saw a steady increase in 2004 and 2005, when the acquisitions of DSM Nutritional Products and NeoResins, combined with clear improvements in other businesses, had a positive effect.

- **Operational Excellence**
  In addition to the merger and acquisition activities in the context of our *Vision 2005* strategy, a large number of Operational Excellence projects and cost efficiency measures clearly contributed to the higher profitability levels, both in 2004 and 2005. DSM started its Operational Excellence program in order to optimize cost efficiencies and the flow of business processes: sourcing – producing – selling. For the *production* part, the Manufacturing Excellence program was developed. Manufacturing Excellence enhanced the effectiveness and professionalism of all operations, maintenance and project work within manufacturing. The program is being implemented successfully, mainly in the Industrial Chemicals and Nutritional Products clusters. Other (parts of) clusters have started the program and will finalize it in 2006/2007.

The portfolio transformation and numerous operational excellence projects have significantly improved DSM's profit profile. Throughout the transformation, DSM further strengthened its financial basis. The Single A credit rating from the major credit rating institutions was maintained throughout the *Vision 2005* period.

[1] Excluding the petrochemicals businesses sold in 2002.

- Sales around € 10 billion by 2005
  Looking back at *Vision 2005: Focus and Value*, it is fair to say that DSM has successfully accomplished this strategy. The € 10 billion sales target turned out to be beyond reach, due to weak economic conditions in 2001-2003 and the substantial weakening of the US dollar – factors whose full extent was not envisaged in the strategy scenarios made in 2000. DSM favored quality over quantity and refrained from buying sales growth for the sake of reaching this target.

- Market capitalization to double
  Shareholders benefited from DSM's policy of preferring quality over quantity, with a doubling of the share price and a Total Shareholder Return of 215% during the *Vision 2005* strategy period.

DSM share Sept. 2000 - Dec. 2005
in €

New strategy: *Vision 2010 – Building on Strengths*

In October 2005, DSM presented its new five-year strategy *Vision 2010 – Building on Strengths*. The strategy was the outcome of the Corporate Strategy Dialog. This study – a twelve-month process – thoroughly analyzed global economic and social trends and conditions, technological developments, price scenarios for energy and raw materials, differentiated growth in the various geographical regions and end-markets, factors potentially impacting on DSM's portfolio, and the four focal business areas for DSM (nutrition, pharma, performance materials and industrial chemicals).

The analyses conducted in the framework of the study resulted in a clear set of conclusions. The outside-in analyses showed that DSM had to take into account a growing divergence in raw material costs. While prices for oil-based raw materials will remain high, costs of bio-based raw materials (e.g. sugar and molasses) are expected to decline further. This will enhance the competitiveness of fermentation-based production – one of the technologies in the field of *white biotech* – in the future.

Demographic trends in combination with economic developments in emerging economies (such as China, India, Russia and Brazil) offer threats as well as opportunities. For about 35% of DSM's current portfolio these rapidly growing economies, with a strongly increasing buying power of the middle class, offer interesting opportunities for growth. Competition from low-cost countries poses threats to the competitiveness of about 25% of DSM's portfolio. Markets in developed countries remain interesting, but opportunities here will have to be captured mainly via innovation. For 40% of DSM's portfolio the impact of low-cost countries is neutral. This mainly relates to products with a local-for-local approach (e.g. fertilizers) and markets with a very high entry barrier based on specific technological positions and IP-protected innovative products.

Furthermore, extensive analyses of global mega-trends in society and technology resulted in the identification of a number of promising innovation areas, offering attractive opportunities for the future: health & prevention (healthy foods, pharma, and personal care), sustainable & clean resources (e.g. fermentation-based production and eco-friendly coating technologies), and materials with advanced properties (notably in the markets for engineering materials and coatings).

The inside-out analyses showed that DSM should grow and enhance the quality of its portfolio along two paths: it should strive for accelerated growth of the specialty leadership components in its portfolio, and it should strengthen the specialty profile of its portfolio, supported by targeted acquisitions. DSM should boost its innovation efforts in a market-driven way. This will be done by accelerating eleven selected projects, via an active new business development policy in an *open innovation* model and by initiating innovation towards carefully selected *Emerging Business Areas* to capture the future, mid to long-term opportunities presented by the three key innovation areas mentioned.

DSM should improve the geographical spread of its activities in order to reduce the present imbalance between sales by origin and sales by destination. This imbalance is undesirable: it makes DSM's results more sensitive to currency fluctuations and creates increasing competitive pressure for certain products from producers based in low-cost countries. Capturing the opportunities of demand growth in emerging economies and expanding production in low-cost countries, where appropriate, will improve the geographical spread and enhance competitiveness.

Operational Excellence will remain a key success factor as cost efficiency continues to play an important role across many of our businesses. Consequently, DSM will vigorously continue and expand its current efforts in the various fields of effective cost management and business process standardization.

The overall conclusion is that DSM possesses a strong base to build on and is fit to capture the opportunities and to face the challenges presented by the future. This is why the new strategy program is called *Vision 2010 – Building on Strengths*.

Four *Emerging Business Areas* (EBAs):

Biomedical Materials An increase in chronic diseases, growing demand for tailored therapies and converging technologies in pharma, nutrition and materials form the rationale behind the selection of this EBA. Dyneema® Purity – a first example in this field – stands for a specially developed, high-performance polyethylene fiber, made available to the medical device industry for use in surgical implants. Target areas for future innovation are drug delivery systems and coatings for stents using nanotechnology. Advanced polymer technology can offer solutions superior to metals and ceramics in these high-performance and value-added niche segments.

Specialty Packaging The drivers leading to the choice of this EBA are growing awareness of the importance of food quality, increasing interaction between a product and its packaging and upcoming regulatory changes. DSM aims to develop innovative packaging, for example solutions for food products, with innovative barrier properties relating to freshness, release of odors, and the ability to monitor the history of the product.

Personalized Nutrition The Personalized Nutrition EBA builds on DSM's strengths in nutrition, food and biotechnology. Based on scientific evidence Personalized Nutrition addresses certain health risks by offering tailor-made and specially developed nutritional products that fit individual consumers' genetic profiles and other factors, such as age and life-style. This way health and well-being can be promoted, whereas the risk of certain health problems may be reduced. DSM is already involved in this personalization trend via a participation in a US start-up which develops and commercializes genetic tests for personalized health and wellness advice.

White Biotechnology With the White Biotechnology EBA DSM will further boost the application of nature's toolset, for example micro-organisms and enzymes, to the production of (fine) chemicals, materials and fuels from renewable resources. A growing cost spread between hydrocarbon and carbohydrate feedstock as well as advances in science and technology will allow White Biotechnology to become a competitive alternative in an increasing range of applications, including nutritional ingredients, fine chemicals, performance materials and base chemicals. DSM will focus on opportunities where White Biotechnology enables drastic process improvement compared to the chemical technologies.

Objectives

DSM's new strategy focuses on accelerating profitable and innovative growth of its specialties portfolio. The overall objective of *Vision 2010* is strong value creation, which should be accomplished via three main levers:

1. Market-driven growth and innovation
Based on existing leadership positions, DSM intends to grow its sales in four *Emerging Business Areas*: personalized nutrition, specialty packaging, biomedical materials and white/industrial biotechnology. This growth will be accelerated by innovation in the markets targeted.

DSM also intends to further grow the specialty content of its portfolio. In this connection the definition of specialties has been made more specific. Whereas under *Vision 2005* all life science products and performance materials businesses were classified as specialty, as of 2006, specialties will be businesses that have product, application or custom manufacturing leadership. Under this sharper definition, the current specialty leadership portfolio represents 40% of DSM's total sales, versus 60% consisting of products that compete primarily on the basis of price or costs.

By 2010 DSM aims to have grown its specialties portfolio to 50-60% of sales, coming from 40% under the new specialty leadership definition. Profitable growth via specialty leadership business, innovation and geographic growth should lead to an underlying sales growth rate of 3-5% per year (including small acquisitions) under an assumed economic scenario and increasing over time within this bracket. The economic scenario assumes a constant euro/dollar exchange rate of 1.20, a crude oil price of $ 50 per barrel, mid-cycle GDP growth rates for the various regions of the globe and generally balanced supply/demand conditions. Moreover, major scope changes via acquisitions or divestments are excluded from the assumed scenario. Organic growth will be complemented with selective acquisitions in the field of nutrition and performance materials.

To boost innovation, significant additional resources will be made available. Some 250 new people will be recruited to work in dedicated, business-driven innovation teams. On average € 50 million per year (€ 30 million in 2006 increasing to € 70 million in 2010) will additionally be spent on innovation. About 15% of capital expenditure will be allocated to new business development in this context. And the innovation infrastructure in DSM's main research centers will be upgraded. By 2010, DSM wishes to generate up to € 1 billion in sales based on these intensified innovation efforts.

2. Increased presence in emerging economies
DSM plans to continue the trend of improving its globally balanced presence by accelerating the internationalization of its asset base and workforce.

The internationalization of DSM's asset base and workforce progressed rapidly under the *Vision 2005* program and will be intensified in the coming years. Identified opportunities such as demand growth in selected emerging economies have led DSM to decide to significantly step up its

Sales
percentages are based on estimates

EBIT
percentages are based on estimates

growth efforts in these promising regions. A stronger presence in selected emerging economies will also help to create a better balance between sales by origin and sales by destination. When evaluating investment proposals, DSM will take these two elements into account. In China, where DSM has been highly active over the past few years, the company expects to double its sales to more than $ 1 billion per year by 2010.

3. Operational Excellence
DSM continues to build on its strong Operational Excellence capabilities to sustain and enhance the cost competitiveness of its businesses.

Over the past five years DSM has successfully introduced and implemented Operational Excellence programs. So far, the focus has been mainly on standardization of business processes in manufacturing, order fulfillment, finance and costing and ICT infrastructure. These programs will be further extended to include more parts of DSM's business portfolio. New initiatives are envisaged in purchasing and prospect-to-order / pricing excellence processes. DSM will also continue to consistently look at productivity improvement in its businesses.

Sustainability

Sustainability is at the heart of doing business in all our fields. Having been named the number one in the chemical industry sector of the Dow Jones Sustainability World Index for the second year in a row, DSM has a leading position to defend, and the company has defined the areas in which it intends to further improve. DSM aims to retain its top positions with regard to Safety, Health and the Environment, for which it has set new ambitious targets in the context of the new strategy. DSM plans to put effort into eco-efficiency and a gradual increase in the use of renewable resources as raw materials for its products. Also, the *Emerging Business Area* of White Biotechnology will aim to exploit the potential that the use of biotechnology offers in terms of new products and cleaner and more cost-efficient industrial processes. In addition, DSM aims to further diversify and internationalize its workforce.

Organizational model

In order to leverage the capabilities of the various business groups, the current organizational model will be aligned with the *Vision 2010* strategy. Pharma activities will be grouped into a new Pharma cluster and the activities of DSM Nutritional Products and DSM Food Specialties will be combined into a new Nutrition cluster. Performance Materials and Industrial Chemicals will remain as clusters. Innovation will be anchored at cluster level, and DSM will also establish a DSM Innovation Center at corporate level. This organization will support innovation in the businesses. The Innovation Center will lead the *Emerging Business Area* programs and the corporate technology, licensing, venturing and intellectual property activities of DSM.

Value creation

With *Vision 2010 – Building on Strengths* DSM expects to create substantial value. The company has set itself the objective of creating more value through higher profitability. DSM targets a CFROI (Cash-Flow Return on Investment) in the *Vision 2010* period of more than 50 base points (0.5%) over its annual weighted average cost of capital (WACC).

Specific margin targets will apply for the various clusters. The new clustering of businesses will allow for more tailored EBITDA/sales margin objectives per cluster:
- Nutrition: > 18%
- Pharma: > 18%
- Performance Materials: ≥ 16%
- Industrial Chemicals: ≥14% (on average over the cycle)

By realizing these value creation targets, DSM aims to achieve a Total Shareholder Return that exceeds the average of DSM's peer group[2].

Corporate Governance

Governance

The general characteristics of DSM's governance system are described in the section of this annual report entitled *Corporate Governance, Risk Management and Internal Control* (page 70). For 2005 a number of developments regarding Corporate Governance at DSM can be reported, although in this respect the year was not as eventful as the preceding one, in which the new Dutch Corporate Governance Code (Tabaksblat Code) was published.

In April 2005, the Annual General Meeting of shareholders discussed the way DSM applies the Dutch Corporate Governance Code. With regard to the direct appointment of new Supervisory Board members and a new Managing Board member, the relevant regulations were complied with. Furthermore, a detailed remuneration policy for Supervisory Board and Managing Board members was submitted to the Annual General Meeting and approved. The proceedings of the Annual General Meeting were also made available online via the internet in 2005. The Vision 2005 Priority Foundation was dissolved because its goal, an orderly execution of the agreed *Vision 2005* strategy, had been achieved.

Internal Control was strengthened in 2005 by a revision of the Corporate Requirements and a thorough and detailed implementation and compliance program via the so-called *True Blue* project. In this project, flying squads of process and internal control experts supported the business groups in introducing and implementing the revised Corporate Requirements.

In line with independence criteria the term of one of the DSM lead auditors within Ernst & Young came to an end; responsibilities have been transferred to a colleague who has not yet worked on the DSM account.

The first operational year of DSM Alert – our whistle-blowing procedure – yielded a limited number of cases (twelve). Some cases were directly solved by providing more information, some did not qualify and some led to corrective measures.

[2] DSM's peer group: AkzoNobel, BASF, CIBA, Clariant, Danisco/Genencor, Degussa, EMS Chemie, ICI, Lanxess, Lonza, Novozymes, Rhodia and Solvay.

Risk Management

The Managing Board is responsible for the design and effectiveness of the company's risk management and control systems. The purpose of these systems is to identify any significant risks to which the company is exposed and to enable effective management of these risks. However, these systems can never provide absolute assurance regarding the achievement of corporate objectives and can never entirely prevent the occurrence of material errors, losses, cases of fraud or the violation of laws or regulations.

Based on these activities and on what is described in the Risk Management section of this report (see page 72), the Managing Board believes, to the best of its knowledge, that it can assert with reasonable assurance that the risk management and internal control system of DSM was effective during the financial year 2005.

A crucial element in the management of a company is clarity concerning the strategic direction and objectives as these serve as a compass and yardstick for all parts of the organization. The Managing Board therefore considers the development of *Vision 2010* as an important element in its enterprise risk management. The three main risks identified in the 2004 Corporate Risk Assessment were also input for the strategy process:

- The entry of Chinese low-cost producers into DSM markets
- The company's innovative capabilities
- The availability of sufficient high-caliber managers and professionals.

In *Vision 2010*, these three risks have been addressed. Special actions and targets have been formulated for the Chinese market and the other emerging markets, an Innovation Center is being created to secure the company's effectiveness in innovation, and major programs are underway to ensure that the company will have at its disposal the human and organizational capabilities that are necessary to reap the benefits of the new strategy.

Moreover, the strategic process was accompanied by a renewed risk assessment at corporate level. In this assessment, two generic risks were identified which are inherent in *Vision 2010*:

- In reality, economic developments may differ from the assumed and defined economic scenario in the strategy. This could influence the financial results and may lead to a deviation from the objectives.
- The results of DSM's increased innovation efforts will also be dependent on our ability to identify developments in the relevant markets and to effectively anticipate these market developments. Market intelligence therefore needs to be strengthened and market and customer orientation enhanced.

All parts of DSM's Governance Framework and Risk Management and Internal Control System will of course be reviewed for consistency with the new strategy and business model.

In 2005 DSM continued implementing the revised Corporate Requirements with great vigor as these Requirements are the basis for sound Risk Management and Internal Control in its operating units. The Requirements with regard to financial and strategic processes were already in place at the beginning of the year, whilst a special program was in progress for the implementation of the revised Requirements concerning safety, health and environment and legal affairs. The latter programs were continued through 2005.

In 2005 the focus was on the Requirements that relate to the flows of goods and money. These include the Requirements regarding the purchasing, manufacturing and marketing & sales processes, as well as demand supply chain planning and financial control processes. Also included are the Unit Risk Management Requirements, which specify the Risk Management organization of the operational units and the need to perform risk assessments. Finally, part of the Requirements in certain support functions are included (human resources, legal, ICT and security). The selection was made in such a way as to cover the risk management and control of goods and money flows for the primary process, including the integrity of related master data, clarity of responsibilities and authorizations, and security of information.

In the *True Blue* project, flying squads of process and internal control experts support the bigger entities of most of the business groups in introducing these Requirements. The squads help the units achieve even stricter documentation of their business processes, sharper clarification of roles and responsibilities and tighter segregation of duties. In units already using the standard DSM ERP environment, or about to implement it, full advantage is taken of the standard functionality available in the system, e.g. to describe processes, provide training in them, and check authorizations.

To ensure lasting compliance, a monitoring tool is being installed in all these units. This tool automatically triggers checks on the effectiveness of key controls and reports control overviews. Continuous education programs are also being developed. Furthermore the external financial audits by DSM's auditors Ernst & Young in 2005 specifically focused on internal control.

In its efforts to strengthen the risk management and internal control system on an ongoing basis, the company subjected the Corporate Requirements to a first review and update. The progress of the compliance programs and the effectiveness of the *True Blue* implementations were discussed with the management of the operational units. The units were also requested to conduct self-assessments, and audits were carried out by Corporate Operational Audit. The efforts in the field of risk management were discussed in the Managing Board and the Audit Committee of the Supervisory Board. Support for the implementation of the revised Corporate Requirements will be continued in 2006. The business groups that were visited by squads in 2005 will take charge of the implementation in the smaller entities themselves. For business groups and corporate activities not yet covered, *True Blue* resources will be available in 2006. The activities will be further aligned with the business process standardization efforts conducted by Corporate ICT. A Home Office function will continue to support all units.

Safety, Health, Environment

Safety

The frequency index of all recordable incidents involving both DSM employees and contractor employees, excluding DSM Nutritional Products, decreased from 0.88 in 2004 to 0.74 in 2005. This is a reduction of 16%. The frequency index of lost workday cases involving DSM employees, excluding DSM Nutritional Products, improved by 23% from 0.22 in 2004 to 0.17 in 2005. At DSM Nutritional Products both indicators increased, from 1.47 to 1.49 and from 0.52 to 0.73, mainly because of improved reporting.

As from 2005, DSM Nutritional Products has been officially consolidated in the safety performance data of DSM. The frequency indices for recordable incidents and lost workday cases for 2005, including DSM Nutritional Products, are 0.95 and 0.33, respectively. This will be the starting point for comparison in the coming years.

Over the past four years, DSM has reduced the frequency index of all recordable incidents by 17% per year on average. Further reduction will be increasingly difficult and will require longer lasting efforts, which will be mainly focused on behavior. In line with *Vision 2010* and the environmental targets laid down, DSM has decided to set as a corporate target a 50% reduction for all recordable incidents involving DSM and contractor employees in 2010 relative to 2005.

DSM regrets having to report the loss of a contractor employee who had a fatal traffic accident in Belgium in June 2005.

Health

In 2005, fourteen cases of occupational disease were recorded at DSM (excluding DSM Nutritional Products), versus twenty cases in the previous year (excluding DSM Nutritional Products). The cases range from ergonomic issues and hearing problems to allergic reactions. A risk inventory and reporting tool was developed and their implementation was piloted in two cases. Occupational health practice was updated and introduced at DSM's European SHE Conference in early 2005.

Environment

The number of non-safety incidents classified as "serious" decreased from four in 2004 to three in 2005. The total number of incidents, including Loss of Primary Containment, amounted to 501 in 2005 compared to 522 in 2004 (both figures excluding DSM Nutritional Products). For DSM Nutritional Products, this number was 147 in 2005. Major emission reductions were achieved at the caprolactam plant in Nanjing, China. Furthermore, an innovative waste water treatment plant was built at the DSM Food Specialties site in Seclin, France.

Of the fourteen environmental targets set for the period 2000-2006, ten had been achieved by the end of 2005. DSM has set new environmental targets for the period 2006-2010. Detailed information on these new targets and on the company's safety, health and environmental performance can be found in the 2005 Triple P Report.

Human Resources

Internationalization

The internationalization of DSM's workforce that has been going on for a number of years continued through 2005. This mainly reflected DSM's strong expansion in China; the DSM workforce in China – including all joint ventures – now numbers approximately 3,500 people. Between 1999 and 2004 the overall percentage of non-Dutch DSM employees increased from 50% to about 70%. At year-end 2005 almost 8,000 DSM employees were based outside Europe. The ongoing trend towards internationalization is having a clear impact on DSM's HR processes and systems. DSM has adapted its expatriation policy, which is now being applied worldwide. The company's ongoing internationalization and the major portfolio changes that have been effected also highlight the importance of good internal communication, which is why DSM undertook various new initiatives in this field in 2005.

Integration of new activities

The integration of DSM Nutritional Products is proceeding swiftly. Various DSM Nutritional Products processes and systems, including remuneration and appraisal systems, have been integrated into the DSM systems. In addition, DSM Nutritional Products has started implementing DSM's management development system and has set up special programs for high potentials. Some 1,100 DSM Nutritional Products employees took part in training courses last year. DSM Nutritional Products also implemented the DSM policies and work processes in the fields of production (Manufacturing Excellence) and safety, health and the environment. The integration of DSM NeoResins is likewise proceeding well.

Here, the emphasis is mainly on combining resources to develop new opportunities and achieve synergies, for example by adopting an integrated market approach and combining technologies.

Recruitment

The changed portfolio and the company's international growth are triggering a clear trend towards recruiting managers on the external labor market. DSM is moreover becoming increasingly conscious of the need to inject more diversity into its management community at all levels. This is another reason for recruiting managers externally, international experience being an important selection criterion. The majority of the new executives recruited in 2005 are non-Dutch. In 2005 new recruitment programs were launched that are geared to specific disciplines, in particular R&D and finance. Also, recruitment-focused business courses took place in China.

Working climate analysis

The working climate analysis conducted in 2004 yielded valuable conclusions, for example about employees' perception of their work and the importance of innovation for DSM's further growth. Innovation is of crucial importance to DSM, and the company will be devoting substantial resources to this goal in the coming period. We are well aware that people need a working environment in which their innovative ideas can thrive and in which management allows scope for this. We will therefore promote creativity and collaboration in all echelons of our organization and across the boundaries of professional disciplines. The next working climate analysis is scheduled for 2008.

DSM as a learning organization

Employee development obviously continues to be important. Besides the individual development of employees, on which an average of 18 hours per employee were spent in 2005, DSM is increasingly devoting attention to structured programs to continue developing the leadership and professional competencies that are important to us. For most of these fields, the DSM Business Academy offers special programs. The Talent Development Centers which were set up in 2004 have functioned well and are an effective complement to our management development systems.

Diversity

The development of a culture based on diversity is fundamental to DSM's HR policy. Targets have been set for each business group in relation to the recruitment, appointment and promotion of women to senior management positions. At the end of 2005 the percentage of female executives stood at 4% (2004: 3%); the percentage of female senior managers was 13% (2004: 11%). In the context of the new corporate strategy *Vision 2010 – Building on Strengths*, DSM will make a strong effort in the coming period to further increase the diversity and the international character of our workforce.

Operational Excellence

DSM's HR organization is working hard to achieve operational excellence. An important precondition for operational excellence in HR is the development and implementation of standard work processes supported by SAP HR. At the end of 2005, a global HR model was developed. This model has been 'localized' at three sites in Switzerland, the USA and the Netherlands and will come into operation in early 2006. The model provides a standardized format for obtaining information about HR developments at a particular site, including absenteeism, training facilities etc, in order to enable the HR organization to respond to these developments, or anticipate them, in a more effective way. Furthermore, Shared Service Centers are being set up to support SAP HR and, from 2006 onwards, to offer HR services at a regional level.

People Matter(s)

The major changes that DSM has implemented in the Human Resources field over the past few years are based on the strategy outlined in the internal strategy plan People Matter(s). DSM is on the whole satisfied with the progress made, and has realized most of the ambitions outlined in the plan. The follow-up activities in the HR field to be undertaken in the coming period will be outlined in a new strategy plan. This new plan will be published in the third quarter of 2006, and will among other things focus on leadership styles, ways to increase diversity, the stimulation of truly market-driven work processes and an innovative specialty culture within the organization, as well as on several other themes intended to contribute to the success of DSM's new corporate strategy.

DSM workforce at year-end in:

	2005	2004
Europe	**14,206**	15,679
- the Netherlands	**7,258**	7,553
- rest of Europe	**6,948**	8,126
Asia	**3,666**	3,488
- China	**2,581**	2,439
- rest of Asia	**1,085**	1,049
North and South America	**3,667**	4,569
rest of the world	**281**	468
total DSM	**21,820**	24,204

DSM workforce at year-end in:

	2005	2004
Life Science Products	**6,239**	6,836
DSM Nutritional Products	**6,119**	6,607
Performance Materials	**4,441**	3,735
Industrial Chemicals	**2,234**	2,566
Other activities	**2,787**	2,953
total, continuing operations	**21,820**	22,697
Discontinued operations	**-**	1,507
total DSM	**21,820**	24,204

Research and Development

Innovation is a key element of DSM's new strategy. An important element in the realization of DSM's innovation ambitions is effective R&D. R&D programs for the coming years will be geared to making a strong contribution to innovation and to supporting process and product improvements for existing businesses.

Apart from business-focused R&D programs, accounting for 90% of total annual R&D expenditure, DSM has a Corporate Research Program in place directed at building and strengthening the technological competences needed to support our strategy. In 2005 we continued to strengthen our technological competences and to enhance our knowledge base, both through in-house work and through collaboration with the external knowledge infrastructure.

Expenditure

Expenditure on R&D in 2005 amounted to € 290 million (3.5% of net sales), a 1% rise compared to the € 286 million (3.7% of net sales) in 2004. R&D expenditure in life science products amounted to 6.3% (2004: to 6.6%). DSM Nutritional Products spent € 80 million, 4.2% of net sales, compared to € 75 million (3.9% of net sales) during the previous year. The figures for Performance Materials are 3.8% (2004: 3.9%) and for Industrial Chemicals 0.8% (2004: 1.0%). At 31 December 2005, a total of 1,970 staff were employed on R&D activities, representing some 9% of the total workforce.

R&D presence in China

In 2005 the global spread of our R&D activities was extended to China, where we took the first steps to establish a multi-business R&D presence. In September we opened the DSM R&D Center China in Shanghai, which combines R&D facilities for some of our Life Science and Performance Materials activities. In November, also in Shanghai, we opened a joint laboratory with Fudan University for research on new technologies for, among other things, food and feed ingredients.

R&D at Life Science Products

The Corporate Research activities of the Life Science Products cluster continued to build on and develop three technology platforms: Advanced Synthetic Methods, Biotechnology and Food & Feed Applications. In 2005, DSM Nutritional Products joined the Corporate Research Program. The Advanced Synthetic Methods activities focused on improved bond-forming reactions with emphasis on catalysis as well as on process intensification. In Biotechnology, the Systems Biology activities focused on further developing a functional genomics platform to best address the scientific questions in our business projects. In Food and Feed Applications, the program will accelerate our development capabilities and contribute to future innovations in both the Human and Animal Nutrition and Health sectors. Our strong formulation technology plays a key role in tailoring these applications.

R&D also made progress in the application of so-called micro-reactors. These are small continuous reactors with a high capacity based on the principle of process intensification. These reactors, which combine cost-effective synthesis with high selectivity, also support our sustainability efforts.

DSM has now completed sequencing the *Penicillium* genome; this will lead to more rational approaches to the development of improved strains for the production of existing and new products. DSM further harvested the fruits of the sequencing of the *Aspergillus* genome, resulting in new powerful tools for the optimization of its production strains for enzymes in the production process for 7-ADCA. The genomic knowledge also allows R&D to far more quickly and effectively select new enzymes to be used in the production of, among other things, new nutritional ingredients.

Use of the above-mentioned tools led to several new developments. One of these is a new enzyme, Brewers Clarex®, which was recently introduced in the brewers market and which prevents chill-haze in beer. Most brewers use a chemical adsorbent to remove protein or polyphenols which cause haze after bottling of the beer. The application of the Brewers Clarex® enzyme is a viable alternative to prevent this haze formation.

Another example is the production of so-called *clear milk*. Again, the use of specific enzymes enables the production of transparent, colorless milk products, which still have all the nutritional properties of milk, have a neutral taste (i.e. no taste) and allow for the production of healthy soft drinks.

Not all developments are carried out exclusively in-house. Fabuless®, a natural product for weight management, was developed by the Swedish company Lipid Technology Provider (LTP), in which DSM Venturing has a stake, whereas the application development was carried out by DSM. Fabuless® is produced exclusively for DSM's dairy applications. The active ingredient is based on specific lipids and suppresses the feeling of hunger via a natural mechanism when it is digested.

R&D at DSM Nutritional Products

R&D activities at DSM Nutritional Products in 2005 focused on the one hand on maintaining and improving the profitability of the more established part of the business by improved processes and, on the other hand, on future growth in new business by developing new products and solutions.

For the established vitamins and carotenoids, the objective is to achieve drastically lower production costs by introducing new process technology, thus securing cost leadership. R&D efforts at Nutritional Products are building on two strengths of DSM's R&D: modern, atom-efficient synthesis applying catalysis and white, or industrial, biotechnology. With respect to atom-efficient synthesis, several activities scouting new routes and technologies for improving our key production process are ongoing. R&D capabilities in white biotechnology – one of DSM's selected *Emerging Business Areas* – have led to the development of new production strains.

Regarding the future growth of new business, the activities in Human Health & Nutrition, Animal Health & Nutrition and Personal Care are aimed at innovative products and product forms. In Human Health & Nutrition, the focus is on developing nutritional ingredients that can help reduce the risk of chronic disease as well as improving wellness. For example, recent human studies have confirmed that our new product Teavigo® increases fat oxidation. Also in recent human studies, the new product Bonistein®, a pure synthetic genistein, has been demonstrated to help reduce bone loss. Science has shown that Bonistein® can improve the benefits of calcium supplements, especially in combination with ROPUFA and the vitamins D and K. Collaborations between DSM Nutritional Products and DSM Food Specialties have resulted in synergies and joint project activities. By further aligning competences in human nutrition, DSM will boost innovation and focus on combining new products with established products for the development of nutritional solutions.

In Animal Health & Nutrition, DSM Nutritional Products develops eubiotic (pre- and pro-biotic) solutions for future market needs, among other things. Maintaining health and performance in livestock without the use of antibiotic growth promoters has

become a core challenge for animal farmers worldwide. In addition, efficacy under practical farm conditions should not be compromised by new, alternative concepts. The Eubiotics R&D program addresses these needs. Combining expertise in Animal Health & Nutrition with the most advanced in-house technologies for rapid screening of natural compound libraries has led to the establishment of a unique platform to identify new products. Several development projects target specific solutions for all relevant species. Improvement of feed conversion remains a key activity. In the successful alliance with Novozymes, joint teams are working on new feed enzymes that target current unmet needs.
Additionally in a new focus area, pet health and nutrition, DSM Nutritional Products is building on its innovative research in Human Health and Personal Care, and is developing attractive new concepts for the pet food industry.

In Personal Care, DSM's focus remains on providing lead ingredients for sun and skin care. Although there are several pigment-based UV filters available, none of them combine performance with excellent application properties. DSM has closed this gap with a new double-coated titanium oxide grade, called Parsol®TX. Parsol®TX is extremely stable in applications with and without UV light and hardly visible on the skin, but nevertheless provides superior protection. Furthermore, in skin care, active ingredients which beautify the skin are in development. For example, Allantoin, a naturally occurring compound which harmonizes skin functions like regeneration, moisture retention and cell renewal, has been added to the program.

R&D at Performance Materials

Corporate Research in the Performance Materials field during 2005 mainly focused on further reinforcement of the key competences that are needed to play a leading role in this field. Competences in chemistry and technology for the synthesis of polymers and resins as well as those in material sciences were expanded, taking into account new developments in science and technology. Special attention was given to the convergence of nanotechnology and biotechnology and its possible consequences for the development of 'smart materials'.

Several new developments were made in coatings. In 2005 DSM focused on the development of functional coatings, such as anti-reflective coatings and hydrophobic (easy-to-clean) coatings. Work on anti-reflective coatings led to the development of OptoClear® and PictoClear™, anti-reflective coating systems based on a nano-structured surface.

The acquisition of NeoResins expanded DSM's knowledge base in eco-friendly resins to include water-based systems and reinforced our technology position in UV-curable resins. This gives us a strong basis for developing new innovative products.

For the automotive industry new resins were developed that reduce the emission of volatiles by 40%. Also, unsaturated polyester resins with a lower styrene content were developed, for an improved working environment in the polyester-producing industry.

Increased insight into, and understanding of, various material properties and of the behaviors of plastic materials during processing supports the development of new applications of our superior nylon 4.6, Stanyl®, our thermoplastic elastomers Arnitel® and Sarlink® and our Dyneema® fiber. New applications and materials were developed based on Sarlink® thermoplastic vulcanizate grades. Various new packaging materials were developed, which form a solid basis for the Emerging Business Area of *Specialty Packaging*. For the petroleum additives market a new product line was developed with excellent soot dispersion properties.

Apart from its application in functional coatings, nanotechnology is increasingly being applied in other areas as well. For example, DSM is using nanotechnology to develop fluids with special optical properties to be deployed in lithographic equipment for the manufacture of advanced computer chips.

DSM Hybrane has developed an advanced paper coating additive, called C*TopBrane™, for a major European manufacturer of starches and starch derivatives. The additive makes it easier to replace expensive synthetic binders by natural materials, thus generating substantial savings for paper makers.

Biomedical materials is one of the four Emerging Business Areas that DSM has identified in its *Vision 2010* strategy. In the biomedical field, an intensive collaboration with the University of Maastricht and with the Academic Hospital of Maastricht (Netherlands) was started. In 2005, DSM Medical Coatings was launched. This unit develops and markets innovative coatings for medical devices such as catheters for cardiovascular and urological uses.

R&D at Industrial Chemicals

The focus of Industrial Chemicals R&D is to actively maintain the existing businesses through process improvement and the development of new processes for existing products, and to increase efficiency and sustainability through waste reduction.
As part of the Corporate Research Program, Industrial Chemicals R&D and Life Science Products R&D worked together on enzymes. New enzymes were discovered and patented for an important step in the fermentative production of caprolactam. At the same time, projects were carried out to improve chemistry and technology operations in the caprolactam plants.
Industrial Chemicals R&D continued to work on the development of new melamine-based coatings in collaboration with Performance Materials R&D. Moreover, building on the success of the newly developed melamine-based glue systems for OSB (Oriented Strand Board), DSM continues to work on application development for systems based on straw and sugar cane.

Report by the Managing Board
Intellectual Property – ICT and e-Business – Purchasing – Macro-economic review

Intellectual Property

Our *Vision 2010* strategy further increases the role of intellectual property. Some 375 new patent applications were filed in 2005. Basic IP positions were obtained in new performance materials and ingredients for human and animal nutrition. The patents connected to the NeoResins business, in total over 300 patents and patent applications in the field of coating technology, were transferred and integrated into our overall patent portfolio. The strategic shift in DSM's portfolio also drives an increasing interest in trademarks and branding. Trademarks such as Dyneema®, Teavigo® and PeptoPro® are becoming well-known names.

DSM is now actively managing about 500 trademarks. DSM continues to strengthen its IP position in China. Most of the patents are also filed in China.

ICT and e-Business

Technical infrastructure

In 2005 a company-wide program was initiated for the regular upgrade of DSM's ICT infrastructure – built in 2000/2001 –, including the global network, e-mail infrastructure, office automation and managed services. The program aims to implement off-the-shelf, proven technologies and reduce the total cost of ownership. The year 2005 was mainly used for preparation activities and the migration of the global network. The actual replacement of work stations and servers will follow in 2006.

ICT security is an issue that requires continuous attention. Efforts to protect DSM's infrastructure and systems from intrusion by computer viruses and hackers were increased in 2005.

The process of separating the ICT infrastructure and the business application systems that DSM Nutritional Products shared with its former parent company Roche was completed in the course of 2005. In addition, a number of improvement projects were executed as part of DSM's *VITAL* integration program. For example, marketing & sales tools were introduced to support DSM Nutritional Products' sales force. Integration between the Outlook XP calendar and DSM's online conferencing system WebEx was improved.

Business process standardization

In 2005, the business process standardization program (Apollo), which aims at improving efficiency and thus further increasing customer satisfaction, continued its roll-out of standardized best-practice processes throughout a number of DSM units, including DSM Food Specialties, DSM Agro, DSM Coating Resins, DSM Composite Resins and DEX Plastomers. Furthermore, preparations were started for the implementation of these standardization processes in DSM Anti-Infectives and DSM Nutritional Products. The units that had already implemented this standardization program made significant progress in improving their order-to-cash, purchasing and financial operations and further streamlined their organizations. The implementation of these processes enables business units to adopt a uniform way of working worldwide. The aim is to increase the internal organization's efficiency through integrated planning and automated order and financial/administrative processes. Apollo enables business unit management to react faster to market developments and it supports DSM's compliance efforts.

Organization

By the end of 2005, the ICT department of DSM Nutritional Products had been fully integrated in the Corporate ICT department, while all business systems management groups were transferred from the other business groups to Corporate ICT. This reorganization has resulted in a main office in the Netherlands with affiliates in Switzerland, the USA, Brazil, Singapore and China. The new organization is capable of offering around-the-clock ICT services to the business.

e-Business

In the past few years DSM has invested in an advanced e-business architecture and infrastructure that enables the company to conduct business with key customers and suppliers in a smooth and "hands-free" manner. DSM is already reaping the benefits of this infrastructure in terms of direct system connectivity, a 24-hour web shop for customers, elogistics, electronic conferencing, electronic invoicing, e-buy and electronic payment.

In 2005, more than 30% of overall group sales on average were generated via various e-channels. Today, DSM is directly connected to more than 300 business partners. In addition, over 5,000 customers place their orders via the DSM web shop, to a total of more than 35,000 orders per year. In 2005, the possibilities in the field of elogistics in particular were further expanded. Over 45,000 messages were shared with logistic providers, allowing smoother and faster handling. DSM is looking into the possibility of using elogistics for road and rail transport in the USA. The company is already using elogistics applications in sea transport between Europe and Asia and is investigating the possibility of using these applications in the rest of the world. DSM also conducts thousands of web-enabled meetings per year via the internet, which reduces travel costs considerably. Via the e-channels DSM also had more than 200,000 downloads of key product- and order-related data in 2005, reducing handling costs.

In the years to come, DSM will further refine its existing e-business applications. In addition, the company will investigate the latest techniques and developments in the field of RFID (Radio Frequency Identification) and CRM (Customer Relations Management), and will use these if they provide added value.

Purchasing

In 2005 DSM further detailed and implemented the new purchasing organization with the aim of ensuring that it will make a sustainable contribution to the company's bottom line.

A global purchasing strategy was developed as an integral part of the group's business strategy. We completed the staffing of the new organization and made a start on the development of standard processes and systems to support the new organization. The new organizational model is based on a centrally led DSM sourcing organization (with a regional presence in Europe, USA and Asia) to fully leverage DSM Purchasing's spend, resources, capability requirements and best practices. It is aligned with the business groups' sourcing organizations responsible for their specific spend. Spend Area Directors have developed spend plans that will be consolidated into a global DSM purchasing plan covering our total spend. This structure is fully aligned with DSM's *Vision 2010* strategy in order to leverage synergies within the company. Job-specific purchasing learning curricula were developed to further professionalize the DSM purchasing community. In addition, a performance management model was developed for the new purchasing organization. We successfully completed the purchasing program launched in early 2004 to achieve substantial annual savings. Contracts were negotiated based on sourcing strategies developed using the Strategic Sourcing Methodology. A major part of these savings were realized in 2005 and will – as planned – be fully realized in 2006. As of 2006, there will be one aligned purchasing organization in place for the whole of DSM.

Macro-economic review

Macro-economic developments in 2005

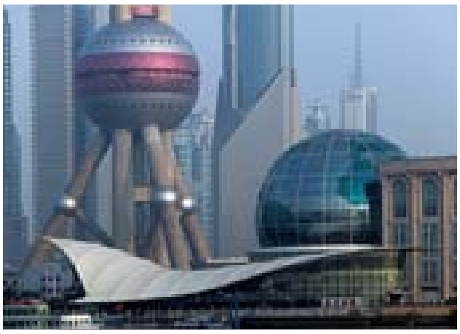
Macro-economic growth in developed countries slowed down somewhat after the favorable developments in 2004, but emerging countries, especially in Asia, continued to grow at very healthy levels. The Asian emerging countries developed to become the most important drivers of global economic growth and positively affected global trade volumes. Also, leading Japanese economic indicators point to the highest growth levels for many years, resulting in increasing exports and increasing domestic demand as well.

Since the fast-growing sectors of the emerging economies make relatively intensive use of commodities, including oil, their economic growth has contributed to upward price pressure. This development has had an impact on several of DSM's markets, mainly in the Industrial Chemicals and Performance Materials clusters.

In Europe, the economy showed only initial signs of recovery in 2005. The value decrease of the euro, from levels of above $ 1.30 towards the end of 2004 and during the first months of 2005 to around $ 1.20 in the second half of 2005, improved European company prospects for exports. The long-anticipated growth of domestic demand took off gradually, and strengthened significantly in the last quarter of 2005.

Many of DSM's businesses benefited from the generally positive economic environment. Global manufacturing output grew by 4% and global chemical output grew by 3% in 2005. Demand growth in engineering plastics, elastomers and other performance materials was above trend on the back of healthy global developments in end-markets such as building & construction, electronics and electrical applications and, to a lesser extent, automotive.

China's importance has increased. China is home to many fast-growing industrial markets as well as many emerging competitors. The country's share of overall global chemical output growth in 2005 was approximately 40%.



Macro-economic outlook for 2006

The consensus is that global GDP growth will amount to 3.3% (2005: 3.2%), with continued strong Asian growth, propelled by robust exports and strong domestic demand in China and India. The Euro-zone economy is forecast to grow by approximately 2% in 2006. Global industrial production is set to grow at around 4%, although there are marked geographical differences in growth rates and per sector. Growth in Western Europe is projected at 2.4%, the USA at 3.1%, the Middle East at 4.9%, Eastern Europe at 5.6% and Asia Pacific at 6.5%, with industrial production growth in China being projected at 12.1%.

If these circumstances materialize without major geopolitical disturbances and currency volatilities, the demand/supply balance for the chemical industry is expected to remain good in 2006.

Statement of income

x € million	2005	2004
net sales	**8,195**	7,832
other operating income	**223**	197
total operating income	**8,418**	8,029
total operating costs	**-7,610**	-7,467
operating profit excluding exceptional items	**808**	562
net finance costs	**-70**	-56
income tax expense	**-180**	-103
share of the profit of associates	**-2**	9
profit attributable to minority interests	**7**	11
net profit excluding exceptional items	**563**	423
net result from exceptional items	**-36**	-130
net profit*	**527**	293

* attributable to equity holders of Royal DSM N.V.

Net sales
At € 8.195 million, net sales in 2005 were almost 5% higher than in the previous year. DSM NeoResins accounted for an increase of 3% in net sales, and divestments accounted for a 3% decrease. Selling prices were on average 5% higher than in 2004. Autonomous volumes remained unchanged. Exchange rates had no effect on sales.

Operating costs
Operating costs rose compared with 2004, closing the year at € 7.6 billion. The main component of these costs, the cost of raw materials and consumables for goods sold, corrected for acquisitions and divestments, rose by approximately € 300 million. Total fixed costs remained stable.

Operating profit
The operating profit excluding exceptional items rose by € 246 million (44%), from € 562 million in 2004 to € 808 million in 2005, mainly as a result of higher margins, lower fixed costs and an improved product mix. The EBITDA margin, i.e. operating profit before depreciation and amortization as a percentage of net sales, rose from 13.6% in 2004 to 16.0% in 2005.

With selling prices showing a stronger increase than raw materials prices, the average margin, i.e. the selling price per unit of product less variable costs, was clearly up from the 2004 level.

Net profit
Net profit rose from € 293 million in 2004 to € 527 million in 2005. Expressed as earnings per ordinary share, the net profit rose from € 1.41 in 2004 to € 2.68 in 2005.

Net finance costs stood at € 70 million in 2005, compared with € 56 million in 2004. The increase was due primarily to the acquisition of DSM NeoResins and hedging costs for the US dollar.

At 24%, the effective tax rate in 2005 was higher than in 2004 (20%). The 4% increase was due to higher profits and a consequent decrease in the relative proportion of income elements taxed at a low rate.

The profit of associates decreased from € 9 million in 2004 to € 2 million negative in 2005 because of adverse developments at Methanor.

The net profit excluding exceptional items increased by € 140 million to € 563 million, which was largely due to the higher level of operating profit.

In 2005 provisions were made and impairments were recognized for the mothballing of the Montreal site (Canada) and the closure of the South Haven site (USA). Also, a provision was created for the restructuring of the Linz site in Austria. Book profits were recorded on the sale of DSM Bakery Ingredients and the sale of land. Furthermore, DSM recorded a book loss on the sale of the SBR business and an impairment of the company's share in the assets of Methanor. On balance several tax items had a positive effect.

Minority interests accounted for € 7 million (2004: €11 million); the figure in question related to activities in North America and China.

Statement of cash flows

x € million		2005		2004
Cash and cash equivalents at 1 January		**1,261**		1,209
Operating activities:				
- net profit plus amortization and depreciation	**1,094**		906	
- change in working capital	**-201**		209	
- other changes	**-200**		-217	
Cash flow from operational activities		**693**		898
Investing activities:				
- capital expenditure	**-393**		-349	
- acquisitions	**-564**		-	
- sale of participations	**192**		-	
- divestments	**30**		28	
- other changes	**-110**		-2	
Net cash used in investing activities		**-845**		-323
Dividend		**-183**		-194
Net cash used in financing activities		**-37**		-339
Changes due to IAS 32/39		**-**		17
Effects of changes in accounting principles and exchange differences		**13**		-7
Cash and cash equivalents at 31 December		**902**		1,261

Balance sheet profile

as %	2005	2004
intangible assets	**10**	5
property, plant and equipment	**37**	40
other non-current assets	**12**	9
cash and cash equivalents	**9**	13
other current assets	**32**	33
total assets	**100**	100
equity	**55**	53*
provisions	**10**	9
non-current liabilities	**14**	15
current liabilities	**21**	23
total liabilities	**100**	100

* Excluding the impact of the temporary reclassification of cumulative preference shares A at year-end 2004.

Capital expenditure and financing

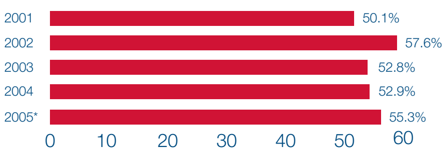
Capital expenditure on intangible assets and property, plant and equipment amounted to € 401 million in 2005, which was below the figure for amortization and depreciation (for cluster details see page 35). This was primarily due to the fact that the selection criteria applied to new investments had been revised. In 2004 and 2005 the level of capital expenditure was relatively low. The level of capital expenditure, including small and new business development type acquisitions, is expected to be above the level of amortization and depreciation in 2006. At € 693 million, net cash provided by operating activities was about 53% of EBITDA.

The balance sheet total (total assets) increased in 2005 and amounted to € 10.0 billion at year-end (2004: € 9.6 billion). Equity increased by € 451 million compared with the position at the end of 2004; this was due mainly to the net profit and exchange differences relating to non-euro-denominated holdings. Equity as a percentage of total assets increased from 53% at the end of 2004 to 55% at the end of 2005. The current ratio (current assets divided by current liabilities) decreased from 1.79 in 2004 to 1.75 in 2005.

Capital expenditure on intangible assets and property, plant and equipment was 20% below the level of amortization and depreciation. The total of intangible assets and property, plant and equipment was € 489 million (11%) higher than in 2004. The working capital was € 155 million higher than in 2004, due in particular to currency exchange rates, effects of acquisitions, higher raw material prices and a higher activity level. Cash decreased strongly and amounted to € 902 million.

Net debt stood at 13% of equity plus net debt at the end of 2005.

Equity
as a % of balance sheet total



* Excluding the impact of the temporary reclassification of cumulative preference shares A.

Dividend

DSM aims to provide a stable and, preferably, rising dividend. The dividend is based on a percentage of cash flow. Barring unforeseen circumstances, this percentage lies within a range of 16 to 20% of the net profit excluding exceptional items minus the dividend payable to holders of cumulative preference shares plus depreciation and amortization.

The proposed dividend on ordinary shares for the year 2005 amounts to € 1.00 per share, about 15% higher than the previous year. This corresponds to 18% of the cash flow (net profit excluding exceptional items (€ 563 million) plus depreciation and amortization (€ 503 million) minus the dividend payable to holders of cumulative preference shares (€ 16 million)). An interim dividend of € 0.29 per ordinary share having been paid in August 2005, the final dividend will amount to € 0.71 per ordinary share.

The dividend will be paid out in cash and will be made payable on 14 April 2006.

DSM outlook for 2006

The general economic outlook for the year 2006 is positive. Consumer confidence is expected to improve in Japan and Europe and remain positive in other regions. In addition, industrial production is also predicted to remain strong in many sectors and regions, including continued strong growth in emerging economies. For the chemical industry, a well-balanced supply and demand situation is anticipated in most markets.

However, growth in the automotive sector – especially in the USA – will probably lag behind.

Against this generally positive outlook, key risks may emerge from major currency fluctuations, more specifically the value of the US dollar against the euro, geopolitical tensions and high and volatile raw material prices.

For 2006, DSM expects continued performance strength in its Nutrition and Performance Materials businesses. For the Pharma businesses a further improvement in performance is envisaged. Industrial Chemicals is expected to see a continuation of the relatively stable business environment. Barring unforeseen circumstances, DSM expects an operating profit from continuing operations[3] for the first quarter of 2006 at or above the level of the first quarter of 2005 (€ 182 million). For the year 2006 as a whole the trading environment is expected to remain positive for DSM.

[3] The 2005 operating profit from continuing operations reported here is exclusive of DSM Bakery Ingredients, DSM Minera and SBR, to enable a meaningful comparison with 2006. The report for the first quarter of 2006 will also include a breakdown of results according to the new clustering of activities.

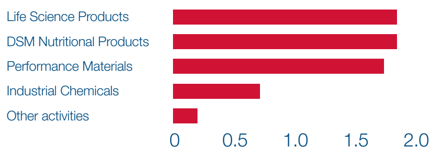
capital expenditure and acquisitions

x € million	**2005**	2004
Life Science Products	**97**	124
DSM Nutritional Products	**97**	55
Performance Materials	**667**	64
Industrial Chemicals	**85**	75
Other activities	**26**	26
total, continuing operations	**972**	344
Discontinued operations	**2**	4
total DSM	**974**	348

capital employed at 31 December

x € million	**2005**	2004
Life Science Products	**1,753**	1,704
DSM Nutritional Products	**1,830**	1,694
Performance Materials	**1,737**	988
Industrial Chemicals	**728**	673
Other activities	**173**	331
total, continuing operations	**6,221**	5,390
Discontinued operations	-	168
total DSM	**6,221**	5,558

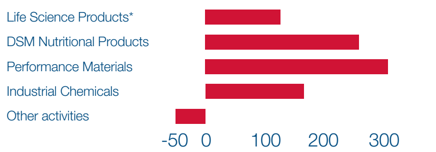
Capital employed by core activity at 31 December 2005
x € billion



EBITDA/net sales

as %	**2005**	2004
Life Science Products	**18.0**	15.2
DSM Nutritional Products	**19.6**	17.4
Performance Materials	**16.8**	12.4
Industrial Chemicals	**14.6**	13.2

Operating profit by core activity at 31 December 2005
x € million



* Excl. discontinued activities

R&D expenditure

	x € million		as a percentage*	
	2005	2004	**2005**	2004
Life Science Products	**93**	98	**6.3**	6.6
DSM Nutritional Products	**80**	75	**4.2**	3.9
Performance Materials	**94**	78	**3.8**	3.9
Industrial Chemicals	**14**	16	**0.8**	1.0
Other activities	**8**	11	**1.6**	2.3
total, continuing operations	**289**	278	**3.6**	3.7
Discontinued operations	**1**	8		
total DSM	**290**	286		

* Of net sales

R&D expenditure 2001-2005
x € million / incl. discontinued activities